

## TO OUR UNITHOLDERS

Our positive trend continues. We are pleased to report \$5.8 million in earnings before income tax for the second quarter of 2011, making it the 9th consecutive quarter of record pre-tax earnings for the Fund. The trend started in Q2 2009 with \$1.8 million in earnings before income taxes.

With current and deferred income tax expenses totaling \$1.5 million, net earnings after tax for the quarter were \$4.3 million.

Similar to last quarter, the second quarter of 2011 is now reported under International Financial Reporting Standards ("IFRS"). Certain comparative figures for 2010 differ from previously reported figures in order to conform to IFRS standards and be comparable to Q2 2011 figures.

During Q2 2011 the Fund achieved an annualized, after-tax return on unitholder's equity (ROE) of 56.3%.

## HIGHLIGHTS

- Pre-tax earnings for the quarter were \$5.8 million, up 24.3% from the \$4.6 million for the second quarter of 2010;
- Earnings per fund unit for the quarter was 17 cents;
- Return on unitholder's equity for the quarter on an annualized basis was 56.3%;
- Unitholder's equity increased 8.3% to \$31.7 million during the quarter;
- Loan originations for the quarter were \$28.0 million, an 11.4% increase from the \$25.1 million for the second quarter of 2010;
- Principal balance of finance receivables was \$152.5 million, increasing 4.6% during the quarter;
- 31+ days delinquent accounts for the quarter were 2.6%, a decrease from 3.3% for the first quarter of 2011 and 3.3% for the second quarter of 2010.

For the first six months of 2011, the Fund has distributed \$3.5 million to its Unitholders, which equates to 41.0% of the after tax net earnings. In retaining 59.0% of the after tax net earnings the book value per unit has increased 19.4% to \$1.29 during the first six months of 2011.

Revenues of \$14.4 million for the second quarter of 2011 represent an increase of 21.4% from the \$11.8 million for the second quarter of 2010 and 6.4% from the \$13.5 million for the first quarter of 2011.

Pre-tax earnings for the quarter were \$5.8 million, up 24.3% from the \$4.6 million for the second quarter of 2010 and 5.0% from the \$5.5 million for the first quarter of 2011.

Loan originations for the second quarter of 2011 were \$28.0 million, an 11.4% increase from the \$25.1 million for the second quarter of 2010 and 14.6% from the \$24.4 million for the first quarter of 2011.

## SIGNIFICANT EVENTS

On June 29, 2011, the Fund announced it won a contract to service a \$150 million loan portfolio consisting of loans similar to those of Carfinco's. In conjunction with this, Carfinco is setting up a service center in Quebec, which is anticipated to be operational in mid-August with approximately 20 employees. The Fund anticipates commencing servicing of the portfolio in early September. Servicing this portfolio will generate additional revenue for the Fund over the next 24 to 36 months as the loans mature. The service center in Quebec will also benefit the Fund in terms of servicing its own portfolio as it builds its presence in the province of Quebec and continues to increase its finance receivables in the other provinces in Eastern Canada.

The Board of Trustees has directed management to investigate the possibility of converting the Fund to a corporation effective January 1, 2012. Whether Carfinco remains a fund or announces a special meeting of its unitholders to vote on conversion to a publicly traded corporation, the Board of Trustees expects to maintain a minimum \$0.025 per month distribution/dividend to its unitholders / shareholders going forward.

Thank you for your support,

Tracy Graf,  
Chief Executive Officer

## MANAGEMENT'S DISCUSSION AND ANALYSIS

The Management's Discussion and Analysis ("MD&A") of Carfinco Income Fund (the "Fund" or "Carfinco" or "we" or "our") should be read in conjunction with the Fund's unaudited interim consolidated financial statements for the period ended June 30, 2011, as well as the audited annual consolidated financial statements for the year ended December 31, 2010, and the accompanying notes to those consolidated financial statements.

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") and International Accounting Standard ("IAS") 34 – Interim Financial Reporting, and are reported in Canadian dollars. For all periods up to and including December 31, 2010, the Fund prepared the consolidated financial statements in accordance with previous Canadian generally accepted accounting principles ("previous GAAP"). With the adoption of IFRS, and the transition date of January 1, 2010, all comparative information for 2010 has been prepared in accordance with IFRS accounting policies. The 2009 comparative information contained within this MD&A is prepared under previous GAAP and has not been represented on an IFRS basis, as is allowed by IFRS 1, the standard related to the first time adoption of IFRS.

## OVERVIEW

Carfinco Income Fund is an unincorporated open-end mutual fund trust established under the laws of Ontario by a Deed of Trust made as of August 26, 2002, as amended and restated on April 23, 2004, and March 17, 2011. The Fund owns 100% of Carfinco Holdings Trust, a wholly owned unincorporated trust, established under the laws of Ontario, and 5.2% of Carfinco Inc., a subsidiary, established under the laws of Ontario. Carfinco Holdings Trust holds the remaining 94.8% ownership of Carfinco Inc. Carfinco Holdings Trust holds a 25.0% interest in Carfinco Limited Partnership, and Carfinco Inc. holds the remaining 75.0% interest, and is the general partner of Carfinco Limited Partnership. The Fund's units trade on The Toronto Stock Exchange under the symbol "CFN.UN."

The Fund, through Carfinco Limited Partnership, purchases loans, originated by select independent and franchise vehicle dealers to consumers buying late model used automobiles. The Fund targets borrowers who are typically unable to obtain financing from traditional sources.

To fund the acquisition of receivables, the Fund uses its borrowings under its credit facility, and cash flows from operating activities, supplemented by the issuance of subordinated debt and fund unit equity where necessary. The Fund generates interest and fee income on its finance receivables and pays interest on borrowings under its credit facility and on outstanding subordinated debentures.

### *Cautionary Statement*

This analysis has been prepared taking into consideration information available to August 3, 2011. Certain statements contained in this interim report constitute "forward-looking statements." When used in this interim report, the words "may", "would", "could", "will", "intend", "plan", "anticipate", "believe", "estimate", "expect", and similar expressions, as they relate to the Fund, its subsidiaries or their management, are intended to identify forward-looking statements. Such statements reflect our current views with respect to future events and are subject to inherent risks, uncertainties and numerous assumptions, including, without limitation, general economic conditions, reliance on debt financing, dependence on non-prime borrowers, inability to sustain receivables, competition, interest rates, regulation, insurance, failure of key systems, debt service, future capital needs and such other risks or factors described from time to time in reports of Carfinco Income Fund that are filed with securities regulatory authorities.

By their nature, forward-looking statements involve numerous assumptions, known and unknown, risks and uncertainties, both general and specific, which contribute to the possibility that predictions, forecasts, projections and other forms of forward-looking information may not be achieved. Many factors could cause our actual results, performance or achievements to be materially different from any future results, performance or achievements that may be expressed or implied by such forward-looking statements and readers are cautioned that the list of factors in the foregoing paragraph is not exhaustive. Should one or more of these risks or uncertainties materialize, or should assumptions underlying the forward-looking statements prove incorrect, actual results may vary materially from those described herein as intended, planned, anticipated, believed, estimated or expected. Accordingly, readers are cautioned not to place undue reliance on forward-looking statements or interpret or regard forward-looking statements as guarantees of future outcomes.

In addition to the careful consideration of the risks described herein, investors should also consider the risk factors set forth in the most recently filed Annual Information Form of the Fund which is incorporated by reference herein. The Annual Information Form is available through the Internet on the Canadian System for Electronic Document Analysis and Retrieval ("SEDAR"), which can be accessed at [www.sedar.com](http://www.sedar.com).

## **DESCRIPTION OF NON-IFRS MEASURES**

Throughout this MD&A, management uses the following terms and ratios not found in IFRS and which do not have a standardized meaning under IFRS and are unlikely to be comparable to similar measures presented by other issuers, and therefore require definition. These non-IFRS measures and additional information should not be considered in isolation or as a substitute for measures prepared in accordance with IFRS.

### ***Distributable cash***

Distributable cash is a non-IFRS measure used by the Fund as an indication of cash generated from operations that is available to reinvest in the business, repay debt, or for distribution to unitholders. The Fund uses it as an indicator of financial strength and liquidity. Distributable cash is calculated by taking cash provided by operating activities, and subtracting purchases of equipment and any amounts retained for operations. Amounts retained reflect amounts to fund future capital requirements, income tax obligations, or other amounts as considered advisable by the Board of Trustees. Please refer to the section entitled "Cash distributions" under this MD&A for additional information and reconciliation with IFRS.

### ***Payout ratio***

The payout ratio is a key measure used by investors to assess the Fund's performance and to provide an indication of the sustainability of cash distributions to unitholders. The payout ratio is calculated as cash distributions during the period divided by distributable cash.

### ***Financial leverage ratio and total capitalization***

The financial leverage ratio is defined as total liabilities excluding derivative financial instruments and subordinated debentures divided by total capitalization. Total capitalization is defined as the total of unitholders' equity, derivative financial instruments, and subordinated debentures. The financial leverage ratio provides an indication of the extent to which the Fund relies on debt financing.

## *Average portfolio yield*

Average portfolio yield is financial revenue divided by average finance receivables in the period. Average portfolio yield provides an indication of the effective yield generated on the finance receivable portfolio before deductions for financial, operating, and income tax expenses.

## *Net financial margin*

Net financial margin is equal to net financial income before operating expenses and income taxes divided by financial revenue. Net financial margin provides an indication of the customer spread, that is, the difference between interest and fee income generated by the Fund on lending to customers and the interest expense it pays to borrow funds, after subtracting provisions for credit losses.

## *Average cost of borrowing*

Average cost of borrowing is equal to interest expense divided by the average bank credit facility and subordinated debenture balance outstanding for the period. The average cost of borrowing provides an indication of the average interest rate that the Fund pays on debt financing.

## *Annualized loss rate*

The annualized loss rate is equal to net write-offs recorded through the allowance for credit losses divided by average finance receivables for the period, presented on an annualized basis. The annualized loss rate is used by the Fund to assess the percentage of the finance receivable portfolio that incurred losses during the period. In addition, the Fund utilizes the annualized loss rate as an alternative measure to the provision for credit losses as it excludes the effect of provisions for (reductions in) the allowance for credit losses during the period which may not coincide with the timing of when write-offs and recoveries are actually incurred.

## *Operating expense ratio on portfolio assets*

The operating expense ratio on portfolio assets is calculated as total operating expenses divided by average finance receivables. The operating expense ratio is used by the Fund to assess the efficiency of the management of the Fund's loan portfolio.

## *Pre-tax return on portfolio assets*

Pre-tax return on portfolio assets is calculated as earnings before income taxes divided by average finance receivables. The pre-tax return on portfolio assets provides an indication of the average return on the Fund's loan portfolio excluding the impact of income taxes.

## *Pre-tax return on adjusted unitholders' equity*

Pre-tax return on adjusted unitholders' equity is equal to earnings before income taxes divided by average adjusted unitholders' equity during the period. The pre-tax return on adjusted unitholders' equity provides an indication of the Fund's return on unitholders' equity while eliminating income tax expenses and recoveries recognized through the consolidated statements of earnings.

Adjusted unitholders' equity is equal to total unitholders' equity subtracting deferred income tax assets and adding income taxes payable. The Fund utilizes adjusted unitholders' equity to measure the amount of unitholders' equity at the end of each period after removing the non-cash effect of income taxes recorded on the statement of financial position.

## *Return on invested capital*

Return on invested capital provides investors with an indication of the return generated by the Fund available to all investors, independent of financial leverage. Return on invested capital is often used by investors to assess the ability of the Fund to create value for investors by generating returns in excess of the Fund's weighted average cost of capital. Return on invested capital is calculated as operating cash flow divided by average invested capital during the period.

Operating cash flow is calculated as cash provided by operating activities excluding interest paid, and income taxes paid, after subtracting purchases of equipment. Operating cash flow is a measurement utilized by investors as it eliminates significant non-cash items and estimates made by management of the Fund through the consolidated statements of earnings and provides an indication of the pre-tax cash flows generated by the Fund's core operations.

Invested capital represents the cumulative amount the Fund has invested in its operations from both debt and equity financing. Invested capital is useful for investors as it measures total investment in the Fund's operations independent of the source of financing and eliminates significant non-cash, and non-operating items included in the consolidated statements of financial position. Invested capital is calculated as total assets excluding the allowance for credit losses and deferred income tax assets, and subtracts non-interest bearing liabilities.

## **RECENT EVENTS**

### *Servicing contract*

On June 29, 2011, the Fund announced it won a contract to service a \$150 million loan portfolio consisting of loans similar to those of Carfinco's. In conjunction with this, Carfinco is setting up a service center in Quebec, which is anticipated to be operational in mid-August with approximately 20 employees. The Fund anticipates commencing servicing of the portfolio in early September. Servicing this portfolio will generate additional revenue for the Fund over the next 24 to 36 months as the loans mature. The service center in Quebec will also benefit the Fund in terms of servicing its own portfolio as it builds its presence in the province of Quebec and continues to increase its finance receivables in the other provinces in Eastern Canada.

## SELECTED FINANCIAL INFORMATION AND FINANCIAL RATIOS

The following table summarizes key financial data to be read in conjunction with the unaudited interim financial statements of the Fund as at and for the three and six months ended June 30, 2011. Such financial statements are prepared in accordance with IFRS and are reported in Canadian dollars.

As at and for the three months ended, (in \$000's for stated values, except ratios and per fund unit amounts)	June 30, 2011	December 31, 2010	June 30, 2010
Total revenue	\$ 14,371	\$ 12,906	\$ 11,835
Earnings before taxes	5,769	5,464	4,640
Net earnings	4,284	6,219	4,702
per fund unit, basic and diluted	\$ 0.17	\$ 0.25	\$ 0.19
Total assets	132,331	123,242	108,250
Finance receivables	135,769	125,228	112,242
Loan originations	27,984	24,532	25,125
Cash distributions	1,846	4,320	3,834
per fund unit	\$ 0.075	\$ 0.180	\$ 0.160

### Ratios

Financial leverage ratio	3.13:1	3.52:1	3.43:1
Allowance for credit losses as a percentage of finance receivables	4.5%	4.3%	5.7%
Annualized loss rate	12.4%	14.3%	16.4%
Return on unitholders' equity <sup>1</sup>	56.3%	96.6%	81.0%
Pre-tax return on adjusted unitholders' equity <sup>1</sup>	73.5%	87.5%	80.9%
Return on portfolio assets <sup>1</sup>	12.9%	20.3%	17.3%
Pre-tax return on portfolio assets <sup>1</sup>	17.4%	17.9%	17.1%
Return on invested capital <sup>1</sup>	21.0%	20.8%	20.5%
Payout ratio	39.9%	83.4%	85.4%
Book value per fund unit	\$ 1.29	\$ 1.08	\$ 0.99

(1) Presented on an annualized basis.

### Highlights

The Fund achieved net earnings of \$4,283,911 (\$0.17 per fund unit – basic and diluted) for the three months ended June 30, 2011 compared to \$4,701,754 (\$0.19 per fund unit – basic and diluted) in the comparative fiscal 2010 quarter. For the six months ended June 30, 2011, the Fund had net earnings of \$8,408,027 (\$0.34 per fund unit – basic and diluted) compared to \$8,021,612 (\$0.33 per fund unit – basic and diluted) for the six months ended June 30, 2010. The net earnings for the quarter represented an increase of \$159,795 or 3.9% from \$4,124,116 recognized in the first quarter of 2011, and a decline of \$417,843 or 8.9% from the second quarter of fiscal 2010. The decline over the prior year quarter was primarily due to the change in tax status of the Fund that became effective on January 1, 2011 and due to reductions of \$500,000 in the allowance for credit losses in the second quarter of fiscal 2010 in comparison with increases in the allowance for credit losses of \$525,000 in the current quarter. Excluding the effects of current and deferred taxes, and changes in the allowance for credit losses during the quarters, the second quarter of 2011 had earnings of \$6,294,317 compared to earnings of \$4,139,848 in the second quarter of fiscal 2010 representing an increase of 52.0%. As the Fund works to achieve

growth in the finance receivable portfolio of 20% for the fiscal 2011 year, increases in the allowance for credit losses were necessary to absorb potential credit losses arising on new volume originated during the quarter. In assessing the impairment of finance receivables, management must rely on estimates and exercise judgment regarding matters for which the ultimate outcome is unknown and, as a result, changes in estimates may cause future assessments to be significantly different than current assessments and may require further increases or decreases in the allowance for credit losses. Please refer to the section entitled "Provision for credit losses" under this MD&A for additional information.

The three months ended June 30, 2011 also experienced an improvement in the annualized loss rate which declined to 12.4% from 12.9% for the three months ended March 31, 2011, 14.3% for the three months ended December 31, 2010 and from 16.4% for the three months ended June 30, 2010. A portion of the reduction in this ratio is reflective of the overall strengthening economic environment in Canada. However, it also illustrates the overall improvement in credit quality of the Fund's finance receivable portfolio as a result of modifications that were made to the Fund's credit criteria in the fourth quarter of 2008. The changes were made in an effort to reduce credit risk during a period of significant economic uncertainty. No material modifications have been made to the Fund's credit criteria since that time.

Management continued to be successful in managing contractual delinquencies with amounts over 30 days outstanding declining over the quarter representing 2.6% of the finance receivables portfolio as at June 30, 2011 compared to 3.3% as at March 31, 2011, 3.1% as at December 31, 2010 and 5.0% as at January 1, 2010. Current accounts represented 92.3% of the portfolio as at June 30, 2011, compared to 91.9% as at December 31, 2010 and 87.7% as at January 1, 2010. In addition, no amounts continued to remain contractually delinquent greater than 90 days.

Finance receivables were \$135,768,638 at the end of the quarter, up 8.4% from \$125,228,265 as at December 31, 2010 and up 21.0% from \$112,242,218 at June 30, 2010. Loan originations were \$27,983,691 for the quarter representing an increase of \$3,569,533 from \$24,414,158 for the three months ended March 31, 2011. Funds advanced on finance receivables for the three months ended June 30, 2011 were \$23,097,507 compared to \$19,901,405 and \$20,572,105 for the three months ended March 31, 2011 and June 30, 2010 respectively. Typically the Fund's loan originations are impacted in the first and fourth quarter of each fiscal year due to seasonality surrounding the holiday seasons. Overall, loan originations for the quarter were in line with management's expectations.

### ***Income taxes***

Prior to January 1, 2011, taxation on publicly traded income trusts and limited partnerships (Specified Investment Flow-Through Entities or "SIFT"), including Carfinco Income Fund, were not subject to an entity-level tax if all of the taxable income of the Fund was allocated to unitholders. In 2007, the *Income Tax Act (Canada)* was amended to impose on Canadian public income trusts an entity-level tax on earnings that the SIFT trust distributes to its unitholders, at a rate applicable to income earned by a Canadian public corporation, and to prevent such trusts from deducting trust distributions when calculating taxable income. Undistributed earnings of the SIFT continue to be taxable at the full tax rate normally applicable to undistributed trust income. This rate is equal to the highest marginal personal income tax rate in the Province the Fund is determined to be a resident.

Prior to March 17, 2011, under the Fund's Deed of Trust, all, or virtually all, of the taxable income of the Fund was required to be allocated to unitholders each fiscal year, and accordingly, no current provision for income taxes was recorded at the Fund level. On March 17, 2011, the Fund's Deed of Trust was amended to remove the obligation of the Fund to distribute all of its taxable income. Under these circumstances, prior to the date of

the amendment, deferred tax assets and liabilities attributable to the Fund are measured at the SIFT tax rate applicable to distributed profits, and subsequently are measured at the tax rate applicable to undistributed profits. Current income tax assets and liabilities are measured at the tax rate applicable dependent upon whether the taxable earnings were distributed or undistributed to unitholders. Future expectations of distributions are not taken into consideration. As a result, the income tax benefit related to the distribution of income to unitholders is recognized in the period when the liability to pay a distribution occurs.

