COUNSEL

CORPORATION

# Management's Discussion and Analysis

# FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2014

**COUNSEL CORPORATION**
**MANAGEMENT'S DISCUSSION AND ANALYSIS**
**FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2014**
(All dollar amounts are in thousands of Canadian dollars, unless otherwise indicated)

## INTRODUCTION

This management's discussion and analysis ("MD&A") of the results of operations of Counsel Corporation ("Counsel" or "the Company") for the three and nine months ended September 30, 2014 and its financial condition as at September 30, 2014 is based on the Company's condensed consolidated interim financial statements prepared in accordance with accounting principles generally accepted in Canada ("Canadian GAAP"), which incorporate International Financial Reporting Standards ("IFRS"), and should be read in conjunction with the audited consolidated financial statements and the notes thereto. Additional information about the Company, including the Annual Information Form, can be found on www.sedar.com. The effective date of this MD&A is November 13, 2014. As of November 13, 2014 the Company had 99,358,448 common shares issued and outstanding.

### Forward-looking Information

*This MD&A contains certain forward-looking statements which are based on management's exercise of business judgment as well as assumptions made by, and information currently available to, management. When used in this document, the words "may", "will", "anticipate", "believe", "estimate", "expect", "intend" and words of similar import, are intended to identify any forward-looking statements. You should not place undue reliance on these forward-looking statements. These statements reflect our current view of future events and are subject to certain risks and uncertainties as outlined in the Company's Annual Information Form and other filings made with securities regulators, which are available on SEDAR (www.sedar.com). These factors include, without limitation: the timing of merger and acquisition activities, expansion opportunities, technological changes and changes to the business environment that may impact the Company, its investments, capital expenditures, and competitive factors which may impact revenue and operating costs. Any of these factors, amongst others, could cause actual results to vary materially from current results or from the Company's currently anticipated future results and financial condition. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, our actual results could differ materially from those anticipated in these forward-looking statements. We undertake no obligation, and do not intend, to update, revise or otherwise publicly release any revisions to these forward-looking statements to reflect events or circumstances after the date hereof, or to reflect the occurrence of any unanticipated events. Although we believe that our expectations are based on reasonable assumptions, we can give no assurance that our expectations will materialize.*

Certain comparative figures have been reclassified to conform to the current period financial statement presentation.

### Counsel Overview

Counsel Corporation is a financial services company operating in the residential mortgage lending business through its wholly owned subsidiary Street Capital Financial Corporation, one of the largest non-bank mortgage lenders in Canada. Founded in 1979 and a public company for more than a quarter century, Counsel's goal is to build consistently profitable, industry-leading financial services companies by investing in great leaders and providing them with the strategic guidance and financial resources they need to succeed.

**Presentation**

In the first quarter of 2013, Counsel's Board of Directors approved of a plan to dispose of the Company's non-core operating business segments. The decision reflects the Company's strategy, undertaken in recent years, to focus on financial services. The disposition plan involved:

- Counsel's subsidiary Heritage Global Inc. ("HGI") (formerly known as Counsel RB Capital Inc.) (OTCQB: HGBL; CSE:HGP), of which Counsel owned 73.3%; ("Asset Liquidation");
- Counsel's subsidiary Fleetwood Fine Furniture LP ("Fleetwood"), of which Counsel owned 71.2% ("Case Goods"); and,
- Counsel's real estate business segment ("Real Estate") including its interest in two properties that are under development and one investment property.

As a result, these entities' assets and liabilities were classified as held for sale as at December 31, 2013 and their operating results were classified separately as discontinued operations in all periods presented. As at the end of the first quarter of 2014, the Company had disposed of its interest in HGI via a dividend-in-kind declared on March 20, 2014. The Company had also disposed of its majority ownership stake in its Case Goods business and Real Estate through sales to third parties.

Counsel is also winding down its private equity business. Counsel's private equity business ("Private Equity") is carried on through its wholly-owned subsidiary, Knight's Bridge Capital Partners Inc. ("Knight's Bridge"), which is responsible for managing Counsel's portfolio investment opportunities. On March 7, 2008, Knight's Bridge closed the KBCP Fund I (the "Fund") with capital commitments in excess of $62,000, including $10,000 of capital committed by Counsel (at June 30, 2014, Counsel had invested approximately $8,300 in the Fund) and approximately $5,000 of capital committed by senior management, with the Fund having a term of ten years. For the first five years of the Fund, Knight's Bridge's mandate was to source new investment opportunities for the Fund. That five-year period expired in the first quarter of 2013 and Knight's Bridge can only invest remaining committed capital into existing investee companies of the Fund. Knight's Bridge earns a 2% fee on the Fund's invested capital and a 20% carried interest on an investment-by-investment basis after all investors have received their pro-rata share of contributed capital plus a preferred return of 8% per annum. Counsel controls and consolidates the Fund. As the business is winding down rather than held-for-sale, it is not classified as a discontinued operation.

