



Western Financial Group

2005





Western Financial Group

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of our results of operations and financial condition should be read in conjunction with our audited consolidated financial statements and related notes as at and for the years ended December 31, 2005, and 2004.

This management's discussion and analysis is dated March 22, 2006 and provides comments regarding our objectives, strategies, financial results, risk management and business outlook. Forward-looking statements involve numerous assumptions, risks and uncertainties, including the risk that prediction and other forward-looking statements may not prove to be accurate. We caution the reader not to place undue reliance on these statements, as a number of important factors could cause actual results to differ materially from the estimates and comments expressed in them. Such factors may include, but are not limited to: changing financial and economic conditions in Canada, particularly in Western Canada; regulatory developments; competition industry trends and availability of capital resources our anticipated success in managing our risks. We caution readers that the foregoing list is not exhaustive. We do not undertake to update any forward-looking statements, written or oral, that we may make from time to time regarding our operations and performance.

The financial statements are expressed in Canadian dollars and have been prepared in accordance with Canadian generally accepted accounting principles (GAAP). We use the term "operating income" to refer to earnings, including investment income, before interest expense, taxes, depreciation and amortization of intangible and capital assets, excluding gain (loss) from the sale of long-term assets and income (loss) from long-term investments. Although operating income and operating margin, each of which are discussed herein, do not have standardized meanings prescribed by GAAP, these measures are determined by reference to our financial statements. We discuss these measures as we feel that they are some of the key indicators of the performance of our business. Operating income is used to measure corporate performance before the costs of capital and amortization of capital and intangible assets. As we continue to make acquisitions, our amortization of intangibles will continue to increase along with interest costs on funds borrowed to finance the acquisitions. In order to evaluate our longer-term sustainable performance, our management believes that operating income provides a relevant measure of our actual performance.

We are a leader in providing insurance, financial services and banking services to more than 250,000 homes and businesses in western Canada through our WFG Agency Network (the "Network"), affiliated insurance brokers, Western Life Assurance Company ("Western Life") and Bank West.

Our primary business is the ownership and operation of WFG Agency Network, which has 56 locations and serves 50 communities in British Columbia, Alberta, Saskatchewan and Manitoba. In addition, we have affiliated offices in 21 locations, serving an additional 18 communities in British Columbia and Saskatchewan. These locations offer a broad variety of property and casualty insurance services including private auto insurance and government auto in BC, Saskatchewan and Manitoba, home and farm insurance, business and specialty insurance, and life products and in many locations, investment and financial services.

In addition, Western Life Assurance Company (formerly Federated Life) was acquired effective February 28, 2005, and brings a wide range of quality life insurance products to the WFG Agency Network offices. These include term and permanent life insurance, group benefits and health and disability insurance. Western Life also has a network of over 2,000 brokers who sell their products.

Bank West ("the Bank"), a Schedule A chartered bank, offers deposit and loan services, including GICs and personal and commercial loans which are offered through their own broker network as well as through WFG Agency Network locations. The Bank has been successful in developing a growing business in recreational vehicles, marine and auto dealership financing and in offering mortgage products.

Investment products are offered from many of the WFG Agency Network locations on a referral basis to Jennings Capital, a full service investment dealer with its head office in Calgary, Alberta, in which we have a 26.6% equity interest.

During 2005, the Company entered into a business relationship with Harvard Developments to combine two well known Regina insurance brokers, Cooks McCallum Hill Insurance and our ISI Agency, under one company - Harvard Western Ventures Inc. Both local brand names were also combined, and the offices now operate under the name Cooks ISI Insurance. This partnership forms the first step in a major initiative to expand the traditional WFG broker network presence into strong insurance brokers in the larger metro markets in Western Canadian cities. In addition we purchased all of the outstanding shares of NHI Insurance Group Inc. in Coronation Alberta, Pender Island Insurance Agency in Pender Island, British Columbia, LeRoy Agencies Ltd. LeRoy Saskatchewan, 538500 Alberta Ltd. in Strathmore,

Alberta, and purchased 20% of Falkins Insurance Group Limited with ten locations in British Columbia. We also had an opportunity to sell a portion of one of our business units whose strategic plans do not include the offering of a broader range of products our Network is focused on providing.

At the end of 2005 we made a business decision to transfer our clients' mutual fund accounts that were being managed under The Western Mutual Fund Company. These accounts are now being managed by Jennings Capital Inc.

We have become specialists over the past nine years of operation due to our focus on small cities, towns and villages in Western Canada with similar demographics and economic drivers. Of the four western provinces in which we operate, Alberta, BC and Saskatchewan are forecast to lead the nation in terms of growth in 2006, and Alberta and BC held down the two top spots for 2005. This focus, on what has been a dynamic region, has helped drive our company's success. By continuing to focus on a key part of the market, we will continue to achieve success through our focus on:

- Efficiently integrating brokers that are located in communities similar to our current communities, minimizing integration difficulties and maximizing synergies;
- Tailoring our product and service offerings and expertise to industries prevalent in our current communities (e.g. agriculture, energy and natural resources); and
- Emphasizing our brand and marketing efforts with a strong regional and rural theme, which we believe is attractive to our customers.

Our strategic objective is to be the financial services provider of choice for individuals and businesses in small cities, towns and villages in Western Canada. In order to achieve our strategic objective we:

- Provide our customers access to a broad range of products;
- Leverage the Network to cross-sell complementary products and services;
- Provide industry-leading service in our core business;
- Expand our manufacturing platform opportunistically;
- Pursue additional Network acquisitions; and
- Build the "Western" brand.

We now have several competitive advantages in our industry:

- Scale in our core business;
- Acquisition and integration experience and expertise;
- A diversified and complementary product offering;
- Customer loyalty from our local presence; and
- Financial strength.

The P&C insurance brokerage industry is sensitive to changes in the P&C insurance industry as a whole. The P&C insurance industry is competitive and highly fragmented with approximately 100 private and government-owned insurers in Canada, with the top five private P&C insurers accounting for approximately 34.9% of the industry's private direct premiums written. In our management's view, this competition has indirectly resulted in P&C insurance companies requiring increased service and efficiency from brokers. The costs of meeting these requirements, which typically include the upgrade and maintenance of technology and information systems and the addition and training of staff, can be significant and are borne by the brokers. Many P&C insurers have also established minimum annual premium volumes as a condition to allowing brokers to distribute their products. We believe that a significant number of brokers are either unable or unwilling to meet these volume demands or increase their investments in their businesses and staff, leading to consolidation opportunities in the P&C insurance brokerage industry. We expect this consolidation trend to continue for the foreseeable future.

We believe that consolidation is the most efficient means of building a network in the fragmented P&C insurance brokerage industry in Canada. Accordingly, we actively search for brokers in small cities, towns and villages in Western Canada to which our management, financial resources, industry experience and marketing skills can be applied in order to enhance the profitability of the acquired business. We have identified 159 communities in Western Canada for expansion over the next six to eight years and we estimate that there are approximately 475 brokers in these communities.

Bank West's growth strategy is to continue to expand and develop its market penetration among the Network's customers and to continue to develop relationships with third-party distribution channels, such as mortgage and loan brokers in Western Canada. While Bank West has grown its assets since inception, it is still in the early stages of its development. We do, however, expect Bank West to contribute net income to our operations over time.

Western Life's operations, marketing and sales have historically been imbedded with the Property & Casualty insurance distributors. Western Life adds a comprehensive suite of life and health insurance products to enhance the Network's product offering and has significant presence in Western Canada.

Our management has identified certain key business drivers to assist it in managing and evaluating the progress of our business, especially the largest component of our business, the Network. These drivers consist of both financial and operational indicators. First, we use **consolidated operating margins** to analyze the change in our mix of business. Then we look at the **operating margins** of the Network to track the efficiency by which we operate and run our business. Third, as we continue to add branch offices to the Network through acquisitions, it is important for us to track the revenues of the Network's existing individual branch offices, or **same-store revenue** change, from one period to the next. Fourth, as we continue to add new products through the sale of P&C insurance and the addition of financial service products through the Network, we expect the average number of products we sell to existing customers to increase. To analyze this, we track the **average number of products per customer account**. We also track the Network's year-to-date annualized percentage change in **same-store customer account increase**. The table below shows our key business drivers.

	<u>Years Ended December 31,</u>				
	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>
Key Business Drivers:					
Consolidated operating margin ⁽¹⁾	15.1%	19.0%	16.8%	17.4%	19.7%
The Network:					
Operating margin	28.7%	28.8%	28.1%	23.7%	
Same-store revenue increase ⁽²⁾	6.8%	6.6%	13.8%	13.0%	6.0%
Average items per customer account ⁽³⁾	1.77	1.67	1.51	1.46	1.42
Same-store customer account increase ⁽⁴⁾	2.8%	4.0%	4.0%	2.0%	— ⁽⁵⁾

Notes:

- (1) Consolidated operating margin is calculated by dividing our total operating income by our total revenue. As we change our mix of business over time we will see the impact on our consolidated operating margins.
- (2) Represents same-store revenue increase for the twelve months ended on the date indicated over the corresponding year in the prior year.
- (3) The average number of products per customer account increased significantly in 2005 as a result of additional products sold to our existing customers, which we only started tracking in 2004.
- (4) Represents year over year annualized increase.
- (5) We did not start tracking same-store customer account increase until 2002.

Three-year Summary
(In \$ thousands except for per share amounts)

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Total revenues	63,584	42,244	32,666
Net Income	4,849	3,395	2,120
Earnings per share-Basic (\$)	0.17	0.18	0.11
Earnings per share-Fully diluted (\$)	0.15	0.16	0.10
Total Assets	278,288	157,107	116,323
Total Long-term Liabilities	100,584	75,944	31,070

Our financial results are divided into four reportable segments: P&C insurance brokerage (the Network), banking services (Bank West), life insurance (Western Life), and corporate and all other (which includes travel agencies, real estate assets, and The Western Mutual Fund Company) but also includes contingent commissions of the Network).

	Years Ended December 31	
	2005	2004
The Network		
Commissions and other customer revenue	\$37,278	\$35,711
Operating expenses	<u>26,571</u>	<u>25,438</u>
Operating income ⁽¹⁾	<u>\$10,707</u>	<u>\$10,273</u>
Bank West		
Interest and investment income	\$4,552	\$2,184
Net interest and investment income	1,227	696
Operating expenses	1,833	1,528
Amortization of start up and reorganization	<u>289</u>	<u>292</u>
Operating loss ⁽¹⁾	<u>\$(895)</u>	<u>\$(1,124)</u>
Western Life		
Premium and investment income	\$18,741	-
Policyholder benefits	9,564	-
Operating expenses	6,806	-
Operating income	2,371	-
Corporate and all other		
Other revenues	\$6,338	\$5,837
Operating expenses	8,817	6,822
Amortization of start-up and reorganization costs	<u>85</u>	<u>151</u>
Operating loss ⁽¹⁾	<u>\$(2,564)</u>	<u>\$(1,136)</u>
Total operating income ⁽¹⁾	<u>\$9,619</u>	<u>\$8,013</u>

Notes:

- (1) We use “operating income” to refer to earnings, before interest expense, taxes, depreciation and amortization of intangible and capital assets. Operating income (loss) is a non-GAAP measure we use to measure our corporate performance before the costs of capital and amortization of capital and intangible assets. This measure may not be comparable to similar measures presented by other issuers and investors are cautioned that it should not be used as an alternative to “net income” or other measures of financial performance calculated in accordance with GAAP.

Year Ended December 31, 2005 compared to the Year Ended December 31, 2004

Results of Operations

Revenue

Total revenue increased by \$21.3 million, or 50.5%, to \$63.6 million compared to \$42.2 million in 2004. This was primarily a result from the acquisition of Western Life (formerly Federated Life) contributing \$18.7 to our revenue in 2005.

The Network’s revenue increased by \$1.6 million to \$37.3 million in 2005 compared to \$35.7 million in 2004. This was primarily due to the growth in same-store revenue of 6.8% (approximately \$1.8 million). We saw an increase in P&C sales of \$1.3 million which includes government auto, revenue from new acquisitions of \$328,000 and annualized revenue from acquisitions completed through 2004 of approximately \$800,000 . We realized a decrease in revenue of \$891,000 from the disposition of WFG Commercial Insurance and a further decrease in our Network’s revenue of \$906,000 as we merged ISI agencies with Cooks McCallum Hill Insurance to form Harvard Western Ventures Inc. Harvard Western Ventures now makes up a portion of our income from long-term investments. An increase of \$385,000 was derived from other income which includes registries income where we saw an increase of \$212,000 which was from new acquisitions in 2005 and a full year of our 2004 acquisitions, and income from the financing of policies for our clients on a monthly pay plan which increased by \$130,000.

Bank West's gross interest income increased by \$2.3 million, to \$4.5 million in 2005 compared to \$2.1 million in 2004. Customer deposits increased by \$45.3 million to \$94.9 million in 2005 from \$49.6 million in 2004 which drove interest and commission expense higher by \$1.6 million. As a result, Bank West's net interest and other income after provisions for loan losses increased by \$531,000 to \$1.2 million in 2005 compared to \$695,000 in 2004. Mortgages and other loans more than doubled to \$90.8 million in 2005 from \$43.4 million in 2004.

Western Life contributed \$18.7 million in total revenue with \$16.4 million in premium revenue and \$2.4 million in investment income. Western Life has increased sales in both group products and P&C add on products.

Revenue from our corporate and all other segment increased by \$501,000 to \$6.3 million in 2005 compared to \$5.8 million in 2004. A portion of the increase was due to contingent commissions received, which increased \$368,000 contributing to total contingent commissions of \$4.2 million in 2005 compared to \$3.9 million in 2004. Included in the \$4.2 million for 2005 was an additional \$753,000 for 2004 which was higher than management's estimate. Our numbers continue to reflect the increased profitability of the business we place with our P&C insurance providers. We also saw an increase in our dividend income by \$216,000 in 2005 due to our preferred share investment in Jennings Capital and our preferred share investment portfolio.

Operating Expenses

Total operating expenses increased by \$10.2 million, or 30.3%, to \$44.0 million in 2005 compared to \$33.8 million in 2004, primarily due to the acquisition of Western Life on February 28, 2005. The addition of Western Life increased our operating expenses by \$6.8 million which accounted for 69.3% of the total increase.

Operating expenses in the Network increased \$1.1 million, or 4.5%, to \$26.6 million in 2005 compared to \$25.4 million in 2004. Our increases in expenses are normally the result of new acquisitions and the increase in activity levels as a result of new business. New acquisitions completed in 2005 increased operating expenses by approximately \$204,000 while the disposition of WFG Commercial Insurance and the merger of ISI with Harvard Western Ventures Inc., as discussed in the Network's revenue analysis, decreased our expenses by \$1.1 million. Acquisitions completed throughout the year in 2004 increased the 2005 expenses by \$543,000. Salaries and wages expense for 2005 increased 7.8% to \$19.2 million from \$17.8 million in 2004. As a percentage of revenue, salaries and wages increased slightly to 51.5% compared to 49.8% in 2004. This movement was due to the additions in senior management to build the infrastructure of the Network to manage existing operations and continued growth both organic and acquisition driven. We saw an increase in travel expense of \$106,000 for the regional meetings held for management and our executives attending branch meetings. The balance of the increase in operating expenses related to advertising, promotion, relocation costs, and office expense.

