File No. CV-10-8630-00CL

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.

FIRST REPORT OF SHERRY TOWNSEND
in her capacity as the Interim Operating Officer of the Applicant

February 18, 2011

Introduction

1. By an Order of this Court dated November 22, 2010, Sherry Townsend was appointed as the Interim Operating Officer ("IOO") of the Nelson Financial Group Ltd., the Applicant in these proceedings. Under the terms of the Appointment Order, an engagement letter between the Applicant and ST Consulting Inc. for the provision of the IOO services was approved. The Court also proved the terms of heads of agreement between the Applicant and its sole voting shareholder, sole director and incumbent president and chief executive officer, Marc Boutet. The heads of agreement provided for Marc Boutet to remove himself as an officer, director and shareholder of the Applicant.

2. Documentation was settled between counsel representing Marc Boutet and the Special Counsel for the Representative Counsel to implement the terms of the heads of agreement. That documentation was reviewed and approved by the IOO. Due to Marc Boutet's absence from Canada, it took some time to obtain execution of all of the documents and the appointment of the IOO was not fully effective until documents were executed and delivered on December 13, 2010. At that time, the IOO assumed full responsibility and authority as the chief executive officer of Nelson Financial Group Ltd.

Activities of the IOO

3. Following the grant of the appointment Order on November 22, 2010, the IOO gathered her team of professional advisors and financial and management consultants. She established that her first priority once her authority as chief executive officer was confirmed would be the establishment of proper operating procedures and the implementation of operating efficiencies. The next priority would be the determination of whether or not the business of Nelson Financial could be organized to have a competitive advantage in a niche market for financial services and to identify what that market and advantage could be. If that was established, the IOO identified a final task as the restructuring of the ownership, balance sheet and management of Nelson Financial to exploit the identified opportunity in a way that would maximize the value for and recovery of investment by the unsecured creditors, particularly the Noteholders.

4. In accordance with the approval of the Court of November 22, 2010, the IOO retained the services of Avansare and provided them with access to all available data concerning the present and past business operations of Nelson Financial. They proceeded

immediately with their review based on that information as to how the business had been operated, exactly what niche it purported to serve and what competitive landscape it faced.

5. Following the closing of the change of management transactions on December 13, 2010, the IOO acting as chief executive officer of Nelson Financial took charge of the premises and the staff. She immediately conducted a review of the activities and functions being performed and took immediate steps on a number of fronts. A program of operating cost management has been devised and implemented. Every element of overhead cost has been reviewed and a number of unnecessary and wasteful costs have been immediately eliminated. The business of Nelson Financial uses a number of continuing services and, in several instances, advantageous renegotiations of the terms and pricing for such services have been affected. It was immediately apparent that there was substantial redundant staffing. Major reductions of costs were immediately and easily made. However, the review of costs and the implementation of savings continue and some of the items will take time.

6. The IOO discovered that substantial resources of Nelson Financial were continuing to be utilized by other businesses and corporations owned by Marc Boutet. Most conspicuously, it was discovered that Nelson Mortgage Group Ltd. was occupying space, utilizing the computer, accounting and internet systems, using the same telephone lines and systems and was using administrative staff of Nelson Financial for its secretarial and accounting support. The IOO established that there were no contractual arrangements in place for these relationships or for any contribution by Nelson Mortgage Group Ltd. to the costs being born by Nelson Financial. She has taken steps to remove the operations

and employees of Nelson Mortgage Group Ltd. from the premises. The computers and servers owned by Nelson Financial have been secured. It was also discovered that mortgage brokers and administrators employed by Nelson Mortgage Group Ltd. were conducting business, utilizing business cards identifying them as employees of Nelson Financial. The IOO has halted such practices.

7. The review of the loan portfolio of Nelson Financial was identified by the IOO as the highest priority issue. This review has identified major deficiencies in the Loan Management System ("LMS") software system that Nelson Financial had purchased in 2008. This does not readily produce reliable aging reports and had not been able to be used effectively as an essential management tool.

