



**Third Quarter Report**  
**July 31, 2011**

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**PACIFIC & WESTERN CREDIT CORP. ANNOUNCES RESULTS FOR ITS THIRD QUARTER ENDED JULY 31, 2011**

**THIRD QUARTER SUMMARY**

(three months ended July 31, 2011, compared to three months ended July 31, 2010, unless otherwise noted):

***Pacific & Western Bank of Canada***

- Net income (loss) for Pacific & Western Bank of Canada (the "Bank"), Pacific & Western Credit Corp.'s wholly-owned subsidiary, for the three months ended July 31, 2011 was (\$453,000) compared to (\$490,000) for the same period a year ago. For the nine months ended July 31, 2011, net income (loss) for the Bank was \$548,000 compared to (\$455,000) for the same period a year ago.
- Net interest income (teb) for the Bank for the three months ended July 31, 2011 was \$5.0 million compared to \$4.5 million last year and for the nine months ended July 31, 2011, total revenue (teb) was \$14.2 million compared to \$13.0 million for the same period a year ago.
- Spread (teb) for the Bank for the three months ended July 31, 2011 increased to 1.35% from 1.21% last year and for the nine months ended July 31, 2011 increased to 1.38% from 1.17% last year.
- Lending assets at July 31, 2011 were \$1.07 billion, an increase of 3% from the end of the previous quarter's figure of \$1.04 billion and compared to \$956 million a year ago.
- The Bank's pipeline shows loan commitments at July 31, 2011 totalling \$204 million compared to \$182 million a year ago.
- Credit quality remains strong with gross impaired loans at July 31, 2011 decreasing to \$913,000 or 0.09% of total loans from \$3.2 million or 0.21% of total loans a year ago.
- Total regulatory capital of the Bank reached a record level at July 31, 2011 of \$151.6 million compared to \$123.7 million a year ago.

***Pacific & Western Credit Corp.***

- Net income (loss) of Pacific & Western Credit Corp. ("the Corporation") for the three months ended July 31, 2011 was (\$3.7 million) or (\$0.18) per share ((\$0.18) diluted) compared to (\$2.5 million) or (\$0.18) per share ((\$0.18) diluted) for the same period a year ago. Prior to the payment of dividends on Class B Preferred Shares, which are recorded as interest expense for accounting purposes, net income (loss) of the Corporation for the current quarter was (\$2.5 million) compared to (\$1.3 million) a year ago. The results for the quarter were negatively impacted by implementation costs relating to the Corporation's private label credit card initiative.
- Net income (loss) of the Corporation for the nine months ended July 31, 2011 was (\$7.7 million) or (\$0.45) per share ((\$0.45) diluted) compared to (\$6.7 million) or (\$0.49) per share ((\$0.49) diluted) for the same period a year ago. Prior to the payment of dividends on Class B Preferred Shares, net income (loss) of the Corporation for the current quarter was (\$4.1 million) compared to (\$3.4 million) a year ago.
- During the third quarter, pursuant to the closing of a public offering, the Corporation issued Units consisting of one common share and one-half warrant to purchase a common share, for net proceeds of \$13.1 million. Subsequent to July 31, 2011, a portion of the proceeds from the public offering were used to reduce consolidated debt of the Corporation by \$10 million. In addition, subsequent to July 31, 2011, the Corporation completed a private placement whereby Units of the Corporation were issued for proceeds of approximately \$5.0 million.
- The Corporation's book value per common share at July 31, 2011 increased to \$1.13 per share from \$0.50 per share a year ago.

## PRESIDENT'S COMMENTS

Our Bank's lending business continued to grow steadily during the third quarter. Loans and leases totalled \$1.07 billion at the end of the quarter, which represented a 3% increase from the previous quarter and a 12% increase from the same period a year ago. Spread on loans and leases also increased from the previous quarter climbing to 2.13% from 2.03% achieved during the previous quarter and 2.06% achieved during the same period last year. Total spread for the Bank that also includes low yielding liquid securities increased to 1.35% from 1.21% last year, and for the nine months ended July 31, 2011 increased to 1.38% from 1.17% last year. This increase in lending assets and spread gave rise to a significant increase in total revenue which for the nine months ending July 31, 2011 totalled \$15.0 million, an 11% increase over last year's figure of \$13.5 million. Although we are pleased with this significant increase in net interest income, our Bank's net interest income figures are still significantly depressed by two large hospital construction loans that were thinly priced prior to the liquidity crisis. The first hospital loan is due to repay at the end of this fiscal year and the second at the end of next year's second quarter. When both of these hospital loans are repaid the Bank's net interest income will benefit by approximately \$5.5 million per year or 55 basis points increase in spread.

As I mentioned in the previous quarter's report, we have been working on two very exciting projects. The first is developing a credit card program for Home Hardware and the second is developing custom software to enable certain industries to deal with our Bank in a more efficient manner. There is of course considerable cost associated with these two initiatives, most of which will be incurred this fiscal year. We are scheduled to launch the Home Hardware credit card on January 2, 2012 and are very excited about the tremendous profit potential this new card has. The second project is also scheduled to be launched early in 2012 and over time should result in a significant reduction in our cost of funds.

We recently completed a public offering and a private placement of units which resulted in additional capital of \$18.1 million. We used most of the proceeds of this offering to repay debts. The interest savings from this debt repayment will be felt in the quarters to come. These offerings also had a positive result of increasing the book value of our shares from \$0.50 per share a year ago to \$1.13 per share at July 31, 2011.

We at Pacific & Western are all looking forward to the quarters to come. We have been working very hard to lay the foundation for a profitable and well diversified financial institution.

## FINANCIAL HIGHLIGHTS

(unaudited)

	for the three months ended		for the nine months ended	
	July 31 2011	July 31 2010	July 31 2011	July 31 2010
(\$ thousands, except per share amounts)				
<b>Pacific &amp; Western Bank of Canada</b>				
<b>Balance Sheet Summary</b>				
Cash and securities	\$ 329,814	\$ 575,740	\$ 329,814	\$ 575,740
Total loans	1,073,885	956,000	1,073,885	956,000
Average loans	1,058,608	940,717	1,019,374	942,916
Total assets	1,432,431	1,566,094	1,432,431	1,566,094
Deposits	1,259,718	1,409,799	1,259,718	1,409,799
Subordinated notes payable	51,500	41,500	51,500	41,500
Shareholder's equity	99,778	81,842	99,778	81,842
<b>Capital ratios</b>				
Total regulatory capital	\$ 151,614	\$ 123,691	\$ 151,614	\$ 123,691
Risk-weighted assets	1,110,599	1,004,497	1,110,599	1,004,497
Assets-to-capital ratio	9.63	12.89	9.63	12.89
Tier 1 risk-based capital ratio	9.10%	8.21%	9.10%	8.21%
Total risk-based capital ratio	13.65%	12.31%	13.65%	12.31%
<b>Results of operations (teb) *</b>				
Net interest income per financial statements	\$ 4,453	\$ 3,807	\$ 12,669	\$ 11,078
Teb adjustment	517	643	1,564	1,936
Net interest income (teb)	4,970	4,450	14,233	13,014
Spread	1.35%	1.21%	1.38%	1.17%
Provision for (recovery of) credit losses	-	19	82	(690)
Other income (charges)	(310)	(245)	829	(165)
Total revenue	4,660	4,186	14,980	13,539
Non-interest expenses	4,909	4,371	13,226	12,629
Net income (loss)	(453)	(490)	548	(455)
Return on average total assets	-0.12%	-0.13%	0.05%	-0.04%
Gross impaired loans to total loans	0.09%	0.21%	0.09%	0.21%
Provision for (recovery of) credit losses as a % of average loans	0.00%	0.00%	0.01%	-0.07%
<b>Pacific &amp; Western Credit Corp., (consolidated)</b>				
<b>Results of operations</b>				
Net income (loss) for the Bank	\$ (453)	\$ (490)	\$ 548	\$ (455)
Deduct interest expense on notes of the parent	(1,430)	(811)	(3,373)	(2,766)
Non-interest expenses of the parent	(653)	(33)	(1,315)	(171)
Net loss before interest expense relating to Class B				
Preferred Share dividends	(2,536)	(1,334)	(4,140)	(3,392)
Interest expense relating to Class B				
Preferred Share dividends	(1,202)	(1,191)	(3,603)	(3,303)
Net loss for the Corporation	\$ (3,738)	\$ (2,525)	\$ (7,743)	\$ (6,695)
Loss per common share:				
Basic	\$ (0.18)	\$ (0.18)	\$ (0.45)	\$ (0.49)
Diluted	\$ (0.18)	\$ (0.18)	\$ (0.45)	\$ (0.49)

### \*Non-GAAP measures

Tax equivalent basis (teb) - like most banks, the Corporation's wholly-owned subsidiary Pacific & Western Bank of Canada analyzes revenue on a teb to permit uniform measurement and comparison of net interest income. Net interest income includes tax-exempt income on certain securities. Since this income is not taxable, the rate of interest or dividends received is lower than would apply to a loan or taxable security of the same amount. The taxable equivalent basis includes an adjustment that increases interest income and the provision for income taxes by the same amount that adjusts the income on the tax-exempt securities to what income would have been had it been taxed at the statutory rate.

