

**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  
NELSON FINANCIAL GROUP LTD.**

Applicant

**AFFIDAVIT OF MICHAEL CARNEGIE**

I, MICHAEL CARNEGIE, of the City of Hamilton, in the Province of Ontario, MAKE AN OATH AND SAY AS FOLLOWS:

1. I am an accountant and a partner with the accounting firm of Taylor Leibow LLP Chartered Accountants and as such have knowledge of the matters to which I hereinafter depose. To the extent that evidence herein is based on information and belief, I believe same to be true.
2. I am a Chartered Accountant and a Chartered Business Valuator. Attached hereto and marked as Exhibit "A" is a copy of my most recent CV.
3. I was asked to review the various financial information provided to the promissory note holders of the company in question (the "Noteholders"), Nelson Financial Group Ltd. (the "Company") and comment on its contents and to assess the financial information provided specifically as it relates to the Plan of Compromise and Arrangement of Nelson Financial Group Ltd., prepared February 11, 2011 (amended February 24, 2011) (the "Plan") and the have reviewed in particular the Plan, the Information Circular dated March 22, 2011 (the "Information Circular") and the Thirteenth Report of the Monitor dated April 7, 2011 (the "13<sup>th</sup> Report"). To the extent that other material was reference, it is specifically stated

herein. Attached hereto and marked respectively as **Exhibits “B”, “C” and “D”** is a copy of the Plan, Information Circular and the 13<sup>th</sup> Report.

#### **STATUS AND STATE OF FINANCIAL RECORDS AND STATEMENTS**

4. The Information Circular sets out at section 13, page 25 as follows: "The financial records of the company (including computer programmes which are being replaced) are in such disorder that it is not possible at this time to prepare proper audited current initial statements." Given this information, I have some initial concerns about the accuracy and reliability of the information being provided to the Noteholders about the Company's financial status and viability. Given this admission by the Company, I would advise any client to make no decision about making any investments with the Company until a proper financial analysis can be prepared using accurate financial information.

#### **FAILURE TO PROVIDE UPDATED TAX ADVICE.**

5. I have reviewed the letter prepared by Evans Martin LLP Chartered Accountants dated July 16, 2010 which provides information to the Noteholders about the tax implications of certain courses of action. The tax opinion contained in this letter is based on a plan that was being developed by the Company and the Monitor during the initial phases of these CCAA proceedings. The plan that was being developed at that time, as is described in the July 16, 2010 letter, has changed. As such, the tax opinion should be updated before any Noteholders are required to make decisions regarding their investment with the Company. Attached hereto and marked as **Exhibit “E”** is a copy of the letter dated July 16, 2010.

#### **CONSIDERATION OF THE OPTIONS AVAILABLE TO NOTEHOLDERS**

##### **a) Options Under the Plan**

6. The Interim Operating Officer (“IOO”) prepared the Plan on which the Noteholders are being asked to vote this Saturday, April 16, 2011. Broadly speaking, the Plan includes an option to exchange their current promissory notes for three types of new securities (the “Ongoing-Concern Option”) and an option to accept a 25% cash payment (the “Cash-Out Option”). I reviewed the Motion Record of the IOO, dated February 25, 2011 which enclosed the Plan.

**b) Liquidation Option**

7. Unless the IOO, the Monitor and the Noteholders have been able to obtain alternative relief, generally, if the Noteholders do not vote in favor of the Plan, it means they are choosing to continue the liquidation process and accept the payout of whatever funds are available for distribution to them in the future.
8. The 13<sup>th</sup> Report contains the most recent liquidation analysis prepared by the Monitor. This analysis shows an expected recovery of 42% over a four-year period of which 20% would likely be paid within the first few months.

**c) Comparison of the Plan to the Liquidation Option**

9. To be able to compare the liquidation option with the Plan, the Noteholders need to understand the values of the various options and more importantly, the values of the securities that are being offered in the Plan. After a review of the Plan, I do not see that any such analysis of value was contained in any of the information forwarded by the IOO or the Monitor, nor was there any guidance to issues such as the time-value-of-money which are critical to the Noteholders' understanding.

**EFFECTS OF INSUFFICIENT FINANCIAL ANALYSIS**

10. The lack of information created a few areas of concern as set out below.

**a) Capital Recovery Debentures**

11. First, the Capital Recovery Debentures (as defined in the Plan) are assigned a principal amount of 25% of the Noteholder's claim. In fact, the value of the Capital Recovery Debentures is substantially less than 25% of the Noteholder's claim because the Capital Recovery Debentures are non-interest-bearing.
12. Depending on the interest rate used in a time-value-of-money calculation, the present value of that future stream of payments can be drastically different. For instance, using a 12% discount rate, which I understand is similar to the coupon rate on the original promissory notes, the value of a \$25,000 Capital Recovery Debenture is approximately \$11,700.

