



# Pacific & Western

Credit Corp.

## Second Quarter Report April 30, 2011

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### PACIFIC & WESTERN CREDIT CORP. ANNOUNCES RESULTS FOR ITS SECOND QUARTER ENDED APRIL 30, 2011

#### SECOND QUARTER SUMMARY

(three months ended April 30, 2011, compared to three months ended April 30, 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 (the "Corporation") wholly-owned subsidiary, for the three months ended April 30, 2011 was \$509,000 compared to (\$643,000) for the same period a year ago. For the six months ended April 30, 2011, net income for the Bank was \$1.0 million compared to \$35,000 for same period a year ago.
- Total revenue (teb) for the Bank for the three months ended April 30, 2011 was \$5.1 million compared to \$4.0 million last year and for the six months ended April 30, 2011, total revenue (teb) was \$10.3 million compared to \$9.4 million for the same period a year ago.
- Total assets of the Bank at April 30, 2011 increased to \$1.50 billion from \$1.37 billion at the end of the previous quarter and from \$1.34 billion last year. Lending assets at April 30, 2011 were \$1.04 billion unchanged from the end of the previous quarter and compared to \$925 million a year ago.
- Total regulatory capital of the Bank reached a record level at April 30, 2011 of \$144.6 million compared to \$122.0 million a year ago.
- Credit quality remains strong with gross impaired loans at April 30, 2011 decreasing to \$1.6 million or 0.11% of total loans from \$5.3 million or 0.57% of total loans a year ago.
- Loan commitments at April 30, 2011 totalled \$233 million compared to \$226 million at the end of the previous quarter and \$103 million a year ago.

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

- Net income (loss) of the Corporation for the three months ended April 30, 2011 was (\$2.2 million) or (\$0.14) per share ((\$0.14) diluted) compared to (\$2.8 million) or (\$0.21) per share ((\$0.21) 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 (\$974,000) compared to (\$1.6 million) a year ago.
- Net income (loss) of the Corporation for the six months ended April 30, 2011 was (\$4.0 million) or (\$0.27) per share ((\$0.27) diluted) compared to (\$4.2 million) or (\$0.30) per share ((\$0.30) 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 (\$1.6 million) compared to (\$2.1 million) a year ago.
- Subsequent to April 30, 2011, 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 \$15.6 million. The proceeds will be used to reduce consolidated debt of the Corporation, purchase additional common share equity of the Bank thereby increasing its regulatory capital and for working capital purposes in the parent company.

## PRESIDENT'S COMMENTS

Our Bank's loan and lease portfolio continued to increase in the second quarter however a particularly wet spring slowed down the draws on our higher yielding construction loans. We expect these construction draws to catch up in the next two quarters. Overall, our loans and leases increased by 1% over the previous quarter's figure. Spread on loans and leases remained relatively constant during the quarter but is considerably below our target levels as we still have two large hospital construction loans on our books. These loans were thinly priced prior to the liquidity crisis. The first hospital loan is due to repay at the end of the fourth quarter 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 or 55 basis points, bringing the spread that we earned on our loans and leases to a level more in line with that of the industry.

The Bank has continued to recover from the effects of the liquidity crisis with the past six months figures showing significant improvement over the same period a year ago. Our loan and lease portfolio now totals \$1.04 billion and a 13% increase over the same period last year. Shareholder's equity now totals \$96 million, a 21% increase over the same period last year. Total regulatory capital totals \$144.6 million, a 19% increase over the same period last year. Total revenue for the past six months totaled \$10.3 million, a 10% increase over the same period last year. Net income was \$1 million versus only \$35,000 earned in the same period last year. This increased profitability reduced Credit Corp's loss before the Preferred Share dividends to \$1.6 million from \$2.1 million in the same period last year.

Subsequent to the quarter end, we completed a public offering to raise capital to retire expensive debt and invest additional regulatory capital in our bank to provide for further growth, particularly in the lease portfolio. The positive effects of this capital raise will be seen in the next quarters.

Over the past several months we have been working on two very exciting projects. The first is developing a credit card platform for Home Hardware and I am pleased to tell you that this project is going very well and should provide a considerable boost to the profits of the Bank and the diversity of its income. The second project is developing custom software to enable certain industries to deal with our Bank in a more efficient manner. This project is also going very well and we are getting close to striking a deal with an industry leader. Finally, those who have been long time shareholders of Pacific and Western will remember that we created an aviation company called, Discovery Air in 2006. This past quarter we completed the sale of the last few shares we owned in this company. Although this project had its "up-and-downs" it did provide significant returns. Including the \$10.8 million dividend we paid to our shareholders, the investment yielded about \$15 million over the years.

## FINANCIAL HIGHLIGHTS

(unaudited)