Bank West's operating expenses increased by \$305,000, or 20.0%, to \$1.8 million in 2005 compared to \$1.5 million in 2004. The increase in general operating expenses was consistent with the growth of the operation. Bank West's salaries and wages expense increased by 10.1% or \$90,000 due to increased staffing levels consistent with the growth of the business. Commissions and loan expense increased \$251,000 consistent with the growth in our mortgages and loans.

The operations of Western Life increased our operating expenses by \$6.8 million for the ten months of operations since the acquisition on February 28, 2005. Western Life has demonstrated efficient control of expenses and lower than expected claims incurred. Commission expenses are higher than anticipated but are in direct correlation to the increase in net premium income. Policy holder benefits were \$9.6 million in 2005 and include provisions for actuarial liabilities, claims incurred and surrenders.

Corporate and all other segment expenses increased \$2.0 million, or 29.2%, to \$8.8 million in 2005 compared to \$6.8 million in 2004. Additional management and accounting staff accounted for approximately \$302,000, and an increase in salaries and wages of \$175,000 with the Western Mutual Fund Company. The amortization cost of our employee share ownership plan increased by \$329,000 due to the increase in overall staff, and participation in the plan has increased to approximately 53.0%. We incurred one-time costs of approximately \$181,000 for expenses related to potential acquisitions we chose not to complete and \$96,000 for costs associated with the valuation of our goodwill. In addition we had one time costs associated with bonuses and awards of \$226,000. We had an increase of \$239,000 associated with promotions, travel, meetings, and education including the employee convention and director and management meetings and seminars. The Western Mutual Fund Company paid out \$300,000 in commissions and increased our computer expense by \$90,000 for the processing platform required for the mutual fund business. The balance of the change in expenses is attributable to our normal operating expenses growing in line with our business with certain cost savings in technology and the reclassification of certain costs to the Network.

Amortization of start-up and reorganization costs decreased by \$69,000, or 15.6%, to \$374,000 in 2005 compared to \$443,000 in 2004, due to the completion of the amortization of certain start-up costs. The start-up costs for Bank West have been fully amortized in 2005 which accounted for \$289,000 of the total amortization costs.

Other Expenses and Income

We recorded a one-time charge of \$670,000 (\$476,000 after-tax) in 2004 associated with legal and other costs related to a claim we had filed against Montreal Trust. During 2004 a judgment was rendered in favor of Montreal Trust. We have determined that there is

sufficient basis upon which to file an appeal. As the outcome of the appeal is not determinable, the costs incurred to date have been recorded as an expense in 2004. Any recovery of costs as a result of the appeal will be recorded in the year recovered.

We recorded a one-time gain of \$630,000 (\$ 277,000 after-tax) on the sale of an agency in 2005 as compared a one-time loss of \$95,000 (\$71,000 after-tax) on the sale of assets in 2004.

Interest and financing costs increased \$60,000, or 2.3%, to \$2.7 million in 2005 compared to \$2.6 million in 2004. With the reclassification of the equity portion of our convertible debentures to debt we had an increase in deferred finance costs of \$299,000 which increased our interest expense by \$75,000.

Amortization of intangible assets increased \$109,000, or 49.5%, to \$329,000 in 2005 compared to \$220,000 in 2004 as a result of the increase in the amount of intangible assets from \$7.1 million in 2004 to \$10.5 million in 2005. The change in intangibles assets is a result of acquisitions and disposals completed in 2005.

Amortization of capital assets increased by \$354,000, or 33.7%, to \$1.4 million in 2005 compared to \$1.1 million in 2004 due to the addition of \$2.0 million of new capital assets and assets related to acquisitions (additions of \$2.5 million less disposals of \$471,000 from the sale of a building). Our additions from the year come from the purchase of office facilities, leasehold improvements, and furniture and computer equipment for new and existing staff.

Income taxes increased \$1.1 million, or 80.7%, to \$2.4 million in 2005 compared to \$1.3 million in 2004 primarily due to increased operating income for the period. Our effective tax rate, however, did increase to 32.8% in 2005 from 28.7% in 2004 with the dispositions of previously acquired goodwill, and an adjustment through future taxes. When the company acquires shares in business acquisitions, there is no tax cost associated with the goodwill acquired. As a result an additional tax expense is realized when these assets are subsequently sold. In 2005, the company sold the operations of ISI Agencies, the operations of which were acquired through a share purchase in a previous year, resulting in an additional tax expense. We had an increase of \$167,000 in tax expense related to the sale of assets, and we recorded a future tax adjustment of \$179,000. In addition we realized a tax benefit of \$113,000 on the gain of the sale of equities.

Net Income

Net income increased \$1.4 million or 42.8%, to \$4.8 million in 2005 compared to \$3.4 million in 2004. This increase was primarily due to the increase in our operating income with the addition of Western Life as well as our gain of \$630,000 on the sale of a portion of two of our reporting units.

Selected Quarterly Financial Information

	<u>For the Quarters Ended — 2005</u>			
	<u>March 31</u>	<u>June 30</u>	<u>September 30</u>	<u>December 31</u>
	<i>(In \$ thousands except per share amounts)</i>			
Total revenue	\$12,263	\$17,529	\$16,037	\$17,755
Net income	1,060	1,548	1,026	1,215
Earnings per share				
Basic	\$0.04	\$0.06	\$0.04	\$0.03
Diluted	\$0.04	\$0.05	\$0.03	\$0.03

	<u>For the Quarters Ended — 2004</u>			
	<u>March 31</u>	<u>June 30</u>	<u>September 30</u>	<u>December 31</u>
	<i>(In \$ thousands except per share amounts)</i>			
Total revenue	\$8,926	\$10,719	\$10,727	\$11,872
Net income	587	989	593	1,226
Earnings per share				
Basic	\$0.03	\$0.05	\$0.03	\$0.07
Diluted	\$0.03	\$0.05	\$0.03	\$0.05

For the quarter ended December 31, 2005 the Company's fourth quarter, we generated revenue of \$17.8 million, net income of \$1.2 million, and earnings per share of \$0.03. This compares to revenue of \$11.9 million, net income of \$1.2 million and earnings per share of \$0.07 in 2004. The fourth quarter increase over 2004 is due primarily to the acquisition of Western Life. Our earnings per share however were reduced with the issuance of 10,350,000 new shares in February 2005. With our Corporate capital planning we deployed funds from equity and subordinated debenture financings, along with the use of our senior credit facility for a number of acquisitions and investments over the course of the year. The full year of earnings will be realized in 2006. In the fourth quarter of 2005 we received an additional \$1.0 million of contingent commissions compared to \$1.9 million in the fourth quarter of 2004. This reflects the change in profitability year over year with the business placed with our P&C insurance providers.

Year Ended December 31, 2004 compared to the Year Ended December 31, 2003

Results of Operations

Revenue

Total revenue increased by \$9.6 million, or 29.3%, to \$42.2 million compared to \$32.7 million in 2003. This was primarily a result of the increase in the Network's revenue, which grew by \$6.6 million, or 22.4%, to \$36.1 million in 2004, compared to \$29.5 million in 2003. This was due to growth in same-store revenue of 6.6% (we only track same-store revenue growth on a last twelve months basis). It was also due to growth in sales of financial services products in the branch offices of 24.5%. Acquisitions made in the fourth quarter of 2003 and in 2004 accounted for approximately \$5.1 million of the increase in revenues. The Network's basic commission revenue also increased by \$6.6 million, or 24.3%, to \$33.8 million in 2004 compared to \$27.2 million in 2003.

Bank West's gross interest income increased by \$1.5 million, to \$2.2 million in 2004 compared to \$644,000 in 2003 (eleven months of operations). Customer deposits more than doubled to \$49.6 million in 2004 from \$20.7 million in 2003 which drove interest and commission expense higher by \$695,000. As a result, Bank West's net interest income increased by \$1.0 million to \$1.3 million in 2004 compared to \$294,000 for 2003 (eleven months of operations). Mortgages and other loans more than doubled to \$43.4 million in 2004 from \$16.3 million in 2003. Furthermore, the introduction of dealership loans increased the loan portfolio by \$12.4 million in 2004.

Revenue from our corporate and all other segment increased by \$2.6 million, or 87.3%, to \$5.5 million in 2004 compared to \$2.9 million in 2003. A significant portion of the increase was due to contingent commissions received, which increased \$1.8 million, or 91.1%, to \$3.9 million in 2004 compared to \$2.0 million in 2003. This improvement reflected the increased profitability of the business placed with our P&C insurance providers. We also realized an increase in investment and interest income of \$160,000 from cash balances in connection with the private placement of Common Shares completed in 2004, which was offset slightly by the reduced dividend income from our smaller preferred share portfolio in 2004.

Operating Expenses

Total operating expenses increased by \$7.2 million, or 26.9%, to \$33.8 million in 2004 compared to \$26.6 million in 2003, primarily due to salaries and wages expense, which was 52.6% of our total revenue for 2004 compared to 52.8% in 2003. Our salaries and wages expense was kept under control through monitoring monthly reports and reflects the general industry trend of expense margin reduction.

Operating expenses in the Network increased \$4.6 million, or 21.7%, to \$25.8 million in 2004 compared to \$21.2 million in 2003, as a result of new acquisitions and the increase in activity levels as a result of new business. New acquisitions increased operating expenses by approximately \$2.8 million and salaries and wages expense for existing operations increased by \$1.4 million. The Network's salaries and wages expense averaged 50.0% of the Network's revenues in 2004 compared to 49.7% in 2003. The balance of the increase in operating expenses related to rent and communication costs, which are two of the key expenses of the Network.

Bank West's operating expenses increased by \$448,000, or 41.5%, to \$1.5 million in 2004 compared to \$1.1 million in 2003 (eleven months of operations). The increase in general operating expenses was consistent with the growth of the operation. Bank West's salaries and wages expense increased by 55.5% or \$318,000 due to increased staffing levels and the accrual of management bonuses. The provision for loan losses increased by \$112,000, which is due to mortgage and loan asset growth that more than doubled to \$43.4 million. This provision reflected our management's best estimate of the losses inherent in the portfolio at the balance sheet date, and the increase in the period reflected the underlying growth of the portfolio of mortgages and loans, and was not due to a deterioration of the credit quality of the portfolio.

Corporate and all other segment expenses increased \$2.1 million, or 48.6%, to \$6.5 million in 2004 compared to \$4.3 million in 2003. Additional management and accounting staff accounted for approximately \$250,000 of the overall increase. Additionally, increased performance bonuses accrued were approximately \$510,000 and of \$72,000 for expenses related to potential acquisitions we chose not to complete. We had an increase in our insurance costs of \$125,000 due to additional coverage and pricing increases and increased printing and mailing costs in connection with our compliance with PIPEDA (Personal Information and Electronic Document Act), which required us to issue a privacy policy letter and brochure to our customers. The balance of the increase is attributable to our normal operating expenses growing in line with our business.

Amortization of start-up and reorganization costs decreased by \$119,000, or 21.1%, to \$443,000 in 2004 compared to \$561,000 in 2003, largely due to the decrease in the amortization costs incurred with the branding of our operations in 2002 that was no longer amortized in 2004. Excluding the \$292,000 incurred in 2004 for the start-up of Bank West and the \$243,000 incurred in 2003, amortization of reorganization costs decreased 52.7% in 2004 compared to 2003.

Operating Income

The Network increased its operating income by \$2.0 million, or 24.3%, to \$10.3 million in 2004 compared to \$8.3 million in 2003. These results were partially offset in both years by operating losses in Bank West and the corporate and all other segment that collectively totaled \$2.3 million in 2004 and \$2.8 million in 2003. This resulted in an overall increase in operating income of \$2.5 million, or 46.2%, to \$8.0 million compared to \$5.5 million in 2003. Our operating margin increased to 19.0% in 2004 compared to 16.8% in 2003. The Network's margins improved through sales of additional products and Bank West increased its revenues to support the fixed expenses of its operations, both of which contributed to our overall growth in operating margins while corporate experienced increased contingent commissions.

Other Expenses

We recorded a loss of \$95,000 (\$74,000 after-tax) on the sale of assets in 2004 compared to \$37,000 (\$28,000 after-tax) in 2003 on the sale of assets as a result of purchase adjustments made to prior years' dispositions that could not be estimated at the time of sale.

Interest and financing costs stayed the same at \$2.6 million in 2004 and 2003 after the re-class. Effective January 1, 2005, the Company adopted the new recommendations of the Canadian Institute of Chartered Accountants with respect to accounting for compound financial instruments that have the characteristics of both a liability and equity. Under the new recommendation the Company records financial instruments that provide for settlement by the issuance of its own capital stock under certain circumstances as financial liabilities. The effect of this change on the current period is an increase in interest and financing costs, a reduction in income tax expense, the reclassification to liabilities of amounts previously recorded as equity and the write off of deferred finance charges previously charged against the equity component of the convertible debentures. This change has been applied retroactively as presented.

December 31, 2004 (In \$ thousands)		
Deferred charges	\$ 926	\$ 1,225
Future income taxes	\$ 528	\$ 629
Long term debt	\$ 20,425	\$ 38,263
Other paid in capital	\$ 17,550	\$ 206
Retained earnings	\$ 6,508	\$ 6,212

We saw reduced interest expense on our preferred share portfolio margin account. In addition, the holders of our 9.0% subordinated convertible redeemable debentures (the "9.0% convertible debentures") converted \$363,000 of these debentures into 145,200 Common Shares and we purchased and subsequently cancelled \$135,700 of our 9.0% convertible debentures pursuant to our normal course issuer bid, which collectively resulted in reduced interest costs in 2004 compared to 2003.

Amortization of intangible assets increased \$87,000, or 66.1%, to \$220,000 in 2004 compared to \$132,000 in 2003 as a result of the increase in the amount of intangible assets from \$4.2 million in 2003 to \$7.1 million in 2004, as a result of acquisitions completed in 2003 and in 2004.

Amortization of capital assets increased by \$125,000, or 13.5%, to \$1.1 million in 2004 compared to \$927,000 in 2003 due to the addition of \$3.7 million of new capital assets and assets related to acquisitions. Our additions from the year come from the purchase of office facilities, leasehold improvements, and furniture and computer equipment for new and existing staff.

Income taxes increased \$579,000, or 51.7%, to \$1.7 million in 2004 compared to \$1.1 million in 2003 primarily due to increased operating income for the period. Our effective tax rate, however, decreased to 28.7% in 2004 from 34.6% in 2003 due to the increase in income from our long-term investments. We also saw a decrease in the statutory tax rate to 33.9% from 37.6%.