Effective June 30, 2011, Carfinco Holdings Trust transferred a 71.1% limited partnership interest in Carfinco Limited Partnership to Carfinco Inc., in accordance with the tax deferral provisions of subsection 85(1) of the *Income Tax Act (Canada)*. As payment for the transfer, Carfinco Inc. issued a 94.8% ownership interest to Carfinco Holdings Trust. As a result of the transaction, effective June 30, 2011, Carfinco Holdings Trust's ownership interest in Carfinco Limited Partnership has been reduced to 25.0%, down from 96.1%, with Carfinco Inc. holding the remaining 75.0% interest.

The Board of Trustees has directed management to investigate the possibility of converting the Fund to corporation effective January 1, 2012 taking into consideration the impact such a transaction may have on the Fund's current strategies consistent with protecting and enhancing unitholder value.

For the three months ended June 30, 2011, a current and deferred income tax expense of \$1,485,406 was recognized compared to \$1,370,610 for the three months ended March 31, 2011 and a recovery of \$61,906 for the three months ended June 30, 2010. The significant increase in the tax expense over the prior year quarter is reflective of the change in tax status previously discussed as the Fund no longer receives a full reduction in its effective income tax rate related to its trust distributions. During the quarter, a reduction in the Fund's deferred tax assets was recognized in the amount of \$543,463, compared to an increase in deferred tax assets of \$205,855 during the first quarter of fiscal 2011. The decline in deferred tax asset balance is primarily due to the CLP unit transfer previously discussed that reduced the effective tax rate on some of the Fund's deductible temporary differences reversing in future periods. However, this decline was offset by a decrease in the current income tax expense in comparison to the prior quarter of \$634,522.

#### ***Cash distributions and payout ratio***

For the three months ended, cash distributions totaled \$1,845,892 (\$0.075 per fund unit) compared to cash distributions of \$1,599,773 (\$0.065 per fund unit) for the three months ended March 31, 2011 and \$3,834,031 (\$0.160 per fund unit) for the three months ended June 30, 2010. For the second quarter of fiscal 2011, the payout ratio increased to 39.9%, up from 39.2% in the first quarter of 2011 but decreased from 85.4% in the second quarter of 2010. On March 9, 2011, the Fund announced an increase in its monthly cash distribution to \$0.025 per fund unit, up from \$0.020 per fund unit and maintained the cash distribution at this level throughout the current quarter.

In fiscal 2010, the Board of Trustees approved that to the extent that the Fund generated taxable income in excess of the monthly cash distributions in any quarter, that all or a portion of the excess taxable income would be distributed in the form of quarterly special distributions. In addition, a special distribution was declared in the fourth quarter of 2010 consisting of cash and units to allocate the remainder of the Fund's taxable income to unitholders. Subsequent to January 1, 2011, the Fund announced, that as a result of the recent change in taxation of the Fund, that a portion of the Fund's net earnings would be retained to fund future growth in the finance receivable portfolio, as such distributions will no longer be deductible or provide a substantial benefit to the Fund for income tax purposes. This change in distribution policy accounts for the decline in the payout ratio in the current quarter when compared to fiscal 2010.

Please refer to the section entitled “Cash distributions” under this MD&A for additional information on the Fund’s distribution policy, and a calculation of distributable cash and the payout ratio.

## RESULTS OF OPERATIONS

The following table summarizes consolidated financial results for each of the respective periods:

For the three months ended, (in \$000’s for stated values, except per unit amounts)	June 30, 2011	December 31, 2010	June 30, 2010
Financial revenue	\$ 14,371	\$ 12,906	\$ 11,835
Financial expenses			
Provision for credit losses	4,636	4,033	3,945
Interest expense	1,255	1,179	1,034
Gain on derivative financial instruments	(59)	(125)	(89)
Net financial income before operating expenses and taxes	8,539	7,819	6,945
Operating expenses	2,770	2,356	2,305
Tax expense (recovery)	1,485	(756)	(62)
Net earnings and comprehensive income	\$ 4,284	\$ 6,219	\$ 4,702
per fund unit, basic and diluted	\$ 0.17	\$ 0.25	\$ 0.19

### Financial Revenue

Carfinco purchases loans, originated by select independent and franchise vehicle dealers to consumers buying late model used automobiles that are typically unable to obtaining financing from traditional sources. The Fund generates interest and fee income on these finance receivables. For the three months ended June 30, 2011, revenues were \$14,370,536 compared to \$13,510,866 and \$11,834,568 for the three months ended March 31, 2011, and June 30, 2010 respectively. These increases represent growth of 6.4% over the prior quarter, and 21.4% over the prior year’s quarter. Revenues are anticipated to move in conjunction with the growth in the finance receivable portfolio with the larger portfolio generating additional interest revenue and collection activity generating additional fee income.

The following table summarizes financial revenues by category:

For the three months ended, (in \$000’s, except ratios)	June 30, 2011	December 31, 2010	June 30, 2010
Interest revenue	\$ 13,681	\$ 12,187	\$ 11,222
Fee income	690	719	613
	\$ 14,371	\$ 12,906	\$ 11,835

### Ratios

Average portfolio yield <sup>1</sup>	43.4%	42.2%	43.5%
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(1) Presented on an annualized basis.

Interest revenue reflects the amortization of financial assets measured at amortized cost under the effective interest method net of provisions recognized under the deferred dealer obligation. The effective interest method discounts estimated future cash flows through the expected life of the financial instrument back to the net carrying amount of the financial asset. The calculation takes into account all contractual terms of the financial instrument, fee income charged to the customer and dealer on origination of the financial asset, purchase premiums or discounts on acquisition, net of any transaction costs that are directly attributable to the financial instrument. The effective interest method does not take into consideration future credit losses as part of the estimation of future cash flows. Provisions recognized under the deferred dealer obligation reflect the estimated amount of future purchase consideration that will be owed by Carfinco to dealerships under certain finance programs whereby a dealership is entitled to participate in the financial performance of finance receivables originated from their dealership.

For the three months ended June 30, 2011, interest revenues increased by \$928,102 or 7.3% over the prior quarter, and by \$2,459,107 or 21.9% over the prior year comparative. For the six months ended June 30, 2011, interest revenues increased by \$4,917,048 or 22.9% compared to the six months ended June 30, 2010. The increases were directly related to growth in the finance receivable balance during the respective periods. The portfolio grew by 5.0% over the prior quarter, and by 21.0% over the prior year quarter.

Fee income is earned from fees charged to the customer subsequent to the origination of the finance receivable that are related to providing subsequent servicing of the financial asset. These fees are expected to fluctuate based upon customer collection rates and delinquencies. During the three months ended June 30, 2011, fee income decreased to \$689,586 from \$758,018 for the three months ended March 31, 2011 and increased from \$612,725 for the three months ended June 30, 2010. For the six months ended June 30, 2011, fee income was \$1,447,604, up 16.2% from \$1,245,379 for the six months ended June 30, 2010. Overall, increases in fee income are anticipated to occur as a result of growth in the finance receivable portfolio that results in additional collection activity.

The average portfolio yield for the period was 43.4% remaining stable with the 42.5% and 43.5% respectively for three months ended March 31, 2011 and June 30, 2010.

## Financial Expenses

The following table summarizes financial expenses:

For the three months ended, (in \$000's for stated values, except ratios)	June 30, 2011	December 31, 2010	June 30, 2010
Provision for credit losses	\$ 4,636	\$ 4,033	\$ 3,945
Interest expense	1,255	1,179	1,034
Gain on derivative financial instruments	(59)	(125)	(89)
	\$ 5,832	\$ 5,087	\$ 4,890
Net financial income before operating expenses and income taxes	\$ 8,539	\$ 7,819	\$ 6,945

## Ratios

Net financial margin	59.4%	60.6%	58.7%
Average cost of borrowing <sup>1</sup>	5.3%	5.2%	5.3%
Annualized loss rate	12.4%	14.3%	16.3%

(1) Presented on an annualized basis.

*Provision for credit losses*

The provision for credit losses increased \$320,939 or 7.4% to \$4,635,948 for the period up from \$4,315,009 for the three months ended March 31, 2011. In comparison to the prior year comparative, the provision for credit losses increased \$690,593 or 17.5%, from \$3,945,355. For the six months ended June 30, 2011, the provision for credit losses increased \$507,951 or 6.0% over the prior year comparative. In the current quarter, the provision for credit losses included a provision to increase the allowance for credit losses by \$525,000 compared to reductions in the allowance for credit losses in the second quarter of 2010 of \$500,000 and increases of \$210,000 in the first quarter of 2011. Excluding the impact of these adjustments, the provision for credit losses for the quarter increased by \$5,939 over the three months ended March 31, 2011, and decreased by \$334,407 over the three months ended June 30, 2010 despite overall growth in the portfolio. For the six months ended June 30, 2011, excluding the impact of adjustments to the allowance for credit losses, the provision for credit losses declined 11.8% or \$1,094,449. Overall these trends are represented in the calculation of the annualized loss rate in the table above which is equal to write-offs, net of recoveries, during the period recognized through the allowance for credit losses divided by average finance receivables over the same period, presented on an annualized basis. Since the first quarter of fiscal 2010, the annualized loss rate has declined to 12.4%, down from the 18.8% at the end of the first quarter of 2010. Management utilizes the annualized loss rate as an alternative measure to the provision for credit losses in examining loan losses as it excludes the effect of provisions for (reductions in) the allowance for credit losses during the period, which may not coincide with the timing of when write-offs and recoveries are actually incurred.

Loans are normally written off when there is no realistic prospect of recovery of the amounts outstanding. Under the Fund's bank credit facility covenants, at 120 days contractual delinquent the relationship with the customer is judged to have broken down and loans are required to be written-off. However, loans may be written-off at less than 120 days contractual delinquent at the discretion of management if through the examination of contractual delinquency and an individual borrower's financial condition it is determined that there is no realistic prospect of recovery of a debtor's obligation. Accounts identified as impaired, but not written-off, are allowed for in establishing and maintaining the allowance for credit losses. Throughout fiscal 2010, and 2011, management wrote-off all loans in contractual arrears greater than 90 days.

The Fund continues to closely monitor contractual delinquencies and credit loss experience making additional provisions for (reductions in) the allowance for credit losses, as it deems appropriate. At the end of fiscal 2009, management remained cautious on expectations regarding Canada's economic recovery and allowed for extended periods of above average contractual delinquencies and loan losses given uncertainty in the economic environment at that time. This coincided with the increased level of loan losses that the Fund had faced in fiscal 2008, and 2009. Throughout 2010, in assessing the allowance for credit losses, management began adjusting expectations on delinquencies and loan losses to lower levels given the improvement in the overall economic environment, and the reduction in write-offs and delinquencies that the Fund was attaining in the finance receivable portfolio. At this time, management feels that the annualized loss rates for the first and second quarter of fiscal 2011, along with the fourth quarter of fiscal 2010 approximate normal operating conditions and has developed expectations for the allowance for credit losses at the end of the quarter on those loss assumptions. As the Fund works to achieve growth in the finance receivable portfolio of 20% per annum, increases in the allowance for credit losses will likely be necessary to absorb credit losses arising on new volume. In assessing the impairment of finance receivables, and the adequacy of the allowance for credit losses, management must rely on estimates and exercise judgment regarding matters for which the ultimate outcome is unknown. As a result, changes in circumstances and assumptions may lead to assessments that are materially different than current assessments and that may require increases or decreases in the allowance for credit losses.

## *Interest expense*

Interest expense for the three months ended June 30, 2011 increased \$65,787 or 5.5% from \$1,189,381 for the three months ended March 31, 2011 and increased \$221,269 or 21.4% from \$1,033,899 for the three months ended June 30, 2010. For the six months ended June 30, 2011, interest expense increased \$411,912 or 20.3% from \$2,032,637 to \$2,444,549. The increase in interest expense over these periods is primarily due to an overall increase in the average outstanding balance on the Fund's bank credit facility. The average cost of borrowing has remained relatively stable at 5.3% for the three months ended June 30, 2011, compared to 5.1% and 5.3% for the three months ended March 31, 2011 and June 30, 2010 respectively. During the current quarter, the Fund had net advanced on the bank credit facility of \$2,157,224 compared to net repayments of \$225,754 during the prior quarter and net advances of \$9,494,858 in the prior year quarter. Advances under the facility were required during the period to fund growth in the finance receivable portfolio.

## *Gain on derivative financial instruments*

On August 23, 2007, the Fund entered into two interest rate swap agreements with a combined notional amount of \$20,000,000. The first agreement had a notional amount of \$10,000,000, a fixed bankers' acceptance rate of 4.92% and a three-year term that ended on August 23, 2010. The second agreement has a notional amount of \$10,000,000, a fixed bankers' acceptance rate of 4.99% and a five-year term ending on August 23, 2012. For the three months ended June 30, 2011, a gain on derivative financial instruments of \$58,817 (six months ended June 30, 2011 - \$140,726) was recorded, and as at June 30, 2011, the fair value of the interest rate swap was a liability of \$407,870 (December 31, 2010 - \$548,596).

The interest rate swap agreements have been classified as financial liabilities measured at fair value through profit or loss with all changes in fair value recorded through net earnings. The Fund enters into interest rate swaps to lock the interest rate on a portion of its debt for longer periods and does not hold any derivative financial instruments for trading or speculation purposes.

## *Operating Expenses*

The following table summarizes operating expenses:

For the three months ended, (in \$000's for stated values, except ratios)	June 30, 2011	December 31, 2010	June 30, 2010
General and administrative	\$ 2,688	\$ 2,423	\$ 2,351
Loss (gain) on unit based payment obligations	36	(109)	(83)
Depreciation of equipment	46	42	37
	\$ 2,770	\$ 2,356	\$ 2,305
Net earnings before taxes	\$ 5,769	\$ 5,464	\$ 4,640

## **Ratios**

Operating expense ratio on portfolio assets	8.4%	7.7%	8.5%
Pre-tax return on portfolio assets	17.4%	17.9%	17.1%

As a percentage of portfolio assets, operating expenses increased over the prior quarter equaling 8.4% compared to 8.2%. Over the prior year comparative, this ratio declined down from 8.5%. The increase in this ratio over the prior quarter is primarily due to increases in salary and benefit expenditures as the Fund has

begun hiring additional staff in anticipation of additional loan origination growth. Management continues to make concerted efforts to improve the Fund's technology infrastructure that may assist in increasing operating effectiveness. The implementation of GPS starter interrupt devices under certain finance programs several years ago has translated into several operating efficiencies as the Fund's customer service and collection departments have been able to administer a larger volume of accounts. This has assisted in minimizing the impact growth in the portfolio has had on the Fund's salary and benefit expenditures in the customer service and collection departments. The Fund continues to look for additional operating efficiencies including finalizing the implementation of a document image system across all departments, and making continued improvements to the Fund's internal reporting systems.

### ***General and administrative***

Significant components of the Fund's general and administrative expenses include salaries and benefits, loan administration costs not directly tied to the acquisition of a finance receivable, office and general expenses, and professional and advisory services. For the three months ended June 30, 2011, general and administrative expenses were \$2,687,090, an increase of 6.0% from general and administrative expenses of \$2,535,663 for the first quarter of 2011, and an increase of \$336,069 or 14.3% for the three months ended June 30, 2010. For the six months ended June 30, 2011, general and administrative expenses increased \$559,910 or 12.0% to \$5,222,753 from \$4,662,843. The increase in general and administrative expenses was due to overall expansion in the Fund's operational structure to accommodate growth in the finance receivables portfolio.

### ***Loss (gain) on unit based payment obligations***

The liability of unit based payment obligations is re-measured at each reporting date with changes in the fair value of the corresponding unit options being recognized in the statement of earnings. For the three months ended June 30, 2011 a loss of \$35,860 (March 31, 2011 – loss of \$1,780, June 30, 2010 – gain of \$83,486) was recognized related to unit-based compensation expense and fair value adjustments. For the six months ended June 30, 2011, a loss on unit based payment obligations of \$37,640 was recognized, compared to a gain of \$42,828 for the six months ended June 30, 2010. The fair value of the unit based payment obligation is calculated utilizing the Black-Scholes Option-Pricing Model, and fluctuations in the fair value of the liability occur as a result of the passage of time, and changes in the underlying value of the Fund's units.

### ***Depreciation of equipment***

Depreciation expense decreased \$10,246 or 18.2% for the three months ended June 30, 2011, down from \$56,216 in the prior quarter. In comparison to the quarter second of 2010, depreciation expense increased \$8,684 or 23.3%. For the six months ended, depreciation expense totaled \$102,186 in comparison to \$88,182 for the prior year comparative. This expense was in line with management's expectations for the quarter and for the six months ended. Equipment purchases of \$45,457 have been made during the year in the normal course of operations.

### ***Income Taxes***

As previously discussed, effective January 1, 2011, the taxation of publicly traded income trusts was modified to impose on such trusts an entity-level tax on the earnings that the trust distributes to its unitholders at a rate applicable to income earned by a Canadian public corporation. Undistributed earnings are taxable at the full tax rate normally applicable to undistributed trust income, that is, the rate of the highest marginal personal income tax rate in the Province in which the Fund is determined to be a resident. The amendments also re-characterized distributions as eligible dividends received from a taxable Canadian corporation which provides

benefit to Canadian resident investors holding their units in taxable accounts as the previous treatment was to characterize such distributions primarily as ordinary income.

As previously discussed, effective June 30, 2011, Carfinco Holdings Trust transferred a 71.1% limited partnership interest in Carfinco Limited Partnership to Carfinco Inc., in accordance with the tax deferral provisions of subsection 85(1) of the *Income Tax Act (Canada)*. As a result of the transaction, effective June 30, 2011, Carfinco Holdings Trust's ownership interest in Carfinco Limited Partnership has been reduced to 25.0%, down from 96.1%, with Carfinco Inc. holding the remaining 75.0% interest.

For the three months ended June 30, 2011, a current and deferred tax expense of \$1,485,406 was recognized compared to \$1,370,610 for the three months ended March 31, 2011 and an expense recovery of \$61,906 for the three months ended June 30, 2010. For the six months ended June 30, 2011, current and deferred tax expense was \$2,856,016, compared to a recovery of \$134,906 for the six months ended June 30, 2010. The significant increase in the tax expense over the prior year comparatives periods is reflective of the change in tax status of the Fund as the tax benefit related to the distribution of taxable earnings to unitholders was significantly reduced.

Management and the Trustees continue to monitor the income trust environment and capital markets to review potential impacts that income taxes have on the Fund's current strategies consistent with protecting and enhancing unitholder value. The Trustees will continue to examine all available alternatives for the structure of the Fund and can choose to convert to a new structure on a tax-deferred basis until December 31, 2012. If the Trustees decide, in the future, to change the Fund's existing structure, there is no way of determining the potential impact (positively or negatively) that any such change might have on the value or trading price of units or any publicly traded replacement securities.

Please refer to Note 8 – Income Taxes in the Fund's unaudited interim consolidated financial statements for the three months and six ended June 30, 2011 for additional information.

## CONSOLIDATED FINANCIAL POSITION

The following table summarizes the Fund's consolidated financial position for the periods presented.

As at (in \$000's for stated values)	June 30, 2011	December 31, 2010	June 30, 2010
Finance receivables – net	\$ 129,651	\$ 119,845	\$ 105,874
Non-portfolio assets	2,680	3,915	2,376
<b>Total assets</b>	<b>132,331</b>	<b>123,760</b>	<b>108,250</b>
Bank credit facility	95,013	93,160	81,360
Other liabilities	5,653	3,379	3,230
<b>Total liabilities</b>	<b>100,666</b>	<b>96,539</b>	<b>84,590</b>
<b>Unitholders' equity</b>	<b>\$ 31,665</b>	<b>\$ 26,703</b>	<b>\$ 23,660</b>

## Assets

Total assets increased by \$5,288,641, or 4.2%, to \$132,331,000 as at June 30, 2011 from \$127,042,359 as at March 31, 2011 and increased by \$9,089,474 or 7.4% from \$123,241,526 as at December 31, 2010. As at June 30, 2011, non-portfolio assets represented 2.03% (December 31, 2010 – 2.76%) of total assets. The portfolio assets include finance receivables, net of the allowance for credit losses.