	for the three months ended		for the six months ended	
	April 30 2011	April 30 2010	April 30 2011	April 30 2010
(\$ thousands, except per share amounts)				
<b>Pacific &amp; Western Bank of Canada</b>				
<b>Balance Sheet Summary</b>				
Cash and securities	\$ 426,923	\$ 382,684	\$ 426,923	\$ 382,684
Total loans	1,043,331	925,434	1,043,331	925,434
Average loans	1,040,756	935,367	1,004,097	927,633
Total assets	1,498,612	1,340,650	1,498,612	1,340,650
Deposits	1,331,379	1,192,779	1,331,379	1,192,779
Subordinated notes payable	51,500	41,500	51,500	41,500
Shareholder's equity	96,253	79,424	96,253	79,424
<b>Capital ratios*</b>				
Total regulatory capital	\$ 144,616	\$ 122,043	\$ 144,616	\$ 122,043
Risk-weighted assets	1,102,075	923,444	1,102,075	923,444
Assets-to-capital ratio	10.54	11.23	10.54	11.23
Tier 1 risk-based capital ratio	8.75%	8.81%	8.75%	8.81%
Total risk-based capital ratio	13.12%	13.22%	13.12%	13.22%
<b>Results of operations (teb) **</b>				
Net interest income per financial statements	\$ 3,889	\$ 2,571	\$ 8,216	\$ 7,271
Teb adjustment	499	623	1,047	1,293
Net interest income (teb)	4,388	3,194	9,263	8,564
Spread	1.26%	0.94%	1.33%	1.26%
Provision for (recovery of) credit losses	42	(735)	82	(709)
Other income	707	49	1,139	80
Total revenue	5,053	3,978	10,320	9,353
Non-interest expenses	4,092	4,158	8,317	8,258
Net income (loss)	509	(643)	1,001	35
Return on average total assets	0.15%	-0.18%	0.14%	0.10%
Gross impaired loans to total loans	0.11%	0.57%	0.11%	0.57%
Provision for (recovery of) credit losses as a % of average loans	0.00%	-0.08%	0.01%	-0.08%
<b>Pacific &amp; Western Credit Corp., (consolidated)</b>				
<b>Results of operations</b>				
Net income (loss) for the Bank	\$ 509	\$ (643)	\$ 1,001	\$ 35
Deduct interest expense on notes of the parent	(1,030)	(927)	(1,943)	(1,903)
Non-interest expenses of the parent	(453)	(73)	(662)	(190)
Net loss before interest expense relating to Class B				
Preferred Share dividends	(974)	(1,643)	(1,604)	(2,058)
Interest expense relating to Class B				
Preferred Share dividends	(1,202)	(1,187)	(2,401)	(2,112)
Net loss for the Corporation	\$ (2,176)	\$ (2,830)	\$ (4,005)	\$ (4,170)
Loss per common share:				
Basic	\$ (0.14)	\$ (0.21)	\$ (0.27)	\$ (0.30)
Diluted	\$ (0.14)	\$ (0.21)	\$ (0.27)	\$ (0.30)

\* See Note 12 to interim financial statements re: Subsequent Event

### \*\*Non-GAAP measures

Tax equivalent basis (teb) - like most banks, the Corporation, through its wholly-owned subsidiary Pacific & Western Bank of Canada (the "Bank"), 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 second quarter of fiscal 2011 should be read in conjunction with the unaudited interim consolidated financial statements for the period ended April 30, 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 (the "Bank") 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 April 30, 2011 was (\$2.2 million) or (\$0.14) per share ((\$0.14) diluted) compared to (\$2.8 million) or (\$0.21) per share ((\$0.21) 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 April 30, 2011 was (\$974,000) compared to (\$1.6 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 six months ending April 30, 2011 was (\$4.0 million) or (\$0.27) per share ((\$0.27) diluted) compared to (\$4.2 million) or (\$0.30) per share ((\$0.30) diluted) for the same period a year ago. Prior to the deduction of dividends on Class B Preferred Shares, net income (loss) for the six months ending April 30, 2011 was (\$1.6 million) compared to (\$2.1 million) for the same period a year ago. The results of the Corporation for the current quarter reflect an increase in lending assets from a year ago and increased spreads on new and renewed loans.

### Pacific & Western Bank of Canada

Net income of the Bank for the three months ending April 30, 2011 was \$509,000 compared to (\$643,000) for the same period a year ago and for the six months ending April 30, 2011 was \$1.0 million compared to \$35,000. As noted above, net income of the Bank for the current quarter and year-to-date reflects an increase in lending assets and improved spreads earned on new and renewed loans. Overall spread (teb) for the three months ended April 30, 2011 was 1.26% compared to 0.94% for the same period a year ago and for the six months ended April 30, 2011 was 1.33% compared to 1.26%.

At April 30, 2011, total assets of the Bank were \$1.50 billion compared to \$1.34 billion a year ago. Lending assets at April 30, 2011 were \$1.04 billion compared to \$925 million a year ago and unchanged from the end of the previous quarter. The growth in lending assets from a year ago was due primarily to an increase of \$61 million in leases sourced primarily through the Bank's bulk lease financing program. Total leases outstanding at April 30, 2011 were \$184 million compared to \$100 million a year ago. Credit quality remains strong, with gross impaired loans decreasing to \$1.6 million at April 30, 2011 from \$5.3 million a year ago. At April 30, 2011, the ratio of gross impaired loans as a percentage of total loans was 0.11% compared to 0.57% last year.

Cash and securities of the Bank at April 30, 2011 were \$427 million or 28% of total assets compared to \$383 million or 29% of total assets a year ago. The amount of cash and securities increased from a year ago as a result of the overall increase in total assets.

### 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, was \$2.8 million for the current quarter compared to \$1.9 million for the same period a year ago. On a year-to-date basis, total revenue (teb) was \$6.0 million compared to \$5.4 million last year.

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

Total revenue (teb) of the Bank was \$5.1 million for the current quarter compared to \$4.0 million for the same period last year and for the current six month period, total revenue (teb) of the Bank was \$10.3 million compared to \$9.4 million. Total revenue of the Bank for the current periods was higher than a year ago due primarily to improved spreads on lending assets.