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF OPERATIONS AND FINANCIAL CONDITION

This management's discussion and analysis (MD&A) of operations and financial condition for the third quarter of fiscal 2011 should be read in conjunction with the unaudited interim consolidated financial statements for the period ended July 31, 2011, included herein, and the audited consolidated financial statements and MD&A for the year ended October 31, 2010, which are available on SEDAR at [www.sedar.com](http://www.sedar.com). Except as discussed below, all other factors discussed and referred to in the MD&A for the year ended October 31, 2010, remain substantially unchanged.

### Overview

Pacific & Western Credit Corp. is a holding company whose shares trade on the Toronto Stock Exchange. Its wholly-owned and principal subsidiary is Pacific & Western Bank of Canada which provides lending services to selected niche markets and operates as a Schedule I bank under the *Bank Act* (Canada).

### Pacific & Western Credit Corp.

Net income (loss) of the Corporation for the three months ending July 31, 2011 was (\$3.7 million) or (\$0.18) per share ((\$0.18) diluted) compared to (\$2.5 million) or (\$0.18) per share ((\$0.18) diluted) for the same period last year. Prior to the deduction of dividends on Class B Preferred Shares, net income (loss) for the three months ending July 31, 2011 was (\$2.5 million) compared to (\$1.3 million) last year. These dividends are recorded as interest expense in the consolidated financial statements as the preferred shares carry certain redemption features and are classified as preferred share liabilities on the Consolidated Balance Sheet.

Net income (loss) of the Corporation for the nine months ending July 31, 2011 was (\$7.7 million) or (\$0.45) per share ((\$0.45) diluted) compared to (\$6.7 million) or (\$0.49) per share ((\$0.49) diluted) for the same period a year ago. Prior to the deduction of dividends on Class B Preferred Shares, net income (loss) for the nine months ending July 31, 2011 was (\$4.1 million) compared to (\$3.4 million) for the same period a year ago. The results of the Corporation for the current quarter and for the year-to-date were negatively impacted by implementation costs relating to its private label credit card initiative which for the nine month period totalled approximately \$650,000 as well as increased consulting and professional fees incurred in the Bank. While these costs were incurred in the current period, they will provide future benefits to the Corporation when the credit card program is launched.

### Pacific & Western Bank of Canada

Net income (loss) of the Bank for the three months ending July 31, 2011 was (\$453,000) compared to (\$490,000) for the same period a year ago and for the nine months ending July 31, 2011 was \$548,000 compared to (\$455,000). The results of the Bank reflect increased lending assets and improved spreads on lending assets and an increase in other income (charges) over the previous year, partially offset by an increase in non-interest expenses. Net interest margin or spread (teb) for the Bank for the three months ended July 31, 2011 increased to 1.35% from 1.21% for the same period a year ago and for the nine months ended July 31, 2011 increased to 1.38% from 1.17%. While the results for the Bank were impacted by improved net interest income, net income was less than the previous quarter due to other income (charges) of (\$310,000) compared to \$707,000 for the previous quarter and increased non-interest expenses, including higher amounts for consulting and professional fees.

At July 31, 2011, total assets of the Bank were \$1.43 billion compared to \$1.57 billion a year ago. Lending assets at July 31, 2011 grew to \$1.07 billion from \$956 million a year ago and from \$1.04 billion at the end of the previous quarter. The growth in lending assets from a year ago was due primarily to an increase of \$60 million in leases sourced primarily through the Bank's bulk lease financing program. Total leases outstanding at July 31, 2011 were \$176 million compared to \$114 million a year ago. Credit quality remains strong, with gross impaired loans decreasing to \$913,000 at July 31, 2011 from \$3.2 million a year ago. At July 31, 2011, the ratio of gross impaired loans as a percentage of total loans was 0.09% compared to 0.21% last year.

### Total Revenue (teb)

#### Pacific & Western Credit Corp.

Consolidated total revenue (teb) of the Corporation, which is comprised of net interest income on a teb basis after the provision for credit losses and other income (charges), was \$2.1 million for the current quarter compared to \$2.1 million for the same period a year ago. On a year-to-date basis, total revenue (teb) was \$8.0 million compared to \$7.5 million last year.

### ***Pacific & Western Bank of Canada***

Total revenue (teb) of the Bank was \$4.7 million for the current quarter compared to \$4.2 million for the same period last year and for the current nine month period, total revenue (teb) of the Bank was \$15.0 million compared to \$13.5 million. Total revenue of the Bank for the current periods increased from a year ago due primarily to growth in lending assets and increased spreads on new and renewed loans.

### ***Net Interest Income and Net Interest Margin***

#### ***Pacific & Western Bank of Canada***

Net interest income (teb) of the Bank increased to \$5.0 million for the current quarter from \$4.5 million for the same period a year ago and for the nine month period ending July 31, 2011, net interest income (teb) increased to \$14.2 million from \$13.0 million last year. Net interest margin or spread (teb) for the Bank, which is net interest income as a percentage of average assets, increased to 1.35% for the current quarter from 1.21% for the same period a year ago and for the nine month period, spread (teb) increased to 1.38% from 1.17% last year. Net interest income and spread for the current periods reflected increased spread from lending operations due to growth in lending assets and increases in spread on those lending assets. Increased net interest income from lending assets was reduced however by lower returns from the Bank's treasury portfolio. This was due to additional liquid assets being held earlier in the year as well by the Bank reallocating its treasury assets and holding higher levels of securities for liquidity purposes and reduced levels of securities for earning investment income.

### ***Other Income (charges)***

Other income (charges) of the Corporation for the three months ended July 31, 2011 totalled (\$290,000) compared to (\$215,000) for the same period last year. Other income (charges) for the current period included fair value adjustments offset by gains on the sale of our remaining shares in Discovery Air Inc. For the nine months ended July 31, 2011, other income totalled \$778,000 compared to (\$124,000) for the same period last year, an increase of \$902,000. Other income for the current nine month period included fair value adjustments relating to securities in the Corporation's treasury portfolio and gains totalling \$596,000 after related expenses, resulting from the sale of shares in Discovery Air Inc. and securitization activities.

### ***Non-Interest Expenses***

Non-interest expenses of the Corporation on a consolidated basis were \$5.6 million for the current quarter compared to \$4.3 million for the same period a year ago and on a year-to-date basis totalled \$14.3 million compared to \$12.8 million last year. The increase in non-interest expenses for the current quarter and for the nine month period compared to a year ago was primarily in general and administrative expenses where the Corporation incurred expenses totalling approximately \$650,000 relating to the start up and implementation of its private label credit card initiative as well as increased professional and consulting fees. While these costs were incurred in the current period, they will provide future benefits to the Corporation when the credit card program is launched. In addition, salaries and benefits increased from last year due to new hires and salary adjustments.

### ***Income Taxes***

The Corporation's statutory federal and provincial income tax rate and that of the Bank is approximately 29% compared to 31% last year with the difference due to changes in enacted statutory income tax rates. The effective rate is impacted by non-taxable dividend income earned on preferred shares held in its treasury portfolio, the tax benefit on operating losses in the parent company not being recorded for accounting purposes and other items not being taxable or deductible for income tax purposes. For the current quarter the Corporation's provision for (recovery of) income taxes was (\$313,000) compared to (\$338,000) a year ago and for the nine month period ended July 31, 2011 was (\$123,000) compared to (\$571,000) a year ago.

At July 31, 2011, the future income tax asset of the Bank was \$11.5 million compared to \$12.4 million a year ago and is primarily a result of income tax losses from previous periods, the benefit of which was recorded at the time. The income tax loss carry-forwards in the Bank are not scheduled to begin expiring until 2027 if unutilized. The income tax losses in the Bank were caused by declines in previous years in the market value of preferred shares, being mostly those of Canadian banks and insurance companies, and operating losses of the Bank.

