

# THE WESTAIM CORPORATION

ANNUAL REPORT 2011



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## ANNUAL REPORT 2011

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All figures are in Canadian Dollars, unless otherwise stated.



## LETTER TO SHAREHOLDERS

Dear Shareholders:

The Westaim Corporation's acquisition of JEVCO Insurance Company in 2010 proves to be a quality investment for the Company. In the year ended December 31, 2011, the Company achieved direct written premiums of \$350 million, net income of \$33 million and a favourable combined ratio of 95.5%. The non-standard automobile line of business, in line with our industry peers, showed greater profitability in 2011 and we expect this trend to continue in 2012. JEVCO's financial condition remained strong in 2011, with its Minimum Capital Test ratio increasing from 321% at December 31, 2010 to 326% at December 31, 2011.

In the third quarter of 2011, the Company invested approximately 10% of its \$1 billion investment portfolio in Canadian dividend paying common equities with the intention of generating an attractive yield. The remaining portfolio is invested mainly in corporate and government bonds. Westaim's capital strategy and management processes are aimed at meeting the Company's objectives of complying with regulatory requirements, maintaining a strong credit rating and maximizing shareholder value.

JEVCO's solid financial performance contributed to the appreciation of Westaim's book value by 10% from \$0.59 per share at December 31, 2010 to \$0.65 per share at December 31, 2011. Since the acquisition of JEVCO on March 29, 2010, Westaim's book value per share has appreciated by 30%. Your Westaim board and management team will continue to look for opportunities to expand the Company's business and maximize value for our shareholders.

On behalf of the Board of Directors, I want to thank all of the Westaim employees and stakeholders for their hard work and support over the past year and look forward to another successful year in 2012.

Sincerely,



J. Cameron MacDonald,  
President and Chief Executive Officer

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*"Westaim" or the "Company" in this Management's Discussion and Analysis ("MD&A") refers to The Westaim Corporation on a consolidated basis. This MD&A, which has been approved by the Westaim Board of Directors, should be read in conjunction with Westaim's audited annual consolidated financial statements including notes for the years ended December 31, 2011 and 2010 as set out on pages 34 to 69 of this Annual Report. Financial data in this MD&A has been derived from the audited annual consolidated financial statements for the year ended December 31, 2011 and 2010 and is intended to enable the reader to assess Westaim's results of operations for the three months and year ended December 31, 2011 and financial condition as at December 31, 2011. See note on International Financial Reporting Standards ("IFRS") below. All amounts are in Canadian dollars unless otherwise indicated. The following commentary is current as of February 28, 2012. Additional information relating to Westaim is available on SEDAR at [www.sedar.com](http://www.sedar.com). Certain totals, subtotals and percentages may not reconcile due to rounding.*

### **International Financial Reporting Standards**

*Commencing in 2011, the Company reports its annual consolidated financial statements using accounting policies consistent with IFRS, with 2010 comparative figures and the January 1, 2010 statement of financial position restated to conform to IFRS, along with reconciliations of equity and comprehensive income from Canadian generally accepted accounting principles ("CGAAP") to IFRS. The 2011 financial statements are prepared in accordance with IFRS, consistent with the unaudited interim consolidated financial statements.*

### **Non-GAAP measures**

*Westaim uses both IFRS and non-GAAP measures to assess performance. The Company cautions readers about non-GAAP measures that do not have a standardized meaning under IFRS and are unlikely to be comparable to similar measures used by other companies. Westaim analyzes insurance operations performance based on operating income and loss ratios, expense ratios and combined ratios. The loss ratio equals net claims and adjustment expenses divided by net premiums earned. The expense ratio equals the sum of commissions, premium taxes and general and administrative expenses divided by net premiums earned. The combined ratio is the sum of the loss ratio and the expense ratio. A combined ratio below 100% demonstrates underwriting profit whereas a combined ratio over 100% demonstrates an underwriting loss. Book value per share represents shareholders' equity at the end of the period, determined on an IFRS basis, divided by the total number of common shares plus convertible preferred shares outstanding on the same date.*

### **Future Oriented Financial Information**

*This MD&A may contain forward-looking statements that involve risks and uncertainties. The Company's actual results could differ materially from these forward-looking statements as a result of various factors, including those discussed hereinafter or in the Company's 2011 Annual Information Form. Please refer to the cautionary note in Section 18 of this MD&A.*

The Westaim Corporation  
Management's Discussion and Analysis  
Year ended December 31, 2011

1. THE COMPANY

Westaim is a publicly traded Canadian-based financial services holding company that invests directly and indirectly through acquisitions, joint ventures and other arrangements, with the objective of providing its shareholders with capital appreciation and real wealth preservation. Westaim's strategy is to pursue investment opportunities to grow shareholder value (as measured by book value per share) over the long term.

On March 29, 2010, the Company acquired all the issued and outstanding shares of JEVCO Insurance Company ("Jevco") from Kingsway Financial Services Inc. (the "Acquisition") and arranged equity financing of \$275 million for the purpose of completing the Acquisition (the "Financing"). The purchase price paid was approximately 94.5% of the book value of Jevco's net assets at December 31, 2009, subject to certain closing and other adjustments. Beginning in the second quarter of 2010, the Company's consolidated operating results include those of Jevco.

Jevco is a leading Canadian property and casualty ("P&C") insurer that sells P&C products through a distribution network of over 2,000 independent brokers.

2. OVERVIEW OF PERFORMANCE

The Company's operating results include the results from the insurance operations of Jevco. Jevco's operating results for the three months ended March 31, 2010 (prior to the date of acquisition of March 29, 2010) were not included in the Company's operating results for 2010.

Highlights (millions except per share data)	Three months ended December 31		Year ended December 31	
	2011	2010	2011	2010
Direct premiums written	\$ 71.5	\$ 72.1	\$ 350.0	\$ 273.4
Net premiums written	\$ 67.5	\$ 65.9	\$ 333.4	\$ 254.9
Net premiums earned	\$ 74.0	\$ 69.2	\$ 326.1	\$ 236.3
Underwriting expenses	68.7	68.6	311.5	230.7
Underwriting income	5.3	0.6	14.6	5.6
Investment return	9.3	9.9	40.4	33.8
Corporate costs excluding share-based compensation	(1.5)	(1.3)	(5.3)	(4.8)
Share-based compensation	(3.1)	(2.7)	(7.8)	(6.6)
Site restoration provision recovery	-	-	0.1	0.5
Other income	-	-	2.3	-
Net gain on business acquisition	-	-	-	22.1
Income from continuing operations, before income taxes	10.0	6.5	44.3	50.6
Income tax (expense) recovery	(0.7)	(3.2)	(11.3)	4.5
Income from continuing operations	9.3	3.3	33.0	55.1
Loss from discontinued operations, net of income taxes	(0.1)	-	(0.2)	(1.0)
<b>Net income</b>	<b>\$ 9.2</b>	<b>\$ 3.3</b>	<b>\$ 32.8</b>	<b>\$ 54.1</b>
Earnings per share				
- Income from continuing operations - basic and diluted	\$ 0.01	\$ 0.01	\$ 0.05	\$ 0.11
- Net income - basic and diluted	\$ 0.01	\$ 0.01	\$ 0.05	\$ 0.11
Book value per share			\$ 0.65	\$ 0.59
Loss ratio	57.6%	63.0%	66.8%	68.6%
Expense ratio	35.3%	36.1%	28.7%	29.0%
Combined ratio	92.9%	99.1%	95.5%	97.6%
<b>Net income</b>	<b>\$ 9.2</b>	<b>\$ 3.3</b>	<b>\$ 32.8</b>	<b>\$ 54.1</b>
Other comprehensive income (loss)	2.3	(6.0)	7.0	4.2
<b>Comprehensive income (loss)</b>	<b>\$ 11.5</b>	<b>\$ (2.7)</b>	<b>\$ 39.8</b>	<b>\$ 58.3</b>

## 2. OVERVIEW OF PERFORMANCE (continued)

### Consolidated Results – Three months ended December 31, 2011

For the three months ended December 31, 2011, the Company reported consolidated net income of \$9.2 million compared to consolidated net income of \$3.3 million for the three months ended December 31, 2010.

Income from continuing operations before income taxes for the three months ended December 31, 2011 was \$10.0 million (2010 - \$6.5 million). Underwriting income was \$5.3 million (2010 - \$0.6 million) and investment return, which includes investment income, foreign exchange gains and losses and net realized investment gains, was \$9.3 million (2010 - \$9.9 million). Share-based compensation costs were \$3.1 million (2010 - \$2.7 million) and other corporate costs were \$1.5 million (2010 - \$1.3 million).

Income tax expense for the three months ended December 31, 2011 was \$0.7 million (2010 - \$3.2 million). The expense is net of a tax benefit of \$2.9 million from the recognition of tax losses resulting from an internal corporate reorganization in December 2011, whereby Jevco acquired and amalgamated with 2266100 Ontario Ltd. and 2266102 Ontario Ltd., former wholly-owned subsidiaries of the Company. Non-capital losses transferred to Jevco in the amount of \$10.9 million were expected to be available to offset Jevco's income for tax purposes, resulting in an income tax recovery of \$2.9 million.

Loss from discontinued operations for the three months ended December 31, 2011 was \$0.1 million (2010 - \$nil).

Investment return included in net income for the fourth quarter of 2011 of \$9.3 million (2010 - \$9.9 million) consists of net investment income earned on portfolio investments of \$7.3 million (2010 - \$7.2 million), net income related to instalment insurance premiums of \$0.8 million (2010 - \$0.8 million), foreign exchange losses of \$0.5 million (2010 - \$0.8 million) and net realized investment gains of \$1.7 million (2010 - \$2.7 million).

Net unrealized investment gains, excluding foreign exchange differences, for the three months ended December 31, 2011 of \$3.0 million (2010 - \$8.7 million loss) relating to the available-for-sale investment portfolio are excluded from net income and are included in other comprehensive income, net of income tax expense of \$0.7 million (2010 - \$2.7 million recovery). In addition, for the three months ended December 31, 2011, net unrealized gains of \$1.0 million (2010 - \$2.0 million losses) relating to the held-to-maturity investment portfolio are excluded from net income and other comprehensive income.

### Consolidated Results – Year ended December 31, 2011

For the year ended December 31, 2011, the Company reported consolidated net income of \$32.8 million compared to consolidated net income of \$54.1 million for the year ended December 31, 2010.

Income from continuing operations before income taxes for the year ended December 31, 2011 was \$44.3 million (2010 - \$50.6 million). Income from continuing operations before income taxes of \$50.6 million for the year ended December 31, 2010 included a net gain on acquisition of Jevco of \$22.1 million as well as the second, third and fourth quarter operating results of Jevco, as Jevco was acquired at the end of the first quarter of 2010. Underwriting income was \$14.6 million (2010 - \$5.6 million) and investment return was \$40.4 million (2010 - \$33.8 million). Other income was \$2.3 million (2010 - \$nil), share-based compensation costs were \$7.8 million (2010 - \$6.6 million), other corporate expenses were \$5.3 million (2010 - \$4.8 million) and site restoration provision recovery was \$0.1 million (2010 - \$0.5 million).

Income tax expense for the year ended December 31, 2011 of \$11.3 million (2010 - \$4.5 million recovery) included the recognition of a tax loss carry forward benefit of \$2.9 million (2010 - \$15.3 million) as a result of an internal corporate reorganization, which offset other income tax expense of \$14.2 million (2010 - \$10.8 million).

Loss from discontinued operations for the year ended December 31, 2011 was \$0.2 million (2010 - \$1.0 million).

Investment return included in net income for the year ended December 31, 2011 of \$40.4 million (2010 - \$33.8 million) consists of net investment income earned on portfolio investments of \$29.0 million (2010 - \$22.1 million), net income related to instalment insurance premiums of \$2.8 million (2010 - \$2.1 million), foreign exchange losses of \$nil (2010 - \$1.1 million) and net realized investment gains of \$8.6 million (2010 - \$10.7 million).

Net unrealized investment gains, excluding foreign exchange differences, for the year ended December 31, 2011 of \$9.7 million (2010 - \$5.9 million) relating to the available-for-sale investment portfolio are excluded from net income and are included in other comprehensive income, net of income tax of \$2.7 million (2010 - \$1.7 million). In addition, for the year ended December 31, 2011, net unrealized gains of \$6.0 million (2010 - \$3.3 million) relating to the held-to-maturity investment portfolio are excluded from net income and other comprehensive income.

### 3. INSURANCE COMPANY ACQUISITION

On January 25, 2010, the Company announced the Acquisition and that it had arranged the Financing in order to complete the Acquisition. For a discussion of the Financing, refer to "Equity Financing" in Section 9, *Liquidity and Capital Resources* of this MD&A. The acquired company, Jevco, is a Canadian federal property and casualty insurance company, specializing in providing insurance products covering non-standard auto, recreational vehicles, commercial auto, property and liability. Jevco also provides surety insurance primarily to participants in the Canadian construction industry.

On March 29, 2010, the Company acquired all the issued and outstanding shares of Jevco at a purchase price of \$261.4 million. The purchase price was allocated to the estimated fair value of the net assets of Jevco on the acquisition date as follows, with comparative carrying values at December 31, 2010 and December 31, 2011.

(millions)	March 29, 2010	December 31, 2010	December 31, 2011
Cash and cash equivalents	\$ 15.7	\$ 21.2	\$ 9.7
Investment income due and accrued	10.0	5.3	5.6
Investments	924.9	992.8	1,018.1
Instalment premiums	52.2	65.1	62.8
Accounts receivable	32.1	26.2	26.0
Recoverable from reinsurers	47.3	29.7	34.0
Claims recoverable from other insurers	27.2	40.2	51.0
Deferred policy acquisition expenses	29.5	29.8	35.6
Deferred income taxes	8.6	22.5	10.1
Property and equipment	19.9	22.7	22.8
Non-current assets held for sale	34.6	-	-
Intangible assets	1.3	2.0	3.8
<b>Total assets</b>	<b>1,203.3</b>	<b>1,257.5</b>	<b>1,279.5</b>
Accounts payable and other liabilities	9.6	18.5	23.6
Income taxes due and accrued	4.1	-	0.8
Unearned premiums	138.1	157.0	164.4
Unpaid claims and adjustment expenses	765.0	705.1	675.1
<b>Total liabilities</b>	<b>916.8</b>	<b>880.6</b>	<b>863.9</b>
<b>Net assets</b>	<b>\$ 286.5</b>	<b>\$ 376.9</b>	<b>\$ 415.6</b>
Purchase price paid	\$ 261.4	\$ 261.4	\$ 261.4
Gain on acquisition	25.1	25.1	25.1
Additional capital contributions:			
- Cash	-	48.0	50.3
- Transfer of future tax benefits	-	15.3	18.2
Dividend to parent company	-	-	(11.0)
Comprehensive income since acquisition:			
- Net income	-	22.9	60.4
- Other comprehensive income	-	4.2	11.2
<b>Company's interest in Jevco</b>	<b>\$ 286.5</b>	<b>\$ 376.9</b>	<b>\$ 415.6</b>

The gain on business acquisition of \$25.1 million resulted from the shares of Jevco being acquired at a discount to the fair value of its net assets. Non-current assets held for sale with an estimated value of \$34.6 million included real estate and other assets held by Jevco on the date of acquisition of Jevco. These assets were subsequently sold in June 2010 for proceeds equal to their carrying value.

The Company made additional capital contributions to Jevco of \$48.0 million on April 29, 2010 and \$2.25 million on March 31, 2011.

In August 2010, Jevco acquired and amalgamated with iFire Technology Ltd. ("iFire"). The income tax losses of iFire, in the amount of \$55.0 million, were expected to be available to offset Jevco's income for tax purposes. A corresponding deferred income tax benefit of \$15.3 million was recognized by the Company in the year ended December 31, 2010.

In October 2011, Jevco paid a cash dividend in the amount of \$11.0 million to the Company.

In December 2011, Jevco acquired and amalgamated with 2266100 Ontario Ltd. and 2266102 Ontario Ltd. The income tax losses of 2266100 Ontario Ltd. and 2266102 Ontario Ltd. in the amount of \$10.9 million were expected to be available to offset Jevco's income for tax purposes. A corresponding deferred income tax benefit of \$2.9 million was recognized by the Company in the year ended December 31, 2011.

Jevco's comprehensive income since the Acquisition has increased the Company's equity by \$71.6 million.

#### 4. DESCRIPTION OF INSURANCE BUSINESS

Established in 1980, Jevco is a provider of property and casualty insurance that operates in Canada distributing its specialty insurance products through a network of independent brokers to both individual and commercial customers. Jevco's vision is to be a first choice specialty insurer while striving to become a recognized alternative to the large players in certain niche insurance markets where it believes it has, or can obtain, a sustainable competitive advantage. The insurance products offered consist of (a) non-standard automobile insurance, (b) insurance for recreational vehicles and motorcycles, (c) standard automobile insurance in Quebec, (d) commercial automobile insurance, (e) property and liability insurance, and (f) surety products.

##### Personal Lines

Personal Lines include non-standard and standard automobile insurance, motorcycle and recreational vehicle insurance.

##### *Personal Automobile*

Personal automobile lines include the run-off of the discontinued "Kplus" product (which targeted risks between the standard and non-standard markets) and the results from mandatory participation in provincial Facility Associations which provide automobile insurance coverage to individuals who are unable to purchase coverage in the voluntary market.

The Company writes non-standard automobile insurance in the provinces of Ontario, Alberta and Quebec as well as standard automobile insurance in Quebec. Jevco began writing non-standard automobile insurance in Ontario effective October 1, 2009.

Non-standard automobile insurance covers individuals who do not qualify for standard automobile insurance because of their payment history, driving record, vehicle type or other factors. Non-standard automobile insurance is accompanied by increased loss exposure, higher claims experience and higher incidence of consumer and service provider fraud. These factors are mitigated by higher premium rates and the tendency of high-risk individuals to own lower value automobiles and to purchase coverage at the minimum prescribed limits. When the driving records of non-standard drivers improve, they may qualify to obtain insurance in the standard market at lower premium rates. As a result, non-standard automobile insurance policies experience a lower retention rate than that of standard market risk policies.

Standard automobile insurance provides coverage for standard risk drivers of private passenger automobiles. Premiums for these policies are usually lower than premiums charged in the non-standard market for comparable coverage. The frequency and severity of accidents and other loss events are also typically lower.

##### *Motorcycle and Recreational Vehicles*

The Company writes motorcycle insurance in the provinces of Ontario, Alberta and Quebec and is the leading writer of motorcycle insurance in Canada. Motorcycle insurance consists primarily of liability, physical damage and personal injury insurance coverage. The Company also writes insurance for ATVs, snowmobiles and watercraft in the Province of Quebec.

##### Commercial Lines

Commercial Lines include property and liability, automobile and surety insurance as well as the run-off of discontinued long haul trucking and home warranty lines.

##### *Property and Liability*

This business focuses on insuring against damage to property and accidents that may occur on such property. It consists of risks that are either difficult to place due to class, age, location or occupancy of the risk. These risks are characterized by high premiums and limited coverage. The Company's specialty property business includes insurance for restaurants, rental properties and garages.

##### *Commercial Automobile*

The Company focuses on specialty or niche types of products such as taxi, driver training, light commercial business vehicles, short or long haul trucking risks and other specialty risks such as sand and gravel, logging and tow trucks. Its strategy is to operate as a niche underwriter of classes that are more difficult to underwrite but where it has considerable expertise and experience. Early in 2011, the Company cautiously re-entered the long haul trucking market supported by a sound reinsurance program.

##### *Surety*

The Company writes contract, commercial, fiduciary and customs and excise bonds. Contract bonds (which include performance, labour and material) guarantee the performance of a construction contract while commercial bonds, which are primarily license type bonds, satisfy the needs



4. DESCRIPTION OF INSURANCE BUSINESS (continued)

of provincial governments which require contractors to be licensed in the province in which they operate. Customs and excise bonds provide security for the benefit of the Canada Revenue Agency in the event there is a failure to remit payment of any duties and taxes.

5. ANALYSIS OF FINANCIAL RESULTS

The Company's operating results include the results from the insurance operations of Jevco. Jevco's operating results for the three months ended March 31, 2010 (prior to the date of acquisition of March 29, 2010) were not included in the Company's operating results for the year ended December 31, 2010.

5.1 Underwriting Income

Details of premiums and underwriting income by lines of business are as follows:

(millions)	Three months ended December 31, 2011			Three months ended December 31, 2010		
	Personal Lines	Commercial Lines	Total	Personal Lines	Commercial Lines	Total
Direct premiums written	\$ 45.5	\$ 26.0	\$ 71.5	\$ 50.2	\$ 21.9	\$ 72.1
Net premiums written	\$ 43.5	\$ 24.0	\$ 67.5	\$ 47.0	\$ 18.9	\$ 65.9
Underwriting income (loss):						
Net premiums earned	\$ 50.7	\$ 23.3	\$ 74.0	\$ 50.0	\$ 19.2	\$ 69.2
Underwriting expenses	52.3	16.4	68.7	61.4	7.2	68.6
Underwriting income (loss)	\$ (1.6)	\$ 6.9	\$ 5.3	\$ (11.4)	\$ 12.0	\$ 0.6
Loss ratio	72.0%	26.2%	57.6%	89.5%	(6.0)%	63.0%
Expense ratio	31.2%	44.4%	35.3%	33.3%	43.6%	36.1%
Combined ratio	103.2%	70.6%	92.9%	122.8%	37.6%	99.1%

The underwriting income for the three months ended December 31, 2011 was \$5.3 million (2010 - \$0.6 million), producing a loss ratio of 57.6% (2010 - 63.0%) and an expense ratio of 35.3% (2010 - 36.1%). In the three months ended December 31, 2011, Personal Lines produced an underwriting loss of \$1.6 million (2010 - \$11.4 million) and Commercial Lines produced an underwriting income of \$6.9 million (2010 - \$12.0 million).

(millions)	Year ended December 31, 2011			Year ended December 31, 2010		
	Personal Lines	Commercial Lines	Total	Personal Lines	Commercial Lines	Total
Direct premiums written	\$ 250.3	\$ 99.7	\$ 350.0	\$ 204.3	\$ 69.1	\$ 273.4
Net premiums written	\$ 241.0	\$ 92.4	\$ 333.4	\$ 192.8	\$ 62.1	\$ 254.9
Underwriting income (loss):						
Net premiums earned	\$ 238.8	\$ 87.3	\$ 326.1	\$ 177.1	\$ 59.2	\$ 236.3
Underwriting expenses	240.5	71.0	311.5	199.2	31.5	230.7
Underwriting income (loss)	\$ (1.7)	\$ 16.3	\$ 14.6	\$ (22.1)	\$ 27.7	\$ 5.6
Loss ratio	76.5%	40.5%	66.8%	86.4%	15.2%	68.6%
Expense ratio	24.2%	40.8%	28.7%	26.1%	38.0%	29.0%
Combined ratio	100.7%	81.3%	95.5%	112.5%	53.2%	97.6%

The underwriting income for the year ended December 31, 2011 was \$14.6 million (2010 - \$5.6 million), producing a loss ratio of 66.8% (2010 - 68.6%) and an expense ratio of 28.7% (2010 - 29.0%). In the year ended December 31, 2011, Personal Lines produced an underwriting loss of \$1.7 million (2010 - \$22.1 million) and Commercial Lines produced an underwriting income of \$16.3 million (2010 - \$27.7 million).

Underwriting expenses include claims, adjustment expenses, commissions, premium taxes and all general and administrative expenses incurred in underwriting income. The discount rate used to determine unpaid claims and adjustment expenses was reduced by 60 basis points as at December 31, 2011, as compared to the December 31, 2010 discount rate which, along with related changes in provision for adverse deviation,

5. ANALYSIS OF FINANCIAL RESULTS (continued)

negatively impacted claims and adjustment expenses by \$4.4 million for the year ended December 31, 2011 (2010 - \$0.3 million). Offsetting this negative impact for the year ended December 31, 2011 was the positive impact of the reversal of the prior year premium deficiency of \$3.9 million. The expense ratio for Commercial Lines is significantly higher compared to Personal Lines due to higher commissions paid on commercial business as well as higher salary costs for the level of underwriting expertise required on commercial products. The expense ratio for the fourth quarter is higher than the year to date ratio in both years due to fourth quarter accruals for broker profit commissions and employee bonuses.

Analysis of the underwriting performance is provided below by line of business.

Personal Lines

The Personal Lines division produced an underwriting loss in the quarter ended December 31, 2011 of \$1.6 million (2010 - \$11.4 million) and in the year ended December 31, 2011 of \$1.7 million (2010 - \$22.1 million). Underwriting results included favourable development of prior years' claims in the three months ended December 31, 2011 of \$8.2 million (2010 - \$8.0 million) and favourable development in the year ended December 31, 2011 of \$10.4 million (2010 - \$8.8 million).

Improvement in underwriting results in the fourth quarter over the fourth quarter last year was due to the Ontario non-standard automobile lines of business. Management took a number of steps to address the results of this business, including a review and cancellation of underperforming brokers, strengthening fraud protection measures and reducing commission in certain territories. In addition, two separate rate increases were granted by the Financial Services Commission of Ontario. The first was a 10% rate increase effective October 1, 2010 for new business and effective November 1, 2010 for renewal business. The second was a further 8.9% increase effective March 6, 2011 for new business and April 6, 2011 for renewal business. Automobile insurance reform legislation intended to control costs of accident benefit claims was introduced in Ontario on September 1, 2010. Indications are that the intended benefits of the reform legislation and management actions are working. Partially offsetting the improvement in the automobile lines for the fourth quarter and full year 2011 over the prior year were losses in the motorcycle line of business due to prior years' claims development and milder than usual weather, which resulted in a longer than expected motorcycle season and therefore a greater frequency of claims. Also negatively affecting 2011 motorcycle results was the delayed implementation of Jevco's 2011 motorcycle premium rate increase of 7.3% until May 1, 2011 for new business and June 10, 2011 for renewal business.

Commercial Lines

The Commercial Lines division posted an underwriting profit in the quarter ended December 31, 2011 of \$6.9 million (2010 - \$12.0 million) and in the year ended December 31, 2011 of \$16.3 million (2010 - \$27.7 million). Included in this profit was favourable development of prior years' claims in the fourth quarter of 2011 of \$10.1 million (2010 - \$12.1 million) and in the year ended December 31, 2011 of \$26.0 million (2010 - \$27.7 million). In the fourth quarter of 2011, the Company experienced several large claims relating to the current year which contributed to the decline in underwriting profitability.