Net Income

Net income increased \$1.3 million, or 60.1%, to \$3.4 million in 2004 compared to \$2.1 million in 2003. This increase was primarily due to the increase in our operating income as well as our equity investment in Jennings, which contributed \$1.3 million to net income in 2004 compared to \$316,000 in 2003.

Liquidity and Capital Resources

Total shareholders' equity as at December 31, 2005 was \$72.7 million, or 54.7% higher than at December 31, 2004. We obtained \$22.3 million (\$20.8 million net) million of new financing through a public offering of subscription receipts issuing 10,350,000 of common shares upon conversion February 28, 2005.

We expect our capital resources will be sufficient to satisfy our financial requirements, which include business acquisitions and capital expenditures. Capital resources include cash, funds raised through the private placements, available senior bank debt and funds generated from operations.

We have a credit facility to a maximum of \$30.5 million negotiated with the Bank of Montreal. As at December 31, 2005, \$10.5 million of this facility had been utilized. Pursuant to the terms of this credit facility, we make monthly loan payments of \$122,000 plus interest. Repayment of the credit facility is dependent upon annual renewal. In the event the Bank of Montreal elects not to extend the initial period, the facility will convert to a two-year committed term facility for all amounts due thereunder. In March 2003, we entered into an interest rate swap agreement exchanging \$8.0 million of floating rate debt for a fixed rate of 6.225%. This debt requires interest payments only. The swap agreement expires May 2008. At December 31, 2005 we were in compliance with the financial covenants of our senior credit facility.

At December 31, 2005, we also had a total of \$15.0 million in subordinated convertible redeemable debentures due 2009 and 2010. At this time we are not in a position to force conversion or are we planning to pursue early redemption of these debentures.

At the close of 2005 we had \$11.0 million of subordinated convertible redeemable debentures outstanding with interest payable semi-annually at 9% per annum. These debentures are convertible at the option of the holder, at any time prior to maturity, into our common shares of the Company at a conversion price of \$2.50. The debentures are due February 2007. We may redeem the debentures at par any time after February 2005 if the twenty-day weighted average trading price of our shares is not less than \$3.10 per share.

At December 31, 2005, we had a total of \$1.0 million of unsecured subordinated notes with interest payable semi-annually at 12% per annum. The notes are redeemable by the company after March 2010.

At December 31, 2005 we had cash and cash equivalents of \$10.4 million as compared to \$12.3 million at December 31, 2004. Operations contributed \$6.4 million as compared to \$1.3 million in 2004 due to the additions of the operations of Western Life and the growth of Bank West. Cash used in investing activities was \$78.5 million in 2005 as compared to \$39.0 million in 2004. We increased our investments in marketable securities and our investment in Jennings Capital along with our investment in Harvard Western Ventures Inc. In addition we had net assets acquired in the acquisition of Federated Life, and several P&C insurance brokerages of \$15.1 million. We had \$201,000 on deposit for acquisitions closing in January 2006. In 2005 we purchased capital assets of \$2.0 million. We increased our use of cash to fund mortgages and loans by \$46.9 million in 2005 as compared to \$26.3 million in 2004. In 2005, \$65.2 million was provided in financing activities with \$45.8 million from customer deposits at Bank West used to fund mortgages and loans. We received net proceeds from the issuance of common shares as previously detailed, and proceeds from the exercise of options of \$21,000. Finally we made repayments of \$1.6 million on our senior credit facility.

Contingent Obligations

In the normal course of business Bank West issues commitments to extend credit to customers which are not recorded in the financial statements. These commitments which are undrawn at year-end are in the form of loans for specific amounts and maturities subject to meeting certain conditions and have no stated expiry dates. The maximum potential amount of future payments under these commitments is \$3.1 million (2004 - \$1.5 million).

The company is committed to the following annual property lease payments, and long-term debt payments between 2006 and 2010.

	<u>Property Leases</u>	<u>Long-Term Debt</u>
2006	\$2,061	\$1,552
2007	2,154	12,157
2008	2,027	7,998
2009	1,636	9,999
2010	1,427	6,000

Transactions with Related Parties

Related parties include directors, officers and their related companies. The prices and term of transactions with related parties are in accordance with normal business practice and recorded at the exchange amount.

- Commissions of nil (2004-\$3,000) were paid to Jennings Capital Inc., an affiliated Company in which a director holds an interest, for management of the Company's marketable securities and interest of \$8,000 (2004 - \$2,000) in respect of the investment margin loan.
- Dividends income on preferred shares of \$182,000 (2004- \$299,000) and income from equity investments of \$976,000 (2004- \$1.0 million) were accrued with respect to our investment in Jennings Capital Inc.
- Dividends on preferred shares in the amount of \$8,000 (2004 - \$12,000) were accrued to a company controlled by a director.
- The Western Mutual Fund Company is able to share certain officers and staff with Jennings Capital Inc. It has accrued \$119,000 (2004- \$112,000) in shared costs which is payable to Jennings Capital Inc.

Subsequent Events

In 2005 the company entered into memorandums of understanding and term sheets with respect to the acquisition of Insurance brokerage businesses of Golden Eagle Agencies Ltd., 606065 Alberta Ltd, 1176496 Alberta Ltd, and 1194595 Alberta Ltd., for a cost of \$2.0 million. The Company finalized the acquisitions in January of 2006.

Subsequent to year end the Company purchased 25% of Northcountry Insurance Agencies Ltd. with an investment of \$1.5 million, and provided short term financing of \$837,000.

Outstanding Share Data

At December 31, 2005 the balance of issued common shares was 30,644,000, for a total value of \$59.7 million. In connection with a private placement completed in 2003 we issued 2,291,000 warrants. We had a second closing in 2004 and issued an additional 909,732 common share purchase warrants for a balance at December 31, 2004 of 3,200,000 common share purchase warrants. These warrants were not exercised and expired December 2005.

We have a fixed stock option plan under which we may grant options to directors, officers, shareholders and consultants for up to 10% of the issued and outstanding shares to an aggregate maximum of 1,600,000 common shares. We granted 223,000 options in 2005, 20,000 options were exercised and 92,000 options were cancelled leaving 680,000 options outstanding at December 31, 2005 of which 457,000 were exercisable and 920,000 are available for grant.

Critical Factors Affecting Results

The level of revenue and earnings from our operations depends on several factors including basic commission levels paid to us for the sale of P&C insurance products, the amount of contingent commissions paid by our main P&C insurance providers, our ability to sell additional financial products and services to the existing customer base of the Network, returns on our corporate and financial investments and our ability to control and manage expenses.

Revenue

A significant element of our revenue is the receipt of basic commissions from our P&C insurance providers. Basic commission levels vary by province and product but generally range from 5.0% to 20.0% of the premiums written and are typically paid at a rate of 12.5% for premiums sold for automobile insurance and 20.0% for premiums sold for property and liability insurance. As part of our overall agreements with our larger P&C insurance providers, we have negotiated various levels of contingent commissions, which are based on previous years' business written with that particular P&C insurer and are usually determined by profitability and volume. Furthermore, the Network's sales of complementary financial products and services such as banking products, life and health insurance products, group benefits, mutual funds and investment products also continue to grow.

In addition we generate revenues from several other sources. Sales of Bank West products and agency banking products such as GICs, loans and mortgages have been growing rapidly and are becoming a meaningful source of revenue, and premiums generated through Western Life for group and individual life insurance, group health coverage, and creditor insurance.

Expenses

Our expenses consist primarily of salaries and wages expense (which include benefits and bonuses) of our staff as well as overhead and administrative expenses. As our single largest expense is employee salaries and wages, any significant changes in this area will have a meaningful impact on our overall expenses. The largest portion of our expenses relate to operating the Network. We monitor the expenses through local budgets that are set by each branch office and segment of the Company. These expense budgets are approved by our senior management and are monitored on an ongoing basis. As the Network is a broker, it does not bear any expense as a result of a customer making an insurance claim. The financial impact of insurance claims is a potential decrease in the contingent commission paid to us. However, as contingent commissions are paid to us based on the aggregate number of policies placed with a P&C insurer, only a very large individual loss could impact the overall contingent commission paid. With the sale of life products actuarial liabilities are computed to properly match policy holder benefits and expenses to revenue.

Investments

Our interest in Jennings Capital and more recently Harvard Western Ventures and Falkins Insurance Group have produced annual returns, which have added to our earnings.

Disclosure Controls and Procedures

As at the financial year ended December 31, 2005, an evaluation was carried out under the supervision of and with the participation of the our management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of our Company's disclosure controls and procedures. Based on that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the design and operation of these disclosure controls and procedures were effective as at December 31, 2005 to provide reasonable assurance that material information relating to us Company and our consolidated subsidiaries would be made known to them by others within those entities.

Regulation

The industries in which we operate are regulated for the sale of all P&C insurance, banking products, life and health insurance products, mutual funds and investments. Changes in these regulations may significantly affect our operations and financial results.

Critical Accounting Estimates and Assumptions

Our consolidated financial statements are prepared in accordance with Canadian GAAP as further described in Note 2 of our audited financial statements. These accounting policies require our management to make estimates and assumptions that affect the reported amount of assets and liabilities as at the date of the financial statements, and income and expenses during the reporting period. Key areas of estimation where management has made difficult, complex or subjective judgments, often as a result of matters that are inherently uncertain, include those relating to the allowance for loan losses, assessment of impairment of goodwill, the useful life of intangible assets, allocation of purchase price of an acquisition to goodwill and intangible assets, allowance for policy cancellations of commission revenue and stock-based compensation, and future income taxes. Estimates are based on our management's experience, terms of contracts and policies, observation of industry trends and information provided by outside sources. These estimates are more fully discussed below.

Mortgages and Loans

Bank West has a general allowance for loan losses for the portfolio of mortgages and loans that it provides to individuals and businesses, which is estimated using industry knowledge of similar loan portfolios. The general allowance is based on an assessment of existing economic and portfolio conditions which will change over time. The general allowance is re-assessed monthly and fluctuates as a result of changes in portfolio volumes, concentrations and risk profile and analysis of evolving trends. Changes in this estimate will impact the net interest income portion of revenue reported by Bank West.

Actuarial Liabilities

Actuarial liabilities are determined by the Appointed Actuary using the Canadian Asset Liability Method and represent the amount, which, together with future policy premiums and investment income, will be sufficient to meet future benefits and expenses.

Reinsurance

Western Life follows the policy of underwriting and reinsuring contracts of insurance which, depending on the type of insurance, limits their liability to a maximum amount of \$100,000 per life insured or \$2,500 per month for any disability income claim. Western Life reflects reinsurance balances on the balance sheet and income statements on a net basis. Western Life has guidelines and a review process in place to ascertain the credit worthiness of the companies to which it cedes. All current new business is placed with registered reinsurers.

Goodwill

Goodwill represents the excess of consideration paid over the fair value of net tangible and intangible assets acquired in business acquisitions and related costs of acquisition. Goodwill is not amortized, but is tested for impairment on an annual basis by comparing the fair value of each reporting segment to its book value. The fair value of a reporting segment is estimated using revenue and earnings multiples that have been observed in the relevant industry. In 2004 an independent valuation confirmed that the valuation principles used were accurate and that there was no impairment to goodwill recorded in the financial statements. An internal evaluation was completed in 2005 and no impairment was identified.

Intangible Assets

Intangible assets in respect of purchased customer contracts and related customer relationships are being amortized on a straight-line basis over the estimated life of the asset. We have relied on our past experience with respect to customer retention in determining a 30-year life for purchased customer contracts and the related relationships. Customer retention rates may change over time based on competition in our markets. Any changes in retention rates would result in changes to the useful life and annual amortization expense. We annually assess whether the life of the intangible asset is appropriate as well as for impairment by comparing the carrying amount to its fair value.

Allocation of the Purchase Price of an Acquisition

Acquiring businesses that are competing with our existing businesses is a fundamental component of our growth strategy. When we acquire a business, the purchase price allocated to the assets acquired and the liabilities assumed are based on their fair values. Any excess of purchase price over identified assets is allocated to goodwill. The fair value of assets, including intangible assets, is determined using valuation methods including net realizable value and discounted cash flows. The use of assumptions, which are based on our management's judgment, is inherent in the application of these valuation methods. The use of different judgments, estimates and valuation methods may result in different allocations of the purchase price and, as a result, different results of operations.

Revenue Recognition

P&C insurance commission revenue is recognized when the P&C insurance policy sold is in place and the amount of the commission earned is determinable. Contingent commissions are recorded when amounts can be determined and are recognized when they are earned. The determination of contingent commissions is based on estimates received from P&C insurance companies and may vary from actual amounts received. Commission revenue is reported net of an allowance for commission losses that may be incurred if a policy is cancelled.

Revenues from banking operations are classified as net interest income with revenue recognized in the period earned.

Premium revenue from all types of life insurance contracts are recognized as revenue when due.

Investment income represents excess working capital that is invested in preferred shares and short-term deposits. Investment and interest income consists of dividends earned and gains (losses) realized on the sale of these preferred shares and interest earned on these deposits.

Changes in Accounting Policies

Effective January 1, 2005, the Company adopted the new recommendations of the Canadian Institute of Chartered Accountants with respect to accounting for compound financial instruments that have the characteristics of both a liability and equity. Under the new recommendation the Company records financial instruments that provide for settlement by the issuance of its own capital stock under certain circumstances as financial liabilities. The effect of this change on the current period is an increase in interest and financing costs, a reduction in income tax expense, the reclassification to liabilities of amounts previously recorded as equity and the write off of deferred finance charges previously charged against the equity component of the convertible debentures.

Accounting for Compound Financial Instruments

(in \$ thousands)	Previously calculated	In accordance with new policy
December 31, 2005		
Interest and financing costs	\$ 1,452	\$ 2,653
Income tax expense	2,974	2,504
Increase in other paid in capital	682	-
Liability component of subordinated convertible debenture	6,945	25,909
Other paid in capital component of subordinated convertible debenture	18,682	206
December 31, 2004		
Deferred charges	\$ 926	\$ 1,225
Future income taxes	528	629
Long term debt	20,425	38,263
Other paid in capital	17,550	206
Retained earnings	6,508	6,212

Revenue Recognition

Effective January 1, 2004, the Company adopted the new recommendations of the Canadian Institute of Chartered Accountants with respect to revenue recognition. Under the new recommendation the Company provides for an allowance with respect to expected losses that may be incurred if customers cancel their insurance policies.

This change has been applied retroactively and the following amounts restated as follows:

(in \$ thousands)	Calculated in accordance with previous policy	In accordance with new policy
December 31, 2004		
Commission revenue	\$41,180	\$41,117
Income tax expense	1,714	1,700
Allowance for cancellations		295
Future income taxes	538	528

Effects of Recent Accounting Pronouncements

In January 2005, the Accounting Standards Board (“AcSB”) issued new standards for the reporting and display of comprehensive income.