**Significant Developments**

Significant developments in 2014:

- A special dividend-in-kind was declared on March 20, 2014, payable on April 30, 2014, to Counsel's shareholders of record as at April 1, 2014, in the amount of approximately 0.2084 shares of HGI for each Counsel share owned on the record date. The dividend comprised all 20,644,481 shares of HGI owned by the Company.

- In the first quarter of 2014, the Company sold its Case Goods business to an investor group led by the President of Fleetwood.

## CONSOLIDATED RESULTS OF OPERATIONS

The Company prepares its quarterly results of operations in accordance with Canadian generally accepted accounting principles as set out in the Handbook of the Chartered Professional Accountants (“CPA”) Canada Handbook (“CPA Handbook”). Accordingly the Company is reporting on this basis in its consolidated financial statements, including comparative figures for prior year quarters.

The following table sets out the Company's consolidated quarterly results of operations for the eight quarters ended September 30, 2014. The amounts have been re-stated to reflect the re-classification of the Asset Liquidation, Case Goods and Real Estate segments as discontinued operations.

| | 2012 Q4 $ | 2013 Q1 $ | 2013 Q2 $ | 2013 Q3 $ | 2013 Q4 $ | 2014 Q1 $ | 2014 Q2 $ | 2014 Q3 $ | Nine months ended September 30, 2013 $ | Nine months ended September 30, 2014 $ |
|---|---|---|---|---|---|---|---|---|---|---|
| **Revenue** | 26,392 | 25,692 | 46,440 | 38,473 | 28,394 | 29,836 | 36,062 | 42,336 | 110,605 | **108,234** |
| **Expenses** | | | | | | | | | | |
| Operating expenses | 18,105 | 17,637 | 29,464 | 24,520 | 15,407 | 15,654 | 20,748 | 25,197 | 71,621 | **61,599** |
| Selling, general and administrative expense | 7,653 | 5,490 | 9,463 | 9,049 | 6,900 | 8,111 | 8,782 | 8,959 | 24,002 | **25,852** |
| Foreign exchange (gain) loss | 49 | - | - | - | 105 | (353) | 9 | (45) | - | **(389)** |
| Depreciation and amortization | 334 | 333 | 330 | 344 | 327 | 294 | 322 | 331 | 1,007 | **947** |
| Interest expense | 562 | 571 | 540 | 447 | 384 | 365 | 344 | 270 | 1,558 | **979** |
| Other | - | - | - | - | (214) | - | - | - | - | **-** |
| **Income (loss) before fair value adjustments** | (311) | 1,661 | 6,643 | 4,113 | 5,485 | 5,765 | 5,857 | 7,624 | 12,417 | **19,246** |
| Fair value (appreciation) impairment | (2,935) | (1,867) | (2,901) | (159) | (4,813) | (3,099) | (6,420) | (8,028) | (4,927) | **(17,547)** |
| **Income (loss) before income tax, and discontinued operations** | 2,624 | 3,528 | 9,544 | 4,272 | 10,298 | 8,864 | 12,277 | 15,652 | 17,344 | **36,793** |
| Income tax provision (recovery) | (5,032) | 458 | 1,767 | 1,206 | 2,297 | 1,447 | 2,125 | 2,073 | 3,431 | **5,645** |
| **Income (loss) from continuing operations** | 7,656 | 3,070 | 7,777 | 3,066 | 8,001 | 7,417 | 10,152 | 13,579 | 13,913 | **31,148** |
| **Income (loss) from discontinued operations** | (6,856) | (1,332) | (1,468) | 307 | (6,156) | (11,782) | 169 | 11 | (2,493) | **(11,602)** |
| **Net income (loss) before non-controlling interest** | 800 | 1,738 | 6,309 | 3,373 | 1,845 | (4,365) | 10,321 | 13,590 | 11,420 | **19,546** |
| **Non-controlling interest** | (128) | (997) | (1,823) | 211 | (1,190) | (2,061) | (4,082) | (5,378) | (2,609) | **(11,521)** |
| **Net income (loss) attributable to shareholders** | 672 | 741 | 4,486 | 3,584 | 655 | (6,426) | 6,239 | 8,212 | 8,811 | **8,025** |
| **Weighted average number of common shares outstanding (in thousands) - basic** | | | | | | | | | 90,622 | **99,072** |
| **Basic net income (loss) per share from:** | | | | | | | | | | |
| Continuing operations | 0.06 | 0.02 | 0.06 | 0.03 | 0.05 | 0.07 | 0.06 | 0.08 | 0.11 | 0.21 |
| Discontinued operations | (0.05) | (0.01) | (0.01) | 0.01 | (0.05) | (0.13) | 0.00 | 0.00 | (0.01) | (0.13) |
| Basic net income (loss) per share | 0.01 | 0.01 | 0.05 | 0.04 | 0.00 | (0.06) | 0.06 | 0.08 | 0.10 | **0.08** |
| **Weighted average number of common shares outstanding (in thousands) - diluted** | | | | | | | | | 90,622 | **99,072** |
| **Diluted net income(loss) per share from:** | | | | | | | | | | |
| Continuing operations | 0.06 | 0.02 | 0.06 | 0.03 | 0.05 | 0.07 | 0.06 | 0.08 | 0.11 | 0.21 |
| Discontinued operations | (0.05) | (0.01) | (0.01) | 0.01 | (0.05) | (0.13) | 0.00 | 0.00 | (0.01) | (0.13) |
| Diluted net income(loss) per share | 0.01 | 0.01 | 0.05 | 0.04 | 0.00 | (0.06) | 0.06 | 0.08 | 0.10 | **0.08** |

