Court File No.: CV-15-530726

ONTARIO
SUPERIOR COURT OF JUSTICE

BETWEEN:

THE CATALYST CAPITAL GROUP INC. and
CALLIDUS CAPITAL CORPORATION

Plaintiffs

- and -

VERITAS INVESTMENT RESEARCH CORPORATION and
WEST FACE CAPITAL INC.

Defendants

STATEMENT OF DEFENCE OF THE DEFENDANT WEST FACE CAPITAL INC.

1. The Defendant West Face Capital Inc. admits the allegations contained in paragraphs 5, 8, 17, 18, and 21 of the Plaintiffs' Statement of Claim.

2. West Face denies all other allegations made in the Claim, except as expressly admitted below.

Overview

3. The Plaintiff, Callidus Capital Corporation, is a distressed lender that prior to April 2014 was wholly-owned by investment funds managed by the other Plaintiff, The Catalyst Capital Group Inc. After Catalyst made an initial public offering of approximately 40% of Callidus's shares in April 2014, Callidus's share price rose over 50% in the following months. Both before and after the IPO, Callidus made numerous representations of robust growth and performance of its loan book. Callidus's market capitalization was by late October 2014 over 2.5 times higher than the disclosed book value of its loans, which could only be justified economically if (a) the loans were all performing, and (b) Callidus could continue to grow its loan book without incurring higher repayment risk or lower interest rates.

4. The Defendant, West Face, is an investment management firm that was skeptical of Callidus's elevated share price for a host of reasons. In late October 2014, West Face was skeptical that Callidus's share price was sustainable and so decided to "short" Callidus. Short-selling is an investment strategy premised on a belief that the shares' price will decline. West Face then conducted further research in order to determine whether to expand or contract its short position in Callidus.

5. Through this research, West Face was able to identify a number of Callidus's past and present borrowers. Contrary to Callidus's public claims not to have any non-performing loans, West Face determined that a number of the loans were not current in their payments of interest and/or principal amounts owing. A number of loans also did not appear to be adequately collateralized. In other words, some of Callidus's loans exceeded the value of the collateral securing them. In addition, in numerous instances Callidus had acquired its borrowers in exchange for the debt owing to Callidus when a sales process initiated following a default by the borrower failed to generate sufficient funds to repay the debt owing to Callidus. West Face also saw no reason to believe that Callidus could continue to grow its loan book without suffering deterioration in either the quality or yield of its loans. West Face therefore expanded its short position.

6. West Face did not publish its research on Callidus, as alleged by the Plaintiffs. It did meet with the other Defendant, Veritas Investment Research Corporation, an independent market research firm. At this meeting, a number of investment research topics were discussed. During the course of the meeting, West Face suggested to Veritas that Callidus might be an appropriate issuer for Veritas to conduct research on. After that meeting, West Face also gave Veritas a list of the Callidus borrowers that West Face had identified through its research of public sources, but did not give Veritas West Face's own internal research. West Face and Veritas had no agreement that Veritas would do any research, let alone what the results of any Veritas research might be. Veritas independently performed its own research on Callidus, and ultimately reached very similar conclusions to those reached by West Face.

7. This action has no merit for at least three reasons. First, West Face never provided a copy of its research analysis on Callidus to Veritas as alleged. Second, West Face's research contained only true statements, or fair comment on those true statements. Indeed, Veritas's independent research reached the same conclusions. Third, West Face and Veritas never conspired. West Face shared with Veritas the idea of examining Callidus in detail, but had no influence on whether Veritas would do its own research, its conclusions if it did, or what Veritas chose to publish to the broader market. This action should be dismissed with costs on a substantial indemnity basis in light of the serious but unfounded allegations of misconduct.

The Parties

8. The Plaintiffs are The Catalyst Capital Group Inc. ("**Catalyst**") and Callidus Capital Corporation ("**Callidus**"). Callidus is majority-owned by funds managed by Catalyst. Newton Glassman is the Chief Executive Officer of both companies.

9. Catalyst is a private equity investment fund manager. It specializes in control and/or influence investments in distressed and undervalued Canadian companies.

10. Callidus is a publicly-traded company listed on the Toronto Stock Exchange under the symbol “CBL”. Callidus went public in April 2014 following an initial public offering. Callidus provides financing to distressed, and typically private, companies that are unable to obtain adequate financing from the capital markets or through conventional lending institutions. Until its IPO, Callidus had been wholly-owned by funds managed by Catalyst. Since its IPO, Catalyst's funds have continued to own approximately 60% of Callidus's outstanding common shares.

11. West Face is an investment management firm. As part of its business, West Face monitors and researches potential investments for the funds that it manages, including potential investments in publicly-traded entities like Callidus. West Face is led by its four Partners, who have, on average, over twenty years of experience in the financial industry.

12. Veritas is Canada's leading independent equity research company. Veritas provides information and advice to help its clients make investment decisions. It is not affiliated with any investment firms or dealers, and does not accept compensation from the companies it chooses to research. It does not sell securities and has no proprietary investments or underwriting operations, and is therefore able to provide conflict-free research (unlike, for example, research analysts who work for investment banks with securities underwriting and corporate advisory operations). Veritas's success depends on its reputation for providing reliable and accurate analysis to its clients.

Catalyst's Animus Towards West Face

13. The Plaintiffs alleged in their Statement of Claim that Catalyst's then-ongoing lawsuit against West Face gave West Face motive to defame, conspire against, and interfere with the Plaintiffs. These allegations are categorically false.

14. West Face's research into Callidus had nothing to do with Catalyst's lawsuit against West Face, and in fact West Face had been following Callidus since before Callidus's IPO, which occurred months before any litigation with Catalyst had arisen. West Face has a fiduciary duty to its clients to invest their funds wisely. West Face researched Callidus as an investment target, and not for any other reason. The end result of West Face's research represented West Face's best understanding of Callidus's underlying strengths and weaknesses. If Callidus's lofty share price in October 2014 had been justified by its underlying loan book and financial fundamentals, West Face's shorting of the stock would have accomplished nothing but lose money. West Face's short sale succeeded because ultimately the market concluded that Callidus was over-valued and Callidus's share price fell.

15. In fact, Catalyst's previous lawsuit against West Face was dismissed in its entirety by Justice Newbould following a trial in June 2016. It was Catalyst, not West Face, who persisted in a series of fruitless proceedings against West Face. To summarize these as briefly as possible:

(a) In May 2014, West Face extended a job offer to Brandon Moyse, who was at that time working at Catalyst as an analyst. Mr. Moyse accepted this offer and tendered his resignation to Catalyst.

(b) In June 2014, Catalyst sued West Face and Mr. Moyse to enforce the confidentiality and non-compete provisions in Mr. Moyse's employment contract with Catalyst (the "**Moyse Action**").

(c) In July 2014, Catalyst obtained, on consent, an interim order prohibiting Mr. Moyse from continuing to work at West Face. This injunction was ultimately extended to December 2014. Mr. Moyse was also required to turn over his electronic devices for imaging and review by an Independent Supervising Solicitor (an "**ISS**").

(d) In October 2014, Catalyst amended its claim in the Moyse Action to assert a claim for damages in respect of West Face's participation in a consortium that acquired WIND Mobile in September 2014. Catalyst further amended its claim in December 2014 to assert a constructive trust over West Face's interest in WIND.

(e) In January 2015, before even receiving the ISS's report of its review of Mr. Moyse's electronic records, Catalyst initiated a motion for, among other things: (i) an interlocutory injunction restraining West Face from participating in the management and/or strategic direction of WIND Mobile; and (ii) an order authorizing the ISS to forensically image and review all of West Face's electronic records, for the stated purpose of determining **whether** West Face had obtained and misused any confidential information of Catalyst from Mr. Moyse. Among other things, Catalyst alleged that West Face had received confidential information about Callidus from Mr. Moyse.

(f) In February 2015, Catalyst amended its motion to seek a finding of contempt and a committal to prison of Mr. Moyse for allegedly deleting computer records contrary to the earlier interim consent order.

(g) Catalyst's motions were heard by Justice Glustein on July 2, 2015. On July 7, His Honour dismissed Catalyst's motion in its entirety, and later awarded West Face costs of $90,000, and Mr. Moyse costs of $70,000. Justice Glustein's reasons are reported at 2015 ONSC 4588.

(h) Catalyst then sought to appeal Justice Glustein's Order directly to the Court of Appeal, over the immediate objections of West Face and Mr. Moyse that the proper appeal route was to the Divisional Court, and then only with leave. West Face and Mr. Moyse were forced to bring motions to quash Catalyst's appeal.

(i) Catalyst ultimately abandoned its appeal to the Court of Appeal as against West Face and consented to West Face's motion to quash. Mr. Moyse's motion to quash was granted by the Court of Appeal.

(j) Catalyst then brought combined motions to the Divisional Court for: (i) an extension of time to seek leave to appeal from the Order of Justice Glustein, and (ii) leave to appeal that Order. Catalyst's motions were heard by Justice Swinton of the Divisional Court on January 21, 2016. Her Honour released reasons denying Catalyst's motions the following day, and awarding West Face $10,000 in costs against Catalyst. Justice Swinton's reasons are reported at 2016 ONSC 554.

