



STREAMLINED...

CARFINCO INCOME FUND

CANADA'S LEADING AUTOMOTIVE SPECIALTY FINANCE INCOME FUND

ANNUAL REPORT 2008

Carfinco focuses on providing consumer car loans to borrowers unable to obtain financing through traditional lending sources. A network of select independent and franchise dealerships offer Carfinco's payment plan to their customers who must, along with the vehicle, meet Carfinco's underwriting guidelines.

The units of the Fund trade on The Toronto Stock Exchange under the symbol "CFN.UN."

# ...FOR STABILITY

In 2008, Carfinco made some difficult but prudent decisions in the second half of the year that have turned out to be extremely beneficial, in light of the global economic reset. The streamlining of 2008 positions Carfinco well, as the economic uncertainty continues. In fact, current credit markets are actually increasing demand for Carfinco's innovative lending strategies, and the Fund is prepared to seize these opportunities.

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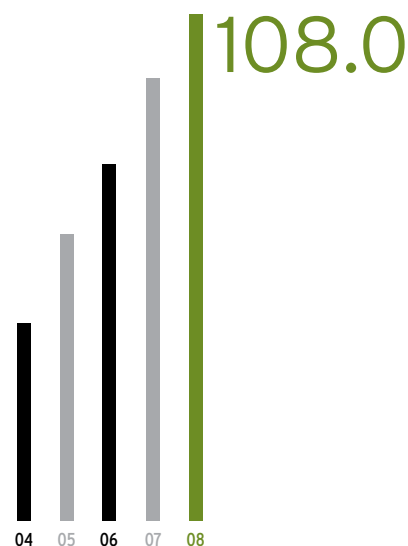
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# Financial Highlights

In spite of the streamlining strategy, Carfinco still managed to grow finance receivables and revenues in 2008, testament to the continued demand for the Fund's innovative lending strategies.

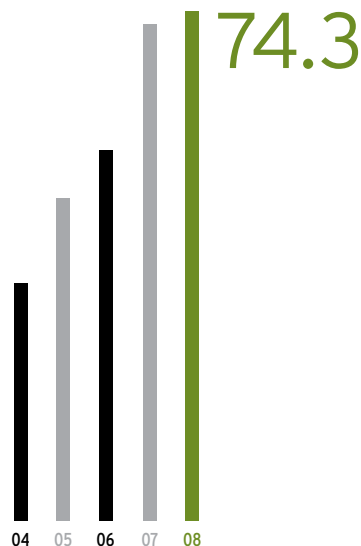
**FINANCE RECEIVABLES**  
(\$ millions)

42.7 61.1 76.0 94.4



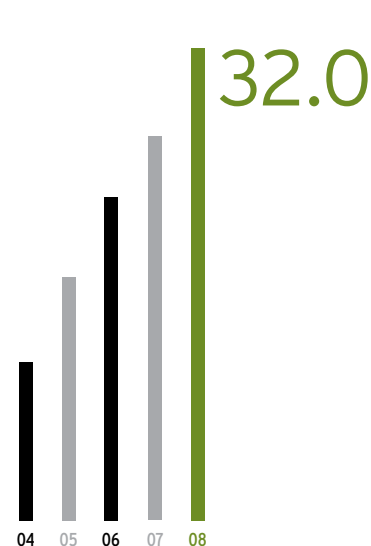
**LOAN ORIGINATIONS**  
(\$ millions)

34.4 46.9 53.7 72.1



**REVENUES**  
(\$ millions)

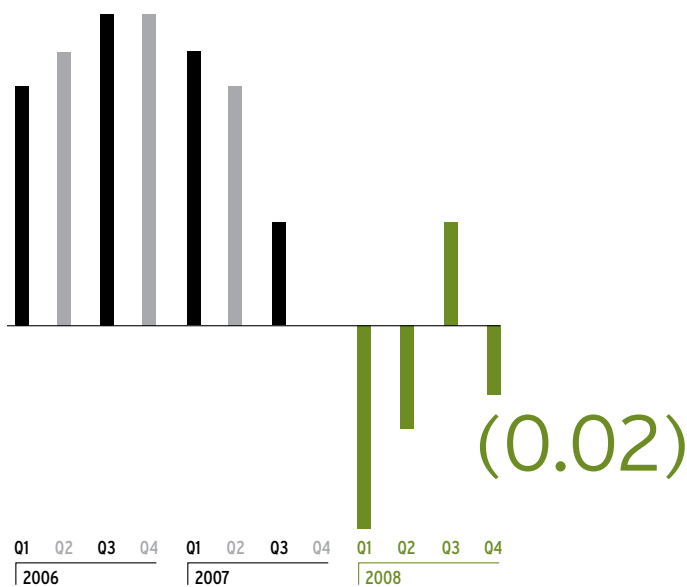
10.7 16.4 21.9 26.0



Out of necessity – as well as anticipation of the unfolding global economic crisis – Carfinco significantly increased its allowance for credit losses and dealer reserve, and tightened its lending policies throughout 2008, significantly reducing the Fund's risk exposure and strengthening its balance sheet for the future.

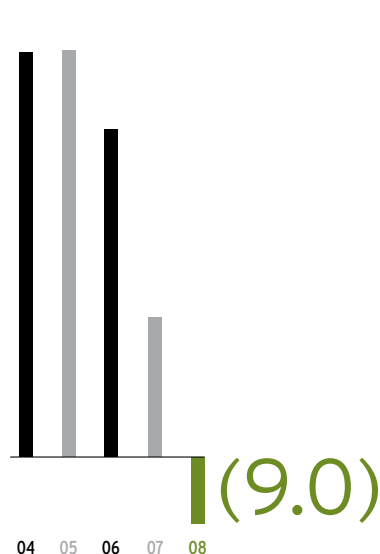
**QUARTERLY EARNINGS PER UNIT**  
(cents)

0.07 0.08 0.09 0.09 0.08 0.07 0.03 nil (0.06) (0.03) 0.03



**RETURN ON UNITHOLDERS' EQUITY**  
(%)

55.1 55.3 44.6 18.9





TRACY GRAF  
Chief Executive Officer

# ...FOR THE FUTURE

Being the leader in a distinct business niche has its advantages, particularly during a period of severe economic contraction. With every market downturn, opportunities are created, and the leaders who survive generally come out stronger in the end.

While there is still plenty of economic uncertainty today, and a lingering lack of confidence in the credit business, one thing is absolutely clear to us. Carfinco has come through these challenges in good financial health, with less competition and increased demand for our innovative products. We enter 2009 with sincere optimism, cautious of the near term, but genuinely excited about our prospects now that 2008 is behind us.

Carfinco is a leading provider of auto financing for consumers who need vehicles but can't get a loan from traditional sources. Over the past decade, Carfinco has been perfecting niche-specific approaches to originations, customer service, credit assessment, pricing, dealer relations, inventory tracking and asset remarketing. Looking ahead, Carfinco's management is confident that the Fund can achieve stability and renewed momentum in 2009.

# To Our Unitholders

The past 12 months have been difficult for most businesses, and Carfinco was no exception. But operating in a major recession has not changed who we are. Carfinco is still a leading provider of auto financing for consumers who need vehicles but can't get a loan from traditional sources. And being a leader has its advantages, particularly during a period of severe economic contraction. With every market downturn, opportunities are created, and the companies that adapt and survive come out stronger in the end.

While there is still plenty of economic uncertainty today, and a lingering lack of confidence in the credit business, Carfinco finds itself better streamlined in its operations, with less competition and increased demand for our innovative products. We have been adapting and enter 2009 with sincere optimism, cautious of the near term, but genuinely excited about our prospects.

As eager as we are to look ahead, it's important to reflect on the "perfect storm" that impacted our performance and how Carfinco's management responded. In 2008, our business endured an unforeseeable confluence of negative forces. Unprecedented meltdowns in the credit and auto industries, inflated gasoline prices, dramatic currency swings affecting used vehicle sales in Canada and a significant decline in auction values of repossessed vehicles all contributed to a difficult year.

As a result, we increased our allowance for credit losses by \$5.7 million due primarily to higher loan losses and delinquency levels as our customers experienced the effect of the recession, as well as continued finance receivable growth. Carfinco also recorded a \$1.5 million charge for two swap agreements entered into in August 2007, which fixed the interest rates on \$20.0 million of our outstanding debt. While both of these entries are non-cash expenses, they have nevertheless negatively affect net earnings and book equity by \$7.2 million.

Fortunately, Carfinco management and the Board of Trustees made several tough decisions throughout the year to fortify the business through these challenges. Two key decisions bear mentioning here. First, we suspended monthly distributions to preserve operating cash flow. Second, to decrease credit risk, we substantially tightened our credit

criteria as the year progressed, which lowered our acceptance rate on new business and slowed our growth. Suspending distributions allowed us to retain equity and maintain a strong balance sheet to weather the downturn. Tightening credit helped to ensure that new loans being written were of high enough quality to be profitable under the new economic conditions.

In spite of the challenges and tightening our credit criteria, we achieved record revenues of \$32.0 million, up 23.0% versus 2007. Distributable cash for the year was a respectable \$5.7 million, compared to \$7.3 million last year. However, including the two non-cash entries of \$7.2 million mentioned above, Carfinco recorded a net loss for the year of \$2.0 million, or 8 cents per unit, compared to net earnings of \$3.8 million, or 18 cents per unit, last year.

These losses and a suspension of the distribution led to a substantial decline in the unit price of Carfinco. This was very disappointing to us as long-term unit holders. We have now begun to see a recovery in the large U.S. sub-prime automotive stocks. We are hopeful that as we come out of recession in Canada, combined with improved operating results, that we will see an appreciation in unit holder value. As a management team, we own more units today than at anytime in our history and we believe we will become a stronger business as we emerge from the recession.

## STREAMLINED OPERATIONS

Given the impact of 2008, we have streamlined our operations and will continue to adjust our business strategy to deal with today's uncertain economic conditions.

At the operations level, management has implemented new procedures to deal with increased delinquencies, and made changes to both loan origination policies and collection procedures. We are making significant improvements to management reporting systems with general upgrades to the hardware and transitioning to a document image storage environment. We are also implementing a computer automated phone dialer system for use by our account management and inventory tracking personnel. The dialer system is a powerful

## To Our Unitholders (continued)

tool for Carfinco, enabling us to set up “campaigns,” which will have a positive impact on collections and skip tracing - and ultimately reduce delinquencies over time.

The labour market in Alberta has also moved in our favour during the last couple of quarters, increasing the number of available qualified applicants. Our strong hiring practices, training programs, and employee benefit packages are helping us to attract and more importantly, retain, valuable professional staff.

### ACCESS TO LENDING CAPITAL

In late 2008, Wells Fargo Financial Corporation Canada joined Bank of America and Bank of Montreal in our lending syndicate, replacing BoS (USA) Inc. Carfinco now benefits from the stability and credibility of the largest lenders in North America in our sector - a huge accomplishment. In early 2008 the credit facility was increased to \$85 million when Bank of Montreal joined the syndicate. When Wells Fargo joined our team, the maturity date of the credit facility was extended for a two-year period to December 15, 2010.

These relationships are an important vote of confidence from our senior lenders, and reflect the differences between Carfinco's business of Canadian non-prime automotive loans and the broader global credit industry.

### NICHE LEADERSHIP

Carfinco continues to be a leading provider of non-prime financing for pre-owned automobiles in Canada. The non-prime vehicle-financing arena is a distinct niche of specialty financing and we've developed a wealth of experience, acumen and risk management tools for this industry.

In a time of severe credit contraction, Carfinco is actually growing its dealer network, as more customers find themselves in our niche and more dealers are willing to try - and subsequently recognize the benefits of - Carfinco's innovative lending strategies. Our network of dealerships spans Canada, from coast to coast.

### THE FUTURE

While we believe the future is brightening for Carfinco, there is still much global economic uncertainty, and we will continue to act cautiously to preserve the Fund's long-term value. Certainly, some of the negative forces from 2008 persist, although we are confident that many of the specific challenges Carfinco faced throughout the year will be lessened in 2009.

In the year ahead, we will continue to focus on increasing efficiencies on all fronts, particularly on G&A expense items, where we believe there is still opportunity for improvement.

I would like to thank our dealer network, customers, dedicated staff and Board of Trustees for your commitment, hard work and perspective in a challenging year. Early in 2009, the Board appointed David Rosenkrantz as Chairman, succeeding David Prussky. David Rosenkrantz has been on the Board of Carfinco since our inception 12 years ago, and is well-suited to take on this leadership role. We will continue to benefit from David Prussky's expertise and advice as he remains a Trustee, and we thank him for his past leadership, which has been crucial to the development of our business.

Looking ahead, the Fund's leadership team is committed to sustainable growth, good governance and transparency, and our strategy and structure continue to be integrated and aligned with unitholder interests.

To our investors, we thank you for your continued belief in our business and we are committed to rewarding your patience with success in 2009 and beyond.



**TRACY GRAF**  
Chief Executive Officer



# HIGHLIGHTS 2008

Grew finance receivables to \$108 million

Experienced record revenues of \$32 million, up 23% from 2007

Increased credit facility to \$85 million

Added Bank of Montreal and Wells Fargo Financial Corporation Canada to lending syndicate

# OUTLOOK 2009

Continue to grow network of dealerships across the country

Focus on increasing efficiencies, particularly on G&A expenses items

Remain committed to sustainable growth, good governance and transparency

# Corporate Governance

The Board of Trustees provides stewardship of the Fund on behalf of unitholders through regular meetings and ongoing contact with Carfinco's management. Through this structured approach, Trustees exercise their duty to support informed, prudent and resolute decision making. Above all, our actions are guided by corporate governance regulations for public companies to ensure high standards of accountability and transparency to unitholders.