5.2 Investment Income and Net Realized and Unrealized Gains

(millions)	Three months ended December 31				Year ended December 31			
	2011		2010		2011		2010	
	Return	Annualized % return	Return	Annualized % return	Return	Annualized % return	Return	Annualized % return
<u>Insurance Company Portfolio</u>								
Income net of expenses	\$ 7.3	2.9%	\$ 7.2	2.9%	\$ 28.9	2.9%	\$ 21.9	3.1%
Realized gains	1.7	0.7%	2.7	1.1%	8.1	0.8%	6.8	0.9%
Foreign currency gain (loss)	(0.5)	-0.2%	(0.7)	-0.3%	0.0	0.0%	(0.8)	-0.1%
Unrealized investment gains								
- available-for-sale investments	3.0		(8.7)		9.7		5.9	
- held-to-maturity investments	1.0		(2.0)		6.0		3.3	
	<u>4.0</u>	1.6%	<u>(10.7)</u>	-4.3%	<u>15.7</u>	1.6%	<u>9.2</u>	1.3%
Insurance Company Portfolio	\$ 12.5	5.0%	\$ (1.5)	-0.6%	\$ 52.7	5.3%	\$ 37.1	5.2%
Portfolio investments – Other *	-		(0.1)		0.6		3.8	
Net instalment premium income	0.8		0.8		2.8		2.1	
	<u>\$ 13.3</u>		<u>\$ (0.8)</u>		<u>\$ 56.1</u>		<u>\$ 43.0</u>	
Average portfolio investments								
- measured at amortized cost	\$1,010.6		\$1,005.3		\$ 993.8		\$ 955.5	

\* includes investment income, gains on sale of investments and foreign currency gains and losses not related to the insurance company portfolio

## 5. ANALYSIS OF FINANCIAL RESULTS (continued)

### *Three months ended December 31, 2011*

Investment income net of expenses for the three months ended December 31, 2011 was \$7.3 million (2010 - \$7.2 million), resulting in an annualized yield for the quarter of 2.9% (2010 - 2.9%). The portfolio is heavily concentrated in short duration, high quality fixed income securities to protect the portfolio from the impact of rising yields and further interest rate increases from the Bank of Canada.

On the portfolio backing the insurance operations, realized gains for the three months ended December 31, 2011 were \$1.7 million (2010 - \$2.7 million) and unrealized gains for the same period were \$4.0 million (2010 - \$10.7 million loss). In the three months ended December 31, 2011, generally weaker economic data in Canada and volatile international markets resulted in increased market values for corporate and government bonds.

Net instalment premium income in the three months ended December 31, 2011 of \$0.8 million (2010 - \$0.8 million) represents interest of \$1.2 million (2010 - \$1.2 million), net of expenses of \$0.4 million (2010 - \$0.4 million), earned from lending funds to policyholders to cover the cost of insurance premiums.

### *Year ended December 31, 2011*

Investment income net of expenses for the year ended December 31, 2011 was \$28.9 million (2010 - \$21.9 million), resulting in an annualized yield of 2.9% (2010 - 3.1%).

Realized gains for the same period on the investment portfolio backing the insurance operations were \$8.1 million (2010 - \$6.8 million) and unrealized gains were \$15.7 million (2010 - \$9.2 million). In addition to the returns on the insurance company portfolio, a gain of \$0.5 million was realized in the second quarter of 2011 on an investment which was previously written off as impaired, prior to January 1, 2010.

Net instalment premium income in the year ended December 31, 2011 of \$2.8 million (2010 - \$2.1 million) represents interest of \$5.1 million (2010 - \$3.7 million), net of expenses of \$2.3 million (2010 - \$1.6 million).

### 5.3 Corporate Costs

Corporate costs, excluding share-based compensation, for the three months ended December 31, 2011 were \$1.5 million (2010 - \$1.3 million) and for the year ended December 31, 2011 were \$5.3 million (2010 - \$4.8 million). Corporate costs include fees for management services provided by Goodwood Management Inc. ("Goodwood"), as discussed in Section 11, *Related Party Transactions* of this MD&A.

### 5.4 Share-based Compensation

Share-based compensation expense for the quarter ended December 31, 2011 was \$3.1 million (2010 - \$2.7 million) and for the year ended December 31, 2011 was \$7.8 million (2010 - \$6.6 million). Share-based compensation expense relates to the Company's outstanding restricted share units granted to Goodwood, and to the issue and revaluation of outstanding deferred share units to directors of the Company and officers of Jevco.

### 5.5 Site Restoration Provision Recovery

The site restoration provision relates to site restoration costs associated with soil and groundwater reclamation and remediation on industrial sites formerly owned by the Company. During the year ended December 31, 2011, remediation costs of \$0.1 million (2010 - \$nil) which were paid by the Company were reimbursed to the Company by the previous owner of the industrial sites. These indemnified outlays had not previously been accrued and therefore were recorded in income as a site restoration provision recovery when received. Changes in estimates of future expenditures resulted in adjustments to the provision during the year ended December 31, 2010 of \$0.5 million. No adjustments to the provision were required for the year ended December 31, 2011.

### 5.6 Other Income

At closing of the Acquisition, discussed in Section 3, *Insurance Company Acquisition* of this MD&A, the Company paid an amount of \$20.0 million to be held in escrow in respect of some of the claims reserve for Jevco's insurance business existing at the time of closing. In the event that the related claims reserve development from December 31, 2009 until December 31, 2012 was adverse to Jevco, the purchase price would have been reduced, to a maximum amount of \$20.0 million. In March 2011, this escrow amount was released upon agreement between the parties in exchange for a payment of \$2.25 million to the Company, which is classified as other income.

5. ANALYSIS OF FINANCIAL RESULTS (continued)

5.7 Income Taxes

For the three months and year ended December 31, 2011, the Company's income tax expense was \$0.7 million and \$11.3 million, respectively, compared to expense of \$3.2 million for the three months ended December 31, 2010 and recovery of \$4.5 million for the year ended December 31, 2010. The income tax expense in the year ended December 31, 2011 included a recovery amount of \$2.9 million resulting from an internal corporate reorganization whereby Jevco acquired and amalgamated with 2266100 Ontario Ltd. and 2266102 Ontario Ltd. The income tax losses of these two companies were transferred to Jevco and non-capital losses of \$10.9 million were expected to be available to offset Jevco's income for tax purposes. The income tax recovery in the year ended December 31, 2010 included an amount of \$15.3 million resulting from an internal corporate reorganization whereby Jevco acquired and amalgamated with iFire. The income tax losses of iFire were transferred to Jevco and non-capital losses of \$55.0 million were expected to be available to offset Jevco's income for tax purposes. Offsetting the recoveries was income tax expense resulting from Jevco's insurance operations of \$3.6 million for the three months ended December 31, 2011 (2010 - \$3.2 million) and \$14.2 million for the year ended December 31, 2011 (2010 - 10.8 million).

5.8 Discontinued Operations

Westaim's former operating units, Westaim Holdings Limited ("WHL" or "Nucryst") and iFire, are presented as discontinued operations in the consolidated financial statements. Loss from discontinued operations, net of income taxes, for the three months ended December 31, 2011 was \$0.1 (2010 - \$nil) and for the year ended December 31, 2011 was \$0.2 million (2010 - \$1.0 million).

In December 2009, Nucryst sold all its operations and assets and in February 2010, the Company completed a capital restructuring and the shares held by the non-controlling shareholders of Nucryst were purchased by Westaim. iFire's operating costs were related to the maintenance of a partially sublet leased building and reported as discontinued operations. The lease was assigned from iFire to WHL in the second quarter of 2010. During the fourth quarter of 2010, iFire was formally dissolved.

5.9 Other Comprehensive Income

Other comprehensive income consists of the change in unrealized gains of the available-for-sale investments, net of foreign exchange gains and losses and income taxes. Unrealized foreign exchange gains and losses under IFRS are reported directly in net income whereas under CGAAP, they were reported in other comprehensive income. For the three months ended December 31, 2011, the net unrealized gain on the available-for-sale investment portfolio was \$2.5 million (2010 - \$9.3 million loss). After excluding foreign exchange losses of \$0.5 million (2010 - \$0.6 million) and deducting income tax expense of \$0.6 million (2010 - \$2.7 million recovery), a \$2.4 million net of tax unrealized investment gain (2010 - \$6.0 million loss) was included in other comprehensive income. For the year ended December 31, 2011, the net unrealized gain on the available-for-sale investment portfolio was \$9.7 million (2010 - \$5.9 million). After deducting income tax expense of \$2.6 million (2010 - \$1.7 million), a \$7.1 million (2010 - \$4.2 million) net of tax increase in unrealized investment gains was included in other comprehensive income. Section 5.2 includes an explanation of the change in investment gains in the three months and year ended December 31, 2011.

6. ANALYSIS OF FINANCIAL POSITION

The Company's consolidated statement of financial position is comprised of the following assets and liabilities:

(millions)	December 31, 2011	December 31, 2010
<b>Assets</b>		
Cash and cash equivalents	\$ 24.3	\$ 32.9
Investments	1,018.6	993.3
Instalment premiums	62.8	65.1
Recoverable from reinsurers	34.0	29.7
Claims recoverable from other insurers	51.0	40.2
Deferred policy acquisition expenses	35.6	29.8
Other assets	69.8	79.4
<b>Total assets</b>	<b>\$ 1,296.1</b>	<b>\$ 1,270.4</b>
<b>Liabilities</b>		
Unearned premiums	\$ 164.4	\$ 157.0
Unpaid claims and adjustment expenses	675.1	705.1
Other liabilities	39.4	31.0
	878.9	893.1
Shareholders' equity	417.2	377.3
<b>Liabilities and shareholders' equity</b>	<b>\$ 1,296.1</b>	<b>\$ 1,270.4</b>

## 6. ANALYSIS OF FINANCIAL POSITION (continued)

### 6.1 Cash and Cash Equivalents

At December 31, 2011, the Company had consolidated cash and cash equivalents of \$24.3 million compared to \$32.9 million at December 31, 2010. Of this balance, \$9.7 million (December 31, 2010 - \$21.2 million) was held by Jevco to support the insurance operations. See further discussion below in Section 9, *Liquidity and Capital Resources* of this MD&A.

### 6.2 Investments

The Company's investment portfolio of \$1,018.6 million at December 31, 2011 (December 31, 2010 - \$993.3 million) consisted of investments held to support the insurance business.

Insurance companies must comply with applicable regulations that prescribe the type, quality and concentration of investments. These regulations permit investments in government, provincial, municipal and corporate bonds, and preferred and common equities, within specified limits and subject to certain qualifications. The Company has its own investment policies and guidelines which meet or exceed the regulatory requirements as well as additional risk management policies to address credit risk, interest rate risk, equity prices risk, liquidity risk and asset diversification. The Investment Committee of the Board of Jevco and senior management monitor the Company's risk exposures and activities that give rise to these exposures.

(millions)	December 31, 2011	December 31, 2010
Carrying value of investment portfolio:		
Term deposits	\$ 84.8	\$ 246.3
Government bonds	261.9	177.3
Corporate debt securities	432.9	473.9
Mortgage and other asset backed securities	122.0	88.7
	<u>901.6</u>	<u>986.2</u>
Common shares	103.9	0.5
Preferred shares	13.1	6.6
	<u>\$ 1,018.6</u>	<u>\$ 993.3</u>

Carrying value is fair value for available-for-sale investments and amortized cost for held-to maturity investments.

The Company manages its investments to support the liabilities of its insurance operations, to preserve capital and to generate attractive, after-tax investment returns while adhering to a low risk philosophy. The investment portfolio consists primarily of corporate and government bonds with relatively short durations. Within the mortgage and other asset backed securities category are government guaranteed residential mortgage backed securities and very high quality consumer credit securities. In August 2011, the Company invested approximately 10% of its investment portfolio in Canadian dividend paying common equities with the intention of generating an attractive yield along with long term capital appreciation. Exposure to foreign currencies, including the United States dollar, is considered to be low, with \$16.4 million invested in U.S. dollar denominated securities at December 31, 2011, primarily to match an equivalent amount of United States dollar claims related liabilities. Investments are managed by unrelated third-party investment management firms and the Company monitors their performance and their compliance with both their individual mandate and the Company's investment policies and guidelines. Two new investment managers were contracted to manage the investment assets of the Company, replacing the sole investment manager who was contracted previously. The transition of the assets to the new investment managers was completed successfully in January 2011.

By virtue of the nature of the Company's business activities, financial instruments make up the majority of the statement of financial position. The risks which arise from holding financial instruments include credit risk, market risk, liquidity risk and cash flow risk. These risks may be caused by factors specific to an individual instrument or factors affecting all instruments traded in the market. The Company has a comprehensive risk management framework to monitor, evaluate and manage the risks assumed in conducting its business.

For a more detailed analysis and quantification of market risk, see Note 24 to the audited annual consolidated financial statements for the year ended December 31, 2011.

### 6.3 Instalment Premiums

The instalment premiums asset at December 31, 2011 was \$62.8 million (December 31, 2010 - \$65.1 million). Premiums are typically payable at the time of policy issue or renewal. The Company offers the option to pay in monthly instalments. The insured pays an additional amount for this option, reflecting handling costs and foregone investment income to the Company.

## 6. ANALYSIS OF FINANCIAL POSITION (continued)

### 6.4 Recoverable from Reinsurers

At December 31, 2011, amounts recoverable from reinsurers totaled \$34.0 million (December 31, 2010 - \$29.7 million). The table below summarizes the credit exposure of the Company for amounts recoverable from reinsurers, by rating assigned by A.M. Best.

Financial strength ratings of reinsurers (millions)	December 31, 2011		December 31, 2010	
	Amount	Percentage	Amount	Percentage
A++	\$ 0.2	1%	\$ 1.9	6%
A+	9.7	29%	5.9	20%
A	22.9	67%	21.8	74%
Other	1.2	3%	0.1	-
	\$ 34.0	100%	\$ 29.7	100%

In the normal course of business, the Company seeks to reduce the loss that may arise from a catastrophe or other events that cause unfavourable underwriting results by reinsuring certain levels of risk, in various areas of exposure, with other insurers. Failure of reinsurers to honour their obligations could result in losses to the Company.

For a more detailed discussion of the Company's reinsurance program, see Section 7, *Reinsurance* of this MD&A and Note 7 to the audited annual consolidated financial statements for the year ended December 31, 2011.

### 6.5 Claims Recoverable from Other Insurers

Claims recoverable from other insurers totaled \$51.0 million at December 31, 2011 (December 31, 2010 - \$40.2 million). In accordance with the Insurance Act of Ontario (the "Act"), an insurance company has a right of indemnification for certain benefits paid to its own insured from the insurer of a third party at fault. The Act also provides for an arbitration process when the two insurers are not in agreement as to the amount of losses to be transferred. Claims recoverable from other insurers represent management's estimate of the amounts recoverable. Failure of other insurers to honour their obligations could result in losses to the Company.

### 6.6 Deferred Policy Acquisition Expenses

At December 31, 2011, deferred policy acquisition expenses were \$35.6 million (December 31, 2010 - \$29.8 million). The Company defers brokers' commissions, premium taxes and other underwriting and marketing costs relating to the acquisition of premiums written to the extent they are considered recoverable. These costs are expensed as the related premiums are earned. The method followed in determining the deferred policy acquisition expenses limits the deferral to its realizable value by giving consideration to estimated future claims and expenses to be incurred as premiums are earned. Anticipated investment income is considered in determining the realizable value of the deferred policy acquisition expenses. Changes in estimates are reflected in the statement of operations in the period in which such estimates are updated.

The underwriting performance in the non-standard automobile line of business improved during 2011 compared to the fourth quarter of 2010 when a premium deficiency resulted in a \$3.9 million write-down of the deferred policy acquisition expenses as at December 31, 2010. In the second quarter of 2011, this write-down of \$3.9 million was reversed which decreased underwriting expenses and resulted in lower expense and combined ratios for the year ended December 31, 2011.

### 6.7 Other assets

Other assets include investment income due and accrued, accounts receivable, income tax assets, property and equipment, and intangible assets.

### 6.8 Unearned Premiums

At December 31, 2011, the unearned premium liability was \$164.4 million (December 31, 2010 - \$157.0 million). Unearned premiums represent the portion of premiums written related to the unexpired risk portion of the policy at the end of the period. The Company earns motorcycle premiums over the period of risk covered by each policy based on past experience and on all other lines evenly over the period covered by each individual insurance contract.

### 6.9 Unpaid Claims and Adjustment Expenses

At December 31, 2011, the provision for unpaid claims and adjustment expenses was \$675.1 million (December 31, 2010 - \$705.1 million). The table below shows the unpaid claims and adjustment expenses by Personal and Commercial Lines of business, direct and net. The net unpaid claims and adjustment expenses are net of both external reinsurance and amounts recoverable from other insurers which are presented as assets in the consolidated statement of financial position.

6. ANALYSIS OF FINANCIAL POSITION (continued)

(millions)	December 31, 2011		December 31, 2010	
	Direct	Net	Direct	Net
Personal Lines	\$ 478.3	\$ 412.7	\$ 468.7	\$ 422.9
Commercial Lines	196.8	179.1	236.4	213.8
	\$ 675.1	\$ 591.8	\$ 705.1	\$ 636.7

A provision for unpaid claims and adjustment expenses includes several components: a provision for unpaid claims based on an estimated liability on individual reported claims (more commonly known as case reserves), an estimated provision for claims that have not yet been reported and expected future development on case reserves, collectively known as the incurred but not reported claims provision ("IBNR"), an estimate of allocated loss adjustment expenses (primarily defense costs) and unallocated loss adjustment expenses (primarily the adjustment handling costs by claims personnel) expected to be incurred in the future. At December 31, 2011, the direct unpaid claims and adjustment expenses of \$675.1 million (December 31, 2010 - \$705.1 million) consisted of \$460.0 million (December 31, 2010 - \$513.0 million) related to case reserves and \$215.1 million (December 31, 2010 - \$192.1 million) related to IBNR.

An evaluation of the adequacy of the provision for unpaid claims and adjustment expenses is completed at the end of each quarter. This evaluation includes a re-estimation of the provision for unpaid claims and adjustment expenses relating to each preceding financial year compared to the provision that was originally established. The results of this comparison and the changes in the provisions for unpaid claims and adjustment expenses for the three months and year ended December 31, 2011 and for the nine months in 2010 from date of acquisition to December 31, 2010 are as follows:

(millions)	Three months ended December 31, 2011	Year ended December 31, 2011	From acquisition on March 29, 2010 to December 31, 2010
<u>Unpaid claims and adjustment expenses</u>			
Beginning of period	\$ 699.1	\$ 705.1	\$ 765.0
Reinsurers' share	(29.8)	(28.2)	(46.2)
Other insurers' share	(47.8)	(40.2)	(27.2)
Beginning of period, net	621.5	636.7	691.6
Paid during the period	(72.2)	(262.7)	(217.0)
Increases (decreases) in accruals due to:			
Current year claims	61.8	249.9	198.2
Prior years' claims	(18.3)	(36.4)	(36.5)
Change in discount rates and provision for adverse deviation	(1.0)	4.3	0.4
End of period, net	591.8	591.8	636.7
Reinsurers' share	32.3	32.3	28.2
Other insurers' share	51.0	51.0	40.2
End of period	\$ 675.1	\$ 675.1	\$ 705.1

Favourable prior years' claims development in the year ended December 31, 2011 of \$36.4 million and for the nine months ended December 31, 2010 of \$36.5 million represents 5.7% and 5.3%, respectively, of opening net unpaid claims and adjustment expenses.

The establishment of a provision for unpaid claims represents management's best estimate of the ultimate cost of both reported but unsettled claims and unreported claims utilizing actuarial and statistical procedures. The provision for unpaid claims represents the discounted estimates of the ultimate net cost of all unpaid claims and loss adjustment expenses plus provisions for adverse deviation. Establishing the provision for unpaid claims relies on the judgment and opinions of a large number of individuals, including the opinions of the Appointed Actuary. Management regularly reviews its estimates and adjusts as experience develops and new information becomes available. In establishing the provision for unpaid claims, the Company also takes into account estimated recoveries, reinsurance, salvage and subrogation.

Factors affecting the provision for unpaid claims include the continually evolving and changing regulatory and legal environments, actuarial studies, professional experience and the expertise of claims personnel and independent adjusters retained to handle individual claims. Changes in claims handling procedures and the individuals involved in the reserving process also affect the provision for unpaid claims. Quality of the data used for projection purposes, existing claims management practices (including claims handling and settlement practices), the effect of inflationary trends on future claims settlement costs, court decisions, economic conditions and public attitudes, all affect the provision for unpaid claims.

Time is a critical part of the provision's determination, since the longer the span between the incidence of a loss and the payment or claim settlement, the more variable the ultimate settlement amount can be. Short-tailed claims, such as property claims, tend to be more predictable than long-tailed claims such as general liability and automobile accident benefit claims. The provision for unpaid claims is discounted to reflect the

## 6. ANALYSIS OF FINANCIAL POSITION (continued)

time value of expected future payouts of claims. Adjustments to estimates of the provision for unpaid claims are reflected in the consolidated statement of operations in the period in which they become known. Even after such adjustments, ultimate liability or recovery may exceed or be less than the revised estimates. A change that increases the provision for unpaid claims is known as an unfavourable development and will reduce net income whereas a change that decreases the provision for unpaid claims is known as a favourable development and will increase net income.

Management has the responsibility to ensure that the provision for unpaid claims, including IBNR, is appropriate. Management establishes, maintains and evaluates its respective provisions for unpaid claims and evaluates all of its respective policy coverages and paid and open claim level data to ascertain claim frequency and severity trends, as well as the effects of inflation or changes in operating structure or process may have on future loss settlements. Management reviews the information by product and geographic regions to monitor emergence of any patterns. Management incorporates all of the above information to record its best estimate of the provision for unpaid claims.

Management also uses actuarial and statistical procedures to allocate the IBNR by accident years and coverages, programs and/or lines of business.

### 6.10 Other Liabilities

Other liabilities of \$39.4 million at December 31, 2011 (December 31, 2010 - \$31.0 million) include accounts payable, accrued liabilities and a leasehold inducement of \$2.6 million (December 31, 2010 - \$2.8 million) which is being amortized to income over the term of the lease. Other liabilities also include a site restoration provision of \$2.4 million at December 31, 2011 (December 31, 2010 - \$2.5 million) (see also Section 5.5). The provision relates to site restoration costs associated with soil and groundwater reclamation and remediation costs. The Company conducts periodic reviews of the underlying assumptions supporting the provision, including remediation costs and regulatory requirements. The site restoration provision was reduced by \$2.6 million upon transition to IFRS as at January 1, 2010, due to the effect of discounting for the time value of money. Potential reimbursements of costs resulting from indemnifications provided by previous owners of the industrial sites have not been recognized in these consolidated financial statements. Any future reimbursements will be recorded when received.

### 6.11 Equity

The details of shareholders' equity are as follows:

(millions)	December 31, 2011	December 31, 2010	January 1, 2010
Common shares	\$ 656.6	\$ 660.6	\$ 426.3
Preferred shares	30.8	30.8	-
Warrants	1.9	1.9	-
Contributed surplus	12.9	8.7	8.7
Accumulated other comprehensive income	11.2	4.2	-
Deficit	(296.2)	(328.9)	(383.0)
Shareholders' equity	\$ 417.2	\$ 377.3	\$ 52.0

The reported book value of the common shares decreased by \$4.0 million from \$660.6 million at December 31, 2010 to \$656.6 million at December 31, 2011 as a result of the Company's purchase of shares with an average book value of \$7.3 million in the third and fourth quarters of 2011 pursuant to the normal course issuer bid discussed in Section 9, *Liquidity and Capital Resources – Capital Management* of this MD&A, offset by proceeds of \$3.3 million for common shares issued to Goodwood in the second quarter of 2011. The difference of \$4.2 million between the market price paid to purchase the Company's common shares of \$3.1 million and the average book value of the shares of \$7.3 million was credited to contributed surplus. The increase in common shares of \$234.3 million in 2010 resulted mainly from the Financing discussed in Section 9, *Liquidity and Capital Resources* of this MD&A. Preferred shares and warrants were issued in 2010 under the Financing. Accumulated other comprehensive income represents the unrealized gains in the insurance company investment portfolio since acquisition. The decrease in deficit of \$32.7 million from December 31, 2010 to December 31, 2011 is due to the net income for the year ended December 31, 2011.

## 7. REINSURANCE

The Company's reinsurance program is designed with the objective of protecting capital and increasing underwriting capacity. The Company has policies to evaluate the financial condition of its reinsurers and monitors concentrations of credit risk arising from common ownership, geography, activities, or economic characteristics of the reinsurers to minimize its exposure to significant losses from reinsurer's insolvency. The reinsurers chosen to participate in the program have a minimum rating at inception of A- from A.M. Best or S&P.



## 7. REINSURANCE (continued)

In 2011, the Company has reinsurance protection which limits the maximum amount on any one loss to \$2.0 million (2010 - \$1.75 million) in the event of a liability claim to a maximum of \$30.0 million (2010 - \$20.0 million), and \$0.75 million (2010 - \$0.75 million) in the event of a property claim to a maximum of \$10.0 million (2010 - \$5.0 million). In addition, the Company has property catastrophe reinsurance which provides coverage in the event of a series of claims arising out of a single occurrence. Reinsurance limits this exposure to \$2.5 million (2010 - \$2.5 million) per occurrence to a maximum of \$25.0 million (2010 - \$25.0 million).

## 8. OUTLOOK

Westaim completed a positive year in 2011 allowing the Company's book value per share to appreciate by 10% from \$0.59 at December 31, 2010 to \$0.65 at December 31, 2011. Management believes Westaim is well positioned to carry out its plan to grow its business organically and through selective acquisitions. The Company is in a solid financial position with a strong balance sheet, ready to respond to opportunities and execute its business plan.

The Ontario non-standard automobile line of business, which represents approximately half of the Personal Lines Gross Written Premium, has responded favorably to the 2010 initiatives taken by management. Management believes these initiatives, along with Ontario legislative changes enacted in September 2010 aimed at controlling the costs of accident benefit claims, improved the loss ratio of this line of business in 2011 in line with industry peers, and profits are expected to continue to improve in 2012. Partially offsetting these favourable results for non-standard automobile was lower than expected performance in recreational vehicles, including Ontario motorcycle. The mild Canadian weather created a longer motorcycle season in 2011 which led to a higher frequency of claims. In addition, adverse development on prior years' motorcycle claims negatively impacted 2011 results. Also negatively affecting 2011 motorcycle results was the delayed implementation of Jevco's 2011 motorcycle premium rate increase of 7.3% until May 1, 2011 for new business and June 10, 2011 for renewal business. In comparison, the 2012 motorcycle rate increase of 8% becomes effective March 15, 2012 for new business and May 15, 2012 for renewal business (before the expected start of the Motorcycle season). Management believes the impact of these rate increases, along with certain product changes planned to be implemented in 2012, will enhance the performance of this line of business going forward.

In Commercial Lines, Jevco continues to build upon its core specialty lines of surety, commercial automobile and specialty commercial risks including the recent return to long-haul trucking, a line of business in which Jevco has historical expertise. The re-entry into the long-haul trucking business was cautious and the overall results were strong. Management expects to see modest growth in 2012 but due to the Company's underwriting approach, management does not expect to see deterioration in the loss ratio. The commercial property and liability business continues to experience excess capital and remains very competitive. However, Jevco's niche property and liability lines continue to perform well across Canada with underwriting quality remaining a focus of management's ongoing growth efforts. Finally, volumes in Surety increased in 2011 while an acceptable loss ratio was maintained. Management expects to be able to retain the Company's market share and historical loss ratio in 2012 despite the potential of a slow economy.

In the first quarter of 2011, two high quality Canadian investment managers were retained to manage Jevco's approximately \$1 billion investment portfolio. The interest rate environment continues to produce lower investment yields relative to historical levels, resulting in significant gains in the Company's largely fixed income portfolio during 2011. During the third quarter, due to the decline in the equity markets and more attractive equity valuations, Jevco reallocated approximately \$100 million of its investment portfolio into high quality, dividend paying Canadian common equities. The Company's strategy going forward is to continue to take advantage of its short duration portfolio to redeploy capital opportunistically in high quality bonds and equities at the appropriate time.