### Three-Month Period ended September 30, 2014 Compared to Three-Month Period Ended September 30, 2013

**Revenues** were $42,336 for the three months ended September 30, 2014 compared to $38,473 for the three months ended September 30, 2013. The revenues were composed primarily of gains on the sale of mortgages sourced and underwritten by the Company’s Mortgage Lending business.

### Expenses, other income and losses:

**Operating expenses** were $25,197 for the three months ended September 30, 2014 compared to $24,520 for the three months ended September 30, 2013. These expenses represent the cost of acquiring the mortgages sold by the Mortgage Lending business.

**Selling, general and administrative ("SG&A") expense** was $8,959 in the three months ended September 30, 2014 compared to $9,049 during the same period of 2013. The SG&A expense primarily relates to SG&A expenses arising from the Mortgage Lending business.

**Foreign exchange gain or loss** was a gain of $45 in the third quarter of 2014 as compared to $nil in the same period of 2013. The foreign exchange gain or loss relates mainly to the conversion of U.S. dollar assets and liabilities and reflects the movement in the value of the Canadian dollar against the U.S. dollar.

**Depreciation and amortization expense** was $331 in the three months ended September 30, 2014 compared to $344 during the same period of 2013.

**Interest expense** was $270 in the third quarter of 2014 compared to $447 during the third quarter of 2013. The reduction in expenses between periods reflects the Company's reduced debt obligations.

The **fair value adjustments** in the three months ended September 30, 2014 resulted in an appreciation of $8,028 compared to an appreciation of $159 in the same period of 2013. The current period's adjustment relates primarily to the recognition of an increase in the fair value of the Company's Private Equity portfolio inclusive of foreign exchange fluctuations, partially offset by the accretion of interest on the contingent liability arising from the acquisition of the Mortgage Lending business.

**Income taxes:**

There was an income tax expense of $2,073 for the three months ended September 30, 2014, compared to an income tax expense of $1,206 for the same period in 2013. The expense relates primarily to deferred tax attributable to profits generated from the Company's Mortgage Lending activities.

The income tax expense (recovery) reflects an estimate of cash taxes expected to be paid (refunds to be received) in the current year, as well as a provision for changes arising during the year in the value of deferred tax assets and liabilities. The likelihood of recovering value from deferred tax assets such as loss carry-forwards, future tax depreciation of capital assets and other assets is assessed and recognized at each quarter-end. Material changes in income tax assets, liabilities, expense and recoveries may occur in the short term.

**Discontinued operations:**

In the third quarter of 2014, the Company recorded a gain of $11 from discontinued operations compared to a gainof $307 in the third quarter of 2013. The Company discontinued its Asset Liquidation, Case Goods and Real Estate segments in the first quarter of 2013. Earnings from each of the segments are reflected in discontinued operations. The Case Goods business and the last Real Estate property were sold to third parties in the first quarter of 2014 while the Asset Liquidation business was distributed to Counsel shareholders via a dividend-in-kind of all of the Company's shares of Heritage Global Inc. in the second quarter of 2014.