## DAVID A. ROSENKRANTZ

### Chairman

David is a co-founder of Patoca Securities Limited and Patoca Corporation. He has served as President and Director of Patoca Securities Limited since 2001, and Chairman of Patoca Corporation since 1993. In addition, David has served as a Director of Stellar Pharmaceuticals Inc., PreMD Inc., Versent Corporation (Chairman since 2004) and RAS Completions Inc.

## TRACY A. GRAF

Tracy was appointed President of the Carfinco Group in November 1998, after a long history as a principal and founder of several successful businesses. These included past roles as General Manager of Graf Management and Cattle Co. Ltd., a Board position with Canadian Simmental Association, including one year as President, and a director of Casablanca Capital Corp., which was traded on the TSX Venture Exchange.

## J. DARYL MACLELLAN

Daryl is President of CIT Canada, a unit of CIT Group Inc. (NYSE: CIT), a leading global commercial and consumer finance company. Daryl is also President of CIT Group Securities (Canada) Inc. A graduate of the University of Waterloo, Daryl is a Chartered Accountant and serves on the Board of Directors of the Canadian Financing Lease Association, as well as a number of other private and public companies.

## BRENT A. CHANNELL

Brent is a co-founder of Thales Alternative Investments Inc., a specialist in alternative investment strategies. He has over 24 years of experience in alternative investments, structured finance, corporate finance and derivatives, primarily with the Royal Bank of Canada and Citibank Canada. Prior to co-founding Thales, Brent was Managing Director of Structured Finance with Citibank Canada.

## MAURICE KAGAN

Maurice is currently President of Sparkle Solutions Income Fund. In addition to his role as a Board member at Carfinco, he is the Chairman of Carfinco's Audit Committee. Until June 2004, Maurice was CFO of Residential Equities Real Estate Investment Trust (ResREIT) and served as Vice President, Corporate at CapREIT until February 2006.

## DAVID M. PRUSSKY

David has been a Director of numerous public and private companies. His Board experience includes postings as a Director at Patoca Securities Limited and Patoca Securities Inc., a securities dealer. From 1993 to the present, David has been a Director of Patoca Corporation, a merchant banking firm, specializing in the small-to-mid-cap market.

## SIMON E. SERRUYA

Simon is co-owner of Yogen Früz/Swensen's International, a foodservice firm with 1,100 locations in over 30 countries worldwide. He has been with the company since 1987, and was instrumental in the growth of Yogen Früz both domestically and internationally, taking the company public in 1994, and recently taking it back privately.

# Management's Discussion and Analysis

The Management's Discussion and Analysis of Carfinco Income Fund (the "Fund") should be read in conjunction with the Fund's audited consolidated financial statements for the years ended December 31, 2008 and 2007, and the accompanying notes to those consolidated financial statements contained in this annual report.

This analysis has been prepared taking into consideration information available to March 25, 2009.

This report contains certain forward-looking statements that involve a number of known and unknown risks, uncertainties and other factors that may cause actual results of events to differ materially from those anticipated in our forward-looking statements.

## 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. The Fund owns 100% of Carfinco Holdings Trust, a wholly owned unincorporated trust, established under the laws of Ontario, and 100% of Carfinco Inc., a wholly owned subsidiary, established under the laws of Ontario. As at January 1, 2009, Carfinco Holdings Trust holds a 95.62% interest in Carfinco Limited Partnership, and Carfinco Inc. ("Carfinco") holds the remaining 4.38% interest, and is the general partner of Carfinco Limited Partnership. The Fund's trust 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. Since commencing the purchase of contracts in March 1997, the Fund has acquired more than \$353.4 million in vehicle purchase contracts. The Fund targets borrowers who are typically unable to obtain financing from traditional sources.

To fund the acquisition of receivables, the Fund uses its borrowings under its credit facility, and the issuance of debt and equity. The Fund generates interest and fee income on its finance receivables and pays interest expense on borrowings under its credit facility and on outstanding subordinated debentures.

## RECENT EVENTS

On January 26, 2009, the Fund announced the appointment of Mr. David Rosenkrantz as the Chairman of the Board. Mr. Rosenkrantz replaced Mr. David Prusky who resigned as Chairman. Mr. Rosenkrantz has been involved with Carfinco since inception, as a member of the Board of Directors and then as a Trustee of the Fund. Mr. Prusky has been a member of Carfinco's Board of Trustees since the formation of the Fund, and continues to serve as a Trustee of the Fund. Prior to the conversion to an income fund, Mr. Prusky was also Chairman of Carfinco's Board of Directors.

On December 15, 2008, the Fund executed the Second Amendment to the Amended and Restated Credit Agreement, dated February 13, 2008. The maximum advance remained at \$85,000,000, while the maturity date of the credit facility was extended for a two-year period to December 15, 2010. Interest charged on the facility increased 75 basis points to Canadian prime rate plus 175 basis points. Wells Fargo Financial Corporation Canada replaced BoS (USA) Inc. in the banking syndicate that also includes Bank of America, N.A. and Bank of Montreal as senior lenders of Carfinco.

On May 20, 2008, the Fund executed the First Amendment to the Amended and Restated Credit Agreement, dated February 13, 2008. The interest coverage ratio was changed, so that the minimum ratio be 0.20:1 for the first quarter of 2008, 0.16:1 for the second quarter of 2008, 1.40 for the third quarter of 2008 and 1.50:1 for each quarter thereafter.

On March 31, 2008, the Fund announced a change in the Fund's distribution policy to maximize the retention of operating cash flow. Carfinco's monthly cash distribution of \$0.027 per trust unit was replaced with a quarterly "in-kind" unit distribution, to distribute all, if any, of the Fund's taxable income to unitholders. Subsequent to this announcement, the Fund has not made any cash distributions or "in kind" unit distributions.

On February 13, 2008, the Fund executed an Amended and Restated Credit Facility. The maximum advance available increased from \$65,000,000 to \$85,000,000, and the maturity date of the credit facility was extended to February 13, 2009. The syndication of lenders increased with the addition of the Bank of Montreal to the existing lenders, BoS (USA) Inc. and the Bank of America, N.A.

## OUTLOOK

The Fund has evaluated Carfinco's growth momentum across the country, and has implemented procedures to deal with increased delinquencies. The Fund continues to experience several challenges, which Management has been actively addressing by implementing changes to both loan origination policies and collection procedures. These changes have been made necessary by the current economic environment, including reduced recovery amounts on repossessed vehicles and an economic downturn in certain areas of Canada.

Credit policies were tightened to reflect economic challenges faced by Canadian consumers. The Fund expects the credit challenges and reduced finance receivable growth rate to continue into the first quarter; however, the cash flow of the business continues to perform well. The reduced levels of new loan originations should result in a reduction in operating expense, which will translate into increased operating efficiency and cash flow.

The hiring and retention of the best administrative and collections staff has always been a focus of the Fund. The labour market in Alberta has improved during the last couple of quarters and the number of available qualified applicants has increased. The Fund's hiring practices, training programs and employee benefit packages help to attract qualified candidates.

The information technology infrastructure will continue to remain a primary focus of management. Projects include improvements to management reporting systems, general upgrades to the hardware, transitioning to a document image storage environment and implementation of an automated phone dialer system.

## ECONOMIC CONDITIONS

North America experienced declines in gross domestic product during the fourth quarter of 2008, with the United States dropping 6.2% and Canada dropping 3.5%. During the past two years, the Fund has experienced higher loss severity on liquidated collateral, due to an overall decrease in the auction values of used vehicles. This decrease in wholesale values started with the past strength of the Canadian dollar, and recently, due to the general economic environment. The Fund also experienced higher overall delinquency levels in 2008, as a result of increases in energy and gasoline prices, and increased unemployment in certain geographic areas. The increase in energy prices placed pressure on household expenditures and affected the customer's ability to fulfill their contractual payment obligations, and although these price levels have abated, the general economic environment has continued to keep the delinquency at an elevated level.

The Fund has responded to the current economic conditions by implementing changes to credit criteria, to ensure that customers are better able to meet their payment obligations and to collection procedures, to more efficiently process collection activities. The Fund has also introduced GPS and "Starter Interrupt" technology to vehicles on its GO Plan program, where the dealer has a vested interest in the performance of finance receivables and can receive additional purchase consideration based on the collection performance of these receivables. This technology provides a significant deterrent to delinquency, and is having a positive impact on this portfolio's delinquency levels.

## RESULTS OF OPERATIONS

The total revenue for 2008 was \$32.01 million, an increase of \$5.98 million over the 2007 total revenue of \$26.03 million. The net loss for 2008 was \$1.99 million, a decrease of \$5.84 million from the 2007 net earnings of \$3.85 million. Earnings per fund unit decreased from \$0.18 in 2007 to a net loss of \$0.08 in 2008. Overall, total revenue increased 23.0%, net earnings decreased 151.7% and earnings per fund unit decreased 144.4% from 2007 to 2008.

The Fund distributed 100.0% of its 2008 taxable income of \$1.90 million. Of this amount, 100.0% was distributed in cash. The Fund also distributed 100.0% of its 2007 taxable income of \$7.11 million. Of this amount, 100.0% was distributed in cash. The Fund intends to continue distributing its taxable income through cash distributions and/or through the issuance of additional trust units.

## REVENUES

The Fund's revenues for 2008 were \$32,013,758 compared to \$26,034,474 for 2007, an increase of \$5,979,284, or 23.0%.

Revenues are anticipated to move in conjunction with the growth in the finance receivable portfolio. The larger portfolio generates additional interest income, and origination and collection activity generates additional administration fee income.

Interest income increased \$5,523,640, or 22.5%, from \$24,507,455 for fiscal 2007 to \$30,031,095 for fiscal 2008. The increase in interest income is directly related to the growth in the finance receivable portfolio and an increase in the overall stated interest rate on the finance receivable portfolio.

Administration fee income increased \$455,644, or 29.8%, from \$1,527,019 for fiscal 2007 to \$1,982,663 for fiscal 2008. The administration fee income increased, due to overall growth in the finance receivable portfolio and to an increase in servicing fees.

## FINANCIAL EXPENSES

### Interest

The interest expense increased \$1,156,588, or 32.7%, from \$3,532,626 for fiscal 2007 to \$4,689,214 for fiscal 2008. After removing the cash costs of the interest rate swap agreements of \$318,677 for fiscal 2008 and \$9,919 for fiscal 2007, the interest expense increased \$847,830 or 24.1%, from fiscal 2007 to fiscal 2008. The increase in interest expense is due primarily to the average outstanding credit facility balance increasing from 2007 to 2008 by 33.3%, and to the addition of subordinated debenture interest, offset by a decrease in the average prime rate from 2007 to 2008 of 22.5%.

### Provision for credit losses

The provision for credit losses increased \$8,170,650, or 81.0%, from \$10,091,788 for fiscal 2007 to \$18,262,438 for fiscal 2008. The \$18,262,438 (2007 - \$10,091,788) provision is composed of \$12,542,438 (2007 - \$7,481,788) in net write-offs and a \$5,720,000 (2007 - \$2,610,000) increase in the allowance for credit losses.

The component for the net write-offs increased 67.6%, while the component for the allowance for credit losses increased 119.2%. The significant increase in the allowance for credit losses component is due to finance receivable portfolio growth during fiscal 2008 in the regular program, which requires additions to the allowance for credit losses and due to higher loss rates experienced on the finance receivable portfolio.

As well, during the past two years, the Fund has been subject to a decrease in auction values of used vehicles, largely due to the strong Canadian dollar and recently, due to the general economic environment. This has resulted in higher losses on delinquent contracts due to lower recoveries on the vehicles securing the contract at the time of liquidation. The decline in economic conditions in certain geographic areas has also resulted in higher delinquency rates experienced by the Fund.

## OPERATING EXPENSES

### General and administrative

General and administrative expenses increased \$1,355,792, or 16.9%, from \$8,013,574 for fiscal 2007 to \$9,369,366 for fiscal 2008. The increase in general and administrative expenses is due to the overall expansion of the operational structure to accommodate the growth in the finance receivable portfolio. Specifically, salaries and benefits costs have increased, as a result of higher staffing levels, and loan administration costs have increased, due to higher funding volumes and collection activities.

### Amortization

Amortization expense increased \$26,654, or 24.1%, from \$110,457 for fiscal 2007 to \$137,111 for fiscal 2008. Purchases of equipment were \$227,000 during fiscal 2008 compared to \$135,422 for fiscal 2007. Management does not expect significant equipment purchases during fiscal 2009.

## INCOME TAXES

The Fund is a "mutual fund trust" for income tax purposes. As such, the Fund is taxed on any taxable income not allocated to unitholders. Pursuant to the Deed of Trust, all or virtually all of the taxable income is allocated to unitholders; consequently, there is no tax liability for the Fund. No future taxes were recorded by the Fund, as there was no Canadian tax obligation.

The Fund follows the liability method of accounting for income taxes for future income taxes. Under this method, future tax assets and liabilities are determined based on the differences between the financial reporting and tax bases of assets and liabilities, and losses carried forward, and measured using the substantively enacted tax rates and laws that will be in effect when the differences are expected to reverse.

## ASSET REVIEW

Total assets increased by \$7,927,982, or 9.2%, to \$94,491,427 at December 31, 2008 from \$86,563,445 at December 31, 2007. Non-portfolio assets have remained constant at 1.2% (December 31, 2007 - 1.2%) of the total assets. The portfolio assets include the finance receivables, allowance for credit losses and the dealer reserve.