Jevco is well positioned with an A.M. Best credit rating of B++ and a December 31, 2011 Minimum Capital Test ("MCT") ratio of 326%.

## 9. LIQUIDITY AND CAPITAL RESOURCES

### Capital Management

The Company's guiding principles for capital management are to maintain the stability and safety of the Company for its stakeholders through optimal capital mix and an adequate level of capital, satisfy all regulatory requirements, ensure the return on capital meets the Board of Directors' expectations relative to the risk taken, and minimize the after-tax cost of capital.

Towards achieving these objectives, the Company employs a strong and efficient capital base and manages capital in accordance with policies established by the Board of Directors. These policies relate to capital strength and capital mix. The Company has a capital management process in place to measure, deploy and monitor its available capital to assess its adequacy on a continuous basis. Management develops the capital strategy and oversees the capital management processes of the Company. Capital is managed using both regulatory capital measures and internal metrics. The Company's capital is primarily derived from share capital, contributed surplus and retained earnings.

As specified in the capital guidelines of the Office of the Superintendent of Financial Institutions Canada ("OSFI"), property and casualty insurance companies are required to maintain an MCT ratio with a supervisory target of 150%. In some cases, OSFI may establish an alternative supervisory target level based upon an individual institution's risk profile. Jevco's policy is to maintain its MCT ratio at a minimum target of 220%. This capital target ratio is reviewed by the Board of Directors at least annually. At December 31, 2011, the MCT ratio of Jevco was 326% compared to 321% at December 31, 2010. The increase of 5% in the MCT ratio at December 31, 2011 from December 31, 2010 is due to the impact of current year comprehensive income retained after dividend paid to the holding company, plus current tax savings resulting from the utilization of available tax losses arising from the 2010 internal corporate reorganization, mostly offset by additional capital requirements due to the reallocation of a portion of the investment portfolio from bonds to common shares. Management performs dynamic capital adequacy testing on the Company to evaluate the potential effects on the Company's financial condition with a set of specified changes in risk factors, corresponding to extreme events that are plausible, but unlikely. Under each scenario, the MCT ratio exceeded the supervisory target MCT ratio and Jevco's financial condition was considered to be satisfactory.

In addition, management periodically performs scenario stress-testing analysis and comparisons of actual, projected and targeted capital positions to ensure adequacy of actual capital.

On August 24, 2011, Westaim announced that the Toronto Stock Exchange (the "TSX") had approved a notice of the Company's intention to make a normal course issuer bid. Pursuant to the terms of the bid, Westaim may purchase its own common shares for cancellation through the facilities of the TSX at the prevailing market price of the common shares. It is expected that the maximum number of common shares which may be purchased by the Company will not exceed 30,173,238, being 10% of the 301,732,838 common shares which were in the "public float" on August 24, 2011. Purchases are subject to a daily maximum of 79,235 common shares, except where such purchases are made in accordance with the "block purchase" exemption under applicable TSX policy. The Company will make purchases at varying times commencing on August 30, 2011 and ending on August 29, 2012. Westaim believes that its common shares have been trading in a price range which does not adequately reflect the value of such shares in relation to the Company's business and its future prospects. As a result, the Company believes that its outstanding shares may represent an attractive investment. As at December 31, 2011 and February 28, 2012, 6,455,000 common shares had been purchased pursuant to the normal course issuer bid.

### Cash Flow

The Company manages its liquidity to ensure that there is sufficient cash to meet all financial commitments and obligations as they fall due. The Company believes it has the flexibility to obtain from internal sources the funds needed to fulfill its cash requirements during the following financial year and to satisfy regulatory capital requirements. The liquidity requirements of the Company's business are met primarily by funds generated from operations, asset maturities and income received on investments. Cash provided from these sources is used primarily for claims and claims adjustment expense payments and operating expenses. The timing and amount of catastrophe claims are inherently unpredictable and may create increased liquidity requirements.

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9. LIQUIDITY AND CAPITAL RESOURCES (continued)

The following tables illustrate the duration of the financial assets of the Company compared to its contractual obligations:

December 31, 2011 (millions)	One year or less	1 to 3 years	4 to 5 Years	More than 5 years	No specific date	Total
Financial assets:						
Cash and cash equivalents	\$ 24.3	\$ -	\$ -	\$ -	\$ -	\$ 24.3
Investment income due and accrued	5.6	-	-	-	-	5.6
Investments available-for-sale	183.6	374.5	158.4	87.6	117.0	921.1
Investments held-to-maturity	-	-	-	97.5	-	97.5
Instalment premiums	62.8	-	-	-	-	62.8
Accounts receivable	27.4	-	-	-	-	27.4
Recoverable from reinsurers	11.7	12.9	6.0	3.4	-	34.0
Claims recoverable from other insurers	17.6	19.4	8.9	5.1	-	51.0
<b>Total financial assets</b>	<b>333.0</b>	<b>406.8</b>	<b>173.3</b>	<b>193.6</b>	<b>117.0</b>	<b>1,223.7</b>
Contractual obligations:						
Accounts payable and accrued liabilities	25.5	5.3	-	-	2.7	33.5
Income taxes, due and accrued	0.8	-	-	-	-	0.8
Unearned premiums	164.4	-	-	-	-	164.4
Unpaid claims and adjustment expenses	231.7	257.5	117.8	68.1	-	675.1
Lease commitments	3.0	5.5	5.4	24.9	-	38.8
Site restoration provision	-	-	-	-	2.4	2.4
<b>Total contractual obligations</b>	<b>425.4</b>	<b>268.3</b>	<b>123.2</b>	<b>93.0</b>	<b>5.1</b>	<b>915.0</b>
<b>Financial assets net of contractual obligations</b>	<b>\$ (92.4)</b>	<b>\$ 138.5</b>	<b>\$ 50.1</b>	<b>\$ 100.6</b>	<b>\$ 111.9</b>	<b>\$ 308.7</b>

December 31, 2010 (millions)	One year or less	1 to 3 years	4 to 5 years	More than 5 years	No specific date	Total
Financial assets:						
Cash and cash equivalents	\$ 32.9	\$ -	\$ -	\$ -	\$ -	\$ 32.9
Investment income due and accrued	5.3	-	-	-	-	5.3
Investments available-for-sale	371.4	128.3	209.6	178.6	7.1	895.0
Investments held-to-maturity	-	-	-	98.3	-	98.3
Instalment premiums	65.1	-	-	-	-	65.1
Accounts receivable	26.5	-	-	-	-	26.5
Recoverable from reinsurers	9.9	11.2	5.4	3.2	-	29.7
Claims recoverable from other insurers	13.4	15.0	7.4	4.4	-	40.2
<b>Total financial assets</b>	<b>524.5</b>	<b>154.5</b>	<b>222.4</b>	<b>284.5</b>	<b>7.1</b>	<b>1,193.0</b>
Contractual obligations:						
Accounts payable and accrued liabilities	18.4	5.2	-	-	2.1	25.7
Unearned premiums	157.0	-	-	-	-	157.0
Unpaid claims and adjustment expenses	234.8	264.3	129.1	76.9	-	705.1
Lease commitments	2.4	5.7	5.6	29.6	-	43.3
Site restoration provision	-	-	-	2.5	-	2.5
<b>Total contractual obligations</b>	<b>412.6</b>	<b>275.2</b>	<b>134.7</b>	<b>109.0</b>	<b>2.1</b>	<b>933.6</b>
<b>Financial assets net of contractual obligations</b>	<b>\$ 111.9</b>	<b>\$ (120.7)</b>	<b>\$ 87.7</b>	<b>\$ 175.5</b>	<b>\$ 5.0</b>	<b>\$ 259.4</b>

The Company's investment guidelines stress preservation of capital and market liquidity to support payment of liabilities. The matching of the duration of financial assets and liabilities is monitored to ensure that all obligations will be met.

9. LIQUIDITY AND CAPITAL RESOURCES (continued)

In connection with the sale of its operations and assets, Nucryst provided an indemnity to the purchaser against certain losses to an aggregate maximum of US\$11 million. The Company also agreed to indemnify the directors, officers and employees of the purchaser, for an indefinite period, from certain potential environmental costs relating to premises formerly leased by Nucryst.

Equity Financing

At closings held on February 9, 2010 and February 19, 2010, the Company issued and sold, on a private placement basis, an aggregate of 550 million subscription receipts at a purchase price of \$0.50 each for aggregate gross proceeds of \$275.0 million. An aggregate of 219 million Subscription Receipts were sold pursuant to an underwriting and agency agreement between the Company and its underwriter and an additional 296 million Subscription Receipts were sold to Her Majesty the Queen in Right of the Province of Alberta through Alberta Investment Management Corporation, for aggregate gross proceeds of \$257.5 million. The remaining 35 million Subscription Receipts were sold to directors and officers of Westaim, funds managed by Goodwood Inc., existing senior management of Jevco and certain other designated investors for gross proceeds of \$17.5 million. Following the approval of shareholders at a special meeting on March 25, 2010 and the receipt of the necessary regulatory approvals, the Acquisition was completed on March 29, 2010 for a purchase price of \$261.4 million. Immediately prior to the closing of the Acquisition on March 29, 2010, the subscription receipts were automatically converted into 486,147,088 common shares and 63,852,912 Series 1 Class A non-voting, convertible participating preferred shares ("Series 1 Class A preferred shares") of the Company. In connection with the Financing, the Company also issued 10,000,000 warrants to purchase an equal number of Series 1 Class A preferred shares of the Company at an exercise price of \$0.50 per share at any time until February 9, 2013. After transaction costs of \$9.9 million, net proceeds of the Financing to the Company were \$265.1 million. The Financing is also described in Note 16 to the audited annual consolidated financial statements for the year ended December 31, 2011.

Regulatory Compliance

Jevco is regulated by OSFI and is required to maintain a level of capital sufficient to support the volume and risk profile of Jevco's business. Generally, OSFI requires insurers to achieve a ratio of at least 150% under an MCT formula.

In connection with the Acquisition, the Company agreed with OSFI that it would maintain liquid and unencumbered assets within the holding company up to a maximum of \$20,000 and depending on Jevco's MCT ratio, this amount may not be required at all. The Company injected additional cash into Jevco of \$48.0 million on April 9, 2010 and \$2.25 million on March 31, 2011, in exchange for additional common shares of Jevco. At December 31, 2011, the MCT ratio of Jevco was 326% (December 31, 2010 - 321%) which eliminates the requirement to maintain the \$20,000 liquid and unencumbered assets within the holding company. Since the Acquisition, the Company continues to own 100% of Jevco's share capital.

Dividends

No dividends were paid in the year ended December 31, 2011 or 2010. The Company's current policy is to retain its cash reserves to finance investments and operations.

Share Capital

At December 31, 2011 and February 28, 2012, the Company had 580,343,960 common shares and 63,852,912 Series 1 Class A non-voting, convertible participating preferred shares ("Series 1 Class A preferred shares") outstanding. Also outstanding at December 31, 2011 were 475,000 stock options, 26,849,193 restricted share units exercisable at future dates for cash and with the right to purchase common shares, and 10,000,000 warrants exercisable for Series 1 Class A preferred shares.

The Company's authorized share capital consists of an unlimited number of common shares, Class A preferred shares and Class B preferred shares. For purposes of the Financing, on February 26, 2010, the Company amended its articles for the issuance of Series 1 Class A preferred shares. The Series 1 Class A preferred shares are entitled to dividends as the directors may declare, provided that an equal dividend is declared on the common shares, and rank equally with the common shares with respect to liquidation proceeds. The Series 1 Class A non-voting preferred shares are convertible into common shares, on a one to one basis, subject to any adjustments resulting from subdivision or consolidation of the common shares, provided that the conversion does not result in the holder owning common shares exceeding an ownership limit of 40%.

9. LIQUIDITY AND CAPITAL RESOURCES (continued)

Share-based compensation plans

On April 12, 2010, the Board of Directors of the Company approved the adoption of a comprehensive long-term equity incentive plan (the "Incentive Plan"), ratified at the Company's annual general meeting of shareholders held on May 12, 2010, designed to combine the Company's prior equity incentive plans, being the Employee and Director Stock Option Plan, the Directors and Officers Share Purchase Program, the Restricted Share Unit Plan, and the Deferred Share Unit Plan, collectively, the "Prior Plans". All awards granted under the Prior Plans remain in full force and effect in accordance with their terms, however, no additional grants will be made under the Prior Plans. See Note 19 to the audited annual consolidated financial statements for the year ended December 31, 2011.

Volatility of Share Price

The price of the common shares may be volatile even though there have been no material changes in the Company's business or finances. In the past, securities class action litigation has often been brought against companies that experience volatility in the market price of their securities. Whether or not meritorious, litigation brought against the Company could result in substantial costs, divert management's attention and resources and harm the Company's financial condition and results of operations.

Market for Securities

The common shares of The Westaim Corporation are listed on The Toronto Stock Exchange ("TSX") under the symbol "WED".

10. RISKS

Westaim and/or Jevco are subject to a number of risks, including the risks described below. The risks and uncertainties described below are those believed to be material, but they may not be the only ones faced by Westaim or Jevco. If any of the following risks, or any other risks and uncertainties that have not yet been identified by Westaim or Jevco or that Westaim or Jevco currently considers not to be material, actually occur or become material risks, the business, prospects, financial condition, results of operations and cash flows of Westaim and/or Jevco could be materially and adversely affected.

**Risk Factors Related to Jevco**

*Financial Risk*

Further information regarding financial risk is included in Notes 13 and 24 to the audited annual consolidated financial statements for the year ended December 31, 2011.

*Strategic Risk*

*The insurance and related industries and businesses in which Jevco operates may be subject to periodic negative publicity which may negatively impact its financial results.*

Jevco's products and services are ultimately distributed to individual consumers. From time-to-time, consumer advocacy groups or the media may focus attention on insurance products and services, thereby subjecting the industry to periodic negative publicity. Jevco also may be negatively impacted if participants in one or more of its markets engage in practices resulting in increased public attention to its businesses. Negative publicity may also result in increased regulation and legislative scrutiny of practices in the property and casualty insurance industry as well as increased litigation. These factors may further increase Jevco's costs of doing business and adversely affect its profitability by impeding its ability to market its products and services, requiring Jevco to change its products or services or by increasing the regulatory burdens under which it operates.

## 10. RISKS (continued)

*The highly competitive environment in which Jevco operates could have an adverse effect on its business, results of operations and financial condition.*

The markets in which Jevco operates are highly competitive. Jevco competes with major insurers, many of which have more financial, marketing, management, technical personnel and other resources than Jevco. There may also be other companies of which Jevco is not aware that may be planning to enter the insurance industry. Insurers in Jevco's markets generally compete on the basis of price, consumer recognition, coverages offered, claims handling, financial stability, customer service and geographic coverage. Although Jevco's pricing is influenced to some degree by that of Jevco's competitors, Jevco generally believes that it is not in its best interest to compete solely on price, and may from time-to-time experience a loss of market share during periods of intense price competition. Jevco's business could be adversely impacted by the loss of business to competitors offering competitive insurance products at lower prices in an attempt to gain market share. This competition could affect Jevco's ability to attract and retain profitable business.

In Jevco's non-standard automobile business, Jevco competes with both large national underwriters and smaller regional companies. Jevco's competitors include other companies that, like Jevco, serve the independent agency market, as well as companies that sell insurance directly to customers. Direct underwriters may have certain competitive advantages over agency underwriters, including increased name recognition, loyalty of the customer base to the insurer rather than to an independent agency and reduced costs to acquire policies. Any new, proposed or potential legislative or industry developments could further increase competition in Jevco's markets.

New competition from these developments could cause the demand for Jevco's products to decrease, which would adversely affect Jevco's profitability. From time-to-time, Jevco's markets may also attract competition from new entrants. In some cases, such entrants may, because of inexperience, the desire for new business or for other reasons, price their insurance below the rates that Jevco believes offer acceptable premiums for the related risk. Further, a number of Jevco's competitors, including new entrants to Jevco's markets, are developing e-business capabilities which may impact the level of business transacted through Jevco's more traditional distribution channels or that may affect pricing in the market as a whole. As new competitors enter the market and as new products are introduced, Jevco may encounter additional and more intense competition and there can be no assurance that Jevco will maintain or increase its revenues or be profitable. To a large degree, the future revenues of Jevco are dependent upon its ability to continue to develop and market its products and to enhance its products to meet changes in customer needs.

Although Jevco's business strategy assumes that the industry will generate competition, there can be no assurance as to how any level of competition may impact the future revenues of Jevco.

*If Jevco is unable to maintain its current claims-paying ratings, Jevco's ability to write insurance and to compete with other insurance companies may be adversely impacted.*

Third party rating agencies assess and rate the claims-paying ability of insurers and reinsurers based upon criteria that they have established. Periodically these rating agencies evaluate Jevco to confirm that it continues to meet the criteria of the ratings previously assigned to it. Financial strength ratings are an important factor in establishing the competitive position of insurance companies and may be expected to have an effect on an insurance company's premiums.

Jevco is rated B++ (Good) by A.M. Best (fifth highest of 15 rating levels) with a stable outlook. A.M. Best issues independent opinions of an insurer's financial strength and its ability to meet policyholder obligations. According to A.M. Best, entities with a B++ rating are deemed "secure" and this rating is assigned to companies that have, in their opinion, a good ability to meet their ongoing insurance obligations. A stable outlook indicates a low likelihood of a rating change over an intermediate term, generally defined as 12 to 36 months, due to stable financial/market trends.

There can be no assurances that A.M. Best will not downgrade Jevco's ratings in the future. If Jevco is unable to maintain its current ratings, its ability to write insurance business and compete with other insurance companies may be adversely affected. Rating agencies evaluate insurance companies based on financial strength and the ability to pay claims, factors that are more relevant to policyholders than to investors. Financial strength ratings by rating agencies are not ratings of securities or recommendations to buy, hold or sell any security and should not be relied upon as such.

*Jevco's business could be adversely affected as a result of changing political, regulatory, economic or other influences.*

The insurance industry is subject to changing political, economic and regulatory influences. These factors affect the practices and operation of insurance and reinsurance organizations. The governments in jurisdictions in which Jevco operates have periodically considered programs to reform or amend their respective insurance and reinsurance systems. Recently, the insurance and reinsurance regulatory framework has been subject to increased scrutiny in many jurisdictions.

## 10. RISKS (continued)

Changes in current insurance regulation may include increased governmental involvement in the insurance industry, initiatives aimed at premium controls, changes to minimum capital requirements, changes in loss transfer legislation, or initiatives that may otherwise change the business and economic environment in which insurance industry participants operate. Historically, the insurance industry has been under pressure from time-to-time from regulators, legislators or special interest groups to reduce, freeze or set rates at levels that are not necessarily related to underlying costs or risks, including initiatives to roll back automobile and other personal line rates. These changes may limit Jevco's ability to price insurance adequately and could require Jevco to discontinue unprofitable product lines, make unplanned modifications to its products and services, or result in delays or cancellations of sales of its products and services. Jevco cannot predict the future impact of changing laws or regulations on its operations and any changes could have a material adverse effect on its results of operations or financial condition.

Where OSFI is concerned about an unsafe course of conduct or an unsound practice in conducting the business of a federally regulated insurance company, OSFI may direct the insurance company to refrain from a course of action or to perform acts necessary to remedy the situation. In certain circumstances, OSFI may take control of the assets of an insurance company or take control of the company itself. 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 Jevco's operations.

The financial performance of the insurance industry has historically tended to fluctuate in cyclical patterns of "soft" markets characterized generally by increased competition, resulting in lower premium rates and underwriting standards, followed by "hard" markets characterized generally by lessening competition, stricter underwriting standards and increasing premium rates. Jevco's profitability tends to follow this cyclical market pattern with profitability generally increasing in hard markets and decreasing in soft markets. These fluctuations in demand and competition could produce underwriting results that would have a negative impact on Jevco's results of operations and financial condition.

### *Operational Risk*

*Jevco's provision for unpaid claims may be inadequate, which would result in a reduction in its net income and might adversely affect its financial condition.*

Jevco's provisions for unpaid claims do not represent an exact calculation of its actual liability, but are estimates involving actuarial and statistical projections at a given point in time of the expected cost of the ultimate settlement and administration of known and unknown claims incurred prior to period end. The process for establishing the provision for unpaid claims reflects the uncertainties and significant judgmental factors inherent in estimating future results of both known and unknown claims and as such, the process is inherently complex and imprecise. These estimates are based upon various factors, including:

- actuarial projections of the cost of settlement and administration of claims reflecting facts and circumstances then known;
- estimates of future trends in claims severity and frequency;
- judicial theories of liability;
- variability in claims handling procedures;
- economic factors such as inflation;
- judicial and legislative trends, and actions such as class action lawsuits and judicial interpretation of coverage or policy exclusions; and
- level of insurance fraud.

Most or all of these factors are not directly quantifiable, particularly on a prospective basis, and the effects of these and unforeseen factors could negatively impact Jevco's ability to accurately assess the risks of the policies that it writes. In addition, there may be significant reporting lags between the occurrence of the insured event and the time it is actually reported to the insurer and additional lags between the time of reporting and final settlement of claims.

Jevco regularly refines its estimates in an ongoing process as claims are reported and settled. The following factors may have a substantial impact on Jevco's future claims and adjustment expenses incurred and reported:

- the amounts of claims payments;
- the expenses that Jevco incurs in resolving claims;
- legislative and judicial developments;
- changes in economic conditions, including inflation; and
- provision for adverse deviation and discount rate assumptions.

As time passes and more information about the claims becomes known, the estimates are appropriately adjusted upward or downward to reflect this additional information. Because of the elements of uncertainty encompassed in this estimation process, and the extended time it can take to settle many of the more substantial claims, several years of experience may be required before a meaningful comparison can be made between actual losses and the original provision for unpaid claims.

## 10. RISKS (continued)

Actual claims and claims adjustment expenses that Jevco incurs under insurance policies that Jevco writes may deviate, perhaps substantially, from the amounts of provisions reflected in its financial statements. To the extent that actual claims incurred exceed its expectations and exceed the provision for unpaid claims reflected on Jevco's financial statements, Jevco will be required to reflect those changes by increasing its provision for unpaid claims. In addition, government regulators could require that Jevco increase its provisions if they determine that Jevco's provisions for unpaid claims are understated. When Jevco increases the provision for unpaid claims, the resulting reduction in its surplus could cause a downgrading of its ratings. Any such downgrade could, in turn, adversely affect Jevco's ability to sell insurance policies. See the risk factors regarding claims-paying ratings above for a more detailed discussion of the impact of a ratings downgrade.

*Jevco relies on independent brokers and is exposed to risks in connection with such reliance.*

Jevco markets and distributes insurance products through a network of independent brokers across Canada. As a result, it relies heavily on these brokers to attract new business and service existing clients. These brokers typically represent more than one insurance company, which may expose Jevco to competition within the agencies and, therefore, Jevco cannot rely on their commitment to its insurance products. In some markets, Jevco operates pursuant to "open market" arrangements in which it has no formal relationships with the brokers who place its risk in these markets. Loss of all or a substantial portion of the business provided by these intermediaries could have a material adverse effect on Jevco's business, results of operations and financial condition or a material decrease in the number of brokers that choose to sell Jevco's products.

In accordance with industry practice, Jevco's customers often pay the premiums for their policies to brokers for payment to Jevco. These premiums are considered paid when received by the broker and thereafter the customer is no longer liable to Jevco for those amounts, whether or not Jevco has actually received the premiums from the broker. Consequently, Jevco assumes a degree of risk associated with its reliance on independent brokers in connection with the settlement of insurance balances.

*The majority of Jevco's direct premiums written are derived from the non-standard automobile and recreational vehicle insurance markets. If the demand for insurance in these markets declines, Jevco's results of operations could decline significantly.*

Jevco is one of the largest writers of non-standard automobile insurance in Ontario and of recreational vehicle insurance in Canada. The size of both of these insurance markets can be affected significantly by many factors outside of Jevco's control, such as the underwriting capacity and underwriting criteria of standard automobile insurance carriers, and Jevco may be specifically affected by these factors. Additionally, an economic downturn in one or more of Jevco's principal markets could result in fewer automobile or recreational vehicle sales, resulting in less demand for these insurance products. To the extent that these insurance markets are affected adversely for any reason, Jevco's direct premiums written will be disproportionately affected due to Jevco's substantial reliance on these insurance markets.

*If reinsurance rates rise significantly or reinsurance becomes unavailable or reinsurers are unable to pay Jevco's claims, Jevco may be adversely affected.*

Jevco purchases reinsurance from third parties in order to reduce its liability on individual risks, however, reinsurance does not relieve Jevco of its primary liability to its policyholders and, as a result, Jevco bears credit risk with respect to its reinsurance. A third party reinsurer's insolvency or inability or unwillingness to make payments under the terms of a reinsurance treaty could have a material adverse effect on Jevco's financial condition or results of operations. The majority of Jevco's amounts recoverable from third party reinsurers and other insurers are unsecured.

Jevco's reinsurance arrangements are with a limited number of reinsurers. This reinsurance may cause an adverse effect on Jevco's results of operations if one or more of its reinsurers are unable to meet its financial obligations. Jevco cannot ensure that its reinsurers will pay all reinsurance claims on a timely basis or at all. Jevco evaluates each reinsurance claim based on the facts of the case, historical experience with the reinsurer on similar claims, and existing law and includes in its reserve for uncollectible reinsurance any amounts deemed uncollectible. The inability to collect amounts due to Jevco under reinsurance arrangements would reduce Jevco's net income and cash flow.

The amount and cost of reinsurance available to Jevco's insurance companies are subject, in large part, to prevailing market conditions beyond Jevco's control and may affect Jevco's level of business and profitability. Jevco's ability to provide insurance at competitive premium rates and coverage limits on a continuing basis depends in part upon the extent to which Jevco can obtain adequate reinsurance in amounts and at rates that will not adversely affect Jevco's competitive position.

In addition, there can be no assurance that developments may not occur in the future which might cause a shortage of reinsurance capacity in those classes of business which Jevco underwrites, which could result in the curtailment of issuing of policies in a certain line of business or containing limits above a certain size. Jevco cannot provide assurances that it will be able to maintain its current reinsurance facilities, which generally are subject to annual renewal. If Jevco is unable to renew any of these facilities upon their expiration or to obtain other reinsurance facilities in adequate amounts and at favourable rates, Jevco may need to modify its underwriting practices or reduce its underwriting commitments.



## 10. RISKS (continued)

*Jevco's business is heavily dependent on technology and Jevco is at risk of its technology being inadequate or inappropriate.*

Jevco is heavily dependent on systems technology to process large volumes of transactions and there would be a risk if the technology employed is inadequate or inappropriate to support current and future business needs and objectives of Jevco. Jevco continues to implement new computer applications as part of a comprehensive approach to improve systems technology, however, in the event of a technology failure, there is no assurance that Jevco will be able to respond effectively and with minimal disruption.

### ***Compliance Risk***

*Jevco's business is subject to risks related to litigation and regulatory actions.*

Jevco is a defendant in a number of claims relating to its insurance and other related business operations. Jevco may from time-to-time be subject to a variety of legal and regulatory actions relating to its current and past business operations, including, but not limited to:

- disputes over coverage or claims adjudication;
- disputes regarding sales practices, disclosure, premium refunds, licensing, regulatory compliance and compensation arrangements;
- disputes with its agents, producers or network providers over compensation and termination of contracts and related claims;
- disputes relating to customers regarding the ratio of premiums to benefits in its various business lines;
- disputes with taxing authorities regarding its tax liabilities; and
- disputes relating to certain businesses acquired or disposed of by it.

