



# Pacific & Western

Credit Corp.

## Third Quarter Report July 31, 2007

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### PACIFIC & WESTERN CREDIT CORP. ANNOUNCES RESULTS FOR ITS THIRD QUARTER ENDED JULY 31, 2007

#### THIRD QUARTER FINANCIAL HIGHLIGHTS

- Lending assets increased 13% to \$923 million from \$820 million a year ago and from \$900 million at the end of the previous quarter.
- Fundings of new loans and leases for the three months ended July 31, 2007 totalled \$125 million compared to \$118 million for the same period a year ago and on a year-to-date basis, totalled \$373 million compared to \$328 million for the same period a year ago.
- Total assets were \$1.23 billion compared to \$1.29 billion a year ago and \$1.37 billion at the end of the previous quarter.
- Net earnings for the quarter were \$127,000 or \$0.01 per share (\$nil diluted) compared to \$11.8 million or \$0.88 per share (\$0.85 diluted) last year.
- On a year-to-date basis, net earnings were \$1.6 million or \$0.10 per share (\$0.10 diluted) compared to \$15.5 million or \$1.15 per share (\$1.11 diluted) for the same period last year.

#### PRESIDENT'S COMMENTS

This quarter saw funding of new loans and leases total \$125 million, bringing new loans and leases funded for the nine-month period to \$373 million compared to \$328 million for the same period a year ago. Taking into consideration loan repayments for the nine months, total lending assets increased by 13% to \$923 million from \$820 million a year ago. However, despite this increase in lending assets, net interest income for the nine months decreased from \$14.5 million to \$13.4 million. This decrease was due primarily to a 33 basis point reduction in spread on the lending portfolio, which for the nine months declined from 2.13% last year to 1.80%. We have seen similar decreases in spreads on our treasury portfolio.

We have chosen to remain committed to our original strategy of lending and investing only in low-risk areas, believing that the unusual market conditions that gave rise to this compression of spreads would eventually end. This is now occurring as a result of the recent liquidity crunch and we are now seeing a rather dramatic increase, of approximately 50 basis points, in the spreads available on our lending and treasury portfolios. As well, we are seeing renewed interest in our receivable purchase program as corporations are seeking alternate funding sources. Recently we have agreed to provide a \$150 million receivable purchase line to another financial institution, and I expect more substantial lines to follow.

Our partnership with EllisDon Corporation to provide infrastructure financing to Ontario's hospital projects, announced previously in the quarter, is also proceeding and we hope to be announcing the financing of the first of a number of hospitals in the near future. I am also pleased to report that our Visa card initiative is proceeding on schedule and we have now begun serious discussions with potential partners to launch our card. We hope to be in a position to announce a partnership in the near future with revenues expected to flow from this initiative in another six months. Finally, our Versabanq Innovations software company which created, what we believe to be, a state of the art banking software package, is on track to commercialize this product by having the software benchmarked by a third party agency.

The first nine months of this year have been challenging for Pacific & Western in that our low-risk lending and investing strategy has caused us to suffer a significant compression of spreads and a reduction of net interest income. However, that situation is no longer the case and I expect spreads and net interest income to return to normal levels. This year we committed significant resources to our Visa card, receivable purchase program and Versabanq software initiatives which all seem close to paying significant dividends. I am pleased with the low-risk strategy that we have adhered to and look forward to reaping the benefits of this strategy and the unique initiatives we are pursuing.

## FINANCIAL HIGHLIGHTS

(unaudited)	for the three months ended		for the nine months ended	
	July 31	July 31	July 31	July 31
(\$ thousands, except per share amounts)	2007	2006	2007	2006
<b>Results of operations (teb)</b>				
Net interest income per financial statements	\$ 3,373	\$ 4,218	\$ 11,878	\$ 13,039
Teb adjustment	559	440	1,494	1,218
Net interest income	3,932	4,658	13,372	14,527
Spread	1.20%	1.48%	1.40%	1.61%
Provision for credit losses	142	321	643	448
Net interest income after provision for credit losses	3,790	4,337	12,729	14,079
Other income	108	12,963	1,361	15,046
Total revenue	3,898	17,300	14,090	29,125
Non-interest expenses	3,643	3,215	10,849	9,603
Net earnings	127	11,803	1,562	15,504
Earnings per common share:				
Basic	\$ 0.01	\$ 0.88	\$ 0.10	\$ 1.15
Diluted	\$ -	\$ 0.85	\$ 0.10	\$ 1.11
Efficiency ratio	90%	18%	73%	32%
Return on average common shareholders' equity	0.45%	78.88%	2.97%	35.83%
Return on average total assets	0.04%	3.76%	0.16%	1.71%
Gross impaired loans to total assets	0.21%	0.12%	0.21%	0.12%
Number of full time equivalent staff	62	52	62	52
<b>Balance Sheet Summary</b>				
Cash and securities	\$ 266,588	\$ 428,980	\$ 266,588	\$ 428,980
Total loans	923,385	819,899	923,385	819,899
Total assets	1,225,583	1,287,458	1,225,583	1,287,458
Average assets	1,296,209	1,245,586	1,277,656	1,209,343
Deposits	1,116,317	1,134,242	1,116,317	1,134,242
Notes payable	35,847	36,186	35,847	36,186
Shareholders' equity	60,981	68,526	60,981	68,526
<b>Capital ratios</b>				
(Based on the subsidiary Pacific & Western Bank of Canada)				
Total regulatory capital	\$ 93,701	\$ 102,402	\$ 93,701	\$ 102,402
Risk weighted assets	752,461	780,315	752,461	780,315
Assets to capital ratio	13.36	12.76	13.36	12.76
Tier 1 risk-based capital ratio	8.47%	9.53%	8.47%	9.53%
Total risk-based capital ratio	12.45%	13.12%	12.45%	13.12%