Unrealized gains and losses on financial assets that will be held as available for sale, unrealized foreign currency translation amounts arising from self-sustaining foreign operations, and changes in the fair value of cash flow hedging instruments, will be recorded in the Consolidated Statement of Other Comprehensive Income until recognized in the Consolidated Statement of Earnings. Other comprehensive income will form part of shareholders’ equity. The impact of implementing these new standards is not yet determinable as it is dependent on the our outstanding positions, hedging strategies and market volatility.

These standards are effective for interim and annual financial statements for the fiscal year beginning November 1, 2006.

Risks Inherent in Our Business

Effective risk management is fundamental to our ability to protect the interest of our shareholders and is required in order to comply with various regulatory requirements applicable to our operations. Our management oversees and manages our risk along with oversight and advice from both our audit and risk committee and that of Bank West and Western Life. We perform an analytical review of our operations during our quarterly reviews and involve every level of our management in our monthly reporting.

Contingent Commissions

Many P&C insurance companies pay us contingent commissions for achieving profitability and premium volume goals set by them and/or based on the loss experience of the insurance we place with them. We generally receive contingent commissions in the first and second quarters of each year in respect of contingent commissions earned in the previous year. However, we have no control over the ability of P&C insurance companies to estimate loss reserves, which is a factor that affects the amount of contingent commissions that we will receive. In addition, because no significant incremental operating costs are incurred when contingent commissions are realized, a significant decrease in contingent commissions can cause a disproportionate decrease in net income and would consequently have a negative impact on our financial results.

There have been developments requiring additional disclosure regarding contingent commissions and related agreements over the last year.

While we are not able to predict whether these recent developments will ultimately impact our revenues attributable to contingent commissions, as mentioned above, any decrease in these commissions would have a disproportionately negative impact on our financial results and limit our ability to incur and service debt and comply with financial covenants in our existing credit facility and could have a material adverse effect on our business, financial condition and result of operations.

Acquisitions and Growth

Our growth plans depend in part upon the ongoing acquisition, at reasonable prices, of independent brokers and other businesses. To meet our growth plans an adequate number of acquisition candidates must be available at prices which will allow us to operate on a profitable basis. We may determine that current market or pricing conditions in the P&C insurance brokerage industry make future acquisitions uneconomic, or that the available acquisition opportunities are not sufficiently attractive to us. Moreover, we may not be able to finance such acquisitions as additional capital may not be available or may not be available on commercially acceptable terms.

To manage any future growth effectively, we will need to continue to implement and improve our operational, financial and management information systems and to hire, train, motivate, manage and retain our employees. There can be no assurance that we will be able to manage such growth effectively, that our management, personnel or systems will be adequate to support our operations or that we will be able to achieve the increased levels of revenue commensurate with the increased levels of operating expenses associated with this growth, and failure to do so could have a material adverse effect on our business, financial condition and results of operations.

As part of our growth strategy, we seek to cross-sell multiple lines of business to existing customers. This strategy may not result in achieving our desired growth. Due in part to the decentralized nature of our operations, we may have difficulty in focusing our employees on our sales management program and cross-selling strategy. In addition, we may have difficulty integrating acquired operations and newly hired employees into our sales management program and cross-selling strategy.

We have identified 159 target communities (that we estimate have 475 brokers) for future expansion in the next six to eight years. There is no assurance that we can complete acquisitions in any of these communities within the estimated timeframe or at all.

Although we conduct due diligence in respect of the business and operations of each of the businesses we acquire, we may not have identified all material facts concerning these businesses. Unanticipated events or liabilities relating to these businesses could have a material

adverse effect on our financial condition. Furthermore, once we have integrated an acquired business, it may not achieve levels of revenue, profitability, or productivity comparable to our existing locations, or otherwise perform as expected. Our failure to succeed in our growth strategy or to integrate one or more acquired business so that it achieves our performance goals may have a material adverse effect on our results of operations and financial condition.

Capital Funding

We will, from time to time, require additional financing to continue to grow our business. Our ability to arrange such financing in the future will depend in part upon the prevailing capital market conditions as well as our business performance. There can be no assurance that we will be successful in our efforts to arrange additional financing, if needed, on terms satisfactory to us. If additional financing is raised by the issuance of Common Shares from treasury our control may change and our shareholders may suffer additional dilution. From time to time we may enter into transactions or expend funds in a manner which may be financed partially or wholly with debt and may increase our debt levels above industry standards.

Interest Rates

An increase in interest rates may result in increased costs of borrowing for us on both existing and future debt instruments or credit facilities and such increased costs would negatively affect our operating results. We are also exposed to interest rate risk arising from the difference between the repricing dates of Bank West's assets and liabilities. The differentials, or interest rate gaps, arise as a result of the differences in term preferences of borrowers and depositors. A positive interest rate gap exists when interest sensitive assets exceed interest sensitive liabilities for a specific repricing period. A positive gap would result in decreased interest income when market interest rates fall because assets are repricing earlier than liabilities. Rising market interest rates have the opposite effect. The effect of an interest rate gap and changing market interest rates may have a negative effect on Bank West's results of operation and financial condition.

Investment Risk

Investment risk is the exposure to investment loss from general economic and stock market fluctuations. We have invested a significant amount of our excess working capital in preferred shares of Canadian corporations rated "Pfd-1" and "P1" and "Pfd-2" and "P2" by Dominion Bond Rating Services or Standard & Poor's, a division of The McGraw-Hill Companies Inc., respectively. Bank West is also invested in government and corporate bonds and securities. A significant decline in the value or yields of these securities that we own could have a material adverse effect on our business, results of operations and financial condition. Our ability to achieve our investment objectives is affected by general economic conditions that are beyond our control. These investments are subject to the risk, among others, that the financial condition of issuers in which we invest may become impaired or the general condition of the stock market deteriorates. We may experience losses as a result of this risk and any such losses may be significant.

Credit Risk

We are exposed to credit risk with respect to our marketable securities, accounts receivable and mortgages and loans receivable. We only invest in Canadian corporations and institutions with large capitalization to reduce credit risk, however, changing economic conditions or the change in the financial condition of the issuer of the securities can result in increased defaults by the issuer whose securities we own. Credit risk associated with our accounts receivable is minimized by our large and diverse customer base, which covers all consumer and business sectors in Western Canada. However, we cannot ensure that our debtors will pay our accounts receivable on a timely basis or at all which could have a material adverse effect on our results of operations and financial condition. Credit risk associated with Bank West's mortgages and loans is mitigated through conservative underwriting policies, charges against real property and mortgage insurance, however, we cannot ensure that Bank West's debtors will pay these loans or mortgages on a timely basis or at all or that any associated security will be sufficient to cover the amount of any indebtedness. As a result, failure to repay these amounts could have a material adverse effect on our results of operations or financial condition.

Pricing Risk

Pricing of life and health insurance policies involves estimates and assumptions of such factors as mortality, morbidity, future investment yields, expenses and surrenders. Pricing risk is the risk that the actual experience will not develop as estimated. Management of pricing risk involves careful product design, extensive use of modeling and sensitivity testing as well as monitoring through experience studies. Despite management of these risks, there can be no guarantee that actual experience will not differ from the assumptions made in the pricing of the insurance products of Western Life from time to time. Western Life manages this risk through comprehensive underwriting and claims payment guidelines. In addition, reinsurance is used to mitigate exposure to individual lives or benefits. Western Life's maximum retentions are subject to board approval.

Regulation

Our insurance, investments and mutual fund operations depend on our continued good standing under the licenses and approvals pursuant to which we operate. In all jurisdictions, the applicable licensing laws and regulations are subject to amendment or interpretation by regulatory authorities, and generally such authorities are vested with relatively broad and general discretion as to the granting, renewing and revoking of licenses and approvals. There can be no assurance that we will be able to obtain or retain all required licenses or that the cost of complying with these regulations will not increase. Any increase in the cost of complying with government regulation will have a negative effect on our operating results, as will the loss or inability to obtain any material license required to operate the business.

Changes to laws or regulations, including the adoption of generous consumer protection measures or other initiatives regarding contingent or other commissions or rates charged for automobile insurance or claims-handling procedures, could materially adversely affect our business, results of operations and financial conditions.

Bank West and Western Life could be subject to regulatory actions, sanctions and fines if a regulatory authority believed it had failed to comply with any applicable law or regulation.

Where the Superintendent is concerned about an unsafe course of conduct or an unsound practice in conducting the business of a bank or a federal insurance company, the Superintendent may direct the bank or insurance company to refrain from a course of action or to perform acts necessary to remedy the situation. The Superintendent may, in certain circumstances, take control of the assets of a bank or insurance company or take control of the bank or insurance company.

More restrictive laws, rules or regulations may be adopted in the future that could make compliance more difficult and/or expensive. Specifically, recently adopted legislation addressing privacy issues, among other matters, is expected to lead to additional regulation of the insurance industry in the coming years, which could result in increased expenses or restrictions on our operations.

The revenue we generate from the sale of automobile insurance policies represents a significant portion of our overall revenues. As a result, any action by government authorities to change the nature of the automobile insurance industry in our markets could affect our commission levels and our revenues.

Nature of our Business

Our fixed costs (including costs associated with salaries and employee benefits and bonuses, depreciation and amortization, and interest expense and principal repayments), account for a significant portion of our costs and expenses. As a result, low productivity resulting from lower demand or other factors or a decrease in the premium rates, volume and commission paid in the segments of the P&C insurance industry in which we operate could have a material adverse effect on our business, financial condition and results of operations.

Brokers distribute insurance policies underwritten by P&C insurance companies. Some P&C insurance companies offer their products through dedicated, captive sales organizations. If the number of such P&C insurance companies increases, our revenues may decrease, which decrease could have a material adverse effect on our business, financial condition and results of operations.

Insurance Products

Our operations and success depend in part upon access to products sold by Canadian and international insurance companies. Our existing brokerage contracts with certain insurance companies do not have a set term or expiry date, but may be terminated by either party between 90-120 days' written notice, depending on the specific contract. To reduce this risk, we have entered into business development agreements with a number of major Canadian insurance companies. Our ability to carry on business is dependent on our continuing ability to attract and maintain relationships with these insurance companies. However, other than pursuant to these agreements, there can be no assurance that we will continue to have access to such insurance products.

An inability to maintain or obtain access to insurance products would have a negative impact on us. Although we can obtain replacement business for departing insurance companies, the loss of such business, particularly of a major current provider, could have a material adverse effect on our business, financial condition and results of operations.

Further, any significant decrease in the premium rates, volume or basic or contingent commissions paid in the segments of the insurance industry in which we operate can adversely impact us.

Competition

We face competition from the estimated 800 independent brokers delivering P&C and life insurance products in rural Western Canada. We also face competition from certain P&C insurance companies, including some owned by Canadian chartered banks, who distribute their products directly to consumers. In addition, Canadian chartered banks pose a potential competitive threat as they are attempting to obtain the legal right to sell insurance at their branches to compete directly with insurance companies and brokers. There are also a number of companies operating in the P&C insurance brokerage industry in Canada that compete with us, including Hub International Limited, Anthony Clark International Insurance Brokers Ltd. and Canada Brokerlink Inc. We also face competition from banks, mutual fund companies, financial planners and other financial service providers in the sale of non-P&C insurance products. We, in general, also face future competition from financial institutions which deliver or are preparing to deliver financial services and insurance products and services by electronic means, most notably through the Internet.

Competition is intense in all of our business lines and in every insurance market. We believe that most of our competition in P&C insurance is from numerous local and regional brokerage firms that focus primarily on middle-market businesses and, to a lesser extent, from larger national brokerage firms. In addition, insurance companies compete with us by directly soliciting customers without the assistance of an independent broker or agent. Weak economic growth, as well as rising P&C insurance rates may exacerbate those various competitive pressures as some of our customers may choose to cut back or eliminate various types of coverage, or choose to seek competitive quotes from other brokers.

Some of our competitors have greater financial and other resources than we do and therefore no assurance can be given that we will be successful in such a competitive environment.

Dependence on Key Personnel

Our success is largely dependent on the performance of our key employees and senior management. Failure to retain our key employees or to attract and retain additional key employees with necessary skills could have a materially adverse impact on our growth and profitability. There can be no assurance that we will be able to engage the services of such personnel or retain our current personnel.

Errors and Omissions Claims

We have extensive operations and are subject to claims and litigation in the ordinary course of business resulting from alleged errors and omissions in placing insurance and handling claims. The placement of insurance and the handling of claims involve substantial amounts of money. Since errors and omissions claims against us may allege our potential liability for all or part of the amounts in question, claimants may seek large damage awards and these claims can involve significant defence costs. Errors and omissions could include, for example, our employees or sub-agents failing, whether negligently or intentionally, to place coverage or file claims on behalf of customers, to appropriately and adequately disclose insurer fee arrangements to our customers, to provide insurance providers with complete and accurate information relating to the risks being insured or to appropriately apply funds that we hold for our customers on a fiduciary basis. It is not always possible to prevent or detect errors and omissions, and the precautions we take may not be effective in all cases.

Our business, financial condition and/or results may be negatively affected if in the future our errors and omissions insurance proves to be inadequate or unavailable. In addition, errors and omissions claims may harm our reputation or divert management resources away from operating our business.

Unpredictable Catastrophic Events

Catastrophes can be caused by various natural and unnatural events. Natural catastrophic events include hurricanes, windstorms, earthquakes, hailstorms, explosions, severe winter weather and fires. Unnatural catastrophic events include hostilities, terrorist acts, riots, crashes and derailments. The incidence and severity of catastrophes are inherently unpredictable. Most catastrophes are restricted to small geographic areas; however, hurricanes, windstorms and earthquakes may produce significant damage in large, heavily populated areas. Catastrophes can cause losses in a variety of P&C insurance lines, including business interruption, business personal property and workers' compensation. It is possible that a catastrophic event or multiple catastrophic events could have a material adverse effect upon contingent commissions we would expect to receive from a P&C insurer that experienced significant losses, which could have a material adverse effect on our net income and financial condition.

Changes in the Business and Economic Environment

Our business and results can be significantly affected by changes in the business and economic environment, including: changes in the level of demand for P&C insurance; price competition and variation in other terms and conditions of trade; increases in the supply of P&C insurance as a result of new capital provided by recent or future market entrants or by existing P&C insurers; volatile and unpredictable developments (including catastrophes); fluctuations in interest rates and/or price competition. The P&C insurance industry historically has experienced pricing and profitability cycles related to levels of industry underwriting capacity. As a consequence of fluctuations in pricing and P&C insurer profitability we may suffer declines in both basic and contingent commissions which could have a material adverse effect on our net income and financial condition.

Failure of Computer and Data Processing Systems

Our business is dependent upon the successful and uninterrupted functioning of our computer and data processing systems. The failure of these systems could interrupt our operations or materially impact our ability to rapidly evaluate and commit to new business opportunities. If sustained or repeated, system failures could result in the loss of existing or potential business relationships or could negatively affect our financial results.