### Finance receivables

As at (in \$000's for stated values, except ratios)	June 30, 2011	December 31, 2010	June 30, 2010
Principal balance of finance receivables	\$ 152,536	\$ 141,125	\$ 126,851
Unamortized fees, discounts, and transaction costs	(18,849)	(18,052)	(16,356)
Accrued interest	2,082	2,155	1,748
Finance receivables	135,769	125,228	112,243
Allowance for credit losses	(6,118)	(5,383)	(6,369)
Finance receivables – net	\$ 129,651	\$ 119,845	\$ 105,874

### Ratios

Allowance for credit losses as a percentage of finance receivables	4.5%	4.3%	5.7%
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Finance receivables grew during the second quarter of 2011 by \$6,407,907, or 5.0%, to \$135,768,638 from \$129,360,731 as at March 31, 2011. In comparison to the prior year comparative, finance receivables grew by \$23,526,420 (21.0%) from \$112,242,218. Overall, loan growth for the quarter was in line with management's expectations.

All finance receivables are secured, under the applicable provincial personal property registry, by motor vehicle collateral. The Fund's strategy continues to be that of the alternative lender to major financial institutions in the higher-risk used vehicle finance market.

### Allowance for credit losses

The management of the Fund maintains an allowance for credit losses, which it establishes to provide for impairment of individual, or groups of, loan assets. Individual impairment is assessed by examining contractual delinquency, and an individual borrower's financial condition, such as the identification of a borrower entering bankruptcy, or other conditions such as the Fund being in the process of legal or collateral repossession proceedings with the debtor. Accounts over 60 days contractually delinquent are automatically considered to be impaired and are fully allowed for. Accounts contractually delinquent less than 60 days are allowed for based upon applying probability-weighted assumptions on the chances of an identified account resulting in a consumer default. If an asset has no individual objective evidence of impairment it is grouped with financial assets with similar credit risk characteristics which are collectively assessed for impairment on the basis of historical loss experience, adjusted to reflect current conditions, while removing future credit losses that have not been incurred. The amount of the allowance for credit losses is measured as the difference between the carrying amounts of the assets on the consolidated statements of financial position and the present value of the estimated future cash flows of the financial assets, discounted at the financial asset's original effective interest rate.

To manage credit risk related to customer defaults, the Fund performs detailed assessments on the value of the underlying security, the customer's financial condition and ability to service the debt both at loan inception and throughout the term of the loan, in addition to maintaining prudent underwriting methods. Also, Carfinco frequently purchases loans at a negotiated price that is less than the principal amount being financed by the debtor. These purchase discounts enable the Fund to minimize its own losses arising on defaults as it limits the level of the Fund's own invested capital at risk.

The Fund's allowance for credit losses had an increase of \$525,000 to \$6,118,100 as at June 30, 2011, up from \$5,593,100 as at March 31, 2011. In comparison to the prior year comparative, the Fund's allowance for credit losses decreased \$250,500 from \$6,368,600 as at June 30, 2010. As a percentage of finance receivables, the allowance for credit losses remained relatively stable over the quarter ending at 4.5%, slightly up from 4.3% at the end of the first quarter. The increase in the allowance over the prior quarter is due to overall growth in the finance receivable portfolio. Although the Fund uses various models and methodologies to assess the adequacy of loss reserves, there is no precise method for estimating impairment of financial assets, and the use of different estimates and methodologies could result in significantly different measurements of the allowance of credit losses.

Please refer to the sections entitled "Provision for credit losses" and "Delinquency and losses" contained within this MD&A for additional information.

## ***Delinquency and losses***

Credit losses, delinquency and provisions as at, and for each of the respective periods, were as follows:

For the three months ended (in \$000's)	June 30, 2011	December 31, 2010	June 30, 2010
Allowance for credit losses, beginning of period	\$ 5,593	\$ 5,719	\$ 6,869
Provisions for credit losses	4,636	4,033	3,945
Write-offs	(4,865)	(5,215)	(5,281)
Recoveries	754	846	836
Allowance for credit losses, end of period	\$ 6,118	\$ 5,383	\$ 6,369

The contractual delinquency at each reporting period is as follows:

	June 30, 2011		December 31, 2010		January 1, 2010	
Current	\$ 125,364,738	92.3%	\$ 115,084,775	91.9%	\$ 88,977,772	87.7%
Contractually past due:						
1 to 30 days	6,874,102	5.1%	6,261,413	5.0%	7,374,643	7.3%
31 to 60 days	2,352,528	1.7%	3,005,479	2.4%	3,328,244	3.3%
61 to 90 days	1,177,270	0.9%	876,598	0.7%	1,722,804	1.7%
91+ days	-	0.0%	-	0.0%	-	0.0%
	\$ 135,768,638	100.0%	\$ 125,228,265	100.0%	\$ 101,403,463	100.0%

## ***Liabilities***

Total liabilities increased by \$2,850,622 or 2.9% to \$100,665,826 as at June 30, 2011, from \$97,815,204 at March 31, 2011. In addition, total liabilities increased by \$16,075,711, or 19.0%, from \$84,590,115 as at June 30, 2010. The increase over the prior quarter is primarily due an increase in the income taxes payable balance of \$941,943 during the period and from increases in the bank credit facility of \$2,059,685. The increase was offset by combined decreases of \$151,006 in accounts payables and accrued liabilities, the deferred dealer obligation, derivative financial instruments, and unit based payment obligations.

Please refer to the section entitled “Income taxes” contained within this MD&A for additional information on the changes in taxation of the Fund effective January 1, 2011.

## ***Bank credit facility***

The Fund executed an Amended and Restated Credit Facility on February 13, 2008, as amended on May 14, 2008, December 15, 2008, June 22, 2010, and September 30, 2010 with the Bank of America, N.A., Wells Fargo Financial Corporation Canada and the Bank of Montreal as co-lenders. The amount of borrowings available under this facility was \$130,000,000 (December 31, 2010 - \$105,000,000, January 1, 2010 - \$85,000,000), subject to a defined borrowing base and a maximum financial leverage ratio of 3.50:1 (December 31, 2010 – 3.50:1, January 1, 2010 – 3.75:1). The bank credit facility is the primary source of cash for funding growth in the finance receivable portfolio. As at June 30, 2011 a total of \$95,013,018 (March 31, 2011 - \$92,953,333, June 30, 2010 - \$81,359,994) was outstanding under the credit facility. The maturity date of the credit facility is June 30, 2013.

## ***Deferred dealer obligation***

The deferred dealer obligation represents the estimated additional purchase consideration payable to dealers on certain loans financed at a discount. Under this program, the dealer has a vested interest in the pools of loans originated from their dealership, and can receive additional purchase consideration based upon the collection performance of the loans within their pool. The obligation is measured based on assessing the historical collection data on this program and making management’s best estimate of the expenditure that would be required to settle the obligation at the end of the reporting period, discounted at a pre-tax rate that reflects risks specific to the liability, and for which cash flow estimates have not already been adjusted to reflect risk in the variability of outcomes. A range of possible outcomes is assessed and, given the inherent variability of possible outcomes, actual outflows of resources may ultimately differ from current expectations requiring increases or decreases in the deferred dealer obligation.

The deferred dealer obligation decreased by \$66,261 or 3.4% during the quarter from \$1,946,648 at March 31, 2011, and increased by \$195,478, or 11.6%, from \$1,684,909 as at June 30, 2010. Overall, growth in the underlying finance receivable portfolio, accompanied by improvements in collection performance of the underlying pools will result in increases in the deferred dealer obligation balance.

## *Unitholders' Equity*

Unitholders' equity increased 8.3% or \$2,438,019 from \$29,227,155 at March 31, 2011 to \$31,665,174 as at June 30, 2011, and increased by 33.8% or \$8,005,648 from \$23,659,526 at June 30, 2010. The increase over the first quarter of 2011 is due to net earnings of \$4,283,911 during the period, which was offset by cash distributions of \$1,845,892.

## *Outstanding unit data*

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. Certain employees of the Fund have been granted unit options to purchase units of the Fund.

As at June 30, 2011 and August 3, 2011 there were 24,611,896 units of the Fund issued and outstanding and 33,334 unit options to acquire units outstanding.

## **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 fund unit equity. The Fund's primary use of cash has been the funding of advances on finance receivables, and the financing of working capital and capital expenditures. The Fund manages its capital resources by utilizing the financial leverage available under the credit facility and, when additional capital is required, it is raised through subordinated debenture or unit issuances.

Management believes that the resources available to the Fund, supplemented by the issuance of subordinated debt and/or fund unit equity, if necessary, provide the needed capital to fund the anticipated expansion of the finance receivable portfolio and investments in operating infrastructure for the upcoming fiscal year.

The Fund examines financial leverage as a key indicator of the strength of the Fund's consolidated statements of financial position. Under the terms of the Fund's bank credit facility, the financial leverage cannot exceed 3.50:1 at the end of any period. As at June 30, 2011, the financial leverage was 3.13:1, down from 3.28:1 at March 31, 2011, 3.52:1 at the end of fiscal 2010 and 3.43:1 at June 30, 2010. The banking syndicate has agreed to use previous GAAP for calculating covenants up to and including December 31, 2010 and will use IFRS for periods commencing on January 1, 2011. Under previous GAAP, the financial leverage ratio was 3.14:1 as at December 31, 2010, and as a result, the Fund was not in breach of this covenant. The decline in this ratio over the prior quarter is primarily due to the retention of net earnings that increased unitholders' equity, with a corresponding increase in the Fund's total capitalization.

The Fund's capitalization is as follows:

As at (in \$000s for stated values)	June 30, 2011	December 31, 2010	June 30, 2010
Bank credit facility	\$ 95,013	\$ 93,160	\$ 81,360
Accounts payable and accrued liabilities	732	899	702
Income taxes payable	2,518	-	-
Deferred dealer obligation	1,880	1,855	1,685
Unit based payment obligations	115	77	56
<b>Total debt</b>	<b>\$ 100,258</b>	<b>\$ 95,991</b>	<b>\$ 83,803</b>
Unitholders' equity	\$ 31,665	\$ 26,703	\$ 23,660
Derivative financial instruments	408	549	788
<b>Total capitalization</b>	<b>\$ 32,073</b>	<b>\$ 27,252</b>	<b>\$ 24,448</b>
<b>Financial leverage</b>	<b>3.13:1</b>	<b>3.52:1</b>	<b>3.43:1</b>

The Fund monitors the interest coverage ratio as a key indication of the Fund's ability to manage its leverage. Under the terms of the Fund's bank credit facility, the interest coverage ratio must exceed, or be equal to 1.50:1 for each quarterly period.

The interest coverage ratio is calculated as the interest coverage divided by the interest expense and is presented as follows:

For the three months ended (in \$000's for stated values, except ratios)	June 30, 2011	December 31, 2010	June 30, 2010
Earnings before taxes	\$ 5,769	\$ 5,464	\$ 4,640
Gain on derivative financial instruments	(59)	(125)	(89)
Depreciation of equipment	46	42	37
Interest expense	1,255	1,179	1,034
<b>Interest coverage</b>	<b>\$ 7,011</b>	<b>\$ 6,560</b>	<b>\$ 5,622</b>
<b>Interest coverage ratio</b>	<b>5.59:1</b>	<b>5.56:1</b>	<b>5.44:1</b>

### *Cash flow and liquidity*

Cash flows provided by operating activities for the three months ended June 30, 2011 was \$5,601,704 compared to \$5,668,264 and \$4,587,035 for the three months ended March 31, 2011 and June 30, 2010 respectively. For the six months ended June 30, 2011, cash provided by operating activities was \$11,269,968 compared to \$9,007,864 for the prior year comparative. For the three months ended, this represented a slight decline of 1.2% or \$66,560 over the prior quarter and an increase of \$1,014,669 or 22.1% over the quarter ended June 30, 2010. For the six months ended, this represented an increase of \$2,262,104 or 25.1%. The increases in cash flows provided by operating activities were primarily the result of the higher finance receivable portfolio that resulted in increases in interest receipts over the comparative periods.

Cash flows used in investing activities for the three months ended June 30, 2011 increased to \$5,770,664 from \$4,169,807 for the prior quarter and decreased from \$7,831,931 in the prior year comparative. This increase over the prior quarter was primarily due to increases in funds advanced on finance receivables of \$3,196,102, offset by and increases in the principal collection of finance receivables of \$1,625,388. The remainder of the change is attributed to differences in the amount of purchases of equipment between the quarters. Seasonality impacted loan originations during the first quarter of fiscal 2011 creating the decline in funds advanced on finance receivables. The increase in the principal collection in the current quarter was due to an overall increase in the average principal balance outstanding on finance receivables during the period, and increases in proceeds received on vehicles repossessed and disposed of at auction.

Cash flows provided by financing activities for the three months ended June 30, 2011 were \$180,058 compared to cash flows used in financing activities of \$1,825,527 in the prior quarter, and cash flows provided by financing activities of \$3,479,493 in the prior year comparative. As management focuses on growth in the finance receivable portfolio, the Fund has begun retaining a larger portion of its earnings reducing the amount of fund unit cash distributions over the comparative year quarters. In addition, this decline in cash distributions enabled the Fund to place less reliance on funding from the bank credit facility in comparison to prior years. During the first quarter of fiscal 2011 net repayments of \$225,754 were made on the bank credit facility during the quarter compared to net advances of \$2,157,224 in the current quarter. The net advances on the bank credit facility in the current quarter were necessary to fund the growth in the finance receivable portfolio.

### *Debt and contractual repayment obligations*

The following table presents the Fund's future payment obligations for certain undiscounted financial liabilities and other contractual obligations:

	2011	Total
Bank credit facility <sup>1</sup>	\$ 95,241,236	\$ 95,241,236
Operating leases <sup>2</sup>	196,500	196,500
	\$ 95,437,736	\$ 95,437,736

(1) The bank credit facility is a demand loan with a stated maturity date of June 30, 2013. The above amount excludes unamortized deferred transaction costs as presented in Note 9 of the Fund's unaudited interim consolidated financial statements.

(2) The Fund is committed to a long term operating lease for building space. Amounts presented represent the minimum annual lease payments, plus estimated operating costs required for the remainder of the fiscal 2011 period.

## CASH DISTRIBUTIONS

### *Distribution policy*

Prior to January 1, 2011, pursuant to the Deed of Trust of the Fund, the Trustees were required to distribute all or virtually all of the income of the Fund for the fiscal year, determined in accordance with the *Income Tax Act (Canada)*, to the unitholders of the Fund. If the Fund did not pay cash distributions for the total income of the Fund, determined in accordance with the *Income Tax Act (Canada)*, the remaining income of the Fund was distributed through additional Trust units having a value equal to the cash shortfall.

As a result of the changes to taxation laws previously discussed, it was the opinion of the Trustees that it was no longer appropriate for the Fund to distribute all of its taxable income to unitholders as such distributions generally will no longer be deductible or provide a substantial benefit to the Fund for income tax purposes. Accordingly, subsequent to January 1, 2011, the Trustees amended the Deed of Trust to remove the Fund's intent to fully distribute all of its taxable income to unitholders each fiscal year. The Board of Trustees has the discretion to set the amount and timing of any distribution and regularly reviews its distribution policy taking into consideration requirements for capital expenditures, working capital, and other reserves considered necessary within good business practices or as required under the Fund's bank credit facility covenants. Cash distributions, if any, are normally payable by the Fund on a monthly basis to unitholders of record on the 20th business day of each month. Distributions are paid on the last business day of the month.

At this time, the Fund has identified a number of opportunities for loan origination growth including continued expansion into the Province of Quebec, dealer expansion across the country, and the introduction of tiered pricing products that cater to higher credit quality customers within different segments of the non-prime market. As a result, on March 9, 2011 the Board announced that, going forward, a portion of the net earnings of the Fund would be retained to fund future growth in the finance receivable portfolio. The Board believes that the pursuit of these opportunities, while maintaining a high return on invested capital, accompanied by stable and consistent distributions, will maximize long-term value creation for unitholders of the Fund. It is currently the Board's intention to maintain the existing monthly cash distribution of \$0.025 per fund unit and will examine the appropriateness of issuing special quarterly distributions or adjusting the monthly cash distribution on an ongoing basis.

### *Distributable cash and payout ratio*

The following is a calculation of the Fund's distributable cash and payout ratio:

For the three months ended (in \$000's for stated values, except percentages and per unit amounts)	June 30, 2011	December 31, 2010	June 30, 2010
Cash provided by operating activities	\$ 5,602	\$ 5,184	\$ 4,587
Add (deduct):			
Purchase of equipment	(38)	(1)	(95)
Amounts retained to fund income tax obligations	(942)	-	-
<b>Distributable cash</b>	<b>\$ 4,622</b>	<b>\$ 5,183</b>	<b>\$ 4,492</b>
Cash distributions paid during the period	\$ 1,846	\$ 4,320	\$ 3,834
<b>Payout ratio</b>	<b>39.9%</b>	<b>83.4%</b>	<b>85.4%</b>
Distributable cash per weighted average units outstanding	\$ 0.188	\$ 0.211	\$ 0.183
Cash distributions per fund unit	\$ 0.075	\$ 0.180	\$ 0.160
Unit distributions per fund unit	-	0.190	-
<b>Total distributions per fund unit</b>	<b>\$ 0.075</b>	<b>\$ 0.370</b>	<b>\$ 0.160</b>

Distributable cash for the three months ended June 30, 2011 amounted to \$4,621,961 or \$0.188 per weighted average fund unit, an increase of \$537,819, or 13.2%, from the three months ended March 31, 2011. In comparison to the three months ended June 30, 2010, distributable cash increased \$130,133, or 2.9%. For the six

months ended June 30, 2011, distributable cash amounted to \$8,706,103 compared to \$8,859,470 for the six months ended June 30, 2010. Cash distributions during the period were \$1,845,892 compared to \$1,599,773 and \$3,834,031 for the three months ended March 31, 2011 and June 30, 2010 respectively. As previously discussed, the decline in the payout ratio and distributable cash figures over the prior year is due to amendments in the Fund's distribution policy, and changes in the taxation of the Fund that impacted the availability of cash for distribution to unitholders.

Although the Fund intends to continue making distributions to our unitholders, there are numerous factors, which affect the Fund's ability to pay cash distributions, and cash distributions are not assured. The Fund's ability to make cash distributions and the actual amount distributed will depend upon, among other things, financial performance, debt covenants and obligations, the ability to refinance debt obligations on similar terms and at similar interest rates, working capital requirements, tax obligations, and future capital requirements.

Additional risk factors that may impact the Fund's ability to pay cash distributions can be found in the section, "Risk Management", and in the Fund's Annual Information Form. Under the terms of our credit facility, the Fund is restricted from declaring distributions and distributing cash if the Fund is in breach of its debt covenants. The debt covenants include, but are not limited to, a financial leverage ratio, a loan availability calculation, an interest coverage ratio and a taxable income restriction. The Fund's current financial performance meets the covenants under our credit facility.