**Nine-Month Period ended September 30, 2014 Compared to Nine-Month Period Ended September 30, 2013**

**Revenues** were $108,234 for the nine months ended September 30, 2014 compared to $110,605 for the nine months ended September 30, 2013. The revenues were composed primarily of gains on the sale of mortgages sourced and underwritten by the Company's Mortgage Lending business. The revenue for the first three quarters of 2014 included a gain of approximately $4,000 from the extinguishment of a debt below its face value.

**Expenses, other income and losses:**

**Operating expenses** were $61,599 for the nine months ended September 30, 2014 compared to $71,621 for the nine months ended September 30, 2013. These expenses represent the cost of acquiring the mortgages sold by the Mortgage Lending business.

**Selling, general and administrative ("SG&A") expense** was $25,852 in the nine months ended September 30, 2014 compared to $24,002 during the same period of 2013. The increase in SG&A expense primarily relates to SG&A expenses arising from the Mortgage Lending business, which were partially offset by allocations to discontinued operations to reflect management's involvement with the disposition process.

**Foreign exchange gain or loss** was a gain of $389 in the first nine months of 2014 as compared to $nil in the same period of 2013. The foreign exchange gain or loss relates mainly to the conversion of U.S. dollar assets and liabilities and reflects the movement in the value of the Canadian dollar against the U.S. dollar.

**Depreciation and amortization expense** was $947 in the nine months ended September 30, 2014 compared to $1,007 during the same period of 2013.

**Interest expense** was $979 in the first nine months of 2014 compared to $1,558 during same period of 2013. The decrease reflects the conversion of the Company's convertible debentures, which were all converted during the first three quarters of 2013.

The **fair value adjustments** in the nine months ended September 30, 2014 resulted in an appreciation of $17,547 compared to an appreciation of $4,927 in the same period of 2013. The current period's adjustment relates primarily to the recognition of an increase in the fair value of the Company's Private Equity portfolio inclusive of foreign exchange fluctuations, partially offset by the accretion of interest on the contingent liability arising from the acquisition of the Mortgage Lending business.

**Income taxes:**

There was an income tax expense of $5,645 for the nine months ended September 30, 2014, compared to an income tax expense of $3,431 for the same period in 2013. The expense relates primarily to deferred tax attributable to profits generated from the Company's Mortgage Lending activities as well as gains realized on the disposition of the Company's Case Goods business.

The income tax expense (recovery) reflects an estimate of cash taxes expected to be paid (refunds to be received) in the current year, as well as a provision for changes arising during the year in the value of deferred tax assets and liabilities. The likelihood of recovering value from deferred tax assets such as loss carry-forwards, future tax depreciation of capital assets and other assets is assessed and recognized at each quarter-end. Material changes in income tax assets, liabilities, expense and recoveries may occur in the short term.

**Discontinued operations:**

In the first nine months of 2014, the Company recorded a loss of $11,521 from discontinued operations compared to a loss of $2,609 in the same period of 2013. The Company discontinued its Asset Liquidation, Case Goods and Real Estate segments in the first quarter of 2013. Earnings from each of the segments are reflected in discontinued operations. The Case Goods business and the last Real Estate property were sold to third parties in the first quarter of 2014 while the Asset Liquidation business was distributed to Counsel shareholders via a dividend-in-kind of all of the Company's shares of Heritage Global Inc. in the second quarter of 2014. In the first nine months of 2014, a fair value impairment of approximately $13,000 was recorded with respect to the Company's investment in Heritage Global Inc.

**RESIDENTIAL MORTGAGE LENDING**

## Overview

Counsel carries on its residential mortgage lending business ("Mortgage Lending") through its subsidiary Street Capital Financial Corporation ("Street Capital"), which was acquired on May 31, 2011. Street Capital was founded by its current senior management team, all of whom have deep experience in the mortgage and consumer lending industry and previously occupied senior management positions at large Canadian financial institutions.

Street Capital is a Canadian residential mortgage lender that provides residential mortgage financing in all provinces of Canada, with the current exception of Quebec, and sells the mortgages that it underwrites to top-tier financial institutions. Over Street Capital's approximately six years of operations, it has successfully built a broad network of brokers and established stringent underwriting and due diligence processes, while maintaining a focus on customer service.