Covenants of the Company

In connection with our ongoing business activities, we have made and may make commitments to lenders, bondholders and regulatory authorities that may limit our flexibility to make, or influence, certain business decisions concerning the payment of dividends or the amount of dividends, raising capital, making acquisitions, and incurring additional debt. We believe that these commitments are or would be comparable to those made by similar businesses to our own.

Financial Instruments

We have entered into certain financial agreements that are considered to be financial instruments. Subordinated convertible debentures are considered to be compound financial instruments and accordingly, a portion of the debentures is recorded as equity in our audited financial statements. We entered into these agreements to obtain the necessary capital to fund business acquisitions. Financial instruments are subject to credit and interest rate risk as described in our audited financial statements.

Current Outlook

Recent rapid growth in P&C insurance premiums, particularly for commercial insurance, is slowing due to improved rate levels. Competition among P&C insurance companies for commercial policies is expected to increase now that rates have reached profitable levels, further slowing the rise in premiums. We expect that rate increases, and consequently our commission increases, will be moderate for the next 12 to 24 months. The 2004 and 2005 automobile insurance reforms, in Alberta is now complete. We do not expect a significant premium rate reduction or increase beyond the normal rate of inflation. We expect that the P&C insurance industry's premium growth rates, and accordingly commission growth rates, in Western Canada will likely return to historical levels in the medium to long-term.

We do not expect there to be material changes to the financial services industry in general that would have a material impact on the growth of Bank West, WFG Agency Network, Western Life or Jennings Capital. We also expect the life and health insurance industry to remain stable in the medium to long-term, especially in the communities in Western Canada where we operate.

Additional information relating to our Company, including our current Annual Information Form, is available on SEDAR at www.sedar.com.

To the Shareholders of Western Financial Group Inc.

We have audited the consolidated balance sheets of Western Financial Group Inc. as at December 31, 2005 and 2004 and the consolidated statements of income, retained earnings and cash flows for each of the years in the two year period ended December 31, 2005. These consolidated financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2005 and 2004 and the results of its operations and its cash flows for each of the years in the two year period ended December 31, 2005 in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants
Calgary, Alberta
March 15, 2006

Management's Responsibility

Management is responsible for preparing the Company's financial statements and the other information that appears in this annual report. Management believes that the consolidated financial statements fairly reflect the form and substance of transactions and reasonably present the Company's financial condition and results of operations in conformity with Canadian generally accepted accounting principles. Management has included in the Company's financial statements amounts that are based on estimates and judgments, which it believes are reasonable under the circumstances.

The Company maintains a system of internal accounting policies, procedures and controls intended to provide reasonable assurance, at appropriate cost, that transactions are executed in accordance with Company authorization and are properly recorded and reported in the financial statements, and that assets are adequately safeguarded. PricewaterhouseCoopers LLP audits the Company's consolidated financial statements in accordance with generally accepted accounting standards in Canada which provide an independent review that the statements present fairly, in all material respects, the financial position and results of this operation.

Western Financial Group Inc. Board of Directors has an Audit Committee with non-management Directors. The Committee meets with financial management and the independent auditors to review accounting, auditing and financial reporting matters.



Scott Tannas
President and Chief Executive Officer



Catherine Rogers
Senior Vice President, Finance and Chief Financial Officer

March 22, 2006

WESTERN FINANCIAL GROUP INC.

CONSOLIDATED BALANCE SHEETS

AS AT DECEMBER 31, 2005 AND 2004
(in thousands, except for per share amounts)

	2005	2004
ASSETS		
Cash	\$ 10,416	\$ 12,290
Marketable securities (Note 4)	67,077	10,568
Accounts receivable (Note 5)	23,076	22,167
Prepaid expenses	5,268	2,199
Deferred charges (Note 6)	720	1,225
Other assets (Note 7)	10,896	4,911
Mortgages and loans (Note 8)	90,841	43,371
Capital assets (Note 9)	9,333	8,901
Intangible assets (Note 10)	10,497	7,081
Goodwill (Note 11)	50,164	44,394
	\$ 278,288	\$ 157,107
LIABILITIES		
Demand loans (Note 12)	\$ 5,100	\$ -
Accounts payable and accrued	25,099	20,978
Actuarial liabilities (Note 13)	33,507	-
Provision for unpaid and unreported claims (Note 13)	6,065	-
Deferred gain on investments	861	-
Income taxes payable	285	646
Customer deposits (Note 14)	95,341	49,571
Long-term debt (Note 15)	37,707	38,263
Future income taxes (Note 19)	1,604	629
	205,569	110,087
SHAREHOLDERS' EQUITY		
Share capital (Note 16)	59,676	40,398
Other paid in capital	206	206
Contributed surplus	1,776	204
Retained earnings	11,061	6,212
	72,719	47,020
	\$ 278,288	\$ 157,107



Approved by the Board:

Director.

S. Tannas



Director.

G. Speirs

WESTERN FINANCIAL GROUP INC.

CONSOLIDATED STATEMENTS OF INCOME AND RETAINED EARNINGS

FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004

(in thousands, except for per share amounts)

	2005	2004
Revenue		
Commissions and other customer income		
Premium income	\$ 42,804	\$ 41,117
Loan interest and investment income	16,745	1,127
	4,035	42,244
	63,584	
Expenses		
Operating expenses	44,027	33,788
Policyholder benefits	9,564	-
Amortization of start up and reorganization costs	374	443
Income before the following	9,619	8,013
Income from long-term investments	1,357	1,323
One time charge (Note 25)	-	(670)
Gain (Loss) on sale of goodwill and other assets	630	(95)
Interest and financing costs on long-term debt	(2,653)	(2,593)
Amortization of intangible assets	(329)	(220)
Amortization of capital assets	(1,406)	(1,052)
Income before income taxes	7,218	4,706
Income taxes (Note 19)	(2,369)	(1,311)
NET INCOME FOR THE YEAR	4,849	3,395
Retained earnings, beginning of year		
As previously reported	6,508	3,319
Change in accounting policy (Note 24)	(296)	(393)
As restated	6,212	2,926
Excess on repurchase of shares and convertible debentures (Note 16)	-	(109)
Retained earnings, end of year	\$ 11,061	\$ 6,212
Earnings per share (Note 22)		
Basic	\$ 0.17	\$ 0.18
Diluted	\$ 0.15	\$ 0.16

WESTERN FINANCIAL GROUP INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004
(in thousands, except for per share amounts)

	2005	2004
CASH PROVIDED BY (USED IN) OPERATIONS		
Net income for the year	\$ 4,849	\$ 3,395
Non-cash items		
Amortization of goodwill and intangible assets	328	220
Amortization of capital assets	1,406	1,052
Future income taxes	37	(232)
Amortization of deferred charges	374	443
Other non-cash expense	932	575
Non-cash dividends	(182)	(856)
Income from long term investments	(1,357)	(299)
Loss on disposal of goodwill and other intangibles	(634)	94
Gain on disposal of other assets	-	(118)
	5,753	4,724
Change in non-cash working capital		
Accounts receivable	1,310	(2,275)
Prepaid expenses	(1,513)	(871)
Accounts payable and accrued	2,362	158
Actuarial liabilities	578	-
Provision for unreported claims	(840)	-
Amortization of deferred gain on investments	(1,191)	-
Income taxes	(74)	172
Deferred start up and reorganization costs	-	(143)
	6,385	1,315
CASH PROVIDED BY (USED IN) INVESTING		
Other assets	(2,858)	(5,852)
Net assets acquired in business acquisitions	(15,097)	(8,310)
Proceeds on sale of capital assets	451	-
Capital asset purchases	(2,042)	(3,716)
Intangible asset purchases	6	(325)
Proceeds on sale of goodwill and intangible assets	-	355
Proceeds on sale of marketable securities	-	2,492
Marketable securities	(12,091)	3,600
Acquisition of loan portfolio	-	(896)
Mortgages and loans	(46,895)	(26,317)
	(78,526)	(38,969)
CASH PROVIDED BY (USED IN) FINANCING		
Repayments of long-term debt	(1,583)	(1,535)
Customer deposits	45,771	28,918
Subordinated debentures	1,000	-
Net proceeds from issue (repurchase) of share capital	20,090	8,492
Repayment of capital lease	-	-
Deferred finance charges	(111)	(43)
Net repayments of investment margin loan	-	(268)
	65,167	35,564
Decrease (increase) in cash for the year	(6,974)	(2,090)
Cash and cash equivalents, beginning of year	12,290	14,380
Cash and cash equivalents, end of year	\$ 5,316	\$ 12,290
Cash and cash equivalents are comprised as follows:		
Cash	\$ 10,416	\$ 12,290
Operating lending facility	(5,100)	-
	\$ 5,316	\$ 12,290

WESTERN FINANCIAL GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004
(in thousands, except for per share amounts)

NOTE 1 OPERATIONS

Western Financial Group Inc. ("the Company") was incorporated in the province of Alberta as 674658 Alberta Inc. on November 15, 1995 and is engaged in the acquisition and operation of insurance and financial service brokerage businesses, banking activities, life and health insurance underwriting and travel agency operations in rural western Canada. The banking activities are carried out through a federally incorporated, wholly owned subsidiary, Bank West, which received its bank charter on November 27, 2002 and commenced operations on January 30, 2003. The life and health insurance underwriting activities are carried out through Western Life Assurance Company ("Western Life") a company licensed to write all classes of life and health insurance, in all provinces in Canada. Western Life is subject to the Insurance Companies Act of Canada .

NOTE 2 ACCOUNTING POLICIES

Basis of Consolidation

These consolidated financial statements include the accounts of the Company and its subsidiary companies, which are wholly owned.

Accounting Estimates

The preparation of the financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities as at the date of the financial statements, and income and expenses during the reporting period. Key areas of estimation where management has made difficult, complex or subjective judgments, often as a result of matters that are inherently uncertain, include those relating to other-than-temporary impairment of investment securities, the allowance for credit losses, allowance for policy cancellations, assessment of impairment of goodwill, the useful life of intangible assets, allocation of purchase price to goodwill and intangible assets and future income taxes. Therefore, actual results could differ from these and other estimates.

Cash and Cash Equivalents

Cash and cash equivalents include cash, short-term deposits and investments that mature within three months at the time of purchase, and the outstanding amount under the Company's operating lending facility.

Marketable Securities

Western Life

Bonds are carried at amortized cost. Realized gains and losses on the disposal of bonds are considered to be an adjustment of future portfolio yield and are deferred and amortized to income over the remaining term to maturity of the security sold.

Preferred and common stocks are carried at moving average market value whereby the carrying value is adjusted towards market value at the rate of 5% per quarter. Realized gains and losses on the disposal of stocks are deferred and amortized to income at the rate of 5% per quarter.

Interest income is recognized on an accrual basis and premium/discount amortization is recorded under the effective interest method.

Bank West

The Bank purchases securities with the intention of holding them until maturity. Equity securities are recorded at cost and debt securities at amortized cost. When there has been a decline in value of debt or equity securities that is other than temporary, the carrying value of securities is appropriately reduced. Such reductions, if any, together with gains and losses on disposals, are included in interest income. Premiums and discounts on purchases are amortized. Interest income earned and amortization of premiums and discounts and dividends received are included in interest income. All securities are held in the investment portfolio.

WESTERN FINANCIAL GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004
(in thousands, except for per share amounts)

Deferred Charges

Deferred charges include costs related to the start up of new businesses, development of new products and certain of the costs of obtaining debt financing. Amounts are being amortized on a straight-line basis commencing in the year of deferral, except for start up costs, which commence when the pre-operating period is over. Financing costs are amortized over the term of the respective debt. Other deferred charges are amortized over periods from three to five years.

Other Assets

Entities which are not controlled and over which the corporation has the ability to exercise significant influence, referred to as affiliated companies, are accounted for using the equity method. The excess of purchase price over underlying net book value of assets for equity accounted for investments is allocated to intangible assets and goodwill. Goodwill is not amortized, but is tested for impairment annually. Intangible assets are amortized over their estimated useful life and recorded as a reduction to income from long-term investments.

Mortgages and Loans

Western Life

Policy loans are carried at their unpaid balance and are fully secured by the cash surrender values of the policies on which the respective loans are made.

Bank West

Current performing loans are stated at cost net of an allowance for credit losses. Loans that are considered impaired are recorded at the net present value of expected future cash flows.

Loans are considered impaired when, in management's opinion, there has been a deterioration in credit quality to the extent that there is no longer reasonable assurance of timely collections of both principal and interest. Loans will be returned to performing status when there is reasonable assurance of collection and all delinquent principal and interest payments are brought current.

Specific allowance

A specific allowance for loss is provided when loans are considered to be impaired, which occurs when they are either more than 90 days in arrears, or there is no longer reasonable assurance of timely collection of outstanding principal and interest.

General allowance

Bank West has provided a general allowance for loan losses, which management estimates are contained within the portfolio on the balance sheet date. The general allowance is established against the loan portfolio in respect of the Bank West's core business lines where assessment of existing economic and portfolio conditions indicate that it is probable that losses have occurred, but where such losses cannot be determined on an item-by-item basis. As Bank West has little operating history, it has utilized industry knowledge in establishing the level of general allowance. This allowance is re-assessed monthly and may fluctuate as a result of changes in portfolio volumes, concentrations and risk profile; analysis of evolving trends and management's current assessment of factors that may have affected the condition of the portfolio.

Capital Assets

Capital assets are recorded at cost and are being amortized over their estimated useful lives on a diminishing balance basis, except for leasehold improvements which are amortized on a straight line basis, commencing in the year of acquisition up to and excluding the year of disposal, at the annual rates detailed in Note 9. In the year of acquisition, one-half of the annual amount of amortization is recorded.

Goodwill

Goodwill represents the excess of consideration paid over the fair value of net tangible and intangible assets acquired in business acquisitions and related costs of acquisition. Goodwill is not amortized, but is tested for impairment on an annual basis by comparing the fair value of each reporting unit to its carrying value. When the carrying value of a reporting unit exceeds its fair value, goodwill is written down to its fair value.

WESTERN FINANCIAL GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004
(in thousands, except for per share amounts)

Intangible Assets

Intangible assets in respect of purchased customer contracts and related customer relationships, brands, trademarks, and distribution channels are being amortized on a straight line basis over a 30 year period. These intangible assets are considered to have a finite life, and as such, are subject to an impairment test when events and circumstances indicate the carrying amounts may not be recoverable.

Actuarial Liabilities

Western Life

Actuarial liabilities are determined by the Appointed Actuary using the Canadian Asset Liability Method and represent the amount, which, together with future policy premiums and investment income, will be sufficient to meet future benefits and expenses.

Reinsurance

Western Life follows the policy of underwriting and reinsuring contracts of insurance which, depending on the type of insurance, limits their liability to a maximum amount of \$100 per life insured or \$2.5 per month for any disability income claim. Western Life reflects reinsurance balances on the balance sheet and income statements on a net basis.