In addition, plaintiffs continue to bring new types of legal claims against insurance and related companies. Current and future court decisions and legislative activity may increase Jevco's exposure to these types of claims. Multiparty or class action claims may present additional exposure to substantial economic, non-economic or punitive damage awards. The loss of even one of these claims, if it resulted in a significant damage award or a judicial ruling that was otherwise detrimental, could create a precedent in the insurance industry that could have a material adverse effect on Jevco's results of operations and financial condition. This risk of potential liability may make reasonable settlements of claims more difficult to obtain. Jevco cannot determine with any certainty what new theories of recovery may evolve or what their impact may be on its business.

Jevco may be subject to governmental or administrative investigations and proceedings in the context of its highly regulated sectors of activity. Jevco cannot predict the outcome of these investigations, proceedings and reviews, and cannot give assurances that such investigations, proceedings or reviews or related litigation or changes in operating policies and practices would not materially adversely affect its results of operations and financial condition. In addition, if Jevco were to experience difficulties with its relationship with a regulatory body in a given jurisdiction, it could have a material adverse effect on its ability to do business in that jurisdiction.

*If Jevco fails to comply with applicable insurance laws or regulatory requirements, Jevco's business, results of operations and financial condition could be adversely affected.*

Jevco is subject to numerous laws and regulations. These laws and regulations delegate regulatory, supervisory and administrative powers to federal and provincial agencies. Such regulation generally is designed to protect policyholders rather than shareholders, and is related to matters including:

- rate setting;
- risk-based capital and solvency standards;
- restrictions on the amount, type, nature, quality and quantity of investment securities;
- the maintenance of adequate reserves for unearned premiums and unpaid claims;
- restrictions on the types of terms that can be included in insurance policies;
- standards for accounting;
- marketing practices;
- claims settlement practices;
- the examination of insurance companies by regulatory authorities, including periodic financial and market conduct examinations;
- the licensing of insurers and their agents;
- limitations on dividends and transactions with affiliates;
- approval of certain reinsurance transactions; and
- insolvency proceedings.

In addition, these regulations typically require Jevco to periodically file financial statements and annual reports, and other information with insurance regulatory authorities, including information concerning its capital structure, ownership, financial condition and general business operations.

## 10. RISKS (continued)

Jevco allocates considerable time and resources to comply with these requirements. Any failure to comply with applicable laws or regulations could result in the imposition of fines or significant restrictions on Jevco's ability to do business, which could adversely affect its results of operations or financial condition. In addition, any changes in laws or regulations, including the adoption of consumer initiatives regarding rates charged for automobile or other insurance coverage or claims handling procedures, could materially adversely affect Jevco's business, results of operations and financial condition.

OSFI has solvency requirements and uses the MCT ratio as its benchmark. If Jevco does not comply with these minimum capital requirements, it may be restricted or prohibited from operating. If Jevco is required to increase its reserves in the future, as a result of unexpectedly poor claims experience or otherwise, Jevco may violate these minimum capital requirements unless it is able to take actions to improve its solvency. As a result, its business, results of operations, and financial condition may be materially adversely affected.

It is not possible to predict the future impact of changing federal, state and provincial regulation on Jevco's operations, and there can be no assurance that laws and regulations enacted in the future will not be more restrictive than existing laws and regulations.

### *Human Resources Risk*

*Jevco's business depends upon key employees, and if Jevco is unable to retain the services of these key employees or to attract and retain additional qualified personnel, Jevco's business may suffer.*

Jevco's success has been, and will continue to be, dependent on its ability to retain the services of its existing key employees and to attract and retain additional qualified personnel in the future. The loss of the services of any of its key employees, or the inability to identify, hire and retain other highly qualified personnel in the future, could adversely affect the quality and profitability of Jevco's business operations.

### **Other Risk Factors Related to Westaim**

*A single shareholder may be able to exert significant influence over Westaim's affairs.*

Her Majesty the Queen in Right of the Province of Alberta ("HMQ"), acting for and on behalf of certain Alberta public sector pension plans, endowments and government funds holds a significant number of Non-Voting Shares as well as warrants entitling it to purchase additional Non-Voting Shares. Accordingly, HMQ has significant influence over the business and affairs of Westaim and has the ability to take shareholder actions irrespective of the vote of any other shareholders, including the ability to prevent certain transactions that it does not believe are in its best interest. This significant influence may discourage transactions involving a change of control of Westaim, including transactions in which minority shareholders of Westaim might otherwise receive a premium for their shares over the then-current market price.

Furthermore, HMQ generally has the right (subject to applicable securities laws) at any time to sell Westaim Shares held by it or to sell its interest in Westaim to a third party without the approval of the minority shareholders and without providing for a purchase of such shareholders' shares. Accordingly, Westaim Shares held by minority shareholders may be less liquid and worth less than they would be if HMQ did not have the ability to influence matters affecting Westaim.

*Westaim may require significant additional funding.*

Westaim's future capital requirements will depend upon many factors, including the expansion of Jevco's sales and marketing efforts, the status of competition and potential acquisitions. There can be no assurance that any additional financing will be available to Westaim on acceptable terms, or at all. If additional funds are raised by issuing equity securities, further dilution to the existing shareholders will result. If adequate funds are not available, Westaim or Jevco may be required to delay, scale back or eliminate its programs. Accordingly, the inability to obtain such financing could have a material adverse effect on Westaim's business, financial condition and results of operations.

## 11. RELATED PARTY TRANSACTIONS

### Key management personnel

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Company, directly or indirectly, including directors of the Company and its subsidiaries.

Members of the Company's key management personnel may, from time to time, purchase insurance offered by the Company in the ordinary course of its business. The terms and conditions of these transactions are substantially similar to the terms and conditions generally available to the public or the Company's employees in general.

11. RELATED PARTY TRANSACTIONS (continued)

Compensation for key management personnel of the Company, including non-executive directors, is as follows:

(millions)	Three months ended December 31		Year ended December 31	
	2011	2010	2011	2010
Salaries and other benefits	\$ 0.6	\$ 0.5	\$ 2.9	\$ 1.6
Share-based payments	0.5	0.3	0.6	1.1
	\$ 1.1	\$ 0.8	\$ 3.5	\$ 2.7

No loans were extended to key management personnel during the year ended December 31, 2011, and there were no outstanding amounts as at December 31, 2011.

Management services agreement

The Company has entered into a management services agreement ("MSA") with Goodwood to manage the day-to-day affairs of the Company and to present investment opportunities for the Board of Directors to consider. Under the MSA, Goodwood provides the services of two directors, one of whom is also the President and Chief Executive Officer, as well as the services of a Chief Financial Officer and other personnel as required.

Goodwood earns a fixed fee to be determined annually by an independent committee of the Board of Directors based on the recommendations of an independent compensation consultant. The fixed fee compensates Goodwood for the time and attention of its officers and employees incurred in furtherance of the Company's business as well as for the office space, equipment, supplies and other facilities provided or made available by Goodwood to the Company. Goodwood is also entitled to participate in an annual incentive bonus plan for the purpose of recognizing the contribution of Goodwood to the Company's business and affairs during the preceding year.

Fees earned by Goodwood under the MSA in the three months ended December 31, 2011 were \$0.6 million (2010 - \$0.6 million) and in the year ended December 31, 2011 were \$3.3 million (2010 - \$1.9 million) inclusive of harmonized sales tax.

In the second quarter of 2011, Goodwood was granted 9,665,709 (2010 - 25,775,225) restricted share units which vest evenly over three years and are payable when vested in cash, with the right to purchase common shares of the Company. Also in the second quarter of 2011, 8,591,741 restricted share units were exercised with a cash payment of \$4.5 million to Goodwood. On May 12, 2011, 6,164,574 common shares were issued to Goodwood at a price of \$0.528 per share.

12. DISCLOSURE CONTROLS AND INTERNAL CONTROLS OVER FINANCIAL REPORTING

Disclosure Controls and Procedures ("DC&P")

DC&P are designed to provide reasonable assurance that information required to be disclosed by the Company in reports filed with or submitted to various securities regulators is recorded, processed, summarized and reported within the time periods specified. This information is gathered and reported to the Company's management, including the Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), so that timely decisions can be made regarding disclosure.

The Company's management, under the supervision of, and with the participation of, the CEO and CFO, have designed and evaluated the Company's DC&P, as required in Canada by "National Instrument – 52-109, Certification of Disclosure in Issuers' Annual and Interim Filings". Based on this evaluation, the CEO and CFO have concluded that, as of December 31, 2011, the Company's DC&P were effective.

Internal Control over Financial Reporting ("ICFR")

Designing, establishing and maintaining adequate ICFR is the responsibility of the Company's management. ICFR is a process designed by, or under the supervision of, senior management, and affected by the Board of Directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and preparation of the Company's consolidated financial statements in accordance with IFRS. Management is responsible for establishing and maintaining ICFR and has designed such controls to ensure that the required objectives of these internal controls have been met. Management uses the Internal Control – Integrated Framework to evaluate the effectiveness of internal control over financial reporting, which is a recognized and suitable framework, issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company regularly reviews and enhances its systems of controls and procedures. However, because of the inherent limitations in all control systems, management acknowledges that ICFR will not prevent or detect all misstatements due to error or fraud. Prior to its release, this annual report to shareholders was reviewed by the Audit Committee and, on the Audit Committee's recommendation, approved by the Company's Board of Directors, similar to prior quarters.

## 12. DISCLOSURE CONTROLS AND INTERNAL CONTROLS OVER FINANCIAL REPORTING (continued)

There were no changes in the Company's ICFR that occurred during the quarter ended December 31, 2011 that have materially affected, or are reasonably likely to materially affect, ICFR.

As of December 31, 2011, the CEO and the CFO of the Company have evaluated the effectiveness of the Company's ICFR. Based on those evaluations, the CEO and CFO have concluded that at December 31, 2011, the controls and procedures were operating effectively. There are no material weaknesses that have been identified by management in this regard.

## 13. CRITICAL ACCOUNTING ESTIMATES AND ASSUMPTIONS

Preparation of financial statements in conformity with IFRS requires management to make estimates and assumptions, some of which relate to matters that are uncertain. As more information becomes known, these estimates and assumptions could change and thus have a material impact on the Company's financial condition and results of operations in the future. The Company has established detailed policies and control procedures that are intended to ensure that management's judgments and estimates are well controlled, independently reviewed and consistently applied from period to period. Management believes that its estimates for determining the valuation of the Company's assets and liabilities are appropriate.

### Provision for Unpaid Claims and Adjustment Expenses

Significant judgment is required to determine amounts recorded in the annual consolidated financial statements for the provision for unpaid claims. The process for establishing the provision for unpaid claims reflects the uncertainties and significant judgmental factors inherent in predicting future results of both known and unknown claims. As such, the process is inherently complex and imprecise and estimates are constantly refined. The process of establishing the provision for unpaid claims relies on the judgment and opinions of a large number of individuals, including the opinions of the Appointed Actuary. Further information regarding estimates used in determining the Company's provision for unpaid claims is discussed in Section 6, *Analysis of Financial Position* of this MD&A and in Notes 13 and 24 to the audited annual consolidated financial statements for the year ended December 31, 2011.

### Impairment of Investments

The establishment of impairment on an investment security requires a number of judgments and estimates. Management performs a quarterly analysis of the investment holdings to determine if declines in market value require a write-down due to impairment. Further information regarding analysis procedures used in determining impairment is discussed in Note 6 to the audited annual consolidated financial statements for the year ended December 31, 2011.

## 14. CRITICAL ACCOUNTING POLICIES AND RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENTS

CGAAP for publicly accountable enterprise companies have been replaced with IFRS for fiscal years beginning on or after January 1, 2011. The Company is reporting its financial statements in accordance with IFRS for the current fiscal year commencing on January 1, 2011. Prior to the adoption of IFRS, the Company prepared its financial statements in accordance with CGAAP. The Company's accounting policies are disclosed in Notes 2 and 3 to the audited annual consolidated financial statements for the year ended December 31, 2011.

## 15. FUTURE ACCOUNTING PRONOUNCEMENTS

IFRS 9 "*Financial Instruments*" ("IFRS 9") was issued in November 2009 and contained requirements for financial assets. This standard addresses classification and measurement of financial assets and replaces the multiple category and measurement models in IAS 39 "*Financial Instruments – Recognition and Measurement*" ("IAS 39"), for debt instruments with a new mixed measurement model having only two categories: "amortized cost" and "fair value through profit or loss". IFRS 9 also replaces the models for measuring equity instruments, and such instruments will either be categorized as "fair value through profit or loss" or at "fair value through other comprehensive income". Requirements for financial liabilities were added to IFRS 9 in October 2010 and largely carried forward existing requirements in IAS 39, except that fair value changes due to credit risk for liabilities designated at fair value through profit and loss will generally be recorded in other comprehensive income. IFRS 9 is effective for annual periods beginning on or after January 1, 2015. The Company has not yet determined the impact of the standard.

IFRS 10 "*Consolidated Financial Statements*" ("IFRS 10"), issued in May 2011, replaces IAS 27 "*Consolidated and Separate Financial Statements*" and SIC-12 "*Consolidation – Special Purpose Entities*". The Company does not currently apply SIC-12 as it does not have special purpose entities. IFRS 10 defines the principle of control and establishes control as the basis for determining which entities are consolidated in the consolidated financial statements. IFRS 10 also sets out the accounting requirements for the preparation of consolidated financial statements. The three elements of control identified in IFRS 10 are power over the investee, exposure or rights to variable returns from involvement with the

15. FUTURE ACCOUNTING PRONOUNCEMENTS (continued)

investee and investor ability to use power over the investee to affect the amount of the investor's returns. The Company expects that the adoption of IFRS 10 will not have a material impact on its financial statements.

IFRS 12 "Disclosure of Interests in Other Entities" ("IFRS 12") requires a company to disclose information that enables users of financial statements to evaluate the nature of, and risks associated with, its interests in other entities and the effects of those interests on its financial position, financial performance and cash flows. IFRS 12 is required to be applied by an entity that has an interest in subsidiaries. The Company expects that the adoption of IFRS 12 will not have a material impact on its financial statements.

IFRS 13 "Fair Value Measurement" ("IFRS 13"), issued in May 2011, establishes a single source of guidance for fair value measurement under IFRS. IFRS 13 defines fair value, provides guidance on its determination and introduces consistent requirements for disclosures on fair value measurements. IFRS 13 does not include requirements on when fair value measurement is required; it prescribes how fair value is to be measured if another IFRS or IAS requires it. IFRS 13 should be applied prospectively from the beginning of the annual period in which it is adopted. The Company has not yet determined the impact of IFRS 13 on its financial statements.

IFRS 10, IFRS 12 and IFRS 13 are effective for annual periods beginning on or after January 1, 2013.

16. QUARTERLY FINANCIAL INFORMATION

(millions)	Q4 2011	Q3 2011	Q2 2011	Q1 2011	Q4 2010	Q3 2010	Q2 2010	Q1 2010
Direct premiums written	\$ 71.5	\$ 88.3	\$ 123.9	\$ 66.3	\$ 72.1	\$ 83.6	\$ 117.7	\$ -
Net premiums earned	74.0	93.2	88.4	70.5	69.2	88.5	78.6	-
Net premiums and investment results included in net income	83.3	107.0	96.9	79.2	79.1	100.5	86.8	3.7
Net underwriting income	5.3	4.5	4.8	0.1	0.6	2.1	3.0	-
Income (loss)								
- from continuing operations	10.0	11.3	6.6	5.8	3.4	22.0	5.1	24.7
- from discontinued operations	(0.1)	-	-	(0.1)	(0.1)	(0.3)	(0.2)	(0.5)
Net income	9.2	11.3	6.6	5.7	3.3	21.7	4.9	24.2
Combined ratio	92.9%	95.1%	94.6%	99.9%	99.1%	97.5%	96.2%	-

Quarterly information for 2010 has been restated for the effect of recognizing foreign currency gains and losses in net income as required under IAS 21 "The Effects of Changes in Foreign Exchange Rates" as noted in Section 17.3, *Impact of IFRS on the statements of operations and comprehensive income* of this MD&A. Due to presentation reclassifications for foreign currency gains and losses, net premiums and investment results in 2010 decreased by \$0.3 for the first quarter, increased by \$1.0 million for the second quarter, decreased by \$0.4 million for the third quarter, and decreased by \$0.6 million for the fourth quarter. Corresponding reclassifications from other comprehensive income to net income, net of income taxes, were: \$nil for the three months ended March 31, 2010; \$0.7 million gain for the three months ended June 30, 2010; \$0.3 million loss for three months ended September 30, 2010; and \$0.4 million loss for the three months ended December 31, 2010 (which net to \$nil for the year ended December 31, 2010).

Gross premiums written recorded in the last seven quarters reflects the premiums written by Jevco. Due to the cyclical nature of certain lines of business such as motorcycle insurance, non-standard automobile insurance and surety, a significant portion of premium is written in the spring months. As a result, premiums written are typically highest in the second quarter. Net premiums earned tend to be highest over the second and third quarters when motorcycle and watercraft insurance premiums are recognized at a correspondingly higher rate. Combined ratios are typically higher through the winter months, as inclement weather has an impact on claims frequency.

The first quarter of 2010 included a gain on business acquisition, net of business acquisition costs, of \$22.1 million. In addition, in the first quarter of 2010, there were non-recurring investment gains at the holding company of \$3.7 million. Jevco's operating results were consolidated beginning in the second quarter of 2010. The last three quarters of continuing operations in 2010 reflect Jevco results and expenses of the holding company. Income in the third quarter of 2010 and the fourth quarter of 2011 included \$15.3 million and \$2.9 million, respectively, relating to the recognition of deferred income tax assets for non-capital losses which were expected to be realized following an internal corporate reorganization in each of those quarters.

## 16. QUARTERLY FINANCIAL INFORMATION (continued)

The losses from discontinued operations included the wind up costs of subsidiary companies, Nucryst and iFire.

## 17. INTERNATIONAL FINANCIAL REPORTING STANDARDS

The Accounting Standards Board confirmed in February 2008 that IFRS would replace CGAAP for publicly accountable enterprises for financial periods beginning on and after January 1, 2011. IFRS are premised on a conceptual framework similar to CGAAP; however, significant differences exist in certain matters of recognition, measurement and disclosure. The adoption of IFRS has been determined to not have a material impact on the reported cash flows or comprehensive income of the Company. The Company's audited annual consolidated financial statements for the year ended December 31, 2011 include comparative IFRS results for the year ended December 31, 2010. IFRS has an impact on the Company's consolidated statements of financial position. In particular, the Company's January 1, 2010 statement of financial position reflects the revaluation of the site restoration provision to its discounted present value. The impact of this difference to equity is an increase of \$2.6 million. The following discussion, along with Note 3 to the audited annual consolidated financial statements for the year ended December 31, 2011 highlights the initial adjustments required to be made on adoption of IFRS in order to provide January 1, 2010 and December 31, 2010 IFRS statements of financial position. The significant accounting policies applied by the Company upon adoption of IFRS are described in Note 2 to the audited annual consolidated financial statements for the year ended December 31, 2011. This discussion has been prepared using the standards and interpretations currently issued and effective at the end of the Company's first annual IFRS reporting period, the year ended December 31, 2011.

### 17.1 IFRS 1: First-time Adoption of International Financial Reporting Standards

Adoption of IFRS requires the application of IFRS 1, "*First-time Adoption of International Financial Reporting Standards*" ("IFRS 1") which provides guidance for an entity's initial adoption of IFRS. IFRS 1 generally requires that an entity apply all IFRS effective at the end of its first IFRS reporting period retrospectively. However, IFRS 1 does require certain mandatory exceptions and limited optional exemptions in specified areas of certain standards from this general requirement. The following are the optional exemptions available under IFRS 1 that are significant to the Company and have been applied in preparing the Company's annual consolidated financial statements under IFRS.

#### Business Combinations

IFRS 1 allows for the guidance under IFRS 3 "*Business Combinations*" ("IFRS 3") to be applied either retrospectively or prospectively. The Company has adopted IFRS 3 prospectively, therefore, only business combinations that occur on or after January 1, 2010 would be accounted for in accordance with IFRS 3.

#### Share-based Payment

A first-time adopter is not required to apply IFRS 2 "*Share-based payment*" ("IFRS 2") to equity instruments that were granted on or before November 7, 2002. A first-time adopter is not required to apply IFRS 2 to equity instruments that were granted after November 7, 2002 and vested before the date of transition to IFRS. If a first-time adopter elects to apply IFRS 2 to such equity instruments, it may do so only if the entity has disclosed publicly the fair value of those equity instruments, determined at the measurement date as defined in IFRS 2.

The Company elected to apply IFRS 2 to equity instruments granted after November 7, 2002 that had not vested by the transition date of January 1, 2010.

#### Leases

IFRIC 4 "*Determining whether an Arrangement contains a Lease*" specifies criteria for determining at the inception of an arrangement, whether the arrangement contains a lease. It also specifies when an arrangement should be reassessed subsequently. IFRS 1 provides an exemption from these requirements. Instead of determining retrospectively whether an arrangement contains a lease at the inception of the arrangement and subsequently reassessing that arrangement as required in the periods prior to the transition to IFRS, entities may determine whether arrangements in existence on the date of transition to IFRS contain leases on the basis of facts and circumstances existing at the date of transition.

The Company has elected to use facts and circumstances existing at the transition date to determine whether an arrangement contains a lease.

#### Insurance Contracts

A specific relief allowed under IFRS 4 "*Insurance Contracts*" (IFRS 4) is that companies may elect to not disclose information about claims development that occurred earlier than five years before the end of the first year in which they apply IFRS 4. The Company has elected to apply the transitional provisions of IFRS 4 and therefore in its financial statement notes, will not disclose details of claims development for periods prior to January 1, 2007.

## 17. INTERNATIONAL FINANCIAL REPORTING STANDARDS (continued)

### 17.2 Impact of IFRS on the statement of financial position

The only significant impact of differences between the Company's statement of financial position under CGAAP and the Company's statement of financial position under IFRS for both January 1, 2010 opening statement of financial position and December 31, 2010 statement of financial position relates to the site restoration provision.

The book value of the site restoration provision, at January 1, 2010 and December 31, 2010, decreased by \$2.6 million and \$2.5 million, respectively, under IFRS compared to the book values reported in accordance with CGAAP. The reduction is primarily related to the reporting of the site restoration provision at discounted present value on transition to IFRS.

### 17.3 Impact of IFRS on the statements of operations and comprehensive income

Under IFRS, the site restoration provision is discounted to its present value. Changes in the provision due to the passage of time or adjustment to discount rates are accreted to income. The amount of the accretion is less than \$0.1 million in both 2011 and 2010.

IFRS 4 requires disclosure in the statement of operations regarding amounts gross of reinsurance and amounts related to reinsurance. Previously, under CGAAP, it was acceptable to present premiums and claims and other expenses net of reinsurance. There is no effect on net income, only on presentation of amounts that comprise net income.

IAS 21 "*The Effects of Changes in Foreign Currency*" requires a company to disclose the amount of exchange differences recognized in net income, other than those arising on financial instruments measured at fair value through profit and loss. Exchange differences related to realized and unrealized foreign currency changes relating to monetary available-for-sale assets are included in net income under IFRS whereas under CGAAP, realized foreign currency changes were included in net income and unrealized changes were included in other comprehensive income. The Company has presented the amount of foreign currency changes on a separate line of the statement of operations. There was no prior period reclassification required in the interim consolidated financial statements for the three months ended March 31, 2011 upon conversion to IFRS as the amount of accumulated unrealized foreign currency changes included in accumulated other comprehensive income was nominal for the periods presented. In the second, third and fourth quarters of 2010, there were reclassification adjustments between net income and other comprehensive income which totaled to a nominal amount for the year ended December 31, 2010, as quantified in Section 16, *Quarterly financial information* of this MD&A.

### 17.4 Impact of IFRS on the notes to the financial statements

Additional disclosures are required for compliance with IFRS. The significant additional disclosures required in order for the Company to comply with IFRS are as follows:

#### Property and equipment

This note presents additional detail related to acquisitions, dispositions and amortization in accordance with IAS 16 "*Property, Plant and Equipment*".

#### Intangible assets

This note presents additional detail related to acquisitions, dispositions and amortization in accordance with IAS 38 "*Intangible Assets*".

#### Insurance assets and liabilities

Additional information is required under IFRS 4 to be disclosed through reconciliations of changes in insurance liabilities and reinsurance assets. In addition, additional information about assumptions is required to be discussed with quantified disclosure when practicable. Note 13c to the Company's audited annual consolidated financial statements for the year ended December 31, 2011 includes discussion of assumptions and presents a reconciliation of the changes in the statements of operations amounts for unpaid claims and adjustment expenses and amounts recoverable from reinsurers.

#### Expenses

The Company reports expenses according to their function in the statement of operations. According to IAS 1 "*Presentation of Financial Statements*", if a company reports expenses by function in the statement of operations, it is required to also disclose the expenses by their nature in the notes to the financial statements. The Company has presented expenses by nature in Note 18 to its audited annual consolidated financial statements for the year ended December 31, 2011.

## 17. INTERNATIONAL FINANCIAL REPORTING STANDARDS (continued)

### Related party disclosures

In accordance with IAS 24 "Related Party Disclosures" ("IAS 24"), the Company has disclosed additional information on compensation expenses for key management personnel, as defined in IAS 24. IAS 24 defines key management personnel as those persons having authority and responsibility for planning, directing and controlling the activities of the Company, directly or indirectly, including directors of the Company and its subsidiaries.

### Risk management

To comply with IFRS 4, additional disclosures are required to enable users of the financial statements to evaluate the nature and extent of risks arising from insurance contracts. In Note 24 to the Company's audited annual consolidated financial statements for the year ended December 31, 2011, the Company has included this expanded disclosure as well as additional IFRS required disclosure about insurance risk such as sensitivity to insurance risk and concentration of insurance risk.

### 17.5 Impact of IFRS on MCT

The MCT is an important measure used in the Company's capital management process as described in Section 9, *Liquidity and Capital Resources* of this MD&A. The MCT of Jevco, the Company's insurance subsidiary, as at December 31, 2010 increased to 321% under IFRS from 320% under CGAAP.

## 18. FUTURE ORIENTED FINANCIAL INFORMATION

Certain portions of this MD&A, as well as other public statements by the Company, contain forward-looking statements. In particular, the words "strategy", "may", "will", "continue", "developed", "objective", "potential", "exploring", "could", "expect", "expected", "expects", "tends", "indicates", and words and expressions of similar import, are intended to identify forward-looking statements. Such forward-looking statements include but are not limited to statements concerning: strategies, alternatives and objectives to maximize value for shareholders; expectations and assumptions relating to the Company's business plan; the effect of adverse changes in equity markets or the Company's operations; the Company's ability to compete successfully in the insurance industry; expectations that the Company can continue to set its premiums at a level which produces an acceptable return compared to the risk assumed; the Company's ability to realize its investment objectives; the adequacy of the Company's provision for unpaid claims; the Company's ability to maintain its claims paying ratings; the Company's ability to obtain reinsurance with reliable carriers at acceptable rates; expectations regarding the Company's assets and liabilities; the Company's ability to retain key employees, customers and broker relationships; management's belief that its estimates for determining the valuation of the Company's assets and liabilities are appropriate; the Company's views regarding potential future remediation costs; the effect of changes to interpretations of tax legislation on income tax provisions in future periods; and the Company's determination that the adoption of new accounting standards will not have a material impact on its consolidated financial statements.