8. A substantial dollar value of delinquent accounts has been identified. It was also identified that collection procedures were not consistently applied. Under the IOO's direction, some $21 million of loans that had been carried on the books of Nelson Financial have been fully reserved and assigned to third party collection agencies under procedures that will ensure consistent follow up on recoveries and write offs. New collection procedures based on industry standards are being implemented with the assistance of consultants. These will ensure an industry-standard delinquency and write off schedule and timely election efforts on delinquent loans. In-house management of delinquencies and of some collection procedures has been reorganized.

9. The IOO also identified problems in loan origination. Nelson Financial had lending standards, including minimum credit scores for loan approvals. The IOO determined that these standards were being routinely disregarded. The manager responsible was

terminated and new loan origination was sharply curtailed through December. The IOO has confirmed to credit approval staff that only good quality paper is to be approved. Consequently, credit scores on new business written have been raised from earlier levels that approached 500 to current levels of about 700. Loan volumes are now rising steadily in February and will continue to rise in future months. The important difference is that the loans now being booked are of a materially better credit quality, which will significantly reduce future credit losses, reserves and write offs.

10. The business of Nelson Financial is financial intermediation of smaller sized consumer loans. Sourcing of these loans requires interaction with retailers of goods and services whose customers can utilize credit made available by Nelson Financial. The IOO has taken major steps to establish new vendor relationships and, particularly importantly, to move Nelson Financial up to being the number one credit supplier to such relationships. In the past, Nelson Financial was frequently the second or third choice supplier of credit to its vendors and consequently saw a disproportionate number of consumer credit applications that had been rejected by others. This contributed greatly to the low credit quality of the portfolio. That has already been turned around.

11. Under the direction of previous management, prior to the commencement of the CCAA proceedings, Lendcare Financial Inc. was the aggregator and supplier of more than half of the loan volume for Nelson Financial. The contractual arrangements between Nelson Financial and Lendcare were terminated under an agreement approved by the Court on June 15, 2010. That agreement contained certain continuing rights for Nelson Financial to receive adjustments on cancelled or bad loan accounts. The deadline for the application for such adjustments was December 31, 2010. The IOO directed an urgent

review of all Lendcare originated accounts and finalization of all claims for adjustments. As a result, a demand was made on Lendcare in December for over $800,000 of adjustment recoveries under the June agreement.

12. In the course of this review, a number of other problems were identified in the portfolio of consumer loans supplied by Lendcare to Nelson Financial. These included a number of retail vendors dealing with Lendcare that are now seen to be identity theft fraud operations. The non-existent or phantom borrower for the financing of non-existent goods and services is a well-understood credit risk in this finance business. It is supposed to be managed by a credit agency review and by a direct communication between the lender and the borrower known in the trade as a "welcome call". It has been discovered that identify theft frauds are adept at creating files for the non-existent consumers on the records of a number of the credit agencies. Consequently, the welcome calls are particularly important. The IOO has instructed counsel to address legal remedies for Nelson Financial.

Business Identity

13. On December 15, 2010, the IOO and her advisors, including members of the Noteholders' Committee advising the Representative Counsel, received a phase one briefing from Avensare as to its initial review of the business and business prospects of Nelson Financial. That review supported the conclusion that there is a viable business and that Nelson Financial can be positioned to advantageously access a market opportunity. Major players have withdrawn from retail consumer financing, in the case of some American-owned bank affiliates due to the fact that their capital was needed for

survival of their parents. The preliminary conclusions of the consultants also included the identification of the fact that Nelson Financial had utilized less than industry-standard management practices in almost every aspect of its activities. The consultants confirmed that, from financial record-keeping through information technology systems, loan origination, credit management and marketing, the business had been managed incompetently. Fortunately, it was immediately obvious that large numbers of these deficiencies could be easily remedied, although there will also be a long period of steady improvement required.

14. On the basis of this Phase one report, confirmed by her own direct review and observations, the IOO concluded that Nelson Financial and its remaining assets represents a business that can be restructured in a manner that will provide a better outcome for its creditors than the alternatives of either a sale of its financial assets or a progressive collection and liquidation process.

15. The IOO instructed Avensare to proceed with Phase two of their consulting process to develop specific detailed recommendations or a management action plan and to set out a business plan and financial projection for a restructured enterprise.