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

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

Net interest income (teb) of the Bank was \$4.4 million for the current quarter compared to \$3.2 million for the same period a year ago and for the six month period, net interest income (teb) was \$9.3 million compared to \$8.6 million last year. Net interest margin or spread (teb) for the Bank, which is net interest income as a percentage of average assets, was 1.26% for the current quarter compared to 0.94% for the same period a year ago. For the six month period, spread (teb) was 1.33% compared to 1.26% last year. Net interest income and spread for the current periods reflected increased spread from lending operations due to growth in lending assets over last year and increases in spread on those lending assets.

### ***Other Income***

Other income of the Corporation for the three months ended April 30, 2011 totalled \$706,000 compared to \$62,000 for the same period last year. The increase in other income for the current period compared to a year ago was a result of fair value adjustments in the current quarter and an impairment charge recorded last year on a security in the Bank's treasury portfolio. For the six months ended April 30, 2011, other income totalled \$1.1 million compared to \$91,000 last year. Other income for the current six month period included fair value adjustments totalling \$487,000 relating to a security in the Corporation's treasury portfolio and gains totalling \$459,000 after related expenses, resulting from securitization activities and the sale of shares in Discovery Air Inc.

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

Non-interest expenses of the Corporation on a consolidated basis were \$4.3 million for the current quarter unchanged from the same period a year ago. On a year-to-date basis non-interest expenses totalled \$8.7 million compared to \$8.5 million last year. The increase in non-interest expenses for the six month period compared to a year ago was primarily in salaries and benefits which increased due to new hires and salary adjustments over the past year but were partially offset by reductions in other categories of non-interest expenses. In addition, during the six months ended April 30, 2011, the Corporation incurred expenses relating to implementation of its private label credit card initiative. The Corporation expects that it will incur additional implementation costs relating to this initiative during the remainder of 2011.

### ***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 \$188,000 compared to (\$160,000) a year ago and for the six month period ended April 30, 2011 was \$190,000 compared to (\$233,000) a year ago.

At April 30, 2011, the future income tax asset of the Bank was \$11.1 million and is primarily a result of income tax losses from previous periods, the benefit of which was recorded at the time. This amount compares to \$13.8 million a year ago. 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 in part by declines 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 April 30, 2011, the market value of the preferred shares had increased from a year ago, trading at a value of \$5.1 million below their amortized cost, compared to \$16.7 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 and other assets. Total comprehensive income (loss) for the three months ended April 30, 2011 was (\$1.2 million) compared to (\$6.8 million) a year ago. For the six months ended April 30, 2011 total comprehensive income (loss) was (\$1.4 million) compared to (\$5.6 million) for the same period last year. The change in the current quarter from the same period last year was due primarily to \$922,000 in after-tax net unrealized gains on available-for-sale assets this quarter compared to (\$3.6 million) in after-tax net unrealized losses last year and for the six month period ended April 30, 2011 the change from the same period last year was due primarily to \$2.3 million in after-tax net unrealized gains on available-for-sale assets compared to (\$198,000) in after-tax net unrealized losses last year.

### ***Balance Sheet***

Total assets of the Corporation at April 30, 2011, were \$1.51 billion compared to \$1.35 billion a year ago. 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***

Cash and securities, which are held primarily for liquidity management purposes and to earn investment income, totalled \$435 million or 29% of total assets at April 30, 2011 compared to \$394 million or 29% of total assets a year ago. The increase in the amount of cash and securities from a year ago is due primarily to the increase in total assets as the Corporation's internal policy requires the maintenance of prudent levels of cash and securities relative to its total assets. 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.

At April 30, 2011, the net unrealized loss in the Corporation's securities portfolio was \$5.9 million compared to a net unrealized loss of \$19.5 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 \$5.1 million below their amortized cost at April 30, 2011 compared to \$16.7 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 \$1.04 billion at April 30, 2011, compared to \$925 million a year ago with the increase being primarily in commercial leases sourced through the Corporation's bulk lease financing program and in corporate loans. At April 30, 2011, the Corporation's total lease portfolio grew to \$184 million from \$100 million a year ago of which approximately \$61 million of the increase relates to our bulk lease program. New lending in the current quarter totalled \$113 million compared to \$89 million a year ago and loan repayments for the current quarter totalled \$107 million compared to \$108 million last year. On a year-to-date basis, new lending totalled \$297 million compared to \$183 million a year ago and loan repayments for the six months totalled \$209 million compared to \$182 million last year. Loan advances in the second quarter were less than those in the previous quarter as traditionally the Corporation experiences a slow down in lending activity during the second quarter as loans drawn in its residential construction portfolio are delayed until spring when construction activity increases. Loan commitments at April 30, 2011 were \$233 million compared to \$103 million a year ago, an indication that the Corporation is seeing increases in the demand for financing in its niche markets.

### *Credit Quality*

Gross impaired loans at April 30, 2011 totalled \$1.6 million or 0.11% of total loans compared to \$5.3 million or 0.57% of total loans a year ago. Provisions for (recovery of) credit losses in the current quarter totalled \$42,000 compared to (\$735,000) a year ago. For the six months ended April 30, 2011, the provision for (recovery of) credit losses totalled \$82,000 compared to (\$701,000) 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 tests of its general allowance model.

