

**Court File No. 06-CL-6482**

**ONTARIO  
SUPERIOR COURT OF JUSTICE  
COMMERCIAL LIST**

**IN THE MATTER OF THE *COMPANIES' CREDITORS*  
*ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED  
AND IN THE MATTER OF A PLAN OF COMPROMISE OR  
ARRANGEMENT OF CERVUS FINANCIAL GROUP INC., CERVUS  
FINANCIAL CORP., AND CERVUS FUNDING CORP.**

**FIRST REPORT OF  
KPMG INC., MONITOR**

**June 8, 2006**

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## I. PURPOSE, QUALIFICATIONS AND RESTRICTIONS OF THIS REPORT

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KPMG Inc. ("KPMG") has prepared this report at the request of Cervus Financial Group Inc. ("CFG") in anticipation that KPMG will be appointed Monitor, as described below.

KPMG has been advised that on June 8, 2006, CFG and certain of its direct and indirect subsidiaries, Cervus Financial Corp. ("CFC") and Cervus Funding Corp. (collectively the "Applicants" or the "Companies"), intend to seek protection from their creditors under the *Companies' Creditors Arrangement Act* R.S.C. 1985 c. C-36, as amended (the "CCAA"). The terms of this proceeding are proposed to be governed by an order of this Court dated June 8, 2006 (the "Initial Order"). KPMG is proposed to be appointed as Monitor of the Applicants during these CCAA proceedings.

Capitalized terms not defined in this Report (as defined below) are as defined in the draft Initial Order or the Purchase and Sale Agreement dated June 8, 2006 between CFG, CFC and 6578268 Canada Inc., a subsidiary of Macquarie Bank Limited ("Macquarie"), (the "Sale Agreement"). A copy of the Sale Agreement is appended to the Affidavit of Mr. Peter Williams, CEO of CFG, sworn June 8, 2006, (the "Williams Affidavit") and filed in support of the CCAA application. The Monitor will make the Initial Order and other information available on its website at [www.kpmg.ca/cervus](http://www.kpmg.ca/cervus).

The purpose of this First Report of the Monitor (the "Report") is to provide information to this Honourable Court in connection with the following:

- (i) the Companies' efforts to canvass the market place for a financing and/or partnership or sale solution prior to the filing of these CCAA proceedings;
- (ii) the Companies' cash flow projection for the 13-week period June 8, 2006 to September 3, 2006 (the "Cash Flow Projection");
- (iii) the likely outcome for creditors and shareholders should the Companies cease operations and undergo bankruptcy or liquidation proceedings; and
- (iv) the proposed process for notifying shareholders of CFG of these proceedings and the Court motion to approve the Sale Agreement as set out in the Companies' motion for the Sale Approval Process Order.

The information contained in this report has been obtained from the records of the Companies and is based on discussions with, and representations made by, management of the Companies, the Chair of the Board of Directors of CFG, and other professional advisors retained in this matter.

The financial information of the Companies has not been audited, reviewed or otherwise verified by the Monitor as to its accuracy or completeness, nor has it necessarily been prepared in accordance with generally accepted accounting principles and the reader is cautioned that this report may not disclose all significant matters about the Companies. Accordingly, the Monitor does not express an opinion or any other form of assurance on the financial or other information presented herein. The Monitor may refine or alter its observations as further information is obtained or is brought to its attention after the date of this report.

The Monitor assumes no responsibility or liability for any loss or damage occasioned by any party as a result of the circulation, publication, reproduction or use of this report. Any use which any party makes of this report, or any reliance on or decision to be made based on this report, is the sole responsibility of such party.

All references to dollars are in Canadian currency unless otherwise noted.

## II. THE COMPANIES' EFFORTS TO CANVASS THE MARKET PLACE

In order to assist this Honourable Court in considering the Sale Agreement, the Monitor has reviewed the following material in connection with the Companies' efforts to canvass the market place for a financing and/or strategic partnership or sale solution prior to filing of these CCAA proceedings:

- (i) the Williams Affidavit, wherein the Companies' efforts to raise new financing, seek out a strategic partnership or to sell the business are described;
- (ii) press releases issued by CFG, as summarized in the table below;