## Distributions

Cash distributions are normally payable by the Fund on a monthly basis to unitholders of record on the 20th business day of each month. Distributions are paid on the last business day of the month. Cash distributions on units of record during the year ended December 31, 2010 three months and six months ended June 30, 2011 are summarized as follows:

Record Date	Payment Date	Cash Distribution per Unit	Total Cash Distribution
January 20, 2010	January 29, 2010	\$ 0.015	\$ 359,003
February 19, 2010	February 26, 2010	0.020	478,671
March 19, 2010	March 31, 2010	0.060	1,436,012
April 20, 2010	April 30, 2010	0.020	478,671
May 20, 2010	May 31, 2010	0.020	479,337
June 18, 2010	June 30, 2010	0.120	2,876,023
July 20, 2010	July 30, 2010	0.020	479,337
August 20, 2010	August 31, 2010	0.020	479,337
September 20, 2010	September 30, 2010	0.120	2,876,023
October 20, 2010	October 29, 2010	0.020	479,337
November 19, 2010	November 30, 2010	0.020	480,004
December 20, 2010	December 31, 2010	0.140	3,360,487
Total cash distributions for 2010		0.595	14,262,242
January 20, 2011	January 31, 2011	0.020	492,238
February 18, 2011	February 28, 2011	0.020	492,238
March 18, 2011	March 31, 2011	0.025	615,297
April 20, 2011	April 29, 2011	0.025	615,297
May 20, 2011	May 31, 2011	0.025	615,297
June 20, 2011	June 30, 2011	0.025	615,298
Total cash distributions for 2011		0.140	3,445,665
Accumulated cash distributions to unitholders for 2010 and 2011		\$ 0.735	\$ 17,707,907

## SUMMARY OF QUARTERLY INFORMATION (UNAUDITED)

(\$000's for stated values, except percentages, and per fund amounts)	2011				2010			2009 <sup>1</sup>
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
Total revenue	\$ 14,371	\$ 13,511	\$ 12,906	\$ 12,580	\$ 11,835	\$ 10,928	\$ 8,562	\$ 8,324
Net earnings	4,284	4,124	6,219	4,986	4,702	3,320	2,608	2,186
per fund unit, basic and diluted	0.17	0.17	0.25	0.20	0.19	0.14	0.11	0.09
Finance receivables	129,651	123,768	119,845	113,619	105,874	98,399	113,222	111,508
Funds advanced on finance receivables	23,098	19,901	20,054	21,134	20,572	17,375	14,342	14,619
Loan originations	27,984	24,414	24,532	25,834	25,125	21,539	17,754	17,997
Allowance for credit losses <sup>2</sup>	6,118	5,593	5,383	5,719	6,369	6,869	17,637	16,862
as a % of finance receivables <sup>2</sup>	4.5%	4.3%	4.3%	4.8%	5.7%	6.5%	15.6%	15.1%
Bank credit facility	95,013	92,953	93,160	87,807	81,360	71,936	68,438	66,054
Subordinated debt	-	-	-	-	-	2,143	2,143	2,143
Unitholders' equity	31,665	29,227	26,703	24,811	23,660	22,792	23,467	24,307
Fund units outstanding	24,612	24,612	24,612	23,967	23,967	23,934	23,934	23,334
Basic weighted average fund units	24,612	24,612	24,595	24,579	24,563	24,545	24,545	24,546
Book value per fund unit	\$ 1.29	\$ 1.19	\$ 1.08	\$ 1.04	\$ 0.99	\$ 0.95	\$ 0.96	\$ 0.99

(1) Comparatives for the 2009 fiscal year are prepared under previous Canadian GAAP, as allowed under IFRS 1 for first time adoption, and have not been re-presented on an IFRS basis. See Note 19 – Transition to International Financial Reporting Standards, in the unaudited interim financial statements as at and for the three and six months ended June 30, 2011 for additional information on the Fund's conversion to IFRS.

(2) Comparatives for 2009 include the dealer reserve which has been eliminated upon transition to IFRS.

Revenues are anticipated to move in conjunction with the growth in the finance receivable portfolio with quarterly revenues having increased proportionately with growth in finance receivables since Q2 2009. Throughout fiscal 2009 portfolio growth was modest as the Fund focused on reducing delinquencies that had increased significantly during 2008 as a result of the recession. Commencing in the first quarter of 2009, and continuing through to the fourth quarter of 2010, the annualized loss rate began to stabilize and decline as contractual delinquencies improved. This improvement resulted in reductions in the provision for credit losses over each period with corresponding increases in net earnings. Effective January 1, 2011, the Fund became a taxable entity which resulted in the decline in net earnings in the current and prior quarter in comparison to the prior year comparatives.

Commencing in fiscal 2010, the Fund became focused on portfolio growth of 20% per annum, which resulted in increased loan originations and funds advanced on finance receivables when compared to fiscal 2009. In the first quarter of 2011 and fourth quarter of 2010, slight declines in loan originations were experienced which can be attributed to lower originations during the holiday seasons. This is typical in Carfinco's experience.

Historically, the Fund has declared monthly distributions, combined with a special year-end cash and unit distribution to allocate the remainder of the Fund's taxable income to unitholders, pursuant to the Fund's Deed of Trust. In fiscal 2010, the Board of Trustees approved that to the extent that the Fund generates taxable income in excess of the monthly cash distributions for any quarter, that all or a portion of the excess taxable income will be distributed in the form of quarterly special distributions providing a more uniform distribution of taxable income throughout the fiscal year. In fiscal 2011, the Board of Trustees made amendments to the Fund's Deed of Trust, as a result of changes in the taxation of the Fund as discussed under the section entitled "Cash distributions" contained within this MD&A. Other than the aforementioned, the Fund's financial results are generally not subject to significant seasonal fluctuations.

## CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Management's discussion and analysis of financial condition and results of operations are made with reference to the unaudited interim consolidated financial statements for the three and six months ended June 30, 2011. A summary of the Fund's significant accounting policies are presented in Note 2 to those consolidated financial statements. Some of the Fund's accounting policies, as required by International Financial Reporting Standards, require management to make subjective, complex judgments and estimates to matters that are inherently uncertain. The Fund believes the policies below are the most critical accounting estimates that affect its operating results, and that would have the most material effect on the financial statements should these policies change or be applied in a different manner.

### *Revenue recognition*

Interest revenue is recognized on the income statement for all financial assets measured at amortized cost using the effective interest rate method. The effective interest rate is the rate that discounts estimated future cash flows through the expected life of the financial instrument back to the net carrying amount of the financial asset. The calculation takes into account all contractual terms of the financial instrument, including prepayment options, fee income charged to the customer and dealer on the origination of all financial assets, and all purchase premiums or discounts, net of any transaction costs that are directly attributable to the financial instrument, but not future credit losses. The application of the method has the effect of recognizing revenue on the financial instrument evenly in proportion to the amount outstanding over the period to maturity or repayment.

Once the recorded value of a financial asset, or a group of similar financial assets, has been reduced due to an impairment loss, interest revenue continues to be recognized using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. This is offset by a corresponding adjustment to the loan loss provisioning charge to reflect the fact that this additional revenue may not be collectable.

Fee income that is integral to the effective yield of a financial asset is recognized as an adjustment to the effective interest rate calculation and is included in interest revenue.

Fees charged to the customer for providing subsequent servicing of a financial asset are recognized as services are provided.

## *Allowance for credit losses*

The Fund assesses on an ongoing basis whether a loan asset or a group of loan assets is impaired. A loan asset or a group of loan assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more loss events that occurred after initial recognition of the asset (a loss event) and the loss event has an impact on the estimated future cash flows of the loan asset or group of loan assets that can be reliably estimated.

The amount of the impairment loss is measured as the difference between the carrying amount of the asset and the present value of the estimated future cash flows, excluding future expected credit losses that have not been incurred, discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of the allowance for credit losses with the amount of the loss recognized through the income statement as a provision for credit losses.

The Fund's finance receivable portfolio is composed of a large number of homogeneous consumer loans, with relatively small balances originated in the same industry, and as such, the evaluation of the loan impairment is performed collectively for the group after allowances are made for individual impairment. Individual impairment is identified at the end of each reporting period by making judgments about the probability of an account going into default based upon information known by the Fund. This includes assessing contractual delinquency, the borrower's financial condition such as the identification of a debtor entering bankruptcy, or other conditions such as the Fund being in the process of legal or collateral repossession proceedings with the debtor.

If it is determined that no objective evidence of impairment exists for an individually assessed financial asset, the asset is included in a group of financial assets with similar credit risk characteristics, and that group of financial assets is collectively assessed for impairment. Future cash flows for the group of loan assets are estimated on the basis of their contractual cash flows and historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect changes in current conditions that did not exist in the period on which the historical loss experience is based, and to remove the effect of conditions in the historical period that do not exist currently. Future credit losses are not recognized. In assessing the impairment of finance receivables, management must rely on estimates and exercise judgment regarding matters for which the ultimate outcome is unknown. All assumptions are reviewed regularly to take account of differences between previously estimated cash flows and eventual losses. Changes in circumstances may cause future assessments to be significantly different than current assessments and may require an increase or decrease in the allowance for credit losses.

## *Deferred dealer obligation*

Provisions are recognized when the Fund has a present legal or constructive obligation as a result of a past event, and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Provisions are measured using management's best estimate of the expenditure required to settle the obligation at the reporting date, and, where the effect is material, are discounted using the expected future cash flows at a pre-tax rate that reflects the current market assessments of the time value of money and the risks specific to the liability. Discount rates are not adjusted to reflect risks specific to the liability to the extent for which future cash flow estimates have already been adjusted to reflect risk in the variability of outcomes. The expense relating to any provision is presented on the statement of earnings net of any reimbursement.

The Fund purchases certain finance receivables at a negotiated price that is less than the original principal amount being financed by the consumer. Under this program, finance receivables originated from each dealer are aggregated into dealer pools that track the collection history, cumulative losses, and overall financial performance of the pool over time. The dealer has a vested interest in their dealer pool, and can receive additional purchase consideration based upon the financial performance of the pool. Under the dealer agreement, a minimum of 20 accounts must be originated under the pool before any dealer participation begins. In addition, a dealer pool can only contain a maximum of 75 accounts at which time, any subsequent originations from that dealership are placed into a new dealer pool.

A provision of the estimated future purchase price consideration potentially payable by Carfinco to the dealership over the life of the pool is recognised as a reduction of interest revenues on the statement of earnings. The provision is based on assessing the historical collection and static loss data of each individual dealer pool, and utilizing that data to develop expectations on future financial performance of the pool at the end of the period. Historical information is adjusted to reflect changes in current conditions that did not exist in historical results, and to remove the effect of conditions in the historical period that do not exist currently. In addition, a range of possible outcomes is examined that take into consideration the inherent variability of possible outcomes, and the risk that actual outflows of resources may ultimately differ from those expected. Changes in circumstances may cause significant differences in future assessments and require increases or decreases in the deferred dealer obligation.

## **FUTURE ACCOUNTING CHANGES**

### ***IFRS 9 – Financial Instruments: Recognition and Measurement***

The Fund will be required to adopt the first phase of IFRS 9 – Financial Instruments: Recognition and Measurement as of January 1, 2013. The new standard was issued as part of the IASB's plan to replace IAS 39 – Financial Instruments: Recognition and Measurement. The IASB project plan for the replacement of IAS 39 consists of three main phases. The first phase addresses the accounting for financial assets and financial liabilities. The second phase will address the impairment of financial instruments, and the third phase will address hedge accounting. The adoption of the first phase of this standard is not expected to have a material impact on the Fund's consolidated financial statements. At this time, the Fund cannot reasonably determine the impact the adoption of the second and third phase will have on the Fund's consolidated financial results.

## **RELATED PARTY TRANSACTIONS**

The Fund's related party transactions are set out in Note 14 to the unaudited interim consolidated financial statements for the three and six months ended June 30, 2011. The transactions with related parties occurred in the normal course of operations at commercial rates agreed upon by the related parties.

Related party transactions include transactions with parties that have control or joint control over the reporting entity, have significant influence over the entity, are members of key management personnel of the Fund including the Trustees and Officers of the Fund, or are close family members of those individuals.

## *Patca Securities Limited*

The Fund has an agreement with Patca Securities Limited for services provided on an ongoing basis. These services include general strategic advice, operational and financial oversight and review, advice on financial structure, advice on senior and/or subordinated debt and equity structure, communication with stakeholders and other general consulting services. Carfinco LP entered into a Consulting Services Agreement with Patca Securities Limited on October 1, 2003, and pursuant to this agreement, Carfinco LP incurs a fixed monthly fee of \$12,500, and a variable monthly fee of one-twelfth of 0.2% of the outstanding principal amount of the finance receivables.

During the six months ended June 30, 2011, payments of \$218,315 (June 30, 2010 - \$189,000) were made to Patca Securities Limited and as at June 30, 2011, there was \$39,791 (December 31, 2010 - \$31,500, January 1, 2010 - \$31,500) payable to Patca Securities Limited. Patca Securities Limited is controlled by individuals who are Trustees of the Fund.

## *Subordinated debentures*

Included in interest expense for the six months ended June 30, 2011 is \$nil (June 30, 2010 - \$38,473) of interest paid to related parties during the period. As at January 1, 2010, \$743,000 of subordinated debentures was issued to related parties. On April 30, 2010, the Fund repaid the outstanding principal balance and accrued interest on the stated maturity date of the subordinated debentures.

## **OFF-BALANCE SHEET ARRANGEMENTS**

The Fund has not entered into any off-balance sheet arrangements.

## **RISK MANAGEMENT**

The operations of the Fund are affected by trends and factors that the Fund may not be able to control and have the potential of affecting its financial condition, results of operations, and cash flow. These trends and factors may include changes in the vehicle financing market sector and the state of the domestic and global economy. It is not possible for management to accurately predict the impact of changes in the operating environment, nor to predict their effect on the Fund's financial condition and results of operations.

The Fund's risks and risk management procedures, as described in our 2010 annual report, have not changed substantially since those statements were issued. For a comprehensive discussion on the Fund's Risk Management, please refer to the December 31, 2010 Management's Discussion and Analysis.

## **OUTLOOK**

Carfinco has continued to produce strong financial results for the three months ended June 30, 2011 reaching record pre-tax earnings for the ninth consecutive quarter. In addition, the Fund's annualized loss rate, and contractual delinquencies each declined during the quarter providing an indication of the improvement in the quality and management of the Fund's loan portfolio as a result of improvements in economic conditions and changes made to the Fund's credit and collection procedures during the 2008 recession.

Finance receivable growth for the six months ended June 30, 2011 has been slightly below target reaching 16.8% on an annualized basis in comparison to our 20.0% forecast. From our discussions with our dealer

partners, overall sales were low during the quarter due to a shortage of off-rental, off-lease, off-fleet and other used vehicles coming onto the market. These shortages in turn placed upward pricing pressures and limits on the availability of units for independent dealers seeking older vehicles. For some, this also resulted in a compression of margins making some previously profitable sales uneconomical for either the dealer or the end consumer.

The Fund has hired additional dealer representatives in an effort to grow our dealer network and increase loan origination volume. In addition, Quebec continues to remain a minimal portion of our loan portfolio that we feel has substantial opportunity for future growth. The Fund reviews its credit and funding policies on an ongoing basis and makes adjustments as necessary to ensure we remain competitive with our dealer pricing and credit terms without compromising our returns or risk tolerance.

Additionally, management remains optimistic with the signing of our contract to service a \$150 million loan portfolio and the addition of our servicing center in Quebec. The servicing portfolio will generate additional revenue for the Fund and the addition of the center in Quebec will benefit the Fund as we build our presence in the Province of Quebec.

## **ECONOMIC CONDITIONS**

The Canadian economy declined unexpectedly in the month of May by 0.3%, while expectations had been set for growth of 0.1%. In addition, the U.S. economy was also weaker than expected expanding by 1.3% on an annualized basis for the second quarter versus expectations of 1.8%. As of June 2011, the unemployment rate in Canada was 7.4%, a slight improvement from 7.7% at the end of the first quarter, however, still above pre-recession levels that ranged from 6.0% to 6.3% in fiscal 2007 and the first half of 2008.

The weakness suggests that the Bank of Canada's GDP forecast of annualized growth of 1.5% for the second quarter of 2011 will not be met and lowers the likelihood of increases to the prime interest rate in the fall. Currently, the U.S. economy needs to grow at a sustained rate of 2.5% or better to begin decreasing their 9.2% unemployment rate.

Overall, the Canadian economy continues to recover at a moderate pace but may continue to be suppressed from uncertainty surrounding the U.S. economy. Despite this, management remains optimistic on the Fund's own outlook, but continues to feel that it is appropriate to remain prudent on credit policies and not significantly relax credit criteria to increase loan originations. Loan losses have stabilized and are well below recessionary levels, however, as the Fund grows its finance receivable portfolio, further increases in the allowance for credit losses may be necessary to absorb credit losses arising on new volume.

## **TRANSITION TO INTERNATIONAL FINANCIAL REPORTING STANDARDS ("IFRS")**

For all periods up to and including the year ended December 31, 2010, the Fund prepared its financial statements in accordance with Canadian generally accepted accounting principles ("GAAP"). On January 1, 2011, the Fund was required to adopt IFRS as issued by the International Accounting Standards Board ("IASB") and interpretations of the International Financial Reporting Interpretations Committee ("IFRIC"). The disclosures concerning transition from GAAP to IFRS are included in Note 19 – Transition to International Financial Reporting Standards in the unaudited interim consolidated financial statements as at, and for the three and six months ended June 30, 2011 and in the Fund's MD&A for the three months ended March 31, 2011.

The Fund has applied the standards in place at the current date of reporting, however changes in accounting policies used to year end date may result in material changes to our reported financial position, earnings, and

cash flows. Therefore, the unaudited consolidated interim financial statements for the period ended June 30, 2011 are subject to change. The Fund's independent auditor has not performed a review of the changes to the Fund's reported financial position and net earnings and comprehensive income as a result of the transition from previous GAAP to IFRS. The financial statements are the responsibility of the Fund's management and have been reviewed and approved by the Audit Committee.

## **INTERNAL CONTROLS OVER DISCLOSURE AND FINANCIAL REPORTING**

The Chief Executive Officer ("CEO") and the Chief Financial Officer ("CFO") are responsible for designing disclosure controls and procedures to ensure that material information is being recorded, processed, summarized, and reported to senior management, including the certifying officers and other members of the Fund's Disclosure Committee, on a timely basis, so that appropriate decisions can be made regarding public disclosure. In addition, the CEO and CFO are responsible to design, or cause to be designed under their supervision, internal controls over financial reporting ("ICFR"), to a standard that provides reasonable assurance of the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS.

### ***Disclosure controls and procedures***

Disclosure controls and procedures, as defined in National Instrument 52-109, Certification of Disclosure in Issuers' Annual and Interim Filings, means controls and other procedures of an issuer that are designed to provide reasonable assurance that information required to be disclosed by the issuer in its annual filings, interim filings or other reports filed or submitted by it under securities legislation is recorded, processed, summarized and reported within the time periods specified in the securities legislation and include controls and procedures designed to ensure that information required to be disclosed by an issuer in its annual filings, interim filings or other reports filed or submitted under securities legislation is accumulated and communicated to the issuer's management, including its certifying officers, as appropriate to allow timely decisions regarding required disclosure.

An evaluation of the effectiveness of the Fund's disclosure controls and procedures were conducted as of June 30, 2011, by and under the supervision of the Fund's management, including the CEO and CFO. Based on this evaluation, the CEO and CFO concluded that the disclosure controls and procedures were effective.

### ***Internal controls over financial reporting***

The Fund's management, including the CEO and CFO, has evaluated the design of the Fund's Internal Controls over Financial Reporting using the control framework and criteria established by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). Based on this evaluation, management has concluded that the Fund's ICFR as of June 30, 2011 were designed and operating effectively, and provides reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS.

### ***Changes in internal controls over financial reporting***

On January 1, 2011, the Fund adopted IFRS as its standard for financial reporting. The Fund's transition to IFRS in the period did not result in any significant changes to the Fund's internal controls over financial reporting. In addition, no other changes were made to internal controls over financial reporting during the three months ended June 30, 2011, that would have materially affected, or would be reasonably considered to materially affect, the Fund's ICFR.

## *Limitations on the effectiveness of disclosure controls and internal controls over financial reporting*

It should be noted that while the Fund's Chief Executive Officer and Chief Financial Officer believe that the Fund's internal controls system and disclosure controls and procedures provides a reasonable level of assurance that the objectives of the control systems are met, they do not expect that the Fund's control system will prevent all errors and fraud. A control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. The design of any system of controls is also based in part upon certain assumptions about the likelihood of future events, and there can be no assurances that any design will succeed in achieving its stated goals under all potential conditions.

The Fund will continue to periodically review our disclosure controls and procedures and internal control over financial reporting and may make modifications from time to time as considered necessary or desirable.

## **NOTICE OF NO AUDITOR REVIEW OF INTERIM FINANCIAL RESULTS**

Pursuant to National Instrument 51-102, Part 4, subsection 4.3(3)(a) issued by the Canadian Securities Administrators, if an auditor has not performed a review of the interim financial statements, they must be accompanied by a notice indicating that the financial statements have not been reviewed by an auditor.

The accompanying unaudited interim financial statements of the Fund as at, and for the three and six months ended June 30, 2011 and 2010, have been prepared in accordance with IFRS and are the responsibility of the Fund's management. The financial statements and related financial reporting matters have been reviewed and approved by the Audit Committee.