### Non-GAAP measures:

Like most banks, the Corporation analyzes revenue on a taxable equivalent basis (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 2007 should be read in conjunction with the unaudited interim consolidated financial statements for the period ended July 31, 2007, included herein, and the audited consolidated financial statements and MD&A for the year ended October 31, 2006, 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, 2006, remain substantially unchanged.

### Overview

Net earnings for the quarter were \$127,000 or \$0.01 per share (\$nil diluted) compared to \$11.8 million or \$0.88 per share (\$0.85 diluted) for the same period a year ago. For the nine months ended July 31, 2007, net earnings were \$1.6 million or \$0.10 per share (\$0.10 diluted) compared to \$15.5 million or \$1.15 per share (\$1.11 diluted) a year ago. Net earnings for the quarter and for the nine months decreased from the same periods a year ago primarily as a result of a decrease in other income and a decrease in net interest income, primarily in our securities portfolio. Net interest income (teb) for the quarter was \$3.9 million compared to \$4.7 million for the same period a year ago and for the nine months was \$13.4 million compared to \$14.5 million a year ago. Other income for the quarter was \$108,000 compared to \$13.0 million a year ago and for the nine months was \$1.4 million compared to \$15.0 million for the same period a year ago. Other income decreased from a year ago primarily due to dilution gains that were realized in 2006 when shares were issued by Discovery Air Inc. (DA), a company which was a subsidiary of the Corporation in 2006.

At July 31, 2007, total assets were \$1.23 billion compared to \$1.29 billion a year ago and \$1.37 billion at the end of the previous quarter. Lending assets increased to \$923 million at the end of the quarter from \$820 million a year ago and from \$900 million at the end of the previous quarter. Credit quality remains strong with gross impaired loans at the end of the quarter of \$2.6 million or 0.21% of total assets compared to \$2.5 million or 0.19% of total assets at the end of the previous quarter and \$1.5 million or 0.12% of total assets a year ago.

### Total Revenue (teb)

Total revenue (teb), which is comprised of net interest income after provision for credit losses and other income, was \$3.9 million for the quarter compared to \$17.3 million a year ago and for the nine months was \$14.1 million compared to \$29.1 million for the same period a year ago.

### Net Interest Income

Net interest income (teb) was \$3.9 million for the quarter, compared to \$4.7 million a year ago and for the nine months was \$13.4 million compared to \$14.5 million a year ago. Net interest margin (teb), which is net interest income as a percentage of average assets, was 1.20% for the quarter compared to 1.48% a year ago and for the nine months was 1.40% compared to 1.61%. The decrease in net interest income and net interest margin was due primarily to a compression of spreads, particularly in our securities portfolio which for the nine months ended July 31, 2007, was 0.45% compared to 0.75% for the same period a year ago. Net interest margin on our loan portfolio for the nine months was 1.80% compared to 2.13% a year ago with the decrease due primarily to a change in the mix in our loan portfolio and competitive market conditions. In addition, our cost of funds for the quarter increased to 4.17% from 3.89% a year ago and on a year-to-date basis, has increased from 3.69% to 4.27% with the change due to increases in the interest rate environment and increased competition for new deposits. However, due to excess liquidity and competitive pricing in the market, we have not seen a comparable increase in yields on new loans or securities.

### Other Income

Other income for the quarter was \$108,000 compared to \$13.0 million for the same period a year ago. This decrease was a result of the third quarter of the previous year including a dilution gain of \$15.6 million resulting from the issue of shares by DA and a write down of \$3.4 million relating to an investment included in our securities portfolio which had been trading below our book value for a prolonged period of time. As the Corporation no longer accounts for its investment in DA on the equity basis, it no longer recognizes dilution gains on shares which DA may issue. For the nine months ended July 31, 2007, other income was \$1.4 million and included a gain of \$888,000 relating to the disposition of DA shares when a special dividend was declared earlier in the year by the Corporation.

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

Non-interest expenses for the quarter were \$3.6 million compared to \$3.2 million for the same period a year ago and for the nine months ended July 31, 2007, were \$10.8 million compared to \$9.6 million for the same period last year. Non-interest expenses for the quarter and on a year-to-date basis increased from last year primarily as a result of higher salaries and benefits due to increased staff levels and costs of the office in Calgary which opened in August, 2006. In addition, the Corporation continues to incur costs which are included in non-interest expenses relating to its credit card initiative and Versabanq Innovations Inc.

Our efficiency ratio (teb), which measures the cost of the Corporation to earn a dollar of revenue, was 90% for the quarter compared to 18% for the same period last year and for the nine months was 73% compared to 32% for the same period a year ago. The change in the efficiency ratio was due primarily to the decrease in net interest and other income in the current quarter and year-to-date. At July 31, 2007, our ratio of assets per full time employee was \$19.8 million compared to \$24.8 million a year ago and at this level, the Corporation continues to lead the other domestic banks.