(k) Catalyst initially opposed an application to approve a Plan of Arrangement regarding the sale of WIND Mobile by the consortium that included West Face on the basis of the allegations it had made in the Moyse Action, and other unpleaded allegations of inducing breach of contract discussed more fully below. In considering that application, Justice Newbould concluded that "Catalyst ha[d] purposefully delayed [the Moyse Action] against West

Face for tactical reasons". Justice Newbould directed an expedited trial of the issue as to whether Catalyst was entitled to a constructive trust over West Face's interest in WIND Mobile for the end of February, 2016. His Honour's Reasons for Judgment are reported at 2016 ONSC 669.

(l) Shortly after Justice Newbould released his Reasons, Catalyst abandoned its claim for a constructive trust over West Face's WIND Mobile shares and consented to an Order approving the Plan of Arrangement. The parties subsequently agreed to a trial of the Moyse Action commencing on June 6, 2016.

(m) On May 31, 2016, six days before the trial of the Moyse Action began, Catalyst commenced an action for conspiracy, breach of confidence and inducing breach of contract against West Face and numerous other defendants in respect of the acquisition of WIND Mobile in September 2014. These allegations overlapped significantly with the allegations respecting WIND in the Moyse Action.

(n) The trial of the Moyse Action was ultimately heard by Justice Newbould for seven days commencing June 6, 2016. On August 18, 2016, Justice Newbould released his Reasons for Judgment dismissing Catalyst's claims against both West Face and Mr. Moyse in their entirety, with costs. In doing so, Justice Newbould made significant negative findings about the credibility of the Catalyst witnesses, particularly Mr. Glassman. Justice Newbould's Reasons are reported at 2016 ONSC 5271.

16. In sum, contrary to the allegations and insinuations in paragraphs 8 to 12, 20, and throughout the Claim, West Face does not have a history of wrongful conduct toward Catalyst, and it is not "out to get" Catalyst. Rather, Catalyst has a history of speculative, aggressive, and unsuccessful litigation against West Face. The Moyse Action had no relevance to West Face's research into Callidus, or its decision to short-sell Callidus shares. The only reason why the Moyse Action is at all relevant to Callidus is set out in the following section.

Catalyst's Allegations Concerning Callidus

17. Catalyst's campaign against West Face in respect of Callidus began in December 2014, when the Plaintiffs began threatening defamation proceedings against West Face based on vague allegations that West Face had prepared, caused to be prepared, or "ha[d] in its possession", a report about Callidus. The Plaintiffs demanded that West Face disclose any such report.

18. West Face has no knowledge of how Catalyst came to be aware of the existence of West Face's internal research on Callidus.

19. West Face denied the Plaintiffs' accusations that West Face had made any defamatory statements about Callidus, and declined to produce its internal research on Callidus (which was proprietary to West Face and revealed West Face's research methodologies and analysis) to another investment manager.

20. As set out above, in January 2015, Catalyst launched its motion in the Moyse Action for multi-faceted interlocutory relief against West Face. As part of that motion, Catalyst alleged that West Face had obtained from Mr. Moyse, and misused, confidential information about Callidus. Callidus was not a party to that action, and Mr. Moyse never had access to confidential *Callidus* information as a former junior analyst of *Catalyst* – Catalyst and Callidus are different companies with different computer systems and different employees (other than Messrs. Newton Glassman and James Riley).

21. In responding to Catalyst's motion, West Face denied that it had any of Catalyst's confidential information concerning Callidus. In substantiating this denial, West Face was forced to make comprehensive disclosure of its internal research on Callidus in order to prove that its knowledge of Callidus's loan book was based on public information, and not on confidential information supposedly disclosed to it by Mr. Moyse. As noted above, Justice Glustein dismissed Catalyst's motion in its entirety on July 7, 2015. At the trial of the Moyse Action in June 2016, Catalyst did not make any allegations or lead any evidence that either Mr. Moyse or West Face had any access to confidential information concerning *Callidus*.

22. After receiving this voluminous disclosure regarding West Face's research into Callidus in the Moyse Action, and then losing the motion before Justice Glustein, Catalyst did not amend its pleading in the Moyse Action to allege misuse of confidential information concerning Callidus. Instead, armed with West Face's internal research about Callidus disclosed to it in the Moyse Action, and having learned during cross-examination that West Face had met with Veritas on December 17, 2014, the Plaintiffs commenced this action for defamation, conspiracy and intentional interference with economic relations on June 18, 2015.

Callidus Goes Public, and Its Shares Begin Trading at a Substantial Premium to Their Book Value

23. As noted above, Callidus conducted an IPO in April 2014. At the time of its IPO, Callidus represented that its loan book consisted of 19 loans, totalling $381 million in "gross loans receivable". Callidus had accumulated a number of these loans (representing a significant portion of its loan book) in the months before going public. For example, three loans representing more than $100 million of the $381 million in total gross loans receivable were originated in the Fall of 2013.

24. In its IPO prospectus, Callidus projected that after the IPO, it would have approximately $334 million in shareholders' equity (a common measure of book value) and 46.04 million shares outstanding, resulting in a book value of $7.26 per share. Yet Callidus was offering its shares to the public at a price of $14 per share (almost twice their book value). Book value is a common financial measure of the value of a company based in part on the original cost to Callidus of acquiring its assets (*i.e.,* loans in Callidus's case).

25. In other words, Callidus was effectively selling to the public an interest in its portfolio of loans at a significant multiple of the acquisition cost to Callidus. Callidus's justification for this multiple was their claim to have a special expertise originating and managing high interest loans without incurring meaningful losses on those loans.

26. Moreover, almost immediately after its IPO, Callidus's shares began to rise in market value and, by mid-August 2014, its shares were trading at over $20 per share –

a significant premium to their IPO price. Even more significantly in West Face's opinion, Callidus's shares were trading at a substantial premium to their book value based on the assets and liabilities reported in Callidus's public financial statements.

27. For example, as at October 23, 2014, Callidus's most recently released financial statements reported shareholders' equity of $381 million, and 48.69 million shares outstanding, resulting in a book value of $7.83 per share. Yet on that date, Callidus's shares opened at $21.00, representing a ratio between market price and book value, or "P/B multiple", of 2.68. Callidus continued to attribute this multiple to its ability to source and manage a continually-growing portfolio of high yield loans while still minimizing default risk.

28. West Face was skeptical of Callidus's claims. Callidus’s "P/B multiple" was much higher than the P/B multiples of the issuers that West Face viewed as the most comparable businesses to Callidus: namely, U.S. business development companies, or "**BDCs**". Moreover, as compared to Callidus, West Face's opinion was that BDCs had stronger loan origination channels, higher levels of portfolio diversification, longer portfolio durations, a lower risk of material loan impairments, more attractive dividend yields, and a practice of fully disclosing their loan books.

29. It was in this market environment that West Face made its decision to short-sell Callidus's shares, on the basis of its investment thesis as set out in detail below.

West Face's Decision to Short-Sell Callidus Shares Based on What It Perceived as Callidus's Excessive Valuation

30. West Face had been monitoring Callidus since before its IPO, and by October 2014, the gap between Callidus's book value and market value indicated to West Face that the market perceived significant intangible value in Callidus's continuing ability to generate an ever-expanding portfolio of high yield loans that would not default or otherwise suffer from impairment in value. West Face believed this continuing ability to be unsustainable, for a number of reasons:

(a) Prior to Callidus's IPO, Bluberi Gaming Technologies, a Canadian company specializing in the development of casino games, had sought financing from West Face. West Face declined Bluberi's request for financing because West Face considered it to be very risky and felt that it lacked realistic business potential. Yet Callidus's IPO prospectus indicated that it had committed approximately $41 million to a "Gaming Technology" company that West Face believed to be Bluberi. From this, West Face believed that Callidus was willing to lend large sums to borrowers that West Face did not consider to be good credit risks. West Face's belief in this regard was ultimately substantiated, as set out in paragraphs 130 to 136 below.

(b) West Face believed that Callidus lacked the resources to grow its loan book at the aggressive pace required to justify the share premium. As a lender, Callidus has to fund its own ability to make loans through either borrowing money itself or issuing its own equity. In order to expand its loan book, Callidus would have to significantly increase its borrowed funds or issue dilutive equity. West Face did not believe the market appreciated these facts.

(c) By the very nature of high-yield loans, Callidus was likely to face adverse selection issues. As their loans matured, Callidus's high performing borrowers would be able to refinance their debts at lower interest rates (either with Callidus or by going to a more traditional lending institution).[1] Thus, in order to continue expanding its loan book, Callidus would have to either (i) accept lower yields, or (ii) be left with only lower quality loans which would be at a greater risk of material impairment.

(d) Callidus's public disclosure provided very limited information about the actual composition of Callidus's loan portfolio. For example, Callidus had

[1] West Face's belief in this respect has turned out to be true. For example, as noted on Callidus's most recently released quarterly financial statements for Q2 2016, during this past quarter two of Callidus's clients fully repaid their Callidus loans and refinanced with conventional lenders.

disclosed very limited information about the identities of its borrowers, the terms of the loans extended by Callidus, the performance of individual loans, the degree to which the loan book or specific loans were appropriately collateralized, or whether its borrowers' interest payments were being met out of the borrowers' cash flows or simply because they were drawing additional funds under their Callidus facilities.