The ultimate realization of the future income tax asset cannot be determined with certainty, however management is of the opinion that it is more likely than not that the Bank will be able to realize the future income tax asset in future years. The realization of the future income tax asset is dependent upon the Bank being able to generate taxable income sufficient to offset these income tax losses. The ability to generate sufficient taxable income may be dependent upon the Bank generating income from operations or on converting non-taxable income sources to taxable income sources during the carry-forward period. It is also dependent upon the market value of the preferred shares recovering in value as they are

carried at market value for income tax purposes with mark-to-market adjustments being added to or deducted from taxable income. At July 31, 2011, the market value of the preferred shares had increased from a year ago, trading at a value of \$3.6 million below their amortized cost compared to \$13.2 million a year ago reflecting improvements in market conditions in the financial services industry.

### ***Comprehensive income (loss)***

Total comprehensive income (loss) is comprised of net income (loss) and other comprehensive income (loss). The Corporation's other comprehensive income (loss) consists of the after-tax changes in unrealized gains and losses on available-for-sale securities. Total comprehensive income (loss) for the three months ended July 31, 2011 was (\$3.8 million) compared to \$382,000 a year ago and for the nine months ended July 31, 2011, total comprehensive income (loss) was (\$5.2 million) compared to (\$5.2 million) for the same period last year. The difference in the current quarter from the same period last year was due primarily to \$504,000 in after-tax net unrealized gains on available-for-sale assets this quarter compared to \$3.1 million in after-tax net unrealized gains last year. The after-tax unrealized gains in the current quarter and in the same quarter last year related to increases in the market value of preferred shares held in the Corporation's treasury portfolio.

### ***Balance Sheet***

Total assets of the Corporation at July 31, 2011, were \$1.45 billion compared to \$1.57 billion a year ago with the decrease due primarily to a more optimal level of cash and securities being held by the Bank offset partially by an increase in lending assets. As the difference between the consolidated assets of the Corporation and the assets of the Bank is not significant, the discussion below will be with respect to that of the Corporation on a consolidated basis.

### ***Cash and Securities***

Securities in the Corporation's treasury portfolio typically consist of Government of Canada and Canadian provincial and municipal bonds, bankers' acceptances and corporate debt and preferred shares. Cash and securities, which are held primarily for liquidity management purposes, totalled \$348 million or 24% of total assets at July 31, 2011 compared to \$584 million or 37% of total assets a year ago. The decrease in the amount of cash and securities from a year ago is due primarily to a decrease in the amount of deposits maturing in the months immediately following July 31, 2011 and as a result the Corporation holding a more optimal level of liquid assets.

At July 31, 2011, the net unrealized loss in the Corporation's securities portfolio was \$5.9 million compared to a net unrealized loss of \$14.4 million a year ago with the change due primarily to improvements in the market value of the preferred shares referred to below. These amounts are recorded net of income taxes in Accumulated Other Comprehensive Income (Loss). The fair values of securities held in the Corporation's treasury portfolio are based primarily on market values as the securities the Corporation owns are publicly traded. The Corporation is of the view that the unrealized losses on the securities it owns do not represent other than temporary declines in value, and impairment writedowns are not required at this time.

The Corporation's holdings of equity securities, consisting primarily of major Canadian banks and insurance companies' preferred shares, traded at a value of \$3.6 million below their amortized cost at July 31, 2011 compared to \$13.2 million below their amortized cost a year ago. The Corporation intends to hold these securities until a recovery in value is achieved. The preferred shares have provisions that will allow the issuers to redeem them at various dates commencing over the years 2011 to 2014; however, there is no legal requirement for the issuers to redeem these shares on those dates. Further recovery in their market values is dependent upon future market conditions or the ultimate future redemption of the shares by the issuers. Management is of the opinion that it is more likely than not that these preferred shares will be redeemed by the issuers at their par redemption dates.

### ***Mortgages and Loans***

Mortgages and loans totalled \$1.07 billion at July 31, 2011, compared to \$956 million a year ago with the increase being primarily in commercial leases sourced through the Corporation's bulk lease financing program and in corporate mortgages and loans. At July 31, 2011, the Corporation's total lease portfolio grew to \$176 million from \$114 million a year ago of which approximately \$60 million of the increase relates to our bulk lease program. New lending in the current quarter totalled \$118 million compared to \$123 million a year ago and loan repayments for the current quarter totalled \$91 million compared to \$101 million last year. On a year-to-date basis, new lending totalled \$415 million compared to \$312 million a year ago and loan repayments for the nine months totalled \$299 million compared to \$285 million last year. Loan commitments at July 31, 2011 were \$204 million compared to \$182 million a year ago. The Corporation is continuing to enter into agreements with vendors for its bulk lease program to provide lease financing and expects to see accelerated growth in this niche in the coming months.

### *Credit Quality*

Gross impaired loans at July 31, 2011 totalled \$913,000 or 0.09% of total loans compared to \$3.2 million or 0.21% of total loans a year ago. The Corporation's loan book has maintained its high credit quality and requires minimal provisions for credit losses. Provisions for (recovery of) credit losses in the current quarter were \$nil compared to \$19,000 a year ago. For the nine months ended July 31, 2011, the provision for (recovery of) credit losses totalled \$82,000 compared to (\$682,000) for the same period last year. The recovery of credit losses recorded in the previous year was due primarily to a reduction in the amount of the Corporation's total general allowance relating to personal loans based on the results of the Corporation's stress testing of its loan portfolio.

At July 31, 2011 the Corporation's general allowance totalled \$2.7 million compared to \$4.3 million a year ago with the decrease due primarily to the reduction of the general allowance relating to personal loans noted above. Based on results from ongoing stress testing of the loan portfolio under various scenarios, and the secured nature of the existing loan portfolio, the Corporation is of the view that any credit losses which exist in its loan portfolio but cannot be specifically identified at this time are adequately provided for.

### *Other Assets*

Other assets totalled \$28.0 million at July 31, 2011 compared to \$33.1 million a year ago. Included in other assets is the future income tax asset of the Bank totalling \$11.5 million compared to \$12.4 million last year and capital assets and prepaid expenses totalling \$15.1 million at July 31, 2011 compared to \$14.5 million last year.

### *Deposits and Other Liabilities*

Deposits are used as a primary source of financing growth in assets and are raised entirely through a well established and well diversified deposit broker network across Canada. Deposits at July 31, 2011 totalled \$1.26 billion compared to \$1.41 billion a year ago, and consist primarily of guaranteed investment certificates. Of these amounts, \$33.2 million or approximately 2.6% of total deposits at the end of the quarter were in the form of demand deposits compared to \$46.8 million or approximately 3.3% of total deposits a year ago, with the remaining deposits having fixed terms. Total deposits were less than a year ago due to the Corporation carrying a lower level of liquid securities as a result of lower deposits maturing in the months immediately following July 31, 2011 compared to the same period a year ago.

A second source of financing growth in assets, and a source of liquidity, is the use of margin lines and securities sold under repurchase agreements. From time to time, the Corporation uses these sources of short term financing when the cost of borrowing is less than the interest rates that would have to be paid on new deposits. At July 31, 2011, the Corporation did not have any amounts outstanding relating to securities sold under repurchase agreements nor were any amounts outstanding a year ago.

Other liabilities consist primarily of the fair value of derivatives and accounts payable and accruals. At July 31, 2011, other liabilities totalled \$24.4 million compared to \$35.1 million a year ago. The fair value of derivatives at July 31, 2011 totalled \$16,181,000 compared to \$16,529,000 last year and under the accounting standard for hedges, the offsetting amount is included in the carrying values of the assets to which they relate.

### *Notes Payable*

Notes payable, net of issue costs, totalled \$92.6 million at July 31, 2011 compared to \$75.4 million a year ago with the change due primarily to the issue of a \$10.0 million of subordinated note by the Bank to an external party, \$5.6 million in short term notes and \$1.5 million in Series C Notes. Excluding issue costs, notes payable consist of Series C Notes totalling \$61.7 million maturing in 2018 and short term notes totalling \$5.8 million maturing in 2015. The short term notes bear interest at rates ranging from 5.50% to 7.00% per annum and the Series C Notes bear interest at 9.00% per annum. In addition, the Corporation has outstanding subordinated notes payable totalling \$31.5 million issued by the Bank to an external party. These subordinated notes bear interest at rates ranging from 8.00% to 11.00%, are callable by the Bank, and mature between 2019 and 2021.

As referred to in Subsequent Events below, in August 2011, the Corporation reduced its consolidated indebtedness by way of the repurchase of a \$10.0 million subordinated note bearing an interest rate of 11% which had been issued by the Bank to an external party. In addition, subsequent to July 31, 2011 the Corporation repaid a short term note of \$5.6 million. As a result of the reduction in the consolidated debt of the Corporation, annual interest expense will be reduced by approximately \$1.4 million.