## ***Income Taxes***

In the current quarter and for the nine months ended July 31, 2007, the Corporation's statutory federal and provincial income tax rate was approximately 36%, the same rate that was in effect for 2006. However, the effective rate was reduced by non-taxable income earned on preferred shares in our securities portfolio. We anticipate that in the remaining quarter of 2007, our effective rate will approximate 12%.

## ***Balance Sheet***

Total assets at July 31, 2007, were \$1.23 billion compared to \$1.29 billion a year ago and \$1.37 billion at the end of the previous quarter. Total assets decreased from the previous quarter and from a year ago as a result of a decrease in securities owned that were sold under repurchase agreements. However, this decrease was partially offset by an increase in lending assets which grew to \$923 million from \$900 million at the end of the previous quarter and from \$820 million a year ago.

## ***Cash and Securities***

Cash and securities, which are held for liquidity management purposes and to earn investment income, were \$267 million compared to \$429 million a year ago and \$433 million at the end of the previous quarter. Securities which are owned by the Corporation consist of government bonds and investment grade corporate debt and preferred shares. Corporate preferred shares are held for the preferential tax treatment their dividends receive. The Corporation does not own any asset backed commercial paper and therefore is not exposed to any direct losses from this type of security as a result of recent market instabilities. The decrease in cash and securities from a year ago and from the previous quarter was due to a decrease in securities owned that were sold under repurchase agreements as the spread which the Corporation could earn on these securities was negligible.

At July 31, 2007, the net unrealized loss in our securities portfolio which is included in accumulated other comprehensive income (loss) totalled \$6.0 million compared to \$210,000 at the end of the previous quarter and \$623,000 a year ago. The change in unrealized losses from the previous quarter was due to recent changes in interest rates which caused decreases in market values of fixed rate preferred shares of investment grade corporations in our securities portfolio.

## ***Mortgages and Loans***

Lending assets grew to \$923 million at the end of the quarter from \$820 million a year ago and from \$900 million at the end of the previous quarter. New lending in the quarter totalled \$125 million, exceeding loan fundings of \$118 million a year ago and bringing loan fundings for the nine months to \$373 million compared to \$328 million a year ago. New lending was offset by loan repayments of \$101 million in the quarter and \$314 million for the nine months. The outlook for new loan funding continues to be promising with total loans committed to at July 31, 2007, approximating \$117 million.

Loan categories which saw increases from a year ago were insured residential mortgages and commercial loans and mortgages to investment grade corporations. These increases were offset by decreases in residential development construction loans and personal loans which consist of immigrant investor loans. Although the changes in our loan portfolio have resulted in lower overall spreads, we have maintained our focus on low risk lending opportunities and have retained our strong credit standards rather than looking to the subprime lending market to increase earnings. At July 31, 2007, the Corporation does not have any exposure to subprime loans and therefore is not exposed to any direct losses from this market.

### ***Other Assets***

Other assets totalled \$35.6 million at the end of the quarter compared to \$34.3 million at the end of the previous quarter and \$38.6 million a year ago. Included in other assets is the Corporation's investment in DA, which at July 31, 2007, had a market value of \$16.8 million including an unrealized gain of \$2.0 million which is included in accumulated other comprehensive income (loss).

### ***Deposits and Financing***

Deposits are used as a primary source of financing growth in assets and are raised entirely through an agent network across Canada. Deposits at the end of the quarter were \$1.12 billion compared to \$1.16 billion at the end of the previous quarter and \$1.13 billion a year ago. A second source of financing asset growth is the use of margin lines and securities sold under repurchase agreements. From time to time, the Corporation uses these sources of financing when the cost of borrowing is less than the interest rates that would have to be paid on new deposits. At the end of the quarter, the Corporation did not have any amounts outstanding from these sources as it was determined that they were not economical. This is in comparison to \$103 million outstanding at the end of the previous quarter and \$40 million a year ago.

Notes payable at July 31, 2007, were \$35.8 million compared to \$36.2 million a year ago with the decrease due to the reclassification of deferred financing charges as required under the new accounting standard on Financial Instruments.

### ***Credit Quality***

Gross impaired loans at the end of the quarter totalled \$2.6 million or 0.21% of total assets, compared to \$2.5 million or 0.19% of total assets at the end of the previous quarter and \$1.5 million or 0.12% of total assets a year ago. The provision for credit losses for the quarter was \$142,000 compared to \$321,000 a year ago and for the nine months ended July 31, 2007, was \$643,000 compared to \$448,000. Total allowances for credit losses, including specific and general allowances, were \$3.2 million at the end of the quarter compared to \$2.3 million a year ago. As discussed previously, the Corporation does not have any exposure to the subprime lending market and therefore will not suffer any direct losses as a result of recent market instability.

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

Shareholders' equity at the end of the quarter was \$61.0 million compared to \$68.5 million a year ago with the decrease due primarily to the special dividend of \$10.8 million declared and distributed earlier in the year and the decrease in accumulated other comprehensive income (loss). These decreases were partially offset by the issue of common shares on exercise of stock options and the retention of earnings. Total common shares outstanding at the end of the quarter were 13,753,652 compared to 13,348,695 a year ago with the increase due primarily to the exercise of common share options. Outstanding common share options totalled 1,071,028 at the end of the quarter compared to 1,365,550 a year ago. Our book value per common share at the end of the quarter was \$4.18 compared to \$4.87 a year ago with the decrease due primarily to the payment of the special dividend earlier in the year.