Street Capital sources its mortgages solely through its network of independent, high quality mortgage brokers, which it continues to develop and expand. Mortgage brokers are an important distribution channel in Canada, capturing almost half of first time homebuyers and 40% of repeat buyers, according to the 2014 Mortgage Consumer Survey by the Canada Mortgage and Housing Corporation ("CMHC"), the Government of Canada's national housing agency. Street Capital targets selective high opportunity broker teams based on a variety of factors, including the volume and quality of mortgages they source. Street Capital incentivizes these brokers to direct business to the company by providing fast and efficient service and support, a broad suite of products, competitive pricing, tiered loyalty programs and discounts. Street Capital, unlike many of its competitors, does not compete with brokers by having its own branch network. By avoiding branch network costs, Street Capital is able to pass the associated savings on to the borrower. Since launching operations in 2008, Street Capital has grown rapidly to become a leader in the mortgage broker market based on funded volume, according to reported industry statistics.

Street Capital offers a broad lineup of high ratio and conventional mortgages at competitive interest rates. Its primary business is originating prime insurable mortgages. In April 2012, Street Capital entered the near prime segment of the mortgage market, with the introduction of its Street Options Program. Near prime is a segment of the mortgage credit market just below prime, which is comprised of borrowers who are unable to find financing through traditional sources. Management believes this market segment is underserved and offers potentially higher profit margins. Street Capital's strategy is to prudently expand this business over time, but its prime business is expected to account for the vast majority of mortgages originated for the foreseeable future.

Street Capital sells the mortgages it originates to financial institutions at the time of placement for a cash premium, and, in some cases, an excess interest rate spread over the remaining life of the mortgage. By not accumulating, or warehousing, mortgages for a period of time prior to sale, Street Capital mitigates interest rate risk. Selling the mortgages also transfers substantially all the risks of ownership to the investor and/or party insuring the mortgage. However, Street Capital has established stringent underwriting and robust quality assurance processes in order to minimize credit risk and thereby ensure the maintenance of a strong wholesale demand for its mortgages from institutional clients. This has resulted in a high quality portfolio of mortgages under administration.

Although Street Capital outsources servicing of the related mortgages to a third party, it administers and remains the face of all direct communication with borrowers throughout the mortgage term. This relationship promotes renewals, and is a key part of the long term growth, profitability and recognition of the Street Capital brand.

Renewals are of particular importance, since the acquisition cost of renewed mortgages is significantly reduced due to minimal broker, marketing, underwriting and other related expenses. Street Capital's targeted renewal rate for mortgages it has originated is approximately 80 per cent, in line with the industry norm. Street Capital's operations began in early 2008 and the bulk of mortgages originated have a five-year term. Therefore, the company expects renewals to grow as the company's portfolio of mortgages under administration matures.

**Growth Strategy**

Street Capital's growth strategy is focused on both increasing the volume of mortgages it originates and its assets under management, and improving its profit margins. To increase volume, the company intends to expand into new regions in order to expand its network of high quality, high volume brokers, and to increase the number of mortgages originated through its existing broker network. To improve profit margins, the company initially broadened its product line in 2012 into higher margin near prime mortgages. In addition, it expects to achieve higher margins as mortgage renewals become a greater part of its mix of business.

In May 2013, Street Capital received approvals from CMHC to be an approved issuer of National Housing Act mortgage backed securities ("NHA MBS") and an approved seller under the Canada Mortgage Bonds ("CMB") program. This will enable the company's mortgages to be pooled into securities designated for sale to Canada Housing Trust under the CMB program. This ability to securitize mortgages, on a limited scale, provides Street Capital with a secondary source of funding and one that can be more profitable than selling mortgages to investors.

In September 2012, Street Capital announced its intention to apply to Canada's Minister of Finance for approval to operate as a federally regulated Schedule I bank, with its banking business primarily focused on residential mortgage lending, as well as on other consumer lending and related services. The application was filed in December 2012. Street Capital remains committed to the mortgage broker channel and intends to continue to operate through this channel, but a bank license would enable Street Capital to broaden its product line into other forms of consumer lending and related services, thereby increasing the company's value proposition to brokers and retail customers. The company anticipates the application process will take an extended period of time, likely at least two years. While Street Capital believes it has the appropriate structure, leadership, maturity and scale to undertake this application process, there is no assurance the application will receive approval. However, in the absence of receiving such approval, the company is confident it can continue to grow its mortgage business under its current business model.

**Results of Operations**

Over the past five years, Street Capital has experienced a steady growth in mortgages originated and sold. The total mortgages sold in the first nine months of 2014 were $5.6 billion, while for the nine months ending September 30, 2013 they were $6.3 billion, placing the company among the top mortgage underwriters within the broker channel in Canada.