These statements are based on current expectations that are subject to risks, uncertainties and assumptions and the Company can give no assurance that these expectations are correct. By their nature, these statements are subject to inherent risks and uncertainties that may be general or specific. A variety of material factors, many of which are beyond the Company's control, may affect the operations, performance and results of the Company and its business, and could cause actual results to differ materially from the expectations expressed in any of these forward-looking statements.

The Company's actual results could differ materially from those anticipated by these forward-looking statements for various reasons generally beyond the Company's control, including but not limited to: (i) difficult economic conditions or a prolonged economic downturn may adversely affect the Company's business; (ii) the Company may not be able to realize its investment objectives or its liquid assets may prove to be insufficient to meet future obligations; (iii) the Company or the insurance industry generally may be subject to negative publicity; (iv) the highly competitive nature of the insurance industry; (v) the Company may be unable to maintain its claims paying ratings; (vi) the Company's business could be affected by political, regulatory, economic or other influences; (vii) the Company's provision for unpaid claims may be inadequate; (viii) the Company relies on independent brokers for much of its business; (ix) a majority of the Company's direct premiums written are concentrated in the non-standard automobile and recreational vehicle insurance markets; (x) rising reinsurance rates or a lack of available reinsurance may adversely affect the Company's business; (xi) risks related to litigation and regulatory actions; (xii) failure to comply with applicable insurance laws or regulatory requirements may adversely affect the Company's business; (xiii) the Company's business depends upon certain key employees; (xiv) the Company may have undisclosed liabilities; (xv) the Company may require significant additional funding; and (xvi) other risk factors set forth in the Company's Annual Report or Annual Information Form. Except as required by law, the Company disclaims any intention or obligation to revise forward-looking statements, whether as a result of new information, future developments, or otherwise. All forward-looking statements are expressly qualified in their entirety by this cautionary statement.





February 28, 2012

## **MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL INFORMATION**

The accompanying consolidated financial statements including the notes thereto have been prepared by, and are the responsibility of, the management of The Westaim Corporation. This responsibility includes selecting appropriate accounting policies and making estimates and informed judgments based on the anticipated impact of current transactions, events and trends, consistent with International Financial Reporting Standards. The Board of Directors is responsible for ensuring that management fulfills its responsibility for financial reporting and internal control. In meeting our responsibility for the reliability and timeliness of financial information, the Company maintains and relies upon a comprehensive system of internal controls including organizational, procedural and disclosure controls. The Audit Committee, which is comprised of three Directors, none of whom is an officer or employee of the Company, meets with management as well as the external auditors to satisfy itself that management is properly discharging its financial reporting responsibilities and to review the consolidated financial statements and the report of the auditors. It reports its findings to the Board of Directors who approve the consolidated financial statements.

As at December 31, 2011, we, as The Westaim Corporation's Chief Executive Officer and Chief Financial Officer, have determined that the Company's internal control over financial reporting is effective. We have certified the annual filings of The Westaim Corporation as required in Canada by National Instrument 52-109 - Certification of Disclosures in Issuers' Annual and Interim Filings (NI 52-109).

The accompanying consolidated financial statements have been audited by Deloitte & Touche LLP, the independent auditors, in accordance with generally accepted auditing standards. The auditors have full and unrestricted access to the Audit Committee.

A handwritten signature in black ink, appearing to read 'J. Cameron MacDonald'.

**J. Cameron MacDonald**  
President and Chief Executive Officer

A handwritten signature in black ink, appearing to read 'Jeffrey A. Sarfin'.

**Jeffrey A. Sarfin**  
Chief Financial Officer

## **Independent Auditor's Report**

### **TO THE SHAREHOLDERS OF THE WESTAIM CORPORATION**

We have audited the accompanying consolidated financial statements of The Westaim Corporation, which comprise the consolidated statements of financial position as at December 31, 2011, December 31, 2010 and January 1, 2010, and the consolidated statements of operations, comprehensive income, changes in equity and cash flows for the years ended December 31, 2011 and December 31, 2010, and a summary of significant accounting policies and other explanatory information.

#### **Management's Responsibility for the Consolidated Financial Statements**

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

#### **Auditor's Responsibility**

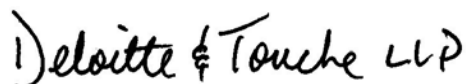
Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

#### **Opinion**

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of The Westaim Corporation as at December 31, 2011, December 31, 2010 and January 1, 2010 and its financial performance and its cash flows for the years ended December 31, 2011 and December 31, 2010 in accordance with International Financial Reporting Standards.



Chartered Accountants  
Licensed Public Accountants

February 28, 2012  
Toronto, Ontario

The Westaim Corporation  
Consolidated Statements of Financial Position

(thousands of Canadian dollars)	December 31 2011	December 31 2010	January 1 2010
<b>ASSETS</b>			
Cash and cash equivalents	\$ 24,347	\$ 32,897	\$ 62,423
Investment income due and accrued	5,567	5,327	-
Investments (note 6)	1,018,559	993,279	9,231
Instalment premiums (note 2g)	62,781	65,104	-
Income taxes recoverable	115	472	-
Accounts receivable	27,454	26,505	913
Recoverable from reinsurers (notes 7)	33,970	29,684	-
Claims recoverable from other insurers (note 8)	50,969	40,246	-
Deferred policy acquisition expenses (note 2j)	35,601	29,802	-
Deferred income taxes (note 9)	10,108	22,477	-
Property and equipment (note 10)	22,818	22,658	-
Intangible assets (note 11)	3,844	1,975	-
	<b>\$ 1,296,133</b>	<b>\$ 1,270,426</b>	<b>\$ 72,567</b>

**LIABILITIES**

Accounts payable and accrued liabilities	\$ 33,523	\$ 25,750	\$ 8,189
Income taxes due and accrued	821	-	850
Unearned premiums (note 12)	164,437	157,007	-
Unpaid claims and adjustment expenses (note 13)	675,094	705,071	-
Leasehold inducements (note 2q)	2,594	2,779	-
Site restoration provision (note 14)	2,401	2,495	2,973
	<b>878,870</b>	<b>893,102</b>	<b>12,012</b>

Commitments and contingent liabilities (note 15)

**EQUITY**

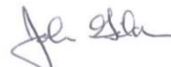
<b>Shareholders' equity</b>			
Share capital (note 16)	687,402	691,435	426,282
Warrants (note 16)	1,900	1,900	-
Contributed surplus (notes 2s and 16)	12,890	8,734	8,734
Accumulated other comprehensive income (note 2t)	11,242	4,177	-
Deficit	(296,171)	(328,922)	(383,045)
	<b>417,263</b>	<b>377,324</b>	<b>51,971</b>
<b>Equity held by non-controlling interest (note 21)</b>	<b>-</b>	<b>-</b>	<b>8,584</b>
	<b>417,263</b>	<b>377,324</b>	<b>60,555</b>
	<b>\$ 1,296,133</b>	<b>\$ 1,270,426</b>	<b>\$ 72,567</b>

The accompanying notes are an integral part of these consolidated financial statements

Approved on behalf of the Board



Ian W. Delaney  
Director



John W. Gildner  
Director

The Westaim Corporation  
Consolidated Statements of Operations

(thousands of Canadian dollars except share and per share data)	Year Ended December 31	
	2011	2010
Written premiums		
Direct	\$ 349,953	\$ 273,382
Reinsurers' share of written premiums	(16,592)	(18,510)
Net written premiums	\$ 333,361	\$ 254,872
Revenue		
Premiums earned	\$ 342,523	\$ 254,453
Reinsurers' share of premiums earned	(16,414)	(18,149)
Investment income (note 17)	35,640	27,216
Investment expenses (notes 17 and 18)	(3,864)	(3,110)
Realized gains and losses on sale of investments	8,583	10,805
Foreign exchange gain (loss)	33	(1,076)
	366,501	270,139
Underwriting expenses		
Claims and adjustment expenses	229,036	159,299
Reinsurers' share of claims and adjustment expenses	(11,096)	2,734
Commissions and premium taxes	58,123	47,142
General and administrative expenses	35,415	21,503
Net underwriting expenses (note 18)	311,478	230,678
Operating income	55,023	39,461
Corporate costs (note 18)	(13,117)	(11,512)
Site restoration provision recovery (note 14)	94	478
Other income (note 5)	2,250	-
Gain on business acquisition (note 5)	-	25,084
Costs of business acquisition (notes 5 and 18)	-	(2,936)
	(10,773)	11,114
Income from continuing operations, before income taxes	44,250	50,575
Income tax expense (recovery) (note 9)		
Current	805	9,466
Deferred	10,524	(14,004)
	11,329	(4,538)
Income from continuing operations	32,921	55,113
Loss from discontinued operations, net of income taxes (note 21)	(170)	(990)
Net income	\$ 32,751	\$ 54,123
Earnings per share (note 22)		
Income from continuing operations - basic and diluted	\$ 0.05	\$ 0.11
Net income - basic and diluted	\$ 0.05	\$ 0.11
Weighted average number of common and Series 1 Class A preferred shares outstanding (in thousands)		
Basic	646,774	511,762
Diluted	656,893	517,786

The accompanying notes are an integral part of these consolidated financial statements

The Westaim Corporation  
Consolidated Statements of Comprehensive Income

(thousands of Canadian dollars)	Year Ended December 31	
	2011	2010
Net income	\$ 32,751	\$ 54,123
Other comprehensive income		
Investment gains, net of income tax <sup>(1)</sup>	12,862	9,314
Reclassification of realized gains to net income, net of income tax <sup>(2)</sup>	(5,797)	(5,137)
Total other comprehensive income	7,065	4,177
<b>Comprehensive income</b>	<b>\$ 39,816</b>	<b>\$ 58,300</b>

<sup>(1)</sup> Net of current income tax expense of \$729 and deferred income tax expense of \$4,129 for the year ended December 31, 2011  
(current income tax expense of \$3,282 and deferred income tax expense of \$118 for the year ended December 31, 2010)

<sup>(2)</sup> Net of deferred income tax recovery of \$2,270 for the year ended December 31, 2011  
(current income tax recovery of \$2,264 and deferred income tax expense of \$562 for the year ended December 31, 2010)

The accompanying notes are an integral part of these consolidated financial statements

The Westaim Corporation  
Consolidated Statements of Changes in Equity

(thousands of Canadian dollars)	Share Capital	Warrants	Contributed Surplus	Accumulated other comprehensive income	Deficit	Non-controlling interest	Total Equity
Balance at January 1, 2011	\$ 691,435	\$ 1,900	\$ 8,734	\$ 4,177	\$ (328,922)	\$ -	\$ 377,324
Comprehensive income	-	-	-	7,065	32,751	-	39,816
Common shares issued and paid (note 16)	3,270	-	-	-	-	-	3,270
Repurchase of shares (note 16)	(7,303)	-	4,156	-	-	-	(3,147)
Balance at December 31, 2011	\$ 687,402	\$ 1,900	\$ 12,890	\$ 11,242	\$ (296,171)	\$ -	\$ 417,263

(thousands of Canadian dollars)	Share Capital	Warrants	Contributed Surplus	Accumulated other comprehensive income	Deficit	Non-controlling interest	Total Equity
Balance at January 1, 2010	\$ 426,282	\$ -	\$ 8,734	\$ -	\$ (383,045)	\$ 8,584	\$ 60,555
Comprehensive income	-	-	-	4,177	54,123	-	58,300
Common shares issued and paid (note 16)	234,369	-	-	-	-	-	234,369
Preferred shares issued and paid (note 16)	30,784	-	-	-	-	-	30,784
Warrants issued (note 16)	-	1,900	-	-	-	-	1,900
Repurchase of shares from non-controlling interest (note 21)	-	-	-	-	-	(8,584)	(8,584)
Balance at December 31, 2010	\$ 691,435	\$ 1,900	\$ 8,734	\$ 4,177	\$ (328,922)	\$ -	\$ 377,324

The accompanying notes are an integral part of these consolidated financial statements

The Westaim Corporation  
Consolidated Cash Flow Statements

(thousands of Canadian dollars)	Year Ended December 31	
	2011	2010
<b>Operating activities</b>		
Income from continuing operations	\$ 32,921	\$ 55,113
Items not affecting cash		
Net realized gains on sale of investments	(8,583)	(10,805)
Share-based compensation	7,823	6,586
Deferred income taxes - net income	10,524	(14,004)
Amortization of bond premiums and discounts	8,326	5,206
Depreciation of property and equipment and amortization of intangible assets	3,249	2,011
Gain on business acquisition	-	(25,084)
Changes in non-cash balances		
Recoverable from reinsurers	(4,286)	17,642
Recoverable from other insurers	(10,723)	(13,095)
Deferred policy acquisition expenses	(5,799)	(296)
Unearned premiums	7,430	18,929
Unpaid claims and adjustment expenses	(29,977)	(59,904)
Net change in other non-cash balances	861	1,916
Cash provided from (used in) continuing operations	11,766	(15,785)
Cash used in discontinued operations	(40)	(6,511)
Cash provided from (used in) operating activities	11,726	(22,296)
<b>Investing activities</b>		
Purchase of investments	(2,414,471)	(1,838,497)
Proceeds from sale and redemption of investments	2,399,350	1,789,887
Purchase of property and equipment and intangible assets	(5,278)	(6,184)
Proceeds from sale of property and equipment	-	34,808
Business acquisition, net of cash acquired (note 5)	-	(245,713)
Cash used in investing activities	(20,399)	(265,699)
<b>Financing activities</b>		
Issuance of share capital, net of cash issuance costs	3,270	267,053
Normal course issuer bid (note 16)	(3,147)	-
Repurchase of shares from non-controlling interest (note 21)	-	(8,584)
Cash provided from financing activities	123	258,469
Net decrease in cash and cash equivalents	(8,550)	(29,526)
Cash and cash equivalents at beginning of year	32,897	62,423
Cash and cash equivalents at end of year	\$ 24,347	\$ 32,897
Cash and cash equivalents is comprised of:		
Cash	\$ 24,347	\$ 32,897
Included in operating cash flows:		
Interest paid	\$ 137	\$ 25
Income taxes paid	\$ 921	\$ 16,981

The accompanying notes are an integral part of these consolidated financial statements

## 1 Nature of Operations and Basis of Preparation

The Westaim Corporation (the "Company") was incorporated on May 7, 1996 by articles of incorporation under the Business Corporations Act (Alberta). The Company trades on the Toronto Stock Exchange under the symbol WED. The Company's registered office is located at 201-212 King Street West, Toronto, Ontario, Canada. These annual financial statements were authorized for issue by the Board of Directors of the Company on February 28, 2012.

The Company, through its wholly-owned subsidiary, Jevco Insurance Company ("Jevco"), operates in the insurance industry in Canada. Jevco is federally incorporated and regulated by the Office of the Superintendent of Financial Institutions ("OSFI") and is licensed in all provinces and territories in Canada to write all classes of insurance, other than life. Jevco primarily writes insurance in Quebec, Ontario and Alberta.

These financial statements also include, on a consolidated basis, the accounts of wholly-owned subsidiaries, Westaim Holdings Limited (formerly Nucrust Pharmaceuticals Corp., "Nucrust"), iFire Technology Ltd. ("iFire"), 2266098 Ontario Ltd., 2266100 Ontario Ltd., 2266102 Ontario Ltd., 2301862 Ontario Ltd. and 2301863 Ontario Ltd. iFire is included in the statement of operations for the year ended December 31, 2010 to the date of its dissolution in October 2010.

These financial statements are prepared in compliance with International Financial Reporting Standards ("IFRS").

All currency amounts are expressed in thousands of Canadian dollars except earnings per share data, unless otherwise noted.

## 2 Summary of Significant Accounting Policies

The significant accounting policies used to prepare these financial statements are as follows:

### *(a) Principles of consolidation*

The financial statements of entities which are controlled by the Company through voting equity interests, referred to as subsidiaries, are consolidated. The financial results of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. Intercompany balances and transactions are eliminated upon consolidation. Results of operations and comprehensive income of Jevco were included commencing in the second quarter of 2010.

### *(b) Use of estimates*

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates and changes in estimates are recorded in the reporting period in which they are determined. Key estimates are discussed in the following accounting policies and applicable notes.

### *(c) Judgments made by management*

Key areas where management has made difficult, complex or subjective judgments in the process of applying the Company's accounting policies, often as a result of matters that are inherently uncertain, include: valuation techniques for fair value determination of investments, investment impairment, income taxes, provision for unpaid claims and adjustment expenses, and site restoration provision. For additional information on these judgments, see note 6 for investments, note 9 for income taxes, note 13 for unpaid claims and adjustment expenses and note 14 for site restoration provision.

### *(d) Foreign currency translation*

The Canadian dollar is the functional and presentation currency of the Company. Transactions in foreign currencies are translated into Canadian dollars at rates of exchange prevailing at the time of such transactions. Monetary assets and liabilities are translated at current rates of exchange. Translation differences on available-for-sale investments are classified as relating either to the amortized cost of the investment or to other changes in the carrying value of the investment. Translation differences relating to the change in amortized cost are recognized in investment income; other translation differences are recognized in foreign exchange gain (loss) in the statement of operations.



## 2 Summary of Significant Accounting Policies (continued)

### *(e) Cash and cash equivalents*

Cash and cash equivalents consist of cash on deposit and highly liquid short-term investments with original maturities of 90 days or less, with the exception of cash equivalents designated as a component of the investment portfolio which are classified as investments.

Cash and cash equivalents which are not designated as a component of the investment portfolio are classified in the financial instrument category of loans and receivables for purposes of measurement. Cash and cash equivalents are valued at fair value at the issuance date and subsequently at amortized cost using the effective interest method. Carrying value is a reasonable approximation of fair value.

### *(f) Investments and investment income*

Investments are classified according to four accounting models: available-for-sale, FVTPL, held-to-maturity and cost. The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition. Most of the investments are classified as available-for-sale because the Company's risk management strategy is to manage its investments to support its insurance liabilities.

Available-for-sale investments are carried at their fair value whereby the unrealized gains and losses are included in accumulated other comprehensive income ("AOCI") until sale or impairment is recognized, at which time cumulative unrealized gains or losses are transferred to net income. Realized gains and losses on sale, determined on an average cost basis, and write-downs to reflect objective evidence of impairment in value are included in 'realized gains and losses on sale of investments'. Changes in the fair value of investments designated as FVTPL are charged or credited to investment income for the current reporting period. Held-to-maturity investments are carried at amortized cost using the effective interest method. When a reliable estimate of the fair value of unquoted equity investments cannot be determined, the equity investment is reported at cost.

The Company accounts for investments using settlement date accounting. Transaction costs for FVTPL investments are expensed. Transaction costs for all other categories of investments are capitalized and, when applicable, amortized over the expected life of the investment using the effective interest method. Interest income on available-for-sale and held-to-maturity investments is calculated using the effective interest method and is included in investment income. Dividend income on common and preferred shares is included in investment income on the ex-dividend date.

The Company conducts quarterly reviews to identify and evaluate investments that show objective indications of possible impairment. Impairment exists when there is objective evidence that, as a result of one or more events occurring after the initial recognition of a debt investment, the estimated future cash flows of the investment have been affected. For available-for-sale equity investments, a significant or prolonged decline in the fair value of the security below its cost is considered to be objective evidence of impairment.

### *(g) Instalment premiums*

Insurance policies that provide for premiums to be paid by instalments are initially reported in written premiums and subsequently included in net income over the term of the policy. The instalment premiums asset represents the premiums related to the unexpired portion of the period of risk.

Interest charged on instalment premiums is reported with investment income. Administrative expenses related to instalment premiums are reported with investment expenses.

### *(h) Recoverable from reinsurers*

Estimates of amounts recoverable from reinsurers on unpaid claims and adjustment expenses are reported separately from related estimated amounts payable to policyholders. Unearned premiums and deferred policy acquisition expenses are also reported before reduction for amounts ceded to reinsurers and the reinsurer's portion is classified with amounts recoverable from reinsurers. Amounts recoverable from reinsurers are estimated in a manner consistent with liabilities associated with the reinsured policy. Amounts recoverable from reinsurers are assessed for indicators of impairment at the end of each reporting period. An impairment loss is recognized and the amount recoverable from reinsurers is reduced by the amount by which the carrying value exceeds the expected recoverable amount under the impairment analysis.

## 2 Summary of Significant Accounting Policies (continued)

### *(i) Claims recoverable from other insurers*

The expected recoveries from other insurers on claims paid to policyholders are recognized as amounts recoverable at the same time as the related liability is recognized using principles consistent with the Company's method for establishing the related liability. Claims recoverable from other insurers are assessed for indicators of impairment at the end of each reporting period. An impairment loss is recognized and the amount of claims recoverable from other insurers is reduced by the amount by which the carrying value exceeds the expected recoverable amount under the impairment analysis.

### *(j) Deferred policy acquisition expenses*

The Company defers brokers' commissions, premium taxes and other underwriting and marketing expenses relating to premiums written to the extent the expenses are considered recoverable. These costs are expensed as the related premiums are earned. Changes in estimates are reported as expenses in the reporting period in which they are determined. Anticipated future claims, expenses and investment income are considered in determining the recoverability of the carrying value of the deferred policy acquisition expenses. Deferred policy acquisition costs are recognized in expenses within twelve months of initial deferral.

### *(k) Income taxes*

Income tax expense is recognized in the statement of operations and the statement of other comprehensive income. Current tax is based on taxable income which differs from net income as reported in the statement of operations and statement of other comprehensive income because of items of income or expense that are taxable or deductible in other years and items that are never taxable or deductible.

Deferred tax assets are generally recognized for all deductible temporary income tax differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilized. Deferred tax liabilities are generally recognized for all taxable temporary differences. Deferred tax assets and liabilities are determined based on the enacted or substantively enacted tax laws and rates that are anticipated to apply in the year of realization. The measurement of deferred tax assets and liabilities reflects the tax consequences that would follow from the manner in which the Company expects to recover or settle the carrying amount of the related assets and liabilities. The carrying amount of the deferred tax asset is reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Income tax assets and liabilities are offset when the Company intends to settle on a net basis and there is a legally enforceable right to offset.

### *(l) Property and equipment*

Property and equipment are reported at cost less accumulated Depreciation. Depreciation of property and equipment is provided using the straight-line method over the estimated useful lives of such assets. The useful lives are 19 to 43 years for buildings, 5 to 15 years for leasehold improvements, 5 to 7 years for furniture and equipment, and 3 to 5 years for computers and automobiles. At the end of each reporting period, management reviews the carrying amounts of property and equipment for indication of impairment. An impairment loss is recognized for the amount by which the carrying amount of the asset exceeds its recoverable amount. The recoverable amount is the higher of fair value less cost to sell and value in use.

### *(m) Non-current assets held for sale*

Non-current assets to be disposed of by sale are reclassified as held for sale in the period in which a formal plan of disposal has been approved, the assets are available for immediate sale, are actively being marketed and the sale is expected to occur within one year. Non-current assets classified as held for sale are carried at the lower of their carrying amount and fair value, net of estimated disposition costs. Losses are recognized immediately where carrying value exceeds fair value and gains are recognized at the time of sale.

### *(n) Intangible assets*

Intangible assets are reported at amortized cost and consist of purchased software and internally developed software. Amortization of intangible assets is provided using the straight-line method over estimated useful lives of 3 to 5 years. At the end of each reporting period, management reviews the carrying amounts of intangible assets for indication of impairment. An impairment loss is recognized for the amount by which the carrying amount of the asset exceeds its recoverable amount. The recoverable amount is the higher of fair value less cost to sell and value in use.

## 2 Summary of Significant Accounting Policies (continued)

### *(o) Premiums and unearned premiums*

Written premiums are the premiums from policies written during the current reporting period.

Premiums earned relate to the portion of the written premiums corresponding to the coverage provided in the current reporting period. The Company earns motorcycle and watercraft premiums unevenly over the period of risk covered by the policy based on its experience. The Company earns premium revenue on all other lines evenly over the period covered by each individual insurance contract.

Unearned premiums reported in the statement of financial position represent the portion of premiums written related to the unexpired risk portion of the policy at the end of the reporting period. The remaining risk periods of the policies as of the date of the statement of financial position are one year or less.

The reinsurers' share of unearned premiums is recognized as amounts recoverable from reinsurers using principles consistent with the Company's method for determining the unearned premiums liability.

### *(p) Unpaid claims and adjustment expenses*

The provision for unpaid claims and adjustment expenses includes an estimate of the cost of projected final settlements of insurance claims incurred on or before the statement of financial position date, including claims incurred but not reported ("IBNR") by policyholders and an estimate of the full amount of all expected expenses. The provision takes into consideration the time value of money using discount rates based on projected investment income from the assets supporting the provisions and includes an explicit provision for adverse deviation. Expected recoveries on unpaid claims and adjustment expenses are recognized as amounts recoverable from other insurers or reinsurers at the same time using principles consistent with the Company's method for establishing the related liability.

These estimates of future claims payments and adjustment expenses are subject to uncertainty and are selected from a wide range of possible outcomes. All provisions are periodically reviewed and evaluated in light of emerging claims experience and changing circumstances. The resulting changes in estimates of the ultimate liability are reported as net claims and adjustment expenses in the reporting period in which they are determined.

### *(q) Leasehold inducements*

Leasehold inducements are liabilities associated with the initial benefits received by the Company related to the rental of office premises. Leasehold inducements are amortized over the term of the lease on a straight-line basis and classified with office expenses (note 18).

### *(r) Site restoration provision*

Future site restoration costs relate to industrial sites previously owned by the Company and are estimated taking into consideration the anticipated method and extent of the remediation consistent with regulatory requirements, industry practices, current technology and possible uses of the site. The estimated amount of future restoration costs is reviewed periodically based on available information. The amount of a provision is the present value of the estimated future restoration costs discounted using the rate of interest of a high quality government bond.

Potential recoveries of costs resulting from indemnifications provided by previous owners of the Company's industrial sites have not been recognized in these financial statements. Any future recoveries of site restoration costs will be recorded when received.

### *(s) Contributed surplus*

Contributed surplus consists of amounts related to stock options as described in the share-based compensation accounting policy note in (v) below and, for share capital of the Company repurchased by the Company, the amount by which the average carrying value of the shares exceeded the cost to repurchase the shares.

### *(t) Accumulated other comprehensive income*

Certain gains and losses arising from changes in fair value are temporarily recorded outside the statement of operations in AOCI as a separate component of shareholders' equity. Comprehensive income consists of net income and other comprehensive income. Other comprehensive income includes the current reporting period change in unrealized gains and losses on available-for-sale investments, other than foreign exchange gains and losses, net of related income tax expense.

## 2 Summary of Significant Accounting Policies (continued)

### *(u) Employee future benefits*

The Company provides employees with benefits under defined contribution plans. Expenses are recognized in the reporting period in which services are rendered.

### *(v) Share-based compensation*

The Company maintains share-based compensation plans, which are described in note 19. Any consideration paid by stock option holders for the purchase of stock is credited to share capital. The cost of stock options is recognized over the period from the issue date to the vesting date and recorded as a component of equity in contributed surplus.

Obligations related to Deferred Share Units ("DSUs") and Restricted Share Units ("RSUs") are accrued as liabilities when a change in value occurs and recognized in compensation expense over the applicable vesting period.

### *(w) Discontinued operations*

The results of discontinued operations are reported as a separate component in the statement of operations and the cash flow statement. Costs associated with exit or disposal activities are recognized in the reporting period in which the liability is incurred.