Western Life has guidelines and a review process in place to ascertain the credit worthiness of the companies to which it cedes. All current new business is placed with registered reinsurers. No information has come to the management's attention indicating weakness or failure of any of its current reinsurers therefore no provision has been made in the accounts for doubtful collection.

Income Taxes

Income taxes are calculated using the liability method of tax accounting. In providing for corporate income taxes, temporary differences between the tax basis of assets or liabilities and their carrying amounts are reflected as future income taxes. The tax rate substantially enacted when these temporary differences are anticipated to reverse is used to calculate future income taxes.

Convertible Subordinated Debentures

Convertible subordinated debentures are recorded in part as debt and in part as equity. The equity component represents the value attributed to the holder's option to convert the principal balance into common shares and is included in other paid in capital. When the debentures are converted to common shares, the equity component is reduced with a corresponding increase to share capital. The equity component of the debentures will be accreted over the term of the debentures through a charge to interest expense and an increase to the liability such that the principal amount due on maturity will be equal to the carrying amount of the debenture at that time.

Preferred Shares

Preferred shares issued by the Company that give the holder the right to require the Company to redeem the share at or after a particular date for a fixed or determinable amount, are recorded as debt. Dividends paid and accrued on such shares are expensed and included in interest on long-term debt.

Revenue Recognition

Contingent profits represent amounts received from insurance companies based on volumes and loss ratios of customer insurance policies written with the respective Company and are recognized in the year earned.

WFG Agency Network

Insurance commission revenue is recognized when the insurance policy sold is in effect and the amount of the commission earned is determinable. The Company maintains an allowance for estimated policy cancellations and commission returns by applying historical policy cancellations and endorsements to the current year revenue adjusted for acquisitions and dispositions.

WESTERN FINANCIAL GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004
(in thousands, except for per share amounts)

Bank West

The Company records interest income earned on performing loans as interest income in the financial statements. Recognition of interest income ceases when a loan is classified as impaired.

Western Life

Premiums for all types of insurance contracts, and contracts with limited mortality or morbidity risk, are generally recognized as revenue when due. When premiums are recognized, actuarial liabilities are computed, with the result that benefits and expenses are matched with such revenue.

Pension Plans and Other Post Retirement Benefits

Western Life has established defined contribution pension plans for eligible qualifying employees. Contributions to these defined contribution pension plans are subject to certain vesting requirements and are a set percentage of employee's annual income.

Stock-Based Compensation

The Company uses the fair-value-based method of accounting for stock-based compensation applying to options issued for years beginning in 2003. Under this method, compensation expense for stock options granted is measured at the fair value at the grant date using the Black-Scholes valuation model. This value is recorded as a charge to net income, with an offsetting credit to contributed surplus, on a straight-line basis over the vesting period.

Any consideration paid by employees and the associated contributed surplus is credited to share capital when the option is exercised.

The matching contribution made by the Company under the employee share ownership plan is being amortized over the vesting period of the shares commencing in the month of contribution.

Interest Rate Swaps

The Company enters into interest rate swaps in order to reduce the impact of fluctuating interest rates on its long-term debt. These swap agreements require the periodic exchange of payments without the exchange of the notional principal amount on which the payments are based. The Company designates its interest rate hedge agreements as hedges of the underlying debt. Interest expense on the debt is adjusted to include the payments made or received under the interest rate swaps. The Company does not enter into derivative financial instruments for speculative or trading purposes.

Comparative Figures

Certain of the comparative figures presented have been reclassified to conform with the current year's presentation.

WESTERN FINANCIAL GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004
(in thousands, except for per share amounts)

NOTE 3 BUSINESS ACQUISITIONS

All business acquisitions are accounted for using the purchase method whereby the assets and liabilities have been recorded at fair market values and the operating results have been included in the Company's financial statements from the effective date of purchase.

December 31, 2005

During the year ended December 31, 2005, the Company acquired all of the outstanding shares of Federated Life Insurance Company of Canada and subsequently changed the name to Western Life Assurance Company. The Company also acquired all of the outstanding shares of the following insurance brokerage businesses: NHI Insurance Group Inc., Pender Island Insurance Agency Inc., LeRoy Agencies Ltd. and 538500 Alberta Ltd.

December 31, 2004

During the year ended December 31, 2004, the Company acquired all of the outstanding shares and certain assets of the following insurance brokerage businesses: Barker Agencies Ltd., Fabian Insurance Services Ltd., Okotoks Insurance Ltd., Robinson Agencies (1980) Ltd., Page Agencies Ltd., and Bru Agencies Ltd.

	Western Life	Insurance Brokerages	2005	2004
Net assets acquired in business acquisitions:				
Cash and short term investments	10,763	(124)	10,639	402
Other investments	42,260	106	42,366	
Other assets	4,222	351	4,573	1,403
Capital assets	253	39	292	141
Intangible assets	3,295	874	4,169	3,066
Goodwill	5,782	2,417	8,199	6,184
Accounts payable and accrued liabilities	(1,403)	(356)	(1,759)	(1,711)
Actuarial liabilities	(32,929)		(32,929)	
Provision for unpaid claims	(6,905)		(6,905)	
Corporate taxes payable	400	(48)	352	
Future taxes payable	(1,961)	(223)	(2,184)	(774)
			26,813	8,712
Cash acquired			(10,639)	(402)
			16,174	\$8,310
Consideration:				
Cash			15,097	\$8,712
Deposits and future acquisition costs			1,077	
			16,174	8,712

Of the total amount assigned to goodwill and intangibles, \$63 (2004 - \$2,812) is deductible for tax purposes.

WESTERN FINANCIAL GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2005 AND 2004
(in thousands, except for per share amounts)

NOTE 4 MARKETABLE SECURITIES

Securities are composed of Canadian Federal Government and Provincial Government treasury bills, acceptances of Canadian Schedule 1 banks and Canadian corporate term-preferred and fixed/floating-preferred shares. Securities are purchased for liquidity and longer-term investment, with the intention of holding to maturity.

2005

	Within 1 year	Over 1 year	Total carrying value	Estimated market value
Fixed income securities				
Canadian government	\$5,021	\$41,697	\$46,718	\$45,999
Bankers' acceptances	8,236	-	8,236	8,233
Preferred shares	479	9,904	10,383	10,325
Other	-	1,739	1,739	1,762
Total	\$13,736	\$53,340	\$67,077	\$66,319

2004

	Within 1 year	Over 1 year	Total carrying value	Estimated market value
Fixed income securities				
Canadian government	\$4,527	\$ -	\$4,527	\$4,527
Bankers' acceptances	1,003	990	1,994	1,992
Preferred shares	129	3,814	3,942	3,975
Other	97	8	105	105
Total	\$5,756	\$4,812	\$10,568	\$10,599

At December 31, 2005, the Bank had pledged Government of Canada Treasury Bill in the amount of \$524 in support of a Clearing Settlement line of credit of \$500. (2004 - \$553).

NOTE 5 ACCOUNTS RECEIVABLE

The Company has recorded contingent commissions receivable of \$286 (2004 - \$322) with respect to policies written through Lloyds of London. These amounts may not be received for up to five years from the year in which the policy is written. Actual amounts received may vary based on actual claims made and administrative expenses incurred.

NOTE 6 DEFERRED CHARGES

	Cost	Accumulated Amortization	Net Book Value
2005			
Start up and reorganization costs	\$ 1,899	\$ 1,899	\$ -
Financing costs	2,283	1,563	720
	\$ 4,182	\$ 3,462	\$ 720
2004			
Start up and reorganization costs			
Financing costs	\$ 1,899	\$ 1,522	\$ 377
	2,621	1,773	848
	\$ 4,520	\$ 3,295	\$ 1,225

WESTERN FINANCIAL GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2005 AND 2004
(in thousands, except for per share amounts)

NOTE 7	OTHER ASSETS	2005	2004
	Investment in Jennings Capital Inc, a corporation in which a director holds an interest.		
	Notes receivable are non-interest bearing and due on demand. These notes have been postponed and subordinated to all other debt of the corporation. The Company has indicated it will not request repayment within the next fiscal year. The fair value of these notes is not determinable.	1,655	1,094
	1,655 (2004 - 1,094) common shares representing 26.61% (2004 - 29.26%) of the outstanding common shares.	2,132	1,016
	5 preferred shares, cumulative dividends at 4% per annum.	500	500
	Investment in Falkins Insurance Agencies Ltd. .758 common voting, .758 common non-voting and .758 preferred non-voting shares representing 20% of the outstanding shares of the corporation. The excess of the Company's interest in the underlying net book value of the assets over the purchase price of \$2,258 million has been allocated to intangible assets and goodwill. Goodwill is not amortized, the portion allocated to intangible assets is being amortized over the economic life of the assets and is treated as an adjustment to equity income.	2,308	-
	Investment in Harvard Ventures Ltd. 1,575 common shares representing 50% of the outstanding common shares of the corporation.	1,644	-
	Loan to a Company controlled by the chief executive officer of the Company. Interest is repayable annually at 4% per annum. Loan is secured by 350 shares of the Company. Market value of the security as at December 31, 2005 was \$861 (2004 - \$893). Due September, 2007.	560	560
	Note receivable with respect to the sale of certain insurance brokerage assets. Interest payable annually 4% per annum. Due December, 2007.	199	199

WESTERN FINANCIAL GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2005 AND 2004

(in thousands, except for per share amounts)

Promissory note, repayable at \$5 per month including interest at 5% per annum. Secured by a general security agreement over all of the assets of Kennedy Insurance Ltd. and a guarantee from its shareholders. Due June, 2006.	145	172
Note receivable with respect the sale of certain insurance brokerage assets. Repayable at \$191 per annum including interest at 4% per annum. The promissory note is secured by a general security agreement covering all of the assets of Platinum Insurance Inc., a hypothecation of the shares of Platinum Insurance Inc., and a corporate guarantee. Due April 2015.	1,547	-
Deposits and future costs for business acquisitions that closed subsequent to year end (Note 23)	<u>205</u>	<u>1,370</u>
	<u>10,896</u>	<u>4,911</u>

WESTERN FINANCIAL GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2005 AND 2004

(in thousands, except for per share amounts)

NOTE 8 MORTGAGES AND LOANS

	2005						
	Residential mortgages - insured	Residential mortgages – uninsured	Automobile and recreational vehicle financing	Farm & commercial mortgages	Premium financing	Other loans and leases	Total
Residential	\$13,378	\$17,271	\$ -	\$ -	\$ -	\$ -	\$30,649
Personal	823	-	30,057	-	4,090	7,744	42,714
Business	-	-	-	6,608	5,702	5,826	18,136
Allowance for credit losses)	(2)	(112))	(297)	(48)	(81)	(118)	(658)
							90,841
Portion maturing in the next year based on contractual terms							(27,820)
							\$63,021

	2004					
	Residential mortgages - insured	Residential mortgages – uninsured	Farm & commercial mortgages	Premium financing	Other loans	Total
Residential	\$8,488	\$7,827	\$ -	\$ -	\$ -	\$16,315
Personal	-	-	-	3,372	9,915	13,287
Business	-	-	5,966	4,609	3,465	14,040
	8,488	7,827	5,966	7,981	13,379	43,641
Allowance for credit losses	(2)	(29)	(42)	(62)	(135)	(270)
						43,371
Portion maturing in the next year						(18,950)
						\$24,421

WESTERN FINANCIAL GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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	Residential Mortgages - Insured	Residential Mortgages - Uninsured	Farm & Commercial Mortgages	Automobile & Recreational Vehicle Financing	Premium Financing	Other loans	Leases	Total
Balance as at December 31, 2004								
General Provision	2	30	42	74	62	49	11	270
Special Provision	-	-	-	-	-	-	-	-
	2	30	42	74	62	49	11	270
Increases in 2005								-
General Provision	(1)	83	6	181	22	49	10	350
Special Provision				52				52
	(1)	83	6	233	22	49	10	402
Write-offs in 2005								-
General Provision					2			2
Special Provision				10				10
	-	-	-	10	2	-	-	12
Balance as at December 31, 2005								-
General Provision	2	113	48	255	81	98	21	618
Special Provision	-	-	-	42		-	-	42
	2	113	48	297	81	98	21	660

WESTERN FINANCIAL GROUP INC.

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NOTE 9 CAPITAL ASSETS

2005		Rate	Cost	Accumulated Amortization	Net Book Value
Land			\$641	\$ -	\$641
Buildings	5%		2,192	348	1,844
Leasehold Improvements	10%		3,334	875	2,459
Furniture and equipment	20%		2,902	1,291	1,611
Computer hardware and software	20%		5,475	2,973	2,502
Leased assets	30%		922	723	199
Automotive	30%		161	84	77
			\$15,627	\$6,294	\$9,333

2004		Rate	Cost	Accumulated Amortization	Net Book Value
Land			\$720	\$ -	\$720
Buildings	5%		2,712	367	2,344
Leasehold Improvements	10%		2,564	629	1,935
Furniture and equipment	20%		2,390	951	1,440
Computer hardware and software	20%		4,276	2,182	2,094
Leased assets	30%		900	642	258
Automotive	30%		161	51	110
			\$13,723	\$4,822	\$8,901

NOTE 10 INTANGIBLE ASSETS

2005	Cost	Accumulated Amortization	Net Book Value	Net Additions
Brands, trade styles, distributions channels and customer contracts and relationships	\$10,779	\$724	\$10,055	\$4,240
Bank West Letters of Patent of Incorporation	442	-	442	-
	\$11,221	\$724	\$10,497	\$4,240
2004				
Customer contracts and relationships	\$7,036	\$397	\$6,639	\$3,429
Bank West Letters of Patent of Incorporation	442	-	442	-
	\$7,478	\$397	\$7,081	\$3,429

WESTERN FINANCIAL GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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NOTE 11 **GOODWILL**

Balance, December 31, 2003	\$	38,808
Goodwill acquired during 2004		6,184
Goodwill disposed of during 2004		(598)
Balance, December 31, 2004		44,394
Goodwill acquired during 2005		8,199
Goodwill disposed of during 2005		(2,429)
 Balance, December 31, 2005	 \$	 50,164

NOTE 12 **DEMAND LOANS**

	2005	2004
Investment margin loan with Jennings Capital Inc., an affiliated company. Due on demand, bearing interest at bank prime plus 1.0% per annum. The effective interest rate on this loan was 6.0% at December 31, 2005. (2004 – 5.25%) Security provided consists of certain marketable securities with a net book value of \$1,625 (2004 - NIL)	\$1,100	\$ -
 Operating lending facility, authorized to a maximum of \$7,500, subject to certain margin requirements, bearing interest at bank prime plus 0.25% per annum. The effective interest rate on this loan was 5.25% at December 31, 2005 (2004 - 4.75%). Security is as described in Note 14.	 4,000	 -
	\$5,100	\$ -

WESTERN FINANCIAL GROUP INC.