Date	Summarized Public Announcements
November 8, 2005	Engagement Agreement with a syndicate led by Desjardins Securities Inc. to act as financial advisor regarding a proposed placement for up to 10 million common shares.
November 22, 2005	Termination of the Engagement Agreement referred to above.
December 16, 2005	Closing of a private placement of \$6.24 million of unsecured convertible debentures.
February 14, 2006	In conjunction with the release of its first quarter results, CFG stated, amongst other things, that it is actively considering a number of strategic financial options that have been presented to CFG that would improve business operations.
March 2, 2006	CFG is reviewing strategic opportunities which would include various forms of short and long term financing, including debt and equity, as well as potential strategic partnerships and alliances with various institutions, certain of which had previously expressed interest in CFG. Also stated that CFG was working with prospective partners and other investors.
March 30, 2006	Strategic review concluded that CFG should raise \$20 million in equity to fund working capital requirements.
May 3, 2006	A non-binding, non-exclusive letter of intent was signed with a major international financial institution which provided for the institution to acquire all of the issued and outstanding shares of CFC or CFG (although not named in the press release, this institution is disclosed in the Williams Affidavit as being Macquarie).
May 15, 2006	In conjunction with release of its second quarter financial results, CFG stated, amongst other things, that: (i) although negotiations with the financial institution were ongoing, there could be no assurance that CFG and the financial institution would enter into and close a definitive agreement; (ii) the ability of CFG to continue as a going concern was contingent on raising additional equity or debt and/or entering into a strategic partnership with a financially strong entity, or the sale of the business; and (iii) CFG was continuing discussions with equity and debt providers and other investors.
May 17, 2006	Termination by the financial institution of the letter of intent referred to above.
June 5, 2006	Stakeholder update stated that CFG's situation remained difficult and under pressure, and that CFG was engaged in discussions with a number of parties, including the party that had previously withdrawn the non-binding letter of intent referred to above.

- (iii) narratives prepared by CFG's Executive Management and the Chairman of the Board to describe the Companies' efforts to raise new financing, seek out strategic partnerships or to sell the business;
- (iv) a narrative prepared by CFG's Executive Management to describe key events in its relationship with its bank lender, Royal Bank of Canada ("RBC"); and
- (v) draft versions of the Sale Agreement.

The Monitor's understanding of the aforementioned material was augmented through additional discussions with management as deemed appropriate by the Monitor.

In addition to the foregoing, the Monitor has recently participated in meetings of the Companies' management and Board of Directors wherein draft versions of the Sale Agreement and the approach for dealing with other potentially interested parties were discussed.

Also relevant to the Companies' efforts to improve their capital structure are their ongoing discussions with RBC. As described in the Williams affidavit, RBC reduced the maximum availability under the Company's primary lending facility, the Warehouse Credit Agreement (the "Warehouse Facility") from \$25 million to \$10 million, prior to terminating the facility on June 2, 2006. The Companies' management has advised the Monitor that RBC will continue to provide the Warehouse Facility provided that CFG proceed expeditiously to conclude the proposed sale transaction with Macquarie within the structure of a CCAA proceeding.

Based on the information reviewed by the Monitor (as outlined above) and the various discussions and meetings that the Monitor has participated in since May 13, 2006, the Companies' efforts to canvass the market place for a financing and/or strategic partnership or sale solution prior to the filing of these CCAA proceedings can be summarized as follows:

- (i) since early November 2005, CFG has issued ten press releases that addressed matters related to their ongoing efforts to improve their capital structure or sell the business;
- (ii) the Companies' Executive Management, the Chairman of the Board of CFG, and parties acting on their respective behalf have made numerous inquiries to gauge the interest of prospective financiers, partners and purchasers of the business; and
- (iii) as described in the Williams Affidavit, 18 parties were solicited and 11 executed Non-Disclosure Agreements to access certain financial information. Five parties accessed further information by attending the data room established at the offices of the Companies' legal counsel or otherwise made available in electronic format and/or conducted on-site due diligence at the Companies' offices.

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### III. CASH FLOW PROJECTION

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The Companies, with the assistance of the Monitor, prepared the Cash Flow Projection that was appended to the Williams Affidavit and filed with this Honorable Court in conjunction with the Companies' application for the Initial Order.

According to the Cash Flow Projection, the Companies' opening cash position as at June 8, 2006 was approximately \$1.3 million. This position is projected to deteriorate throughout the projection period.

By the end of week two, during which the Companies intend to make a motion for approval of the Sale Agreement (the "Approval Motion") on June 15, 2006, the Cash Flow Projection shows cumulative net cash outflows of approximately \$2.6 million, including a payment of approximately \$1.878 million for mortgage insurance premiums. As a result, the first advance under the DIP Operating Facility will be approximately \$1.3 million as at June 18, 2006.

By the end of week five, cumulative net cash outflows are projected to be approximately \$3.3 million, resulting in advances under the DIP Operating Facility of approximately \$2.0 million. At that point in time, assuming all conditions to the Sale Agreement have been achieved or waived, and the sale transaction is closed, CFG will have no further obligations with respect to the funding of the day-to-day obligations of the business. The Cash Flow Projection will be updated at that time to reflect the inflow of the net sale proceeds from closing of the Sale Agreement and the projected disbursements going forward (largely the costs associated with the CCAA process).

The Initial Order provides for the payment of pre CCAA filing mortgage insurance premiums. The Cash Flow Projection shows a payment of approximately \$1.878 million being made the week beginning June 12, 2006 for such premiums. The payment is to be made for the premium liability for the period May 1, 2006 to June 7, 2006. Such \$1.878 million payment is to be made to satisfy certain conditions of the Sale Agreement. The Cash Flow Projection reflects daily payment of these premiums during the period of the CCAA proceedings.