A key measure of success is the growth in Street Capital's portfolio of mortgages under administration. The company ended the first nine months of 2014 with $20.4 billion in mortgages under administration compared to $16.7 billion at September 30, 2013 and $17.5 billion at December 31, 2013.

The following schedule sets out the growth in mortgages under administration and the quarterly mortgage sales in billions over the eight quarters ended September 30, 2014

| | At Dec 31, 2012 $ | At Mar 31, 2013 $ | At Jun 30, 2013 $ | At Sep 30, 2013 $ | At Dec 31, 2013 $ | At Mar 31, 2014 $ | At Jun 30, 2014 $ | At Sep 30, 2014 $ |
|---|---|---|---|---|---|---|---|---|
| Mortgages under administration ($billions) | 12.0 | 13.3 | 15.0 | 16.7 | 17.5 | 18.2 | 19.3 | 20.4 |

| | 2012 Q4 $ | 2013 Q1 $ | 2013 Q2 $ | 2013 Q3 $ | 2013 Q4 $ | 2014 Q1 $ | 2014 Q2 $ | 2014 Q3 $ |
|---|---|---|---|---|---|---|---|---|
| Mortgages sold ($billions) | 1.6 | 1.6 | 2.5 | 2.3 | 1.4 | 1.4 | 1.9 | 2.3 |

**Mortgage Lending revenue** was $102,848 for the nine months ending September 30, 2014 compared to $110,022 for the same period ending September 30, 2013, and is comprised of the gain on sales of mortgages underwritten by Street Capital. The gain on sale decreased on a year to date basis reflecting lower mortgage sales compared to the same period in the prior year.

**Mortgage Lending operating expense** was $61,599 for the nine months ended September 30, 2014 compared to $71,621 for the same period ended September 30, 2013. Mortgage lending operating expense consists of the cost to source mortgages sold by Street Capital, and reflects the sales volume.

## CAPITAL RESOURCES AND LIQUIDITY

### Summary of Consolidated Statement of Financial Position Data

| | December 31, 2012 $ | December 31, 2013 $ | September 30, 2014 $ |
|---|---|---|---|
| Total assets | 247,616 | 258,203 | 225,787 |
| Working capital | (6,815) | (5,000) | 5,450 |
| Long-term financial liabilities | 41,623 | 20,604 | 28,032 |
| Dividends declared | 0.022 / share (i) | - | 0.167 / share (ii) |

(i) Approximate value of dividend- in- kind of approximately 0.0719 shares of Terra Firma.
(ii) Approximate value of dividend-in-kind of approximately 0.2084 shares of HGI.

### Working capital

The Company's working capital increased by $10,450 in the first nine months of 2014. The main contributor to the increase was the disposition of the Company's discontinued operations during the first quarter of 2014 and increased current receivables arising from the growth in the business.

### Sources of funding

The Company had $17,298 in cash and cash equivalents at September 30, 2014 (December 31, 2013 - $17,580). This includes approximately $12,133 of restricted cash representing funds held in trust by our Mortgage Lending business for the purposes of funding third party mortgage loans and repayments collected on behalf of third party investors via a third party service provider.

The primary sources of funds in the first nine months of 2014 were distributions from portfolio investments and new bank and other financings, as well as income from our Mortgage Lending business.

**Uses of funding**

During the first nine months of 2014, funds were principally used to make mortgage and loan payments and for regular operations of the business.

**Dividends**

In March 2014 Counsel declared a special dividend-in-kind of the Company's entire holding of 20.6 million shares of HGI. The special dividend was paid on April 30, 2014 to shareholders of record as at April 1, 2014. Holders of the Company's common shares received approximately 0.2084 HGI shares for each Counsel share owned on the record date.

**Acquisition of securities**

There were no securities acquisitions in 2011, 2012, 2013 or in the first nine months of 2014.

**Convertible debentures**

Counsel partially financed the acquisition of Street Capital on May 31, 2011 by a non-brokered private placement of 8%, convertible unsecured subordinated debentures (the "Debentures") for gross proceeds of $12,000. The Debentures were due on May 31, 2014 and were originally convertible at $1.25 per common share; however, as a result of the payment of a special dividend in kind on January 1, 2013, the conversion rate was reduced to $1.2264 per common share. As at the end of the third quarter of 2013, the entire $12,000 of the debentures had been converted to 9,784,735 common shares.