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NOTE 13 POLICY LIABILITIES

The basic assumptions made in establishing policy liabilities are best estimates for a range of possible outcomes. To recognize the uncertainty in establishing these estimates, to allow for possible deterioration in experience and to provide greater comfort that the actuarial reserves are adequate to pay future benefits, the actuary is required to include in each assumption a range of allowable margins prescribed by the Canadian Institute of Actuaries.

Western Life maintains margins near the middle of the allowable range. In total, our margin increases our actuarial reserves by 14% (\$4.5 million).

Policy Liabilities are comprised of:

	2005
	(\$000)
Actuarial liabilities	33,507
Provision for unpaid and unreported claims	6,065
	<hr/>
Total policy liabilities	39,572
	<hr/> <hr/>

Actuarial liabilities are comprised of the following amounts for each significant line of business:

	2005
	(\$000)
Individual Life	29,756
Group Life	859
Annuities	1,149
Accident and Sickness	1,743
	<hr/>
	33,507
	<hr/> <hr/>

The actuarial liabilities have been determined by the Appointed Actuary using accepted actuarial practice involving the use of assumptions for such factors as mortality and morbidity rates, future investment yields, future expense levels and rates of withdrawal. The process of determining actuarial liabilities necessarily involves the risk that actual results may vary from assumed results. The risk varies in proportion to the length of the period covered by each assumption and the potential volatility of actual results.

Each assumption is determined based on expected experience plus a margin. The margin provides for uncertainty in establishing expected experience and to allow for possible deterioration in experience. The additional reserve resulting from using assumptions which include these margins is referred to as the provision for adverse deviations. The provision will be included in future income to the extent it is not required to cover adverse experience.

WESTERN FINANCIAL GROUP INC.

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The nature and method of determining the significant assumptions made in the computation of actuarial liabilities are described below.

Mortality and morbidity rates - Estimates of future mortality and morbidity rates are based on the Company's and industry experience over extended periods.

Investment yields - Assumptions regarding future investment yields are based on current yield rates, adjusted to reflect uncertainties associated with projections of future interest rates.

Expense levels - Future expense assumptions are based on the Company's past experience and projections for the future.

Rates of withdrawal - Policyholders may lapse their policies by discontinuing premium payments or surrender their policies for the cash surrender value. Estimates of future rates of withdrawal are based on previous Company experience augmented by industry experience.

Assets supporting actuarial liabilities

	2005			Total
	Bonds	Shares	Other	
	(\$000)	(\$000)	(\$000)	(\$000)
Balance Sheet Value				
Non-participating				
Individual life	28,247		823	29,070
Group Life	1,120		-	1,120
Individual Annuity	1,264		-	1,264
Accident & Sickness	1,742		-	1,742
Claim Liabilities	3,308		3,193	6,501
Other Including				
Capital Surplus	7,755	6,431	6,685	20,871
Total Balance Sheet				
Value	43,436	6,431	10,701	60,568
Total Market Value	45,743	6,353	10,701	62,797

Cash flows of assets supporting actuarial liabilities are matched within reasonable limits. Changes in the fair values of assets are essentially offset by changes in the fair value of actuarial liabilities.

WESTERN FINANCIAL GROUP INC.

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	2005 (\$000)
Change in actuarial liabilities	
Balance, beginning of period	\$ 32,896
Normal change	524
Change in actuarial assumptions	87
Balance, end of year	\$ 33,507

NOTE 14 CUSTOMER DEPOSITS

Customer deposits are comprised of guaranteed investment certificates ("GIC") denominated in Canadian currency, with fixed maturities not exceeding 5 years from date of deposit. Canada Deposit Insurance Corporation ("CDIC") insures these deposits to the extent of \$100 (2004 - \$60) per Canadian resident. The uninsured portion represents 0.89% (2004 – 1.49%) of the total portfolio.

2005						
Terms to maturity	1 yr & under	1-2 years	2-3 years	3-4 years	4-5 years	Total
Businesses	\$3,740	\$1,229	\$789	\$1,100	\$1,183	\$8,041
Individuals	27,108	13,559	15,084	16,948	14,601	87,300
	\$30,848	\$14,788	\$15,873	\$18,048	\$15,784	\$95,341

2004						
Terms to maturity	1 yr and under	1-2 years	2-3 years	3-4 years	4-5 years	Total
Businesses	\$1,659	\$633	\$262	\$743	\$1,035	\$4,333
Individuals	8,237	2,672	4,325	13,952	16,052	45,238
	\$9,896	\$3,305	\$4,587	\$14,695	\$17,087	\$49,571

WESTERN FINANCIAL GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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NOTE 15 LONG-TERM DEBT

	2005	2004
Bank loans provided by a Canadian chartered bank, authorized to a maximum of \$30,543		
Bank loans, repayable at \$122 per month plus interest at the rates detailed below.		
Interest at bank prime rate plus .50% per annum. The effective rate of interest at December 31, 2005 was 5.5% (2004- 4.75%).	\$ 543	\$503
Interest at 4.725% (2004 – 4.175%) per annum	2,000	3,500
Bank loan with interest only payable monthly. The Company has entered into an interest rate swap agreement (Note 28), whereby the interest rate on this bank loan has been fixed at a rate of 6.225% per annum until May, 2008.	8,000	8,000
Repayment of these bank loans is dependent upon annual renewal. If the bank elects not to renew, all amounts will be repayable over two years.		
Collateral provided for the above bank loans, as well as the overdraft lending facility and the demand loan described in Note 12, consists of a general security agreement, a general assignment of accounts receivable, a pledge of all shares of each subsidiary, an unlimited guarantee from each subsidiary supported by a general security agreement and general assignment of accounts receivable, a first charge \$25,000 collateral mortgage over real property of the subsidiaries, a subordination agreement from each of the debenture holders, and an assignment of all risk insurance.		
\$10,974 (2004- \$10,974) subordinated convertible redeemable debenture, interest payable semi-annually at 9% per annum. Convertible at the option of the holder, at any time prior to maturity, into common shares of the Company at a conversion price of \$2.50 per share. At any time after February 28, 2005, the Company may redeem the debentures at par if the 20 day weighted average trading price of its shares is not less than \$3.10. On maturity, the Company may repay the debentures by issuing shares of the Company based on 95% of the average trading price at that time. Due February, 2007. As this debenture includes an equity component related to the holder's conversion option, a portion is recorded as other paid in capital.	10,961	10,954
\$5,000 subordinated convertible redeemable debenture, interest payable semi-annually at 4% per annum. Convertible at the option of the holder, at any time prior to maturity, into common shares of the Company at a conversion price of \$3.25 per share. Due January, 2010. As this debenture includes an equity component related to the holder's conversion option, a portion is recorded as other paid in capital.	4,980	4,975

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	2005	2004
\$10,000 subordinated convertible redeemable debenture, interest payable semi-annually at 4% per annum. Convertible at the option of the holder, at any time prior to maturity, into common shares of the Company at a conversion price of \$3.00 per share. At any time after March 31, 2001, the Company may redeem the debentures at par if the shares of the Company have traded at \$3.90 or on maturity the Company may repay the debenture by issuing shares, provided that the ratio of earnings before interest, taxes, depreciation and amortization to the combined principal and interest payments for the quarter immediately preceding the maturity date is 1.25 to 1. Due March, 2009. As this debenture includes an equity component related to the holder's conversion option, a portion is recorded as other paid in capital.	9,967	9,957
Unsecured subordinated notes, interest payable semi-annually at 12% per annum. Redeemable by the company after March, 2010.	1,000	
Finance contracts repayable at \$1.6 per month including interest at 0% to 6% per annum. Security provided consists of certain automotive assets.	55	73
.2 (2004 – .3) preferred shares, Series 1, with a par value of \$1.0, issued to a company controlled by a director, redeemable at par by the holder at 20% annually, cumulative dividends at 4% per annum.	200	300
	37,707	38,263

Estimated principal repayments of long-term debt, assuming renewal on the same or similar terms, in each of the next five years are as follows:

2006	\$	1,552
2007	\$	12,157
2008	\$	7,998
2009	\$	9,999
2010	\$	6,000

WESTERN FINANCIAL GROUP INC.

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NOTE 16 **SHARE CAPITAL**

Common shares			
Authorized shares			
Unlimited number of common, without nominal or par value			
Unlimited number of first preferred, issuable in series			
Unlimited number of second preferred			
		Number	
Amount			
Issued common shares			
Balance, December 31, 2003	16,461		30,438
Common shares issued for:			
Cash pursuant to stock options exercised			
Private placement	3,919		9,295
Issued on conversion of debenture	145		363
Cancelled under the terms of an issuer bid	(190)		(379)
Escrowed shares cancelled	(62)		(142)
Costs of private placement (net of tax benefit of \$383)			(757)
Balance, December 31, 2004	20,274	\$	38,818
Common shares issued for:			
Cash pursuant to stock options exercised	20		40
Cash pursuant to prospectus offering	10,350		22,253
Costs of prospectus offering (net of tax benefit of \$742)			(1,435)
Balance, December 31, 2005	30,644	\$	59,676

WESTERN FINANCIAL GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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NOTE 16 SHARE CAPITAL (continued)

Common share purchase warrants		
Issued in connection with private placement		
of 4,581 common shares		
Balance December 31, 2004	3,200	\$ 1,580
Expired in the year	<u>(3,200)</u>	<u>(1,580)</u>
Balance December 31, 2005	<u>-</u>	<u>-</u>
First preferred Series 1 shares recorded as long term debt (Note 15)		
Balance, December 31, 2003	.4	400
Cancelled on redemption	<u>(.1)</u>	<u>(.100)</u>
Balance, December 31, 2004	.3	\$ 300
Cancelled on redemption	<u>(.1)</u>	<u>(100)</u>
Balance, December 31, 2005	<u>.2</u>	<u>\$ 200</u>
Total Share Capital		\$ <u>40,398</u>
Balance December 31, 2004		
Balance December 31, 2005		\$ <u>59,676</u>

Escrowed Shares

Common shares issued as consideration for business acquisitions are subject to certain escrow provisions that restrict their trading. As at December 31, 2005, 251 (December 31, 2004 - 509) shares were being held in escrow.

Cancellation Of Share Capital

During the year ended December 31, 2004, the Company acquired and cancelled 190 shares pursuant to a normal course issuer bid for cash consideration of \$487. The excess of cash consideration over the assigned value of these shares has been recorded as a charge to retained earnings.

WESTERN FINANCIAL GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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NOTE 17 STOCK BASED COMPENSATION

Stock Options

The Company has a fixed stock option plan under which it may grant options to directors, officers, employees and consultants for up to 10% of the issued and outstanding shares to an aggregate maximum of 1,600 common shares. The option price is equivalent to the share market price on the date granted.

	2005	Weighted Average Exercise Price	2004	Weighted Average Exercise Price
	Share Options		Share Options	
Outstanding, beginning of year	569	\$2.57	557	\$2.42
Granted	223	2.42	132	2.76
Exercised	(20)	2.00	-	-
Cancelled	(92)	2.50	(120)	2.10
Outstanding, end of year	680	2.54	569	2.57
Exercisable, end of year	457	2.60	487	2.52
Available for grant, end of year	920		1,031	

The following table summarizes information about fixed stock options outstanding at December 31, 2005.

Exercise Price Range	Number Outstanding	Weighted Average Remaining Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
\$2.00 - \$2.99	600	2.79 years	\$2.46	377	\$2.52
\$3.00- \$3.20	80	2.17	\$3.00	80	\$3.00
	680			457	

During the year, the Company granted 223 (2004 - 132) options to purchase common shares at exercise prices from \$2.14 to \$2.45, which was equal to or greater than the market value of the shares on the date granted. The following table summarizes information about stock options granted during the year.

Number granted	Market price	Exercise price	Fair value
73	\$ 2.09	\$ 2.14	\$ 0.59
50	\$ 2.45	\$ 2.45	\$ 0.62
100	2.60	2.45	0.77

The Company has recorded \$30 (2004 - \$140) as compensation expense and contributed surplus, in respect of options vested during the year, based on a fair value determination estimated using the Black Scholes option-pricing model.

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Under the fair value method, the value of stock options at the grant date that have vested during the year are estimated using the Black-Scholes option-pricing model using the following assumptions:

	2005	2004
Expected option life (years)	3-5	4
Risk free rate	3.53%-3.91%	3.68% - 3.90%
Expected stock volatility	30%	30%
Dividend yield	0%	0%

Employee Share Ownership Plan

The Company participates in an Employee Share Ownership Plan which enables substantially all employees to purchase common stock of the Company. Eligible employees make personal contributions to the plan up to 5% of their earnings which are matched by the Company. Personal and Company matching contributions are used to acquire common stock in the Company at market prices. All acquisitions are for shares currently issued and there is no commitment under the plan for the Company to issue additional shares.

NOTE 18 SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

	2005	2004
Dividends received	\$ 1,052	\$ 407
Interest paid	\$ 4,256	\$ 3,054
Income taxes paid	\$ 2,031	\$ 1,285
Dividends on preferred shares	\$ 12	\$ 12
Non-cash investing and financing activities		
Finance contract	\$ -	\$ 33
Conversion of 9% convertible debentures	\$ -	\$ 363
Proceeds from sale of goodwill	\$ -	\$ 355

WESTERN FINANCIAL GROUP INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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NOTE 19 INCOME TAXES

	2005	2004
Future income taxes	\$ 37	(232)
Current income taxes	<u>2,332</u>	<u>1,931</u>
	\$ 2,369	1,699

The Company's actual income tax expense differs from the expected income tax expense as follows:

	2005		2004	
	%	Amount	%	Amount
Expected income tax expense	34	\$ 2,427	34	\$ 1,314
Non-deductible expenses	1	76	1	98
Non-taxable income	(5)	(339)	(6)	(402)
Income tax rate and other adjustments	<u>3</u>	<u>205</u>		<u>16</u>
Actual income tax expense	33	\$ 2,369	29	\$ 1,026

The major components of future income tax liability using the combined federal and provincial tax rates of 34% (2004 - 34%) are as follows:

	2005	2004
Capital assets and other	\$733	396
Goodwill and intangibles	2,662	1,729
Deferred charges and share issue costs	(810)	(433)
Tax loss carryforwards	(1,249)	(873)
Allowance for credit losses	(221)	(91)
Allowance for cancellations	(101)	(100)
Actuarial liabilities	595	-
Deferred gains (losses)	(5)	-
	\$1,604	629

WESTERN FINANCIAL GROUP INC.

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NOTE 20 EARNINGS PER SHARE

December 31, 2005

	Income	Shares	Per share
Earnings per share from continuing operations			
Basic earnings per share	4,849	28,965	\$ 0.17
Effect of dilutive securities			
Stock options		8	
Convertible debentures	1,079	9,742	
Diluted earnings per share	5,928	38,715	\$ 0.15

Non-dilutive options to purchase 542 common shares at prices ranging from \$2.40 to \$3.00 per share were not included in the computation of diluted earnings per share because the options' exercise prices were greater than the average market price of the common shares for the year.