16. One immediate conclusion reached by the consultants and the IOO was that the Nelson Financial brand had been substantially destroyed by the activities of Marc Boutet, by the CCAA proceeding itself and by the proceedings before the Ontario Securities Commission. The IOO concluded that a re-branding and fresh start was essential to create an acceptable profile and credibility in the marketplace for the restructured business. A new name and style has been developed and, as of January 21, 2011, Nelson

Financial Group Ltd. commenced doing business under the name and style of Provider Capital Group Inc. The domain name www.providercapitalgroup.com has been registered and the website is functioning, although still under construction. The IOO has directed that the corporate name of Nelson Financial Group Ltd. will be changed under the terms of the Plan of Arrangement to become Provider Capital Group Inc.

17. During the last several weeks, the IOO has directed the attention of her staff to business development. A number of new vendors have been signed up and are already online. During January and so far in February, there has been a dramatic increase in loan origination. There are additional new vendors in negotiation who have committed that they will deal with Provider Capital Group Inc. once the restructuring is completed and the uncertainty of the CCAA proceeding has ended.

18. This business development effort has particularly included renegotiating contracts with several existing vendors. Provider Capital Group has become their "first" or "co-first" lender of choice. This change has materially improved credit scores of loan offerings coming to us. The IOO has directed that the business development strategy must ensure increasing loan quality originating from secure, long-term partnerships with well known vendors. The IOO has determined that Provider Capital Group Inc. will be able to grow its lending portfolio within the full financial ability of its balance sheet.

Information Systems

19. The IOO and consultants advising her have identified that the computer systems and software programs utilized by Nelson Financial were highly deficient and that these contributed materially to its financial losses. IT consultants with specialist experience in

the consumer finance industry are preparing new systems for loan adjudication, loan management and financial reporting. These will require capital expenditure and will only be implemented after the plan of arrangement is approved..

Employees

20. The IOO identified immediately that there were redundant and unproductive employees. She also identified employees who were either incapable of or intentionally refusing to follow established good practices. Serious deficiencies were discovered in credit approval as referred to above. In collections, several employees were discovered to be utilizing abusive, threatening and obscene communications in their collection calls. The IOO has terminated the employment of three employees on this basis. She has also reduced staff by terminating the employment of a number of other redundant or improperly qualified personnel. Since November 22, the payroll of Nelson Financial has been reduced from 24 personnel to **15** persons.

21. The IOO is satisfied that the business of Nelson Financial to be carried on in the future as Provider Capital Group Inc. can be conducted at these lower levels of staffing efficiently and effectively. As a result, significantly less space is required than the over 7,000 square feet represented by the premises at 900 Dillingham Road, Pickering. Even though large portions of that space were actually used by Marc Boutet for his personal use and for his other businesses, the costs and terms of the non-arm's length lease with Paladin Investment Holdings Ltd. are more than the business needs or can afford. The IOO recommends that the company should be authorized to terminate the lease as of July 31, 2011 under section 32 of the CCAA.

The Plan of Arrangement

22. The IOO, together with several members of the Noteholders' Advisory Committee with relevant business skills and experience and with the support and assistance of the consultants, Avensare, under the consulting arrangements authorized by the Court, has developed a Business Plan for the development and growth of the consumer and finance business to be conducted by Provider Capital Group Inc. That Plan and its financial projections are currently being finalized. A summary of the Business Plan will be provided to all creditors before the Meeting of Creditors to consider the Plan of Arrangement. However, the details of the Plan have elements of commercial confidentiality and their public disclosure could give competitors of Provider Capital Group Inc. an inappropriate commercial advantage. The IOO asks that the Court permit the filing of the full Business Plan on a sealed basis and that it be provided to the Monitor, Representative Counsel and the Special Counsel under their commitments of confidentiality. Such commitments have already been received from the Representative Counsel and the Special Counsel, both of whom have contributed to and participated in the development of the Business Plan.

23. The Business Plan indicates that before providing returns by capital repayments and dividends for the creditors' investment, Provider Capital Group Inc. will have material profitability in the first fiscal period following the implementation of the Plan. Further, the Plan indicates and the IOO is satisfied that it will have increasing profitability in future fiscal periods. It is the opinion of the IOO that the Business Plan will result in an enterprise where the common shares held by the unsecured creditors under the terms of the Plan will, in several years, provide a substantial recovery of the losses of the

creditors. It is possible that the business can develop to a level that will provide a full recovery in the future.