On July 17, 2007, the Corporation announced that it had filed a Notice of Intention to make a Normal Course Issuer Bid, pursuant to which the Corporation may purchase for cancellation up to 1 million of its common shares. The Bid will terminate on July 18, 2008. The price that the Corporation pays for any common shares is the market price at the time of purchase. The Corporation believes that the market price of its common shares is unusually low and does not fully reflect the value of its business and future business prospects. As a result, the Corporation believes that purchasing its common shares represents an attractive investment opportunity and an appropriate and desirable use of available funds. To the end of July 31, 2007, the Corporation had repurchased for cancellation 3,100 common shares for a total cost of \$23,000.

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

At August 29, 2007, there were 13,740,452 common shares outstanding with the change due to 13,200 common shares repurchased for cancellation under the Normal Course Issuer Bid. There have been no changes in the amount of common share options outstanding since July 31, 2007.

### ***Capital Management***

Total regulatory capital in the Corporation's principal subsidiary, Pacific & Western Bank of Canada, totalled \$93.7 million at the end of the quarter compared to \$96.9 million at the end of the previous quarter and \$102.4 million a year ago. The decrease in total regulatory capital from a year ago was a result of a dividend of \$11 million paid earlier in the year to the Corporation. At July 31, 2007, regulatory capital consisted of \$63.7 million in shareholder's equity (Tier 1 capital) and \$30 million in subordinated debentures of the Bank (Tier 2 capital).

The Bank's total risk-based capital ratio, which is the ratio of regulatory capital to risk-weighted assets, was 12.45% at the end of the quarter compared to 12.45% at the end of the previous quarter and 13.12% a year ago. The Bank has an internal target for its risk-based capital ratio of 11% and manages its regulatory capital and risk-weighted assets so this target is exceeded. The Bank's Tier 1 risk-based capital ratio, which is the ratio of Tier 1 capital to risk-weighted assets, was 8.47% at the end of the quarter compared to 8.43% at the end of the previous quarter and 9.53% a year ago. The Bank's assets to capital ratio was 13.36 at the end of the quarter compared to 14.32 at the end of the previous quarter and 12.76 a year ago.

### Performance Targets

Performance targets established for the 2007 fiscal year and 2007 year-to-date are noted below with actual results for the nine months ended July 31, 2007.

	2007		
	Annual Target	Year-to-Date Target	Year-to-Date Results
Earnings per common share	\$0.43	\$0.29	\$0.10
Spread (teb)	1.67%	1.64%	1.40%
Loan growth	33.00%	22.00%	6.90%
Total asset growth	12.00%	12.00%	-7.80%
Return on average common shareholders' equity	8.72%	5.93%	2.97%
Return on average total assets	0.42%	0.29%	0.16%

As noted earlier, actual results for the nine months ended July 31, 2007, fell short of year-to-date targets due to the short fall in lending assets and a compression of spreads primarily in our securities portfolio. In addition, net earnings for the nine months were negatively impacted by a tax provision in the second quarter of \$420,000 on a gain of \$2.3 million for income tax purposes which resulted from the disposition of DA shares distributed as a special dividend.

### Summary of Quarterly Results

(thousands of dollars except per share amounts)

	2007			2006			2005	
	Q3	Q2	Q1	Q4	Q3	Q2*	Q1*	Q4*
<b>Results of operations:</b>								
Total interest income								
per financial statements	\$ 16,978	\$ 17,538	\$ 18,163	\$ 18,677	\$ 16,418	\$ 15,104	\$ 15,138	\$ 13,845
Teb adjustment	559	492	444	432	440	352	427	484
Total interest income	17,537	18,030	18,607	19,109	16,858	15,456	15,565	14,329
Yield on assets (%)	5.37%	5.42%	5.49%	5.79%	5.37%	5.37%	5.40%	5.21%
Interest expense	13,605	13,495	13,701	14,415	12,200	10,560	10,591	9,846
Cost of funds (%)	4.17%	4.06%	4.04%	4.37%	3.89%	3.67%	3.68%	3.58%
Net interest income	3,932	4,535	4,906	4,694	4,658	4,896	4,974	4,483
Net interest margin (%)	1.20%	1.36%	1.45%	1.42%	1.48%	1.70%	1.72%	1.63%
Provision for credit losses	142	72	429	339	321	78	49	147
Other income	108	294	959	1,116	12,963	1,251	832	2,592
Total revenue	3,898	4,757	5,436	5,471	17,300	6,069	5,757	6,928
Non-interest expenses	3,643	3,548	3,658	3,252	3,215	3,104	3,284	3,904
Income before income taxes	255	1,209	1,778	2,219	14,085	2,965	2,473	3,024
Income tax provision	128	865	687	737	2,282	1,040	1,051	1,196
Non-controlling interest	-	-	-	-	-	117	237	(72)
Net earnings	127	344	1,091	1,482	11,803	2,042	1,659	1,756
Earnings per share								
-basic	\$ 0.01	\$ 0.02	\$ 0.08	\$ 0.11	\$ 0.88	\$ 0.15	\$ 0.12	\$ 0.13
-diluted	\$ -	\$ 0.02	\$ 0.07	\$ 0.10	\$ 0.85	\$ 0.14	\$ 0.12	\$ 0.13

\*Results for these quarters include the results of the operations for DA accounted for on the consolidation basis. DA was subsequently accounted for on the equity basis until October 31, 2006.