The Fund's independent auditor has not performed a review of these financial statements as at and for the three and six months ended June 30, 2011 and 2010 in accordance with the standards established by the Canadian Institute of Chartered Accountants for a review of interim financial statements by an entity's auditor.

## CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

(unaudited)	June 30, 2011	December 31, 2010 (Note 19)	January 1, 2010 (Note 19)
<b>Assets</b>			
Finance receivables (Note 5)	\$ 135,768,638	\$ 125,228,265	\$ 101,403,463
Allowance for credit losses (Note 6)	(6,118,100)	(5,383,100)	(7,236,000)
Finance receivables – net	129,650,538	119,845,165	94,167,463
Cash	523,648	839,620	467,674
Inventories	88,453	147,000	287,800
Other assets	949,939	896,982	520,206
Equipment (Note 7)	295,678	352,407	373,433
Deferred tax assets (Note 8)	822,744	1,160,352	180,519
	2,680,462	3,396,361	1,829,632
	\$ 132,331,000	\$ 123,241,526	\$ 95,997,095
<b>Liabilities</b>			
Bank credit facility (Note 9)	\$ 95,013,018	\$ 93,159,937	\$ 68,438,145
Accounts payable and accrued liabilities (Note 10)	731,567	898,678	694,519
Taxes payable (Note 8)	2,518,408	-	-
Deferred dealer obligation (Note 11)	1,880,387	1,854,567	1,847,863
Derivative financial instruments (Note 12)	407,870	548,596	1,096,128
Subordinated debentures	-	-	2,143,000
Unit based payment obligation (Note 13(b))	114,576	76,936	31,809
	100,665,826	96,538,714	74,251,464
<b>Unitholders' Equity</b>			
Fund unit equity (Note 13(a))	35,119,425	35,119,425	30,566,633
Contributed surplus	615,362	615,362	615,362
Deficit	(4,069,613)	(9,031,975)	(8,390,192)
	31,665,174	26,702,812	21,745,631
	\$ 132,331,000	\$ 123,241,526	\$ 95,997,095

Commitments (Note 18)

See accompanying notes to the Interim Consolidated Financial Statements.

## CONSOLIDATED STATEMENTS OF EARNINGS, AND COMPREHENSIVE INCOME

(unaudited)	Three months ended		Six months ended	
	June 30, 2011	June 30, 2010 (Note 19)	June 30, 2011	June 30, 2010 (Note 19)
<b>Financial revenue</b>				
Interest revenue	\$ 13,680,950	\$ 11,221,843	\$ 26,433,798	\$ 21,516,750
Fee income	689,586	612,725	1,447,604	1,245,379
	14,370,536	11,834,568	27,881,402	22,762,129
<b>Financial expenses</b>				
Interest expense	1,255,168	1,033,899	2,444,549	2,032,637
Provision for credit losses	4,635,948	3,945,355	8,950,957	8,443,006
Gain on derivative financial instruments	(58,817)	(89,355)	(140,726)	(308,417)
Net financial income before operating expenses and taxes	8,538,237	6,944,669	16,626,622	12,594,903
<b>Operating expenses</b>				
General and administrative (Note 4)	2,687,090	2,351,021	5,222,753	4,662,843
Loss (gain) on unit based payment obligation (Note 13(b))	35,860	(83,486)	37,640	(42,828)
Depreciation of equipment	45,970	37,286	102,186	88,182
	2,768,920	2,304,821	5,362,579	4,708,197
Earnings before taxes	5,769,317	4,639,848	11,264,043	7,886,706
<b>Taxes (Note 8)</b>				
Current	941,943	-	2,518,408	-
Deferred (recovery)	543,463	(61,906)	337,608	(134,906)
	1,485,406	(61,906)	2,856,016	(134,906)
Net earnings and comprehensive income	\$ 4,283,911	\$ 4,701,754	\$ 8,408,027	\$ 8,021,612
Earnings per fund unit (Note 13(d))				
Basic	\$ 0.17	\$ 0.19	\$ 0.34	\$ 0.33
Diluted	\$ 0.17	\$ 0.19	\$ 0.34	\$ 0.33

See accompanying notes to the Interim Consolidated Financial Statements.

## CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(unaudited)	Fund unit equity	Contributed surplus	Deficit	Total (Note 19)
Balance, January 1, 2010	\$ 30,566,633	\$ 615,362	\$ (9,436,364)	\$ 21,745,631
Net earnings and comprehensive income	-	-	8,021,612	8,021,612
Cash distributions on fund unit equity	-	-	(6,107,717)	(6,107,717)
Balance, June 30, 2010	30,566,633	615,362	(7,522,469)	23,659,526
Net earnings and comprehensive income	-	-	11,205,056	11,205,056
Cash distributions on fund unit equity	-	-	(8,154,525)	(8,154,525)
Unit distributions on fund unit equity	4,560,037	-	(4,560,037)	-
Fund unit issuance costs, net of tax	(7,245)	-	-	(7,245)
Balance, December 31, 2010	35,119,425	615,362	(9,031,975)	26,702,812
Net earnings and comprehensive income	-	-	8,408,027	8,408,027
Cash distributions on fund unit equity	-	-	(3,445,665)	(3,445,665)
Balance, June 30, 2011	\$ 35,119,425	\$ 615,362	\$ (4,069,613)	\$ 31,665,174

See accompanying notes to the Interim Consolidated Financial Statements.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited)	Three months ended		Six months ended	
	June 30, 2011	June 30, 2010 (Note 19)	June 30, 2011	June 30, 2010 (Note 19)
Increase (decrease) in cash				
<b>Operating activities</b>				
Net earnings	\$ 4,283,911	\$ 4,701,754	\$ 8,408,027	\$ 8,021,612
Non-cash items included in net earnings (Note 17)	(6,281,415)	(6,440,050)	(12,183,176)	(11,439,076)
Changes in operating assets and liabilities (Note 17)	(714,882)	(450,342)	(1,410,598)	(819,960)
Interest received	9,522,845	7,774,213	18,821,659	15,191,500
Interest paid	(1,208,755)	(998,540)	(2,365,944)	(1,949,212)
Net cash provided by operating activities	5,601,704	4,587,035	11,269,968	9,007,864
<b>Investing activities</b>				
Funds advanced on finance receivables	(23,097,507)	(20,572,105)	(42,998,912)	(37,946,721)
Principal collection on finance receivables	17,364,643	12,835,381	33,103,898	24,741,179
Purchase of equipment	(37,800)	(95,207)	(45,457)	(148,394)
Net cash used in investing activities	(5,770,664)	(7,831,931)	(9,940,471)	(13,353,936)
<b>Financing activities</b>				
Advances on bank credit facility	4,757,224	9,494,858	6,581,470	12,958,509
Repayments on bank credit facility	(2,600,000)	-	(4,650,000)	-
Repayments on subordinated debentures	-	(2,143,000)	-	(2,143,000)
Deferred transaction costs	(131,274)	(105,000)	(131,274)	(105,000)
Proceeds on exercise of fund unit options	-	66,666	-	66,666
Fund unit cash distributions	(1,845,892)	(3,834,031)	(3,445,665)	(6,107,717)
Net cash provided by (used in) financing activities	180,058	3,479,493	(1,645,469)	4,669,458
Net increase (decrease) in cash	11,098	234,597	(315,972)	323,386
Cash, beginning of period	512,550	556,463	839,620	467,674
Cash, end of period	\$ 523,648	\$ 791,060	\$ 523,648	\$ 791,060

See accompanying notes to the Interim Consolidated Financial Statements.

**NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**  
**For the three and six months ended June 30, 2011 and 2010**

**1. ORGANIZATION OF THE FUND AND DESCRIPTION OF BUSINESS**

Carfinco Income Fund (the "Fund" or "Carfinco") 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, as amended and restated on April 23, 2004, and March 17, 2011. The Fund owns 100% of Carfinco Holdings Trust ("CHT"), a wholly owned unincorporated trust, established under the laws of Ontario and 5.2% of Carfinco Inc. ("CAR"), a subsidiary established under the laws of Ontario. CHT holds the remaining 94.8% ownership of CAR. CHT holds 25.0% and is the limited partner of Carfinco Limited Partnership ("CLP") and CAR holds the remaining 75.0% and is the general partner of CLP. CLP is in the business of providing consumer financing for vehicle purchases.

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

**2. BASIS OF PRESENTATION**

The Fund is required to present the annual audited consolidated financial statements for the year ended December 31, 2011 under International Financial Reporting Standards ("IFRS"). For all periods up to and including the year ended December 31, 2010, the Fund prepared its financial statements in accordance with Canadian generally accepted accounting principles ("GAAP"). These unaudited interim consolidated financial statements for the three and six months ended June 30, 2011 have been prepared in accordance with International Accounting Standard ("IAS") 34 – Interim Financial Reporting. Amounts relating to the three and six months ended June 30, 2010, and as at December 31, 2010 have been restated as necessary to be compliant with our accounting policies under IFRS. The accounting policies adopted in these interim consolidated financial statements are consistent with the accounting policies the Fund expects to adopt in its IFRS consolidated financial statements for the year ended December 31, 2011 and are based on IFRS as issued by the International Accounting Standards Board ("IASB") that the Fund expects to be applicable at that time. These interim consolidated financial statements do not include all necessary annual disclosures in accordance with IFRS and should be read in conjunction with the Fund's audited consolidated financial statements for the year ended December 31, 2010 presented under Canadian GAAP and in conjunction with the disclosures concerning the transition from GAAP to IFRS included in Note 19 – Transition to International Financial Reporting Standards.

These interim consolidated financial statements were prepared on a going concern basis under the historical cost method except for certain financial assets and liabilities which are measured at fair value. The interim consolidated financial statements for the three and six months ended June 30, 2011 were authorized for issue in accordance with a resolution of the Board of Trustees on August 3, 2011.

## NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) For the three and six months ended June 30, 2011 and 2010

### 3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies we follow are described in Note 2 of the unaudited interim consolidated financial statements for the three months ended March 31, 2011.

#### Recent pronouncements

The Fund has reviewed new and revised accounting pronouncements that have been issued but are not yet effective and determined that the following may have an impact on the Fund:

#### *IFRS 9 – Financial Instruments: Recognition and Measurement*

The Fund will be required to adopt the first phase of IFRS 9 – Financial Instruments: Recognition and Measurement as of January 1, 2013. The new standard was issued as part of the IASB’s plan to replace IAS 39 – Financial Instruments: Recognition and Measurement. The IASB project plan for the replacement of IAS 39 consists of three main phases. The first phase addresses the accounting for financial assets and financial liabilities. The second phase will address the impairment of financial instruments, and the third phase will address hedge accounting. The adoption of the first phase of this standard is not expected to have a material impact on the Fund’s consolidated financial statements. At this time, the Fund cannot reasonably determine the impact the adoption of the second and third phase will have on the Fund’s consolidated financial results.

### 4. GENERAL AND ADMINISTRATIVE EXPENSES

	Three months ended		Six months ended	
	June 30, 2011	June 30, 2010	June 30, 2011	June 30, 2010
Salaries, benefits, and director’s remuneration	\$ 1,370,233	\$ 1,255,577	\$ 2,643,429	\$ 2,438,981
Loan administration	627,862	451,433	1,190,934	961,383
General and administrative	407,368	408,076	783,856	804,595
Professional and advisory services	194,517	174,789	452,781	345,494
Sales, marketing, and travel	87,110	61,146	151,753	112,390
	<u>\$ 2,687,090</u>	<u>\$ 2,351,021</u>	<u>\$ 5,222,753</u>	<u>\$ 4,662,843</u>

## NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) For the three and six months ended June 30, 2011 and 2010

### 5. FINANCE RECEIVABLES

Finance receivables consist of conditional sales contracts, which have terms of 12 to 60 months with fixed rates of interest. A vehicle collateralizes each individual finance receivable.

The contractual payments, including principal and interest, and the average stated contractual interest rates are due in the years as follows:

	June 30, 2011		December 31, 2010		January 1, 2010	
2010					\$ 56,935,064	29.2%
2011	\$ 39,549,724	29.3%	\$ 71,350,829	29.3%	52,409,014	29.3%
2012	75,578,624	29.3%	65,621,727	29.4%	43,629,495	29.4%
2013	64,696,466	29.3%	50,552,473	29.4%	21,386,003	29.4%
2014	44,272,085	29.3%	25,676,457	29.4%	2,043,337	29.3%
2015	14,687,780	29.0%	4,244,816	29.2%		
2016	876,828	29.2%				
Gross finance receivables	239,661,507		217,446,302		176,402,913	
Unearned interest income	(87,125,771)		(76,321,354)		(62,326,987)	
Principal balance	152,535,736		141,124,948		114,075,926	
Unamortized fees, discounts, and transaction costs	(18,849,081)		(18,052,063)		(14,587,700)	
Accrued interest	2,081,983		2,155,380		1,915,237	
Finance receivables	\$ 135,768,638		\$ 125,228,265		\$ 101,403,463	

The Fund's experience has shown that the actual contractual payment stream will vary depending on a number of variables. These variables include prepayment rates, write-offs and deferrals. Accordingly, the maturities of finance receivables shown in the table above are not to be regarded as a forecast of future cash collections.

## NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) For the three and six months ended June 30, 2011 and 2010

An analysis of the age and credit quality of financial assets in each of the periods presented is as follows:

### *Portfolio aging*

	June 30, 2011		December 31, 2010		January 1, 2010	
Current	\$ 125,364,738	92.3%	\$ 115,084,775	91.9%	\$ 88,977,772	87.7%
Contractually past due:						
1 to 30 days	6,874,102	5.1%	6,261,413	5.0%	7,374,643	7.3%
31 to 60 days	2,352,528	1.7%	3,005,479	2.4%	3,328,244	3.3%
61 to 90 days	1,177,270	0.9%	876,598	0.7%	1,722,804	1.7%
91+ days	-	0.0%	-	0.0%	-	0.0%
	\$ 135,768,638	100.0%	\$ 125,228,265	100.0%	\$ 101,403,463	100.0%

### *Credit quality*

	June 30, 2011		December 31, 2010		January 1, 2010	
Neither past due nor impaired	\$ 112,308,782	82.7%	\$ 103,438,547	82.6%	\$ 80,101,794	79.0%
Past due but not impaired:						
1 to 30 days	4,338,393	3.2%	4,257,761	3.4%	5,278,429	5.2%
31 to 60 days	778,228	0.6%	1,127,054	0.9%	1,661,766	1.6%
Impaired	18,343,235	13.5%	16,404,903	13.1%	14,361,474	14.2%
	\$ 135,768,638	100.0%	\$ 125,228,265	100.0%	\$ 101,403,463	100.0%

The credit risk inherent in loans and receivables is detailed in Note 16 – Financial Risk Management. Under the review of credit quality, financial assets where there is evidence of non-payment or other objective evidence of impairment are considered to be impaired. Based upon historical information on customer default rates, management considers the credit quality of loans and receivables that are neither past due nor impaired to be satisfactory.

Past due but not impaired balances relate to financial assets which are contractually overdue but are not deemed impaired unless the customer is contractually overdue by greater than 60 days, at which point in time, the expected future cash flows from the financial assets deteriorate significantly. Impaired balances are defined as accounts contractually overdue greater than 60 days, debtors that have a deteriorated financial condition, such as borrowers entering bankruptcy or the Fund being in the process of legal or collateral repossession proceedings, and loan assets that exhibit an above average probability of going into default, such as borrowers that missed their first contractual loan payment.

As at June 30, 2011, \$477,512 of interest was accrued on impaired financial assets (December 31, 2010 – \$447,818, January 1, 2010 - \$476,212).

## NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) For the three and six months ended June 30, 2011 and 2010

### 6. ALLOWANCE FOR CREDIT LOSSES

The change in the allowance for credit losses during the periods presented is as follows:

	Total
Allowance, January 1, 2010	\$ 7,236,000
Provision for credit losses	16,607,583
Write-offs	(21,682,492)
Recoveries	3,222,009
Allowance, December 31, 2010	5,383,100
Provision for credit losses	8,950,957
Write-offs	(9,762,975)
Recoveries	1,547,018
Allowance, June 30, 2011	\$ 6,118,100

A summary of the collective and individual components of the allowance for credit losses is as follows:

	June 30, 2011	December 31, 2010	January 1, 2010
Allowance for credit losses – collective	\$ 325,000	\$ 501,600	\$ 2,215,400
Allowance for credit losses – individual	5,793,100	4,881,500	5,020,600
	\$ 6,118,100	\$ 5,383,100	\$ 7,236,000

## NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) For the three and six months ended June 30, 2011 and 2010

### 7. EQUIPMENT

	Furniture and Equipment	Computer and Office	Leasehold Improvements	Total
<b>Cost:</b>				
Balance at January 1, 2011	\$ 245,934	\$ 460,742	\$ 164,964	\$ 871,640
Additions	-	45,457	-	45,457
Disposals	(41,549)	(49,054)	-	(90,603)
Balance at June 30, 2011	\$ 204,385	\$ 457,145	\$ 164,964	\$ 826,494
<b>Depreciation and impairment:</b>				
Balance at January 1, 2011	\$ 135,772	\$ 291,448	\$ 92,013	\$ 519,233
Depreciation	27,760	37,950	36,476	102,186
Disposals	(41,549)	(49,054)	-	(90,603)
Balance at June 30, 2011	\$ 121,983	\$ 280,344	\$ 128,489	\$ 530,816
Net book value at June 30, 2011	\$ 82,402	\$ 176,801	\$ 36,475	\$ 295,678
<b>Cost:</b>				
Balance at January 1, 2010	\$ 272,271	\$ 583,861	\$ 85,227	\$ 941,359
Additions	39,304	32,743	79,737	151,784
Disposals	(65,641)	(155,862)	-	(221,503)
Balance at December 31, 2010	\$ 245,934	\$ 460,742	\$ 164,964	\$ 871,640
<b>Depreciation and impairment:</b>				
Balance at January 1, 2010	\$ 162,970	\$ 370,210	\$ 34,746	\$ 567,926
Depreciation	38,443	77,100	57,267	172,810
Disposals	(65,641)	(155,862)	-	(221,503)
Balance at December 31, 2010	\$ 135,772	\$ 291,448	\$ 92,013	\$ 519,233
Net book value at January 1, 2010	\$ 109,301	\$ 213,651	\$ 50,481	\$ 373,433
Net book value at December 31, 2010	\$ 110,162	\$ 169,294	\$ 72,951	\$ 352,407

**NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**  
For the three and six months ended June 30, 2011 and 2010

**8. INCOME TAXES**

*Taxation of the Fund*

Prior to January 1, 2011, taxation on publicly traded income trusts and limited partnerships (Specified Investment Flow-Through Entities or “SIFT”), including Carfinco Income Fund, were not subject to an entity-level tax if all of the taxable income of the Fund was allocated to unitholders. In 2007, the *Income Tax Act (Canada)* was amended to impose on Canadian public income trusts an entity-level tax on earnings that the SIFT trust distributes to its unitholders, at a rate applicable to income earned by a Canadian public corporation, and to prevent such trusts from deducting trust distributions when calculating taxable income. Undistributed earnings of the SIFT continue to be taxable at the full tax rate normally applicable to undistributed trust income.

Prior to March 17, 2011, under the Fund’s Deed of Trust, all, or virtually all, of the taxable income of the Fund was required to be allocated to unitholders each fiscal year, and accordingly, no current provision for income taxes was recorded at the Fund level. On March 17, 2011, the Fund’s Deed of Trust was amended to remove the obligation of the Fund to distribute all of its taxable income. Under these circumstances, prior to the date of the amendment, deferred tax assets and liabilities attributable to the Fund are measured at the SIFT tax rate applicable to distributed profits, and subsequently are measured at the tax rate applicable to undistributed profits. Current income tax assets and liabilities are measured at the tax rate applicable dependent upon whether the taxable earnings were distributed or undistributed to unitholders. Future expectations of distributions are not taken into consideration. As a result, the income tax benefit related to the distribution of income to unitholders is recognized in the period when the liability to pay a distribution occurs.