At April 30, 2011 the Corporation's general allowance totalled \$3.2 million compared to \$4.3 million a year ago with the decrease due 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 \$27.1 million at April 30, 2011 compared to \$31.0 million a year ago. Included in other assets is the future income tax asset of the Bank totalling \$11.1 million compared to \$13.8 million last year and capital assets and prepaid expenses totalling \$14.5 million at April 30, 2011 compared to \$14.0 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 April 30, 2011 totalled \$1.33 billion compared to \$1.19 billion a year ago, and consist primarily of guaranteed investment certificates. Of these amounts, \$34.0 million or approximately 2.5% of total deposits at the end of the quarter were in the form of demand deposits compared to \$46.4 million or approximately 3.9% of total deposits a year ago, with the remaining deposits having fixed terms.

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 April 30, 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 other accruals. At April 30, 2011, other liabilities totalled \$22.5 million compared to \$29.9 million a year ago.

### *Notes Payable*

Notes payable, net of issue costs, totalled \$90.2 million at April 30, 2011 compared to \$75.6 million a year ago with the increase due primarily to the issuances over the past year of \$10.0 million of subordinated notes by the Bank to an external party, \$3.0 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 \$3.2 million maturing in 2015. The short term notes bear interest at rates ranging from 5.5% to 7.00% per annum and the Series C Notes bear interest at 9.0% 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% to 11%, are callable by the Bank, and mature between 2019 and 2021.

### *Preferred Share Liabilities*

At April 30, 2011, the Corporation had 1,909,458 Class B Preferred Shares outstanding with a total value of \$47.6 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 \$41.0 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 \$41.0 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 April 30, 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, the issuance of securities and interest income earned by the Corporation.

## **Shareholders' Equity**

At April 30, 2011, Shareholders' Equity was \$20.0 million compared to \$11.4 million a year ago with the increase due primarily to the issue of common shares, 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 April 30, 2011 compared to (\$14.6 million) a year ago.

Common shares outstanding at April 30, 2011 totalled 15,853,526 compared to 13,983,972 a year ago with the change due to common shares issued as part of the dividends on the Class B Preferred Shares and one million common shares issued this quarter under a private placement. Outstanding common share options totalled 508,333 at the end of the quarter compared to 931,933 a year ago with the change due to the expiry of common share options. The Corporation's book value per common share at the end of the quarter was \$0.91 compared to \$0.44 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 April 30, 2011 would be \$2.38 per share.

At April 30, 2011, there were 314,572 Class A Preferred Shares outstanding, unchanged from last year and 1,909,458 Class B Preferred Shares outstanding, also unchanged from last year.

## **Updated Share Information**

As at June 8, 2011, there were 23,329,526 common shares outstanding with the increase due to 7,476,000 common shares issued by way of a public offering which closed on May 26, 2011 for cash proceeds of \$15.6 million (see Subsequent Event below). In addition, at June 8, 2011 there were 4,111,800 warrants outstanding which were issued pursuant to the public offering. There were no changes in the number of common share options, Class A or Class B Preferred Shares since April 30, 2011.

## **Subsequent Event**

Subsequent to April 30, 2011, 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 \$15.6 million. The proceeds will be used to reduce consolidated debt of the Corporation by \$10.0 million, purchase additional common share equity of the Bank totalling \$4.0 million thereby increasing its regulatory capital and the remainder for working capital purposes in the parent company.

After taking into consideration the additional investment of \$4.0 million common equity into the Bank, the April 30, 2011 Tier 1 risk-based capital ratio and the total risk-based capital ratio of the Bank would be 9.11% and 13.67% respectively.

## **Capital Management**

Total regulatory capital in the Corporation's principal subsidiary, the Bank, reached a record level of \$144.6 million at the end of the quarter compared to \$122.0 million a year ago with the increase due primarily to \$4.6 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 13.12% at the end of the quarter compared to 13.22% 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 8.75% at the end of the quarter compared to 8.81% last year. The Bank's assets-to-capital ratio was 10.54 at the end of the quarter compared to 11.23 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	
	Q2	Q1	Q4	Q3	Q2	Q1	Q4	Q3
<b>Results of operations:</b>								
Total interest income								
per financial statements	\$ 13,353	\$ 13,163	\$ 13,648	\$ 13,459	\$ 11,417	\$ 14,364	\$ 18,222	\$ 15,999
Teb adjustment	499	548	626	643	623	669	667	621
Total interest income	13,852	13,711	14,274	14,102	12,040	15,033	18,889	16,620
Interest expense	11,673	10,924	11,105	11,750	10,953	11,561	14,137	16,400
Net interest income	2,179	2,787	3,169	2,352	1,087	3,472	4,752	220
Provision for (recovery of) credit losses	42	40	(473)	19	(735)	26	3,183	148
Impairment writedowns	-	-	-	-	(326)	-	-	-
Other income (charges)	706	362	481	(215)	388	21	1,887	507
Total revenue	2,843	3,109	4,123	2,118	1,884	3,467	3,456	579
Non-interest expenses	4,332	4,388	4,486	4,338	4,251	4,211	4,405	3,816
Income (loss) before income taxes	(1,489)	(1,280)	(363)	(2,220)	(2,367)	(744)	(949)	(3,237)
Income tax provision (recovery)	687	550	1,016	305	463	596	1,108	(268)
Net income (loss) *	\$ (2,176)	\$ (1,829)	\$ (1,379)	\$ (2,525)	\$ (2,830)	\$ (1,340)	\$ (2,057)	\$ (2,969)
Earnings (loss) per share								
-basic	\$ (0.14)	\$ (0.13)	\$ (0.10)	\$ (0.18)	\$ (0.21)	\$ (0.10)	\$ (0.15)	\$ (0.22)
-diluted	\$ (0.14)	\$ (0.13)	\$ (0.10)	\$ (0.18)	\$ (0.21)	\$ (0.10)	\$ (0.15)	\$ (0.22)

The financial results of the Corporation for each of the last eight quarters are summarized above. In general, the Corporation's results over the periods, particularly total interest income and net interest income over the past year, are comparable, and since 2009 reflect the impact of additional capital buffers maintained by the Bank as well as the cost of maintaining higher levels of liquidity, both a reflection of the recent liquidity crisis. An additional factor in this trend was the dividends on Class B Preferred Shares issued by the Corporation in the fourth quarter of 2009 which are recorded as interest expense for accounting purposes.