### Finance receivables

The finance receivables grew during fiscal 2008 by \$13,633,566, or 14.4%, to \$108,016,961. Funds advanced on finance receivables amounted to \$64,939,145 for fiscal 2008, compared to \$63,369,878 for fiscal 2007, an increase of only \$1,569,267, or 2.5%. The funding levels did not increase significantly during 2008, as changes were made to underwriting guidelines to decrease credit risk. The Fund continues to adhere to consistent underwriting standards to achieve portfolio growth.

All finance receivables are secured, under the applicable provincial personal property registry, by motor vehicle collateral. The increase in the size of the finance receivable portfolio is due to the Fund's financing activity in the non-prime sector of the auto finance industry. 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 and dealer reserve

The Fund's allowance for credit losses, including dealer reserve, increased \$5,768,851, or 65.0%, to \$14,644,715 at December 31, 2008 from \$8,875,864 at December 31, 2007. Allowance for credit losses, including dealer reserve, as a percentage of finance receivables was 13.6% at December 31, 2008, compared to 9.4% at December 31, 2007. The Fund will continue to monitor its credit loss experience and make additional provisions, as it deems appropriate.

The management of the Fund establishes and maintains an allowance for credit losses, which it considers adequate to absorb probable credit losses existing in the finance receivable portfolio. The allowance for credit losses consists of accumulated specific and general components, which are deducted from the finance receivable portfolio. In addition to the allowance for credit losses, a dealer reserve has been established to absorb potential credit losses. The dealer reserve is recorded on certain finance receivables purchased by the Fund at a negotiated price that is less than the original principal amount being financed. Under this program, the dealer has a vested interest in the performance of these finance receivables, and can receive additional purchase consideration based on the collection performance of these finance receivables.

The Fund's finance receivable portfolio is composed of a large number of homogenous consumer loans, with relatively small balances originated in the same industry, and as such, the evaluation of the allowance for credit losses is performed collectively for the group after allowance for specific losses. The estimated allowance for credit loss requirements are determined by assessing the individual finance receivables in arrears, the perceived effect of current economic conditions or other circumstances on the remaining finance receivables, the historical industry ratios of write-offs, and the Fund's current write-off and recovery experience.

## DELINQUENCY AND LOSSES

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

(000s FOR STATED VALUES, EXCEPT PERCENTAGES)	2008		2007	
Finance receivables outstanding at year end	\$	108,017	\$	94,383
Average finance receivables for the year	\$	101,200	\$	85,186
Allowance and reserve as a percentage of the finance receivables		13.6%		9.4%
Continuity of allowance for credit losses:				
Allowance, beginning of year	\$	6,470	\$	3,860
Provision for credit losses		18,262		10,092
Write-offs		(14,254)		(9,114)
Recoveries		1,712		1,632
Allowance, end of year	\$	12,190	\$	6,470
Continuity of dealer reserve:				
Reserve, beginning of year	\$	2,406	\$	2,701
Reserve on new volume		6,339		5,187
Write-offs		(6,811)		(6,156)
Recoveries		521		674
Reserve, end of year	\$	2,455	\$	2,406

Contractual delinquency at each year end were as follows:

DECEMBER 31	2008				
	CURRENT	1 TO 30 DAYS	31 TO 60 DAYS	61 TO 90 DAYS	91 DAYS PLUS
Amount of finance receivables	\$ 91,341,800	\$ 8,931,200	\$ 3,579,700	\$ 2,096,100	\$ 2,068,200
Percent of finance receivables	84.6%	8.3%	3.3%	1.9%	1.9%
Amount specifically impaired	\$ 701,700	\$ 305,000	\$ 668,300	\$ 2,096,100	\$ 2,068,200
DECEMBER 31	2007				
	CURRENT	1 TO 30 DAYS	31 TO 60 DAYS	61 TO 90 DAYS	91 DAYS PLUS
Amount of finance receivables	\$ 77,021,700	\$ 9,822,800	\$ 4,312,700	\$ 1,912,200	\$ 1,314,000
Percent of finance receivables	81.6%	10.4%	4.6%	2.0%	1.4%
Amount specifically impaired	\$ 444,600	\$ 149,200	\$ 202,900	\$ 1,011,800	\$ 1,314,000

The Fund originates transactions in a relatively high-risk segment of the consumer finance industry; therefore, write-offs are anticipated. The management of the Fund establishes and maintains an allowance for credit losses, which it considers adequate to absorb probable credit losses existing in the finance receivable portfolio. The Fund reviews static pool loss rates, historical industry ratios of write-offs, current write-off and recovery experience, estimates of the underlying collateral value, and economic conditions and trends to make the necessary judgments as to the appropriateness of the allowance for credit losses. Static pool loss rates are a measure of long term performance and credit quality of that pool over time by relating a write-off back to its origination date. Although the Fund uses various models and methodologies to assess the adequacy of loss reserves, there is no precise method for estimating the losses existing in the finance receivable portfolio.

During 2007 and 2008, the Fund experienced a decrease in values of vehicles disposed of at auction. The weakness in the used vehicle market began in 2007, due to a strong Canadian dollar, and continued in 2008 as the general economy deteriorated. This has resulted in higher losses on contracts, due to lower recoveries on the vehicles securing the contract at the time of liquidation. The decline in economic conditions in certain geographic areas has also resulted in higher delinquency rates experienced by the Fund.

## LIABILITY REVIEW

Total liabilities increased by \$11,805,318, or 18.9%, to \$74,269,271 at December 31, 2008, from \$62,463,953 at December 31, 2007.

### Deferred dealer obligation

The deferred dealer obligation balance decreased by \$585,862, or 26.7%, from \$2,190,247 at December 31, 2007, to \$1,604,385 at December 31, 2008. The obligation decreased during 2008, primarily as a result of a specific dealer's portfolio winding down.

The Fund purchases certain finance receivables at a negotiated price that is less than the original principal amount being financed. The dealer has a vested interest in the performance of these finance receivables, and can receive additional purchase consideration based on the collection performance of these finance receivables. The deferred dealer obligation represents the estimated additional purchase consideration owed to the dealers, which is composed of the accumulated obligations recorded on the origination of these finance receivables, and of charges to interest revenue based on estimates of the obligation balance.

## LIQUIDITY AND CAPITAL RESOURCES

The Fund's primary sources of cash have been cash flows from operating activities, borrowings under its credit facility, and the issuance of debt and equity. The Fund's primary uses of cash have been the funding of advances on finance receivables and the purchase of equipment. Management believes that the resources available to the Fund provide the needed capital to fund the anticipated expansion of the finance receivable portfolio and investments in operating infrastructure for fiscal 2009.

The Fund's capitalization at each year end, and averages for the years, are as follows:

(000s FOR STATED VALUES)	2008		2007	
	BALANCE AT YEAR END	AVERAGE FOR THE YEAR	BALANCE AT YEAR END	AVERAGE FOR THE YEAR
Bank credit facility	\$ 67,878	\$ 63,046	\$ 58,213	\$ 52,803
Accounts payable and accrued liabilities	503	979	1,454	1,053
Deferred dealer obligation	1,604	1,897	2,190	2,319
Total debt	\$ 69,985	\$ 65,922	\$ 61,857	\$ 56,175
Unitholders' equity	\$ 20,222	\$ 22,161	\$ 24,099	\$ 20,367
Deferred gain	-	-	-	94
Deferred costs	-	-	-	(63)
Derivatives	1,983	1,212	440	220
Long term debt	2,300	1,150	-	-
Total capitalization	\$ 24,505	\$ 24,523	\$ 24,539	\$ 20,618
Financial leverage	2.86:1	2.69:1	2.52:1	2.72:1

The Fund manages its capital resources by utilizing the financial leverage available under the credit facility. When additional capital is required, it is raised from operating cash flows and through subordinated debenture or unit issuances.

### Bank credit facility

The Fund executed an Amended and Restated Credit Facility on February 13, 2008, as amended on May 20, 2008 and December 15, 2008 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 is \$85,000,000 (2007 - \$65,000,000), subject to a defined borrowing base and a maximum financial leverage ratio of 3.75:1. The bank credit facility is the primary source of cash for funding growth in the finance receivable portfolio. As at December 31, 2008, a total of \$67,878,411 (2007 - \$58,213,096) was outstanding under the credit facility. The maturity date of the credit facility is December 15, 2010 (2007 - February 13, 2009).

## Unitholders' equity

The unitholders' equity decreased \$3,877,336, or 16.1%, during fiscal 2008 from \$24,099,492 at December 31, 2007, to \$20,222,156 at December 31, 2008. The decrease is due to a net loss of \$1,987,563 incurred during the year, combined with cash distributions of \$1,890,046 made during the first quarter of 2008.

As at December 31, 2008, and March 25, 2009, the following units of the Fund were issued and outstanding:

Units	23,322,566
Units held for unit purchase financing	16,680

## DISTRIBUTABLE CASH (see Non-GAAP Measures)

(000s FOR STATED VALUES, EXCEPT PERCENTAGES)

	2008	2007
Cash provided by operating activities	\$ 18,108	\$ 14,945
Add (deduct)		
Long-term unfunded contractual operational obligations (1)	(1,375)	(600)
Significant non-cash items during the period (2)(3)	(11,000)	(7,041)
Distributable cash	\$ 5,733	\$ 7,304
Cash distributions paid during the year	\$ 1,890	\$ 7,110
Payout ratio	33.0%	97.3%
Distributable cash per weighted average units outstanding	\$ 0.247	\$ 0.330
Cash distributions per fund unit	\$ 0.081	\$ 0.324
Unit distributions per fund unit	—	—
Total distributions per fund unit	\$ 0.081	\$ 0.324

(1) The Fund records an obligation to dealers that is recorded on the balance sheet as Deferred Dealer Obligation. Provision to fund a portion of such obligations is made through charges to the income statement.

(2) The significant non-cash items during the period are excluded from the calculation of distributable cash, as their inclusion would not properly reflect the cash available for distribution.

(3) The deduction for significant non-cash items during the period has been amended for 2007 to include the portion of the Provision for Credit Losses used to increase the balance of the Allowance for Credit Losses.

Distributable cash in 2008 amounted to \$5.733 million, or \$0.247 per unit, a decrease of \$1.571 million, or 21.5% and \$0.083 per unit from 2007. Cash distributions of \$0.081 per unit were paid to unitholders at a payout ratio for the year of 33.0%.

The Fund's distribution 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.

Overall, the Fund capitalizes an insignificant amount, and over the past two years has made equipment purchases of only \$362,422. Therefore, no deduction is made for productive capacity maintenance when calculating distributable cash. The Fund's ability to maintain productive capacity is expensed on an annual basis.

Pursuant to the Deed of Trust of the Fund, the Trustees must distribute all or virtually all of the income of the Fund for the fiscal year, determined in accordance with the *Income Tax Act (Canada)*, to the unitholders of the Fund. If the Fund does 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 is distributed through additional Trust Units having a value equal to the cash shortfall.

As at December 31, 2008, the Fund had \$1,890,046 in taxable income, of which \$1,890,046 was distributed in cash. As at December 31, 2007, the Fund had \$7,110,657 in taxable income, of which \$7,110,657 was distributed in cash.

To fund the acquisition of receivables and grow the finance receivable portfolio, the Fund will utilize the financial leverage available under the credit facility. When additional capital is required, it is raised through subordinated debenture or unit issuances.

Although the Fund intends to continue making distributions to our unitholders, 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, possible future tax obligations and future capital requirements.

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. These 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 is in compliance with the financial ratio covenants under our credit facility.

There are numerous factors, which affect the Fund's ability to pay cash distributions to its unitholders, and cash distributions cannot be assured. A description of those risk factors can be found in the section, "Risk Management", and in the Fund's Annual Information Form.