(e) Because Callidus's loans have limited or no financial covenants, the quality of the assets against which Callidus's loans are secured is crucial to the quality of its loan book. Yet Callidus had disclosed little information about exactly what collateral was backing each of its loans. In short, Callidus had given the market very little information on which to assess the risks associated with Callidus's business or loan portfolio, and the market appeared to be taking Callidus's bold claims on faith.

(f) Finally, by late October 2014, West Face had discovered information casting into doubt the representations in Callidus's IPO prospectus that none of its loans were impaired. Specifically, by October 23, 2014, West Face had uncovered concerning details about Callidus's approximately $38 million dollar loan to Xchange Technology (the material facts regarding this loan are set out in paragraphs 84 to 92 below). Callidus had made no disclosure in its IPO prospectus about the difficulties regarding this loan (which at that time made up a material percentage of Callidus's loan book). The fact that, in addition to the concerns about Bluberi noted above, Callidus had at least one large loan with significant indications of impairment that had not been disclosed raised a "red flag" concerning Callidus's public representations.

31. In addition, given the 18-20% interest rates that it charges, Callidus is effectively a lender of last resort, and its borrowers carry a concomitant risk of default. While Callidus has represented that it benefits from certain guarantees provided by Catalyst of certain principal amounts owing on some of the loans in its loan book, Callidus had not

fully disclosed the terms of those guarantees, especially which specific loans were covered by the guarantees.

32. In any event, Callidus claimed that the Catalyst guarantees only covered losses of principal on some (but not all) of Callidus's loans. In other words, these guarantees did not protect against the failure by Callidus's borrowers to make interest payments, and they certainly could not guarantee that Callidus would be able to sustain a growing book of 18-20% loans without material impairment.

33. For all of these reasons, and based on its experience in the industry, West Face believed that the significant premium of Callidus's share price over its book value was unwarranted. In other words, West Face did not consider Callidus's claim to have exceptional lending capabilities to be sustainable. Accordingly, West Face decided on or around October 23, 2014 to begin short-selling Callidus's shares.

34. While West Face **began** short-selling Callidus shares on October 23, 2014, it did not acquire the whole of its short position on that date. Nor was its decision to short-sell Callidus shares an irreversible decision. On the contrary, and as set out in the following section, West Face believed that more detailed research into Callidus would aid it in determining whether it should continue short-selling Callidus shares, or, perhaps, change course and reduce its short position.

West Face's Research Into Callidus's Loan Portfolio

35. On or around the same date that West Face began short-selling Callidus shares (October 23, 2014), West Face began to conduct more detailed research into Callidus beyond its public disclosure. West Face's goal was to understand as much as possible about the specific composition of Callidus's loan book through public sources of information, with a view to more fully assessing Callidus's lending capabilities. More precisely, West Face sought to learn, through publicly available resources:

(a) Who were the borrowers to whom Callidus had extended credit?

(b) What were the typical terms on which Callidus was lending (for example, commitment size, term to maturity, interest rates, covenants, etc.)?

(c) What collateral was backing the Callidus loans?

(d) How were the businesses of the borrowers performing, and specifically, were there any signs of financial difficulty or non-performance amongst these borrowers?

(e) Were the loans being re-paid at their stated initial maturity dates, or rolling over at the same or different rates of interest? and

(f) Were the borrowers meeting their interest obligations in cash, or was Callidus extending additional financing to some borrowers in order to cover interest payments?

36. Beginning in early November 2014, West Face began summarizing its research and analysis in a proprietary, internal working document (the "**Callidus Analysis**"). West Face continued to update and develop its Callidus Analysis over time as it learned new information about Callidus's loans. As such, and contrary to the Claim, there is not one "West Face Report".

37. As set out further below, West Face's research revealed significant issues with some of the loans in Callidus's loan book. In West Face's view, its research only served to validate its thesis that Callidus's claims to have exceptional lending capabilities were overstated and that Callidus's share price was overvalued. For this reason, West Face continued to short-sell Callidus shares through to December 24, 2014. For the majority of that time, Callidus's shares continued to trade at above $20 per share.

38. West Face's research was conducted solely on its own account and for its own internal purposes. West Face did not conspire with Veritas or any other party. It was simply researching a trading position, which is how it advances the financial interests of the investment funds that it manages.

39. West Face specifically denies the allegations in paragraphs 23, 24, 33, 36 and 38 to 40 of the Claim that it had any intention to harm the Plaintiffs. Instead, as explained above, West Face's research into Callidus was conducted in good faith based on publicly-available information in order to support West Face's investment decisions. By short selling Callidus shares, West Face was essentially making a prediction that Callidus's share price would decline. That prediction turned out to be accurate.

West Face's Meeting with Veritas on December 17, 2014

40. West Face chose not to publish its Callidus Analysis, at least in part because it considered Catalyst and its founder Newton Glassman to be extremely litigious. West Face believed that if Catalyst obtained the Callidus Analysis, it would sue for defamation regardless of the merits of West Face's research. West Face does not know how the Plaintiffs first learned that West Face had created an internal report on Callidus. However, the Plaintiffs' letters threatening defamation proceedings in early December 2014 reinforced West Face's decision not to publish its Callidus Analysis. At this time, Callidus's share price was still over $20.

41. In early December 2014, West Face and Veritas arranged a meeting to exchange research, thoughts, and ideas (including but not limited to the subject of Callidus). West Face had considerable respect for Veritas (as Canada's leading independent research boutique in Canada), and was interested in finding out whether Veritas had conducted its own research on Callidus, and/or whether Veritas's views on Callidus corresponded with those of West Face.

42. On December 17, 2014, representatives of West Face met with representatives of Veritas for approximately an hour and a half (the "**December 17 Meeting**"). During the course of this meeting, West Face and Veritas discussed a number of topics, including Callidus. With respect to Callidus in particular, West Face told Veritas that it had been following Callidus's public disclosure and had also conducted its own research into Callidus's loan book. West Face advised Veritas that it had identified a number of Callidus's borrowers/loans, and that its research to date had raised concerns with some of the loans in Callidus's loan book.

43. Contrary to paragraph 22 of the Claim, West Face did not give Veritas a copy of the Callidus Analysis at the December 17 Meeting, or at any other time. Nor did West Face discuss any of the specific contents of its research, with the exception of a brief discussion of the public information that West Face had discovered about Xchange Technology.

44. Veritas advised West Face that it had not done any research into Callidus, but that it would consider whether to conduct its own research into Callidus. Veritas also said that if it did ultimately choose to research Callidus, it would not inform West Face of the results of any such research until it was published. The parties reached no agreement of any kind about Callidus – indeed, no agreement was ever discussed.

45. Toward the end of this meeting, Veritas asked West Face to provide it with the names of Callidus's borrowers that West Face had been able to identify through its research from public sources. West Face sent Veritas this list by email the following day. The list was titled "Estimated Partial Reconstruction of Callidus Loan Book from Public Information Sources", and contained only objective information about Callidus's loan book that West Face had been able to identify from public sources (the "**December 18 List**"). West Face also provided three links to public websites regarding bankruptcy and/or insolvency proceedings surrounding some of Callidus's loans.

46. West Face had minimal contact with Veritas after sending the December 18 List. The subsequent contact between the two firms primarily related to Veritas's soliciting West Face to become a client of its research product. As set out above, West Face never gave Veritas a copy of the Callidus Analysis. On the contrary, Veritas did its own research, independent of West Face.

Events Following December 18, 2014

47. On December 24, 2014, West Face ceased accumulating its short position in Callidus. By that time, Callidus's share price had dropped to approximately $18 per share (which was still well above book value).

48. As set out in detail above, in January 2015 Catalyst commenced a motion in the Moyse Action alleging, among other things, that West Face had obtained and misused confidential information about Callidus. West Face filed its responding motion materials on March 13, 2015. These materials included the then-current copy of West Face's Callidus Analysis, in order to demonstrate that it was based on public sources of information and not on confidential information obtained from Mr. Moyse.

49. West Face began closing out its short position beginning on March 19, 2015, and continued to do so until mid-June 2015. This involved West Face buying Callidus shares in the market in order to return shares that had previously been borrowed to be sold as part of the short-selling strategy. During that time period, when West Face was buying Callidus shares, Callidus's share price dropped from approximately $17 per share to just over $13 per share. However, on April 15, 2015, before Veritas published its report on Callidus, Callidus's share price closed at $16.82 per share.

50. On April 16, 2015, approximately one month after West Face began closing out its short position, Veritas published a report on Callidus (the "**Veritas Report**"). In the Veritas Report, Veritas highlighted various risks and concerns related to Callidus's business. However, Veritas did not provide an investment recommendation (that is, Veritas did not advise readers to buy, hold, or sell Callidus shares).

51. Veritas published the Veritas Report separately and independently of West Face. While Veritas had indicated to West Face that it was researching Callidus, West Face had no knowledge of what Veritas's research had revealed, no knowledge that Veritas was going to publish its research findings to the public nor when it would do so, and no involvement in the publication of the Veritas Report. Moreover, West Face had no knowledge that Veritas had reached similar conclusions as West Face had regarding Callidus's business and loan book.