Total interest income for the current quarter was comparable to previous quarters. Interest expense increased from the previous quarters as a result of additional subordinated debt issued by the Bank in the current quarter to an external party and as a result of a higher level of deposits at April 30, 2011. The amount of deposits increased at the end of the current quarter to provide the Bank with additional liquidity in light of higher levels of deposits maturing in the coming quarter.

Other income during the current quarter reflects fair value adjustments relating to a security in the Corporation's treasury portfolio and gains on the sale of shares in Discovery Air Inc. Subsequent to April 30, 2011 the Corporation disposed of the remainder of its shares in Discovery Air Inc.

The provision for credit losses and non-interest expenses over the past year have been comparable between quarters with non-interest expenses reflecting actions taken by management to control increases in discretionary expenses.

### 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.

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: June 8, 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>April 30 2011</b>	<b>October 31 2010</b>	<b>April 30 2010</b>
	(unaudited)		(unaudited)
<b>Assets</b>			
Cash and cash equivalents	\$ 229,593	\$ 96,989	\$ 49,059
Securities	205,142	234,661	344,683
Mortgages and loans	1,043,331	964,862	925,434
Other assets	27,064	26,220	31,042
	<u>\$ 1,505,130</u>	<u>\$ 1,322,732</u>	<u>\$ 1,350,218</u>
<b>Liabilities and Shareholders' Equity</b>			
Deposits	\$ 1,331,379	\$ 1,150,903	\$ 1,192,779
Notes payable	90,189	75,559	75,567
Other liabilities	22,530	38,396	29,917
	<u>1,444,098</u>	<u>1,264,858</u>	<u>1,298,263</u>
Preferred share liabilities	40,995	40,744	40,537
<b>Shareholders' equity</b>			
Share capital	48,471	44,054	42,672
Deficit	(24,619)	(20,548)	(16,644)
Accumulated other comprehensive income (loss)	(3,815)	(6,376)	(14,610)
	<u>20,037</u>	<u>17,130</u>	<u>11,418</u>
	<u>\$ 1,505,130</u>	<u>\$ 1,322,732</u>	<u>\$ 1,350,218</u>

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

	<i>for the three months ended</i>		<i>for the six months ended</i>	
	<b>April 30 2011</b>	<b>April 30 2010</b>	<b>April 30 2011</b>	<b>April 30 2010</b>
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
<b>Interest income</b>				
Interest income on loans	\$ 10,643	\$ 10,730	\$ 20,968	\$ 21,829
Interest and income from securities	1,974	2,390	3,783	7,086
Loan fee income	736	856	1,765	2,108
	<u>13,353</u>	<u>13,976</u>	<u>26,516</u>	<u>31,023</u>
<b>Interest expense</b>				
Deposits and other	8,192	10,286	15,828	21,449
Notes payable	2,279	2,039	4,368	4,195
Preferred share liabilities	1,202	1,187	2,401	2,112
	<u>11,673</u>	<u>13,512</u>	<u>22,597</u>	<u>27,756</u>
Net interest income	1,680	464	3,919	3,267
Provision for (recovery of) credit losses	42	(735)	82	(701)
Net interest income after provision for (recovery of) credit losses	1,638	1,199	3,837	3,968
Other income	706	62	1,068	91
	<u>2,344</u>	<u>1,261</u>	<u>4,905</u>	<u>4,059</u>
<b>Non-interest expenses</b>				
Salaries and benefits	2,119	1,813	4,195	3,669
General and administrative	1,808	1,932	3,644	3,789
Premises and equipment	405	506	881	1,004
	<u>4,332</u>	<u>4,251</u>	<u>8,720</u>	<u>8,462</u>
Loss before income taxes	(1,988)	(2,990)	(3,815)	(4,403)
Income tax provision (recovery)	188	(160)	190	(233)
<b>Net loss</b>	<u>\$ (2,176)</u>	<u>\$ (2,830)</u>	<u>\$ (4,005)</u>	<u>\$ (4,170)</u>
Basic loss per share	<u>\$ (0.14)</u>	<u>\$ (0.21)</u>	<u>\$ (0.27)</u>	<u>\$ (0.30)</u>
Diluted loss per share	<u>\$ (0.14)</u>	<u>\$ (0.21)</u>	<u>\$ (0.27)</u>	<u>\$ (0.30)</u>
Weighted average number of common shares	<u>15,674,000</u>	<u>13,872,000</u>	<u>15,081,000</u>	<u>13,797,000</u>

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

(thousands of dollars)

	<i>for the three months ended</i>		<i>for the six months ended</i>	
	<b>April 30</b>	<b>April 30</b>	<b>April 30</b>	<b>April 30</b>
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
Total net loss	\$ (2,176)	\$ (2,830)	\$ (4,005)	\$ (4,170)
Other comprehensive income (loss), net of tax:				
Net unrealized gains (losses) on assets held as available-for-sale <sup>(1)</sup>	922	(3,605)	2,317	(198)
Amount transferred to net loss for available-for-sale assets <sup>(2)</sup>	62	(629)	244	(1,490)
Amount transferred to net income for impairment writedown on available-for-sale assets <sup>(3)</sup>	-	231	-	231
Total other comprehensive income (loss)	984	(4,003)	2,561	(1,457)
Total comprehensive income (loss)	<u>\$ (1,192)</u>	<u>\$ (6,833)</u>	<u>\$ (1,444)</u>	<u>\$ (5,627)</u>

(1) Net of income tax benefit (expense) for the three months of \$377 (2010-\$1,333) and six months of 946 (2010-\$73) .