## 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. Distributions on units of record during the years ended December 31, 2008 and 2007 are summarized as follows:

RECORD DATE	PAYMENT DATE	CASH DISTRIBUTION PER UNIT	TOTAL CASH DISTRIBUTION
January 18, 2008	January 31, 2008	\$ 0.027	\$ 630,015
February 20, 2008	February 29, 2008	0.027	630,015
March 20, 2008	March 31, 2008	0.027	630,016
Total cash distribution for 2008		0.081	1,890,046
January 19, 2007	January 31, 2007	0.027	555,033
February 20, 2007	February 28, 2007	0.027	555,033
March 20, 2007	March 30, 2007	0.027	555,034
April 20, 2007	April 30, 2007	0.027	555,155
May 22, 2007	May 31, 2007	0.027	555,155
June 15, 2007	June 29, 2007	0.027	555,155
July 20, 2007	July 31, 2007	0.027	630,015
August 20, 2007	August 31, 2007	0.027	630,015
September 20, 2007	September 28, 2007	0.027	630,016
October 19, 2007	October 31, 2007	0.027	630,015
November 20, 2007	November 30, 2007	0.027	630,015
December 20, 2007	December 31, 2007	0.027	630,016
Total cash distribution for 2007		0.324	7,110,657
Accumulated cash distributions to unitholders for 2008 and 2007		\$ 0.405	\$ 9,000,703

## SELECTED ANNUAL INFORMATION AND KEY FINANCIAL RATIOS

(000s FOR STATED VALUES, EXCEPT PERCENTAGES AND PER FUND UNIT AMOUNTS)

	2008	2007	2006
Total revenue	\$ 32,014	\$ 26,034	\$ 21,932
Net (loss) earnings	\$ (1,988)	\$ 3,846	\$ 6,267
(Loss) earnings per fund unit – basic and diluted	\$ (0.08)	\$ 0.18	\$ 0.33
Total assets	\$ 94,491	\$ 86,563	\$ 70,140
Finance receivables	\$ 108,017	\$ 94,383	\$ 75,989
Finance receivables – average	\$ 101,200	\$ 85,186	\$ 68,561
Funds advanced on finance receivables	\$ 64,939	\$ 63,370	\$ 45,208
Loan originations	\$ 74,279	\$ 72,051	\$ 53,666
Allowance for credit losses and dealer reserve	\$ 14,645	\$ 8,876	\$ 6,561
Allowance and reserve as a percentage of finance receivables	13.6%	9.4%	8.6%
Total liabilities	\$ 74,269	\$ 62,464	\$ 53,505
Total debt	\$ 69,986	\$ 61,858	\$ 50,492
Bank credit facility	\$ 67,878	\$ 58,213	\$ 47,393
Long term debt	\$ 2,300	\$ –	\$ –
Unitholders' equity	\$ 20,222	\$ 24,099	\$ 16,634
Unitholders' equity – average	\$ 22,161	\$ 20,367	\$ 14,054
Total capitalization	\$ 24,505	\$ 24,540	\$ 16,696
Fund units outstanding	23,323	23,306	20,508
Book value per fund unit	\$ 0.87	\$ 1.03	\$ 0.81
Debt to equity ratio	2.86:1	2.52:1	3.02:1
Return on unitholders' equity	(9.0)%	18.9%	44.6%
Return on average finance receivables	(2.0)%	4.5%	9.1%
Average cost of borrowing	7.3%	6.7%	6.8%
Operating expense ratio	9.4%	9.5%	10.0%
Non-portfolio assets	1.2%	1.2%	1.0%
Cash distributions	\$ 1,890	\$ 7,111	\$ 6,281
Cash distributions – cumulative	\$ 21,540	\$ 19,650	\$ 12,539
Cash distributions per fund unit	\$ 0.081	\$ 0.324	\$ 0.333
Cash distributions per fund unit – cumulative	\$ 1.101	\$ 1.020	\$ 0.696

## SUMMARY OF QUARTERLY INFORMATION (unaudited)

(000s FOR STATED VALUES, EXCEPT PERCENTAGES AND PER FUND UNIT AMOUNTS)								
	2008				2007			
	Q4 (\$)	Q3 (\$)	Q2 (\$)	Q1 (\$)	Q4 (\$)	Q3 (\$)	Q2 (\$)	Q1 (\$)
Total revenue	8,172	8,338	7,928	7,576	7,305	6,746	6,188	5,795
Net (loss) earnings	(560)	690	(721)	(1,396)	(38)	754	1,506	1,624
(Loss) earnings per fund unit – basic and diluted	(0.02)	0.03	(0.03)	(0.06)	–	0.03	0.07	0.08
Finance receivables	108,017	108,637	105,757	100,181	94,383	88,552	80,344	73,408
Funds advanced on finance receivables	12,341	15,484	19,225	17,889	15,994	17,913	17,943	11,520
Loan originations	15,001	17,926	21,371	19,982	19,072	21,025	19,286	12,668
Allowance and dealer reserve	14,645	13,923	12,642	10,587	8,876	6,965	6,152	6,050
Allowance and reserve as a % of finance receivables	13.6%	12.8%	12.0%	10.6%	9.4%	7.9%	7.7%	8.2%
Bank credit facility	67,878	69,831	69,397	66,416	58,213	52,173	44,486	48,217
Long term debt	2,300	2,300	1,800	–	–	–	–	–
Unitholders' equity	20,222	20,834	20,144	20,865	24,099	26,028	27,164	16,655
Fund units outstanding	23,323	23,323	23,323	23,323	23,306	23,306	23,306	20,528
Basic weighted average fund units	23,323	23,323	23,323	23,306	23,306	23,306	20,805	20,508
Book value per fund unit	0.87	0.89	0.86	0.90	1.03	1.12	1.31	0.81

Total revenue increased proportionately with the increase in finance receivables until Q4 2008, when the portfolio and revenue decreased from the previous quarter. Earnings per fund unit have decreased each of the five quarters leading up to Q2 2008, as a result of unit equity issuances in November 2006 and June 2007 and a decrease in net earnings. The improvement in earnings per fund unit during Q3 2008 is due primarily to a reduction in provision for credit losses, relating to a lower increase in the allowance for credit losses during the quarter.

A net loss of \$560,118 in Q4 2008 was due to a significant loss on derivatives of \$1,099,644 recorded during the quarter. Net loss decreased from Q2 2008 to net earnings in Q3 2008, due to a reduction in the increase in the allowance for credit losses and an increase in revenue. Net loss decreased from Q1 2008 to Q2 2008, due to a non-cash gain of \$292,990 on derivatives in the second quarter versus a loss of \$532,789 during the first. Net earnings decreased from Q4 2007 to Q1 2008, due to a non-cash increase of \$2,170,000 in the allowance for credit losses and to a non-cash loss of \$532,789 on derivatives during the first quarter. Net earnings decreased from Q3 2007 to Q4 2007, due to a non-cash increase of \$1,755,000 in the allowance for credit losses and to a non-cash loss of \$189,524 on derivatives. Net earnings decreased from Q2 2007 to Q3 2007, due to a non-cash increase of \$855,000 in the allowance for credit losses, to an increase in general and administrative expenses to manage the portfolio growth, and to a non-cash loss of \$250,770 on derivatives. Net earnings decreased from Q1 2007 to Q2 2007, due to an increase in the allowance for credit losses, which is recorded through the provision for credit losses, and to an increase in the general and administrative expenses to manage the portfolio growth.

The finance receivable portfolio has increased significantly during the last two years, due to the implementation of the Curomax and DealerAccess online portals, which increased the consumer applications received by Carfinco. This increase in applications has resulted in increased funding, as reflected in the funds advanced on finance receivables during Q2 2007 through Q2 2008. The decrease in funding levels in Q3 and Q4 2008 is attributed to changes in loan origination policies and collection procedures to deal with recent increases in delinquencies.

The allowance and dealer reserve as a percentage of the finance receivables decreased in the five quarters leading up to Q3 2007, due to the mix of financial components used to assess the adequacy of the Fund's allowance for credit losses on its various programs and to an increase in loss rates during the period. The significant increases in the allowance and dealer reserve commencing in Q3 2007 is the result of a change in the mix of financial components used to assess the allowance for credit losses and increases in delinquency and loss rates on the finance receivables portfolio. Management assesses the adequacy of the allowance for credit losses on a regular basis.

The bank credit facility did not increase significantly during Q3 2008 and started to decline due to the decrease in funding volume discussed above. The bank credit facility decreased from Q1 2007 to Q2 2007, due to repayment using net proceeds from the issuance of trust units in June 2007 for gross proceeds of \$11.5 million. 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 debt or unit issuances.

Unitholders' equity increased in Q2 2007, due to the issuance of units mentioned above. These unit issuances resulted in an increase in the number of fund units outstanding and in an increase in the book value per fund unit.

#### DISCUSSION OF FOURTH QUARTER RESULTS (unaudited)

THREE MONTHS ENDED DECEMBER 31

(000s FOR STATED VALUES, EXCEPT PER FUND UNIT AMOUNTS)

	2008	2007
<b>Financial revenue</b>		
Interest income	\$ 7,666,765	\$ 6,842,713
Administration fees	505,554	461,958
	<u>8,172,319</u>	<u>7,304,671</u>
<b>Financial expenses</b>		
Interest	1,177,976	998,490
Net financial income before provision for credit losses	6,994,343	6,306,181
Provision for credit losses	4,101,212	3,881,889
Net financial income before operating expenses	2,893,131	2,424,292
<b>Operating Expenses</b>		
General and administrative	2,308,432	2,243,654
Loss on derivatives	1,099,644	189,524
Amortization of equipment	45,173	29,673
	<u>3,453,249</u>	<u>2,462,851</u>
Net loss and comprehensive loss	\$ (560,118)	\$ (38,559)
Net loss per fund unit – basic and diluted	\$ (0.02)	\$ –

Revenues for the fourth quarter of 2008 were \$8,172,319, compared to \$7,304,671 for the same period in 2007, an increase of 11.9%. The higher revenues were attributable to the increase in the finance receivables of 14.4% during the comparative periods.

Interest expense increased from \$998,490 during the fourth quarter of 2007, to \$1,177,976 during the same period in 2008, an increase of 18.0%. Provision for credit losses increased from \$3,881,889 for the fourth quarter of 2007, to \$4,101,212 during the same period in 2008, an increase of 5.6%. General and administrative expenses were \$2,308,432, compared to \$2,243,654 for the same period in 2007, an increase of 2.9%. Loss on derivatives was \$1,099,644 during the fourth quarter of 2008, compared to \$189,524 for the same period in 2007. Amortization of \$45,173 for the quarter was similar to the \$29,673 from the same period in 2007.

Prior to the loss on derivatives, the net loss in the fourth quarter of 2007 and 2008 becomes net earnings of \$539,526 for the fourth quarter of 2008 and \$150,965 for the fourth quarter of 2007.

## CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Management's discussion and analysis of financial condition and results of operations are made with reference to the audited consolidated financial statements for the year ended December 31, 2008. A summary of the Fund's significant accounting policies are presented in Note 2 to these consolidated financial statements. Some of the Fund's accounting policies, as required by generally accepted accounting principles, require management to make subjective, complex judgments and estimates to matters that are inherently uncertain. The Fund believes the most critical accounting policies 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, are those governing revenue recognition, the allowance for credit losses and the deferred dealer obligation.

## RELATED-PARTY TRANSACTIONS - PATICA SECURITIES LIMITED

The Fund has an agreement with Patuca Securities Limited for services provided on an ongoing basis. These services include general strategic advice, 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 Patuca Securities Limited on October 1, 2003, and pursuant to this agreement, Carfinco LP incurs a fixed monthly fee of \$13,375, and a variable monthly fee of one-twelfth of 0.2% of the outstanding principal amount of the finance receivables. During fiscal 2008, payments of \$380,448 (2007 - \$334,699) were made to Patuca Securities Limited and at December 31, 2008, there was \$32,354 (December 31, 2007 - \$30,401) payable to Patuca Securities Limited. Patuca Securities Limited is controlled by individuals who are Trustees of the Fund. The related party transactions occurred at the exchange amount, which is the consideration established and agreed to by the related parties.

## RELATED-PARTY TRANSACTIONS - DEBENTURE HOLDERS

During 2008, the Fund issued 14% debentures in the aggregate principal amount of \$900,000 to related parties and during the year, interest payments of \$56,309 were paid to debenture holders that are related parties. These related parties were either Trustees and/or Officers of the Fund, or family members of Trustees and/or Officers of the Fund. The related party transactions occurred at the exchange amount, which is the consideration established and agreed to by the related parties.

## DERIVATIVE FINANCIAL INSTRUMENTS

The Fund utilizes derivative financial instruments, in the form of interest rate swap agreements, to reduce the impact of fluctuating interest rates on its bank credit facility. These swap agreements require the monthly exchange of payments, without the exchange of the notional principal amount on which the payments are based. Interest expense on the debt is adjusted to include the payments made or received under the interest rate swaps.

A derivative must be designated and effective to be accounted for as a hedge. For cash flow hedges, effectiveness is achieved if the changes in the cash flows of the derivatives substantially offset the changes in the cash flows of the hedged item, and if the timing of the cash flows is similar. Gains and losses on derivatives that are part of a designated hedging relationship are recognized in other comprehensive income, until such time as the hedging relationship ceases. Derivatives classified as "financial asset or financial liabilities held for trading" and not part of a designated hedging relationship are measured at fair value at each balance sheet date, with gains and losses recognized in net earnings.

On August 23, 2007, the Fund entered into two interest rate swap agreements, to pay fixed and receive variable with a combined notional amount of \$20,000,000. The first agreement has a notional amount of \$10,000,000, a fixed rate of 4.92% and a three-year term ending on August 23, 2010. The second agreement has a notional amount of \$10,000,000, a fixed rate of 4.99% and a five-year term ending on August 23, 2012.

These interest rate swap agreements have been classified as "held-for-trading financial instruments" and are not part of a hedging relationship, and are measured at fair value with all gains and losses recorded through net earnings. During 2008, a loss of \$1,543,192 (2007 - \$440,294) was recorded, and the fair value of the interest rate swaps at December 31, 2008 was a liability of \$1,983,486 (December 31, 2007 - \$440,294).

## OFF-BALANCE-SHEET ARRANGEMENTS

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

## CONTRACTUAL OBLIGATIONS

The Fund is committed to a long term operating lease for building space. The minimum annual lease payments, plus estimated operating costs required for the next three years, are as follows: \$371,000 for 2009, \$382,000 for 2010 and \$393,000 for 2011.

## RISK MANAGEMENT

### General

The operations of the Fund are affected by trends and factors that the Fund may not be able to control. 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.

### Competitive environment

There can be no assurance that the Fund will be able to compete successfully against its current or future competitors, or that such competition will not have a material adverse effect on the financial condition and results of operations of the Fund. Overall, the market for the financial services offered by the Fund is highly competitive and many of the companies operating in this sector have greater financial, technical and marketing resources than the Fund and generate greater revenues. Relatively low barriers to entry into our markets exist and the Fund expects to face additional competition over time from new entrants into its market sector.

### Reliance on key personnel

The Fund is dependent on the abilities, experience and efforts of its senior management and other key employees. If these individuals become unable or unwilling to continue their employment, there may be a material adverse effect on the Fund's financial condition, results of operations and business prospects.

### Liquidity risk

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

### Credit risk

Credit risk involves the loss of principal and/or interest from the failure of debtors, for any reason, to honour the financial or contractual obligations to the Fund. In the event of payment default, the collateral value of the financed vehicle may not cover the outstanding contract balance and costs of recovery.

