

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.**

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

June 28, 2006

Table of Contents

I. PURPOSE, QUALIFICATIONS AND RESTRICTIONS OF THIS REPORT1

II. SETTLEMENT AGREEMENT2

III. SUMMARY AND CONCLUSIONS.....4

I. PURPOSE, QUALIFICATIONS AND RESTRICTIONS OF THIS REPORT

On June 8, 2006, Cervus Financial Group Inc. (“CFG”) and certain of its direct and indirect subsidiaries, Cervus Financial Corp. (“CFC”) and Cervus Funding Corp. (collectively the “Applicants” or the “Companies”) filed for and obtained 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 governed by an order of this Court dated June 8, 2006 (the “Initial Order”). Pursuant to the Initial Order, KPMG Inc. (“KPMG”) was appointed as monitor (the “Monitor”) of the Applicants during these CCAA proceedings.

Capitalized terms not defined in this Second Report (as defined below) are as defined in the Initial Order or the Purchase and Sale Agreement between CFG, CFC and 6578268 Canada Inc. (the “Sale Agreement”).

The purpose of this Second Report is to provide information to this Honourable Court and the Applicants’ stakeholders in connection with the Settlement Agreement dated as of June 28, 2006 (the “Settlement Agreement”) between CFG, CFC, Mr. Gary Bartholomew (“Mr. Bartholomew”) and CyberNorth Ventures Inc. (“CyberNorth”).

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, 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. SETTLEMENT AGREEMENT

In order to assist this Honourable Court in considering the Settlement Agreement, the Monitor has reviewed the following material in connection with the arrangements between CFG and CFC and Mr. Bartholomew and CyberNorth:

- (i) the Succession Agreement dated February 28, 2006 between CFC and Mr. Bartholomew (the "Succession Agreement"), which sets out the terms under which, among other things, Mr. Bartholomew provided consulting services to Mr. Peter Williams, the current CEO of CFG. A copy of the Succession Agreement is attached as Exhibit C to the Affidavit of Mr. Grant MacKenzie, sworn June 28, 2006 (the "MacKenzie Affidavit"), and filed in support of the application for Court approval of the Settlement Agreement;
- (ii) the Sale Agreement;
- (iii) the Settlement Agreement attached as Exhibit D to the MacKenzie Affidavit; and
- (iv) the MacKenzie Affidavit.

The Monitor's understanding of the above material was augmented through additional discussions with management of the Companies as well as legal counsel for Mr. Bartholomew and for the Purchaser as deemed appropriate by the Monitor.

Mr. Bartholomew is the former CEO of CFG and former President of CFC. Mr. Bartholomew's employment by CFG and CFC was through the engagement of Mr. Bartholomew's consulting company, CyberNorth. Mr. Bartholomew resigned as CEO of CFG and President of CFC on March 2, 2006, shortly after entering into the Succession Agreement.

Paragraph 7.3 of the Sale Agreement sets out certain conditions for the benefit of the Purchaser that must be satisfied, complied with or waived by the Purchaser at or prior to the Time of Closing. In particular, Paragraph 7.3(12) of the Sale Agreement states that:

CFC shall have received a full and final release of all claims against CFC from a former executive of the Vendor and CFC as identified by the Purchaser, in form and substance satisfactory to the Purchaser, or there shall be a Holdback from the Purchase Price in an amount and on such terms and conditions acceptable to the Purchaser

The Monitor has been informed by the Companies' management that the former executive referred to in Paragraph 7.3(12) of the Sale Agreement is Mr. Bartholomew.

In order to satisfy the above condition to the Sale Agreement, CFG and CFC have entered into the Settlement Agreement with Mr. Bartholomew and CyberNorth. Certain of the key terms of the Settlement Agreement are as follows:

- (i) subject to approval being granted by this Honourable Court and subject to the completion of the Sale Agreement, CyberNorth is to receive a payment of \$200,000, plus GST, and reimbursement of its legal expenses incurred in connection with the Settlement Agreement to a maximum of \$15,000, plus GST;
- (ii) the terms of the release granted under the Succession Agreement will be adopted under the terms of the Settlement Agreement, with certain amendments as described in the MacKenzie Affidavit;