December 31, 2004

	Income	Shares	Per share
Basic earnings per share	3,395	19,014	\$ 0.18
Effect of dilutive securities			
Stock options	-	45	
Convertible debentures	1,076	9,262	
Diluted earnings per share	4,471	28,322	\$ 0.16

Non-dilutive options to purchase 162 common shares at \$2.85 and \$3.00 per share and non-dilutive warrants to purchase 3,200 common shares at \$2.90 per share were not included in the computation of diluted earnings per share because the options' and warrants' exercise prices were greater than the average market price of the common shares for the year.

NOTE 21 COMMITMENTS

In the normal course of business Bank West issues commitments to extend credit to customers which are not recorded in the financial statements. These commitments which are undrawn at year-end are in the form of loans for specific amounts and maturities subject to meeting certain conditions and have no stated expiry dates. The maximum potential amount of future payments under these commitments is \$3,091 (2004 - \$1,507).

Under the terms of property leases expiring between 2006 and 2011, the Company is committed to the following annual lease payments:

2006	\$	2,061
2007	\$	2,154
2008	\$	2,027
2009	\$	1,636
2010	\$	1,427

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NOTE 22 RELATED PARTY TRANSACTIONS

Related parties include directors, officers and their related companies. The prices and term of transactions with related parties are in accordance with normal business practice and recorded at the exchange amount.

- Commissions of nil (2004-\$3) were paid to Jennings Capital Inc., an affiliated Company in which a director holds an interest, for management of the Company's marketable securities, and interest of \$8 (2004 - \$2) in respect of the investment margin loan described in Note 12.
- Dividends income on preferred shares of \$182 (2004- \$299) and income from equity investments of \$976 (2004- \$1,023) were accrued with respect to our investment in Jennings Capital Inc.
- Dividends on preferred shares in the amount of \$8 (2004 - \$12) were accrued to a company controlled by a director.
- The Western Mutual Fund Company is able to share certain officers and staff with Jennings Capital Inc. It has accrued \$119 (2004- \$112) in shared costs which is payable to Jennings Capital Inc.

Other transactions and balances outstanding are included in Other Assets as disclosed in Note 7.

NOTE 23 SUBSEQUENT EVENTS

In 2005 the company entered into memorandums of understanding and term sheets with respect to the acquisition of Insurance brokerage businesses of Golden Eagle Agencies Ltd., 606065 Alberta Ltd, 1176496 Alberta Ltd, and 1194595 Alberta Ltd., for a cost of \$2,006. The Company finalized the acquisitions in January of 2006.

Subsequent to year end the Company purchased 25% of Northcountry Insurance Agencies Ltd. with an investment of \$1,471, and provided short term financing of \$837.

NOTE 24 CHANGES IN ACCOUNTING POLICIES

December 31, 2005

Effective January 1, 2005, the Company adopted the new recommendations of the Canadian Institute of Chartered Accountants with respect to accounting for compound financial instruments that have the characteristics of both a liability and equity. Under the new recommendation the Company records financial instruments that provide for settlement by the issuance of its own capital stock under certain circumstances as financial liabilities. The effect of this change on the current period is an increase in interest and financing costs, a reduction in income tax expense, the reclassification to liabilities of amounts previously recorded as equity and the write off of deferred finance charges previously charged against the equity component of the convertible debentures.

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This change has been applied retroactively as follows:

	Previously calculated	In accordance with new policy
December 31, 2005		
Interest and financing costs	\$ 1,452	\$ 2,653
Income tax expense	\$ 2,974	\$ 2,504
Increase in other paid in capital	\$ 682	\$ -
Liability component of subordinated convertible debenture	\$6,945	25,909
Other paid in capital component of subordinated convertible debenture	18,682	206
December 31, 2004		
Deferred charges	\$ 926	\$ 1,225
Future income taxes	\$ 528	\$ 629
Long term debt	\$ 20,425	\$ 38,263
Other paid in capital	\$ 17,550	\$ 206
Retained earnings	\$ 6,508	\$ 6,212

December 31, 2004

Effective January 1, 2004, the Company adopted the new recommendations of the Canadian Institute of Chartered Accountants with respect to revenue recognition. Under the new recommendation the Company provides for an allowance with respect to expected losses that may be incurred if customers cancel their insurance policies.

This change has been applied retroactively and following amounts restated as follows:

	Previously reported	In accordance with new policy
December 31, 2004		
Commission revenue	41,180	41,117
Income tax expense	1,714	1,700
Allowance for cancellations		295
Future income taxes	538	528

NOTE 25 PREPAID EXPENSES

At December 31, 2003, prepaid expenses include \$403 in respect of legal and other costs associated with a claim filed against Montreal Trust. In 2004 the Company received a judgment in favor of Montreal Trust. Management has determined that there is sufficient basis upon which to file an appeal. As the outcome of this appeal is not determinable, the costs incurred to date have been recorded as a one-time charge in 2004. Any recovery of costs as a result of the appeal will be recorded in the year received.

WESTERN FINANCIAL GROUP INC.

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NOTE 26 FINANCIAL INSTRUMENTS

For certain of the Company's financial instruments, including cash, accounts receivable, demand loans, accounts payable and accrued liabilities, the carrying amounts approximate fair value due to the immediate or short-term maturity of these financial instruments. The fair value of marketable securities has been estimated based on market values of the securities as at December 31. (Note 4)

The fair value of fixed rate mortgages and loans has been estimated by discounting the expected future cash flows at market rates for loans with similar terms and risks. For floating rates loans, fair value is assumed to be equal to book value as the interest rates on these loans automatically reprice to market. Fair value of mortgages and loans as at December 31, 2005 is estimated to be \$91,071 (2004 - \$45,080).

The fair value of customer deposits is determined by discounting the contractual cash flows, using market interest rates currently offered for deposits with similar terms and risks and is estimated to be \$ 92,822 as at December 31, 2005 (2004 - \$49,486).

Management considers that no events have occurred subsequent to the arrangement of the credit agreement with its bank that would indicate that the fair value of bank loans differs substantially from their carrying value.

The fair value of the \$10,974 (2004 - \$10,974) convertible debentures is based on the quoted market price of the debentures at the respective balance sheet dates and, as at December 31, 2005 was approximately \$12,072 (2004 - \$11,907).

The fair values of the \$5,000 and \$10,000 convertible debentures are not determinable due to the existence of business development agreements with the holders that would have the effect of reducing the effective rate.

The fair value of actuarial liabilities and provisions for unpaid and unreported claims are as disclosed in Note 13.

The fair value of the preferred shares is not determinable as there is no active market for these instruments.

Credit Risk

The Company is exposed to credit risk with respect to its marketable securities, accounts receivable and mortgages and loans receivable.

Restricting both the type and the term of investments mitigates marketable securities risk. The Company only invests in Canadian corporations and institutions with large capitalization and acceptable liquidity to reduce credit risk.

Accounts receivable risk is minimized by the Company's large customer base, which covers all consumer and business sectors in British Columbia, Saskatchewan and Alberta. The Company follows a program of credit evaluations of customers and limits the amount of credit extended when deemed necessary.

Credit risk with respect to mortgages and loans is mitigated through conservative underwriting policies and charges against real property that reduce the Company's risk exposure on these loans. Certain of the residential mortgages are insured through Canada Mortgage and Housing Corporation.

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NOTE 26 FINANCIAL INSTRUMENTS (continued)

Interest Rate Risk

The Company entered into an interest rate swap agreement, expiring in May 2008, to manage the interest rate risk on a portion of its bank debt. Under the terms of the agreement, the variable rate of interest on the underlying debt instrument is swapped for a fixed rate of 6.225% per annum. The counter-party to this agreement is a large Canadian financial institution, which presents minimal credit risk. The actual amount of gain or loss on this hedge will fluctuate with current interest rates. As at December 31, 2005 the actual interest rate on the underlying debt instrument was 4.62653% (2004 – 3,996%) per annum. Assuming this interest rate were in effect for the term of the agreement, the Company would recognize an annual loss of \$128 as interest expense.

The Company is exposed to interest rate risk arising from fluctuations in interest rates on certain of its bank term loans payable. The Company is also exposed to interest rate risk arising from the mismatch, or gap, between the assets and liabilities of Bank West that are scheduled to mature or re-price on particular dates.

December 31, 2005	Floating Rate	Less than 3 months	3 months - 1 year	Total within 1 year	Over 1 year to 5 years	Non-interest rate sensitive	Total
Assets:							
Cash Resources	\$ 3,884	\$ -	\$ -	\$ 3,884	\$ -	\$ -	\$ 3,884
Securities	-	5,512	1,857	7,369	1,720	96	9,185
Loans	9,329	6,516	11,959	27,804	63,730	(658)	90,875
Other assets	-	-	-	-	-	4,961	4,961
Total	\$13,213	\$12,028	\$13,816	\$39,057	\$65,450	\$4,399	\$108,906
Liabilities & Equity:							
Deposits	-	\$ 8,406	\$ 22,012	\$ 30,418	\$ 64,493	\$ -	\$94,911
Other Liabilities	-	-	-	-	-	2,167	2,167
Shareholder's Equity	-	-	-	-	-	11,827	11,827
Total	\$ -	\$ 8,406	\$ 22,012	\$ 30,418	\$64,493	\$ 13,995	\$108,906
Interest-rate Sensitive Gap	13,213	3,622	(8,196)	8,639	956	(9,595)	
Cumulative Gap	13,213	16,835	8,639	-	9,595	-	
Cumulative gap as a percentage of total assets	12%	15%	8%		9%		
<hr/>							
December 31, 2004	Floating Rate	Less than 3 months	3 months - 1 year	Total within 1 year	Over 1 year to 5 years	Non-interest rate sensitive	Total
Assets:							
Cash Resources	\$ 2,281	\$ -	\$ -	\$ 2,281	\$ -	\$ -	\$ 2,281
Securities	-	3,499	2,156	5,655	4,540	268	10,463
Loans	8,356	4,721	5,854	18,931	24,465	(270)	43,127
Other assets	-	-	-	-	-	2,526	2,526
Total	\$10,638	\$8,219	\$8,010	\$26,868	\$29,005	\$2,524	\$58,397
Liabilities & Equity:							
Deposits	-	\$ 4,301	\$ 5,595	\$ 9,896	\$ 39,674	\$ -	\$49,571
Other Liabilities	-	-	-	-	-	1,479	1,479
Shareholder's Equity	-	-	-	-	-	7,347	7,347

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Total	\$ -	\$ 4,301	\$ 5,595	\$ 9,896	\$ 39,674	\$ 8,826	\$58,397
Interest-rate Sensitive Gap	10,638	3,918	2,415	16,972	(10,669)	(6,302)	
Cumulative Gap	10,638	14,556	16,972	-	6,302	-	
Cumulative gap as a percentage of total assets	18%	25%	29%		11%		

NOTE 27 SEGMENTED INFORMATION

The Company has four reportable segments: insurance brokerage, banking services, life insurance, and corporate and all other which includes travel agencies and real estate assets. The insurance brokerage segment provides a variety of property, casualty, life and health, and investment products and services to customers across Western Canada through WFG Agency Network. The banking segment commenced operations in January 2003 and provides premium financing to customers of the insurance segment as well as loans and mortgages to other customers through Bank West. The life segment offers a range of disability products along with group life and health through WFG Agency Network and other distribution channels.

The results of these business segments are based on the internal financial reporting systems of the Company. The accounting policies used in these segments are generally consistent with those followed in the preparation of the consolidated financial statements as disclosed in Note 2.

Management monitors the financial performance of WFG Agency Network based on operating income and customer accounts receivable. The operations of Bank West, and Western Life are monitored based on net income before income tax; the financial position is monitored based on net assets used in that segment as reported in the financial statements of Bank West and Western Life.

Because of the integrated nature of the Company's operations, all other assets, including intangibles and goodwill, are managed and reported at a corporate level. Goodwill is, however, allocated to reporting units within each segment for purposes of impairment testing. All amortization expense and interest on long term debt is recorded as a corporate expense.

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2005

Revenue	Bank West	(1)	Western Life Assurance	(1)	WFG Agency Network	(1)	Corporate and all other	(1)	Total
Commissions, premiums and other customer revenues			16,786	(402)	37,414	(136)	6,144	(257)	59,549
Loan interest and investment income	4,552		2,435	(78)			494	(43)	7,360
Interest paid on customer deposits	(2,924)								(2,924)
Provision for credit losses	(401)								(401)
Net interest and investment income	1,227		2,435	(78)			494		4,035
Total revenue	1,227		19,221	(480)	37,414	(136)	6,638	(300)	63,584
Operating expenses	(1,891)	58	(16,657)	287	(27,174)	603	(8,817)		(53,591)
Amortization of start up and reorganization costs	(289)						(85)		(374)
Operating income	(953)	58	2,564	(193)	10,240	467	(2,264)	(300)	9,619
Income from long- term investments							1,357		1,357
Gain (Loss) on sale of goodwill and other assets							630		630
Amortization of capital assets	(49)		(122)				(1,235)		(1,406)
Amortization of intangibles							(329)		(329)
Interest and financing costs on long-term debt			(10)				(2,643)		(2,653)
	(1,002)		2,432	33	10,240		(4,485)		7,218
Total assets	108,906		60,568		13,991		95,484		278,288
Goodwill			4,942		44,442		780		50,164

Note

(1) Inter-segment eliminations

WESTERN FINANCIAL GROUP INC.

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	Bank West	WFG Agency Network	Corporate and all other	Corporate eliminations	Total
2004					
Revenues					
Commissions and other customer revenues	\$-	35,690	5,576	(149)	41,117
Loan interest and investment income	2,184				2,184
Interest paid on customer deposits	(1,297)				(1,297)
Provision for credit losses	(191)				(191)
Net interest and investment income	696	21	410		1,127
Total revenue	696	35,711	5,986	(149)	42,244
Operating expenses	(1,528)	(25,438)	(6,971)	149	(33,788)
Amortization of start up and reorganization costs	(292)		(151)		(443)
Operating income	(1,124)	10,273	(1,136)		8,013
Income from equity investments	-		1,323		1,323
One time charge			(670)		(670)
Gain (Loss) on sale of goodwill and other assets	-		(95)		(95)
Amortization of capital assets			(1,052)		(1,052)
Amortization of intangibles	-		(220)		(220)
Interest and financing costs on long-term debt	-		(2,593)		(2,593)
	\$(1,124)	10,273	(4,443)		4,706
Total assets	\$58,397	14,071	84,639		157,107
Goodwill	\$	43,614	780		44,394

During 2005, two companies individually comprised 24%, and 18%, of total commissions earned in the WFG Agency Network segments.

During 2004, two companies individually comprised 21%, and 17%, of total commissions earned in the WFG Agency Network segments.