The Fund originates transactions in a relatively high-risk segment of the consumer finance industry. Therefore, write-offs are anticipated. The management of the Fund establishes and maintains an allowance for credit losses, which it considers adequate to absorb probable credit losses existing in the finance receivable portfolio.

The Fund reviews static pool loss rates, historical industry ratios of write-offs, current write-off and recovery experience, estimates of the underlying collateral value, and economic conditions and trends to make the necessary judgments as to the appropriateness of the allowance for credit losses. Static pool loss rates are a measure of long term performance and credit quality, where static pool loss rates are calculated by identifying a pool of assets and tracking the performance of that pool by relating a write-off back to its origination date. Although the Fund uses various models and methodologies to assess the adequacy of loss reserves, there is no precise method for estimating the losses existing in the finance receivable portfolio.

### Interest rate risk

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

### INCOME TAX MATTERS

On October 31, 2006, the Minister of Finance announced the proposed Tax Fairness Plan for Canadians that includes a tax on distributions from publicly traded income trusts and limited partnerships. Existing publicly traded income trusts, such as Carfinco Income Fund, would not be subject to the proposed tax until their 2011 taxation year.

On June 22, 2007, the *Budget Implementation Act 2007 (Canada)* was enacted, which included the taxation on publicly-traded income trusts and limited partnerships (Specified Investment Flow-Through Entities or "SIFT"), including Carfinco Income Fund, effective January 1, 2011. As such, the Fund reviewed all temporary differences that were previously not recorded as future income tax assets or liabilities at the Fund level. Recognition of these future income tax assets or liabilities is recorded only for temporary differences expected to reverse after the date that the taxation changes take effect, being January 2011. The only such temporary difference relates to fund unit issue costs, which are recorded against fund unit equity and are being deducted against taxable income over a five-year period. At a future income tax rate of 28.50%, an amount of \$51,393 was recorded as a future income tax asset.

### ACCOUNTING POLICIES

#### Initial Adoption of Accounting Policies

The following is a discussion of relevant changes to accounting policies adopted as a result of Handbook revisions that were released, revised or became effective since the Fund's audited financial statements for the year ended December 31, 2007 were issued.

CICA Handbook Section 1400, General Standards of Financial Statement Presentation was amended to include requirements to assess and disclose an entity's ability to continue as a going concern. There was no material effect on the Fund's financial statements or disclosures when the amended standards were adopted on January 1, 2008.

New CICA Handbook Section 1535, Capital Disclosures requires the disclosure of both qualitative and quantitative information that enables financial statement users to evaluate the objectives, policies and processes for managing capital. Section 1535 specifies the disclosure of (i) an entity's objectives, policies and processes for managing capital; (ii) quantitative data about what the entity regards as capital; (iii) whether the entity has complied with any capital requirements; and (iv) if it has not complied, the consequences of such non-compliance. There was no material effect on the Fund's financial statements when the new standard was adopted on January 1, 2008, other than the addition of required note disclosure. Disclosures recommended by the new handbook section have been included in Note 14 of the consolidated financial statements.

New CICA Handbook Section 3862, Financial Instruments - Disclosures, modifies the disclosure requirements for financial instruments that were included in Section 3861, Financial Instruments - Disclosure and Presentation. Section 3863, Financial Instruments - Presentation, carries forward unchanged the presentation requirements of the previous Section 3861, Financial Instruments - Disclosure and Presentation. These new sections place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks. These new standards require disclosures related to the significance of financial instruments on the Fund's financial position and performance and the nature and extent of risk arising from financial instruments in which the Fund is exposed and how the Fund manages the risks. There was no material effect on the Fund's financial statements when the CICA Handbook Section 3862 was adopted on January 1, 2008, other than the addition of required note disclosure. Disclosures recommended by the new handbook section have been included in Note 18 of the consolidated financial statements.

## FUTURE ACCOUNTING CHANGES

### International Financial Reporting Standards

In February 2008, the Canadian Accounting Standards Board confirmed that Canadian public entities will have to adopt International Financial Reporting Standards ("IFRS"), effective for fiscal years beginning on or after January 1, 2011. The Fund will issue consolidated financial statements in accordance with IFRS commencing in the first quarter ended March 31, 2011, with comparative information.

In May 2008, the Canadian Securities Administrators issued Staff Notice 52-320, which provides guidance on the disclosure of changes in expected accounting policies related to the conversion to IFRS. In accordance with the notice, for purposes of the year ended December 31, 2008, the Fund is required to discuss the status of the key elements and timing of its conversion plan.

The Fund has initiated its conversion plan from Canadian GAAP to IFRS. It has developed a project team, led by its Chief Financial Officer and other members of its finance group. Progress reporting to the Fund's Board of Trustees on the conversion project began in the first quarter of 2009. The conversion plan will include three phases:

**Scoping Phase** - a preliminary high-level diagnostic to identify key areas in which there may be significant differences between IFRS and Canadian GAAP for the Fund's consolidated financial statements. Includes preliminary considerations with respect to processes, controls systems and resources to facilitate the conversion process. The Fund initiated this phase in the first quarter of 2009 and is working towards completion in mid-2009.

**Design Phase** - establish key milestones for the conversion project and determine internal resource requirements to facilitate the conversion. A more detailed assessment of the impact of IFRS will be completed. This phase has not been initiated.

**Implementation Phase** - the conclusions and recommendations arrived at during the design phase are to be implemented. This phase will include monitoring the progress of the implementation of changes to process, procedures and information systems. The Fund has not commenced with this phase. This phase has not been initiated.

The impact of the adoption of IFRS on the consolidated financial statements of the Fund has not yet been determined. Although much of Canadian GAAP is similar to IFRS, there are some GAAP differences that may significantly impact the Fund's financial statements. As the Fund progresses through its conversion plan, the implementation of the plan may change, due to changes to IFRS and related interpretation. The Fund does not intend to early adopt IFRS prior to January 1, 2011.

## NON-GAAP MEASURES

### Distributable cash

Distributable cash is a non-GAAP measure generally used by Canadian income trusts as an indicator of financial performance, and it should not be seen as a measurement of liquidity, or a substitute for comparable metrics prepared in accordance with GAAP. This measure is commonly used by investors, management and other stakeholders to evaluate the ongoing performance of the Fund. Distributable cash may differ from similar calculations as reported by other entities and, accordingly, may not be comparable to distributable cash as reported by such entities. For reconciliation with GAAP, please refer to the "Distributable Cash" section.

### Cash distributions per unit and payout ratio

The Fund reports on cash distributions per unit and payout ratio (actual cash distribution divided by distributable cash) because they are key measures used by investors to value the Fund, assess its performance and provide an indication of the sustainability of distributions. Cash distributions per unit and the payout ratio depend on the Fund's distributable cash and the Fund's distribution policy.

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 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.

### CONTROLS AND PROCEDURES

The Fund has established and maintains disclosure controls and procedures over financial reporting. Management evaluated, under the supervision of, and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, the effectiveness of the Fund's disclosure controls and procedures (as defined by the Canadian Securities Administrators), as of December 31, 2008. Based on that evaluation using the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") control framework, the Chief Executive Officer and the Chief Financial Officer concluded that such procedures are adequate and effective to provide reasonable assurance that material information relating to the Fund and its consolidated entities and would be made known to them by others within those entities to allow for accurate and complete disclosures in annual and interim filings or other reports.

The Fund's Chief Executive Officer and Chief Financial Officer are responsible for certifying that the Fund has designed, or caused to be designed, 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 the Canadian generally accepted accounting principles utilized by the Fund. The certifying officers have evaluated the design of the Fund's ICFR and assessed the effectiveness of the internal controls over financial reporting as at December 31, 2008, and based on that assessment, determined the Fund's internal controls over financial reporting was designed and operating effectively.

Although management has been able to reach this conclusion, they have identified certain weaknesses in ICFR, due to lack of segregation of duties. Segregation of duties is a basic, key internal control and one of the most difficult to achieve. It is used to ensure that errors or irregularities are prevented or detected on a timely basis by employees in the normal course of business. Due to limited resources, adequate segregation of duties within the accounting group was not achieved. This creates a risk that inaccurate journal entries could be made and not corrected on a timely basis. The result is that the Fund is reliant on the performance of mitigating procedures during its financial close processes in order to ensure the financial statements are presented fairly in all material respects. Management will continue to review the assignment of responsibilities and, where possible, improve on segregation. Management has mitigated the risks arising from these weaknesses, through a combination of extensive and detailed review by the Chief Financial Officer of the financial reports and the integrity and reputation of senior financial and accounting personnel.

No changes were made to internal controls over financial reporting during the quarter ended December 31, 2008, that would have materially affected, or would be reasonably considered to materially affect, these controls.

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.

#### CAUTIONARY STATEMENT

Certain statements contained in this annual report constitute "forward-looking statements". When used in this annual 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).

# Management's Responsibility for Financial Reporting

The accompanying consolidated financial statements, the notes thereto and other financial information enclosed have been prepared by, and are the responsibility of, the management of Carfinco Income Fund.

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles, using management's best estimates and judgments when appropriate. The Board of Trustees is responsible for ensuring that management fulfills its responsibility for financial reporting and internal control. The Board carries out this responsibility principally through its Audit Committee. The Audit Committee, which is comprised of three non-management Trustees, meets with management as well as the external auditors to satisfy itself that management is properly discharging its financial reporting responsibilities, and to review the consolidated financial statements and the report of the auditors. The auditors have full and unrestricted access to the Audit Committee. The financial statements have been audited by Grant Thornton LLP, the independent auditors, in accordance with Canadian generally accepted auditing standards.



Tracy Graf, **President and Chief Executive Officer**



Troy Graf, **Vice President and Chief Financial Officer**

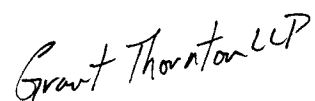
# Auditors' Report

## TO THE UNITHOLDERS OF CARFINCO INCOME FUND

We have audited the consolidated balance sheets of Carfinco Income Fund as at December 31, 2008 and 2007, and the consolidated statements of (loss) earnings, comprehensive (loss) income and deficit and consolidated statements of cash flows for each of the years ended December 31, 2008 and 2007. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Fund as at December 31, 2008 and 2007 and the results of its consolidated operations and cash flows for each of the years ended December 31, 2008 and 2007 in accordance with Canadian generally accepted accounting principles.



Chartered Accountants **Edmonton, Canada** / March 16, 2009

# Consolidated Balance Sheets

DECEMBER 31

2008

2007

## Assets

Finance receivables (Note 4)	\$ 108,016,961	\$ 94,383,395
Allowance for credit losses (Note 5)	(12,190,000)	(6,470,000)
Dealer reserve (Note 6)	(2,454,715)	(2,405,864)
Finance receivables – net	93,372,246	85,507,531
Cash	29,162	–
Other assets	633,178	637,569
Equipment (Note 7)	456,841	366,952
Future income taxes	–	51,393
	1,119,181	1,055,914
	\$ 94,491,427	\$ 86,563,445

## Liabilities

Bank credit facility (Note 8)	\$ 67,878,411	\$ 58,213,096
Bank overdraft	–	165,886
Accounts payable and accrued liabilities	502,989	1,454,430
Deferred dealer obligation (Note 9)	1,604,385	2,190,247
Derivatives (Note 10)	1,983,486	440,294
Long term debt (Note 11)	2,300,000	–
	74,269,271	62,463,953

## Unitholders' Equity

Unitholders' capital (Note 12)	29,583,463	29,583,190
Deficit (Note 12)	(9,361,307)	(5,483,698)
	20,222,156	24,099,492
	\$ 94,491,427	\$ 86,563,445

Commitments (Note 17)

See accompanying notes to the Consolidated Financial Statements.

On behalf of the Board of Trustees



Tracy Graf, Trustee



David Rosenkrantz, Trustee

# Consolidated Statements of (Loss) Earnings, Comprehensive (Loss) Income and Deficit

YEARS ENDED DECEMBER 31

2008

2007

## Financial Revenue

Interest	\$ 30,031,095	\$ 24,507,455
Administration fees	1,982,663	1,527,019
	<u>32,013,758</u>	<u>26,034,474</u>

## Financial Expenses

Interest	4,689,214	3,532,626
Net financial income before provision for credit losses	<u>27,324,544</u>	<u>22,501,848</u>
Provision for credit losses	18,262,438	10,091,788
Net financial income before operating expenses	<u>9,062,106</u>	<u>12,410,060</u>

## Operating Expenses

General and administrative	9,369,366	8,013,574
Loss on derivatives	1,543,192	440,294
Amortization of equipment	137,111	110,457
	<u>11,049,669</u>	<u>8,564,325</u>
Net (loss) earnings and comprehensive (loss) income	<u>\$ (1,987,563)</u>	<u>\$ 3,845,735</u>

## Deficit, beginning of year

	\$ (5,483,698)	\$ (2,218,776)
Net (loss) earnings	(1,987,563)	3,845,735
Cash distributions on fund unit equity (Note 13)	(1,890,046)	(7,110,657)
Deficit, end of year	<u>\$ (9,361,307)</u>	<u>\$ (5,483,698)</u>

## (Loss) Earnings per Fund Unit

Basic and diluted	\$ (0.08)	\$ 0.18
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See accompanying notes to the Consolidated Financial Statements.