West Face and Veritas Did Not "Conspire" to Defame Callidus or Interfere With Its Economic Relations

52. Contrary to paragraph 23 of the Claim, at no time, whether during the December 17 Meeting or at any other time, did West Face and Veritas "conspire" to defame the

Plaintiffs or to interfere with Callidus's economic relations so as to induce a broad sell-off of Callidus's shares.

53. Specifically, at no time did West Face and Veritas enter into a common intention or agreement to defame the Plaintiffs or to interfere with Callidus's economic relations. Indeed, as set out below, West Face did not defame or intentionally interfere with Callidus's economic relations, let alone conspire to do so.

54. Moreover, West Face's predominant purpose in meeting with Veritas was **not** to injure the Plaintiffs. Its purpose was to exchange research, thoughts and ideas with Canada’s leading investment research boutique about a variety of subjects, only one of which was Callidus.

55. In short, contrary to the inference in paragraph 24 of the Claim, the "impression" that Veritas had separately and independently published the Veritas Report was not a false one – West Face had no involvement in the preparation or publication of the Veritas Report, and the Defendants were not acting jointly or in concert. To the extent that there is "consensus" between West Face's Callidus Analysis and the Veritas Report, that consensus is simply the result of both West Face and Veritas applying standard financial analysis to the same publicly-available information.

56. Even if the Defendants were acting together (which is denied), they had no unlawful purpose and employed no unlawful means. West Face's purpose in contacting Veritas was to share ideas and to possibly solicit Veritas's independent analysis. As will be described below, West Face's Callidus Analysis contained only true statements of fact and reasonable fair comments based on those facts.

West Face Did Not Defame Callidus or Catalyst

(i) ***West Face Did Not Publish the Callidus Analysis or any Alleged Defamatory Statements***

57. Contrary to the allegations made throughout the Claim and in particular paragraphs 21 to 24 and 27, and as alluded to above, West Face did not provide its Callidus Analysis to Veritas directly or indirectly. West Face did not give Veritas the

Callidus Analysis on or around December 17, 2014 or at any other time. All that West Face provided to Veritas was the December 18 List and links to various public websites evidencing Callidus loans.

58. The December 18 List contains none of the allegedly false and defamatory statements attributed to West Face by the Plaintiffs at paragraphs 27(a) to (m) of the Claim (the "**Alleged Defamatory Statements**"). Nothing in the December 18 List is defamatory of the Plaintiffs – it is simply a list of the borrowers/loans of Callidus that West Face had identified through its internal research. There is therefore no "publication" of the Callidus Analysis and the Claim fails for this reason alone.

59. Moreover, three of the Alleged Defamatory Statements are simply not found anywhere in the Callidus Analysis. These are:

Para.	**Alleged Defamatory Statements**
27(c)	Callidus's loan book contained approximately $235 million in loan commitments that have undisclosed strong indicators of material impairment.
27(e)	Callidus's customers typically have negative cash flow, are in bankruptcy or are severely distressed.
27(f)	Callidus’s public disclosure misstates the value of its loan impairment provisions.

(ii) Many of the Alleged Defamatory Statements Are Not Defamatory of the Plaintiffs

60. Regardless of whether publication occurred, no statement is actionable for defamation unless it is reasonably understood to refer to the plaintiff in a defamatory sense.

61. Of the Alleged Defamatory Statements particularized by the Plaintiffs in subparagraphs 27(a) to (m) of the Claim, the following are, on their plain and ordinary meaning, not defamatory of Callidus:

Para.	**Alleged Defamatory Statements**
27(a)	Callidus claims not to have realized losses on principal on Callidus-originated loans;
27(b)	Six of the loans Callidus has outstanding are in restructuring, bankruptcy or court proceedings;
27(k)	Callidus claims it can loan $1 billion to distressed borrowers without incurring any loan losses;
27(l)	Callidus is similar to a U.S. business development corporation ("BDC");
27(m)	West Face obtained its information from publicly available sources.

(iii) ***The Alleged Defamatory Statements are Justifiable***

62. In the alternative and in any event, any Alleged Defamatory Statement actually published by West Face to Veritas on or around December 17 was (or is) materially true in substance and in fact, and West Face was justified in making it.

63. Without limiting the generality of the foregoing, the particulars of West Face's justification defence are as follows, listed in the order in which they appear in the Claims.

(a) **"Callidus Claims Not To Have Realized Losses on Principal on Callidus-Originated Loans"**

64. This Alleged Defamatory Statement does not concern whether Callidus actually had unrealized losses. Callidus's allegation is that West Face made a defamatory statement about what **Callidus** had claimed. In fact, leading up to the December 17

Meeting, Callidus had frequently claimed not to have realized losses on principal on Callidus-originated loans.

65. For example, in Callidus's IPO Prospectus dated April 15, 2014, Callidus stated four separate times (on pages 1, 4, 22, and 28):

> Callidus has a strong track record, as evidenced by, among other things, **no realized losses on principal on Callidus originated loans** after consideration of liquidated collateral and costs to settle from 2011 until 2013. (emphasis added)

66. Callidus went even further in a press release dated November 24, 2014, in which it claimed:

> As previously disclosed, Callidus's gross loans receivable at November 4, 2014 was $684 million as compared with $381 million at December 31, 2013. Notwithstanding this significant growth, **no loans in Callidus's loan portfolio are non-performing and there have been no realized loan losses over that period**. (emphasis added)

67. In fact, in a conference call with investors on November 7, 2014 regarding Callidus's third quarter results, Callidus's CEO Newton Glassman went even further and claimed that Callidus did not even have a loan that was behind on any obligations, principal or interest:

> So IFRS is a bit annoying. Technically, under IFRS, you have to allocate the provision on a loan-by-loan basis. So - and I think we went through this in the IPO, but just to remind people, we set up a separate watch list, which is the stuff that although performing - **because we don't have a single loan in the portfolio that's not performing, and just to remind again everybody, performing means current in interest and all obligations - so we don't have a single loan in our book that is nonperforming**. (emphasis added)

68. In short, the Alleged Defamatory Statement that Callidus claimed not to have any realized losses on Callidus-originated loans is true. In fact, Callidus had actually made the even stronger claim that none of its loans were non-performing in any way, however originated.

(b) "Six of the Loans Callidus Has Outstanding Are in Restructuring, Bankruptcy or Court Proceedings"

69. The Alleged Defamatory Statement that "Six of the loans Callidus has outstanding are in restructuring, bankruptcy or court proceedings" was made in the version of the Callidus Analysis that West Face filed in the Moyse Action in March 2015. However, this Alleged Defamatory Statement was not contained in the December 2014 version of the Callidus Analysis or in the December 18 List that West Face emailed to Veritas. Rather, the December 18 List simply included a column titled: "Bankruptcy or Restructuring Involved?". The word "Yes" appeared next to the 13 Callidus loans (out of a total of 35 Callidus loans that West Face believed it had identified by that date) that West Face believed, based on its public research, involved bankruptcy, insolvency or restructuring at one point or another. Of the loans with the word "Yes" in the "Bankruptcy or Restructuring Involved?" column, only four (not six) were listed as being "Outstanding".

70. It is a matter of public record that many of Callidus's loans are or were involved in restructuring, bankruptcy, or Court proceedings, including the four outstanding loans identified as such on the December 18 List.

71. The four outstanding loans identified on the December 18 List as involving bankruptcy or restructuring were Callidus's loans to: (1) Sher-wood Hockey Inc.; (2) Natura World; (3) Xchange Technology; and (4) Arthon.

(1) Callidus's Outstanding Loan to Sher-Wood Hockey Inc.

72. Hockey stick manufacturer Sher-wood Hockey filed a proposal with its creditors under the *Companies' Creditors Arrangement Act* (the "***CCAA***") in or around 2009, at which time it was purchased by Carpe Diem Growth Capital. In 2011, Callidus acquired Sher-wood Hockey and the loan to it as part of Callidus's acquisition of a larger portfolio of distressed assets that Callidus purchased during a further restructuring of Sher-wood. In short, Callidus bought into a loan that was already involved in restructuring proceedings. West Face matched this loan to the one identified as "Company B" in Callidus's IPO Prospectus.

(2) Callidus's Outstanding Loan to Natura World

73. Callidus acquired its loan to Natura World in the beginning of December 2011. Immediately thereafter, on December 16, 2011, Natura World filed a notice of intention to make a proposal to its creditors pursuant to the *Bankruptcy and Insolvency Act* (the "***BIA***"). Natura World was deemed to have made an assignment into bankruptcy on April 16, 2012, following the failure of its restructuring proposal to its creditors (which at that point included Callidus). West Face matched this loan to the one identified as "Company D" in Callidus's IPO Prospectus.

(3) Callidus's Outstanding Loan to Xchange Technology

74. Callidus advanced a one-year loan of $22 million to Xchange Technology in October 2012. In October 2013, Callidus brought an application appointing Duff & Phelps as receiver and approving a "stalking horse" sales process for the sale of substantially all of Xchange Technology's business and assets. Further particulars regarding Callidus's loan to Xchange Technology are set out below. West Face matched this loan to the one identified as "Company G" in Callidus's IPO Prospectus.