Net interest income and net interest margin (teb) for the third quarter decreased from previous quarters and from a year ago as a result of a compression of spreads primarily in our securities portfolio, competitive pricing for new loans and increased competition for new deposits resulting in an increase in our cost of funds. Other income was less in the third quarter compared to previous quarters as there were no gains from DA realized in the period. Non-interest expenses in the third quarter were comparable to the previous quarter but increased from a year ago as a result of higher salaries and benefits due to increased staff levels and the costs of the office in Calgary which opened in August 2006. The income tax provision increased in the second quarter as a result of a tax provision on a gain for income tax purposes which resulted from the disposition of DA shares when they were distributed as a special dividend in that quarter.

### ***Changes in Accounting Policies***

Newly issued accounting standards by The Canadian Institute of Chartered Accountants relating to comprehensive income, equity, financial instruments and hedges were adopted by the Corporation effective November 1, 2006. As a result of these new standards, a new category, accumulated other comprehensive income, forms part of Shareholders' Equity and certain unrealized gains or losses on available-for-sale financial instruments are reported in accumulated other comprehensive income until realization.

At July 31, 2007, accumulated other comprehensive loss totalled \$2.5 million and consisted of unrealized losses of \$6.0 million related to securities held as available-for-sale, unrealized gains of \$2.0 million related to our investment in DA which has been designated as available-for-sale and deferred losses of \$371,000 related to previously closed cash flow hedges no longer included in other assets. These amounts were before future income tax recoveries totalling \$1.9 million which are also included in accumulated other comprehensive income (loss).

The new accounting standard relating to hedges requires the Corporation to fair value the hedging item and the hedged item with the changes recorded through net earnings. As a result of this standard, at July 31, 2007, mortgages and loans and other assets include fair value adjustments totalling \$421,000 however, there was no impact on net earnings as the fair value adjustment to mortgages and loans and other assets offset each other.

### ***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 29, 2007**

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

The statements in this management's discussion and analysis which relate to the future are forward-looking statements. By their very nature, forward-looking statements involve inherent risks and uncertainties, both general and specific, and 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.

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. There is no undertaking 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.

# **PACIFIC & WESTERN CREDIT CORP.**

## **Consolidated Balance Sheet**

(thousands of dollars)

	<u>July 31</u> <u>2007</u> (unaudited)	<u>October 31</u> <u>2006</u>	<u>July 31</u> <u>2006</u> (unaudited)
<b>Assets</b>			
Cash resources	\$ 25,714	\$ 207,720	\$ 135,010
Securities	240,874	217,698	293,970
Mortgages and loans	923,385	863,830	819,899
Other assets	35,610	40,481	38,579
	<u>\$ 1,225,583</u>	<u>\$ 1,329,729</u>	<u>\$ 1,287,458</u>
<b>Liabilities and Shareholders' Equity</b>			
Deposits	\$ 1,116,317	\$ 1,210,555	\$ 1,134,242
Notes payable	35,847	36,184	36,186
Other liabilities	12,438	12,340	48,504
	<u>1,164,602</u>	<u>1,259,079</u>	<u>1,218,932</u>
<b>Shareholders' equity</b>			
Share capital	39,917	37,775	37,134
Retained earnings	23,513	32,875	31,392
Accumulated other comprehensive income (loss) (note 1)	(2,449)	-	-
	<u>60,981</u>	<u>70,650</u>	<u>68,526</u>
	<u>\$ 1,225,583</u>	<u>\$ 1,329,729</u>	<u>\$ 1,287,458</u>

# PACIFIC & WESTERN CREDIT CORP.

## Consolidated Statement of Earnings (thousands of dollars)

	<i>for the three months ended</i>		<i>for the nine months ended</i>	
	<b>July 31 2007</b>	<b>July 31 2006</b>	<b>July 31 2007</b>	<b>July 31 2006</b>
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
<b>Interest income</b>				
Interest income on loans	\$ 12,923	\$ 12,090	\$ 38,796	\$ 34,679
Interest and income from securities	3,486	3,850	12,100	10,400
Loan fee income	569	478	1,783	1,581
	<u>16,978</u>	<u>16,418</u>	<u>52,679</u>	<u>46,660</u>
<b>Interest expense</b>				
Deposits and other	12,701	11,311	38,168	30,755
Notes payable	904	889	2,633	2,596
	<u>13,605</u>	<u>12,200</u>	<u>40,801</u>	<u>33,351</u>
Net interest income	3,373	4,218	11,878	13,309
Provision for credit losses	142	321	643	448
Net interest income after provision for credit losses	3,231	3,897	11,235	12,861
Other income	108	12,963	1,361	15,046
	<u>3,339</u>	<u>16,860</u>	<u>12,596</u>	<u>27,907</u>
<b>Non-interest expenses</b>				
Salaries and benefits	2,048	1,801	6,262	5,425
General and administrative	1,134	1,092	3,274	3,318
Premises and equipment	461	322	1,313	860
	<u>3,643</u>	<u>3,215</u>	<u>10,849</u>	<u>9,603</u>
Earnings (loss) before income taxes and other	(304)	13,645	1,747	18,304
Income tax (recovery) provision	(431)	1,842	185	3,154
Non-controlling interest	-	-	-	354
<b>Net earnings</b>	<b>\$ 127</b>	<b>\$ 11,803</b>	<b>\$ 1,562</b>	<b>\$ 15,504</b>
Basic earnings per share	\$ 0.01	\$ 0.88	\$ 0.10	\$ 1.15
Diluted earnings per share	\$ -	\$ 0.85	\$ 0.10	\$ 1.11
Weighted average number of common shares	13,757,000	13,347,000	13,652,000	13,335,000