### ***Preferred Share Liabilities***

At July 31, 2011, the Corporation had 1,909,458 Class B Preferred Shares outstanding with a total value of \$47.7 million, before deducting issue costs of \$2.6 million. As these Class B Preferred Shares carry certain redemption features and are convertible into common shares of the Corporation, an amount of \$41.1 million, net of issue and conversion costs, representing the fair value of the Corporation's obligation to make future payments of principal and interest has been classified on the Corporation's Consolidated Balance Sheet as Preferred Share Liabilities. In addition, an amount of \$4.3 million, net of issue costs, representing the equity portion of the Class B Preferred Shares, has been included in Shareholders' Equity on the Corporation's Consolidated Balance Sheet. As the Class B Preferred Shares may be redeemed by the Corporation in 2019 for \$47.7 million, the preferred share liability amount of \$41.1 million will be adjusted over the remaining term to redemption until the amount is equal to the estimated redemption amount, with the increase included in interest expense in the Consolidated Statement of Operations, calculated using an effective interest rate of 11.8%.

### ***Liquidity***

At July 31, 2011, Pacific & Western Credit Corp., on a non-consolidated basis, has sufficient funds on hand to meet its cash obligations due to the end of fiscal 2012. These obligations relate primarily to payments of interest on notes payable and the expected cash portion of dividends on Class B Preferred Shares. The funding for the obligations of the Corporation beyond 2012 is expected to come primarily from cash on hand in the Corporation, further issuance of securities and interest income earned by the Corporation.

### ***Shareholders' Equity***

At July 31, 2011, Shareholders' Equity was \$32.0 million compared to \$12.5 million a year ago with the increase due primarily to the issue of common shares and warrants pursuant to a public offering which closed during the quarter, an increase in Accumulated Comprehensive Income (Loss) as a result of the increase in the market value of preferred shares, offset by net losses incurred from last year. Accumulated Other Comprehensive Income (Loss) which is included in Shareholder's Equity, was (\$3.8 million) at July 31, 2011 compared to (\$11.7 million) a year ago.

Common shares outstanding at July 31, 2011 totalled 23,663,542 compared to 14,209,410 a year ago with the change due to 7,476,000 common shares issued under the recent public offering, 1,000,000 common shares issued under a private placement and common shares issued as part of the dividends on the Class B Preferred Shares. Outstanding common share options totalled 1,160,333 at the end of the quarter compared to 930,433 a year ago with the change due to common share options issued to a service provider and the expiry of common share options. In addition, the Corporation has 4,298,700 warrants outstanding at July 31, 2011 resulting from the recent public offering and 747,600 broker warrants outstanding which if exercised would result in one common share and one-half warrant being issued for \$2.25 each and 56,070 broker warrants which if exercised would result in one warrant being issued for \$0.22 each. The warrants expire in November 2012.

The Corporation's book value per common share at the end of the quarter was \$1.13 compared to \$0.50 a year ago. Assuming the outstanding Class B Preferred Shares are converted into common shares on the basis of \$5.00 per share, the Corporation's book value per common share at July 31, 2011 would be \$2.18 per share.

At July 31, 2011, there were 314,572 Class A Preferred Shares outstanding, unchanged from a year ago and 1,909,458 Class B Preferred Shares outstanding, also unchanged from a year ago.

### ***Updated Share Information***

As at August 31, 2011, there were 25,863,542 common shares outstanding with the increase from July 31, 2011 due to 2,200,000 common shares issued pursuant to a private placement (See Subsequent Events). In addition, at August 31, 2011 there were 5,398,700 warrants outstanding with the increase from July 31, 2011 due to 1,100,000 warrants issued pursuant to the private placement. There were no changes in the number of common share options, Class A or Class B Preferred Shares since July 31, 2011.

### ***Subsequent Events***

Subsequent to July 31, 2011, pursuant to the closing of a private placement, the Corporation issued Units consisting of one common share and one-half warrant to purchase a common share, for net proceeds of approximately \$5.0 million. The proceeds were used to reduce consolidated debt of the Corporation.

In addition, subsequent to July 31, 2011, the Corporation reduced its consolidated indebtedness by way of the repurchase of a \$10.0 million subordinated note bearing an interest rate of 11% which had been issued by the Bank to an external party.

### Capital Management

Total regulatory capital in the Corporation's principal subsidiary, the Bank, reached a record level of \$151.6 million at the end of the quarter compared to \$123.7 million a year ago with the increase due primarily to \$8.6 million of additional Tier 1 capital in the form of common shares being issued by the Bank to the Corporation, additional subordinated notes issued by the Bank to an external party, improvements in the market value of preferred shares of Canadian banks and insurance companies which the Bank holds in its securities portfolio and operating results of the Bank over the past year. Regulatory capital includes the after-tax effect of unrealized gains and losses on available-for-sale equity securities owned by the Bank.

The Bank's total risk-based capital ratio, which is the ratio of regulatory capital to risk-weighted assets, was 13.65% at the end of the quarter compared to 12.31% a year ago. The Bank's Tier 1 risk-based capital ratio, which is the ratio of Tier 1 capital to risk-weighted assets, was 9.10% at the end of the quarter compared to 8.21% last year. The Bank's assets-to-capital ratio was 9.63 at the end of the quarter compared to 12.89 a year ago. The changes in the Bank's capital ratios from a year ago were due to the increase in regulatory capital as well as an increase in risk-weighted assets, primarily from the increase in total assets and increased amounts of off-balance sheet items in the form of loan commitments.

See note 10 to the interim consolidated financial statements for more information regarding capital management.

### Summary of Quarterly Results (teb)

(thousands of dollars except per share amounts)	2011			2010			2009	
	Q3	Q2	Q1	Q4	Q3	Q2	Q1	Q4
<b>Results of operations:</b>								
Total interest income								
per financial statements	\$ 14,492	\$ 13,353	\$ 13,163	\$ 13,648	\$ 13,459	\$ 11,417	\$ 14,364	\$ 18,222
Teb adjustment	517	499	548	626	643	623	669	667
Total interest income	15,009	13,852	13,711	14,274	14,102	12,040	15,033	18,889
Interest expense	12,637	11,673	10,924	11,105	11,750	10,953	11,561	14,137
Net interest income	2,372	2,179	2,787	3,169	2,352	1,087	3,472	4,752
Provision for (recovery of) credit losses	-	42	40	(473)	19	(735)	26	3,183
Other income (charges)	(290)	706	362	481	(215)	62	21	1,887
Total revenue	2,082	2,843	3,109	4,123	2,118	1,884	3,467	3,456
Non-interest expenses	5,616	4,332	4,388	4,486	4,338	4,251	4,211	4,405
Income (loss) before income taxes	(3,534)	(1,489)	(1,280)	(363)	(2,220)	(2,367)	(744)	(949)
Income tax provision (recovery)	204	687	550	1,016	305	463	596	1,108
Net income (loss)	\$ (3,738)	\$ (2,176)	\$ (1,829)	\$ (1,379)	\$ (2,525)	\$ (2,830)	\$ (1,340)	\$ (2,057)
Earnings (loss) per share								
-basic	\$ (0.18)	\$ (0.14)	\$ (0.13)	\$ (0.10)	\$ (0.18)	\$ (0.21)	\$ (0.10)	\$ (0.15)
-diluted	\$ (0.18)	\$ (0.14)	\$ (0.13)	\$ (0.10)	\$ (0.18)	\$ (0.21)	\$ (0.10)	\$ (0.15)

The financial results of the Corporation for each of the last eight quarters are summarized above. Generally the Corporation's results over the periods, particularly total interest income and net interest income are comparable between quarters. Total interest income in 2011 reflects the impact of increased levels of lending assets and increased yields being earned on new and renewed loans. Total interest income between quarters can fluctuate depending on the amount and timing of loan fees recorded as these are related to loan advances and commitments earned for each quarter. Increased interest income has not translated directly into increases in net interest income in the periods as a result of increased interest expense from additional notes payable, subordinated notes and Class B preferred shares issued. As noted previously, subsequent to July 31, 2011, the Corporation repurchased \$10.0 million of subordinated notes issued by the Bank and repaid \$5.6 million in short term notes. As a result of the reduction in the consolidated debt of the Corporation, annual interest expense will be reduced by approximately \$1.4 million.

Other income during the current quarter includes fair value adjustments relating to securities in the Corporation's treasury portfolio, net of gains on the sale of shares in Discovery Air Inc.

Non-interest expenses over the past year have been comparable between quarters until the current quarter. Non-interest expenses increased in the current quarter as a result of increased professional and consulting fees and expenses being incurred totalling approximately \$650,000 relating to implementation of the Corporation's private label credit card initiative. The Corporation expects that it will incur additional implementation costs relating to this initiative during the remainder of 2011.

### ***Significant Accounting Policies***

Significant accounting policies are detailed on pages 58 to 61 of the Corporation's 2010 Annual Report. There have been no changes in accounting policies or new significant accounting policies adopted during the current period.