(2) Net of income tax benefit (expense) for the three months of \$nil (2010-\$233) and six months \$75 (2010-\$533).

(3) Net of income tax benefit (expense) for the three months of \$nil (2010-(\$85)) and six months \$nil (2010-(\$85)).

**PACIFIC & WESTERN CREDIT CORP.****Consolidated Statement of Changes in Shareholders' Equity**  
(thousands of dollars)

	<i>for the three months ended</i>		<i>for the six months ended</i>	
	<b>April 30 2011</b>	<b>April 30 2010</b>	<b>April 30 2011</b>	<b>April 30 2010</b>
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
<b>Common shares</b>				
Balance, beginning of period	\$ 38,969	\$ 36,288	\$ 38,295	\$ 35,817
Shares issued, net of costs	3,055	-	3,055	-
Issued on payment of Class B preferred share dividend	674	659	1,348	1,130
Balance, end of period	<u>\$ 42,698</u>	<u>\$ 36,947</u>	<u>\$ 42,698</u>	<u>\$ 36,947</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	\$ 4,038	\$ 4,262	\$ 3,022
Shares issued, net of costs	-	224	-	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	\$ 443	\$ 381	\$ 436	\$ 326
Fair value of stock option transactions (note 6)	7	21	14	76
Balance, end of period	<u>\$ 450</u>	<u>\$ 402</u>	<u>\$ 450</u>	<u>\$ 402</u>
<b>Deficit</b>				
Balance, beginning of period	\$ (22,443)	\$ (13,814)	\$ (20,548)	\$ (12,408)
Net loss	(2,176)	(2,830)	(4,005)	(4,170)
Dividends on preferred shares	-	-	(66)	(66)
Balance, end of period	<u>\$ (24,619)</u>	<u>\$ (16,644)</u>	<u>\$ (24,619)</u>	<u>\$ (16,644)</u>
<b>Accumulated other comprehensive income (loss), net of taxes</b>				
Balance, beginning of period	\$ (4,799)	\$ (10,607)	\$ (6,376)	\$ (13,153)
Other comprehensive income (loss)	984	(4,003)	2,561	(1,457)
Balance, end of period	<u>\$ (3,815)</u>	<u>\$ (14,610)</u>	<u>\$ (3,815)</u>	<u>\$ (14,610)</u>
<b>Total shareholders' equity</b>	<u>\$ 20,037</u>	<u>\$ 11,418</u>	<u>\$ 20,037</u>	<u>\$ 11,418</u>

# PACIFIC & WESTERN CREDIT CORP.

## Consolidated Statement of Cash Flows

(thousands of dollars)

	<i>for the three months ended</i>		<i>for the six months ended</i>	
	<b>April 30</b>	<b>April 30</b>	<b>April 30</b>	<b>April 30</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	\$ (2,176)	\$ (2,830)	\$ (4,005)	\$ (4,170)
Items not involving cash:				
Provision for (recovery of) credit losses	42	(735)	82	(701)
Stock-based compensation (note 6)	7	21	14	76
Future income tax recovery	(47)	(160)	(45)	(233)
Gain on sale of available-for-sale assets	(254)	(122)	(378)	(1,790)
Gains realized on securitization	-	(884)	(205)	(884)
Change in derivative financial instruments	-	329	-	329
Unrealized gains on held-for-trading securities	(335)	-	(487)	-
Interest expense on preferred share liabilities	540	659	1,214	1,130
Change in other assets and liabilities	(1,131)	4,982	(8,469)	14,615
	<u>(3,354)</u>	<u>1,260</u>	<u>(12,279)</u>	<u>8,372</u>
<b>Investing:</b>				
Purchase of securities	(71,022)	(143,280)	(203,279)	(417,540)
Proceeds from sale and maturity of securities	79,218	64,384	236,404	346,212
Mortgages and loans	(6,761)	16,270	(95,428)	(977)
Proceeds of mortgage securitizations	-	-	8,575	-
Securitization retained interests	-	-	746	-
	<u>1,435</u>	<u>(62,626)</u>	<u>(52,982)</u>	<u>(72,305)</u>
<b>Financing:</b>				
Deposits	119,206	(71,353)	180,476	(24,357)
Notes payable	9,900	(2,612)	14,400	(2,612)
Proceeds of shares issued, net of costs	3,055	-	3,055	-
Preferred share liabilities	-	3,621	-	14,308
Short term financings	-	(20,164)	-	(46,578)
Dividends paid	-	-	(66)	(66)
	<u>132,161</u>	<u>(90,508)</u>	<u>197,865</u>	<u>(59,305)</u>
Increase (decrease) in cash resources	130,242	(151,874)	132,604	(123,238)
Cash resources, beginning of period	<u>99,351</u>	<u>200,933</u>	<u>96,989</u>	<u>172,297</u>
Cash resources, end of period	<u>\$ 229,593</u>	<u>\$ 49,059</u>	<u>\$ 229,593</u>	<u>\$ 49,059</u>
Supplementary cash flow information:				
Interest paid during the period	\$ 7,633	\$ 11,733	\$ 16,334	\$ 23,976
Income taxes paid during the period	\$ -	\$ -	\$ -	\$ -