# Consolidated Statements of Cash Flows

YEARS ENDED DECEMBER 31

2008

2007

Increase (decrease) in cash and cash equivalents

## Operating

Net (loss) earnings \$ (1,987,563) \$ 3,845,735

Adjustments to reconcile net (loss) earnings to net cash from operations:

Provision for credit losses	18,262,438	10,091,788
Amortization of equipment	137,111	110,457
Accrued interest	(326,229)	(410,796)
Deferred dealer obligation	1,375,000	600,000
Derivatives	1,543,192	440,294
Accounts payable and accrued liabilities	(951,441)	803,182
Other assets	4,391	(535,050)
Future income taxes	51,393	(51,393)

18,108,292 14,894,217

## Investing

Funds advanced on finance receivables	(64,939,145)	(63,369,878)
Principal collections on finance receivables	43,038,541	37,720,291
Change in finance receivable reserves and transaction costs	(5,861,182)	(3,856,582)
Purchase of equipment	(227,000)	(135,422)

(27,988,786) (29,641,591)

## Financing

Advances on bank credit facility	19,765,315	26,220,275
Repayments on bank credit facility	(10,100,000)	(15,400,000)
Issuance of long term debt	2,300,000	–
Repayments on unit purchase financing	51,666	82,666
Fund units issued on public offering	–	11,500,065
Fund unit issue costs	(51,393)	(852,407)
Fund unit cash distribution	(1,890,046)	(7,110,657)

10,075,542 14,439,942

Net increase (decrease) in cash and cash equivalents

195,048 (307,432)

## Cash and cash equivalents

Beginning of year (165,886) 141,546

End of year \$ 29,162 \$ (165,886)

## Supplemental cash flow information:

Interest paid \$ 4,426,908 \$ 3,442,010

See accompanying notes to the Consolidated Financial Statements.

# Notes to the Consolidated Financial Statements

December 31, 2008

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

Carfinco Income Fund (the "Fund") is an unincorporated open-end mutual fund trust established under the laws of the Province of Ontario by a Deed of Trust made as of August 26, 2002, as amended and restated on April 23, 2004. The Fund owns 100% of Carfinco Holdings Trust ("CHT"), a wholly owned unincorporated trust, established under the laws of Ontario and 100% of Carfinco Inc. ("CAR"), a wholly owned subsidiary, established under the laws of Ontario. CHT holds 92.39% and is the limited partner of Carfinco Limited Partnership ("CLP") and CAR holds the remaining 7.61% 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. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements of the Fund have been prepared by management, in accordance with Canadian generally accepted accounting principles, and reflect the following significant accounting policies:

### Basis of presentation

The consolidated financial statements include the accounts of the Fund, CHT, CAR and CLP. All inter-company accounts and transactions have been eliminated on consolidation. Any subsequent reference to the Fund within the notes to the consolidated financial statements refers to the consolidated Fund.

### Use of estimates

In preparing financial statements in conformity with Canadian generally accepted accounting principles, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. The most significant of these estimates relates to the determination of the allowance for credit losses, related reserves, deferred dealer obligation and future income taxes. Actual results could differ from those estimates.

### Cash and cash equivalents

Cash and cash equivalents include cash on hand and balances with banks, net of bank overdrafts and highly liquid temporary money market instruments with original maturities of three months or less. The bank credit facility and other long term borrowings are considered to be financing activities.

### Finance receivables

Finance receivables are recorded at amortized cost, using the effective interest method, net of unearned income, which includes loan origination fees.

A finance receivable is recognized as being impaired when management is no longer reasonably assured of the timely collection of the full amount of principal and interest. As a matter of practice, a loan is deemed to be impaired if it is 60 or more days contractually delinquent, or if it has been specifically identified. When loans are classified as impaired, the book value of these finance receivables are reduced to their estimated realizable value by totally or partially writing off the finance receivable and/or establishing an allowance for credit losses. Estimated realizable value is measured by discounting the expected future cash flows at the effective interest rate inherent in the loan. In subsequent periods, recoveries on amounts previously written off and any increase in the carrying value of the loan are credited to the allowance for credit losses.

### Revenue recognition

Interest income is recorded on an accrual basis, where interest is earned over the life of the related finance receivable contract. Accrual of interest income is suspended on finance receivables classified as impaired.

Fee income charged to the customer, in excess of the costs incurred, on the origination of finance receivables and fee income charged to the dealer on the origination of finance receivables are recorded as unearned administration fees and are a component of the finance receivables portfolio. These unearned administration fees are recognized into interest income using the effective interest method.

Fees charged to the customer during the subsequent servicing of the finance receivables are recognized upon collection of funds to Administration Fees revenue.

### Allowance for credit losses

The management of the Fund establishes and maintains an allowance for credit losses, which it considers adequate to absorb probable credit losses existing in the finance receivable portfolio. The allowance for credit losses consists of accumulated specific and general components, which are deducted from the finance receivable portfolio. In addition to the allowance for credit losses, a dealer reserve has been established to absorb potential credit losses. The dealer reserve is recorded on certain finance receivables purchased by the Fund at a negotiated price that is less than the original principal amount being financed. Under this program, the dealer has a vested interest in the performance of these finance receivables and can receive additional purchase consideration based on the collection performance of these finance receivables.

The Fund's finance receivable portfolio is composed of a large number of homogenous consumer loans, with relatively small balances originated in the same industry, and as such, the evaluation of the allowance for credit losses is performed collectively for the group after allowance for specific losses. The estimated allowance for credit loss requirements are determined by assessing the individual finance receivables in arrears, the perceived effect of current economic conditions or other circumstances on the remaining finance receivables, the historical industry ratios of write-offs, and the Fund's current write-off and recovery experience.

### Other assets

The other assets balance includes prepaid expenses and assets held for resale. Assets held for resale consists of vehicles that have been repossessed by the Fund and are available for final disposition. These assets are stated at net realizable value. Costs associated with repossession, transport and auction preparation are reported under general and administrative expense in the period in which they were incurred.

### Equipment

Equipment is recorded at cost, less accumulated amortization. Equipment is amortized over its estimated useful lives, using the following rates and methods:

- Computer and office equipment/30%, declining balance
- Furniture and equipment/20%, declining balance
- Leasehold improvements/Straight-line over the term of the related lease

Amortization is recorded when equipment is acquired and available for use.

### Transaction costs

Transaction costs relating to the renewal of the bank credit facility are recorded against the bank credit facility and are amortized over the expected life of the related debt using the effective interest method. Transaction costs relating to finance receivables are added to the initial carrying amount, and recognized into income using the effective interest method.

**Income taxes**

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

The Fund follows the liability method of accounting for income taxes. Under this method, future income tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities, and losses carried forward, and measured using the substantively enacted tax rates and laws that will be in effect when the differences are expected to reverse.

**Deferred dealer obligation**

The Fund purchases certain finance receivables at a negotiated price that is less than the original principal amount being financed. Under this program, the dealer has a vested interest in the performance of these finance receivables, and can receive additional purchase consideration based on the collection performance of these finance receivables. The deferred dealer obligation represents the estimated additional purchase consideration owed to the dealers, which is composed of the accumulated obligations recorded on the origination of these finance receivables and of charges to interest revenue based on estimates of the obligation balance.

**(Loss) earnings per fund unit**

Basic (loss) earnings per fund unit is computed by dividing net (loss) earnings by the weighted average number of fund units outstanding during the reporting period. Diluted (loss) earnings per fund unit is computed similar to basic (loss) earnings per fund unit, except that the weighted average fund units outstanding are adjusted for the impact of all potential dilutive units outstanding during the reporting period. For unit purchase financing, the treasury stock method is used, whereby the number of additional fund units is calculated by assuming that units held were released, and that the proceeds were used to acquire fund units at the closing market price for the year.

**Derivative financial instruments**

The Fund utilizes derivative financial instruments, in the form of interest rate swap agreements, to reduce the impact of fluctuating interest rates on its bank credit facility. These swap agreements require the monthly exchange of payments without the exchange of the notional principal amount on which the payments are based. Interest expense on the debt is adjusted to include the payments made or received under the interest rate swaps.

A derivative must be designated and effective to be accounted for as a hedge. For cash flow hedges, effectiveness is achieved if the changes in the cash flows of the derivatives substantially offset the changes in the cash flows of the hedged item, and if the timing of the cash flows is similar. Gains and losses on derivatives that are part of a designated hedging relationship are recognized in other comprehensive income.

The Fund has not designated the interest rate swap agreements as hedges, and they have been classified as “financial assets or financial liabilities held for trading.” They are measured at fair value at each balance sheet date with gains and losses recognized in net earnings.

**Measurement uncertainty**

The primary areas of measurement uncertainty are the assumptions used in the calculation of the allowance for credit losses, dealer reserve, deferred dealer obligation and future income taxes.

**Future Accounting Changes - International Financial Reporting Standards**

In February 2008, the Canadian Accounting Standards Board confirmed that Canadian public entities will have to adopt International Financial Reporting Standards (“IFRS”) effective for fiscal years beginning on or after January 1, 2011. The Fund will issue consolidated financial statements in accordance with IFRS commencing in the first quarter ended March 31, 2011, with comparative information. The impact of the adoption of IFRS on the consolidated financial statements of the Fund has not yet been determined. The Fund has begun to develop its convergence plan in order to transition its financial statement reporting,

presentation and disclosure for IFRS to meet the January 1, 2011 deadline. The process of evaluating the potential impact of IFRS on its consolidated financial statements is ongoing as new standards and recommendations are issued by the International Standards Board. The Fund does not intend to early adopt IFRS prior to January 1, 2011.

### 3. ADOPTION OF NEW STANDARDS

CICA Handbook Section 1400, General Standards of Financial Statement Presentation was amended to include requirements to assess and disclose an entity's ability to continue as a going concern. There was no material effect on the Fund's financial statements or disclosures when the amended standards were adopted on January 1, 2008.

New CICA Handbook Section 1535, Capital Disclosures requires the disclosure of both qualitative and quantitative information that enables financial statement users to evaluate the objectives, policies and processes for managing capital. Section 1535 specifies the disclosure of (i) an entity's objectives, policies and processes for managing capital; (ii) quantitative data about what the entity regards as capital; (iii) whether the entity has complied with any capital requirements; and (iv) if it has not complied, the consequences of such non-compliance. There was no material effect on the Fund's financial statements when the new standard was adopted on January 1, 2008, other than the addition of required note disclosure. Disclosures recommended by the new handbook section have been included in Note 14.

New CICA Handbook Section 3862, Financial Instruments - Disclosures, modifies the disclosure requirements for financial instruments that were included in Section 3861, Financial Instruments - Disclosure and Presentation. Section 3863, Financial Instruments - Presentation, carries forward unchanged the presentation requirements of the previous Section 3861, Financial Instruments - Disclosure and Presentation. Section 3862 places increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks. These new standards require disclosures related to the significance of financial instruments on the Fund's financial position and performance and the nature and extent of risk arising from financial instruments in which the Fund is exposed and how the Fund manages the risks. There was no material effect on the Fund's financial statements when the CICA Handbook Section 3862 was adopted on January 1, 2008, other than the addition of required note disclosure. Disclosures recommended by the new handbook section have been included in Note 18.

### 4. FINANCE RECEIVABLES

Finance receivables consist of conditional sales contracts, which have terms of 12 to 60 months with fixed rates of interest. Each individual finance receivable is collateralized by a vehicle.

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

DECEMBER 31	2008	AVERAGE STATED INTEREST RATE	2007	AVERAGE STATED INTEREST RATE
2008			\$ 45,691,689	28.5%
2009	\$ 52,870,569	29.0%	41,954,932	28.5%
2010	48,443,964	29.0%	34,900,116	28.6%
2011	41,377,688	29.2%	24,415,242	28.8%
2012	27,741,744	29.4%	9,528,542	29.3%
2013	7,020,162	29.3%	-	-
Gross finance receivables	177,454,127		156,490,521	
Unearned interest income	(67,133,481)		(59,965,158)	
Unearned administration fees	(4,218,013)		(3,730,067)	
Principal of finance receivables	106,102,633		92,795,296	
Accrued interest	1,914,328		1,588,099	
Finance receivables	\$ 108,016,961		\$ 94,383,395	

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.

During the past two years, the Fund has been subject to a decrease in auction values of used vehicles. This has resulted in higher loss severity on contracts, due to lower recoveries on the vehicles securing the contract at the time of liquidation. The decline in economic conditions has also resulted in higher delinquency and loss rates experienced by the Fund. These conditions have resulted in a significant increase in the specific and general components of the allowance for credit losses.

The impaired loans and the related allowance for specific credit losses and a summary of the general and specific allowance components are as follows:

DECEMBER 31	2008	2007
Impaired loans	\$ 6,983,200	\$ 3,840,900
Specific allowance and dealer reserve	(5,839,300)	(3,122,500)
Carrying amount	\$ 1,143,900	\$ 718,400
Allowance for credit losses – general	\$ 8,410,600	\$ 4,376,300
Allowance for credit losses – specific	3,779,400	2,093,700
Allowance for credit losses	12,190,000	6,470,000
Dealer reserve – general	394,815	1,377,064
Dealer reserve – specific	2,059,900	1,028,800
Dealer reserve	2,454,715	2,405,864
	\$ 14,644,715	\$ 8,875,864

## 5. ALLOWANCE FOR CREDIT LOSSES

DECEMBER 31	2008	2007
Allowance, beginning of year	\$ 6,470,000	\$ 3,860,000
Provision for credit losses	18,262,438	10,091,788
Write-offs	(14,254,555)	(9,114,214)
Recoveries	1,712,117	1,632,426
Allowance, end of year	\$ 12,190,000	\$ 6,470,000

## 6. DEALER RESERVE

DECEMBER 31	2008	2007
Reserve, beginning of year	\$ 2,405,864	\$ 2,700,751
Reserve on new volume	6,338,850	5,186,552
Write-offs	(6,810,654)	(6,155,663)
Recoveries	520,655	674,224
Reserve, end of year	\$ 2,454,715	\$ 2,405,864

**7. EQUIPMENT**

DECEMBER 31	2008		
	COST	ACCUMULATED AMORTIZATION	NET BOOK VALUE
Computer and office equipment	\$ 536,556	260,616	\$ 275,940
Furniture and equipment	270,470	122,581	147,889
Leasehold improvements	96,671	63,659	33,012
	<b>\$ 903,697</b>	<b>446,856</b>	<b>\$ 456,841</b>

DECEMBER 31	2007		
	COST	ACCUMULATED AMORTIZATION	NET BOOK VALUE
Computer and office equipment	\$ 360,437	179,728	\$ 180,709
Furniture and equipment	233,164	89,409	143,755
Leasehold improvements	83,095	40,607	42,488
	<b>\$ 676,696</b>	<b>309,744</b>	<b>\$ 366,952</b>

**8. BANK CREDIT FACILITY**

DECEMBER 31	2008	2007
Bank credit facility	\$ 67,878,411	\$ 58,213,096

The bank credit facility is a demand loan, which is the lesser at any time of: a) \$85,000,000 (2007 - \$65,000,000) 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% (2007 - 1.00%). 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% (2007 - 2.5%). A stand-by fee of 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 December 15, 2010 (2007 - October 4, 2008).