### ***Future Change in Accounting Policies***

#### ***International Financial Reporting Standards***

The Canadian Institute of Chartered Accountants has announced that public companies will be required to transition from Canadian Generally Accepted Accounting Principles (GAAP) to International Financial Reporting Standards (IFRS). For the Corporation, this will take place with its fiscal period commencing November 1, 2011. This transition date will require the restatement for comparative purposes of amounts reported by the Corporation for the interim periods and for the year ending October 31, 2011.

The Corporation continues its process of transition from current Canadian GAAP to IFRS. It has a project team assigned to plan for and achieve a smooth transition to IFRS. Regular reporting to the Audit Committee of the Board of Directors on the status of the IFRS implementation continues to take place. The Corporation and the Bank also provide frequent updates of its IFRS implementation status to its external auditors and to the Office of the Superintendent of Financial Institutions (OSFI).

The implementation project consists of three phases which include: research, diagnostic and planning phase; impact analysis, evaluation and design phase; and implementation, training and review phase. The Corporation has completed the research, diagnostic and planning phase, including the establishment of a detailed timetable with benchmarks, and has completed several aspects of the impact analysis, evaluation and design phase. The Corporation has completed the evaluation and design phase and continues its impact analysis. The results thus far of the Corporation's analysis of IFRS in comparison to Canadian GAAP have identified several differences. However the differences identified thus far are not expected to have a material impact on the reporting results and financial position of the Corporation other than those differences relating to derecognition on transfers of certain financial assets.

Under IFRS certain financial assets that previously qualified for derecognition on transfer are expected to be re-recognized. This would result in an adjustment to retained earnings intended to unwind the previously reported impact of all securitization transactions undertaken and retroactively re-recognize the assets that were previously considered to have been sold subsequent to January 1, 2004, as amortizing assets that continue to reside on the Consolidated Balance Sheet, earning spread income over their term. As at July 31, 2011, insured mortgages which previously qualified for derecognition under GAAP and which will be required to be added back to the consolidated balance sheet under IFRS totalled \$32.3 million.

In addition, under IFRS the basis for determining impairment in the Corporation's available-for-sale securities, specifically the preferred shares it holds in its treasury portfolio, will change from that used under Canadian Generally Accepted Accounting Principles. The result will be that any impairment in these securities as determined under IFRS prior to November 1, 2011 will be recorded at the date of transition through a transfer between Accumulated Comprehensive Income (Loss) and Retained Earnings (Deficit). Total Shareholders' Equity will remain unchanged as a result of this adjustment.

As the Corporation prepares for its transition to IFRS, it continues to monitor all ongoing changes to IFRS and adjust its transition and implementation plans accordingly. The Corporation's transition remains in line with its implementation schedule and is on track to meet the timelines essential to changeover.

## ***Risk Management***

The risk management policies and procedures of the Corporation are provided in its annual MD&A for the year ended October 31, 2010, and are found on pages 39 to 42 of the Corporation's 2010 Annual Report.

## ***Controls and Procedures***

During the most recent interim period, there have been no changes in the Corporation's policies and procedures and other processes that comprise its internal control over financial reporting, that have materially affected, or are reasonably likely to materially affect, the Corporation's internal control over financial reporting.

**Dated: August 31, 2011**

## ***Forward-Looking Statements***

The statements in this management's discussion and analysis that relate to the future are forward-looking statements. By their very nature, forward-looking statements involve inherent risks and uncertainties, both general and specific, many of which are out of our control. Risks exist that predictions, forecasts, projections and other forward-looking statements will not be achieved. Readers are cautioned not to place undue reliance on these forward-looking statements as a number of important factors could cause actual results to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward-looking statements. These factors include, but are not limited to, the strength of the Canadian economy in general and the strength of the local economies within Canada in which we conduct operations; the effects of changes in monetary and fiscal policy, including changes in interest rate policies of the Bank of Canada; the effects of competition in the markets in which we operate; inflation; capital market fluctuations; the timely development and introduction of new products in receptive markets; the impact of changes in the laws and regulations regulating financial services; changes in tax laws; technological changes; unexpected judicial or regulatory proceedings; unexpected changes in consumer spending and savings habits; and our anticipation of and success in managing the risks implicated by the foregoing. For a detailed discussion of certain key factors that may affect our future results, please see page 43 of our 2010 Annual Report.

The foregoing list of important factors is not exhaustive. When relying on forward-looking statements to make decisions, investors and others should carefully consider the foregoing factors and other uncertainties and potential events. The forward-looking information contained in the management's discussion and analysis is presented to assist our shareholders in understanding our financial position and may not be appropriate for any other purposes. Except as required by securities law, we do not undertake to update any forward-looking statement that is contained in this management's discussion and analysis or made from time to time by the Corporation or on its behalf.

# **PACIFIC & WESTERN CREDIT CORP.**

## **Consolidated Balance Sheet**

(thousands of dollars)

	<b>July 31 2011</b>	<b>October 31 2010</b>	<b>July 31 2010</b>
	(unaudited)		(unaudited)
<b>Assets</b>			
Cash and cash equivalents	\$ 179,911	\$ 96,989	\$ 218,401
Securities	168,036	234,661	365,919
Mortgages and loans	1,073,885	964,862	956,000
Other assets	28,028	26,220	33,091
	<u>\$ 1,449,860</u>	<u>\$ 1,322,732</u>	<u>\$ 1,573,411</u>
<b>Liabilities and Shareholders' Equity</b>			
Deposits	\$ 1,259,718	\$ 1,150,903	\$ 1,409,799
Notes payable	92,588	75,559	75,394
Other liabilities	24,430	38,396	35,102
	<u>1,376,736</u>	<u>1,264,858</u>	<u>1,520,295</u>
Preferred share liabilities	41,122	40,744	40,623
<b>Shareholders' equity</b>			
Share capital	64,196	44,054	43,365
Deficit	(28,357)	(20,548)	(19,169)
Accumulated other comprehensive income (loss)	(3,837)	(6,376)	(11,703)
	<u>32,002</u>	<u>17,130</u>	<u>12,493</u>
	<u>\$ 1,449,860</u>	<u>\$ 1,322,732</u>	<u>\$ 1,573,411</u>

**PACIFIC & WESTERN CREDIT CORP.**  
**Consolidated Statement of Operations**  
(thousands of dollars)

	<i>for the three months ended</i>		<i>for the nine months ended</i>	
	<b>July 31</b>	<b>July 31</b>	<b>July 31</b>	<b>July 31</b>
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
<b>Interest income</b>				
Interest income on loans	\$ 11,073	\$ 8,702	\$ 32,041	\$ 25,289
Interest and income from securities	2,425	3,670	6,208	10,756
Loan fee income	994	1,087	2,759	3,195
	<u>14,492</u>	<u>13,459</u>	<u>41,008</u>	<u>39,240</u>
<b>Interest expense</b>				
Deposits and other	8,619	8,468	24,447	24,675
Notes payable	2,815	2,091	7,183	6,286
Preferred share liabilities	1,203	1,191	3,604	3,303
	<u>12,637</u>	<u>11,750</u>	<u>35,234</u>	<u>34,264</u>
Net interest income	1,855	1,709	5,774	4,976
Provision for (recovery of) credit losses	-	19	82	(682)
Net interest income after provision for (recovery of) credit losses	1,855	1,690	5,692	5,658
Other income (charges)	(290)	(215)	778	(124)
	<u>1,565</u>	<u>1,475</u>	<u>6,470</u>	<u>5,534</u>
<b>Non-interest expenses</b>				
Salaries and benefits	2,442	1,927	6,637	5,596
General and administrative	2,787	1,893	6,431	5,682
Premises and equipment	387	518	1,268	1,522
	<u>5,616</u>	<u>4,338</u>	<u>14,336</u>	<u>12,800</u>
Loss before income taxes	(4,051)	(2,863)	(7,866)	(7,266)
Income tax recovery	(313)	(338)	(123)	(571)
<b>Net loss</b>	<u>\$ (3,738)</u>	<u>\$ (2,525)</u>	<u>\$ (7,743)</u>	<u>\$ (6,695)</u>
Basic loss per share	<u>\$ (0.18)</u>	<u>\$ (0.18)</u>	<u>\$ (0.45)</u>	<u>\$ (0.49)</u>
Diluted loss per share	<u>\$ (0.18)</u>	<u>\$ (0.18)</u>	<u>\$ (0.45)</u>	<u>\$ (0.49)</u>
Weighted average number of common shares	<u>21,329,000</u>	<u>14,060,000</u>	<u>17,187,000</u>	<u>13,886,000</u>

**PACIFIC & WESTERN CREDIT CORP.****Consolidated Statement of Comprehensive Income (Loss)**

(thousands of dollars)

	<i>for the three months ended</i>		<i>for the nine months ended</i>	
	<b>July 31</b>	<b>July 31</b>	<b>July 31</b>	<b>July 31</b>
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
Total net loss	\$ (3,738)	\$ (2,525)	\$ (7,743)	\$ (6,695)
Other comprehensive income (loss), net of tax:				
Net unrealized gains on assets held as available-for-sale <sup>(1)</sup>	504	3,103	2,821	2,905
Amount transferred to net loss for available-for-sale assets <sup>(2)</sup>	(526)	(196)	(282)	(1,455)
Total other comprehensive income (loss)	(22)	2,907	2,539	1,450
Total comprehensive income (loss)	<u>\$ (3,760)</u>	<u>\$ 382</u>	<u>\$ (5,204)</u>	<u>\$ (5,245)</u>

(1) Net of income tax benefit (expense) for the three months of (\$206) (2010-(\$1,147)) and nine months of (\$1,152) (2010-(\$1,074)).