### *(x) Earnings per share*

Basic earnings per share is calculated by dividing net income by the total of the weighted average number of common shares outstanding during the reporting period plus the weighted average number of preferred shares outstanding during the reporting period. The preferred shares are considered in-substance common shares.

Diluted earnings per share is calculated on the basis of the weighted average number of shares outstanding during the reporting period plus an estimate of the additional common shares that would have been outstanding if potentially dilutive common shares had been issued using the "treasury stock" method. No adjustments to net income are required for dividends, interest or other changes in income for purposes of calculating diluted earnings per share.

### *(y) Automobile insurance industry pools*

When certain automobile owners are unable to obtain insurance via the voluntary insurance market, they are insured via the Facility Association ("FA"). In addition, entities can choose to cede certain risks to FA administered risk sharing pools ("RSP"). The related risks associated with FA insurance policies and policies ceded by companies to the RSP are aggregated and shared by the entities in the property and casualty insurance industry, generally in proportion to market share. The Company applies the same accounting policies to FA and RSP insurance it assumes as it does to insurance policies issued by the Company directly to its policyholders. Ceded and assumed RSP and FA premiums are reported in direct written premiums in the statement of operations.

## 3 Adoption of International Financial Reporting Standards

Canadian generally accepted accounting principles ("CGAAP") for publicly accountable enterprise companies have been replaced with International Financial Reporting Standards ("IFRS") for fiscal years beginning on or after January 1, 2011. The Company is reporting its financial statements in accordance with IFRS for the current fiscal year commencing on January 1, 2011. Prior to the adoption of IFRS, the Company prepared its financial statements in accordance with CGAAP.

The Company has prepared these financial statements using accounting policies consistent with IFRS, including 2010 comparative figures and the January 1, 2010 statement of financial position restated to conform to IFRS. Reconciliations of equity and comprehensive income from CGAAP to IFRS are presented in this note. The transition date is the first date at which IFRS was applied, which was January 1, 2010 ("transition date"). The Company has applied IFRS 1 "First-Time Adoption of International Financial Reporting Standards" ("IFRS 1") in preparing these financial statements.

### 3 Adoption of International Financial Reporting Standards (continued)

#### *Elected exemptions from full retrospective application of IFRS*

In preparing these financial statements, the Company elected to apply, as permitted by IFRS 1, certain optional exemptions as follows:

#### *(a) Business combinations*

The Company has applied the business combination exemption in IFRS 1. As a result, IFRS 3 "*Business Combinations*" will not be retrospectively applied to past business combinations. Accordingly, the Company has not restated business combinations that took place prior to the transition date.

#### *(b) Share-based payment*

The Company has elected to apply IFRS 2 "*Share-based Payment*" to equity instruments granted after November 7, 2002 that had not vested by the transition date.

#### *(c) Leases*

The Company has elected to use facts and circumstances existing at the transition date to determine whether an arrangement on the transition date contained a lease.

#### *(d) Insurance contracts*

The Company has elected to apply the transitional provisions in IFRS 4 "*Insurance Contracts*". This election provides the option to not disclose information about claims development that occurred earlier than five years before the end of the first financial year that it applies IFRS, which for the Company is the year ended December 31, 2011.

#### *Mandatory exceptions to full retrospective application of IFRS*

In preparing these financial statements, the Company has applied, as required by IFRS 1, certain mandatory exemptions from full retrospective application of IFRS as follows:

#### *(e) Estimates*

Hindsight was not used to create or revise estimates. Estimates previously made by the Company at the transition date in accordance with CGAAP are consistent with their application in accordance with IFRS at the transition date.

#### *(f) Derecognition of financial assets and financial liabilities*

Non-derivative financial assets and non-derivative financial liabilities that were derecognized before January 1, 2004 under CGAAP were not recognized at the transition date.

#### *Reconciliation of Equity*

The equity under CGAAP as previously reported as at the transition date of January 1, 2010 and December 31, 2010, reconciles to the equity under IFRS at each of these dates as follows:

	December 31, 2010	January 1, 2010
Equity under CGAAP	\$ 374,819	\$ 58,003
Adjustment to deficit to transition to IFRS:		
Site restoration provision	(A) 2,505	2,552
Equity under IFRS	\$ 377,324	\$ 60,555

### 3 Adoption of International Financial Reporting Standards (continued)

#### *Reconciliation of Comprehensive Income*

The comprehensive income under CGAAP, as previously reported for the year ended December 31, 2010, reconciles to the comprehensive income under IFRS as follows:

	Year ended December 31, 2010	
Comprehensive income under CGAAP	\$	58,347
Adjustment to net income to transition to IFRS:		
Site restoration provision	(A)	(47)
Comprehensive income under IFRS	\$	58,300

(A) *Site restoration provision*

Under IFRS, in accordance with International Accounting Standard ("IAS") 37 "*Provisions, Contingent Liabilities and Contingent Assets*", the site restoration provision should be the amount of the present value of the expenditures expected to be required to settle the future obligations. Previously under CGAAP, the provision did not consider the time value of money and expected expenditures were not discounted to their present value. The increase in equity represents the difference in the carrying value of the site restoration provision under IFRS from its carrying amount under CGAAP. Under IFRS, the site restoration provision was reduced by \$2,505 as at December 31, 2010 (January 1, 2010 - \$2,552), which represents the pre-tax difference determined between the discounted and undiscounted site restoration provision. There is no tax impact as the related deferred tax asset has not been recognized in the financial statements.

### 4 Accounting Standards Issued But Not Yet Applied

IFRS 9 "*Financial Instruments*" ("IFRS 9") was issued in November 2009 and will replace IAS 39 "*Financial Instruments: Recognition and Measurement*" ("IAS 39"). IFRS 9 prescribes a single approach to determine whether a financial asset is measured at amortized cost or fair value, replacing the multiple rules permissible under IAS 39. The approach in IFRS 9 is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. IFRS 9 also requires a single impairment method to be used, replacing the multiple impairment methods permissible under IAS 39. The Company has not yet determined the impact of IFRS 9 on its financial statements. IFRS 9 is effective for years beginning on or after January 1, 2015.

IFRS 10 "*Consolidated Financial Statements*" ("IFRS 10"), issued in May 2011, replaces IAS 27 "*Consolidated and Separate Financial Statements*" and SIC-12 "*Consolidation – Special Purpose Entities*". The Company does not currently apply SIC-12 as it does not have special purpose entities. IFRS 10 defines the principle of control and establishes control as the basis for determining which entities are consolidated in the consolidated financial statements. IFRS 10 also sets out the accounting requirements for the preparation of consolidated financial statements. The three elements of control identified in IFRS 10 are power over the investee, exposure or rights to variable returns from involvement with the investee and investor ability to use power over the investee to affect the amount of the investor's returns. The Company expects that the adoption of IFRS 10 will not have a material impact on its financial statements.

IFRS 12 "*Disclosure of Interests in Other Entities*" ("IFRS 12") requires a company to disclose information that enables users of financial statements to evaluate the nature of, and risks associated with, its interests in other entities and the effects of those interests on its financial position, financial performance and cash flows. IFRS 12 is required to be applied by an entity that has an interest in subsidiaries. The Company expects that the adoption of IFRS 12 will not have a material impact on its financial statements.

IFRS 13 "*Fair Value Measurement*" ("IFRS 13"), issued in May 2011, establishes a single source of guidance for fair value measurement under IFRS. IFRS 13 defines fair value, provides guidance on its determination and introduces consistent requirements for disclosures on fair value measurements. IFRS 13 does not include requirements on when fair value measurement is required; it prescribes how fair value is to be measured if another IFRS or IAS requires it. IFRS 13 should be applied prospectively from the beginning of the year in which it is adopted. The Company has not yet determined the impact of IFRS 13 on its financial statements.

IFRS 10, IFRS 12 and IFRS 13 are effective for years beginning on or after January 1, 2013, with earlier adoption permitted.

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5 Business Acquisition

On January 25, 2010, the Company announced that it had agreed to acquire all of the issued and outstanding shares of Jevco from Kingsway Financial Services Inc. (the "Acquisition") and had arranged equity financing of \$275,000 for the purpose of completing the Acquisition (the "Financing").

Jevco, a federal property and casualty insurance company, was incorporated under the Insurance Companies Act on April 10, 1980, and is licensed in all provinces and territories in Canada to write all classes of insurance, other than life. Jevco specializes in providing insurance products covering non-standard and standard auto, recreational vehicles, commercial auto, property and liability. Jevco also provides surety insurance primarily to participants in the Canadian construction industry.

At closings held on February 9, 2010 and February 19, 2010 in connection with the Financing, the Company issued and sold, on a private placement basis, an aggregate of 550,000,000 subscription receipts at a purchase price of \$0.50 each for aggregate gross proceeds of \$275,000. Following the approval of shareholders at a special meeting on March 25, 2010 and the receipt of the necessary regulatory approvals, the Acquisition was completed on March 29, 2010 for a purchase price of \$261,408. Immediately prior to the closing of the Acquisition on March 29, 2010, the subscription receipts were automatically converted into 486,147,088 common shares and 63,852,912 Series 1 Class A non-voting, convertible participating preferred shares of the Company. In connection with the Financing, the Company also issued 10,000,000 warrants to purchase an equal number of Series 1 Class A non-voting, convertible participating shares of the Company at an exercise price of \$0.50 per share. The warrants expire on February 9, 2013 (note 16).

Proceeds of the Financing to the Company were \$265,103, net of transaction costs of \$9,897, of which \$1,900 was non-cash and related to the valuation of the warrants issued. The deferred tax asset related to the transaction costs has not been recognized as the utilization probability threshold has not been met.

The difference between the purchase price of \$261,408 and the fair value of net assets of Jevco has been reported as a gain on business acquisition in these financial statements, as follows:

Net assets acquired at estimated fair value:	
Cash and cash equivalents	\$ 15,695
Investment income due and accrued	9,943
Investments	924,853
Instalment premiums	52,243
Accounts receivable	32,131
Recoverable from reinsurers	47,326
Claims recoverable from other insurers	27,151
Deferred policy acquisition expenses	29,506
Deferred income taxes	8,609
Property and equipment	19,882
Non-current assets held for sale	34,650
Intangible assets	1,312
Accounts payable and accrued liabilities	(9,644)
Income taxes due and accrued	(4,112)
Unearned premiums	(138,078)
Unpaid claims and adjustment expenses	(764,975)
	<u>\$ 286,492</u>
Purchase price paid - cash	\$ 261,408
Gain on business acquisition – excess of fair value over purchase price	25,084
	<u>\$ 286,492</u>

Management has used its best estimates in determining the fair values of the net assets acquired. The gain on business acquisition of \$25,084 resulted from the shares of Jevco being acquired at a discount to the acquisition-date fair value of its net assets.

At closing of the Acquisition, the Company paid an amount of \$20,000 to be held in escrow in respect of some of the claims reserve for Jevco's insurance business existing at the time of closing. In the event that the related claims reserve development from December 31, 2009 until December 31, 2012 was adverse to Jevco, the purchase price would have been reduced, to a maximum amount of \$20,000. In March 2011, this escrow amount was released upon agreement between the parties in exchange for a payment of \$2,250 to the Company. This escrow amount has been recognized in the statement of operations for the year ended December 31, 2011 and is classified as other income.

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5 Business Acquisition (continued)

The transaction costs in connection with the acquisition of Jevco amounted to \$2,936, consisting of consulting, legal, accounting, and investment advisory fees, and were expensed in these financial statements.

As the acquisition took place at the end of March 2010, the consolidated financial statements for the year ended December 31, 2010 included the gain on business acquisition of \$25,084 and only income attributable to Jevco from the date of acquisition to December 31, 2010. Had the acquisition of Jevco been effected at January 1, 2010, the consolidated net income would have been \$59,271 and the consolidated revenue would have been \$348,682 for the year ended December 31, 2010. These pro-forma amounts represent an approximate measure of the performance of the Company and may provide a reference point for comparison to future reporting periods. In estimating this pro-forma consolidated net income and consolidated revenue of the Company, it was assumed that the Financing took place on January 1, 2010 at no additional transaction cost, and that the amortization of fair value adjustments for investments were determined as if the investments were acquired at the fair values arising in the initial accounting for the business combination.

6 Investments

The table below provides details of the investments classified by category:

Category of investments:	December 31, 2011	December 31, 2010	January 1, 2010
Available-for-sale - carried at fair value	\$ 920,591	\$ 894,482	\$ -
Held-to-maturity - carried at amortized cost	97,468	98,297	-
FVTPL - carried at fair value	-	-	9,231
Available-for-sale - carried at cost	500	500	-
	\$ 1,018,559	\$ 993,279	\$ 9,231

The following tables provide details of the amortized cost and fair value of available-for-sale investments, carried at fair value:

	December 31, 2011			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Short-term investments	\$ 84,780	\$ 6	\$ -	\$ 84,786
Canadian bonds:				
- Government	187,681	1,463	273	188,871
- Corporate	371,600	8,854	378	380,076
- Mortgage backed	40,526	937	7	41,456
- Other asset backed	79,615	933	41	80,507
U.S. bonds - Corporate	28,142	282	104	28,320
	792,344	12,475	803	804,016
Common shares - Canadian	100,605	4,918	2,090	103,433
Preferred shares - Canadian	12,072	1,116	46	13,142
	\$ 905,021	\$ 18,509	\$ 2,939	\$ 920,591

	December 31, 2010			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Short-term investments	\$ 246,316	\$ 3	\$ 5	\$ 246,314
Canadian bonds:				
- Government	103,421	290	14	103,697
- Corporate	392,200	5,218	885	396,533
- Mortgage backed	16,099	295	-	16,394
- Other asset backed	72,177	192	97	72,272
U.S. bonds - Corporate	39,097	501	93	39,505
Other bonds - Corporate	13,187	4	-	13,191
	882,497	6,503	1,094	887,906
Preferred shares - Canadian	6,099	477	-	6,576
	\$ 888,596	\$ 6,980	\$ 1,094	\$ 894,482



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6 Investments (continued)

The following tables present the amortized cost and fair value of held-to-maturity investments, carried at amortized cost:

	December 31, 2011			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Canadian bonds:				
- Government	\$ 73,006	\$ 7,634	\$ -	\$ 80,640
- Corporate	24,462	1,679	-	26,141
	\$ 97,468	\$ 9,313	\$ -	\$ 106,781

	December 31, 2010			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Canadian bonds:				
- Government	\$ 73,623	\$ 2,826	\$ -	\$ 76,449
- Corporate	24,674	505	-	25,179
	\$ 98,297	\$ 3,331	\$ -	\$ 101,628

The following table presents the amortized cost and fair value of FVTPL investments, carried at fair value:

	January 1, 2010			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
Short-term investments	\$ 5,264	\$ -	\$ -	\$ 5,264
Master Asset Vehicle Notes	7,902	-	4,165	3,737
Credit facility repayment option	230	-	-	230
	\$ 13,396	\$ -	\$ 4,165	\$ 9,231

The available-for-sale investments carried at cost consist of an investment in a private company. This equity investment is carried at cost as it does not have a quoted price in an active market and its fair value cannot be measured reliably. Should there be objective evidence that the investment is impaired, an impairment loss will be recorded.

*Fair value determination*

Fair value amounts represent estimates of the consideration that would currently be agreed upon between knowledgeable, willing parties who are under no compulsion to act and are best evidenced by quoted market prices, if they exist. The calculation of estimated fair value is based on market conditions at a specific point in time and may not be reflective of future fair values.

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6 Investments (continued)

The Company uses a fair value hierarchy to categorize the inputs used in valuation techniques to measure fair value. The extent of the Company's use of quoted market prices (Level 1), internal models using observable market information as inputs (Level 2) and internal models without observable market information (Level 3) in the valuation of the Company's investments at December 31, 2011, December 31, 2010 and January 1, 2010 is as follows:

December 31, 2011	Fair value	Level 1	Level 2	Level 3
<b>Available-for-sale investments:</b>				
Short-term investments	\$ 84,786	\$ -	\$ 84,786	\$ -
Canadian bonds:				
- Government	188,871	-	188,871	-
- Corporate	380,076	-	379,176	900
- Mortgage backed	41,456	-	41,456	-
- Other asset backed	80,507	-	80,507	-
U.S. bonds - Corporate	28,320	-	28,320	-
Common shares - Canadian	103,433	103,433	-	-
Preferred shares - Canadian	13,142	13,142	-	-
	\$ 920,591	\$ 116,575	\$ 803,116	\$ 900
<b>Held-to-maturity investments:</b>				
Canadian bonds:				
-Government	\$ 80,640	\$ -	\$ 80,640	\$ -
-Corporate	26,141	-	26,141	-
	\$ 106,781	\$ -	\$ 106,781	\$ -
<b>December 31, 2010</b>				
	Fair value	Level 1	Level 2	Level 3
<b>Available-for-sale investments:</b>				
Short-term investments	\$ 246,314	\$ -	\$ 246,314	\$ -
Canadian bonds:				
- Government	103,697	-	103,697	-
- Corporate	396,533	-	395,633	900
- Mortgage backed	16,394	-	16,394	-
- Other asset backed	72,272	-	72,272	-
U.S. bonds - Corporate	39,505	-	39,505	-
Other bonds - Corporate	13,191	-	13,191	-
Preferred shares - Canadian	6,576	6,576	-	-
	\$ 894,482	\$ 6,576	\$ 887,006	\$ 900
<b>Held-to-maturity investments:</b>				
Canadian bonds:				
-Government	\$ 76,449	\$ -	\$ 76,449	\$ -
-Corporate	25,179	-	25,179	-
	\$ 101,628	\$ -	\$ 101,628	\$ -
<b>January 1, 2010</b>				
	Fair value	Level 1	Level 2	Level 3
<b>FVTPL investments:</b>				
Short-term investments	\$ 5,264	\$ -	\$ 5,264	\$ -
Master Asset Vehicle notes	3,737	-	-	3,737
Credit facility repayment option	230	-	-	230
	\$ 9,231	\$ -	\$ 5,264	\$ 3,967

The investments held at December 31, 2011, classified at level 3 with a value of \$900, were acquired upon the Acquisition for \$900. It was determined that no change in level of classification or fair valuation was required for the year ended December 31, 2011 or between the acquisition date of March 29, 2010 and December 31, 2010. The Master Asset Vehicle notes held at January 1, 2010, classified at level 3 with a value of \$3,737, were sold during the year ended December 31, 2010 for \$4,750 and the corresponding credit facility repayment option, valued at \$230 at January 1, 2010, was terminated.

## 6 Investments (continued)

### *Impairment Analysis*

Management performs a quarterly analysis of investment holdings to determine whether there is objective evidence that the estimated cash flows of the investments have been affected. The analysis includes the following procedures as deemed appropriate by management:

- assessing whether any credit losses are expected for those investments. This assessment includes consideration of, among other things, all available information and factors having a bearing upon collectability such as changes to credit rating by rating agencies, financial condition of the issuer, expected cash flows and value of any underlying collateral;
- identifying all security holdings in unrealized loss positions that have existed for at least six months or other circumstances that management believes may impact the recoverability of the investment;
- obtaining a valuation analysis from third party investment managers regarding the intrinsic value of these holdings based on their knowledge, experience and other market based valuation techniques;
- reviewing the trading range of certain investments over the preceding year;
- assessing whether declines in market value for debt investment holdings represent objective evidence of impairment based on their investment grade credit ratings from third party security rating agencies;
- assessing whether declines in market value for any debt investment holdings with non-investment grade credit rating represent objective evidence of impairment based on the history of its debt service record; and
- determining necessary provisions for declines in market values for which there is objective evidence of impairment based on analyses performed.

The risks and uncertainties inherent in the assessment methodology utilized to determine whether declines in market value represent objective evidence of impairment include, but may not be limited to, the following:

- the opinion of professional investment managers could be incorrect;
- the past trading patterns of individual investments may not reflect future valuation trends;
- the credit ratings assigned by independent credit rating agencies may be incorrect due to unforeseen or unknown facts related to a company's financial situation; and
- the debt service pattern of non-investment grade investments may not reflect future debt service capabilities and may not reflect unknown underlying financial problems.

As a result of the impairment analysis performed by management, no write-downs were required for the years ended December 31, 2011 and 2010.

The Company reported a gain on sale of Savvion, Inc. of \$2,185 in the year ended December 31, 2010 which is included in net realized gains and losses on sale of investments. During 2011, an additional gain of \$515 was recorded following the release of an amount held in escrow. This investment was previously written off for accounting purposes as a result of impairment analysis.

## 7 Recoverable from Reinsurers

The amount recoverable from reinsurers is detailed as follows:

	December 31, 2011	December 31, 2010	January 1, 2010
Unearned premiums	\$ 1,690	\$ 1,512	\$ -
Unpaid claims and adjustment expenses (note 13)	32,280	28,172	-
	\$ 33,970	\$ 29,684	\$ -

Details of the change in the amount recoverable from reinsurers for the years ended December 31, 2011 and 2010 are included in note 13c.

The Company follows the policy of underwriting and reinsuring contracts of insurance, which limits its net exposure to a maximum amount on any one claim. The Company has reinsurance protection which limits the maximum amount on any one claim to \$2,000 (2010 - \$1,750) in the event of a liability claim to a maximum of \$30,000 (2010 - \$20,000) and \$750 (2010 - \$750) in the event of a property claim to a maximum of \$10,000 (2010 - \$5,000). In addition, the Company has property catastrophe reinsurance which provides coverage in the event of a series of claims arising out of a single occurrence. The reinsurance limits this exposure to \$2,500 (2010 - \$2,500) per occurrence to a maximum of \$25,000 (2010 - \$25,000).

Credit risk related to reinsurance is described in note 24.

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8 Claims Recoverable from Other Insurers

In accordance with the Insurance Act of Ontario (the "Act"), the Company has a right of indemnification for certain policy benefits paid to its own insured from the insurer of a third party at fault. The Act also provides for an arbitration process when the two insurers are not in agreement as to the amount of claims to be transferred. Failure of other insurers to honor their obligations could result in losses to the Company.

9 Income Taxes

Income taxes are recognized for deferred income taxes attributed to estimated differences between the financial statement carrying values of existing assets and liabilities and their respective income tax bases.

The Company's deferred income tax asset consists of deferred taxes related to the following:

	December 31, 2011	December 31, 2010	January 1, 2010
Non-capital loss carry-forwards	\$ 2,862	\$ 15,288	\$ -
Unpaid claims and adjustment expenses	7,653	8,616	-
Property and equipment and intangible assets	(1,231)	(1,251)	-
Other	824	(176)	-
Deferred income tax asset	\$ 10,108	\$ 22,477	\$ -

In December 2011, Jevco acquired and amalgamated with 2266100 Ontario Ltd. and 2266102 Ontario Ltd., and previously unrecognized non-capital losses of \$10,875 were transferred to Jevco. In August 2010, Jevco acquired and amalgamated with iFire, and previously unrecognized non-capital losses of \$55,027 were transferred to Jevco. The deferred income tax asset related to these loss carry-forwards was \$2,862 at December 31, 2011 (December 31, 2010 - \$15,288).

As the realization of any related tax benefits is not probable, no deferred income tax assets have been recognized for the following:

	December 31, 2011	December 31, 2010	January 1, 2010
Non-capital loss carry-forwards	\$ 37,774	\$ 38,887	\$ 121,066
Capital loss carry-forwards	96,194	99,278	46,716
Scientific research and experimental development expenditures	6,280	6,280	6,280
Deductible temporary differences	28,333	27,238	9,180
Investment tax credits	8,672	8,672	9,933

The unrecognized non-capital losses and investment tax credits will expire at various times to the end of 2031, as follows:

Non-capital losses by year of expiry:		Investment tax credits by year of expiry:	
2014	\$ 13,528	2018	\$ 3,241
2015	452	2019	888
2027	7,883	2020	961
2028	6,151	2021	823
2029	9,048	2022	643
2030	102	2023	324
2031	610	Beyond 2023	1,792
	\$ 37,774		\$ 8,672

Temporary differences associated with investments in subsidiaries for which deferred tax liabilities have not been recognized were \$99,131 at December 31, 2011 (December 31, 2010 - \$62,525, January 1, 2010 - \$nil). The Company is able to control the timing of the reversal of these temporary differences and it is not probable that these temporary differences will reverse in the foreseeable future.

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9 Income Taxes (continued)

The major components of the income tax provision recognized in the statement of operations are as follows:

	Year ended December 31	
	2011	2010
Current tax expense in respect of the current year	\$ 805	\$ 9,466
Deferred tax expense:		
Recognition of previously unrecognized tax losses	(2,862)	(15,288)
Origination and reversal of temporary differences due to:		
Non-capital losses	14,410	-
Unpaid claims and adjustment expenses	963	1,191
Other	(1,987)	93
<b>Income tax expense (recovery)</b>	<b>\$ 11,329</b>	<b>\$ (4,538)</b>

The following is a reconciliation of income taxes calculated at the statutory income tax rate to the income tax expense (recovery) included in the statement of operations:

	Year ended December 31	
	2011	2010
Income from continuing operations before income taxes	\$ 44,250	\$ 50,575
Statutory income tax rate	28.1%	30.8%
Income taxes at statutory income tax rate	12,434	15,577
Variations due to:		
Recognition of previously unrecognized tax losses	(2,862)	(15,288)
Gain on acquisition of Jevco, net of expenses (note 5)	-	(6,764)
Other	1,757	1,937
<b>Income tax expense (recovery)</b>	<b>\$ 11,329</b>	<b>\$ (4,538)</b>

10 Property and Equipment

During the year ended December 31, 2011, details of the movement in the carrying values by class of property and equipment are as follows:

	Land	Building	Leasehold improvements	Furniture and equipment	Computers	Automobiles	Total
January 1, 2011	\$ 1,283	\$ 16,227	\$ 2,779	\$ 1,969	\$ 241	\$ 159	\$ 22,658
Additions	-	39	489	760	901	108	2,297
Depreciation	-	(645)	(227)	(792)	(391)	(82)	(2,137)
<b>December 31, 2011</b>	<b>\$ 1,283</b>	<b>\$ 15,621</b>	<b>\$ 3,041</b>	<b>\$ 1,937</b>	<b>\$ 751</b>	<b>\$ 185</b>	<b>\$ 22,818</b>

Details of cost and accumulated depreciation of property and equipment at December 31, 2011 are as follows:

	Land	Building	Leasehold improvements	Furniture and equipment	Computers	Automobiles	Total
Cost	\$ 1,283	\$ 16,584	\$ 3,268	\$ 2,784	\$ 1,663	\$ 286	\$ 25,868
Depreciation	-	(963)	(227)	(847)	(912)	(101)	(3,050)
	\$ 1,283	\$ 15,621	\$ 3,041	\$ 1,937	\$ 751	\$ 185	\$ 22,818

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10 Property and Equipment (continued)

During the year ended December 31, 2010, details of the movement in the carrying values by class of property and equipment are as follows:

	Land	Building	Leasehold improvements	Furniture and equipment	Computers	Automobiles	Total
January 1, 2010	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
Additions upon acquisition of subsidiary	1,283	16,545	-	1,429	615	10	19,882
Additions	-	-	2,779	1,242	234	173	4,428
Dispositions	-	-	-	(647)	(87)	-	(734)
Depreciation	-	(318)	-	(55)	(521)	(24)	(918)
December 31, 2010	\$ 1,283	\$ 16,227	\$ 2,779	\$ 1,969	\$ 241	\$ 159	\$ 22,658

Details of cost and accumulated depreciation of property and equipment at December 31, 2010 are as follows:

	Land	Building	Leasehold improvements	Furniture and equipment	Computers	Automobiles	Total
Cost	\$ 1,283	\$ 16,545	\$ 2,779	\$ 2,024	\$ 762	\$ 183	\$ 23,576
Depreciation	-	(318)	-	(55)	(521)	(24)	(918)
	\$ 1,283	\$ 16,227	\$ 2,779	\$ 1,969	\$ 241	\$ 159	\$ 22,658

11 Intangible Assets

	Year ended December 31, 2011			Year ended December 31, 2010		
	Cost	Accumulated amortization	Net book value	Cost	Accumulated amortization	Net book value
Balance at January 1	\$ 3,068	\$ (1,093)	\$ 1,975	\$ -	\$ -	\$ -
Acquired on acquisition of subsidiary	-	-	-	1,312	-	1,312
Additions	2,981	-	2,981	1,756	-	1,756
Amortization	-	(1,112)	(1,112)	-	(1,093)	(1,093)
Balance at end of year	\$ 6,049	\$ (2,205)	\$ 3,844	\$ 3,068	\$ (1,093)	\$ 1,975

12 Unearned Premiums

The Company earns motorcycle and watercraft premiums unevenly over the period of risk covered by the policy based on claims reporting patterns specific to its motorcycle and watercraft experience. The Company earns premium revenue on all other lines evenly over the period covered by each individual insurance contract. Unearned premiums reported in the statement of financial position represent the portion of premiums written related to the unexpired risk portion of the policy at the end of the reporting period. The unearned premiums liability at December 31, 2011 and December 31, 2010 was tested to ensure the liability was sufficient to pay for future claims and expenses to service the unexpired policies to which the liability was related. This test, known as the liability adequacy test, is performed annually by the Appointed Actuary.