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#### **IV. PRELIMINARY LIQUIDATION ANALYSIS**

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The most recent financial statements available to the Monitor from the Companies are for the quarter ended March 31, 2006. The Monitor has prepared a preliminary liquidation analysis based on the amounts shown in those financial statements.

In a scenario where:

- (i) the Sale Agreement fails to close;
- (ii) no other interested parties come forward with a credible financing or purchase offer with the ability to close a purchase transaction in the very short term;
- (iii) the Company is unable to arrange an alternate DIP facility, or similar arrangements, to meet immediate funding requirements; and
- (iv) the Company ceases operations and undergoes a bankruptcy or liquidation proceeding,

the Monitor estimates that creditors of CFG would recover less than 100% of their claim amounts and that there would be no recovery available to CFG's shareholders. In contrast, provided the Sale Agreement closes as intended, the sale transaction with Macquarie could result in full payment to CFG's creditors and a distribution to CFG's shareholders. Until such time as a claims process has been concluded, it is premature for the Monitor to estimate the amount of the distribution that may be made to CFG's shareholders.

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## V. SALE APPROVAL PROCESS ORDER

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Pursuant to a separate Order (the "Sale Approval Process Order") to be sought in conjunction with the application for the Initial Order, the transactions contemplated therein and the vesting of assets is to be heard by this Honourable Court on June 15, 2006. Among other things, the draft Sale Approval Process Order contemplates that notice of the Approval Motion will be given by the Applicants to the holders of all issued and outstanding common shares of CFG (the "Shares") and to unsecured creditors of CFG via:

- (i) issuing forthwith the press release and filing it with the System for Electronic Document Analysis and Retrieval ("SEDAR");
- (ii) posting forthwith the press release on the Monitor's website at [www.kpmg.ca/cervus](http://www.kpmg.ca/cervus);
- (iii) mailing forthwith the press release to the Founders and Individual Shareholders as defined in the Williams Affidavit;
- (iv) filing forthwith of a Material Change Report with SEDAR; and
- (v) placing advertisements in the Globe & Mail and National Post newspapers on June 10 and 12, 2006.

From its discussions with the Companies, the Monitor recognizes that in the ordinary course the proposed sale transaction would be subject to the prior approval of the shareholders of CFG by special resolution. The Monitor also recognizes from those same discussions that CFG proposes the notice mechanisms referred to above in recognition that shareholder approval cannot be obtained in the timeframe proposed by the parties for completion of the sale transaction.

With input from its independent legal counsel, the Monitor has considered the adequacy of the above notice mechanisms to the holders of the Shares and has concluded that in the circumstances such provisions represent a reasonable attempt to provide notice of these proceedings, and in particular the Sale Agreement, to the shareholders of CFG while at the same time recognizing the short time frame within which the transaction contemplated in the Sale Agreement must be closed in order to generate any potential financial recovery for those same shareholders.

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## VI. SUMMARY AND CONCLUSIONS

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The Monitor is of the view that:

- (i) the market place was canvassed by the Companies for a financing and/or partnership or sale solution, which culminated in the Sale Agreement;
- (ii) the availability of the RBC Warehouse Facility is critical to the ongoing operations of the Companies, and that the Companies' management advises that the availability of the facility by RBC is dependent on proceeding expeditiously to conclude the proposed sale transaction;
- (iii) the Cash Flow Projection shows that the Companies' will be unable to continue to fund their operations, absent the DIP Operating Facility or similar financing, beyond June 15, 2006;
- (iv) the Monitor's preliminary liquidation analysis indicates the creditors of CFG would recover less than 100% of their claim amounts and that there would be no recovery available to CFG's shareholders in the event of a bankruptcy or liquidation; and
- (v) in the circumstances, the notice provisions proposed in the Sale Approval Process Order represent a reasonable attempt to provide notice of these proceedings and the Sale Agreement to the shareholders and unsecured creditors of CFG while at the same time recognizing the short time frame within which the transaction contemplated in the Sale Agreement is to be closed.

Accordingly, in the circumstances, the Monitor respectfully recommends that the Sale Agreement is worthy of submission to this Honourable Court for approval on June 15, 2006 in the manner contemplated in the Initial Order and the Sale Approval Process Order.

**RESPECTFULLY SUBMITTED,**

Dated the 8<sup>th</sup> day of June, 2006.

**KPMG INC.**

**In its capacity as Court-Appointed Monitor of  
CERVUS FINANCIAL GROUP INC.,  
CERVUS FINANCIAL CORP., AND  
CERVUS FUNDING CORP.**



Per: *Alan J. Hutchens*  
*Senior Vice-President*  
*416-777-8916*

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS  
AMENDED

Court File No:

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FINANCIAL GROUP INC., CERVUS FINANCIAL CORP. AND CERVUS FUNDING CORP.

**SUPERIOR COURT OF JUSTICE**

**Commercial List**

Proceeding commenced at Toronto

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