(2) Net of income tax benefit (expense) for the three months of \$215 (2010-\$73) and nine months \$115 (2010-\$511).

## PACIFIC & WESTERN CREDIT CORP.

### Consolidated Statement of Changes in Shareholders' Equity

(thousands of dollars)

	<i>for the three months ended</i>		<i>for the nine months ended</i>	
	<b>July 31 2011</b>	<b>July 31 2010</b>	<b>July 31 2011</b>	<b>July 31 2010</b>
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
<b>Common shares</b>				
Balance, beginning of period	\$ 42,698	\$ 36,947	\$ 38,295	\$ 35,817
Shares issued, net of costs	13,056	-	16,111	-
Issued on payment of Class B preferred share dividend	674	674	2,022	1,804
Balance, end of period	<u>\$ 56,428</u>	<u>\$ 37,621</u>	<u>\$ 56,428</u>	<u>\$ 37,621</u>
<b>Common share purchase warrants</b>				
Balance, beginning of period	\$ -	\$ -	\$ -	\$ -
Warrants issued	1,761	-	1,761	-
Balance, end of period	<u>\$ 1,761</u>	<u>\$ -</u>	<u>\$ 1,761</u>	<u>\$ -</u>
<b>Class A preferred shares</b>				
Balance, beginning and end of period	<u>\$ 1,061</u>	<u>\$ 1,061</u>	<u>\$ 1,061</u>	<u>\$ 1,061</u>
<b>Class B preferred shares</b>				
Balance, beginning of period	\$ 4,262	\$ 4,262	\$ 4,262	\$ 3,022
Shares issued, net of costs	-	-	-	1,240
Balance, end of period	<u>\$ 4,262</u>	<u>\$ 4,262</u>	<u>\$ 4,262</u>	<u>\$ 4,262</u>
<b>Contributed surplus</b>				
Balance, beginning of period	\$ 450	\$ 402	\$ 436	\$ 326
Fair value of stock option transactions (note 6)	234	19	248	95
Balance, end of period	<u>\$ 684</u>	<u>\$ 421</u>	<u>\$ 684</u>	<u>\$ 421</u>
<b>Deficit</b>				
Balance, beginning of period	\$ (24,619)	\$ (16,644)	\$ (20,548)	\$ (12,408)
Net loss	(3,738)	(2,525)	(7,743)	(6,695)
Dividends on preferred shares	-	-	(66)	(66)
Balance, end of period	<u>\$ (28,357)</u>	<u>\$ (19,169)</u>	<u>\$ (28,357)</u>	<u>\$ (19,169)</u>
<b>Accumulated other comprehensive income (loss), net of taxes</b>				
Balance, beginning of period	\$ (3,815)	\$ (14,610)	\$ (6,376)	\$ (13,153)
Other comprehensive income (loss)	(22)	2,907	2,539	1,450
Balance, end of period	<u>\$ (3,837)</u>	<u>\$ (11,703)</u>	<u>\$ (3,837)</u>	<u>\$ (11,703)</u>
<b>Total shareholders' equity</b>	<u><u>\$ 32,002</u></u>	<u><u>\$ 12,493</u></u>	<u><u>\$ 32,002</u></u>	<u><u>\$ 12,493</u></u>

# PACIFIC & WESTERN CREDIT CORP.

## Consolidated Statement of Cash Flows

(thousands of dollars)

	<i>for the three months ended</i>		<i>for the nine months ended</i>	
	<b>July 31</b>	<b>July 31</b>	<b>July 31</b>	<b>July 31</b>
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
<b>Cash provided by (used in):</b>				
<b>Operations:</b>				
Net loss	\$ (3,738)	\$ (2,525)	\$ (7,743)	\$ (6,695)
Items not involving cash:				
Provision for (recovery of) credit losses	-	19	82	(682)
Stock-based compensation (note 6)	6	19	20	95
Future income tax recovery	(313)	(338)	(358)	(571)
Gain on sale of available-for-sale assets	(452)	(251)	(830)	(2,041)
Gains realized on securitization	-	(370)	(205)	(1,153)
Gain on foreclosed real estate	-	(377)	-	(377)
Change in derivative financial instruments	-	462	-	569
Net unrealized losses (gains) on securities	414	538	(73)	1,108
Interest expense on preferred share liabilities	674	790	1,888	2,340
Change in other assets and liabilities	(919)	(4,450)	(9,388)	9,102
	<u>(4,328)</u>	<u>(6,483)</u>	<u>(16,607)</u>	<u>1,695</u>
<b>Investing:</b>				
Purchase of securities	(196,014)	(157,222)	(399,293)	(574,762)
Proceeds from sale and maturity of securities	232,341	141,826	468,745	488,038
Mortgages and loans	(27,645)	(38,470)	(123,073)	(53,600)
Proceeds of mortgage securitizations	-	11,765	8,575	24,220
Securitization retained interests	-	906	746	2,604
	<u>8,682</u>	<u>(41,195)</u>	<u>(44,300)</u>	<u>(113,500)</u>
<b>Financing:</b>				
Deposits	(71,661)	217,020	108,815	192,663
Notes payable	2,580	-	16,980	(2,612)
Proceeds of units issued, net of costs	15,045	-	18,100	-
Preferred share liabilities	-	-	-	14,503
Short term financings	-	-	-	(46,578)
Dividends paid	-	-	(66)	(67)
	<u>(54,036)</u>	<u>217,020</u>	<u>143,829</u>	<u>157,909</u>
Increase (decrease) in cash resources	(49,682)	169,342	82,922	46,104
Cash resources, beginning of period	<u>229,593</u>	<u>49,059</u>	<u>96,989</u>	<u>172,297</u>
Cash resources, end of period	<u>\$ 179,911</u>	<u>\$ 218,401</u>	<u>\$ 179,911</u>	<u>\$ 218,401</u>
Supplementary cash flow information:				
Interest paid during the period	\$ 15,439	\$ 11,981	\$ 31,773	\$ 35,957
Income taxes paid during the period	\$ -	\$ -	\$ -	\$ -

**PACIFIC & WESTERN CREDIT CORP.**  
**Notes to the interim consolidated financial statements (unaudited)**  
**For the nine months ended July 31, 2011**

**1. Basis of presentation**

The interim consolidated financial statements of Pacific & Western Credit Corp. (the Corporation) should be read in conjunction with the Corporation's consolidated financial statements for the year ended October 31, 2010, which are available on SEDAR at [www.sedar.com](http://www.sedar.com). These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles using the same accounting policies and methods as were used for the Corporation's financial statements for the year ended October 31, 2010.

The risk management policies and procedures of the Corporation relating to credit, liquidity, and market risk are included on pages 39 - 42 of the 2010 annual report and are an integral part of the Interim Consolidated Financial Statements.

**2. Securities**

The Corporation's cash and securities are comprised of cash, bankers acceptances, federal government treasury bills, federal, provincial and municipal government bonds, government insured mortgage-backed securities, corporate bonds and corporate preferred shares.

**3. Allowance for credit losses**

	<i>for the three months ended</i>				<i>for the nine months ended</i>			
	July 31, 2011			July 31, 2010	July 31, 2011			July 31, 2010
	General allowance	Specific allowance	Total allowance	Total allowance	General allowance	Specific allowance	Total allowance	Total allowance
(thousands of dollars)								
Balance, beginning of the period	\$ 3,230	\$ 855	\$ 4,085	\$ 5,297	\$ 3,812	\$ 1,048	\$ 4,860	\$ 9,534
Provision for (recovery of) credit losses	-	-	-	19	107	(25)	82	(682)
Write-offs	(511)	(5)	(516)	17	(1,200)	(173)	(1,373)	(3,519)
Balance, end of period	\$ 2,719	\$ 850	\$ 3,569	\$ 5,333	\$ 2,719	\$ 850	\$ 3,569	\$ 5,333

Gross impaired loans at July 31, 2011 totalled \$913,000 (July 31, 2010 - \$3,219,000). Loans past due but not impaired at July 31, 2011 totalled \$nil (July 31, 2010 - \$209,000).