13. The Noteholder who does not understand that the Capital Recovery Debentures are non-interest bearing might mistakenly think that they are getting a 25% recovery when, based on the example shown, the recovery, while still not certain or guaranteed, is \$11,700. Attached hereto as **Exhibit "F"** is a copy of the calculations I completed to arrive at these figures.
14. It is important to note in any assessment of the proper interest rate used to calculate the value of the Capital Recovery Debentures, that the Capital Recovery Debentures are deemed to be "unsecured obligations" under the Plan.

**b) Value of Special Shares and Common Shares**

15. Second, the new special shares and the common shares issued under the Plan need to be assessed for value, or potential value, so the Noteholders can make an informed decision of the benefits of choosing the Ongoing-Concern Option.
16. Under the Plan, the new special shares carry a 6% non-cumulative dividend. However, none of the projected financial information contained in the Information Circular, the Plan or the 13<sup>th</sup> Report show any payment of dividends.
17. Therefore, it follows that any value attributed to these equity securities can only be gleaned upon the sale of the shares unless dividends are established. It is also important to note that dividends are not like interest payments which when unpaid, also bear interest – which means that unrealized dividends do not earn a return on investment.
18. A quick and unsophisticated calculation shows that the present value of the annual net income which might be available for dividends in the first five years after the implementation of the Plan is underwhelming. Using the same 12% interest rate, (despite the fact that as an equity security, shares are more risky than debt) the present value of the Noteholder's portion of the shares was calculated to be approximately 15.2% of the Noteholder's claim. Attached hereto as **Exhibit "G"** is a copy of the calculations I completed to arrive at these figures.

19. An alternate view of present value is to go beyond year five and assume the earnings available for dividends will continue in perpetuity. Therefore, using a 20% interest rate to reflect the additional uncertainty of making such long-term projections, the present value of the share securities is approximately 26% of the Noteholder's claim. Attached hereto as **Exhibit "H"** is a copy of the calculations I completed to arrive at these figures.
20. The following sample calculations were prepared using the projections contained in the Information Circular – "Scenario One". It is my opinion that this scenario, while not described as optimistic, is the most aggressive of the three scenarios presented.
21. It is my opinion that, because the Noteholders are being asked to vote on April 16, 2011, and the information about the Plan only became available to them on April 7, 2011, and the information needed to make a full and proper analysis of the financial implications to the Noteholders is not available even as of the date of this affidavit, there is not enough time for the Noteholders to fully understand the value implications of the various options, or retain professional advisors capable of preparing the needed analysis and advising them accordingly.
22. For instance, the Noteholders need to be able to compare the expected values that they will get if they vote in favour or against the Plan versus the values now set out in the 13<sup>th</sup> Report for liquidation.
23. Using the sample calculations from above, the Noteholders need to be able to compare an expected present value of 26.9% of their claim (being the 11.7% value of the Capital Recovery Debenture and the 15.2% value of the shares) or 37.7% of their claim (being the 11.7% value of the Capital Recovery Debenture and the 26% value of the shares in the perpetuity calculation). They will then have to compare that to the 42% expected recovery. However, the 42% recovery does not have a value of 42% because of the time value of money.
24. A present value calculation using a 12% interest rate shows that the value of 42% is actually 36.7%. Attached hereto as **Exhibit "I"** is a copy of the calculations I completed to arrive at these figures.

25. Another area of concern is that the 42% expected recovery under the liquidation option is based on analysis prepared by the Monitor that is not based on recent information. Rather, it appears that the Monitor rolled forward an analysis from almost a year ago. I suspect that the reason for the lack of full update is connected to the state of the financial records of the Company as was noted earlier. One of the areas of update that would be of particular interest is to be able to compare the 'bad debt reserve' booked over year ago with the recovery experience since that date.

26. I swear this affidavit in good faith and for no improper purpose.

SWORN before me at the City  
Of Waterloo, in the Province of Ontario  
This 12<sup>th</sup> day of April 2011.

  
\_\_\_\_\_  
A Commissioner, etc.

)  
)  
)  
)  
)

  
\_\_\_\_\_  
**MICHAEL CARNEGIE**