24. The Plan of Arrangement dated February 11, 2011 has been filed with the Court. The Plan is based upon the determination made by the IOO and confirmed by the financial advisers and the consultants that, at the present time, the going concern value of the assets, principally funds on hand and the loan portfolio, of the company is about $18 million. There is a concern that a sale in distress circumstances or a liquidation of these assets would produce less due to the costs that would be associated with such proceedings. The Plan believes that that level of value should be reflected in securities that will have that cost basis for tax purposes and can be redeemed in the future as funds permit. The future value that may be generated by successful business operations of Provider Capital Group Inc. should belong to the creditors whose assets will be utilized to develop that business. The Plan provides for that result by distributing to the creditors 100% of the common shares in proportion to each creditor's Proven Claim. Those common shares represent the future recovery of the losses that the creditors, principally the Noteholders, have suffered on their total claims of approximately $37 million.

25. The Representative Counsel and the Noteholders' Advisory Committee have been directly engaged in the process of developing the specific terms of the Plan of Arrangement. The Noteholders' Committee felt that an expectation had been created by the proposal presented by the Monitor on behalf of Marc Boutet at the July 20, 2010 meeting of Noteholders, notwithstanding that it is now clear that the past activities of Marc Boutet made such a Plan impossible even when it was proposed. Those expectations however persist and they included an early cash check out option for some

creditors at a substantial discount. That option has been included in the Plan and provides for a 25 cents on the dollar alternative, although it is necessarily limited to not more than $10 million. It is the opinion of the IOO that this alternative is very disadvantageous to creditors and she will not recommend that creditors should exercise it.

26. A more substantive area of debate has been the nature of the securities that should record the estimated current value of the interests of the creditors in Nelson Financial. It had been first suggested that that should be represented entirely by preferred shares. Although Provider Capital Group Inc. will conduct itself on a completely different basis than that followed by Nelson Financial Group Ltd. under the control of Marc Boutet, including, for example, the provision of audited financial statements to all shareholders, the calamity suffered by the investors who were persuaded to accept preferred shares in Nelson Financial is fresh in creditors' minds. Members of the Committee appreciated that a strong opening balance sheet would benefit the business prospects of their company. However, some wanted to see part of their stake in the form of a debt instrument and wanted to see some assured cash flow return after a year of receiving nothing.

27. The Plan provides that each creditor will receive 25% of their Proven Claim in the form of special shares bearing a cumulative dividend at 6% per annum which will only be paid in the future when the business is well established. Next they will each receive 25% of their Proven Claim in the form of what has been designated as a capital recovery debenture. This debenture will have mandatory principal payments equal to .5% each month (equivalent to the retirement of 6% of the original principal amount each year). The debentures will be unsecured debt and will permit the raising of expansion capital by

borrowings from arm's length financial institutions provided that the corporation is profitable. The debentures are convertible at any time into special shares so that they will thereafter earn a return of 6% per annum as a cumulative dividend although payment of such return may be deferred.

28. The IOO, the Representative Counsel and members of the Noteholders' Advisory Committee are satisfied that these terms produce a reasonable compromise between the differing needs and wishes of differently situated Noteholders.

29. The IOO recognizes that there are a number of small, unsecured trade creditors who were caught on the date of filing of the CCAA proceedings. The IOO is satisfied that the use of a "convenience class" to a maximum of $1,000 per creditor is reasonable in the circumstances of Nelson Financial and will not be material to its financial position.

The Approval Process

30. The IOO is satisfied that the Representative Counsel and, particularly the work of the volunteer Noteholders serving on the Advisory Committee of Noteholders, has established active and effective communication with all Noteholders who are interested in addressing the restructuring of their investments. A website has been established and it is well used for communication to the Noteholders and by them to obtain information. In terms of Noteholder communication, the meeting of Noteholders held on July 20, 2010 was much appreciated by the Noteholders in attendance and they were a clear majority of the entire body of Noteholders. The IOO recommends the same format of meeting for the Meeting of Creditors to be convened to consider the Plan. The IOO is satisfied that the Representative Counsel is a suitable, experienced and neutral professional who is well

qualified to conduct the Meeting in a fair and proper manner so that any opinions of any of the creditors will be properly heard and considered by the Meeting.