Loans are secured primarily by collateral mortgages against real estate with respect to real estate lending and specific charges against equipment being financed for other lending activities.

**4. Notes payable**

At July 31, 2011, notes payable, excluding issue costs, consist of Series C Notes totalling \$61.7 million (2010-\$55.3 million) which mature in 2018, and short term notes totalling \$5.8 million which mature in 2015. Notes payable bear interest at rates ranging from 5.5% to 9.0% per annum. In addition, the Corporation has subordinated notes of the Bank totalling \$31.5 million (2010-\$21.5 million) owing to a third party. These subordinated notes bear interest at rates ranging from 8% to 11%, are callable by the Bank and mature in 2019 and 2021.

**5. Preferred share liabilities**

At July 31, 2011 the Corporation had 1,909,458 (2010-1,909,458) Class B Preferred Shares outstanding with a total value of \$45.4 million (2010-\$44.9 million) less issue costs of \$2.6 million (2010-\$2.8 million). As these Class B Preferred Shares carry certain redemption features and are convertible into common shares of the Corporation, an amount of \$41.1 million (2010-\$40.6 million), net of issue costs, representing the fair value of the Corporation's obligation to make future payments of principal and interest, has been classified on the Corporation's Consolidated Balance Sheet as a Preferred Share Liability. In addition, an amount of \$4.3 million (2010-\$4.3 million), representing the equity element of the Class B Preferred Shares, net of issue costs, has been included in Shareholders' Equity on the Corporation's Consolidated Balance Sheet.

As the Class B Preferred Shares can be redeemed by the Corporation in 2019 for approximately \$47.7 million, the preferred share liability amount of \$41.1million (2010-\$40.6 million) will be increased over the remaining term to redemption, until the liability amount is equal to the estimated redemption amount with the increase included in interest expense in the Consolidated Statement of Operations calculated using an effective interest rate of 11.8%.

## 6. Shareholders' equity

### i. Share capital:

	Common shares outstanding	Stock Options	
		Number	Weighted- average exercise price
Outstanding, October 31, 2010	14,434,242	508,333	\$ 7.87
Granted	-	670,000	2.80
Issued for cash proceeds	8,476,000	-	-
Issued pursuant to Class B Preferred Share dividend	753,300	-	-
Expired	-	(18,000)	6.28
Outstanding, end of period	23,663,542	1,160,333	\$ 4.97

In addition, at July 31, 2011, there were 314,572 (2010-314,572) Class A Preferred Shares outstanding and 1,909,458 (2010-1,909,458) Class B Preferred Shares outstanding.

During the three months ended July 31, 2011, pursuant to the closing of a public offering, the Corporation issued 7,476,000 Units consisting of one common share and one-half warrant to purchase a common share, for net proceeds of \$13.1 million. This was in addition to 1,000,000 common shares issued in February 2011 for net proceeds of \$3,055,000.

Pursuant to the public offering, the Corporation issued 4,298,700 warrants with a fair value of \$1,761,000 assigned to the warrants and recorded in Shareholders' Equity. Each warrant entitles the holder to purchase one common share of the Corporation for \$2.80 per share. In addition, the Corporation has 747,600 broker warrants outstanding which if exercised would result in one common share and one-half warrant being issued for \$2.25 each and 56,070 broker warrants which if exercised would result in one warrant being issued for \$0.22 each. The warrants expire in November 2012.

During the three months ended July 31, 2011, 670,000 options were granted to a service provider. These options are exercisable into common shares at \$2.80 per share and expire in November 2012. The fair value of the options was estimated using the Black-Scholes option pricing model based on the following assumptions: (i) risk-free interest rate of 1.54%, (ii) expected option life of 18 months and (iii) expected volatility of 60.3%. The fair value of options granted was estimated at \$0.34 per option.

During the nine months ended July 31, 2011, the Corporation recognized \$20,000 (2010 - \$95,000) of compensation expense relating to the estimated fair value of stock options granted in prior periods. No options were granted to employees under the stock option plan during the current period. The fair value of options granted during the prior periods was estimated using the Black-Scholes option pricing model based on the following weighted-average assumptions: (i) risk-free interest rate of 2.31%, (ii) expected option life of 5 years, (iii) expected volatility of 45%, and (iv) expected forfeiture rate of 5%. The weighted average fair value of options granted was estimated at \$1.38 per option.

## ii. Accumulated other comprehensive income (loss):

The balance in accumulated other comprehensive income (loss), net of income taxes, consists of:

(thousands of dollars)	July 31 2011	July 31 2010
Net unrealized losses on assets held as available-for-sale	\$ (3,837)	\$ (11,703)
Balance, end of period	\$ (3,837)	\$ (11,703)

Net of income tax benefit of \$1,567 (2010 - \$4,329).

## 7. Derivative instruments

At July 31, 2011, the Corporation had outstanding contracts for asset liability management purposes to swap between floating and fixed interest rates with notional amounts totalling \$246,245,000 (2010 - \$245,532,000). The Corporation only enters into these interest rate contracts for its own account and does not act as an intermediary in this market. These contracts have a risk-weight of \$585,000 (2010 - \$686,000) for purposes of determining the Bank's regulatory capital ratios. As required under the accounting standard relating to hedges, at July 31, 2011, \$16,181,000 (2010 - \$16,529,000) relating to these contracts was included in other liabilities and the offsetting amount included in the carrying values of the assets to which they relate.

In addition, the Corporation enters into interest rate swap arrangements with accredited counterparties in order to transact with the Canada Housing Trust, as it securitizes mortgages under the CMB Program. Changes in the fair values of these arrangements are included in gains on securitization activities and included in other income in the Consolidated Statement of Operations. Approved counterparties are limited to Canadian chartered banks. At July 31, 2011 the notional amount of these contracts totalled \$34,045,000 (2010 - \$24,705,000).

## 8. Commitments and contingencies

The amount of credit related commitments represents the maximum amount of additional credit that the Corporation could be obligated to extend. Under certain circumstances, the Corporation may cancel loan commitments at its option. The amount with respect to the letters of credit are not necessarily indicative of credit risk as many of these arrangements are contracted for a limited period of usually less than one year and will expire or terminate without being drawn upon.

(thousands of dollars)	July 31 2011	July 31 2010
Loan commitments	\$ 204,209	\$ 181,869
Letters of credit	27,644	28,190
	\$ 231,853	\$ 210,059

In the ordinary course of business, the Corporation and its subsidiaries are party to claims or possible claims against it. Management of the Corporation believes that the resolution of any outstanding claims will not be material to the financial position of the Corporation.

In the ordinary course of business, cash and securities are pledged against liabilities and off-balance sheet items. Details of assets pledged are as follows:

(thousands of dollars)	July 31 2011	July 31 2010
Collateral related to derivative contracts	\$ 15,950	\$ 16,984
Collateral related to letters of credit	8,968	4,758
	\$ 24,918	\$ 21,742

## 9. Securitization activities

The Corporation securitizes Government of Canada guaranteed residential mortgages through the creation of mortgage-backed securities and removes the mortgages from its consolidated balance sheet. As at July 31, 2011, outstanding securitized mortgages totalled \$32,268,000 (2010 - \$24,239,000).

Retained interests are accounted for at the settlement date. The fair value of retained interests is determined with Internal valuation models using market data inputs, where possible, by discounting the expected future cash flows at similar Government of Canada bond interest rates plus a spread. The Corporation has assumed no credit risk for purposes of measuring its retained interests since all mortgages securitized to date are guaranteed by the Government of Canada.

During the nine months ended July 31, 2011, mortgages totalling \$8,581,000 (2010 - \$24,368,000) were securitized and sold for cash proceeds of \$8,575,000 (2010 - \$24,220,000). The retained rights to future excess interests totalled \$746,000 (2010 - \$2,604,000) and the servicing liability totalled \$68,000 (2010 - \$178,000). The key assumptions used in measuring the retained interests at the date of securitization included a weighted –average discount rate of 2.62% (2010 – 2.78%) and a weighted-average excess spread of 0.73% (2010 – 0.94%). It was determined that a 10% and a 20% adverse change in the discount rate used to determine the carrying value of the retained interests would not have a material impact on the financial position of the Corporation.

Gains on mortgages securitized and sold during the nine months ended July 31, 2011 totalled \$145,000 (2010 - \$1,153,000), after related expenses and are included in other income (charges) in the Consolidated Statement of Operations.