## 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</b>	<b>July 31</b>	<b>July 31</b>	<b>July 31</b>
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
<b>Common shares</b>				
Balance, beginning of period	\$ 35,894	\$ 33,353	\$ 33,986	\$ 33,191
Shares issued	-	28	1,898	190
Shares repurchased	(23)	-	(23)	-
Amount transferred from contributed surplus	-	-	10	-
Balance, end of period	<u>\$ 35,871</u>	<u>\$ 33,381</u>	<u>\$ 35,871</u>	<u>\$ 33,381</u>
<b>Class A preferred shares</b>				
Balance, beginning and end of period	<u>\$ 3,545</u>	<u>\$ 3,545</u>	<u>\$ 3,545</u>	<u>\$ 3,545</u>
<b>Stock-based compensation</b>				
Balance, beginning of period	\$ 445	\$ 208	\$ 244	\$ 58
Fair value of stock option transactions (note 3)	56	-	267	150
Amount transferred to common shares	-	-	(10)	-
Balance, end of period	<u>\$ 501</u>	<u>\$ 208</u>	<u>\$ 501</u>	<u>\$ 208</u>
<b>Retained earnings</b>				
Balance, beginning of period	\$ 23,386	\$ 19,590	\$ 32,875	\$ 16,129
Transitional adjustment (note 1a)	-	-	103	-
Net earnings	127	11,803	1,562	15,504
Dividends in kind (note 5)	-	-	(10,787)	-
Dividends on preferred shares	-	-	(240)	(240)
Balance, end of period	<u>\$ 23,513</u>	<u>\$ 31,393</u>	<u>\$ 23,513</u>	<u>\$ 31,393</u>
<b>Accumulated other comprehensive income (loss), net of taxes (note 1)</b>				
Balance, beginning of period	\$ 1,253	\$ -	\$ -	\$ -
Transitional adjustment	-	-	3,982	-
Net unrealized losses on assets held as available-for-sale	(3,799)	-	(5,241)	-
Amount transferred to net income for hedges	53	-	159	-
Amount transferred to net income for sale of available-for-sale securities	44	-	(1,349)	-
	<u>(3,702)</u>	<u>-</u>	<u>(6,431)</u>	<u>-</u>
Balance, end of period	<u>\$ (2,449)</u>	<u>\$ -</u>	<u>\$ (2,449)</u>	<u>\$ -</u>
<b>Total shareholders' equity</b>	<u><u>\$ 60,981</u></u>	<u><u>\$ 68,527</u></u>	<u><u>\$ 60,981</u></u>	<u><u>\$ 68,527</u></u>

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

(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>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
<b>Accumulated other comprehensive income (loss), net of taxes</b>				
Balance, end of period, consists of:				
Net unrealized losses on assets held as				
available-for-sale	\$ (2,212)	\$ -	\$ (2,212)	\$ -
Deferred losses related to previously				
closed cash flow hedges	(237)	-	(237)	-
Balance, end of period	<u>\$ (2,449)</u>	<u>\$ -</u>	<u>\$ (2,449)</u>	<u>\$ -</u>
<b>Comprehensive income (loss)</b>				
Total net income	\$ 127	\$ -	\$ 1,562	\$ -
Other comprehensive income (loss)	(3,702)	-	(6,431)	-
Total comprehensive income (loss)	<u>\$ (3,575)</u>	<u>\$ -</u>	<u>\$ (4,869)</u>	<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>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
<b>Cash provided by (used in):</b>				
<b>Operations:</b>				
Net earnings	\$ 127	\$ 11,803	\$ 1,562	\$ 15,504
Items not involving cash:				
Provision for credit losses	142	321	643	448
Other provisions	-	3,982	-	3,982
Future income tax (recovery) provision	(431)	1,828	185	3,091
Stock-based compensation (note 3)	56	-	267	250
Gain on disposal of shares	-	-	(888)	-
Non-controlling interest	-	-	-	(354)
Dilution gains	-	(15,647)	-	(16,936)
Equity earnings	-	(969)	-	(914)
Change in derivative financial instruments	2,652	-	648	-
Change in other assets and liabilities	4,594	1,857	(2,008)	5,470
	<u>7,140</u>	<u>3,175</u>	<u>409</u>	<u>10,541</u>
<b>Investing:</b>				
Securities	49,472	(11,420)	(29,192)	(17,485)
Mortgages and loans	(25,171)	(27,549)	(60,620)	(71,040)
	<u>24,301</u>	<u>(38,969)</u>	<u>(89,812)</u>	<u>(88,525)</u>
<b>Financing:</b>				
Deposits	(39,066)	180,330	(94,238)	198,484
Short term financings	(103,021)	(110,273)	-	(57,972)
Proceeds of common shares issued	-	28	1,898	190
Shares repurchased	(23)	-	(23)	-
Dividends paid	-	-	(240)	(240)
	<u>(142,110)</u>	<u>70,085</u>	<u>(92,603)</u>	<u>140,462</u>
Increase (decrease) in cash resources	(110,669)	34,291	(182,006)	62,478
Cash resources, beginning of period	<u>136,383</u>	<u>100,719</u>	<u>207,720</u>	<u>72,532</u>
Cash resources, end of period	<u>\$ 25,714</u>	<u>\$ 135,010</u>	<u>\$ 25,714</u>	<u>\$ 135,010</u>
<b>Supplementary cash flow information:</b>				
Interest paid during the period	\$ 22,549	\$ 13,429	\$ 43,573	\$ 31,048
Income taxes paid during the period	\$ 79	\$ 17	\$ 421	\$ 853