(4) Callidus's Outstanding Loan to Arthon

75. While the Arthon Group included a number of entities, the four main operating companies within the group were: (1) Arthon Contractors; (2) Arthon Equipment; (3) Coalmont Energy; and (4) Sandhill Materials.

76. In 2013, Arthon's primary secured lender was HSBC. Various HSBC facilities were secured and cross-collateralized within the Arthon Group. In late October 2013, HSBC served notices of its intention to enforce its security. As a result, various entities within the group were forced to apply for protection under the *CCAA*. Alvarez & Marsal was appointed as monitor for these companies.

77. In December 2013, Arthon's then $47 million loan from HSBC was assigned to Callidus. Callidus also agreed to provide an additional $5 million in interim financing. In short, Callidus bought into a loan that was already involved in restructuring proceedings.

78. West Face matched this loan to the one identified as "Company S" in Callidus's IPO Prospectus.

(5) Callidus's Other Outstanding Loans Involved in Restructuring, Bankruptcy, or Court Proceedings

79. In addition to the four loans that West Face identified on the December 18 List as being both: (i) outstanding (at the time), and (ii) involved at some point in bankruptcy or restructuring, West Face subsequently discovered that Callidus had two more outstanding loans that were involved in restructuring, bankruptcy, or Court proceedings that West Face had not yet identified at that time. As such, in December 2014 it was true that Callidus had (at least) six outstanding loans that were involved in restructuring, bankruptcy, or Court proceedings. Specifically, in December 2014:

(a) Callidus's then-outstanding loan to Groupe Arsenault was involved in restructuring, bankruptcy, or Court proceedings. On August 12, 2014, Groupe Arsenault had filed a notice of intention to make a proposal to its creditors under the *BIA* and for the appointment of an interim receiver. Callidus subsequently succeeded in a motion to appoint a receiver over the Group's assets in 2015; and

(b) Callidus's then-outstanding $34 million loan to Esco Marine was involved in court proceedings commenced by Callidus in December 2014 for a temporary restraining order and preliminary injunction. Callidus itself alleged that Esco Marine was in default, in extreme financial distress, and incapable of paying a money judgment.

80. In the alternative and in any event, even if the four loans that West Face identified on the December 18 List as being both: (i) outstanding (at the time), and (ii) previously involved in bankruptcy or restructuring were not, in fact, outstanding or involved in bankruptcy or restructuring, this Alleged Defamatory Statement was nevertheless materially true in substance and in fact. The full details of which of Callidus's then-outstanding loans are or were involved in restructuring, bankruptcy or Court proceedings are maintained in secrecy by the Plaintiffs. Based on information

that West Face has discovered to date, it believes additional, undisclosed Callidus loans are also involved in bankruptcy, restructuring or court proceedings.

(c) "Callidus's Loan Book Contained Approximately $235 Million in Loan Commitments that Have Undisclosed Strong Indicators of Material Impairment"

81. As set out above, this statement is not found in either the December 18 List or any iteration of the Callidus Analysis. It was never made by West Face. Rather, it was made in the Veritas Report.

82. In any event, the statement was true. On or around December 17, 2014, Callidus's loan book contained millions of dollars of loan commitments that had undisclosed strong indicators of material impairment. The full details of Callidus's loan book are known to the Plaintiffs.

83. Without limiting the generality of the foregoing nor the ability to obtain full discovery of Callidus's loan book as at December 2014, the following specific loans of concern had strong indicators of material impairment, none of which had been disclosed by Callidus at that time. They also undermine Callidus's claims to having exceptional lending capabilities.

(1) Callidus's Outstanding Loan to Xchange Technology Had Undisclosed Strong Indicators of Material Impairment

84. As touched on above, Callidus advanced a one year loan of $22 million to Xchange Technology in October 2012. In February and May 2013, before maturity of the loan, Xchange Technology ran two separate capital raising processes with KPMG and Canaccord Genuity in an attempt to refinance the Callidus loan. Both processes failed. Of the 56 parties contacted in the Canaccord process, only one party proceeded to the due diligence stage, and passed on the opportunity shortly thereafter. Subsequently, the company's founder offered to purchase the company for total consideration of $17 million ($5 million less than Callidus's original loan), which Callidus rejected. This amount would not have permitted Xchange Technology to repay 100% of the principal amount due to Callidus, let alone accrued interest.

85. In October 2013, Callidus commenced a receivership application appointing Duff & Phelps as receiver and approving a "stalking horse" sales process for the sale of substantially all of the Xchange Technology's business and assets. Callidus would have incurred a substantial shortfall on its advances had Xchange Technology's business and assets been liquidated.

86. Duff & Phelps carried out the sales process. Of 88 prospective purchasers identified by Duff & Phelps, only three executed a confidentiality agreement and gained access to the data room, and no offers were submitted by any of these prospective purchasers.

87. Callidus served as the stalking horse and credit bid on Xchange Technology in November 2013. The purchase price to be paid was to be the Callidus debt less $3 million, plus priority payables. At the time, Callidus was owed approximately $38 million, and Xchange Technology was not generating sufficient cash flow to service its obligations to Callidus. Moreover, Callidus had continued to provide advances to the company over the preceding several months.

88. Around the same time period, Triangle Capital, the second lien creditor of Xchange Technology whose debt was subordinate to Callidus's, wrote down its investment of $6.4 million to $0.

89. In short, in December 2014 (the time the Plaintiffs allege this statement was made), Callidus was owed more than $38 million on its loan to Xchange Technology, and the best non-Callidus bid that Duff & Phelps had received for the entire company had been $17 million (which Callidus had rejected).

90. Collectively, the information set out above amounted to a strong indicator of material impairment as at December 2014. Yet at that time, Callidus had not disclosed any material impairment on this loan.

91. After more than a year, the sale of Xchange Technology to Callidus finally closed in or around January 2015. Callidus held the asset for sale from that time on, and, to the best of West Face's knowledge, the company continued to incur millions of dollars in

losses in Callidus's hands. By September 30, 2015, Callidus's financial statements listed the assets held for sale with a value of $66.9 million. In a judgment in Ontario dated May 31, 2016, Justice Newbould held that the basis for the $66.9 million figure in Callidus's financial statements was "not at all clear".

92. In any event, Callidus's interim financial statements for the first quarter of 2016 indicate that Callidus called on the Catalyst guarantee. Funds managed by Catalyst purchased Xchange Technology from Callidus for $101.3 million, which Callidus indicated was the "total outstanding principal plus accrued and unpaid interest". Callidus primarily used the proceeds from the guarantee to repay a portion of the balance outstanding to Catalyst from Callidus under a subordinated bridge facility. No funds were recovered from an independent third party.

(2) Callidus's Outstanding Loan to Arthon Had Undisclosed Strong Indicators of Material Impairment

93. As described above, while the Arthon Group had a number of entities, the four main operating companies within the group were: (1) Arthon Contractors; (2) Arthon Equipment; (3) Coalmont Energy; and (4) Sandhill Materials. Callidus had advanced approximately $52 million to the Arthon Group, which had filed for CCAA protection in late 2013 with Alvarez & Marsal as Monitor.

94. Arthon Contractors was the active construction arm of the group. Arthon Equipment owned the equipment used and leased by Arthon Contractors. Coalmont Energy had the rights to operate a coal mine in British Columbia (the "**Coalmont Mine**"), and Sandhill Materials held title to a major deposit of natural aggregate materials (primarily gravel and sand) in the process of development, also in B.C.

95. In 2013, Arthon experienced a number of difficulties. Among others, there was a spill of filtercake slurry material from the Coalmont Mine, which halted operation of the mine.

96. As part of its CCAA process, Arthon unsuccessfully tried to sell both the Coalmont Mine and approximately 100 pieces of heavy equipment that had been

rendered redundant as a result of the inactivity of the mine. In April 2014, in the face of declining coal prices, Arthon revised the focus of its immediate restructuring efforts away from a sale of all or part of the Coalmont Mine. Instead, the company turned its attention to: (i) preserving the Coalmont Mine for potential operation or sale at a later date; (ii) continuing to sell the redundant equipment; and (iii) pursuing a refinancing and/or sale of all or part of Sandhill Materials.

97. By the end of October 2014, the equipment sales process had resulted in total net proceeds of only $6 million, on sales of 28 pieces of equipment. The company advised that it would no longer focus on sales of equipment. Total amounts due to Callidus at that time were approximately $44.6 million, although a further advance of $10 million to Sandhill Materials was being negotiated by Callidus.

98. In summary, in the Fall of 2014, Callidus had approximately $45 million due from the Arthon Group (with another $10 million advance being negotiated), yet the group's only assets of material value were two non-operating projects: the Coalmont Mine and Sandhill Materials. As set out above, the sales process for the Coalmont Mine had failed and coal prices were falling, and Sandhill Materials required approximately $25 to $30 million in additional capital to develop. By January 2015, Arthon's debt to Callidus totalled $53.8 million.

99. Collectively, the information set out above amounted to a strong indicator of material impairment as at around December 17, 2014. Yet at that time, Callidus had not disclosed any material impairment on this loan.