## 10. Capital Management

### i. Overview

The Corporation's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The impact of the level of capital on shareholders' return is also important and the Corporation recognizes the need to maintain a balance between the higher returns that might be possible with greater leverage and the advantages and security afforded by a sound capital position.

The Corporation's primary subsidiary is Pacific & Western Bank of Canada (the Bank) which operates as a Schedule 1 bank under the *Bank Act* (Canada) and is regulated by the Office of the Superintendent of Financial Institutions Canada (OSFI). OSFI sets and monitors capital requirements for the Bank. As a result, the following discussion on capital management is with respect to the capital of the Bank.

Capital is managed in accordance with policies and plans that are regularly reviewed and approved by the Board of Directors and take into account forecasted capital needs and markets. The goal is to maintain adequate regulatory capital to be considered well capitalized, protect consumer deposits and provide capacity for internally generated growth and strategic opportunities that do not otherwise require accessing the public capital markets, all the while providing a satisfactory return for shareholders. The Bank's regulatory capital is comprised of share capital, retained earnings and unrealized gains (losses) on available-for-sale equity securities (Tier 1 capital) and subordinated notes (Tier 2 capital).

The Bank monitors its capital adequacy and related capital ratios on a daily basis and has policies setting internal maximum and minimum amounts for its capital ratios. These capital ratios consist of the assets-to-capital multiple and the risk-based capital ratios.

ii. **Assets-to-Capital Multiple:**

The Bank's growth in total assets is limited by a permitted assets-to-capital multiple which is prescribed by OSFI and is defined as the ratio of the total assets of the Bank to its regulatory capital. The Bank's assets-to-capital ratio is calculated as follows:

(thousands of dollars)	July 31 2011	July 31 2010
Total assets (on and off-balance sheet)	\$ 1,460,075	\$ 1,594,315
Capital		
Common shares	\$ 103,965	\$ 95,365
Retained earnings (deficit)	(350)	(1,820)
Unrealized loss on available-for-sale equity securities	(2,539)	(11,084)
Subordinated debentures	50,538	41,230
Total regulatory capital	\$ 151,614	\$ 123,691
Assets-to-capital ratio	9.63	12.89

iii. **Risk-Based Capital Ratios:**

OSFI requires banks to measure capital adequacy in accordance with guidelines for determining risk-adjusted capital and risk-weighted assets including off-balance sheet credit instruments. Based on the deemed credit risk for each type of asset, a weighting of 0% to 150% is assigned to determine the risk-based capital ratio. OSFI requires banks to maintain a minimum total risk-based capital ratio of 10% and a Tier 1 risk-based capital ratio in excess of 7%. The guidelines also require the inclusion of an explicit capital charge for operational risk in determining the amount of risk-weighted assets.

The Bank's risk-based capital ratios are as follows:

(thousands of dollars)	July 31 2011		July 31 2010	
	Notional/ Drawn Amount	Risk Weighted Balance	Notional/ Drawn Amount	Risk Weighted Balance
Balance sheet assets	\$ 1,432,431	\$ 978,205	\$ 1,566,094	\$ 890,255
Off-balance sheet assets	510,366	104,132	479,830	91,432
Charge for operational risk		28,262		22,810
Total risk-weighted assets		\$ 1,110,599		\$ 1,004,497
Regulatory capital		151,614		123,691
Total risk-based capital ratio		13.65%		12.31%
Tier 1 risk-based capital ratio		9.10%		8.21%

**Basel III Capital Accord**

In December, 2010 the Basel Committee on Banking Supervision (the Committee) announced that it had agreed on new rules which support international standards on capital adequacy and liquidity (Basel III). The rules are expected to be published in the near future and will include the transitional arrangements and grandfathering rules. Transition to the new standards is expected to begin in 2013 with full compliance by 2019. Although the final rules have not been published and OSFI has yet to determine how to implement the proposals, the following capital changes are expected to be relevant to the Bank:

- Increased focus on tangible common equity.
- All forms of non-common equity such as the Bank's conventional subordinated debentures must include a clause that would require conversion to common equity in the event that OSFI deems the institution to be insolvent.
- Potential changes in the risk-weighting of certain assets.
- Additional capital buffers.
- New requirements for levels of liquidity and new liquidity measurements.

The Bank does not expect the implementation of the new rules to have a significant impact on its capital position or on its operations given its lack of complexity in operations and capital structure. It expects that over the implementation period it will see an increase in its capital position through retention of earnings and additional capital buffers. It also expects to see over the implementation period, an increase in its liquid assets in order to adhere to the new requirements on liquidity and new liquidity measurements.

## 11. Interest Rate Position

The Corporation is subject to interest rate risk which is the risk that a movement in interest rates could negatively impact spread, net interest income and the economic value of assets, liabilities and shareholders' equity. The following table provides the duration difference between the Bank's assets and liabilities and the potential after-tax impact of a 100 basis point shift in interest rates on the Bank's earnings during a 12 month period and the potential after-tax impact of a 100 basis point shift in interest rates on the Bank's shareholder's equity over a 60 month period.

	July 31 2011		July 31 2010	
	Increase 100 bps	Decrease 100 bps	Increase 100 bps	Decrease 100 bps
(thousands of dollars)				
Maximum interest exposure during a 12 month period	\$ 2,305	n/m	\$ 2,830	n/m
Maximum interest exposure during a 60 month period	\$ 5,074	n/m	\$ 1,784	n/m
Duration difference between assets and liabilities (months)	2.5		0.8	
n/m - not meaningful				

## 12. Subsequent Events

Subsequent to July 31, 2011, pursuant to the closing of a private placement, the Corporation issued Units consisting of one common share and one-half warrant to purchase a common share, for net proceeds of approximately \$5.0 million. The proceeds were used to reduce consolidated debt of the Corporation.

In addition, subsequent to July 31, 2011, the Corporation reduced its consolidated indebtedness by way of the repurchase of a \$10.0 million subordinated note bearing an interest rate of 11% which had been issued by the Bank to an external party.

### 13. Subsidiary Company Information:

The following table presents summary financial information of the Bank:

(thousands of dollars)	<b>July 31 2011</b>	<b>July 31 2010</b>
	(unaudited)	(unaudited)
Cash and cash equivalents	\$ 161,778	\$ 209,821
Securities	168,036	365,919
Mortgages and loans	1,073,885	956,000
Other assets	28,732	34,354
	<u>\$ 1,432,431</u>	<u>\$ 1,566,094</u>
Deposits	\$ 1,259,718	\$ 1,409,799
Subordinated notes payable	51,500	41,500
Other liabilities	21,435	32,953
	<u>1,332,653</u>	<u>1,484,252</u>
Share capital	103,965	95,365
Deficit	(350)	(1,820)
Accumulated other comprehensive income (loss)	(3,837)	(11,703)
Shareholder's equity	<u>99,778</u>	<u>81,842</u>
	<u>\$ 1,432,431</u>	<u>\$ 1,566,094</u>

(thousands of dollars)	<i>for the three months ended</i>		<i>for the nine months ended</i>	
	<b>July 31 2011</b>	<b>July 31 2010</b>	<b>July 31 2011</b>	<b>July 31 2010</b>
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
Interest income	\$ 14,458	\$ 13,451	\$ 40,926	\$ 39,220
Interest expense	10,005	9,644	28,257	28,142
Net interest income	<u>4,453</u>	<u>3,807</u>	<u>12,669</u>	<u>11,078</u>
Provision for (recovery of) credit losses	-	19	82	(690)
Net interest income after provision for credit losses	4,453	3,788	12,587	11,768
Other income (charges)	<u>(310)</u>	<u>(245)</u>	<u>829</u>	<u>(165)</u>
Total revenue	4,143	3,543	13,416	11,603
Non-interest expenses	4,909	4,371	13,226	12,629
Income (loss) before income taxes	(766)	(828)	190	(1,026)
Income tax recovery	<u>(313)</u>	<u>(338)</u>	<u>(358)</u>	<u>(571)</u>
Net income (loss)	<u>\$ (453)</u>	<u>\$ (490)</u>	<u>\$ 548</u>	<u>\$ (455)</u>

Pacific & Western Bank of Canada (PWBank), a Schedule I chartered bank, is a branchless financial institution with over \$1.4 billion in assets. PWBank specializes in providing innovative financing to large corporate and government entities including hospitals, school boards, universities and colleges, municipalities and provincial and federal government agencies.

Pacific & Western Bank of Canada is wholly owned by Pacific & Western Credit Corp., whose shares trade on the TSX under the symbol PWC.

On behalf of the Board of Directors: David R. Taylor, President & C.E.O.

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