*Carfinco Limited Partnership (“CLP”) Unit Transfer*

Effective June 30, 2011, Carfinco Holdings Trust transferred a 71.1% limited partnership interest in Carfinco Limited Partnership to Carfinco Inc., in accordance with the tax deferral provisions of subsection 85(1) of the *Income Tax Act (Canada)*. As payment for the transfer, Carfinco Inc. issued a 94.8% ownership interest to Carfinco Holdings Trust. As a result of the transaction, effective June 30, 2011, Carfinco Holdings Trust’s ownership interest in Carfinco Limited Partnership has been reduced to 25.0%, down from 96.1%, with Carfinco Inc. holding the remaining 75.0% interest.

## NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) For the three and six months ended June 30, 2011 and 2010

### *Components of deferred taxes*

The Fund and the Fund's subsidiary entities, have tax pools that impact the allocation of taxable income and that exceed the carrying value of assets and liabilities. The tax pools are composed of the following:

	June 30, 2011	December 31, 2010	January 1, 2010
Allowance for credit losses	\$ 3,518,100	\$ 4,924,439	\$ 4,298,854
Equipment	58,875	61,323	38,423
Transaction costs	(1,504,904)	(1,390,874)	(1,349,340)
Derivative financial instruments	407,870	548,596	1,096,128
Unit issue costs	102,491	194,509	493,382
Tax loss carry-forwards	54,844	54,844	777
<b>Total tax values in excess of carrying values</b>	<b>\$ 2,637,276</b>	<b>\$ 4,392,837</b>	<b>\$ 4,578,224</b>

The tax effects that give rise to significant portions of deferred tax assets and liabilities are presented below:

	June 30, 2011	December 31, 2010	January 1, 2010
<b>Deferred tax assets:</b>			
Allowance for credit losses	\$ 1,030,358	\$ 1,304,976	\$ 52,720
Equipment	15,532	15,950	10,088
Derivative financial instruments	159,069	142,086	131,598
Unit issue costs	39,972	51,388	48,921
Tax loss carry-forwards	14,534	14,534	218
	1,259,465	1,528,934	243,545
Valuation allowance	-	-	(46,478)
<b>Total deferred tax assets</b>	<b>1,259,465</b>	<b>1,528,934</b>	<b>197,067</b>
<b>Deferred tax liabilities:</b>			
Transaction costs	(436,721)	(368,582)	(16,548)
<b>Total deferred tax liabilities</b>	<b>(436,721)</b>	<b>(368,582)</b>	<b>(16,548)</b>
<b>Net deferred tax assets</b>	<b>\$ 822,744</b>	<b>\$ 1,160,352</b>	<b>\$ 180,519</b>

In assessing whether the deferred tax assets are realizable, management considers whether it is more likely than not that some portion or all of the deferred tax assets will be utilized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Based upon projections for future taxable income, management has not provided for a valuation allowance as at June 30, 2011 and December 31, 2010. The amount of the deferred

## NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) For the three and six months ended June 30, 2011 and 2010

tax assets considered realizable, however, could be reduced in the near-term if estimates of future taxable income during the carry-forward period are reduced.

At June 30, 2011, loss carry-forwards of \$54,844 (December 31, 2010 - \$54,844, January 1, 2010 - \$777) are available to reduce taxable income of the Fund's incorporated subsidiary, Carfinco Inc. These losses expire in the following years: 2027 - \$777, 2030 - \$54,067.

### 9. BANK CREDIT FACILITY

	June 30, 2011	December 31, 2010	January 1, 2010
Bankers' acceptance equivalent loans:			
Interest rate of 3.73%, maturing on January 19, 2010	\$ -	\$ -	\$ 65,000,000
Interest rate of 4.54%, maturing on February 14, 2011	-	85,000,000	-
Interest rate of 4.61%, maturing on July 13, 2011	90,000,000	-	-
Prime rate loan	5,241,236	8,309,766	3,570,658
Unamortized deferred transaction costs	(228,218)	(149,829)	(132,513)
	<u>\$ 95,013,018</u>	<u>\$ 93,159,937</u>	<u>\$ 68,438,145</u>

Interest expense includes amortization of deferred transaction costs in each of the periods presented as follows:

	Three months ended		Six months ended	
	June 30, 2011	June 30, 2010	June 30, 2011	June 30, 2010
Amortization of deferred transaction costs	\$ 33,736	\$ 34,170	\$ 52,885	\$ 68,340

#### *Terms and security*

The bank credit facility is a demand loan, which is the lesser at any time of: a) \$130,000,000 (December 31, 2010 - \$105,000,000, January 1, 2010 - \$85,000,000) 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 1.75% (December 31, 2010 - 1.75%, January 1, 2010 - 1.75%). The Fund also has the option to lock a portion of the outstanding loan balance, for a period of up to 180 days, in bankers' acceptance equivalent loans, which bear interest at the bankers' acceptance rate available at the inception of the equivalent loan, plus 3.25% (December 31, 2010 - 3.25%, January 1, 2010 - 3.25%). A stand-by fee of 0.375% (December 31, 2010 - 0.375%, January 1, 2010 - 0.25%) per annum applies to the unused portion of the facility and is calculated, then applied to the outstanding bank credit facility balance, on a monthly basis. The stated maturity date of the credit facility is June 30, 2013 (December 31, 2010 - June 30, 2013, January 1, 2010 - December 15, 2010).

## NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) For the three and six months ended June 30, 2011 and 2010

The collateral security lodged by the Fund to support the credit facility is a general security agreement covering all property held by the Fund. The terms of the credit facility provide for certain covenants (see Note 15), all of which the Fund was in compliance with at June 30, 2011, December 31, 2010, and January 1, 2010. As a result of the transition to IFRS (see Note 19) the Fund exceeded the financial leverage ratio as at December 31, 2010. The banking syndicate has agreed to use previous GAAP for calculating covenants up to and including December 31, 2010 and will use IFRS for periods commencing on January 1, 2011. Under previous GAAP, the financial leverage ratio was 3.14:1 as at December 31, 2010, and as a result, the Fund was not in breach of this covenant.

### 10. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities consist of the following components:

	June 30, 2011	December 31, 2010	January 1, 2010
Accounts payable and accrued liabilities	\$ 531,567	\$ 551,678	\$ 362,019
Refundable dealer deposits <sup>1</sup>	200,000	347,000	332,500
	<b>\$ 731,567</b>	<b>\$ 898,678</b>	<b>\$ 694,519</b>

- (1) Refundable dealer deposits reflect amounts paid by dealerships to participate under certain finance programs. The deposits are refundable to the dealership contingent upon a specified volume of loans being originated within a twelve month period.

### 11. DEFERRED DEALER OBLIGATION

The deferred dealer obligation relates mainly to loans purchased at a negotiated price that is less than the original principal amount being financed. Under this program, the dealer can receive additional purchase consideration based upon the collection performance of these finance receivables.

	Total
Deferred dealer obligation, January 1, 2010	\$ 1,847,863
Provisions made during the period	661,589
Provisions utilized during the period	(701,673)
Changes in and unwinding of the discount rate during the period	46,788
Deferred dealer obligation, December 31, 2010	1,854,567
Provisions made during the period	322,767
Provisions utilized during the period	(322,667)
Changes in and unwinding of the discount rate during the period	25,720
Deferred dealer obligation, June 30, 2011	<b>\$ 1,880,387</b>

## NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) For the three and six months ended June 30, 2011 and 2010

The provision was calculated by taking into account the finance term, historical collection, prepayment, write-off, and deferment rates on loans originated under this program. The loans have a maximum term of 48 months. The timing of outflows of economic benefits associated with the purchase price consideration varies depending on a number of factors, and as such, the provision and timing of outflows are subject to uncertainty.

### 12. DERIVATIVE FINANCIAL INSTRUMENTS

On August 23, 2007, the Fund entered into two interest rate swap agreements with a combined notional amount of \$20,000,000 which fixes the interest rate on a portion of the Fund's bank credit facility. The first agreement had a notional amount of \$10,000,000, a fixed bankers' acceptance rate of 4.92% and a three-year term that ended on August 23, 2010. The second agreement has a notional amount of \$10,000,000, a fixed bankers' acceptance rate of 4.99% and a five-year term ending on August 23, 2012. The remaining interest rate swap agreement has been classified as a "financial instrument measured at fair value through profit or loss." The Fund enters into interest rate swaps to lock the interest rate on a portion of its debt for longer periods and does not hold any derivative financial instruments for trading or speculation purposes.

During the three months ended June 30, 2011, a gain of \$58,817 (June 30, 2010 - \$89,355) was recorded. During the six months ended June 30, 2011, a gain of \$140,726 (June 30, 2010 - \$308,417) was recorded, and the fair value of the interest rate swap at June 30, 2011 was a liability of \$407,870 (December 31, 2010 - \$548,596, January 1, 2010 - \$1,096,128).

### 13. FUND UNITS AND UNITHOLDERS' EQUITY

#### a) *Fund units*

Under IAS 32, an instrument is classified as a financial liability if it contains a puttable feature, such as a contractual obligation for the issuer of the instrument to repurchase or redeem the instrument for cash or another financial asset. The Fund's units are redeemable at the holder's option, generally at any time, subject to certain restrictions, at a redemption price equal to the lesser of 95% of the 10-day simple average closing market price of the Fund's units subsequent to the redemption date, or 100% of the closing market price on the redemption date. The total amount payable by the Fund in any calendar month shall not exceed \$75,000 unless waived by the Trustee's at their sole discretion. These redemption privileges classify the Fund's units as financial liabilities under IAS 32 prior to the consideration of the puttable instrument exemption.

IAS 32 allows certain financial liabilities to be measured as equity if certain criteria are met. As at each reporting date, the units of the Fund met the puttable instrument exemption and are therefore classified as equity.

The estimated cash outflow required, as at June 30, 2011, to settle the redemption obligation would be \$158,746,729 (December 31, 2010 - \$175,975,056, January 1, 2010 - \$58,637,141), as calculated on the closing market price of the Fund's units on that date. The Trustees manage this obligation by limiting the total amount payable by the Fund, in any calendar month, to \$75,000 under the terms of the Deed of Trust. Historically, the Fund has not been asked to redeem units for cash.

## NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) For the three and six months ended June 30, 2011 and 2010

### 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:

	Number	Fund unit equity
Balance, January 1, 2010	23,933,527	\$ 30,566,633
Exercised employee unit options	66,666	-
Fund units issued on fund unit distribution	611,703	4,560,037
Fund unit issuance costs, net of tax	-	(7,245)
Balance, December 31, 2010	24,611,896	35,119,425
Balance, June 30, 2011	24,611,896	\$ 35,119,425

### b) *Unit based payment obligations*

On November 30, 2009, the Fund announced that the Board of Trustees approved a one-time issuance of unit options to certain employees of the Fund. Each unit option issued is exercisable to acquire one trust unit of the Fund at a price of \$2.00 per unit vesting over three years, expiring on November 13, 2012. One-third of the options issued vested immediately, with the remaining options issued vesting at a rate of one-third on the two subsequent award date anniversaries. The Fund does not currently have a unit based compensation program for its employees.

As a result of the ability of unitholders to redeem their Fund units for cash or other financial assets, options to acquire units are classified as cash-settled liabilities and are measured at fair value at each reporting date. The impact of fair value re-measurements during the vesting period are recognized immediately in the statement of earnings to the extent that they relate to past services. As a result, the recognized liability at the end of each reporting period is equal to the total fair value of the liability. The fair value of unit options is measured using the Black-Scholes Option-Pricing Model.

## NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) For the three and six months ended June 30, 2011 and 2010

The continuity of the Fund's outstanding and exercisable unit options is as follows:

	Unit Options	Weighted Average Exercise Price
Outstanding, January 1, 2010	100,000	\$ 2.00
Granted	-	-
Exercised	(66,666)	2.00
Outstanding, December 31, 2010	33,334	\$ 2.00
Exercisable, January 1, 2010	33,333	\$ 2.00
Exercisable, December 31, 2010	-	-

	Unit Options	Weighted Average Exercise Price
Outstanding, December 31, 2010	33,334	\$ 2.00
Granted	-	-
Exercised	-	-
Outstanding, June 30, 2011	33,334	\$ 2.00
Exercisable, June 30, 2011	-	\$ -

The following table summarizes information about options outstanding and exercisable for each of the periods presented:

June 30, 2011	Options Outstanding			Options Exercisable		
	Exercise Price Range	Number	Remaining Life (Years)	Weighted Average Exercise Price	Number	Weighted Average Exercise Price
	\$2.00	33,334	1.38	\$ 2.00	-	\$ -

## NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) For the three and six months ended June 30, 2011 and 2010

December 31, 2010		Options Outstanding		Options Exercisable	
Exercise Price Range	Number	Remaining Life (Years)	Weighted Average Exercise Price	Number	Weighted Average Exercise Price
\$2.00	33,334	1.87	\$ 2.00	-	\$ -

January 1, 2010		Options Outstanding		Options Exercisable	
Exercise Price Range	Number	Remaining Life (Years)	Weighted Average Exercise Price	Number	Weighted Average Exercise Price
\$2.00	100,000	2.87	\$ 2.00	33,333	\$ 2.00

For the six months ended June 30, 2011, a loss of \$37,640 (June 30, 2010 – gain of \$42,828) of unit-based payment obligations were recognized related to unit-based compensation expense and fair value adjustments.

### c) *Distribution of income to unitholders'*

Prior to January 1, 2011, pursuant to the Deed of Trust of the Fund, the Trustees were required to distribute all, or virtually all, of the income of the Fund for the fiscal year, determined in accordance with the *Income Tax Act (Canada)*, to the unitholders of the Fund through a combination of cash and/or unit distributions.

As a result of the recent changes to taxation laws, it was the opinion of the Trustees that it was no longer appropriate that the Fund be required to distribute all of its taxable income to unitholders as such distributions generally will no longer be deductible or provide a substantial benefit to the Fund for income tax purposes. Accordingly, on March 17, 2011, the Trustees amended the Deed of Trust to remove the requirement to fully distribute its taxable income to unitholders each fiscal year. On March 9, 2011, the Fund announced an increase in its monthly cash distribution to \$0.025 per fund unit and stated that, going forward, a portion of the net earnings of the Fund will be retained to fund future growth in the finance receivable portfolio.

The Fund's policy is to make distributions to unitholders of its available cash, consistent with good business practices considering requirements for capital expenditures, working capital, and other reserves considered advisable by the Trustees of the Fund. All such distributions are discretionary. Cash distributions, if any, are normally payable by the Fund on a monthly basis to unitholders of record on the 20th business day of each month. Distributions are paid on the last business day of the month.

## NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) For the three and six months ended June 30, 2011 and 2010

Distributions on units of record during the six months ended June 30, 2011 and year ended December 31, 2010 are summarized as follows:

Record Date	Payment Date	Cash Distribution per Unit	Total Cash Distribution
January 20, 2010	January 29, 2010	\$ 0.015	\$ 359,003
February 19, 2010	February 26, 2010	0.020	478,671
March 19, 2010	March 31, 2010	0.060	1,436,012
April 20, 2010	April 30, 2010	0.020	478,671
May 20, 2010	May 31, 2010	0.020	479,337
June 18, 2010	June 30, 2010	0.120	2,876,023
July 20, 2010	July 30, 2010	0.020	479,337
August 20, 2010	August 31, 2010	0.020	479,337
September 20, 2010	September 30, 2010	0.120	2,876,023
October 20, 2010	October 29, 2010	0.020	479,337
November 19, 2010	November 30, 2010	0.020	480,004
December 20, 2010	December 31, 2010	0.140	3,360,487
Total cash distributions for 2010		0.595	14,262,242
January 20, 2011	January 31, 2011	0.020	492,238
February 18, 2011	February 28, 2011	0.020	492,238
March 18, 2011	March 31, 2011	0.025	615,297
April 20, 2011	April 29, 2011	0.025	615,297
May 20, 2011	May 31, 2011	0.025	615,297
June 20, 2011	June 30, 2011	0.025	615,298
Total cash distributions for 2011		0.140	3,445,665
Accumulated cash distributions to unitholders for 2010 and 2011		\$ 0.735	\$ 17,707,907

## NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) For the three and six months ended June 30, 2011 and 2010

### d) Earnings per fund unit

The following table sets forth the computation of basic and diluted earnings per fund unit:

	Three months ended		Six months ended	
	June 30, 2011	June 30, 2010	June 30, 2011	June 30, 2010
Basic and diluted:				
Net earnings	\$ 4,283,911	\$ 4,701,754	\$ 8,408,027	\$ 8,021,612
Weighted average number				
of fund units outstanding <sup>1</sup>	24,611,896	24,563,179	24,611,896	24,554,254
Basic and diluted earnings per fund unit	\$ 0.17	\$ 0.19	\$ 0.34	\$ 0.33

(1) The weighted average number of fund units outstanding for the three and six months ended June 30, 2010 has been restated for the 611,703 additional Trust Units distributed to unitholders on December 31, 2010.

Diluted earnings per fund unit is calculated by adjusting the weighted average number of units outstanding, and net earnings for the effects of all dilutive instruments. Unit options are evaluated as to whether or not they are dilutive based on the effect on earnings for any adjustments that would be made upon exercise of the unit options, such as the elimination of the unit based payment obligation liability, and for increases in the weighted average number of units outstanding. In calculating diluted earnings per fund unit for each of the periods presented, unit options were excluded as their effect would be antidilutive.

## 14. RELATED PARTY TRANSACTIONS

Related party transactions include transactions with parties that have control or joint control over the reporting entity, have significant influence over the entity, are members of key management personnel of the Fund including the Trustees and Officers of the Fund, or are close family members of those individuals.

The Fund enters into transactions, arrangements, and agreements involving Trustees, Officers, and key management personnel in the normal course of business operations at commercial rates agreed upon by the related parties. Transactions between the Fund and its subsidiaries, which are related parties, have been eliminated on consolidation and are not disclosed in this note.

## NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) For the three and six months ended June 30, 2011 and 2010

### *Compensation of key management personnel*

The key management personnel of the Fund are deemed to be the executive and non-executive trustees of Carfinco Income Fund, and the members of the senior management group.

	Three months ended		Six months ended	
	June 30, 2011	June 30, 2010	June 30, 2011	June 30, 2010
Short-term employee benefits	\$ 285,018	\$ 254,171	\$ 575,961	\$ 516,097
Loss (gain) on unit based payment obligation	35,860	(83,486)	37,640	(42,828)
	\$ 320,878	\$ 170,685	\$ 613,601	\$ 473,269

Short-term employee benefits comprise of salaries, bonuses, trustee fees, and benefits in the period. Details of the Fund's unit-based payment obligations are outlined in Note 13(b) of the consolidated financial statements.

### *Patica Securities Limited*

The Fund has an agreement with Patica Securities Limited for services provided on an ongoing basis. These services include general strategic advice, operational and financial oversight and review, advice on financial structure, advice on senior and/or subordinated debt and equity structure, communication with stakeholders and other general consulting services. Carfinco LP entered into a Consulting Services Agreement with Patica Securities Limited on October 1, 2003, and pursuant to this agreement, Carfinco LP incurs a fixed monthly fee of \$12,500, and a variable monthly fee of one-twelfth of 0.2% of the outstanding principal amount of the finance receivables.

During the six months ended June 30, 2011, payments of \$218,315 (June 30, 2010 - \$189,000) were made to Patica Securities Limited and at, there was \$39,791 (December 31, 2010 - \$31,500, January 1, 2010 - \$31,500) payable to Patica Securities Limited. Patica Securities Limited is controlled by individuals who are Trustees of the Fund.

### *Subordinated debentures*

Included in interest expense for the six months ended June 30, 2011 is \$nil (June 30, 2010 - \$38,473) of interest paid to related parties during the period. As at January 1, 2010, \$743,000 of subordinated debentures was issued to related parties. On April 30, 2010, the Fund repaid the outstanding principal balance and accrued interest on the stated maturity date of the subordinated debentures.

**NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**  
**For the three and six months ended June 30, 2011 and 2010**

**15. CAPITAL MANAGEMENT**

The Fund's objectives when managing capital are to ensure sufficient liquidity to support its financial objectives and strategic plans, to ensure its financial covenants are met, and to maximize and protect unitholder value.