(3) Callidus's Outstanding Loan to Leader Energy Had Undisclosed Strong Indicators of Material Impairment

100. Leader Energy provides well completion services in the Canadian energy sector.

101. On March 6, 2013, Callidus entered into a credit facility with Leader Energy. The credit facility included a demand revolving facility of up to $4 million, and a one-year demand non-revolving loan of up to $12 million.

102. On October 31, 2013, Callidus advanced an additional $1 million demand non-revolving single advance loan repayable by January 31, 2014. At the same time, Callidus extended the pre-existing facilities for an additional six months, to September 6, 2014.

103. In March 2014, Callidus increased the size of Leader Energy's demand revolving facility from $4 million to $5 million.

104. By the end of August 2014, Leader Energy was in dire straits. It was actively selling assets, and was being sued for $7 million following its default on a lease of a vacant facility in Alberta. Moreover, it was "over advanced" on its demand revolving facility by approximately $0.85 million.

105. Around the same time, Callidus and Leader Energy agreed to combine its pre-existing $1 million and $12 million facilities into a demand non-revolving single advance term loan. At that time, the aggregate outstanding balance was $11.4 million, due September 6, 2014.

106. By December 17, 2014, Callidus was owed approximately $14.4 million, Leader was still over-advanced on its revolving facility, and the loan was two months past its maturity date.

107. Collectively, this information amounted to a strong indicator of material impairment as at December 17, 2014. Yet at that time, Callidus had not disclosed any material impairment on this loan.

108. Shortly thereafter, on February 19, 2015, Leader Energy filed a notice of intention to make a proposal to its creditors pursuant to the BIA. Leader Energy failed to make a satisfactory proposal within the Court-ordered stay period, and was deemed bankrupt on August 20, 2015. MNP Ltd. was appointed as the company's bankruptcy trustee. In September 2015, MNP was appointed as the "agent" of all of Leader Energy's assets, property and undertakings pursuant to a general security agreement with Callidus (although the company's operations were shut down prior to that point, and all of the

employees had been terminated). As of September 2015, Leader Energy's outstanding obligation to Callidus was $12,720,269.27.

(4) Callidus's Outstanding Loan to North American Tungsten Had Undisclosed Strong Indicators of Material Impairment

109. North American Tungsten engaged in tungsten mining. As at December 17, 2014, its primary assets were the Cantung mine in the Northwest Territories and the undeveloped Mactung mineral property in Yukon.

110. Callidus loaned North American Tungsten $11 million in May 2014. However, by December 2014, the loan had grown to $13.3 million and the company required additional funding from Callidus. While Callidus's then $13.3 million loan to North American Tungsten was secured, the security was over all assets of the company *excluding* the Mactung property, certain accounts receivable, and all mining and mineral leases, claims and tenures. The mineral reserves of the Cantung mine supported a mine life through to only 2017-2018. The mine also faces significant reclamation liabilities related to anticipated closure costs of the mine.

111. Collectively, this information amounted to a strong indicator of material impairment as at December 17, 2014. Yet at that time, Callidus had not disclosed any material impairment on this loan.

112. West Face's concerns regarding this loan were confirmed when North American Tungsten filed for *CCAA* protection in the Summer of 2015. In the context of those proceedings, Callidus's Vice President Craig Boyer gave sworn affidavit evidence that by November 2015, North American Tungsten owed Callidus approximately $16.5 million (including principal, accrued interest, and fees), and that the "quantum of recovery" on the assets over which Callidus had security was "speculative".

(5) Callidus's Outstanding Loan to Esco Marine Had Undisclosed Strong Indicators of Material Impairment

113. Esco Marine is a marine yard based in Brownsville, Texas. It specializes in recycling metals and properly disposing of obsolete maritime vessels.

114. Callidus and Esco entered into a loan agreement on June 30, 2014, pursuant to which Callidus agreed to lend up to $34 million. The loan took the form of a borrowing base facility in conjunction with several other facilities. Because Esco Marine was in severe financial distress, a "Blocked Account" was set up, into which Esco was obligated to deposit all funds from all sources. All funds deposited into the Blocked Account would be the property of Callidus.

115. In November 2014, Esco Marine resorted to diverting funds away from the Blocked Account in order to pay amounts due to critical vendors and employees. Callidus alleged that this act constituted theft, and in December 2014, Callidus filed a temporary restraining order and preliminary injunction against Esco Marine in order to protect its collateral because Esco Marine was in default, in extreme financial distress, and incapable of paying a money judgment.

116. On or around December 17, 2014, the net book value of Esco Marine's assets was less than its total liabilities.

117. Collectively, this information amounted to a strong indicator of material impairment. Yet as at December 17, 2014, Callidus had not disclosed any material impairment on this loan. Three months later, in March 2015, Callidus sought the appointment of a receiver, claiming that Esco had "reach[ed] the point of financial disintegration".

(6) Callidus's Loan to Deepak International Had Strong Undisclosed Indicators of Material Impairment

118. On January 7, 2013, the Government of the North West Territories ("**GNWT**") granted Deepak International "Approved NWT Diamond Manufacturer" status. This enabled Deepak to purchase a portion of the territory's rough diamond production. At the same time, Deepak was in the process of acquiring two GNWT-owned buildings in Yellowknife and the lease of related airport lands as the site of its diamond manufacturing operations.

119. On April 21, 2014, Callidus and Deepak signed a term sheet providing for a loan of up to $20.5 million. Callidus conducted extremely limited due diligence before agreeing to this loan. Callidus provided financing on the basis that Deepak International owned $18 million in automated diamond cutting machinery held in storage containers near the Yellowknife airport. However these storage containers contained only worthless materials.

120. On February 17, 2015, Callidus disclosed that it was owed $2.6 million by Deepak and that "no cash flow is expected … until construction of the facility is completed".

121. As at December 17, 2014, there was no timeline for when construction of the facilities would begin, much less when the company would start to produce cash flow. As of that date, the company had no operations to speak of.

122. Collectively, this information amounted to a strong indicator of material impairment of the loan. Yet as at December 17, 2014, Callidus had not disclosed any material impairment on this loan. In fact, Callidus subsequently commenced a lawsuit against the company and its principals for $5.9 million.

(7) Callidus's Loan to Harvey Industries Had Strong Undisclosed Indicators of Material Impairment

123. Harvey Industries is an aluminum casting, machining, assembly, testing and producer in the automotive industry. It operates one plant, in Wabash, Indiana.

124. In November 2012, the company's financial condition was deteriorating. Beginning on November 7, 2012, Callidus extended several commercial loans to Harvey Industries in the aggregate principal amount of US$41.5 million. The purpose of these loans was to refinance the company's existing debt and to provide working capital.

125. Harvey Industries's financial condition continued to deteriorate. Commencing in December 2013, Callidus executed a series of forbearance agreements extending the maturity date of the Callidus loans to December 31, 2014 and providing other financial accommodations to the company.

126. Nevertheless, Harvey Industries defaulted on the loans at the end of December 2014. At that time, Harvey Industries owed Callidus approximately US$39 million in principal under the loan documents, not including additional deferred fees, interest, costs, and other charges. Despite the company's default, Callidus continued to make advances to Harvey Industries in order to protect its secured interests in the company.

127. On February 18, 2015, Callidus commenced legal proceedings against Harvey Industries for, among other things, the appointment of a receiver. A receiver was appointed on or around March 20, 2015.

128. During the course of the receivership, the receiver estimated the value of Harvey Industries' assets to be in the range of approximately US$4.9 million to US$9.1 million. Following a marketing and sales process, the receiver held an auction for all of the company's assets on June 10, 2015. After several rounds of bidding between Callidus and one other party, Callidus made the highest bid – a credit bid of US$25.2 million.

129. Collectively, this information amounted to a strong indicator of material impairment as at December 17, 2014 (days before Harvey Industries defaulted on the extended repayment date for its US$39 million principal indebtedness to Callidus). Yet at that time, Callidus had not disclosed any material impairment on this loan.

(8) Callidus's Loan to Bluberi Gaming Had Strong Undisclosed Indicators of Material Impairment

130. Bluberi Gaming Technologies Inc. is a Canadian company that specializes in the development, sale and deployment of casino games. It is based out of Drummondville, Quebec.

131. On August 31, 2012, Callidus agreed to provide Bluberi certain credit facilities up to an amount of $24 million. Callidus provided Bluberi this loan on the basis of a business plan that projected the deployment of 3,300 gaming machines by May 2013. Ultimately only 324 machines were deployed by December 2013, roughly 10% of the original planned deployment. The same business plan forecasted Bluberi's EBITDA to

reach $25.5 million by December 2013. Bluberi's actual performance on its audited 2013 financial statements reflected EBITDA of negative $2.6 million.

132. Despite the disappointing results, Callidus continued to lend money to Bluberi. In April 2013, Callidus agreed to increase the indebtedness available under the credit facilities to approximately $30 million. On or about June 19, 2014, Callidus agreed to further increase indebtedness available under the credit facilities up to an aggregate amount of approximately $54 million.

133. By December 2014, Bluberi had consistently been overextended on its revolving demand facility, and Callidus had extended credit well beyond Bluberi's borrowing base despite increases to the facility limits. In short, Callidus allowed its facilities to fund the company's losses.