**PACIFIC & WESTERN CREDIT CORP.**  
**Notes to the interim consolidated financial statements (unaudited)**  
**For the nine months ended July 31, 2007**

**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, 2006, 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, 2006, with the exception of accounting policies relating to newly issued accounting standards by The Canadian Institute of Chartered Accountants. These new accounting policies include those relating to financial instruments, hedges and comprehensive income are as follows:

a) Financial instruments:

All financial assets are classified as one of the following: held-to-maturity, loans and receivables, held for trading or available-for-sale. All financial liabilities are classified as held for trading or other liabilities. Financial assets and liabilities held for trading are measured at fair value with gains and losses recognized in net earnings. Financial assets held-to-maturity, loans and receivables and financial liabilities other than those held-for-trading, are measured at amortized cost based on the effective interest method. Available-for-sale instruments are measured at fair value with gains and losses, net of tax, recognized in other comprehensive income.

At November 1, 2006, all of the assets in the Corporation's securities portfolio as well as its investment in Discovery Air Inc. (DA) were designated as available-for-sale.

At November 1, 2006, a transitional adjustment to accumulated other comprehensive income totalled \$3,982,000 and consisted of unrealized losses of \$1,075,000 related to securities held as available-for-sale, unrealized gains of \$6,150,000 related to our investment in DA which is included in other assets and deferred losses of \$618,000 related to previously closed cash flow hedges that are no longer included in other assets. In addition, other liabilities increased by \$475,000 relating to future income taxes on the above items.

At November 1, 2006 a transitional adjustment to retained earnings of \$103,000 was recorded related to changing the amortization method on financial instruments from the straight-line method to the effective interest rate method.

b) Hedges:

In a fair value hedging relationship, the carrying value of the hedged item is adjusted by gains or losses attributable to the hedged risk and recorded in net earnings. This change in fair value of the hedged item, to the extent the hedging relationship is effective, is offset by changes in the fair value of the derivative also measured at fair value on the balance sheet date, with changes in value recorded through net earnings.

At November 1, 2006, mortgages and loans and other liabilities increased by \$1,915,000 relating to the transitional adjustment for the fair value however, there was no impact on retained earnings.

c) Comprehensive income:

Unrealized gains and losses on financial instruments that are held as available-for-sale, and changes in the fair value of cash flow hedging instruments, are recorded in other comprehensive income, net of tax, until recognized in earnings.

## 2. Allowance for credit losses

(thousands of dollars)	<i>for the three months ended</i>				<i>for the nine months ended</i>			
			July 31,	July 31,			July 31,	July 31,
	General	Specific	2007	2006	General	Specific	2007	2006
	allowance	allowance	Total	Total	allowance	allowance	allowance	Total
			allowance	allowance				allowance
Balance, beginning of the period	\$ 2,415	\$ 687	\$ 3,102	\$ 2,017	\$ 2,208	\$ 358	\$ 2,566	\$ 1,889
Provision for credit losses	121	21	142	321	328	315	643	448
Recoveries (write-offs)	-	-	-	(63)	-	35	35	(62)
Balance, end of period	\$ 2,536	\$ 708	\$ 3,244	\$ 2,275	\$ 2,536	\$ 708	\$ 3,244	\$ 2,275

Gross impaired loans at July 31, 2007 totalled \$2,616,000 (July 31, 2007 - \$1,501,000).

## 3. Income taxes

(thousands of dollars)	<i>for the three months ended</i>		<i>for the nine months ended</i>	
	July 31	July 31	July 31	July 31
	2007	2006	2007	2006
Tax provision at basic rate of 36%	\$ (109)	\$ 4,912	\$ 629	\$ 6,589
Changes resulting from:				
Non-taxable income from securities	(338)	(255)	(864)	(707)
Dividend in kind	-	-	420	-
Gains	-	(2,838)	(160)	(3,070)
Other permanent differences	16	23	160	342
Income tax (recovery) provision	\$ (431)	\$ 1,842	\$ 185	\$ 3,154

In addition, included in accumulated other comprehensive income (loss) at July 31, 2007, is a future income tax asset of \$1.8 million relating to assets held as available-for-sale and a future income tax asset of \$134,000 relating to deferred losses on previously closed cash flow hedges.