The Fund views its capital as a combination of its subordinated debentures, unrealized derivative liability and unitholders' equity balances. In general, the overall capital level of the Fund is evaluated and determined in the context of the Fund's current financial objectives and strategic plans. To fund the acquisition of receivables and grow the finance receivable portfolio, the Fund utilizes the credit facility and when additional capital is required, it is raised through subordinated debenture or unit issuances. Generally, the Fund has maintained a high level of indebtedness in order to maximize returns on unitholders' equity with the Fund historically distributing a high portion of cash flow in lieu of reducing indebtedness. The Fund carries a level of cash on hand, generally in an amount determined for short-term changes in non-cash working capital balances and to fund near term finance receivable acquisitions. The equity component of capital increases or decreases based upon the income of the business less cash distributions paid.

The calculation of the Fund's capital for the periods presented is as follows:

	June 30, 2011	December 31, 2010	January 1, 2010
Unitholders' equity	\$ 31,665,174	\$ 26,702,812	\$ 21,745,631
Derivative financial instruments	407,870	548,596	1,096,128
Subordinated debentures	-	-	2,143,000
<b>Total capitalization</b>	<b>\$ 32,073,044</b>	<b>\$ 27,251,408</b>	<b>\$ 24,984,759</b>

The Fund's indebtedness is subject to a number of covenants and restrictions including the requirement to meet certain financial ratios and financial condition tests at a consolidated level. These covenants include, but are not limited to, a financial leverage ratio, an interest coverage ratio, a loan availability calculation, and a minimum loss reserve requirement. The Fund was in compliance with all covenants as at June 30, 2011, December 31, 2010, June 30, 2010 and January 1, 2010. As a result of the transition to IFRS (see Note 19), the Fund exceeded the financial leverage ratio at December 31, 2010. The banking syndicate has agreed to use previous GAAP for calculating covenants up to and including December 31, 2010 and will use IFRS for periods commencing on January 1, 2011. Under previous GAAP, the financial leverage ratio was 3.14:1 as at December 31, 2010, and as a result, the Fund was not in breach of this covenant. In addition, as at June 30, 2011, December 31, 2010, June 30, 2010, and January 1, 2010, the Fund was in compliance with the minimum loss reserve requirement, and had not withdrawn funds under the bank credit facility in excess of the amount permitted in accordance with the loan availability calculation.

## NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) For the three and six months ended June 30, 2011 and 2010

The following financial condition ratios are monitored by the Fund in managing its capital structure:

Covenants	Requirement	June 30, 2011	December 31, 2010	June 30, 2010	January 1, 2010
Financial leverage ratio <sup>1</sup>	< 3.50	3.13	3.52	3.43	2.84
Interest coverage ratio (quarterly)	>=1.50	5.59	5.56	5.44	

- (1) As a result of the transition to IFRS (see Note 19), the Fund exceeded the financial leverage ratio at December 31, 2010. The banking syndicate has agreed to use previous GAAP for calculating covenants up to and including December 31, 2010 and will use IFRS for periods commencing on January 1, 2011. Under previous GAAP, the financial leverage ratio was 3.14:1 as at December 31, 2010, and as a result, the Fund was not in breach of this covenant.

The financial leverage ratio is calculated as total liabilities excluding derivatives, and subordinated debentures divided by total capitalization.

The interest coverage ratio is calculated as adjusted net earnings divided by interest expense for the trailing three months ended. Adjusted net earnings is calculated as earnings before income taxes, plus gain on derivatives, interest expense, and depreciation of equipment for the trailing three months ended.

### 16. FINANCIAL RISK MANAGEMENT

The Fund is exposed to a number of financial risks in the normal course of its business operations, including market risks resulting from fluctuations in interest rates, as well as credit and liquidity risks. The following summarizes the types of market price risks that the Fund is exposed, and the policies and procedures for measuring and managing risk.

#### a) Credit risk

Credit risk is the risk of an unexpected loss if a customer or counterparty to a financial instrument fails to meet its contractual obligations. For the Fund, credit risk arises principally through the Fund's finance receivables that are a result of transactions within the consumer finance industry and, as such, contain an element of credit risk in the event that the counterparties are unable to meet the terms of their agreements. Credit risk primarily arises from events and circumstances that are outside the Fund's control relating to customer under-performance from factors such as loss of employment, divorce, illness, business failure, adverse economic conditions or fraud. The Fund originates transactions in a relatively high-risk segment of the consumer finance industry and, therefore, write-offs are anticipated.

To manage credit risk, the Fund performs detailed assessments on the value of the security, the customer's financial condition and ability to service the debt both at loan inception and throughout the term of the loan, in addition to maintaining prudent underwriting methods. Carfinco also frequently purchases loans at a negotiated price that is less than the principal amount being financed by the debtor enabling the Fund to minimize losses arising on defaults by limiting the level of the Fund's own capital at risk. Credit risk associated with the Fund's cash holdings is managed by holding its funds with reputable financial institutions.

## NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) For the three and six months ended June 30, 2011 and 2010

### *Concentration*

All of the Fund's loans and receivables cater to a high-risk segment of the consumer finance market, focusing on individuals unable to obtain financing from traditional lending sources due to limited, poor, or no credit history. Carfinco's finance receivable portfolio is composed of a large number of homogeneous consumer loans, and as such, no individual customer constitutes a significant portion of the finance receivable portfolio. In addition to limiting the value of each customer's debt, Carfinco maintains a large geographically disbursed loan portfolio that reduces the risk of loss arising from adverse regional economic conditions.

As of each of the periods presented, the geographic distribution of the Fund's loan portfolio is as follows:

June 30, 2011	Western Canada	Eastern Canada	Total
Finance receivables	\$ 79,761,081	\$ 56,007,557	\$ 135,768,638
Percent of finance receivables	58.7%	41.3%	100.0%

December 31, 2010	Western Canada	Eastern Canada	Total
Finance receivables	\$ 72,191,486	\$ 53,036,779	\$ 125,228,265
Percent of finance receivables	57.7%	42.3%	100.0%

January 1, 2010	Western Canada	Eastern Canada	Total
Finance receivables	\$ 53,795,688	\$ 47,607,775	\$ 101,403,463
Percent of finance receivables	53.1%	46.9%	100.0%

### *Exposure to credit risk*

The Fund's maximum exposure to credit risk is represented by the carrying amount for finance receivables and cash. Carfinco secures each individual finance receivable with the registration of a security interest/lien against tangible assets. The Fund is exposed to the risk that the security upon which its advances are made may reduce in value, so that the Fund may not recover some or all of its advances in the event of a customer default.

An analysis of the age and credit quality of financial assets is outlined in Note 5 – Finance Receivables.

## NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) For the three and six months ended June 30, 2011 and 2010

### b) Liquidity risk

Liquidity risk is the risk that the Fund may not generate sufficient cash or cash equivalents in a timely and cost-effective manner to satisfy financial liabilities as they come due. The Fund manages liquidity risk through management of its capital structure and financial leverage as outlined in Note 15 – Capital Management. The Fund also manages liquidity risk by continuously monitoring actual and projected cash flows to ensure that there is sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions.

The Fund primarily relies on its bank credit facility as its primary source of funding. As at June 30, 2011, the Fund had un-drawn and committed bank borrowing facilities of \$34,758,764. The Fund has been successful in renewing and expanding these facilities in the past, however, if the Fund were unable to renew these facilities, or 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.

Management believes that internally generated cash flows supplemented by borrowings under the bank credit facility and the issuance of subordinated debt and/or fund unit equity, if necessary, will be sufficient to cover the Fund's normal operating and capital expenditures.

The following tables set out the gross undiscounted contractual maturities of the Fund's financial instruments:<sup>1</sup>

June 30, 2011	2011	2012	2013	2014 +	Total
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#### Financial assets:

Cash	\$ 523,648	-	-	-	\$ 523,648
Finance receivables <sup>2</sup>	39,549,724	75,578,624	64,696,466	59,836,693	239,661,507

#### Financial liabilities:

Bank credit facility <sup>3</sup>	95,241,236	-	-	-	95,241,236
Accounts payable and accruals	731,567	-	-	-	731,567
Derivative financial instruments <sup>4</sup>	188,096	228,255	-	-	416,351

December 31, 2010	2011	2012	2013	2014 +	Total
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#### Financial assets:

Cash	\$ 839,620	-	-	-	\$ 839,620
Finance receivables <sup>2</sup>	71,350,829	65,621,727	50,552,473	29,921,273	217,446,302

#### Financial liabilities:

Bank credit facility <sup>3</sup>	93,309,766	-	-	-	93,309,766
Accounts payable and accruals	898,678	-	-	-	898,678
Derivative financial instruments <sup>4</sup>	355,380	214,923	-	-	570,303

## NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) For the three and six months ended June 30, 2011 and 2010

January 1, 2010	2010	2011	2012	2013 +	Total
<b>Financial assets:</b>					
Cash	\$ 467,674	-	-	-	\$ 467,674
Finance receivables <sup>2</sup>	56,935,064	52,409,014	43,629,495	23,429,340	176,402,913
<b>Financial liabilities:</b>					
Bank credit facility <sup>3</sup>	68,570,658	-	-	-	68,570,658
Accounts payable and accruals	694,519	-	-	-	694,519
Derivative financial instruments <sup>4</sup>	742,609	380,736	176,096	-	1,299,441
Subordinated debentures <sup>5</sup>	2,241,637	-	-	-	2,241,637

- 1) The financial instruments are shown gross to reflect capital and interest. As a result, the amounts presented may not be equal to the carrying amounts presented on the Fund's statement of financial position.
- 2) Figures presented represent the contractual payments, including principal and interest, of the Fund's finance receivables. Historical experience has shown that the actual contractual payment stream will vary depending on a number of variables including prepayment rates, write-offs, and deferments. Accordingly, the maturities of finance receivables shown in the table above are not to be regarded as a forecast of future cash collections.
- 3) The bank credit facility is a demand loan with a stated maturity date of June 30, 2013 (December 31, 2010 – June 30, 2013, January 1, 2010 – December 15, 2010).
- 4) Derivative financial instruments represent the estimated contractual payments on the Fund's interest rate swap agreements based upon the Banker's Acceptance Canadian Dealer Offered Rate yield curve as at the reporting date.
- 5) Included in the contractual maturities is \$98,637 of interest payments on subordinated debentures.

### c) Market risk

Market risk is the risk of losses that results from changes in market prices, such as interest rates, equity prices, or foreign exchange rates, that have the effect of modifying the Fund's future cash flows, or fair values of its financial instruments. The principal market risk to the Fund is interest rate risk. When issued, the Fund's subordinated debt contracts bear interest at fixed rates of interest. The bank credit facility bears interest at a floating rate, and as a result, the Fund's borrowing costs on this facility are subject to interest rate cash flow risk, as the required cash flows to service the debt will fluctuate with changes in market rates. The Fund attempts to mitigate this risk by using bankers' acceptance equivalent loans to lock the interest rate on a portion of its debt for short periods and by using interest rate swap agreements to lock the interest rate on a portion of its debt for longer periods.

## NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) For the three and six months ended June 30, 2011 and 2010

As at June 30, 2011, the Fund had entered into the following arrangements to minimize its exposure to changes in floating interest rates:

June 30, 2011	Maturity Date	Notional Amount	Fixed Rate
Floating to fixed interest rate swap	August 23, 2012	\$ 10,000,000	4.99%
Banker's acceptance equivalent loans	July 13, 2011	\$ 90,000,000	4.61%

The Fund estimates that a 100 basis point increase (decrease) in interest rates during the period, with all the other variables constant, would result in an increase (decrease) in interest expense as follows:

For the six months ended	June 30, 2011	June 30, 2010
Bank credit facility	\$ 469,000	\$ 371,000
Interest rate swap agreements	(50,000)	(99,000)
	\$ 419,000	\$ 272,000

The Fund's finance receivables bear interest at a fixed rate, and are not subject to interest rate cash flow risk.

### *Fair value*

The Fund's policy for determining the fair value of financial instruments is outlined in Note 2 – Summary of Significant Accounting Policies. The following methods and assumptions were used to estimate the fair value of each financial instrument:

- Finance receivables is calculated by discounting the expected future cash flows of the portfolio at current market rates for loans with similar terms and risk, as currently, there is no organized market for valuing the finance receivable portfolio;
- Cash, bank credit facility, accounts payable and accrued liabilities, and subordinated debentures are assumed to approximate their carrying value, due to their short term nature;
- Derivative financial instruments are calculated using market prices that the Fund would pay or receive to settle the related arrangements;

## NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) For the three and six months ended June 30, 2011 and 2010

The following table sets out a comparison of the carrying amount and fair values of finance receivables:

Finance receivables – net	June 30, 2011	December 31, 2010	January 1, 2010
Book value	\$ 129,650,538	\$ 119,845,165	\$ 94,167,463
Fair value	133,008,173	121,897,644	96,783,467

The fair values of the remainder of the Fund's financial assets and financial liabilities are not considered to be materially different from their carrying values on the consolidated statement of financial position. Although the Fund believes that its estimates of fair value are appropriate, the use of different methodologies or assumptions could lead to different estimates of fair value.

IFRS 7 requires disclosure of a three-level hierarchy for fair value measurements based upon transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

- Level 1: Fair value is based on quoted market prices in active markets for identical assets or liabilities.
- Level 2: Fair value is based on observable inputs other than Level 1 prices, such as quoted market prices for similar, but not identical, assets or liabilities in active markets, quoted market prices for identical assets or liabilities in markets that are not active, and other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3: Fair value is based on non-observable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Financial instruments classified within Level 3 of the fair value hierarchy are initially fair valued at their transaction price, which is considered the best estimate of fair value. After initial measurement, the fair value of Level 3 assets and liabilities is determined using valuation models, discounted cash flow methodologies, or similar techniques.

The following table presents, the level within the fair value hierarchy for each financial asset and liability measured at fair value:

June 30, 2011	Level 1	Level 2	Level 3	Total
Financial liabilities:				
Derivative financial instruments	\$ -	\$ 407,870	\$ -	\$ 407,870

## NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) For the three and six months ended June 30, 2011 and 2010

December 31, 2010	Level 1	Level 2	Level 3	Total
Financial liabilities:				
Derivative financial instruments	\$ -	\$ 548,596	\$ -	\$ 548,596

January 1, 2010	Level 1	Level 2	Level 3	Total
Financial liabilities:				
Derivative financial instruments	\$ -	\$ 1,096,128	\$ -	\$ 1,096,128

During the three and six months ended June 30, 2011 and 2010, no financial instruments measured at fair value were classified as Level 3 financial instruments. The Fund has not made changes to its valuation techniques over the prior period.

### 17. ADDITIONAL CASH FLOW INFORMATION

#### *Non-cash items included in net earnings*

	Three months ended		Six months ended	
	June 30, 2011	June 30, 2010	June 30, 2011	June 30, 2010
Interest revenue	\$ (13,680,950)	\$ (11,221,843)	\$ (26,433,798)	\$ (21,516,750)
Interest expense	1,255,168	1,033,899	2,444,549	2,032,637
Gain on derivative financial instruments	(58,817)	(89,355)	(140,726)	(308,417)
Provision for credit losses	4,635,948	3,945,355	8,950,957	8,443,006
Depreciation of equipment	45,970	37,286	102,186	88,182
Loss (gain) on unit based payment obligation	35,860	(83,486)	37,640	(42,828)
Current income tax expense	941,943	-	2,518,408	-
Deferred tax expense (recovery)	543,463	(61,906)	337,608	(134,906)
	\$ (6,281,415)	\$ (6,440,050)	\$ (12,183,176)	\$ (11,439,076)

## NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) For the three and six months ended June 30, 2011 and 2010

### *Change in operating assets and liabilities*

	Three months ended		Six months ended	
	June 30, 2011	June 30, 2010	June 30, 2011	June 30, 2010
Finance receivables	\$ (492,077)	\$ (155,441)	\$ (926,409)	\$ (377,271)
Inventories	112	(31,400)	58,547	132,099
Other assets	53,619	(43,749)	(52,957)	(159,986)
Accounts payable and accrued liabilities	(61,787)	15,996	(167,111)	7,335
Deferred dealer obligation	(214,749)	(235,748)	(322,668)	(419,137)
	\$ (714,882)	\$ (450,342)	\$ (1,410,598)	\$ (816,960)

## 18. COMMITMENTS

### *Operating lease arrangements*

The Fund has entered into commercial leases for operating premises. These leases had an average life of 3.5 years at inception with no renewal options included in the contracts. There are no restrictions placed upon the lessee by entering into these leases. Under the terms of the leasing agreements, all leases expire on December 31, 2011.

Included in general and administrative expenses for the six months ended June 30, 2011 is \$190,544 (June 30, 2010 - \$174,094) of operating lease expenses. Future minimum lease payments under non-cancellable operating leases as at the end of the period are as follows:

	June 30, 2011	December 31, 2010	January 1, 2010
Within one year	\$ 196,500	\$ 393,000	\$ 382,000
After one year but not more than five years	-	-	393,000
More than five years	-	-	-
	\$ 196,500	\$ 393,000	\$ 775,000

**NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**  
**For the three and six months ended June 30, 2011 and 2010**

**19. TRANSITION TO INTERNATIONAL FINANCIAL REPORTING STANDARDS**

For all periods up to and including the year ended December 31, 2010, the Fund prepared its financial statements in accordance with Canadian generally accepted accounting principles (“GAAP”). As a publicly listed company in Canada, we are required to prepare consolidated financial statements in accordance with International Financial Reporting Standards (“IFRS”) for all periods after January 1, 2011, including comparative historical information.

IFRS employs a conceptual framework that is similar to GAAP, however, differences between GAAP and IFRS were identified that have impacted certain matters regarding recognition, measurement, and disclosures for the Fund. While the adoption of IFRS did not change the actual cash flows of Carfinco, the adoption resulted in changes to the Fund’s reported financial position and net earnings and comprehensive income. In order to assist users of the financial statements to better understand these changes, the Fund’s GAAP consolidated statement of financial position, statements of earnings and comprehensive income, and statements of changes in equity for the three and six months ended June 30, 2010 and for the year ended December 31, 2010 have been reconciled to IFRS with the principal adjustments explained in this note. In addition, this note explains the principal adjustments made by the Fund in restating its GAAP statement of financial position as at January 1, 2010, the Fund’s transition date to IFRS.

***Exemptions applied***

IFRS 1 – First Time Adoption of International Financial Reporting Standards allows first-time adopters certain exemptions in applying IFRS at the transition date. Under IFRS 1 the standards are applied retrospectively at the transition date with all adjustments to assets and liabilities taken to unitholders’ equity unless certain exemptions are applied. In adopting IFRS the Fund did not utilize any of the available IFRS 1 exemptions.

## NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) For the three and six months ended June 30, 2011 and 2010

The January 1, 2010 GAAP statement of financial position has been reconciled to IFRS as follows:

As at January 1, 2010	Note	GAAP	Transition Adjustments	IFRS
<b>Assets</b>				
Finance receivables	19(a)(i-iii)	\$ 113,222,303	\$ (11,818,840)	\$ 101,403,463
Allowance for credit losses	19(a)(iv)	(12,400,000)	5,164,000	(7,236,000)
Dealer reserve	19(a)(i)	(5,237,091)	5,237,091	-
Finance receivables – net		95,585,212	(1,417,749)	94,167,463
Cash		467,674	-	467,674
Inventories	19(a)(iii)	-	287,800	287,800
Other assets	19(a)(iii)	1,093,006	(572,800)	520,206
Equipment		373,433	-	373,433
Deferred tax assets	19(d)	167,361	13,158	180,519
		2,101,474	(271,842)	1,829,632
		\$ 97,686,686	\$ (1,689,591)	\$ 95,997,095
<b>Liabilities</b>				
Bank credit facility		\$ 68,438,145	\$ -	\$ 68,438,145
Accounts payable and accrued liabilities		694,519	-	694,519
Deferred dealer obligation		1,847,863	-	1,847,863
Derivative financial instruments		1,096,128	-	1,096,128
Subordinated debentures		2,143,000	-	2,143,000
Unit based payment obligation	19(c)	-	31,809	31,809
		74,219,655	31,809	74,251,464
<b>Unitholders' Equity</b>				
Fund unit equity		30,566,633	-	30,566,633
Contributed surplus	19(c)	619,962	(4,600)	615,362
Deficit	(page 66)	(7,719,564)	(1,716,800)	(9,436,364)
		23,467,031	(1,721,400)	21,745,631
		\$ 97,686,686	\$ (1,689,591)	\$ 95,997,095

## NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) For the three and six months ended June 30, 2011 and 2010

The GAAP statement of changes in equity as at January 1, 2010 has been reconciled to IFRS as follows:

	Fund unit equity	Contributed surplus	Deficit	Total
Balance under GAAP, January 1, 2010	\$ 30,566,633	\$ 619,962	\$ (7,719,564)	\$ 23,467,031
Adjustments:				
Finance receivables (Note 19(a))	-	-	(1,702,749)	(1,702,749)
Unit based payment obligation (Note 19(c))	-	(4,600)	(27,209)	(31,809)
Deferred taxes (Note 19(d))	-	-	13,158	13,158
Total transition adjustments	-	(4,600)	(1,716,800)	(1,712,200)
Balance under IFRS, January 1, 2010	\$ 30,566,633	\$ 615,362	\$ (9,436,364)	\$ 21,745,631

## NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) For the three and six months ended June 30, 2011 and 2010

The GAAP statement of earnings and comprehensive income for the three months ended June 30, 2010 has been reconciled to IFRS as follows:

For the three months ended June 30, 2010	Note	GAAP	Transition Adjustments	IFRS
<b>Financial revenue</b>				
Interest revenue	19(a)(i-ii)(b)	\$ 8,590,230	\$ 2,631,613	\$ 11,221,843
Fee income		612,725	-	612,725
		9,202,955	2,631,613	11,834,568
<b>Financial expenses</b>				
Interest expense	19(b)	1,020,380	13,519	1,033,899
Provision for credit losses	19(a)(i)(iv)	1,558,393	2,386,962	3,945,355
Gain on derivative financial instruments		(89,355)	-	(89,355)
Net financial income before operating expenses, and taxes		6,713,537	231,132	6,944,669
<b>Operating expenses</b>				
General and administrative	19(c)	2,355,021	(4,000)	2,351,021
Gain on unit based payment obligation	19(c)	-	(83,486)	(83,486)
Depreciation of equipment		37,286	-	37,286
		2,392,307	(87,486)	2,304,821
Earnings before taxes		4,321,230	318,618	4,639,848
<b>Taxes</b>				
Deferred (recovery)	19(d)	(18,580)	(43,326)	(61,906)
		(18,580)	(43,326)	(61,906)
Net earnings and comprehensive income		\$ 4,339,810	\$ 361,944	\$ 4,701,754

## NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) For the three and six months ended June 30, 2011 and 2010

The GAAP statement of earnings and comprehensive income for the six months ended June 30, 2010 has been reconciled to IFRS as follows:

For the six months ended June 30, 2010	Note	GAAP	Transition Adjustments	IFRS
<b>Financial revenue</b>				
Interest revenue	19(a)(i-ii)(b)	\$ 16,583,266	\$ 4,933,484	\$ 21,516,750
Fee income		1,245,379	-	1,245,379
		17,828,645	4,933,484	22,762,129
<b>Financial expenses</b>				
Interest expense	19(b)	2,005,222	27,415	2,032,637
Provision for credit losses	19(a)(i)(iv)	3,453,090	4,989,916	8,443,006
Gain on derivative financial instruments		(308,417)	-	(308,417)
Net financial income before				
operating expenses, and taxes		12,678,750	(83,847)	12,594,903
<b>Operating expenses</b>				
General and administrative	19(c)	4,687,643	(24,800)	4,662,843
Gain on unit based payment obligation	19(c)	-	(42,828)	(42,828)
Depreciation of equipment		88,182	-	88,182
		4,775,825	(67,628)	4,708,197
Earnings before taxes				
		7,902,925	(16,219)	7,886,706
<b>Taxes</b>				
Deferred (recovery)	19(d)	(11,917)	(122,989)	(134,906)
		(11,917)	(122,989)	(134,906)
Net earnings and comprehensive income				
		\$ 7,914,842	\$ 106,770	\$ 8,021,612

## NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) For the three and six months ended June 30, 2011 and 2010

The GAAP statement of changes in equity as at June 30, 2010 has been reconciled to IFRS as follows:

	Fund unit equity	Contributed surplus	Deficit	Total
Balance under GAAP, June 30, 2010	\$ 30,652,599	\$ 625,462	\$ (5,912,439)	\$ 25,365,622
Adjustments:				
Finance receivables (Note 19(a))	-	-	(1,786,596)	(1,786,596)
Unit based payment obligation (Note 19(c))	(85,966)	(10,100)	40,419	(55,647)
Deferred taxes (Note 19(d))	-	-	136,147	136,147
Total transition adjustments	(85,966)	(10,100)	(1,610,030)	(1,706,096)
Balance under IFRS, June 30, 2010	\$ 30,566,633	\$ 615,362	\$ (7,522,469)	\$ 23,659,526

## NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) For the three and six months ended June 30, 2011 and 2010

The June 30, 2010 GAAP statement of financial position has been reconciled to IFRS as follows:

As at June 30, 2010	Note	GAAP	Transition Adjustments	IFRS
<b>Assets</b>				
Finance receivables	19(a)(i-iii)	\$ 125,477,075	\$ (13,234,857)	\$ 112,242,218
Allowance for credit losses	19(a)(iv)	(12,150,000)	5,781,400	(6,368,600)
Dealer reserve	19(a)(i)	(5,907,560)	5,907,560	-
Finance receivables – net		107,419,515	(1,545,897)	105,873,618
Cash		791,060	-	791,060
Inventories	19(a)(iii)	-	155,701	155,701
Other assets	19(a)(iii)	1,076,592	(396,400)	680,192
Equipment		433,645	-	433,645
Deferred tax assets	19(d)	179,278	136,147	315,425
		2,480,575	(104,552)	2,376,023
		\$ 109,900,090	\$ (1,650,449)	\$ 108,249,641
<b>Liabilities</b>				
Bank credit facility		\$ 81,359,994	\$ -	\$ 81,359,994
Accounts payable and accrued liabilities		701,854	-	701,854
Deferred dealer obligation		1,684,909	-	1,684,909
Derivative financial instruments		787,711	-	787,711
Unit based payment obligation	19(c)	-	55,647	55,647
		84,534,468	55,647	84,590,115
<b>Unitholders' Equity</b>				
Fund unit equity		30,652,599	(85,966)	30,566,633
Contributed surplus	19(c)	625,462	(10,100)	615,362
Deficit	(page 69)	(5,912,439)	(1,610,030)	(7,522,469)
		25,365,622	(1,706,096)	23,659,526
		\$ 109,900,090	\$ (1,650,449)	\$ 108,249,641

## NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) For the three and six months ended June 30, 2011 and 2010

The GAAP statement of earnings and comprehensive income for the year ended December 31, 2010 has been reconciled to IFRS as follows:

For the year ended December 31, 2010	Note	GAAP	Transition Adjustments	IFRS
<b>Financial revenue</b>				
Interest revenue	19(a)(i-ii)(b)	\$ 35,290,051	\$ 10,352,829	\$ 45,642,880
Fee income		2,605,396	-	2,605,396
		37,895,447	10,352,829	48,248,276
<b>Financial expenses</b>				
Interest expense	19(b)	4,287,905	46,787	4,334,692
Provision for credit losses	19(a)(i)(iv)	6,580,505	10,027,078	16,607,583
Gain on derivative financial instruments		(547,532)	-	(547,532)
Net financial income before				
operating expenses and taxes		27,574,569	278,964	27,853,533
<b>Operating expenses</b>				
General and administrative	19(c)	9,564,540	(44,900)	9,519,640
Gain on unit based payment obligation	19(c)	-	(88,205)	(88,205)
Depreciation of equipment		172,810	-	172,810
		9,737,350	(133,105)	9,604,245
Earnings before taxes		17,837,219	412,069	18,249,288
<b>Taxes</b>				
Deferred (recovery)	19(d)	(2,827,043)	(1,849,663)	(977,380)
		(2,827,043)	(1,849,663)	(977,380)
Net earnings and comprehensive income		\$ 20,664,262	\$ (1,437,594)	\$ 19,226,668

## NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) For the three and six months ended June 30, 2011 and 2010

The GAAP statement of changes in equity as at December 31, 2010 has been reconciled to IFRS as follows:

	Fund unit equity	Contributed surplus	Deficit	Total
Balance under GAAP, December 31, 2010	\$ 35,291,357	\$ 626,262	\$ (5,877,581)	\$ 30,040,038
Adjustments:				
Finance receivables (Note 19(a))	-	-	(1,423,785)	(1,423,785)
Unit based payment obligations (Note 19(c))	(171,932)	(10,900)	105,896	(76,936)
Deferred taxes (Note 19(d))	-	-	(1,836,505)	(1,836,505)
Total transition adjustments	(171,932)	(10,900)	(3,154,394)	(3,337,226)
Balance under IFRS, December 31, 2010	\$ 35,119,425	\$ 615,362	\$ (9,031,975)	\$ 26,702,812

## NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) For the three and six months ended June 30, 2011 and 2010

The December 31, 2010 GAAP statement of financial position has been reconciled to IFRS as follows:

As at December 31, 2010	Note	GAAP	Transition Adjustments	IFRS
<b>Assets</b>				
Finance receivables	19(a)(i-iii)	\$ 139,478,407	\$ (14,250,142)	\$ 125,228,265
Allowance for credit losses	19(a)(iv)	(11,650,000)	6,266,900	(5,383,100)
Dealer reserve	19(a)(i)	(6,854,357)	6,854,357	-
Finance receivables – net		120,974,050	(1,128,885)	119,845,165
Cash		839,620	-	839,620
Inventories	19(a)(iii)	-	147,000	147,000
Other assets	19(a)(iii)	1,338,882	(441,900)	896,982
Equipment		352,407	-	352,407
Deferred tax assets	19(d)	2,996,857	(1,836,505)	1,160,352
		5,527,766	(2,131,405)	3,396,361
		\$ 126,501,816	\$ (3,260,290)	\$ 123,241,526
<b>Liabilities</b>				
Bank credit facility		\$ 93,159,937	\$ -	\$ 93,159,937
Accounts payable and accrued liabilities		898,678	-	898,678
Deferred dealer obligation		1,854,567	-	1,854,567
Derivative financial instruments		548,596	-	548,596
Unit based payment obligation	19(c)	-	76,936	76,936
		96,461,778	76,936	96,538,714
<b>Unitholders' Equity</b>				
Fund unit equity	19(c)	35,291,357	(171,932)	35,119,425
Contributed surplus	19(c)	626,262	(10,900)	615,362
Deficit	(page 72)	(5,877,581)	(3,154,394)	(9,031,975)
		30,040,038	(3,337,226)	26,702,812
		\$ 126,501,816	\$ (3,260,290)	\$ 123,241,526

**NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**  
For the three and six months ended June 30, 2011 and 2010

*Explanation of transition to IFRS*

a) Finance receivables

i. Dealer reserve

Under Canadian GAAP, a dealer reserve had been established to absorb potential credit losses arising on certain finance programs. The dealer reserve was recorded on certain finance receivables purchased by the Fund at a negotiated price that was less than the original principal amount being financed. The dealer reserve was composed of the accumulated discounts recorded on the origination of these finance receivables net of write-offs and recoveries incurred under the programs.

Under IFRS, all financial instruments are initially recognized at fair value plus any directly attributable transaction costs, premiums or discounts of acquisition or issue. As a result, the dealer reserve has been reclassified upon transition to IFRS, with all purchase discounts on these finance programs treated as an adjustment to the carrying value of finance receivables on the statement of financial position. These discounts are amortized against interest revenue using the effective interest method over the period to maturity of the related finance receivable. In addition, all write-offs and recoveries recognized through the dealer reserve under previous GAAP have been reclassified and are recorded through the provision for credit losses on the statement of comprehensive income.

ii. Accrued interest on impaired loans

Under IAS 39, interest charges on finance receivables continue to accrue at the effective interest rate on all impaired capital balances throughout the life of the agreement irrespective of the terms of the loan and whether the customer is actually being charged arrears interest. This is offset by a corresponding increase to the provision for credit losses to reflect the fact that this additional revenue may not be collectible. Under previous GAAP, the accrual of interest revenues on finance receivables classified as impaired was suspended.

iii. Assets held for resale

Under IAS 39, collateral available for disposition is not recognized as an asset separate from an impaired finance receivable except to the extent that the estimated net realizable value of the collateral is not already reflected in the carrying value of the impaired financial asset. Under previous GAAP, the Fund recognized an asset separate from an impaired finance receivable on all repossessed collateral that was available for final disposition with a corresponding reduction in the carrying value of the impaired finance receivable where applicable.

## NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) For the three and six months ended June 30, 2011 and 2010

### iv. Impairment of financial assets and allowance for credit losses

Under Canadian GAAP, the allowance for credit losses consisted of accumulated specific and general components which were deducted from the finance receivable portfolio. The allowance for credit losses was determined by identifying objective evidence of impairment as a result of one or more loss events that occurred after the initial recognition of the asset, and that loss event had an impact on the estimated future cash flows of the finance receivable or group of finance receivables that could be reliably measured. Objective evidence of impairment included identifying specific indicators that a borrower was experiencing financial difficulty, such as individual finance receivables in arrears, or the probability that they would enter bankruptcy or other financial reorganization. Financial assets that bore no specific indicators of impairment were evaluated for impairment collectively by assessing the current economic conditions, historical industry ratios of write-offs, historical losses on a static pool basis, estimates of the underlying collateral value, and the Fund's current write-off and recovery experience.

Substantial portions of Canadian GAAP and IFRS are converged with respect to impairment of financial assets, however, under IAS 39, more emphasis is placed on identifying specific indicators of impairment subsequent to loan origination, and general provisions are not permitted if they cannot be supported by objective evidence of impairment. Similar to Canadian GAAP, if it is determined that no objective evidence of impairment exists for an individually assessed financial asset, the asset is grouped with financial assets with similar credit risk characteristics, and that group of financial assets is collectively assessed for impairment utilizing a discounted cash flow analysis. For the Fund, future cash flows for the group are estimated on the basis of their contractual cash flows and historical loss experience while excluding future credit losses, even if this is not in line with total expected losses over the entire life of the loan. The amount of the impairment loss is measured as the difference between the carrying amount of finance receivables on the statement of financial position, and the present value of the estimated future cash flows discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of the allowance for credit losses.

The impact arising from the IFRS measurement differences related to finance receivables are as follows:

#### *Consolidated statement of financial position*

	December 31, 2010	June 30, 2010	January 1, 2010
Decrease in finance receivables	\$ (14,250,142)	\$ (13,234,857)	\$ (11,818,840)
Decrease in allowance for credit losses	6,266,900	5,781,400	5,164,000
Decrease in dealer reserve	6,854,357	5,907,560	5,237,091
Decrease in other assets	(441,900)	(396,400)	(572,800)
Increase in inventories	147,000	155,701	287,800
Increase in deficit	\$ (1,423,785)	\$ (1,786,596)	\$ (1,702,749)

## NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) For the three and six months ended June 30, 2011 and 2010

### *Consolidated statement of comprehensive income*

	Twelve Months Ended December 31, 2010	Six Months Ended June 30, 2010	Three Months Ended June 30, 2010
Increase in interest revenue	\$ 10,306,042	\$ 4,906,069	\$ 2,618,094
Increase in provision for credit losses	(10,027,078)	(4,989,916)	(2,386,962)
Decrease (increase) in deficit	\$ 278,964	\$ (83,847)	\$ 231,132

### b) Provisions

IAS 37 requires that where discounting is used in the measurement of a provision that the carrying amount of the provision be increased in each period to reflect the passage of time with the increase recognized as a borrowing cost. Under Canadian GAAP, the Fund reassessed its deferred dealer obligation at the end of each period and recognized charges against interest revenue based upon estimates of the obligation balance without the recognition of an interest expense reflecting changes in, and unwinding of the discount rate used in calculating the provision related to the passage of time.

The impact arising from the IFRS measurement differences related to provisions are as follows:

### *Consolidated statement of comprehensive income*

	Twelve Months Ended 2010	Six Months Ended 2010	Three Months Ended 2010
Increase in interest revenues	\$ 46,787	\$ 27,415	\$ 13,519
Increase in interest expense	(46,787)	(27,415)	(13,519)
(Increase) decrease in deficit	\$ -	\$ -	\$ -

## NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) For the three and six months ended June 30, 2011 and 2010

### c) Unit based payment obligations

Under previous GAAP, unit-based compensation was classified as equity settled. The fair value of unit options were measured at their grant utilizing the Black-Scholes Option-Pricing-Model, and were recognized over their vesting period with a corresponding increase in contributed surplus.

Under IFRS, as a result of the ability of unitholders to redeem their Fund units for cash or other financial assets, IAS 32 requires options to acquire units to be classified as a liability (cash-settled). In accordance with IFRS, at the date of transition, contributed surplus arising from historical unit-based compensation expense was reclassified as a liability as was re-measured to fair value. The unit options were then re-measured to fair value at each reporting date utilizing the Black-Scholes Option-Pricing-Model.

The impact arising from the IFRS measurement differences related to unit based payment obligations are as follows:

#### *Consolidated statement of financial position*

	December 31, 2010	June 30, 2010	January 1, 2010
Decrease in contributed surplus	\$ 10,900	\$ 10,100	\$ 4,600
Decrease in fund unit equity	171,932	85,966	-
Increase in unit based payment obligation	(76,936)	(55,647)	(31,809)
Decrease (increase) in deficit	\$ 105,896	\$ 40,419	\$ (27,209)

#### *Consolidated statement of comprehensive income*

	Twelve Months Ended December 31, 2010	Six Months Ended June 30, 2010	Three Months Ended June 30, 2010
Decrease in unit-based compensation expense	\$ 44,900	\$ 24,800	\$ 4,000
Gain on unit based payment obligation	88,205	42,828	83,486
Decrease in deficit	\$ 133,105	\$ 67,628	\$ 87,486

## NOTES TO THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) For the three and six months ended June 30, 2011 and 2010

### d) Income taxes

The above changes increased (decreased) the net deferred tax asset as follows due to changes in the temporary differences existing between the tax bases of assets and liabilities and their carrying amount for financial reporting purposes. Please refer to note 7 – Income Taxes for additional information on the tax rates used in the calculation of deferred tax assets as at each reporting period.

#### *Consolidated statement of financial position*

	December 31, 2010	June 30, 2010	January 1, 2010
(Decrease) increase in deferred tax assets	\$ (1,836,505)	\$ 136,147	\$ 13,158
(Increase) decrease in deficit	\$ (1,836,505)	\$ 136,147	\$ 13,158

#### *Consolidated statement of comprehensive income*

	Twelve Months Ended December 31, 2010	Six Months Ended June 30, 2010	Three Months Ended June 30, 2010
(Increase) decrease in deferred tax expense	\$ (1,849,663)	\$ 122,989	\$ 43,326
(Increase) decrease in deficit	\$ (1,849,663)	\$ 122,989	\$ 43,326

### e) Statement of cash flows

The presentation of the cash flow statement in accordance with IFRS differs from the presentation of the cash flow statement in accordance with Canadian GAAP. In particular, interest received, interest paid, and income taxes paid have been moved into the body of the statement of cash flows, whereas they were previously disclosed as supplementary information. In addition, the changes made to the consolidated statements of financial position and statements of comprehensive income have resulted in reclassifications of various amounts on the statement of cash flows.

### f) Earnings per fund unit

The above changes had the effect of changing earnings per fund unit for the periods presented. In particular, the changes noted in note 19(c) impacted the calculation of diluted earnings per fund unit. Please refer to note 13(d) for additional information on the calculation of diluted earnings per fund unit for the periods presented. There were no adjustments to the basic weighted average number of units outstanding in each period.