134. Collectively, this information amounted to a strong indicator of material impairment as at December 17, 2014. Yet at that time, Callidus had not disclosed any material impairment on this loan.

135. Again, West Face’s concerns were essentially validated by what subsequently occurred. The company subsequently filed for *CCAA* protection in November 2015. Ernst & Young was appointed as monitor, and Bluberi Gaming successfully applied for the approval of a sale solicitation process. While Callidus negotiated to purchase Bluberi’s assets through this process, Callidus has encountered delays and obstacles transferring the necessary gaming licenses from the relevant regulatory authorities, and the transaction cannot close until those licences are appropriately addressed.

136. Callidus is still owed approximately $85 million. Approximately $15 million of this amount is comprised of accrued interest and deferred fees.

(9) Callidus's Loan to Groupe Arsenault Had Strong Undisclosed Indicators of Material Impairment

137. On December 11, 2012, Callidus extended a series of demand loans to Groupe Arsenault and related companies. During the Winter of 2013-2014, Groupe Arsenault began to experience liquidity problems.

138. On August 12, 2014, Groupe Arsenault filed a notice of intention to make a proposal to its creditors under the *BIA* and for the appointment of an interim receiver. In December 2014, Callidus consented to the company's delay in putting forward a proposal to its creditors. However, the company failed to put forward a proposal satisfactory to Callidus, and in February 2015 Callidus successfully moved for the appointment of a receiver over all of Groupe Arsenault's assets. As of March 4, 2015, Callidus was owed over $5 million in principal and interest.

139. Collectively, this information amounted to a strong indicator of material impairment as at December 17, 2014 (months after Groupe Arsenault had filed its notice of intention to make a proposal). Yet at that time, Callidus had not disclosed any material impairment on this loan.

(10) Callidus's Loan to Alken Basin Drilling Ltd. Had Strong Undisclosed Indicators of Material Impairment

140. On March 31, 2014, Callidus granted $28.5 million in credit facilities to Alken Basin Drilling, an Alberta-based drilling services company. By December 1, 2014, Alken was in financial trouble. On that date, Alken employed Range Corporate Advisors to assist it in managing and improving its liquidity, turning around its financial and operating performance, and repaying Callidus.

141. Furthermore, and also in or around December 2014, Callidus retained Hilco Valuation Services to provide a forced liquidation value appraisal report in recognition of the potential that Callidus's loan to Alken might be impaired, and that Callidus would be forced to call on its security. The Hilco appraisal (dated December 23, 2014) revealed to Callidus that it would most likely suffer a significant shortfall in recovering its loan advances to Alken.

142. Collectively, this information amounted to a strong indication of material impairment at or around December 17, 2014. Yet at that time, Callidus had not disclosed any material impairment on the loan. Callidus has subsequently sued Alken for recovery of its loans and a receiver has been appointed over Alken's assets.

(d) "Callidus Secures Its Loans Against Undeveloped Mining Assets"

143. As set out above, Callidus's loan to Arthon was secured against the shuttered coal mine and undeveloped natural aggregates assets, owned by Coalmont Energy and Sandhill Materials, respectively. Realizing value from these assets would require significant development work, including the injection of significant additional capital and incurring development risk.

(e) "Callidus's Customers Typically Have Negative Cash Flow, are in Bankruptcy or are Severely Distressed"

144. As set out above, this Alleged Defamatory Statements is not found anywhere in the Callidus Analysis (nor the December 18 List).

145. In any event, Callidus's business model is focussed on distressed borrowers. This is why Callidus is able to lend at 20% interest rates. By their nature, these borrowers will often have negative cash flows, and/or be in bankruptcy, and/or be severely distressed. As set out above, the December 18 List identified 13 of Callidus's loans that were involved in bankruptcy or insolvency proceedings, and a number of the Callidus borrowers that West Face has identified appear to have negative cash flow, are in bankruptcy or are severely distressed.

146. Callidus itself has publicized that it operates in the distressed lending sector and that it is not uncommon for Callidus to deal with borrowers that undergo some form of restructuring. Based on this model, and what West Face has learned about some of Callidus's loans, it is likely that a number of Callidus's undisclosed loans are also in distress.

(f) "Callidus's Public Disclosure Misstates the Value of its Loan Impairment Provisions"

147. As set out above, this Alleged Defamatory Statements is not found anywhere in the Callidus Analysis (nor the December 18 List).

148. However, for the reasons set out above, Callidus's public disclosure as at December 2014 did misstate the value of its loan impairment provisions. Full disclosure of Callidus's loan book will assist in determining the true scope of impairment.

149. As at December 2014, Callidus's then most recently released financial statements (being its Q3 2014 interim financial statements dated November 6, 2014) provided for a loan loss allowance of approximately $15.5 million. The company has an allowance for loan losses of approximately $69.0 million as of June 30, 2016. West Face does not know whether this increased allowance for loan losses relates to loans existing as at December 2014, or loans made since then. However, based on the facts described above Callidus had mis-stated its loan impairment as at December 17, 2014.

150. For example, as set out above in paragraph 92, Catalyst funds purchased Xchange Technology from Callidus for $101.3 million, which Callidus had been holding for sale (following its credit bit following a failed sales process). Yet, prior to the acquisition of Xchange Technology by Catalyst, the impairment associated with this asset was only approximately $13.1 million in Callidus's financial statements.

151. More broadly, since the Callidus IPO in early 2013, a material and growing portion of Callidus's loan assets have been transformed into equity interests in the debtor businesses. These equity interests represent a materially different asset class and risk profile than the debt investments Callidus previously held. At the end of 2013, the "Assets held for sale" line item in the Callidus balance sheet was $11.4 million. This line item fell to $0 at the end of the third quarter of 2014, following the sale of Sherwood Hockey. However, by the end of the first quarter of 2015, "Assets held for sale" grew to $62.6 million, apparently in connection with the acquisition by Callidus of the XTG business, and then to $102.4 million by the end of 2015, when the line item was renamed "Assets acquired from loans". The "Assets acquired from loans" line item then fell to $33.7 million at the end of the first quarter of 2016 with the sale of the XTG business to the Catalyst funds pursuant to the loan guarantees provided by the Catalyst funds. But by the end of the second quarter of 2016, Callidus's most recent public disclosure of financial reporting, the "Assets acquired from loans" line item was back to

$95.4 million. With the impending completion of Callidus's acquisition of the Bluberi business following the default of the $85 million debt owing by Bluberi, the "Assets acquired from loans" line item seems likely to significantly increase again.

152. As described above, Callidus has repeatedly converted its debt instruments into equity after a sales process failed to produce an independent bid for anything close to the value of Callidus's outstanding loan. Transforming debt investments into equity interests raises concerns about risks of possible unrecognized material loan impairment losses, absent disclosure of the performance of those equity interests and the associated independent valuation work supporting the value stated in Callidus's financial statements. Callidus has not disclosed the detailed performance of those equity interests comprising the "Assets acquired from loans". This disclosure is necessary to determine the scope of impairment, if any, of those assets. Callidus's conversion of debt to equity had begun in December 2014, and reinforced the concerns raised in West Face's Callidus Analysis. That these concerns have continued to manifest since then is further justification of those concerns.

(g) **"Callidus Has Misrepresented the Quality of its Loan Book to Its Investors"**

153. For the reasons set out above, Callidus has misrepresented the quality of its loan book to its investors. The full extent of that misrepresentation can only be determined when the loan book has been fully disclosed.

(h) **"Impairments in Any Single Loan in Callidus's Loan Book Would Have a Meaningful Impact on Callidus's Earnings and Book Value"**

154. This Alleged Defamatory Statement is found in the Callidus Research, but must be read in its proper context. Callidus's closest comparables in the industry (U.S. BDCs) are significantly more diversified, with hundreds if not thousands of distinct loans. With such a large number of loans, the impairment of a single loan would not have a material impact on the company.

155. Conversely, on or around December 17, 2014, Callidus had fewer than 40 existing loans. Because of Callidus's highly concentrated portfolio, the problems in

Callidus's loan book described above would have had a meaningful impact on Callidus's earnings and book value.

156. For example, impairments to the loans described above to Xchange Technology, Arthon, Esco Marine, Harvey Industries and Bluberi Gaming could each have had a meaningful impact on Callidus's earnings and book value.

(i) **"Callidus Is At Risk of a 20% Write-Down of Its "Identified" Loan Book"**

157. The problems with Callidus's loans to, among other borrowers, Xchange Technology, Arthon, Leader Energy, North American Tungsten, Esco Marine and Deepak International showed that Callidus was at risk of a 20% write down of the loans in Callidus's loan book that West Face was able to identify through its research of publicly available information. Callidus of course had many other loans that West Face had been unable to identify as at December 17, 2014. For example, West Face has since identified Callidus's problematic loans to Bluberi Gaming, Harvey Industries, Groupe Arsenault and Alken Basin Drilling. The concerns in the loans that West Face has identified, and Callidus's general lack of transparency, raised reasonable concerns about the unidentified loans. The full extent of the risks facing Callidus will be determined on discovery.