31. The IOO is satisfied that the facilities of Nelson Financial, together with other resources available to her, are more than adequate to handle the logistics of mailing, proxy solicitation, voting letter recording and the scrutinizing functions at the Meeting of Creditors. The IOO has satisfied herself that the terms proposed in the draft meeting order are practical and will be effective.

Extension of the Stay

32. The cash position of Nelson Financial is currently very strong with bank balances of about $2 million and rising. In addition to these funds, $5,000,000 of funds belonging to Nelson Financial are continuing to be held by the Monitor notwithstanding the Order of December 9, 2010.

33. Attached to this report is an updated cash flow projection for the period through to the end of May, 2011. This projection reflects the substantial reduction of lending that the IOO directed in December following the discovery that prudent and established credit practices were not being followed. As new vendors have been brought on stream and as Nelson Financial has renegotiated its arrangements with some existing vendors, lending activity has increased. From a weekly low of $24,249, lending is now back to $75,752 in the first week of February and is expected to continue to rise substantially during the next few months. The IOO expects that there will be a further major increase in activity once a plan of arrangement is approved. As discussed earlier in this Report, the credit quality

of the new loans now being made is significantly better than that achieved by Nelson Financial in the past.

34. The cash flow impact of implementation of the Plan of Arrangement is not reflected in the attached projection even though it is expected that implementation will take place in the forecast period. There are an adequate reserves for the maximum requirement of $2,500,000 under the terms of the cash exit option contained in the Plan.

35. Nelson Financial and the Noteholder creditors have been and continue to proceed diligently in their efforts to complete a restructuring of the Nelson Financial. The Applicant is now under the firm control and direction of the IOO with the support and assistance of the Representative Counsel. These officers of the Court are acting in good faith, with due diligence and in compliance with the orders of this Court made in the CCAA proceeding.

36. The Plan of Arrangement, subject to the finalization of the Litigation Trust, together with the Notice of Motion seeking a meeting order and an extension of the stay under the Initial Order were served on the service list on February 14, 2011. The Court is asked to order a meeting of the creditors with proven claims to be convened on Saturday, March 26, 2011. The IOO has been advised by the Monitor that its principal will be out of Canada on that date. It may be necessary to move the date of the meeting to April 2, 2011 to accommodate the Monitor's schedule. While the IOO expects that the Plan will be approved by the creditors and thereafter by the Court, appeal periods and other matters may delay implementation until late April or early May. The IOO considers that an extension of the stay in the Initial Order to May 31, 2011 will provide adequate time for

this restructuring to be completed or for other contingencies to be addressed in a timely manner with the Court.

Recommendations of the Interim Operating Officer

37. The IOO recommends to this Honourable Court as follows:

a) That the Plan of Arrangement dated February 11, 2011 be accepted for filing;

b) That the Plan of Arrangement be referred to a meeting of the creditors of Nelson Financial Group Ltd. holding Proven Claims as unsecured creditors as established under the terms of the Claims Procedure Order to be convened on March 26, 2011 at the Ajax Convention Centre, 550 Beck Crescent, Ajax, Ontario;

c) That the Representative Counsel be directed to Chair the Meeting and to conduct it in accordance with the terms of the draft Order;

d) That, if the Plan should be approved by resolution passed at the Meeting by the requisite majorities, that the Meeting further consider nominations and by resolution make its selections as to five qualified persons to be designated as the directors of Provider Capital Group Inc. in accordance with the Articles of Reorganization provided for under the Plan and to be filed upon the order of this Honourable Court pursuant to s.186 of the Ontario *Business Corporations Act;* and

e) That the stay of any proceedings against Nelson Financial Group Ltd. under the Initial Order be extended to May 31, 2011.

The foregoing Report, as amended, is respectfully submitted this 19th day of December, 2011.

Sherry Townsend
Interim Operating Officer of
Nelson Financial Group Ltd.

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