- (iii) the parties are to execute and deliver the mutual release of all claims against each other under the Succession Agreement except for claims under the Settlement Agreement, in the form of the draft mutual release attached to the Settlement Agreement as Schedule B and Mr. Bartholomew and CyberNorth are to execute the acknowledgement in the form of the draft acknowledgement attached to the Settlement Agreement as Schedule C;
- (iv) Mr. Bartholomew is to continue to cooperate and assist CFG with the settlement and completion of the transfer of 8.1 million shares of CFG by certain founding shareholders of CFG, including Bartholomew, to CFG and a management performance trust pursuant to the terms of the Succession Agreement; and
- (v) the confidentiality and non-solicitation provisions of the Succession Agreement will be adopted under the terms of the Settlement Agreement.

As indicated above, certain of the release and other provisions of the Settlement Agreement have been adopted from the Succession Agreement. The settlement payment amount of \$200,000, plus GST, is an amount that was negotiated between CFG/CFC and Mr. Bartholomew/CyberNorth with reference to the amounts that might otherwise be due to Mr. Bartholomew/CyberNorth under the terms of the Succession Agreement.

Certain of the key financial terms of the Succession Agreement are as follows:

- (i) CFC is to pay a monthly consulting fee of \$18,333.33 to CyberNorth until December 31, 2006;
- (ii) CFC is to pay a bonus in the amount of \$75,000 to CyberNorth (50% upon execution of the agreement and 50% on June 30, 2006);
- (iii) CFC is to pay another bonus of \$100,000 to CyberNorth upon the performance by Mr. Bartholomew of certain performance milestones; and
- (iv) CFC is to pay \$12,500 to Mr. Bartholomew as a reimbursement for legal fees.

The Succession Agreement also provides for a success fee at market rates to be paid to Mr. Bartholomew for completed transactions introduced by Mr. Bartholomew.

Management estimates that the maximum amount that could be due to Mr. Bartholomew/CyberNorth under the Settlement Agreement, including a success fee in connection with the Sale Agreement, is in excess of \$670,000. The settlement payment of \$200,000, plus GST, that has been negotiated recognizes that there are differing views amongst CFG/CFC and Mr. Bartholomew/CyberNorth as to whether certain of the financial components of the Succession Agreement are due and payable.

The Monitor also acknowledges paragraphs 5 and 6 of the draft Order Approving Settlement which has been prepared in connection with this matter. Should it prove necessary to do so pursuant to paragraph 6 of such Order, if made, the Monitor is prepared to pursue payment of the amount necessary with respect to "tail" insurance coverage. The Monitor understands that the amount of such payment is approximately \$27,000 in accordance with the insurance policy.

III. SUMMARY AND CONCLUSIONS

The Monitor is of the view that the proposed Settlement Agreement:

- (i) satisfies the condition in favour of the Purchaser set out in paragraph 7.3(12) of the Sale Agreement and enhances the likelihood of achieving a successful closing of the Sale Agreement;
- (ii) eliminates the Holdback that otherwise would be required (in the absence of satisfying the condition) under paragraph 7.3(12) of the Sale Agreement, and thereby, serves to reduce uncertainty as to the amount and timing of potential distributions to CFG's creditors and shareholders; and
- (iii) eliminates any potential delays in the anticipated claims process that might otherwise have been caused if a claim was filed in these proceedings by Mr. Bartholomew/CyberNorth.

Accordingly, the Monitor respectfully recommends approval of the Settlement Agreement.

RESPECTFULLY SUBMITTED,

Dated the 28th 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: 06-CL-6482

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF CERVUS FINANCIAL GROUP INC., CERVUS FINANCIAL CORP., AND CERVUS FUNDING CORP.

SUPERIOR COURT OF JUSTICE

Commercial List

Proceeding commenced at Toronto

SECOND REPORT OF KPMG INC., MONITOR

**Miller Thomson LLP
Barristers and Solicitors
Suite 5800
40 King Street West
Toronto, Ontario M5H 3S1**

Jeffrey C. Carhart

Phone: 416-595-8615

Fax: 416-595-8695

Solicitors for KPMG Inc., Monitor