(j) **"Prior to and After the IPO, Catalyst Increased the Size of Callidus's Loan Book by Taking on Lower-Quality Loans"**

158. Both before and after its IPO, Callidus's loan book experienced tremendous growth as a result of taking on high-risk, high-yield loans. Indeed, the essence of Callidus's business is to provide financing to companies that are unable to obtain adequate financing from traditional lenders, and Callidus acknowledges that the "perceived risks" of its borrowers are what allow Callidus to charge high interest rates. High-risk loans of this nature are less likely to be repaid and can therefore be fairly described as being of "lower quality".

159. The problems with some of the specific loans identified by West Face have been described above.

(k) **"Callidus Claims It Can Loan $1 Billion to Distressed Borrowers Without Incurring Any Loan Losses"**

160. Again, this Alleged Defamatory Statement does not concern whether Callidus actually could loan $1 billion to distressed borrowers without incurring any loan losses (which, if true, is a positive as opposed to defamatory statement about Callidus). Callidus's allegation is that West Face made an allegedly defamatory statement about what **Callidus** had claimed.

161. As set out above in paragraphs 64 to 68, as of December 17, 2014, Callidus had frequently claimed not to have incurred any loan losses, and its portfolio exceeded $1 billion in gross loans receivable on that date or shortly thereafter.

162. In the alternative, to the extent Callidus's allegation is that West Face was implying that Callidus could not loan $1 billion to distressed borrowers without incurring any loan losses, that statement is true.

163. In addition to the examples cited above, Callidus is likely to face loan losses with respect to its loan to the Gray Aqua group of companies, which was outstanding as at December 2014 and which West Face subsequently matched to the loan identified as "Company R" in Callidus's IPO Prospectus.

164. The Gray Aqua group of companies is a salmon fish farming business operating in the Maritimes. In 2013, the Gray Aqua business experienced financial difficulties ostensibly attributable to an infection experienced at some of its salmon farming sites and a related order by the Canadian Food Inspection Agency to “depopulate” its inventory at those sites. As a result of these financial challenges, Gray Aqua’s then-secured lender, HSBC, demanded immediately repayment of the amounts due to it from Gray Aqua. In December 2013, Callidus acquired $10.8 million in debt owing to HSBC by the Gray Aqua companies, apparently at a discount. At the same time, Callidus entered into a credit agreement with the Gray Aqua companies, pursuant to which it provided various demand credit facilities totaling up to a maximum of $43.5 million. The debts were originally due by September 15, 2014, but were subsequently extended to January 31, 2016.

165. Gray Aqua experienced a sea lice infestation in certain of its sites in early July 2015, which resulted in elevated mortality rates and reduced biomass growth rates within the inventory. The "harvest" from Gray Aqua's Indian Tea Point site had been anticipated to be the first successful harvest post-Callidus financing. Whereas the borrower had anticipated generating $16 to $19 million in sales revenues from the Indian Tea Point harvest, as a result of the sea lice infestation and other operational issues, the total harvest revenue from Indian Tea Point only generated approximately $3.5 million. As a result of the Indian Tea Point crop failure, there was a borrowing base default with respect to one of the Callidus credit facilities beginning in August 2015, which continues to date, in the amount of $12.2 million.

166. Furthermore, the Gray Aqua companies did not repay the loans at maturity in January 2016, following which the New Brunswick Court appointed a receiver in April 2016, on application by Callidus. As of late April 2016, the Gray Aqua companies owed Callidus (as a secured creditor) $56.3 million, representing over 95% of all secured and unsecured creditor claims. The Business Development Bank of Canada is also a secured creditor of the Gray companies in respect of at least $1.8 million, and possibly up to $3.3 million.

167. However, notwithstanding that the sea lice infestation was made known to Callidus in August 2015, Callidus only reported a pre-tax loan loss provision of $22.7 million in its 2015 annual financial statements (*i.e.*, in Q4 2015), and not in its Q3 2015 interim financial results when Callidus discovered the infestation, delaying the disclosure of the Gray Aqua provision to late March 2016, when the 2015 full year financial results were released. Additionally, in March 2016, Callidus was informed by the borrower that approximately 380,000 smolt in the hatchery facility had to be destroyed due to an outbreak of bacterial kidney disease, further negatively impacting collateral values. Callidus and BDC are party to an intercreditor agreement which gives the BDC security priority over Callidus security for certain collateral.

168. The loan loss provision of $22.7 million proved to be inadequate. In its recently released financial results for Q2 2016 released August 11, 2016, Callidus made a

further $12 million provision for loan losses related to Gray Aqua, and indicated that total loan loss provision on the Gray Aqua loan had grown to $37.4 million.

(l) **"Callidus is Similar to a U.S. Business Development Corporation"**

169. West Face assessed Callidus to be *similar* (but not identical) to certain U.S. business development corporations. Identifying comparable publicly-traded issuers is a common approach to valuation in the investment business.

170. A U.S. BDC is a form of public company in the U.S. that provides financing to small and mid-sized businesses. They typically hold a large portfolio of loans and provide their investors with a way to invest in the debts of small to mid-sized businesses. BDCs are investment companies and answer to an independent board of directors. Examples of BDCs include American Capital, Apollo Investment Corporation, and Ares Capital Corporation, among others.

171. West Face's comparison of Callidus to BDCs does not have a defamatory meaning. BDCs are not "bad" investments. Different investors will be attracted to different kinds of companies, and many investors invest in BDCs, which provide such investors with the possibility of capital appreciation and/or current income (through dividends). West Face's opinion that Callidus is similar to certain U.S. BDCs is simply that they are comparable – West Face acknowledges that they are not identical and that there may be differences or dissimilarities.

172. In any event, this statement is true in substance and in fact. Without limiting the generality of the foregoing, Callidus is "similar to" U.S. BDCs in a number of ways, including:

(a) both Callidus and BDCs provide customized financing solutions to small and mid-sized businesses that have difficulty raising capital from traditional sources (like banks);

(b) both Callidus and BDCs lend to a variety of different industries; and

(c) both Callidus and BDCs have portfolio monitoring policies and procedures in place.

(m) **"West Face Obtained Its Information From Publicly Available Sources"**

173. As set out above, West Face obtained all of its information about Callidus and its loan book from publicly available sources of information.

174. Moreover, as set out above, this Alleged Defamatory Statement does not refer to Callidus in any defamatory way.

Fair Comment

175. In the further alternative and in any event, any Alleged Defamatory Statement actually made by West Face to Veritas on or around December 17, 2014 was an honest opinion held by West Face having regard to the actual facts and information that it had discovered through its research, as described above. Any publication by West Face was a fair comment made honestly and without malice and on a matter of public interest. Callidus is a public company widely-covered by various analysts, and the quality of its loan book is of significant interest to the Canadian financial community.

West Face Did Not Intentionally Interfere with Callidus’s Economic Relations

176. Contrary to paragraphs 38 and 39 of the Claim, West Face did not intentionally interfere with Callidus’s economic relations with its investors.

177. Specifically, West Face did not "deceive" any of Callidus’s shareholders into believing Callidus's share price was overvalued, and West Face puts the Plaintiffs to the strict proof thereof. As set out above, none of West Face's research was deceptive or false, nor was it published to any Callidus shareholder. To the extent that any of Callidus’s shareholders retrieved or became aware of the version of the Callidus Analysis that West Face filed in response to Catalyst’s allegations in the Moyse Action (as described above), that “publication” of the Callidus Analysis is protected by absolute privilege and cannot found an “unlawful act” for the purposes of the tort of intentional interference with economic relations. In any event, West Face filed the Callidus

Analysis in Court not to interfere with Callidus's relationship with its shareholders, but to respond to specific allegations made against it in litigation by Catalyst.

178. In any event, even if West Face's conduct did induce Callidus's then-existing shareholders to sell their Callidus shares, such conduct was not otherwise unlawful and West Face had no intention to harm the Plaintiffs.

The Plaintiffs Have Not Suffered Any Damages As a Result of West Face's Conduct

179. The Plaintiffs have suffered no damages as a result of the alleged defamation, conspiracy, and intentional interference with economic relations, and West Face puts the Plaintiffs to the strict proof thereof.

180. Contrary to paragraph 37 of the Claim, the drop in Callidus's share price was not caused by any alleged conduct by West Face. Rather, the drop in Callidus's share price (which continued to fall long after Veritas published the Veritas Report in April 2015) was a result of the issues and concerns with Callidus's business and loan book that both West Face and Veritas independently and correctly identified through their research.

181. Specifically with respect to defamation, the Plaintiffs' reputations in the financial industry were not lowered as a result of the alleged defamation. Moreover, even if the Plaintiffs could prove that any one or more of the above Alleged Defamatory Statements: (i) was published by West Face; (ii) was capable of a defamatory meaning; (iii) was not justified; and (iv) was not a fair comment by West Face; such statements did not materially injury the Plaintiffs' reputations in view of what facts, including any Alleged Defamatory Statements, are true.

182. Contrary to paragraph 37, neither Callidus nor Catalyst has suffered harm as a result of Callidus's share price being "lower" for a prolonged period of time.

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STATEMENT OF DEFENCE OF WEST FACE CAPITAL INC.

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