## 4. Share capital and stock-based compensation

	Common shares outstanding	Employee Stock Options	
		Number	Weighted- average exercise price
Outstanding, October 31, 2006	13,421,585	1,291,160	\$ 7.65
Granted	-	117,235	11.76
Exercised	335,167	(335,167)	6.09
Expired	-	(2,200)	10.15
Repurchased	(3,100)	-	-
Outstanding, end of period	13,753,652	1,071,028	\$ 8.58

In addition, at July 31, 2007, there were 1,142,556 (2006-1,142,556) preferred shares outstanding.

During the nine months ended July 31, 2007, the Corporation recognized \$267,000 (2006-\$250,000) of salaries and benefits expense relating to the estimated fair value of stock options granted. The fair value of options granted during the period was estimated using the Black-Scholes option pricing model based on the following weighted-average assumptions: (i) risk-free interest rate of 4.07% (2006-3.90%), (ii) expected option life of 5 years (2006-5 years), (iii)

expected volatility of 30% (2006-45%), and (iv) expected forfeiture rate of 5% (2006-5%). The weighted average fair value of options granted was estimated at \$3.87 (2006-\$4.94) per share.

During the nine months ended July 31, 2007, \$10,000 (2006-\$nil) was transferred from contributed surplus to common shares relating to the exercise of options that had previously been expensed.

On July 17, 2007, the Corporation announced that it had filed a Notice of Intention to make a Normal Course Issuer Bid, pursuant to which the Corporation may purchase for cancellation up to 1 million of its common shares. The bid will terminate on July 18, 2008. The price that the Corporation pays for any common shares will be the market price at the time of acquisition. To July 31, 2007, the Corporation had repurchased for cancellation 3,100 common shares for a total cost of \$23,000.

## 5. Special dividend

On March 7, 2007, the Corporation distributed a special dividend to common shareholders of record at the close of business on February 16, 2007. The dividend was comprised of Class A common shares of DA and was payable based on .53 of a DA share for every one common share of the Corporation held.

The value of the special dividend on the declaration date was determined to be \$10,787,000, which resulted in a gain of \$888,000 being transferred from other comprehensive income to net income in the period.

## 6. Derivative instruments

At July 31, 2007, the Corporation had outstanding contracts for asset liability management purposes to swap between floating and fixed interest rates with notional amounts totalling \$72,011,000 (2006-\$47,231,000). 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 current replacement cost of \$nil (2006-\$nil), a credit equivalent amount of \$1,035,000 (2006-\$673,000) and a risk weighted balance of \$207,000 (2006-\$135,000). At July 31, 2007, these contracts were in a favorable position of \$424,000 (2006-unfavorable position of \$604,000). Under the new accounting standard relating to hedges, this amount is included in other assets on the consolidated balance sheet, however there is no impact on net earnings.

At July 31, 2007, the Corporation had outstanding credit derivative contracts for credit risk management purposes under which the Corporation would be compensated by the counterparty to the contract for losses on a security or loan in the event a default occurs. At July 31, 2007, the counterparties to these contracts which totalled \$19.4 million (2006-\$40.3 million) consisted of Canadian chartered banks. The contracts have a nominal fair value and mature within three years.

## 7. Commitments and contingencies

The amount of credit related commitments represents the maximum amount of additional credit that the Corporation could be obligated to extend. 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.

Loan commitments	\$ 116,741,000
Letters of credit	29,465,000
	<u>\$ 146,206,000</u>

The Corporation has guaranteed the repayment of bank indebtedness of one of its equity investments to the extent of \$1,000,000. The guarantee expires when the related bank indebtedness has been repaid in full. Payments under the guarantee would be required if the investee fails to meet the scheduled repayments. While the Corporation does not expect to be required to make any payments related to the guarantee, any amounts paid may not be recoverable.

## 8. Segmented information

The Corporation operates in one business segment which provides lending services to public sector, commercial and personal markets. Its lending activities are to clients in all of the Canadian provinces and territories. The segmented information reported in the prior year as Other Operations related to the Corporation's investment in Discovery Air Inc., which due to the Corporation's dilution of its interest in 2006, is now accounted for as an available-for-sale asset.

## CORPORATE INFORMATION

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

#### **DIRECTORS**

**Douglas W. Gough, B.B.A. (Hons.), M.B.A.**

Director, Chairman of the Board  
Pacific & Western Bank of Canada  
and Pacific & Western Credit Corp.  
President, Kaldo Investments Corporation

**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.

**Honourable Thomas A. Hockin, P.C., Hons.B.A.  
(Business), M.P.A., Ph.D., ICD.D.**

Director – Pacific & Western Bank of Canada  
and Pacific & Western Credit Corp.  
Retired, former President & C.E.O., The Investment Funds  
Institute of Canada and Canadian Institute of Financial  
Planning

**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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Retired, former Senior Partner, PricewaterhouseCoopers LLP

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

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

**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.

#### **OFFICERS**

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**Richard H.L. Jankura, B.B.A.(Hons.), C.A.**

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**Barry D. Walter, B.Comm., C.A.**

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**Ross P. Duggan**

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