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, all of which the Fund was in compliance with at December 31, 2008.

The following table presents components of the outstanding bank credit facility where the interest rate is the bankers' acceptance rate available at the inception of the equivalent loan, plus 3.25% (2007 - 2.50%):

DECEMBER 31	2008	2007
Bankers' acceptance equivalent loans		
Interest rate of 7.31%, maturing on February 25, 2008	\$ -	\$ 10,000,000
Prime rate loan	68,232,745	48,273,029
Unamortized transaction costs	(354,334)	(59,933)
	<b>\$ 67,878,411</b>	<b>\$ 58,213,096</b>

## 9. DEFERRED DEALER OBLIGATION

DECEMBER 31	2008	2007
Deferred dealer obligation, beginning of year	\$ 2,190,247	\$ 2,448,348
Deferred dealer obligation on new volume	596,330	642,018
Advances to dealer	(1,182,192)	(900,119)
Deferred dealer obligation, end of year	\$ 1,604,385	\$ 2,190,247

## 10. DERIVATIVES

On August 23, 2007, the Fund entered into two interest rate swap agreements, to pay fixed and receive variable, with a combined notional amount of \$20,000,000. The first agreement has a notional amount of \$10,000,000, a fixed rate of 4.92% and a three-year term ending on August 23, 2010. The second agreement has a notional amount of \$10,000,000, a fixed rate of 4.99% and a five-year term ending on August 23, 2012.

These interest rate swap agreements have been classified as "held-for-trading financial instruments," and are measured at fair value with all gains and losses recorded through net earnings. During fiscal 2008, a loss of \$1,543,192 (2007 - \$440,294) was recorded, and the fair value of the interest rate swaps at December 31, 2008 was a liability of \$1,983,486 (December 31, 2007 - \$440,294).

## 11. LONG TERM DEBT

DECEMBER 31	2008	2007
Long term debt, beginning of year	\$ -	\$ -
Issuance of 14% debentures, maturing on April 30, 2010	2,300,000	-
Long term debt, end of year	\$ 2,300,000	\$ -
Interest expense, during the year, on long term debt	\$ 166,470	\$ -

These debentures are unsecured, bear interest at 14% per annum and the interest payments are payable monthly in arrears. The debentures are redeemable in whole or part, by the Fund during the term of the debentures, at the option of the Fund.

## 12. UNITHOLDERS' EQUITY

### Authorized:

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

DECEMBER 31	NUMBER	2008	NUMBER	2007
Unitholders' equity, beginning of year	23,305,906	\$ 24,099,492	20,508,146	\$ 16,634,090
Unit purchase repayment	16,660	51,666	26,660	82,666
Fund units issued on public offering	-	-	2,771,100	11,500,065
Fund unit issue costs	-	(51,393)	-	(852,407)
Fund unit distribution (cash distribution)	-	(1,890,046)	-	(7,110,657)
Change in units in the year	16,660	(1,889,773)	2,797,760	3,619,667
Net (loss) earnings for the year	-	(1,987,563)	-	3,845,735
Unitholders' equity, end of year	23,322,566	\$ 20,222,156	23,305,906	\$ 24,099,492

Unitholders' capital and deficit consist of the following components:

DECEMBER 31	2008	2007
<b>Unitholders' capital</b>		
Fund unit equity	\$ 28,968,101	\$ 28,967,828
Contributed surplus	615,362	615,362
	<u>29,583,463</u>	<u>29,583,190</u>
<b>Deficit</b>		
Accumulated net earnings	15,859,203	17,846,766
Accumulated unit distributions on fund unit equity	(3,681,095)	(3,681,095)
Accumulated cash distributions on fund unit equity	(21,539,415)	(19,649,369)
	<u>(9,361,307)</u>	<u>(5,483,698)</u>
<b>Unitholders' equity</b>	<b>\$ 20,222,156</b>	<b>\$ 24,099,492</b>

#### Distribution of income to unitholders

Pursuant to the Deed of Trust of the Fund, the Trustees must distribute all or virtually all of the income of the Fund for the fiscal year, determined in accordance with the *Income Tax Act (Canada)*, to the unitholders of the Fund. If the Fund does 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 is distributed through additional Trust Units having a value equal to the cash shortfall.

As at December 31, 2008, the Fund had \$1,890,046 in taxable income, of which \$1,890,046 was distributed in cash. As at December 31, 2007, the Fund had \$7,110,657 in taxable income, of which \$7,110,657 was distributed in cash.

#### Unit purchase financing

The Fund entered into unit loan agreements on March 31, 2006 with four individuals who are employees of the Fund. The loans have an aggregate principal amount of \$51,666 (2007 - \$103,334), bear interest at the prescribed interest rate, as set by the Canada Revenue Agency, and are repayable in full on March 31, 2009. The loans are secured by 16,680 (2007 - 33,340) trust units. As at December 31, 2008, the market value of the security was \$5,000 (2007 - \$101,687).

#### (Loss) Earnings per fund unit

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

DECEMBER 31	2008	2007
<b>Numerator for basic and diluted (loss) earnings per fund unit:</b>		
Net (loss) earnings	\$ (1,987,563)	\$ 3,845,735
<b>Denominator:</b>		
Weighted average fund units	23,318,424	21,992,512
Denominator for diluted (loss) earnings per fund unit	23,318,424	21,992,512
<b>(Loss) earnings per fund unit – basic and diluted</b>	<b>\$ (0.08)</b>	<b>\$ 0.18</b>

### 13. ACCUMULATED CASH DISTRIBUTIONS TO UNITHOLDERS

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. Distributions on units of record during the years ended December 31, 2008 and 2007 are summarized as follows:

RECORD DATE	PAYMENT DATE	CASH DISTRIBUTION PER UNIT	TOTAL CASH DISTRIBUTION
January 18, 2008	January 31, 2008	\$ 0.027	\$ 630,015
February 20, 2008	February 29, 2008	0.027	630,015
March 20, 2008	March 31, 2008	0.027	630,016
Total cash distribution for 2008		0.081	1,890,046
January 19, 2007	January 31, 2007	0.027	555,033
February 20, 2007	February 28, 2007	0.027	555,033
March 20, 2007	March 30, 2007	0.027	555,034
April 20, 2007	April 30, 2007	0.027	555,155
May 22, 2007	May 31, 2007	0.027	555,155
June 15, 2007	June 29, 2007	0.027	555,155
July 20, 2007	July 31, 2007	0.027	630,015
August 20, 2007	August 31, 2007	0.027	630,015
September 20, 2007	September 28, 2007	0.027	630,016
October 19, 2007	October 31, 2007	0.027	630,015
November 20, 2007	November 30, 2007	0.027	630,015
December 20, 2007	December 31, 2007	0.027	630,016
Total cash distribution for 2007		0.324	7,110,657
Accumulated cash distributions to unitholders for 2007 and 2008		\$ 0.405	\$ 9,000,703

### 14. CAPITAL DISCLOSURE

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 the combination of its long term debt, unrealized derivative liability and unitholders' equity balances, which leverages the debt provided under the Fund's bank credit facility. In general, the overall capital level of the Fund is evaluated and determined in the context of its financial objectives and its strategic plan. The calculation of the Fund's capital is as follows:

DECEMBER 31	2008	2007
Unitholders' equity	\$ 20,222,156	\$ 24,099,492
Derivatives	1,983,486	440,294
Long term debt	2,300,000	—
Total capitalization	\$ 24,505,642	\$ 24,539,786

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 finance receivable acquisitions.

To fund the acquisition of receivables and grow the finance receivable portfolio, the Fund utilizes the financial leverage available under 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. The Fund has historically distributed a high portion of cash flow and has not focused on reducing indebtedness.

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 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 maximum financial leverage ratio, which is calculated as total debt divided by total capitalization, is 3.75:1. This ratio was 2.86:1 at December 31, 2008 (December 31, 2007 - 2.52:1). The Fund maintains minimum loss reserves, as part of banking requirements. The Fund's loan availability under the bank credit facility is the lesser of \$85,000,000 (2007 - \$65,000,000), and the total of an advance rate applied to the value of acceptable outstanding finance receivables. The Fund was in compliance with all covenants during the period.

During the second quarter of 2008, the Fund requested and received an amendment to the interest coverage ratio, so that the minimum ratio be 0.20:1 for the first quarter of 2008, 0.16:1 for the second quarter of 2008, 1.40:1 for the third quarter of 2008 and 1.50:1 for each quarter thereafter. The interest coverage ratio was 1.50:1 for the fourth quarter of 2008. In the current market environment, the Board of Trustees believes that it is in the best interests of the Fund to meet its equity requirements through the retention of operating cash flow and issue units in lieu of cash.

The equity component of capital increases or decreases based upon the income of the business less the cash distribution paid. The Fund will also review its level of equity in the context of the change in taxation, which impacts the Fund commencing in 2011.

## 15. RELATED PARTY TRANSACTIONS

### **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, advice on financial structure, advice on senior and/or subordinated debt and equity structure, communication with stakeholders and other general consulting services. CLP entered into a Consulting Services Agreement with Patca Securities Limited on October 1, 2003, and pursuant to this agreement, CLP incurs a fixed monthly fee of \$13,375, and a variable monthly fee of one-twelfth of 0.2% of the outstanding principal amount of the finance receivables.

During fiscal 2008, payments of \$380,448, (2007 - \$334,699) were made to Patca Securities Limited and at December 31, 2008, there was \$32,354 (December 31, 2007 - \$30,401) payable to Patca Securities Limited. Patca Securities Limited is controlled by individuals who are Trustees of the Fund.

**Long term debt (debentures)**

The following table presents the long term debt transactions with related parties:

DECEMBER 31	2008	2007
Long term debt issued to related parties, beginning of year	\$ -	\$ -
Issuance of 14% debentures on May 16, 2008	300,000	-
Issuance of 14% debenture on June 30, 2008	100,000	-
Issuance of 14% debentures on July 20, 2008	200,000	-
Issuance of 14% debenture on August 12, 2008	200,000	-
Issuance of 14% debenture on August 27, 2008	100,000	-
Long term debt issued to related parties, end of year	\$ 900,000	\$ -
Interest paid to related parties, during the year	\$ 56,309	\$ -

The related parties participating in long term debt transactions were either Trustees and/or Officers of the Fund, or family members of Trustees and/or Officers of the Fund.

The related party transactions, including those with Patuca Securities Limited, occurred at the exchange amount, which is the consideration established and agreed to by the related parties.

**16. INCOME TAXES**

On October 31, 2006, the Minister of Finance announced the proposed Tax Fairness Plan for Canadians that includes a tax on distributions from publicly traded income trusts and limited partnerships. Existing publicly traded income trusts, such as Carfinco Income Fund, would not be subject to the proposed tax until their 2011 taxation year.

On June 22, 2007, the *Budget Implementation Act 2007 (Canada)* was enacted, which included the taxation on publicly-traded income trusts and limited partnerships (Specified Investment Flow-Through Entities or "SIFT"), including Carfinco Income Fund, effective January 1, 2011. As such, the Fund reviewed all temporary differences that were previously not recorded as future income tax assets or liabilities at the fund level.

Under the terms of the Deed of Trust, all or virtually all of the taxable income will be allocated to unitholders. In 2008 and 2007, the Fund allocated all of its taxable income to unitholders, and accordingly, no provision for income taxes was recorded at the Fund level.

The following is a reconciliation of income taxes, calculated at the Canadian combined federal and provincial tax statutory rates, for each of the periods presented:

DECEMBER 31	2008	2007
Net (loss) earnings	\$ (1,987,563)	\$ 3,845,735
Loss (earnings) applicable to unitholders	1,791,434	(4,168,459)
Earnings (loss) applicable to incorporated subsidiary	\$ (196,129)	\$ (322,724)
Canadian statutory rates (federal and provincial)	29.5%	32.1%
Provision for income taxes at statutory rates	\$ (57,858)	\$ (103,594)
Increase related to:		
Expenses not deductible for tax and other	26,718	8,909
Valuation allowance	30,870	73,062
Changes in federal and provincial tax rates	270	21,623
Income tax	\$ -	\$ -

The Fund and the underlying 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:

DECEMBER 31	2008	2007
Allowance for credit losses	\$ 9,171,695	\$ 5,508,035
Equipment	15,628	15,815
Transaction costs	(756,495)	-
Derivatives	1,983,486	440,294
Unit issue costs	862,717	1,236,573
Tax loss carry-forwards	21,545	35,922
Termination of interest rate swap agreements	-	46,299
<b>Total tax values in excess of carrying values</b>	<b>\$ 11,298,576</b>	<b>\$ 7,282,938</b>

Included in the tax pools above is \$1,456,563 (2007 - \$757,846) related to the Fund and the Fund's incorporated subsidiary, CAR. These pools translate into a future tax asset balance of \$400,681 (2007 - \$214,981). The Fund and CAR have provided for a valuation allowance of \$400,681 (2007 - \$163,588) against this balance, and therefore no future income tax asset has been recognized in the consolidated financial statements in 2008 (2007 - \$51,393).