**PACIFIC & WESTERN CREDIT CORP.**  
**Notes to the interim consolidated financial statements (unaudited)**  
**For the six months ended April 30, 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 six months ended</i>			
	April 30, 2011			April 30, 2010	April 30, 2011			April 30, 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	\$ 3,381	\$ 875	\$ 4,256	\$ 9,560	\$ 3,812	\$ 1,048	\$ 4,860	\$ 9,534
Provision for (recovery of) credit losses	56	(14)	42	(735)	107	(25)	82	(701)
Write-offs	(207)	(6)	(213)	(3,528)	(689)	(168)	(857)	(3,536)
Balance, end of period	\$ 3,230	\$ 855	\$ 4,085	\$ 5,297	\$ 3,230	\$ 855	\$ 4,085	\$ 5,297

Gross impaired loans at April 30, 2011 totalled \$1,598,000 (April 30, 2010 - \$5,246,000). Loans past due but not impaired at April 30, 2011 totalled \$65,000 (April 30, 2010 - \$487,000).

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 April 30, 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 \$3.2 million which mature in 2015. Notes payable bear interest at rates ranging from 5.5% to 9.00% 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.

On February 25, 2011, the Corporation converted a short term note in the amount of \$5.0 million, maturing April 2012, into a Series C note in the amount of \$4.9 million.

**5. Preferred share liabilities**

At April 30, 2011 the Corporation had 1,909,458 (2010-1,909,458) Class B Preferred Shares outstanding with a total value of \$45.3 million (2010-\$44.8 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 \$41.0 million (2010-\$40.5 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 \$41.0 million (2010-\$40.5 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	Employee Stock Options	
		Number	Weighted- average exercise price
Outstanding, October 31, 2010	14,434,242	508,333	\$ 7.87
Granted	-	-	-
Issued for cash proceeds	1,000,000	-	-
Issued pursuant to Class B Preferred Share dividend	419,284	-	-
Expired	-	-	-
Outstanding, end of period	15,853,526	508,333	\$ 7.87

In addition, at April 30, 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 six months ended April 30, 2011, the Corporation recognized \$14,000 (2010 - \$76,000) of compensation expense relating to the estimated fair value of stock options granted in prior periods. No options were granted during the current period, however, the fair value of options granted during the prior period 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 share.

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

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

(thousands of dollars)	April 30 2011	April 30 2010
Net unrealized losses on assets held as available-for-sale	\$ (3,815)	\$ (14,610)
Balance, end of period	\$ (3,815)	\$ (14,610)

Net of income tax benefit of \$1,558 (2010 - \$5,404).

## 7. Derivative instruments

At April 30, 2011, the Corporation had outstanding contracts for asset liability management purposes to swap between floating and fixed interest rates with notional amounts totalling \$238,256,000 (2010 - \$281,572,000). 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 \$682,000 (2010 - \$924,000) for purposes of determining the Bank's regulatory capital ratios. As required under the accounting standard relating to hedges, at April 30, 2011, \$13,031,000 (2010 - \$12,591,000) 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 April 30, 2011 the notional amount of these contracts totalled \$33,834,000 (2010 - \$12,680,000).

## 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)	April 30 2011	April 30 2010
Loan commitments	\$ 233,159	\$ 103,138
Letters of credit	25,019	29,383
	<u>\$ 258,178</u>	<u>\$ 132,521</u>

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)	April 30 2011	April 30 2010
Collateral related to derivative contracts	\$ 12,871	\$ 11,162
Collateral related to letters of credit	5,080	4
	<u>\$ 17,951</u>	<u>\$ 11,166</u>

## 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 April 30, 2011, outstanding securitized mortgages totalled \$32,419,000 (2010 - \$12,492,000).

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 six months ended April 30, 2011, mortgages totalling \$8,581,000 (2010 - \$12,540,000) were securitized and sold for cash proceeds of \$8,575,000 (2010 - \$12,455,000). The retained rights to future excess interests totalled \$746,000 (2010 - \$1,698,000) and the servicing liability totalled \$68,000 (2010 - \$90,000). The key assumptions used in measuring the retained interests at the date of securitization included a weighted – average discount rate of 2.62% (2010 – 2.73%) and a weighted-average excess spread of 0.73% (2010 – 1.25). 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 six months ended April 30, 2011 totalled \$145,000 (2010 - \$884,000), after related expenses and are included in other income 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 multiple is calculated as follows:

(thousands of dollars)	April 30 2011	April 30 2010
Total assets (on and off-balance sheet)	\$ 1,523,631	\$ 1,370,033
Capital		
Common shares	\$ 99,965	\$ 95,365
Retained earnings (deficit)	104	(1,331)
Unrealized loss on available-for-sale equity securities	(3,658)	(12,672)
Subordinated debentures	48,205	40,681
Total regulatory capital	\$ 144,616	\$ 122,043
Assets-to-capital ratio	10.54	11.23

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:

	April 30 2011		April 30 2010	
(thousands of dollars)	Notional/ Drawn Amount	Risk Weighted Balance	Notional/ Drawn Amount	Risk Weighted Balance
Balance sheet assets	\$ 1,498,612	\$ 962,274	\$ 1,340,650	\$ 824,736
Off-balance sheet assets	528,853	117,493	426,633	59,714
Charge for operational risk		22,308		38,994
Total risk-weighted assets		\$ 1,102,075		\$ 923,444
Regulatory capital		144,616		122,043
Total risk-based capital ratio		13.12%		13.22%
Tier 1 risk-based capital ratio		8.75%		8.81%

See Note 12-Subsequent Event relating to risk-based capital ratios.