In Canada, automobile insurance premium rates, other than for fleet automobiles are regulated by provincial government authorities. Regulation of premium rates is based on claims and other costs of providing insurance coverage. Regulatory approvals can limit or reduce premium rates that can be charged, or delay the implementation of changes in rates. A significant portion of the Company's revenue is subject to regulatory approvals.

The unearned premiums amount corresponds to policies with less than twelve months duration.

### 13 Unpaid Claims and Adjustment Expenses

#### *(a) Nature of unpaid claims and adjustment expenses*

The establishment of the provision for unpaid claims and adjustment expenses is based on known facts and interpretation of circumstances and is therefore a complex and dynamic process influenced by a large variety of factors. These factors include the Company's own experience with similar cases and historical trends involving claim payment patterns, loss payments, pending levels of unpaid claims and adjustment expenses, product mix and concentration, claims severity and claim frequency patterns.

Other factors include the continually evolving and changing regulatory and legal environment, actuarial studies, professional experience and expertise of the Company's claim departments' personnel and independent adjusters retained to handle individual claims, the quality of the data used for projection purposes, existing claims management practices including claims handling and settlement practices, the effect of inflationary trends on future claims settlement costs, investment rates of return, court decisions, economic conditions and public attitudes. In addition, time can be a critical part of the provision determination, since the longer the span between the incidence of a loss and the settlement of the claims, the more variable the ultimate settlement amount can be. Accordingly, short-tailed claims, such as property claims, tend to be more reasonably predictable than long-tailed claims, such as general liability and automobile accident benefit claims.

The process of establishing the provision relies on the judgment and opinions of a large number of individuals, on historical precedents and trends, on prevailing legal, economic, social and regulatory trends and on expectations as to future developments. The provision reflects expectations of the ultimate cost of resolution and administration of claims based on an assessment of facts and circumstances then known together with a review of historical settlement patterns, estimates of trends in claims severity and frequency, legal theories of liability and other factors.

Variables affecting the determination of the provision are the receipt of additional claims information and other internal and external factors, such as changes in claims handling procedures, economic inflation, legal and judicial trends, legislative changes, and inclusion of exposures not contemplated at the time of policy inception. The provision for claims and adjustment expenses is reviewed separately by, and must be acceptable to, management of the Company, the Appointed Actuary and an external valuation actuary during the Company's triennial actuarial examination.

#### *(b) Methodologies and assumptions*

The best estimates of future claims and adjustment expenses have been determined from the projected ultimate claims and adjustment expenses based on the reported / paid claims development method, the Bornhuetter-Ferguson method, the Berquist-Sherman method and the expected claims method. Considerations in the choice of methods to estimate ultimate claims included, among other factors, the line of business, the number of years' experience and the age of the accident years being developed. A description of each of these methods is as follows:

##### *(i) Reported / paid claims development method*

The distinguishing characteristics of the development method are that ultimate claims for each accident year are produced from recorded values assuming the future claim development is similar to the prior years' development. The underlying assumption is that claims recorded to date will continue to develop in a similar manner in the future.

##### *(ii) Bornhuetter-Ferguson method*

The key assumption of the Bornhuetter-Ferguson method is that unreported claims will develop based on expected claims. In other words, the claims reported to date contain no informational value as to the amount of claims yet to be reported. It is most frequently used for lines of business with long settlement patterns, and lines of business subject to the occurrence of large claims.

##### *(iii) Berquist-Sherman method*

The adjusted reported development method, also known as the Berquist-Sherman method, is analogous to the reported / paid claims development method except that the reported claims used in the calculation of development factors are first adjusted to a common case reserve adequacy basis. A case reserve is a provision for unpaid claims and adjustment expenses for known claims. Compared to the reported / paid claims method, which relies on consistency in reserving philosophies and procedures to produce reliable results, the Berquist-Sherman method modifies the raw data to restate historical case reserves to the level that the current case reserves would imply, after the consideration of trend.

13 Unpaid Claims and Adjustment Expenses (continued)

(iv) Expected claims method

Using the expected claims method, ultimate claims projections are based upon prior measures of the anticipated claims. An expected claims ratio is applied to the measure of exposure to determine estimated ultimate claims for each year. This method is more commonly used in lines of business with longer emergence and settlement patterns.

For each line of business, a roll-forward of the liabilities to December 31, 2011 was performed based on the September 30, 2011 analysis. The December 31, 2011 liabilities were based on actuarial assumptions as established in the September 30, 2011 analysis and adjusted, as appropriate, based on the actual claims experience. This approach is based on the assumption that the change in reported / paid development factors for the three months would not be significantly affected by the development of reported claims during the three months ended December 31, 2011. In addition, this approach is based on the Bornhuetter-Ferguson method principles, where the December 31, 2011 IBNR reserves are calculated based on the September 30, 2011 IBNR reserves projected to December 31, 2011 based on the selected reported / paid development factors, adjusted if necessary, and then added to the actual reported claims valued as of December 31, 2011 to determine the ultimate claims as of December 31, 2011. Variations in the ultimate claims by lines of business and/or accident years from September 30, 2011 to December 31, 2011 may exist. The same approach was followed in 2010 to determine the actual reported claims and IBNR at December 31, 2010.

Claims paid and reported, direct and net of reinsurance recoveries and net of salvage and subrogation, were tracked by lines of business, accident years and development periods in a format known as claims development triangles (note 24). Selected claims development factors were calculated based on the historical development pattern of the reported claims development triangles. Judgment was used whenever there was a wide variability in the past development factors due to a small claims sample or due to a new class of business; development factors which seemed abnormal were disregarded in selecting the claims development factors. Owing to the changes in reserving philosophy and practices stemming from new claims management, significant variations were observed in the development triangles. The Berquist-Sherman method was used to adjust the historical claims information for these changes.

Claims data includes external claims adjustment expenses, and for a portion of the portfolio includes internal claims adjustment expenses ("IAE"). For the portion of the portfolio which includes IAE, a provision for IAE has been determined based on the ratio of paid IAE to paid claims. This method assumes that half of the IAE is required when the claim is first recorded. The remaining half of the IAE is required to maintain the claim. This IAE percentage is applied to the pure IBNR and to half of the case reserves plus IBNR for known claims. For the remainder of the portfolio, the IAE are included in the claims data.

The provision for unpaid claims and adjustment expenses is discounted using an interest rate based on the Company's projected investment income from the assets supporting the unpaid claims and adjustment expense liabilities, and reflecting the estimated timing of payments and recoveries. The discount rate used as at December 31, 2011 was 3.1% (December 31, 2010 - 3.7%). Reinsurance recoverable estimates and claims recoverable from other insurers are discounted in a manner consistent with the method used to establish the related liability.

The undiscounted reserves do not include provisions for adverse deviation whereas the discounted provision for unpaid claims and adjustment expenses, discounted claims recoverable from other insurers and discounted reinsurance recoverable estimates include provisions for adverse deviation to allow for possible deterioration of experience relating to asset default, interest rate risk, claims development and recoverability of reinsurance balances.

The following table shows unpaid claims and adjustment expenses on an undiscounted basis and a discounted basis:

	December 31, 2011		December 31, 2010		January 1, 2010	
	Undiscounted	Discounted	Undiscounted	Discounted	Undiscounted	Discounted
Unpaid claims and adjustment expenses	\$ 651,007	\$ 675,094	\$ 691,246	\$ 705,071	\$ -	\$ -
Claims recoverable from other insurers	(49,151)	(50,969)	(39,457)	(40,246)	-	-
Recoverable from reinsurers (note 7)	(31,128)	(32,280)	(31,894)	(28,172)	-	-
Net unpaid claims and adjustment expenses	\$ 570,728	\$ 591,845	\$ 619,895	\$ 636,653	\$ -	\$ -

An evaluation of the adequacy of claims liabilities is completed at the end of each financial quarter. This evaluation includes a re-estimation of the liability for unpaid claims and adjustment expenses compared to the liability that was originally established.

(c) Changes in assumptions

Unpaid claims and adjustment expenses at December 31, 2011 were compared to the expected reported claims to determine whether the current actuarial assumptions are adequate for the determination of the IBNR provision at December 31, 2011. As a result, it was



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13 Unpaid Claims and Adjustment Expenses (continued)

determined that the actual reported claims and adjustment expenses for the year for personal automobile business were generally lower than the expected claims and adjustment expenses, and the IBNR provision at December 31, 2011 was reduced accordingly.

The provision for unpaid claims and adjustment expenses consists of reported claims, known as case reserves, and IBNR. During the year ended December 31, 2010, changes in reserving philosophy were introduced by the Company's claims management which increased the average case reserves. As a result, the net IBNR at December 31, 2010 was reduced to take into consideration the changes in average case reserves through a greater emphasis on the Berquist-Sherman method, thereby generating a reduction in the net IBNR of approximately \$13,700 for the personal automobile business and \$5,100 for the commercial automobile business which offset the increase in the net case reserves. Continuing this emphasis on increased average case reserves, the net IBNR reserve at December 31, 2011 was reduced by an additional \$6,500 for the personal automobile business and \$2,000 for the Ontario motorcycle business to offset a corresponding increase in the net case reserves.

The discount rate is selected based on the expected yields of the assets supporting the policy liabilities. As at December 31, 2011, the discount rate was reduced by 60 basis points as compared to the December 31, 2010 discount rate, which along with related changes in provision for adverse deviation, resulted in an increase in the claims liabilities of \$4,359. From the date of the Acquisition on March 29, 2010 to December 31, 2010, the discount rate decreased by 40 basis points, which along with related changes in provision for adverse deviation, increased the claims liabilities by \$338.

Sensitivity to changes in assumptions is discussed with insurance risk in note 24.

The change in the provision for unpaid claims and adjustment expenses is as follows:

	Year ended December 31, 2011			Year ended December 31, 2010		
	Direct	Ceded	Net	Direct	Ceded	Net
Balance, net of recoveries, at January 1	\$ 664,825	\$ 28,172	\$ 636,653	\$ -	\$ -	\$ -
Acquisition, March 29, 2010	-	-	-	737,824	46,176	691,648
Paid during the year	(269,736)	(6,988)	(262,748)	(232,299)	(15,270)	(217,029)
Change in provision related to:						
Current year claims	256,058	6,120	249,938	199,381	1,178	198,203
Prior years claims	(36,255)	102	(36,357)	(38,650)	(2,143)	(36,507)
Discount rates and provision for adverse deviation	9,233	4,874	4,359	(1,431)	(1,769)	338
Balance, net of recoveries, at end of year	624,125	32,280	591,845	664,825	28,172	636,653
Recoverable from other insurers	50,969	-	50,969	40,246	-	40,246
Unpaid claims and adjustment expenses	\$ 675,094	\$ 32,280	\$ 642,814	\$ 705,071	\$ 28,172	\$ 676,899

The provision for unpaid claims and adjustment expenses by case reserves and IBNR is as follows:

	December 31, 2011			December 31, 2010			January 1, 2010		
	Direct	Ceded	Net	Direct	Ceded	Net	Direct	Ceded	Net
Case reserves	\$ 459,934	\$ 13,486	\$ 446,448	\$ 512,973	\$ 17,205	\$ 495,768	\$ -	\$ -	\$ -
IBNR	215,160	18,794	196,366	192,098	10,967	181,131	-	-	-
	\$ 675,094	\$ 32,280	\$ 642,814	\$ 705,071	\$ 28,172	\$ 676,899	\$ -	\$ -	\$ -

The provision for unpaid claims and adjustment expenses by major lines of business is as follows:

	December 31, 2011	December 31, 2010	January 1, 2010
Personal lines	\$ 478,261	\$ 468,691	\$ -
Commercial lines	196,833	236,380	-
	\$ 675,094	\$ 705,071	\$ -

#### 14 Site Restoration Provision

The site restoration provision is based on periodic independent estimates of costs associated with soil and groundwater reclamation and remediation of industrial sites formerly owned by the Company. The change in site restoration provision is as follows:

	Year ended December 31, 2011	Year ended December 31, 2010
Balance at beginning of year	\$ 2,495	\$ 2,973
Changes due to:		
Estimates of future expenditures	(2)	(523)
Expenditures	(158)	-
Passage of time and discount rates	66	45
Balance at end of year	\$ 2,401	\$ 2,495

Change in estimates of future expenditures are as a result of periodic reviews of the underlying assumptions supporting the provision, including remediation costs and regulatory requirements. The Company does not expect to settle any portion of the site restoration provision within twelve months after December 31, 2011.

Potential reimbursements of costs resulting from indemnifications provided by previous owners of the industrial sites have not been recognized in these financial statements. Any future reimbursements will be recorded when received.

#### 15 Commitments and Contingent Liabilities

- (a) In connection with the Acquisition, the Company agreed with OSFI that it would maintain liquid and unencumbered assets within the holding company up to a maximum of \$20,000 and depending on Jevco's minimum capital test ("MCT") ratio, this amount may not be required at all. At December 31, 2011, the MCT ratio of Jevco was 326% (December 31, 2010 - 321%) and therefore, no portion of the \$20,000 liquid and unencumbered assets is required to be maintained within the holding company.
- (b) In connection with its operations, the Company is from time to time named as defendant in actions for damages and costs allegedly sustained by the plaintiffs. While it is not possible to estimate the outcome of the various proceedings at this time, such actions have generally been resolved with minimal expenses in excess of amounts provided for. The Company does not believe that it will incur any significant additional expenses in connection with such actions.
- (c) The Company has operating leases for office space in major cities across Canada with remaining lease terms of up to 15 years. Future minimum annual lease payments under operating leases and subleases are:

Not later than one year	\$ 2,976
Later than one year and not later than five years	\$ 10,991
Later than five years	\$ 24,926

- (d) The Company has purchased a number of annuities in settlement of claims which at the time of purchase resulted in derecognition of the related liability from the statement of financial position. These annuities have been purchased from registered Canadian life insurers with high claims paying ability ratings as determined by outside rating organizations. The total value of the annuities purchased by the Company at December 31, 2011 was \$56,275 (December 31, 2010 - \$50,225, January 1, 2010 - \$nil). The Company has a credit risk with respect to the failure of these life insurers. The Company has assessed the fair value of this credit risk as insignificant based on the claims paying ability of the life insurers and historical experience.
- (e) In connection with the sale of the operations and assets of Nucryst, Nucryst agreed to indemnify the purchaser against certain liabilities or losses as described in the asset purchase agreement to an aggregate maximum of US\$11,000, subject to certain exclusions. The Company also agreed to indemnify the purchaser and the purchaser's directors, officers and employees, for an indefinite period, from certain environmental liabilities and costs relating to the premises formerly leased by Nucryst in Fort Saskatchewan, Alberta. No amounts have been accrued related to these indemnities.

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15 Commitments and Contingent Liabilities (continued)

- (f) The Company has agreements to indemnify its Officers and Directors for certain events or occurrences while the Officer or Director is or was serving at the Company's request in such capacity. The maximum potential amount of future payments is unlimited. However, the Company maintains Director and Officer Liability insurance coverage that enables the Company to recover a portion of any future payments.
- (g) The Company has provided indemnifications to third parties with respect to future site restoration costs to be incurred on properties previously owned by the Company. These estimated costs have been included in the site restoration provision (note 14).
- (h) From time to time, the Company pledges assets to third parties to collateralize liabilities incurred under its insurance policies or for services provided by the third parties. At December 31, 2011, the amount of pledged assets was \$nil (December 31, 2010 - \$500, January 1, 2010 - \$nil). Collateral pledging transactions are conducted under terms that are common and customary to standard collateral pledging and are subject to the Company's risk management controls.

16 Share Capital, Warrants and Contributed Surplus

*Share Capital*

The Company's authorized share capital consists of an unlimited number of common shares with no par value, Class A preferred shares with no par value and Class B preferred shares with no par value. For purposes of the Financing, on February 26, 2010, the Company amended its articles for the issuance of Series 1 Class A non-voting, convertible participating preferred shares ("Series 1 Class A preferred shares"). The Series 1 Class A preferred shares are entitled to dividends as the directors may declare, provided that an equal dividend is declared on the common shares, and rank equally with the common shares with respect to liquidation proceeds. The Series 1 Class A preferred shares are convertible into common shares, on a one to one basis, subject to any adjustments resulting from subdivision or consolidation of the common shares, provided that the conversion does not result in the holder owning common shares exceeding an ownership limit of 40%. No shares of the Company are held by the Company or by its subsidiaries.

The Company's share capital at December 31, 2011, December 31, 2010 and January 1, 2010 is as follows:

	December 31, 2011	December 31, 2010	January 1, 2010
Common shares issued and fully paid	\$ 656,618	\$ 660,651	\$ 426,282
Series 1 Class A preferred shares issued and fully paid	30,784	30,784	-
	\$ 687,402	\$ 691,435	\$ 426,282

Changes in the Company's common shares and Series 1 Class A preferred shares outstanding during the year ended December 31, 2011 and 2010 are as follows:

Common shares (thousands)	Year ended December 31			
	2011	2010	2011	2010
	Number		Stated Capital	
Balance at beginning of year	580,565	94,221	\$ 660,651	\$ 426,282
Issued upon private placement (note 5)	-	486,147	-	234,319
Stock options exercised (note 19)	70	197	15	50
Issued	6,164	-	3,255	-
Purchased and cancelled	(6,455)	-	(7,303)	-
Balance at end of year	580,344	580,565	\$ 656,618	\$ 660,651

Series 1 Class A preferred shares (thousands)	Year ended December 31			
	2011	2010	2011	2010
	Number		Stated Capital	
Balance at beginning of year	63,853	-	\$ 30,784	\$ -
Issued upon private placement (note 5)	-	63,853	-	30,784
Balance at end of year	63,853	63,853	\$ 30,784	\$ 30,784

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16 Share Capital, Warrants and Contributed Surplus (continued)

To finance the Acquisition, the Company issued and sold, on a private placement basis, an aggregate of 550,000,000 subscription receipts for aggregate gross proceeds of \$275,000. Following the approval of shareholders at a special meeting on March 25, 2010 and the receipt of the necessary regulatory approvals, the Acquisition was completed on March 29, 2010. Immediately prior to the closing of the Acquisition on March 29, 2010, the subscription receipts were automatically converted into 486,147,088 common shares and 63,852,912 Series 1 Class A preferred shares. The proceeds of the Financing to the Company were \$265,103, net of transaction costs of \$9,897, of which \$1,900 was non-cash expense related to the warrants issued.

In the year ended December 31, 2011, 70,000 common shares (2010 - 196,667 common shares) were issued upon the exercise of 70,000 stock options (2010 - 196,667 stock options).

On May 16, 2011, 6,164,574 common shares were issued to Goodwood Management Inc. ("Goodwood") at a price of \$0.528 per share. Further details are provided in note 19.

*Warrants*

In connection with the Financing, 10,000,000 warrants were issued to purchase an equal number of Series 1 Class A preferred shares of the Company at an exercise price of \$0.50 per share. The fair value of the warrants at the time of issuance on February 9, 2010 was \$1,900 and was reported as a separate component of shareholders' equity. The fair value of the warrants was estimated using the Black-Scholes option pricing model assuming a risk-free interest rate of 1.59% and a volatility of 30.0%. The warrants expire on February 9, 2013.

*Contributed Surplus*

In August 2011, the Company filed a normal course issuer bid which entitles the Company to acquire up to 30,173,238 common shares between August 30, 2011 and August 29, 2012. The Company has repurchased 6,455,000 common shares on the open market through the normal course issuer bid at an average price per share of \$0.4875, for an aggregate consideration of \$3,147. The amount by which the average carrying value exceeded the cost of reacquiring the shares of \$4,156 has been credited to contributed surplus.

17 Investment Income

The following table provides details of the investment income:

	Year ended December 31	
	2011	2010
Interest income	\$ 28,589	\$ 23,175
Dividend income	1,906	300
Instalment premiums financing income	5,145	3,741
Investment income	35,640	27,216
Investment expenses	(3,864)	(3,110)
Net investment income	\$ 31,776	\$ 24,106

18 Expenses

The following table summarizes expenses by function as presented in the statement of operations:

Expenses by function	Year ended December 31	
	2011	2010
Investment	\$ 3,864	\$ 3,110
Underwriting	311,478	230,678
Corporate	13,117	11,512
Business acquisition	-	2,936
	\$ 328,459	\$ 248,236

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18 Expenses (continued)

The following table summarizes the expenses by nature:

Expenses by nature	Year ended December 31	
	2011	2010
Claims	\$ 206,215	\$ 144,163
Reinsurers' share of claims and adjustment expenses	(11,096)	2,734
Commissions	48,100	38,275
Premium taxes	10,023	8,867
Salaries and benefits	35,316	23,812
Share-based compensation	7,823	6,586
Office expenses	22,747	16,066
Professional fees	5,028	4,931
Depreciation of property and equipment	2,137	918
Amortization of intangible assets	1,112	1,093
Management services	3,274	1,907
Investment management fees	1,195	1,251
Surety administrative charges	(3,415)	(2,367)
	\$ 328,459	\$ 248,236

For the year ended December 31, 2011, \$1,353 (2010 - \$1,157) was included in salaries and benefits for future employee benefits under defined contribution plans, and \$2,024 (2010 - \$1,661) was included in office expenses for lease expenses.

19 Share-based Compensation

On April 12, 2010, the Board of Directors of the Company approved the adoption of a comprehensive long-term equity incentive plan (the "Incentive Plan"), ratified at the Company's annual general meeting of shareholders held on May 12, 2010, designed to combine the Company's prior equity incentive plans, being the Employee and Director Stock Option Plan, the Directors and Officers Share Purchase Program, the Restricted Share Unit Plan, and the Deferred Share Unit Plan, collectively, the "Prior Plans". All awards granted under the Prior Plans remain in full force and effect in accordance with their terms, however, no additional grants will be made under the Prior Plans. Under the Incentive Plan, the Company may grant share-based awards for an initial number of 63,858,049 common shares of the Company.

**Stock Options** – Changes to the number of stock options for the years ended December 31, 2011 and 2010 are as follows:

	Year ended December 31, 2011		Year ended December 31, 2010	
	Number (thousands)	Weighted Average Exercise Price in dollars	Number (thousands)	Weighted Average Exercise Price in dollars
Common share stock options				
Outstanding at beginning of year	1,072	\$ 4.03	2,292	\$ 5.30
Exercised	(70)	\$ 0.22	(197)	\$ 0.25
Expired and forfeited	(527)	\$ 5.19	(1,023)	\$ 12.14
Outstanding at end of year	475	\$ 3.30	1,072	\$ 4.03

All stock options outstanding are exercisable. Information about stock options outstanding at December 31, 2011 is as follows:

Range of Exercise Prices in dollars	Number (thousands)	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price in dollars
\$0.22 - \$0.99	27	5.9 years	\$ 0.22
\$1.00 - \$3.99	323	3.2 years	\$ 2.58
\$4.00 - \$6.18	125	1.7 years	\$ 5.83
	475	3.0 years	\$ 3.30

## 19 Share-based Compensation (continued)

**Deferred Share Units** – DSUs are granted to non-executive Directors of the Company as well as non-executive Directors, officers and employees of Jevco and are issued at the market value of the Company's shares at the date of grant. Directors may elect to receive DSUs in lieu of fees, which are issued at the market value of the Company's shares at the date of grant (prior to June 30, 2010 were issued at 90% of the market value). DSUs issued to officers and employees of Jevco vest as to one-third on the first anniversary, one-third on the second anniversary and one-third on the third anniversary of their date of grant. Vested DSUs are paid out in cash when the participant ceases to be a director, officer or employee.

Changes to the number of DSUs for the years ended December 31, 2011 and 2010 are as follows:

DSUs (thousands)	Year ended December 31	
	2011	2010
Outstanding at beginning of year	4,609	2,633
Granted	1,006	1,976
Exercised	(77)	–
Outstanding at end of year	5,538	4,609

No DSUs were exercised in the years ended December 31, 2011 and 2010. For the year ended December 31, 2011, compensation expense relating to DSUs was \$601 (2010 – \$1,056). At December 31, 2011, a liability of \$2,723 (December 31, 2010 - \$2,122, January 1, 2010 - \$1,066) has been accrued with respect to issued DSUs.

**Restricted Share Units** – RSUs granted vest over three years, one third on each of the one year, two year and three year anniversary of the grant date, and are payable in cash when vested. The holder may elect to apply all or part of such cash payment to a subscription for common shares of the Company.

Changes to the number of RSUs for the years ended December 31, 2011 and 2010 are as follows:

RSUs (thousands)	Year ended December 31	
	2011	2010
Outstanding at beginning of year	25,775	–
Granted	9,666	25,775
Exercised	(8,592)	–
Outstanding at end of year	26,849	25,775

In the year ended December 31, 2011, 9,665,709 RSUs (2010 - 25,775,225 RSUs) were granted and 8,591,741 RSUs were exercised with a cash payment of \$4,536. Compensation expense with respect to RSUs for the year ended December 31, 2011 was \$7,222 (2010 - \$5,530). At December 31, 2011, accounts payable and accrued liabilities included accrued expense related to these RSUs of \$8,216 (December 31, 2010 - \$5,530, January 1, 2010 - \$nil).

## 20 Related Party Transactions

### *Management services agreement*

In April 2009, the Company entered into a management services agreement ("MSA") with Goodwood to manage the day-to-day affairs of the Company and to present strategic investment opportunities for the Board of Directors to consider. Goodwood is required to provide certain services to the Company including the services of two directors, one of whom is also President and Chief Executive Officer, and a Chief Financial Officer. The MSA currently provides that Goodwood will be paid an annual service fee designed to compensate Goodwood for the time and attention of its officers and employees incurred in furtherance of the Company's business as well as for the office space, equipment, supplies and other facilities provided or made available by Goodwood to the Company. The amount of the services fee will be based on the latest report prepared by an independent compensation consultant. Goodwood will also be entitled to participate in an annual incentive bonus plan for the purpose of recognizing the contribution of Goodwood to the Company's business.