**Contingencies**

The Company, from time to time, is involved in various claims, legal and tax proceedings and complaints arising in the ordinary course of business. The Company is not aware of any pending or threatened proceedings that would have a material adverse effect on the consolidated financial condition or future results of the Company.

## CRITICAL ACCOUNTING ESTIMATES

This MD&A discusses the Company's consolidated financial statements, which have been prepared in accordance with International Financial Reporting Standards ("IFRS"). The preparation of these financial statements requires the use of estimates, assumptions and judgments that in some cases relate to matters that are inherently uncertain, and which affect the amounts reported as assets, liabilities, revenue and expense in the consolidated financial statements and accompanying notes. Key areas of such estimation are: re-measurement at fair value of financial instruments, valuations of receivables (i.e. duration factors on deferred interest receivable) and inventories, impairment of property, plant and equipment, portfolio investments, intangibles and goodwill, provisions, accounting accruals, the useful life and residual value of certain assets, accounting for deferred income taxes, and allowance for credit losses. Allowance for credit losses represent management's best estimate of losses incurred in our loan portfolio at the date of the statement of financial position and requires management's judgment in making assumptions and estimations. The determination of the Company's deferred tax asset or liability requires significant management judgment as the recognition is dependent on management's projection of future taxable profits and tax rates expected to be in effect in the period in which the asset is realized or the liability settled.

The classification, presentation and measurement of discontinued operations also involves significant estimates, assumptions and judgments. Changes to estimates and assumptions may affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements, as well as the reported amounts of revenue and expense during the reporting period. Actual results could also differ from those estimates under different assumptions and conditions.

The fair values of portfolio investments that are not quoted in an active market are determined by using valuation techniques, primarily earnings multiples, discounted cash flows and recent comparable transactions. The inputs in the earnings multiples models include observable data, such as earnings multiples of companies that are comparable to the relevant portfolio company, and unobservable data, such as forecast earnings for the portfolio company. In discounted cash flow models, unobservable inputs are the projected cash flows of the relevant portfolio company and the risk premiums for liquidity and credit risk that are incorporated into the discount rate.

Critical judgments include the determination of cash generating units ("CGUs") and the allocation of certain costs among the CGUs, and the determination of depreciation and amortization periods for property, plant and equipment and intangible assets.

## SUMMARY OF ACCOUNTING POLICIES

This MD&A should be read in conjunction with the Company's consolidated financial statements and notes. To aid in the understanding of the Company's financial reporting, some of its accounting policies are described below. These policies have the potential to significantly impact the Company's financial statements, either because of the significance of the financial statement item to which they relate, or because they require judgment and estimation due to the uncertainty involved in measuring, at a specific point in time, events which are continuous in nature.

### Basis of preparation

The Company prepares its financial statements in accordance with Canadian generally accepted accounting principles as set out in the Handbook of the Chartered Professional Accountants ("CPA") Canada Handbook ("CPA Handbook"). The condensed consolidated interim financial statements have been prepared in accordance with IAS 34 – Interim financial Reporting under International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and using the accounting policies the Company applied in its consolidated financial statements as of and for the year ended December 31, 2013 except for the adoption of new standards and amendments effective January 1, 2014 described in Note 3 of the condensed consolidated interim financial statements. The accounting policies the Company applied in its annual consolidated financial statements as of and for the year ended December 31, 2013, are disclosed in Note 3 of such financial statements, to which reference should be made in reading the condensed consolidated interim financial statements.

The condensed consolidated interim financial statements are presented in Canadian dollars, except when otherwise indicated.

### Consolidation

These consolidated financial statements include the accounts of the Company and its consolidated subsidiaries, which are entities over which the Company has control. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefit from its activities. Furthermore, effective January 1, 2013, IFRS 10 requires the consolidation of an investee only if the investor possesses power over the investee, has exposure to variable returns from its investment with the investee and has the ability to use its power over the investee to affect its returns. Non-controlling interests in the equity and results of the Company's subsidiaries are shown separately in the consolidated statement of changes in equity. Intercompany balances and transactions among the Company and its subsidiaries are eliminated on consolidation.

The Company's principal subsidiaries comprising continuing and discontinued operations and its respective ownership interest in each subsidiary as at September 30, 2014 and December 31, 2013 are as follows:

| | September 30, 2014 % | December 31, 2013 % |
|---|---|---|
| Street Capital Financial Corporation | 100.0 | 100.0 |
| Knight's Bridge Capital Partners Inc. | 100.0 | 100.0 |
| Heritage Global Inc. ("HGI")* (i) | - | 73.3 |
| Fleetwood Fine Furniture LP ("Fleetwood")* (i) | - | 71.2 |

**Business units reclassified as discontinued operations in the first quarter of 2013*

(i) As of March 31, 2014, the Company disposed of its interests in both HGI and Fleetwood via a dividend-in-kind and sale of majority interest, respectively.