The tax pools related to the CAR are \$677,570 (2007 - \$576,653) and translate into a future income tax asset balance of \$194,458 (2007 - \$163,588). CAR has provided for a valuation allowance of \$194,458 (2007 - \$163,588) against this balance, and therefore, no future income tax asset has been recognized. These tax pools are composed of the following:

DECEMBER 31	2008	2007
Allowance for credit losses	\$ 697,966	\$ 524,916
Equipment	15,628	15,815
Transaction costs	(57,569)	-
Tax loss carry-forwards	21,545	35,922
	<b>\$ 677,570</b>	<b>\$ 576,653</b>

The unused non-capital tax loss carry-forwards of \$21,545 (2007 - \$35,922) also relate to Carfinco Inc. These losses expire in the following years: 2026 - \$19,434 and 2027 - \$2,111.

The tax pools related to the Fund are \$778,993 (2007 - \$181,193) and translate into a future income tax asset balance of \$206,223 (2007 - \$51,393). The Fund has provided for a valuation allowance of \$206,223 (2007 - \$nil) against this balance, and therefore, no future income tax asset has been recognized. Recognition of these future income tax assets or liabilities is recorded only for temporary differences expected to reverse after the date that the taxation changes take effect, being January 2011. These tax pools are composed of the following:

DECEMBER 31	2008	2007
Unit issue costs	\$ 181,193	\$ 181,193
Derivatives	597,800	-
	<b>\$ 778,993</b>	<b>\$ 181,193</b>

Income tax provision, including current and future income tax assets and liabilities, require estimates and interpretations of federal and provincial income tax rules and regulations, and judgments as to their interpretation and application to the Fund. Therefore, it is possible that the value of the Fund's income tax assets and liabilities could change in the future and that changes to these amounts could have a material effect on these consolidated financial statements.

## 17. COMMITMENTS

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

2009	\$ 371,000
2010	\$ 382,000
2011	\$ 393,000

## 18. FINANCIAL INSTRUMENTS

All financial instruments are classified into one of the following five categories: held-for-trading, held-to-maturity investments, loans and receivables, available-for-sale financial assets or other financial liabilities. All financial instruments, including derivatives, are included on the consolidated balance sheet and are initially measured at fair market value. Subsequent measurement and recognition of changes in fair value of financial instruments depend on their initial classification. Held-for-trading financial instruments are measured at fair value and all gains and losses are included in net earnings in the period in which they arise. Available-for-sale financial instruments are measured at fair value with revaluation gains and losses, net of tax, included in other comprehensive income until the instruments are derecognized or impaired. Loans and receivables, held-to-maturity investments and other financial liabilities are measured at amortized cost using the effective interest method.

The Fund has classified finance receivables as "loans and receivables", cash and cash equivalents as "financial assets held-for-trading", and the bank credit facility, accounts payable and accrued liabilities, deferred dealer obligation, bank overdraft and long term debt as "other financial liabilities". Derivatives have been classified as "financial liabilities held-for-trading".

The estimated fair value of financial instruments has been determined using available market information or other appropriate valuation methodologies. Considerable judgment is required in developing estimates of fair value and actual results can differ from the estimate.

The following table presents the carrying amount and estimated fair values of the Fund's financial assets and financial liabilities:

DECEMBER 31	2008		2007	
	CARRYING AMOUNT	FAIR VALUE	CARRYING AMOUNT	FAIR VALUE
<b>Financial assets</b>				
Finance receivables – net	\$ 93,372,246	\$ (A)	\$ 85,507,531	\$ (B)
Cash and cash equivalents	\$ 29,162	\$ 29,162	\$ –	\$ –
<b>Financial liabilities</b>				
Bank credit facility	\$ 67,878,411	\$ 67,878,411	\$ 58,213,096	\$ 58,213,096
Bank overdraft	\$ –	\$ –	\$ 165,886	\$ 165,886
Accounts payable and accrued liabilities	\$ 502,989	\$ 502,989	\$ 1,454,430	\$ 1,408,131
Deferred dealer obligation	\$ 1,604,385	\$ 1,604,385	\$ 2,190,247	\$ 2,190,247
Derivatives	\$ 1,983,486	\$ 1,983,486	\$ 440,294	\$ 440,294
Long term debt	\$ 2,300,000	\$ 2,300,000	\$ –	\$ –

The following methods and assumptions were used to estimate the fair value of each class of financial instrument:

- The fair value of finance receivables - net is calculated by discounting the estimated future cash flows of the portfolio at a range of the rates from the inherent stated interest rates, as currently, there is no organized market for valuing the finance receivable portfolio.

DECEMBER 31	(A) 2008		(B) 2007	
	DISCOUNT RATE	FAIR VALUE	DISCOUNT RATE	FAIR VALUE
Upper value	27.0%	\$ 93,973,000	26.7%	\$ 86,904,000
Lower value	31.9%	\$ 90,302,000	30.4%	\$ 83,464,000

- Cash and cash equivalents, bank credit facility, bank overdraft and accounts payable and accrued liabilities are assumed to approximate their carrying values, due to their short-term nature.
- The fair value of the deferred dealer obligation is calculated by discounting the estimated future cash flows of a certain portfolio of finance receivables at investment rates to support the future liability. These finance receivables were purchased by the Fund at a negotiated price that is less than the original principal amount being financed. The dealer has a vested interest in these finance receivables and can receive additional purchase consideration based on their collection performance. The deferred dealer obligation represents the estimated additional purchase consideration owed to the dealers. The estimated cash flows will vary depending on a number of variables including prepayment rates, write-offs and deferments.
- The fair value of derivatives is determined using estimated cash flows. These derivatives are classified as financial assets or financial liabilities held-for-trading, and during 2008, a loss of \$1,543,192 (2007 - \$440,294) was expensed.
- The fair value of long term debt approximates carrying value because it was recently issued.

The nature of these instruments and the Fund's operations expose the Fund to interest rate risk and credit risk. The Fund manages its exposure to these risks by operating in a manner that minimizes its exposure to the extent practical.

#### 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. The Fund's finance receivables are a result of transactions within the consumer finance industry and, as such, contain an element of credit risk in the event that the counter parties are unable to meet the terms of the agreements. The Fund secures individual finance receivables by registering a security interest/lien against tangible assets.

The Fund performs ongoing credit evaluations of its customers' financial condition and limits the amount of credit extended when deemed necessary. The Fund maintains an allowance for credit losses, and any such losses to date have been within management's expectations. The Fund's maximum exposure to credit risk is represented by the carrying amount for finance receivables.

Contractual delinquency at each year end were as follows:

DECEMBER 31	2008				
	CURRENT	1 TO 30 DAYS	31 TO 60 DAYS	61 TO 90 DAYS	91 DAYS PLUS
Amount of finance receivables	\$ 91,341,800	\$ 8,931,200	\$ 3,579,700	\$ 2,096,100	\$ 2,068,200
Percent of finance receivables	84.6%	8.3%	3.3%	1.9%	1.9%
Amount specifically impaired	\$ 701,700	\$ 305,000	\$ 668,300	\$ 2,096,100	\$ 2,068,200

DECEMBER 31	2007				
	CURRENT	1 TO 30 DAYS	31 TO 60 DAYS	61 TO 90 DAYS	91 DAYS PLUS
Amount of finance receivables	\$ 77,021,700	\$ 9,822,800	\$ 4,312,700	\$ 1,912,200	\$ 1,314,000
Percent of finance receivables	81.6%	10.4%	4.6%	2.0%	1.4%
Amount specifically impaired	\$ 444,600	\$ 149,200	\$ 202,900	\$ 1,011,800	\$ 1,314,000

**Interest rate risk**

Interest rate risk is the risk that fair value or future cash flows will fluctuate from changes in market interest rates. The Fund's borrowing costs are impacted by changes in interest rates. The Fund attempts to mitigate this risk by using bankers' acceptance equivalent loans to lock the interest rate on a portion of the debt for short periods and by using interest rate swap agreements to lock the interest rate on a portion of the debt for longer periods.

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 has a notional amount of \$10,000,000, a fixed rate of 4.92% and a three-year term ending on August 23, 2010. The second agreement has a notional amount of \$10,000,000, a fixed rate of 4.99% and a five-year term ending on August 23, 2012. The Fund did not hold any banker's acceptance equivalent loans at December 31, 2008.

Finance receivables bear interest at a fixed rate, and are not subject to interest rate cash flow risk. The bank credit facility bears interest at a floating rate. The floating rate debt is subject to interest rate cash flow risk, as the required cash flows to service the debt will fluctuate, as a result of changes in market rates. The Fund estimates that a 100 basis point increase (decrease) in interest rates during fiscal 2008, with all the other variables constant, would result in an increase (decrease) in interest expense on the bank credit facility of approximately \$670,000 for fiscal 2008, and a decrease (increase) in interest expense of approximately \$200,000 for the cash cost of the interest rate swap agreements for fiscal 2008. For these two items combined, a 100 basis point increase (decrease) in interest rates during fiscal 2008 would result in an increase (decrease) in interest expense of approximately \$470,000.

**Liquidity risk**

Liquidity risk is the risk that the Fund may not have cash available to satisfy financial liabilities as they come due. The Fund utilizes borrowings under its credit facility to ensure it has sufficient funds to meet current financial requirements. The Fund closely monitors its liquidity position and plans capital structure requirements and the purchase of finance receivable contracts accordingly.

The contractual payments and maturities of significant financial liabilities at December 31, 2008 are as follows:

	2009	2010	2011	2012	Total
Bank credit facility	\$ -	67,878,411	-	-	\$ 67,878,411
Accounts payable and accrued liabilities	502,989	-	-	-	502,989
Deferred dealer obligation	641,800	449,200	256,700	256,685	1,604,385
Derivatives	759,600	626,000	358,800	239,086	1,983,486
Long term debt	-	2,300,000	-	-	2,300,000
	\$ 1,904,389	71,253,611	615,500	495,771	\$ 74,269,271

**19. SUBSEQUENT EVENTS****Reorganization of debt**

On January 1, 2009, the Fund reorganized debt owed by CLP to the Fund. The debt owed by CLP to the Fund was assigned to CHT by the Fund. CHT in turn issued a note to the Fund for the full value of the debt. The resulting debt between CLP and CHT was settled by CLP through the issuance of additional units in CLP to CHT. As a result of the issuance of additional partnership units, CHT's holdings in CLP increased from 92.39% to 95.62%, and CAR's holdings of CLP decreased from 7.61% to 4.38%.

**20. COMPARATIVE FIGURES**

Certain of the prior year's comparative figures have been reclassified to conform to the current year's presentation. In 2008, the Fund has grouped changes in finance receivable reserves and transaction costs in investing rather than operating activities, and has reclassified the prior year amounts.

## CARFINCO INCOME FUND

Whitemud Business Park  
4245 - 97 Street, Suite 300  
Edmonton, AB T6E 5Y7

## LISTING

The Toronto Stock Exchange  
Symbol: CFN.UN

# Unitholder Information

## TRUSTEES

Tracy A. Graf  
President and CEO, Carfinco  
Edmonton, AB

David Prussky  
Director, Patica Securities Limited  
Toronto, ON

David Rosenkrantz  
Director, Patica Securities Limited  
Toronto, ON

J. Daryl MacLellan  
President, CIT Canada  
Toronto, ON

Brent Channell  
Principal, Thales Alternative  
Investments Inc.  
Toronto, ON

Maurice Kagan  
President, Sparkle Solutions  
Income Fund  
Toronto, ON

Simon Serruya  
Owner and COO,  
Yogen Früz International Inc.  
Toronto, ON

## OFFICERS (CARFINCO INC.)

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

Troy S.F. Graf  
Vice President, Carfinco Inc.

David Prussky  
Treasurer, Carfinco Inc.

## BANKERS

Bank of Montreal  
Roper Road Branch  
5340 - 75 Street  
Edmonton, AB T6E 6S4

## AUDITORS

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

## BANK CREDIT FACILITY

Bank of America, N.A.  
Simcoe Place  
200 Front Street West, Suite 2700  
Toronto, ON M5V 3L2

Wells Fargo Financial Corporation Canada  
Co-lender

Bank of Montreal  
Co-lender

## SOLICITOR

Bryan & Company LLP  
2600 Manulife Place  
10180 - 101 Street  
Edmonton, AB T5J 3Y2

## REGISTRAR AND TRANSFER AGENT

Equity Transfer & Trust Company  
200 University Avenue, Suite 400  
Toronto, ON M5H 4H1

## INVESTOR RELATIONS

Tracy Graf  
Telephone: 1-888-486-4356

## ANNUAL MEETING

May 7, 2009  
at 10:00am MT  
Carfinco Head Office Board Room  
Suite 300, 4245-97 Street  
Edmonton, AB





CARFINCO INCOME FUND  
4245 - 97 Street, Suite 300  
Edmonton, AB T6E 5Y7

Telephone: 1-888-486-4356  
Facsimile: 1-888-486-7456  
Website: [www.carfinco.com](http://www.carfinco.com)