For the year ended December 31, 2011, Goodwood earned fees, inclusive of harmonized sales tax, of \$3,274 (2010 - \$1,920). At December 31, 2011, fees of \$226 (December 31, 2010 - \$212, January 1, 2010 - \$1,093) were included in accounts payable and accrued liabilities.

All RSUs outstanding at December 31, 2011 are held by Goodwood (note 19).

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20 Related Party Transactions (continued)

*Transactions with key management personnel*

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Company, directly or indirectly, including directors of the Company and its subsidiaries.

Compensation expenses related to key management personnel for the years ended December 31, 2011 and 2010 are as follows:

	Year ended December 31	
	2011	2010
Short-term employee benefits	\$ 2,864	\$ 1,569
Post-employment benefits	63	39
Share-based compensation	601	1,056
	<u>\$ 3,528</u>	<u>\$ 2,664</u>

The Company agreed to pay a related party, a company controlled by a member of key management personnel and his family, a transaction fee related to the Acquisition contingent upon the future financial performance of Jevco, to a maximum of \$1,121 over three years. The full amount of \$1,121 in respect of this agreement was accrued and reported as a cost of business acquisition in the statement of operations for the year ended December 31, 2010. At December 31, 2011, \$747 (December 31, 2010 - \$1,121, January 1, 2010 - \$nil) was included in accounts payable and accrued liabilities.

21 Discontinued Operations

Discontinued operations represent Nucryst's and iFire's operating results and cash flows for the years ended December 31, 2011 and 2010. There was no revenue, amortization, depreciation or income tax expense related to these discontinued operations in the years ended December 31, 2011 or 2010. At December 31, 2011, accounts payable and accrued liabilities included \$273 (December 31, 2010 - \$379, January 1, 2010 - \$5,703) related to discontinued operations.

Loss from discontinued operations of Nucryst for the year ended December 31, 2011 was \$170 (2010 - \$848). During the year ended December 31, 2011, Nucryst incurred lease expense of \$174 and total expenses of \$174 (2010 - lease expense of \$208 and total expenses of \$1,062) related to the wind up of its operations.

In November 2009, Nucryst entered into a purchase and sale agreement to sell all of its operations and assets. The sale transaction was completed effective December 22, 2009. In November 2009, the Company entered into an agreement with Nucryst under which Nucryst agreed to amalgamate with a newly-formed, wholly-owned subsidiary of the Company. Under the terms of the amalgamation, non-controlling common shareholders of Nucryst received redeemable preferred shares of the amalgamated company, Westaim Holdings Limited, which they subsequently redeemed. At January 1, 2010, the Company's ownership in Nucryst was 74.7% with the non-controlling interest holding 25.3% with a carrying value of \$8,584. Following the capital restructuring completed on February 8, 2010, Nucryst became wholly-owned by the Company.

Loss from discontinued operations of iFire for the year ended December 31, 2010 was \$142, primarily related to lease expense for the ongoing maintenance of a leased building. During 2010, the rental building lease and corresponding liability were transferred to Nucryst and during the fourth quarter of 2010, iFire was formally dissolved.

Earnings per share from discontinued operations for the year ended December 31, 2011 was \$nil (2010 - \$nil).

## 22 Earnings per Share

The Company uses the treasury stock method to calculate diluted earnings per share. Following the treasury stock method, the Company's earnings per share numerator for diluted earnings per share remains unchanged from the basic earnings per share calculation, as the assumed exercise of the Company's stock options and warrants does not result in an adjustment to income. The reconciliation of the number of weighted average common shares plus Series 1 Class A preferred shares used in the denominator to calculate diluted earnings per share is as follows:

Weighted average number of common shares and Series 1 Class A preferred shares (in thousands)	Year ended December 31	
	2011	2010
Basic earnings per share	646,774	511,762
Effect of dilutive securities		
- restricted share units	9,453	4,717
- warrants	649	1,206
- stock options	17	101
Diluted earnings per share	656,893	517,786

The Series 1 Class A preferred shares are considered in-substance common shares and are included in the calculation of the basic earnings per share.

Stock options to purchase 475,000 common shares were outstanding at December 31, 2011 (December 31, 2010 - 1,072,500) and warrants to purchase 10,000,000 Series 1 Class A preferred shares were outstanding at December 31, 2011 (December 31, 2010 - 10,000,000). Of the stock options outstanding at December 31, 2011, 447,800 (December 31, 2010 - 975,300) were excluded in the calculation of diluted earnings per share because the exercise price of the stock options was greater than the weighted average market value of the common shares in the year.

## 23 Capital Management

The Company's objectives when managing capital are:

- meeting regulatory requirements;
- maintaining a strong credit rating; and
- maximizing shareholder value.

In order to achieve the Company's capital management objectives, it employs a strong and efficient capital base and manages capital in accordance with policies established by the Board of Directors. These policies relate to capital strength, capital mix, dividends and return on capital. The Company has a capital management process in place to measure, deploy and monitor its available capital to assess its adequacy on a continuous basis.

Management develops the capital strategy and oversees the capital management processes. Capital is managed using both regulatory capital measures and internal metrics.

The Company's capital consists of its shareholders' equity. These funds are mainly invested in the equity of Jevco. Jevco is regulated by OSFI and is required to maintain a level of capital sufficient to support the volume and risk profile of Jevco's business. Generally, OSFI requires insurers to achieve a ratio of at least 150% of an MCT formula.

In connection with the Acquisition, the Company agreed with OSFI that it would maintain liquid and unencumbered assets within the holding company up to a maximum of \$20,000 and depending on Jevco's MCT ratio, this amount may not be required at all. At December 31, 2011, the MCT ratio of Jevco was 326% (December 31, 2010 - 321%) which eliminates the requirement to maintain the \$20,000 liquid and unencumbered assets within the holding company.



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24 Risk Management

By virtue of the nature of the insurance company business, financial instruments comprise the majority of the Company's statement of financial position at December 31, 2011. The most significant identified risks to the Company which arise from holding financial instruments include credit risk, market risk, liquidity risk and insurance underwriting risk. The market risk exposure of the Company is related to changes in interest rates and adverse movement in equity prices. The insurance underwriting risk of the Company is primarily related to pricing risk, concentration of risk and reserving risk. The Investment Committee of the Board of Jevco and senior management monitor the Company's risk exposures and activities that give rise to these exposures. The Appointed Actuary performs quarterly and annual analyses of the effect of various projected adverse scenarios on the financial condition of the Company which are compared to a base scenario using the Company's business plan. Management considers the results of these analyses in its risk management procedures. The Company has a comprehensive risk management framework to monitor, evaluate and manage the risks assumed in conducting its business.

Further details are provided below on the risk management objectives and policies as they relate to specific financial risks:

Credit risk

The Company is exposed to credit risk principally through its investments and balances recoverable from reinsurers. The Company monitors concentration and credit risk through policies to limit and monitor its exposure to individual issuers or related groups, with the exception of Canadian government bonds, as well as through ongoing review of the credit ratings of issuers held in the investment portfolio. The Company has policies to evaluate the financial condition of its reinsurers and monitors concentrations of credit risk arising from similar geographic regions, activities, or economic characteristics of the reinsurers to minimize its exposure to significant losses from reinsurer's insolvency.

The tables below summarize the Company's credit exposure from its investments in fixed income investments by DBRS Limited rating.

Available-for-sale fixed income portfolio (measured at fair value)

DBRS Limited rating	December 31, 2011		December 31, 2010		January 1, 2010	
AAA	\$ 359,155	44.7%	\$ 366,877	41.3%	\$ -	-
AA	257,502	32.0%	225,105	25.4%	-	-
A	166,658	20.7%	245,801	27.7%	-	-
BBB	18,456	2.3%	48,821	5.5%	-	-
Not rated	2,245	0.3%	1,302	0.1%	-	-
	\$ 804,016	100.0%	\$ 887,906	100.0%	\$ -	-

Held-to-maturity fixed income portfolio (measured at amortized cost)

DBRS Limited rating	December 31, 2011		December 31, 2010		January 1, 2010	
AAA	\$ 18,883	19.4%	\$ 18,950	19.3%	\$ -	-
AA	65,140	66.8%	65,768	66.9%	-	-
A	13,445	13.8%	13,579	13.8%	-	-
	\$ 97,468	100.0%	\$ 98,297	100.0%	\$ -	-

At December 31, 2011, 97.4% (2010 – 94.4%) of the Company's available-for-sale fixed income portfolio and 100.0% (2010 – 100.0%) of the held-to-maturity fixed income portfolio was rated "A" or better.

The table below summarizes the Company's credit exposure for amounts recoverable from reinsurers, by rating, as assigned by A.M. Best to the applicable reinsurers.

A.M. Best rating	December 31, 2011		December 31, 2010		January 1, 2010	
A++	\$ 180	0.5%	\$ 1,883	6.3%	\$ -	-
A+	9,723	28.6%	5,915	19.9%	-	-
A	22,884	67.4%	21,781	73.4%	-	-
B++	284	0.8%	47	0.2%	-	-
Not rated	899	2.7%	58	0.2%	-	-
	\$ 33,970	100.0%	\$ 29,684	100.0%	\$ -	-

## 24 Risk Management (continued)

### Interest rate risk

The Company is subject to risk exposure due to changes in interest rates. Because the investments are mainly comprised of fixed income securities, periodic changes in interest rates impact the financial results to the extent that reinvestment yields are different than the original yields on maturing securities. Also, during periods of rising interest rates, the market value of the existing fixed income securities will generally decrease and realized gains on fixed income securities will likely be reduced. The reverse is true during periods of declining interest rates. Offsetting the effect on assets, any change in interest rates has an impact on the market yield rate which is used for discounting unpaid claims and adjustment expenses.

The Company manages interest rate risk by monitoring the matching of the duration of the assets and liabilities. Duration is a measure used to estimate the extent market values of fixed income instruments change with changes in interest rates. Using this measure, it is estimated that:

- (i) An immediate hypothetical 100 basis point (1.0%) parallel increase in interest rates would decrease the fair value of the available-for-sale fixed income investments by approximately \$18,400 at December 31, 2011 (December 31, 2010 - \$21,500, January 1, 2010 - \$nil), representing 2.3% (December 31, 2010 - 2.4%) of the fair value of \$804,016 (December 31, 2010 - \$887,906) of the available-for-sale fixed income investments portfolio.
- (ii) An immediate hypothetical 100 basis point (1.0%) parallel decrease in interest rates would increase the carrying value of the net unpaid claims and adjustment expenses by approximately \$12,900 at December 31, 2011 (December 31, 2010 - \$13,800, January 1, 2010 - \$nil), representing 2.2% (December 31, 2010 - 2.2%) of the \$591,845 (December 31, 2010 - \$636,653) carrying value of the unpaid claims and adjustment expenses, net of amounts recoverable from reinsurers and other insurers.

Computation of the prospective effect of hypothetical interest rate changes is based on numerous assumptions, including maintenance of the existing level and composition of fixed income security assets at the indicated date, and should not be relied on as indicative of future results. The computation is based on the following assumptions:

- the fixed income investments in the Company's portfolio are not impaired;
- credit and liquidity risks have not been considered;
- interest rates and equity prices move independently; and
- shifts in the yield curve are parallel.

### Equity prices risk

The Company is exposed to general and specific equity risk through its preferred share and common share investments. General equity risk is the risk of price volatility due to changes in general economic or stock market conditions. Specific equity risk is the risk of price fluctuations due to entity specific characteristics.

Company management estimates that a 10% decrease in the prices of common and preferred shares held as at December 31, 2011 would have decreased other comprehensive income before tax by \$11,658 (December 31, 2010 - \$658, January 1, 2010 - \$nil). A 10% increase in the prices of common and preferred shares held would have increased other comprehensive income by a corresponding amount.

### Liquidity risk

Liquidity risk is the risk of having insufficient cash resources to meet current financial obligations without raising funds at unfavorable rates or selling assets on a forced basis. Liquidity risk arises from general business activities and in the course of managing assets and liabilities. There is risk of loss to the extent that the sale of a security prior to its maturity is required to provide liquidity to satisfy policyholder and other cash outflows. The purpose of liquidity management is to ensure that there is sufficient cash to meet all financial commitments and obligations as they fall due. Liquidity requirements are met primarily through funds generated from operations, asset maturities and income and other returns received on investments. Cash provided from these sources is used primarily for claims and claims adjustment expense payments and operating expenses. To meet these cash requirements, the Company has policies to limit and monitor its exposure to individual issuers or related groups and to ensure that assets and liabilities are broadly matched in terms of their duration and currency.

The following tables summarize the carrying values of financial instruments by contractual maturity or expected cash flow dates (the actual dates may differ from contractual maturity because certain securities and debentures have the right to call or prepay obligations with or without call or prepayment penalties):

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24 Risk Management (continued)

At December 31, 2011	Less than one year	One to five years	Five to ten years	More than ten years	No Specific Date	Total
Financial assets:						
Cash and cash equivalents	\$ 24,347	\$ -	\$ -	\$ -	\$ -	\$ 24,347
Investment income due and accrued	5,567	-	-	-	-	5,567
Investments available-for-sale	183,573	532,861	81,595	5,987	117,075	921,091
Investments held-to-maturity	-	-	97,468	-	-	97,468
Instalment premiums	62,781	-	-	-	-	62,781
Accounts receivable	27,454	-	-	-	-	27,454
Recoverable from reinsurers	11,659	18,884	2,989	438	-	33,970
Claims recoverable from other insurers	17,493	28,334	4,485	657	-	50,969
	\$ 332,874	\$ 580,079	\$ 186,537	\$ 7,082	\$ 117,075	\$ 1,223,647
Financial liabilities:						
Accounts payable and accrued liabilities	\$ 25,502	\$ 5,298	\$ -	\$ -	\$ 2,723	\$ 33,523
Unpaid claims and adjustment expenses	231,692	375,285	59,408	8,709	-	675,094
	\$ 257,194	\$ 380,583	\$ 59,408	\$ 8,709	\$ 2,723	\$ 708,617
At December 31, 2010						
Financial assets:						
Cash and cash equivalents	\$ 32,897	\$ -	\$ -	\$ -	\$ -	\$ 32,897
Investment income due and accrued	5,327	-	-	-	-	5,327
Investments available-for-sale	371,419	337,934	178,553	-	7,076	894,982
Investments held-to-maturity	-	-	98,297	-	-	98,297
Instalment premiums	65,104	-	-	-	-	65,104
Accounts receivable	26,505	-	-	-	-	26,505
Recoverable from reinsurers	9,888	16,564	3,081	151	-	29,684
Claims recoverable from other insurers	13,406	22,457	4,178	205	-	40,246
	\$ 524,546	\$ 376,955	\$ 284,109	\$ 356	\$ 7,076	\$ 1,193,042
Financial liabilities:						
Accounts payable and accrued liabilities	\$ 18,423	\$ 5,205	\$ -	\$ -	\$ 2,122	\$ 25,750
Unpaid claims and adjustment expenses	234,859	393,430	73,186	3,596	-	705,071
	\$ 253,282	\$ 398,635	\$ 73,186	\$ 3,596	\$ 2,122	\$ 730,821
At January 1, 2010						
Financial assets:						
Cash and cash equivalents	\$ 62,423	\$ -	\$ -	\$ -	\$ -	\$ 62,423
Investments held-for-trading	5,264	3,967	-	-	-	9,231
Accounts receivable	913	-	-	-	-	913
	\$ 68,600	\$ 3,967	\$ -	\$ -	\$ -	\$ 72,567
Financial liabilities:						
Accounts payable and accrued liabilities	\$ 7,123	\$ -	\$ -	\$ -	\$ 1,066	\$ 8,189

The liquidity of the Company's investment portfolio is sufficient to generate cash to meet short term operational needs that are not met through cash flows from operations.

The carrying value of the provision for unpaid claims and adjustment expenses is based on the present value of future cash flows with provisions for adverse deviation and is considered to be an indicator of fair value as there is no ready market for the trading of insurance policy liabilities. Similarly, the carrying values of claims recoverable from other insurers and recoverable from reinsurers are indicators of fair

## 24 Risk Management (continued)

value as they are calculated on the same basis as the provision for unpaid claims and adjustment expenses. The carrying value of all other financial instruments approximates their fair value due to the short term to maturity of those financial instruments.

The annual coupon rates for the fixed term investments range from 1.0% to 12.2% at December 31, 2011 (1.1% to 12.2% at December 31, 2010). The average effective book yield using amortized cost and the contractual interest rates, adjusted for any amortization of premiums and discounts at December 31, 2011 is 2.8% (December 31, 2010 - 2.8%).

### Insurance risk

Insurance risk is the risk that the total cost of claims and acquisition expenses will exceed premiums received and can arise from numerous factors. The Company has identified pricing risk, concentration of risk and reserving risk as its most significant sources of insurance risks. The Company's underwriting objective is to develop business within its target market on a prudent and diversified basis and to achieve profitable underwriting results.

### *Pricing risk*

Pricing risk arises when actual claims experience differs from the assumptions included in pricing calculations. Historically, the underwriting results of the property and casualty industry have fluctuated significantly due to the cyclicality of the insurance market. The market cycle is affected by the frequency and severity of claims, levels of capacity and demand, general economic conditions and price competition. The Company focuses on profitable underwriting using a combination of experienced underwriting staff, pricing models and price adequacy monitoring tools. The Company prices its products taking into account numerous factors including claims frequency and severity trends, product line expense ratios, special risk factors associated with the capital required to support the product line, and the investment income earned on that capital. The Company's pricing is designed to ensure an appropriate return on capital while also providing long-term rate stability. These factors are reviewed and adjusted periodically to ensure they reflect the current environment.

### *Concentration of risk*

The Company writes property and casualty insurance contracts generally over twelve-month durations. The most significant risks arise from natural disasters, climate change and other catastrophes. A concentration of risk may also arise from a single insurance contract issued to a particular demographic type of policyholder, within a geographical location or to types of commercial business. The relative variability of the outcome is mitigated if there is a large portfolio of similar risks. The Company's exposure to concentration of insurance risk is mitigated by a portfolio diversified across different geographic areas and lines of business. The Company has a reinsurance program to limit the exposure to catastrophic losses from any one catastrophe (note 7).

The Company has approximately 60% of its business in Ontario and is exposed to trends, social inflation, judicial changes and regulatory changes affecting this business. The geographical diversity by location of the underlying insurance risk is summarized below by reference to premiums written for the years ended December 31, 2011 and 2010:

	Year ended December 31, 2011			Year ended December 31, 2010		
	Direct	Ceded	Net	Direct	Ceded	Net
Ontario	\$ 220,013	\$ 9,753	\$ 210,260	\$ 174,372	\$ 11,263	\$ 163,109
Quebec	90,250	4,751	85,499	69,454	5,146	64,308
Alberta	30,062	1,145	28,917	22,959	1,364	21,595
Other	9,628	943	8,685	6,597	737	5,860
	\$ 349,953	\$ 16,592	\$ 333,361	\$ 273,382	\$ 18,510	\$ 254,872

The portfolio of insurance by personal and commercial lines is summarized below by reference to premiums written for the years ended December 31, 2011 and 2010:

	Year ended December 31, 2011			Year ended December 31, 2010		
	Direct	Ceded	Net	Direct	Ceded	Net
Personal lines	\$ 250,308	\$ 9,333	\$ 240,975	\$ 204,322	\$ 11,584	\$ 192,738
Commercial lines	99,645	7,259	92,386	69,060	6,926	62,134
	\$ 349,953	\$ 16,592	\$ 333,361	\$ 273,382	\$ 18,510	\$ 254,872

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24 Risk Management (continued)

*Reserving risk*

Reserving risk arises when actual ultimate paid claims and adjustment expenses are different from the estimated unpaid claims and adjustment expenses reserve. Reserving risk includes both the risk that reserves are too low with the result that not enough reserves are provided for the payment of claims, and the risk that reserves are too high because management is overly conservative in establishing reserves. Reserving patterns are the basis of the actuarial projection of future claims costs and inconsistent patterns can have a significant impact on the financial position of the Company. Reserve changes associated with claims of prior periods are recognized in the current period, which could have an impact on current year earnings. Claims data included in the reserving is used for product and reinsurance pricing; inaccurate reserving levels may cause delays in establishing proper pricing.

Sensitivity analyses

Risks associated with property and casualty insurance contracts are complex and subject to a number of variables which complicate quantitative sensitivity analysis. The Company considers that the liability for its unpaid claims and adjustment expenses recognized in the statement of financial position is adequate. However, actual experience will differ from the expected outcome.

Among all the lines of business, the non-standard automobile line of business in Ontario has the largest unpaid claims and adjustment expense liabilities. Given the nature of this line of business and the fact that it has a very long tail (meaning claims may take a long period of time to settle), the estimate of this line is the most critical to the assumptions used. If the tail factor selection on this line of business was 5% higher, the net unpaid claims and adjustment expense liabilities would be increased by approximately \$35,700. The net effect on net income and shareholders' equity would be a reduction of approximately \$25,700. If the expected loss ratios used in the calculation of the IBNR reserves were 5% higher in all accident years, the net unpaid claims and adjustment expense liabilities would be approximately \$6,100 higher, generating a net reduction in net income and shareholders' equity of approximately \$4,400. Changes in assumptions on other lines of business are considered to be less material.

Claims development tables

The following tables show the development of actual claims and adjustment expenses compared to the provisions for unpaid claims and adjustment expenses on a direct basis and a net of reinsurance recoverable basis.

Claims development – Direct:

	Accident year					Total December 31, 2011
	2007	2008	2009	2010	2011	
Estimates of ultimate claims and adjustment expenses as at:						
December 31, 2007	\$ 293,594					
December 31, 2008	298,017	\$ 334,040				
December 31, 2009	299,667	331,591	\$ 332,529			
December 31, 2010	298,751	325,375	328,792	\$ 252,560		
December 31, 2011	290,901	326,139	323,240	249,492	\$ 256,058	\$ 1,445,830
Direct cumulative claims and adjustment expense payments to:						
December 31, 2007	\$ 67,085					
December 31, 2008	114,736	\$ 87,041				
December 31, 2009	176,509	176,551	\$ 123,994			
December 31, 2010	206,365	209,125	186,346	\$ 90,990		
December 31, 2011	234,177	236,373	216,947	138,316	\$ 90,248	916,061
Provision for years 2007 to 2011						529,769
Provision for years prior to 2007						72,087
Unpaid claims and adjustment expenses, net of recoveries - undiscounted						601,856
Effect of discounting and provision for adverse development						22,269
Unpaid claims and adjustment expenses, net of recoveries from other insurers						624,125
Recoverable from other insurers						50,969
Unpaid claims and adjustment expenses (note 13)						\$675,094

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24 Risk Management (continued)

Claims development – Net of reinsurance recoverable:

	Accident year					Total December 31, 2011
	2007	2008	2009	2010	2011	
Estimates of net ultimate claims and adjustment expenses as at:						
December 31, 2007	\$ 247,821					
December 31, 2008	251,157	\$ 283,984				
December 31, 2009	253,500	283,006	\$ 301,526			
December 31, 2010	250,386	277,098	296,202	\$ 250,662		
December 31, 2011	242,686	277,413	290,070	245,489	\$249,938	\$ 1,305,596
Net cumulative claims and adjustment expense payments to:						
December 31, 2007	\$ 52,247					
December 31, 2008	88,460	\$ 69,226				
December 31, 2009	136,568	133,992	\$ 97,222			
December 31, 2010	166,383	163,921	158,357	\$ 90,948		
December 31, 2011	192,671	190,594	188,854	138,235	\$ 90,196	800,550
Provision for years 2007 to 2011						505,046
Provision for years prior to 2007						65,682
Unpaid claims and adjustment expenses, net of recoveries - undiscounted						570,728
Effect of discounting and provision for adverse development						21,117
Unpaid claims and adjustment expenses, net of reinsurance and recoveries from other insurers						591,845
Recoverable from other insurers						50,969
Net unpaid claims and adjustment expenses (note 13)						\$ 642,814

25 Operating Segment

The Company has one reportable segment which comprises the Company's property and casualty insurance business. All other includes corporate activities and the Company's discontinued operations. The accounting policies of the reportable segment are the same as the Company's accounting policies described in note 2. Segment net income represents segment net income without allocation of certain administration costs. The Company acquired the property and casualty insurance business on March 29, 2010 and commenced the consolidation of operations and comprehensive income beginning with the second quarter of 2010.

	Year ended December 31, 2011			Year ended December 31, 2010		
	Insurance segment	All other	Total	Insurance segment	All other	Total
Revenue	\$ 365,870	\$ 631	\$ 366,501	\$ 266,288	\$ 3,851	\$ 270,139
Underwriting expenses	311,478	-	311,478	230,678	-	230,678
Amortization and depreciation expense	3,249	-	3,249	2,011	-	2,011
Income tax expense (recovery)	14,191	(2,862)	11,329	10,750	(15,288)	(4,538)
Net income (loss)	37,910	(5,159)	32,751	22,898	31,225	54,123
Other comprehensive income	7,065	-	7,065	4,177	-	4,177
Comprehensive income (loss)	44,975	(5,159)	39,816	27,075	31,225	58,300

	December 31, 2011			December 31, 2010		
	Insurance segment	All other	Total	Insurance segment	All other	Total
Assets	\$ 1,279,524	\$ 16,609	\$ 1,296,133	\$ 1,257,460	\$ 12,966	\$ 1,270,426
Liabilities	863,903	14,967	878,870	880,605	12,497	893,102

# SHAREHOLDER INFORMATION

## BOARD OF DIRECTORS

### Ian W. Delaney<sup>3</sup>

Non-executive Chairman of the Board,  
The Westaim Corporation

Chairman, Sherritt International Corporation

### Brian Gibson<sup>2, 3</sup>

Senior Vice-President, Public Equities  
Alberta Investment Management Corporation

### John Gildner<sup>1, 2, 3</sup>

Independent Businessman

### J. Cameron MacDonald

President and Chief Executive Officer,  
The Westaim Corporation

President and Chief Executive Officer, Goodwood Inc.

### Daniel P. Owen<sup>1, 2, 3</sup>

Chairman and Chief Executive Officer, Molin Holdings  
Limited

Chairman, Heli-Lynx Helicopter Services Inc.

### Peter J. Puccetti

Chairman and Chief Investment Officer, Goodwood Inc.

### Bruce V. Walter<sup>1, 2, 3</sup>

Chairman, WW Mines Inc.

Vice Chairman, Centerra Gold Inc.

*Numbers indicate the individual's committee membership:*

- 1. Member of the Audit Committee*
- 2. Member of the Human Resources and Compensation Committee*
- 3. Member of the Corporate Governance Committee*

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**The Westaim Corporation Annual General Meeting of Shareholders** Wednesday May 16, 2012 9:00 a.m.

St. Andrew's Club & Conference Centre,  
27th Floor,  
150 King Street West, Toronto, Ontario

## CORPORATE INFORMATION

## STOCK INFORMATION

## TRANSFER AGENT

### J. Cameron MacDonald

President and Chief Executive Officer

### Jeffrey A. Sarfin

Chief Financial Officer

Traded on the Toronto Stock Exchange  
under the symbol **WED**

Shares issued and outstanding  
at December 31, 2011 were 580,343,960

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