**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, a slight 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 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 impact after-tax impact of a 100 basis point shift in interest rates on the Bank's shareholder's equity over a 60 month period.

	April 30 2011		April 30 2010	
	Increase 100 bps	Decrease 100 bps	Increase 100 bps	Decrease 100 bps
(thousands of dollars)				
Maximum interest exposure during a 12 month period	\$ 2,108	n/m	\$ 1,417	n/m
Maximum interest exposure during a 60 month period	\$ 3,580	n/m	\$ (548)	n/m

n/m - not meaningful

## 12. Subsequent event

Subsequent to April 30, 2011, 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 \$15.6 million. The proceeds will be used to reduce consolidated debt of the Corporation by \$10.0 million, purchase additional common shares of the Bank totalling \$4.0 million thereby increasing its regulatory capital and the remainder for working capital purposes in the parent company.

After taking into consideration the additional investment of \$4.0 million common equity into the Bank, the April 30, 2011 Tier 1 risk-based capital ratio and the total risk-based capital ratio of the Bank would be 9.11% and 13.67% respectively.

### 13. Subsidiary company information:

The following table presents summary financial information of the Bank:

(thousands of dollars)	<b>April 30 2011</b>	<b>April 30 2010</b>
	(unaudited)	(unaudited)
Cash and cash equivalents	\$ 221,781	\$ 38,001
Securities	205,142	344,683
Mortgages and loans	1,043,331	925,434
Other assets	28,358	32,532
	<u>\$ 1,498,612</u>	<u>\$ 1,340,650</u>
Deposits	\$ 1,331,379	\$ 1,192,779
Subordinated notes payable	51,500	41,500
Other liabilities	19,480	26,947
	<u>1,402,359</u>	<u>1,261,226</u>
Share capital	99,965	95,365
Retained earnings (deficit)	103	(1,331)
Accumulated other comprehensive income (loss)	(3,815)	(14,610)
Shareholder's equity	96,253	79,424
	<u>\$ 1,498,612</u>	<u>\$ 1,340,650</u>

(thousands of dollars)	<i>for the three months ended</i>		<i>for the six months ended</i>	
	<b>April 30 2011</b>	<b>April 30 2010</b>	<b>April 30 2011</b>	<b>April 30 2010</b>
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
Interest income	\$ 13,330	\$ 11,410	\$ 26,468	\$ 25,770
Interest expense	9,441	8,839	18,252	18,499
Net interest income	3,889	2,571	8,216	7,271
Provision for (recovery of) credit losses	42	(735)	82	(709)
Net interest income after provision for credit losses	3,847	3,306	8,134	7,980
Other income	707	49	1,139	80
Net interest income and other income	4,554	3,355	9,273	8,060
Non-interest expenses	4,092	4,158	8,317	8,258
Income (loss) before income taxes	462	(803)	956	(198)
Income tax recovery	(47)	(160)	(45)	(233)
Net income (loss)	<u>\$ 509</u>	<u>\$ (643)</u>	<u>\$ 1,001</u>	<u>\$ 35</u>

## CORPORATE INFORMATION

### **PACIFIC & WESTERN CREDIT CORP. and PACIFIC & WESTERN BANK OF CANADA**

## DIRECTORS

### **C. Scott Ritchie, Hons.B.A. (Business), LL.B., Q.C.**

Director, Chairman of the Board  
Pacific & Western Bank of Canada  
and Pacific & Western Credit Corp.  
Partner, Siskind, Cromarty, Ivey, Dowler LLP,  
Barristers and Solicitors

### **Robbert-Jan Brabander, M.Sc. (Economics)**

Director – Pacific & Western Bank of Canada  
Former Chief Financial Officer & Treasurer of  
General Motors of Canada Limited

### **David A. Bratton, B.A.(Hons.), M.B.A., CHRP, FCMC**

Director – Pacific & Western Bank of Canada  
and Pacific & Western Credit Corp.  
President, Bratton Consulting Inc.

### **Arnold E. Hillier, B.Comm., C.A.**

Director – Pacific & Western Bank of Canada  
and Pacific & Western Credit Corp.  
Retired, former Chairman, Chief Executive Officer  
and Chief Financial Officer, Claude Resources Inc.

### **Colin Litton, FCA, ICD.D.**

Director – Pacific & Western Bank of Canada  
and Pacific & Western Credit Corp.  
Retired, former partner, KPMG

### **Susan T. McGovern, B.Sc.**

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Assistant Executive Director  
Ontario Sewer and Watermain Construction Association  
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### **William T. Mitchell, FCA**

Director – Pacific & Western Bank of Canada  
and Pacific & Western Credit Corp.  
Retired, former senior partner, PricewaterhouseCoopers LLP

### **Paul G. Oliver, FCA, ICD.D.**

Director – Pacific & Western Bank of Canada  
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### **David R. Taylor, B.Sc. (Hons.), M.B.A., F.I.C.B.**

Director – Pacific & Western Bank of Canada  
and Pacific & Western Credit Corp.  
President and Chief Executive Officer, Pacific & Western Bank  
of Canada and Pacific & Western Credit Corp.

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Trading Symbol: PWC

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