**Securitized mortgages and securitization liabilities**

The Company securitizes insured residential mortgages through the Government of Canada's National Housing Act ("NHA") Mortgage Backed Securities ("MBS") program, which is facilitated by Canada Mortgage and Housing Corporation ("CMHC"). The Company securitizes the mortgages through the creation of MBS and the ultimate sale of MBS to either third party investors or through the CMB program.

Sales of MBS that do not qualify for de-recognition result in the related mortgages being classified as mortgages receivable – securitized financing on the consolidated statements of financial position, which are accounted for at amortized cost, plus accrued interest, and are reported net of unamortized origination fees, commitment income and premiums or discounts. Net fees and any premium or discount relating to mortgage origination are amortized to income on an effective yield basis over the term of the mortgages to which they relate, and are included in interest income in the consolidated statements of operations.

In addition, these transactions are considered secured financing and result in the recognition of securitization liabilities. Securitization liabilities are recorded at amortized cost, plus accrued interest, and are reported net of any unamortized premiums or discounts and transaction costs incurred in obtaining the secured financing. Interest expense is allocated over the expected term of borrowing by applying the effective interest rate to the carrying amount of the liability.

**Gains on securitization**

When an asset is derecognized, the related mortgages are removed from the consolidated statement of financial position and a gain or loss is recognized in the consolidated statement of operations.

**Future accounting changes**

**Financial Instruments** – The IASB has issued a new standard, IFRS 9 Financial Instruments, which will ultimately replace IAS 39, Financial Instruments: Recognition and Measurement. On February 25, 2014, the IASB tentatively decided to require an entity to apply IFRS 9 for annual periods beginning on or after January 1, 2018. The Company has yet to assess the impact of the new standard on its results of operations, financial position and disclosures.

**Revenue from contracts with customers** - The Company will be required to adopt IFRS 15, *Revenue from Contracts with Customers* (IFRS 15), which provides a single principle-based framework that applies to contracts with customers, for annual periods beginning on or after January 1, 2017. Management is currently evaluating the potential impact that the adoption of IFRS 15 will have on the Company's consolidated financial statements.

**Recently adopted accounting standards and amendments**

**Financial instruments: Presentation** - Amendment to IAS 32, Financial Instruments: Presentation on asset and liability offsetting clarifies some of the requirements for offsetting financial assets and financial liabilities on the statement of financial position. The amendment to this standard is effective for annual periods beginning on or after January 1, 2014. The adoption of this amendment did not have a significant impact on the Company's results of operations, financial position and disclosures.

**Impairment of assets** - Amendment to IAS 36, Impairment of Assets establishes the disclosure of information about the recoverable amount of impaired assets if that amount is based on fair value less cost of disposal. The amendment to this standard is effective for annual periods beginning on or after January 1, 2014. The adoption of this amendment did not have a significant impact on the Company's results of operations, financial position and disclosures.

## DISCLOSURE CONTROLS AND PROCEDURES

Counsel's Chief Executive Officer and Chief Financial Officer are responsible for establishing and maintaining the Company's disclosure controls and procedures. The Company's disclosure controls and procedures are designed to provide reasonable assurance that information required to be disclosed by the Company is recorded, processed, summarized and reported within the time periods specified under Canadian securities laws, and include controls and procedures that are designed to ensure that information is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure. As of the end of the period covered by this MD&A, the Company's Chief Executive Officer and the Chief Financial Officer evaluated the Company's disclosure controls and procedures and, based upon that review and evaluation, concluded that those disclosure controls and procedures are effective.

## INTERNAL CONTROL OVER FINANCIAL REPORTING

Counsel's management is responsible for establishing and maintaining adequate internal control over financial reporting ("ICFR") to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS. The control framework used to design Counsel's ICFR is based on *"Internal Control over Financial Reporting – Guidance for Smaller Public Companies*" published by COSO.

Based on the results of testing and evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this report, the Company's ICFR was effective to provide reasonable assurance that the information required to be disclosed in the Company's reports and regulatory filings does not contain any material misstatements.

There were no changes to ICFR during the period ended September 30, 2014 that have materially affected, or are expected to have a material effect on, the Company's financial reporting.