

Estate No. 31-1894062

**IN THE MATTER OF THE BANKRUPTCY OF
NORTEK COMPUTERS LTD.
OF THE CITY OF NORTH BAY
IN THE PROVINCE OF ONTARIO**

TRUSTEE'S PRELIMINARY REPORT TO THE FIRST MEETING OF CREDITORS
August 12th, 2014

DISCLAIMER:

In preparing this report and making the comments herein, The Trustee has been provided with, and has relied upon certain unaudited, draft and/or internal financial information, the Bankrupt's books and records, discussion with management of the Bankrupt company, and information from third party sources, being the Bankrupt's Accountant and/or Book-keeper, collectively ("the Information").

Except as described in this Report:

- a) The Trustee has not audited, reviewed or otherwise attempted to verify the accuracy or completeness of the Information in a matter that would wholly or partially comply with the generally Accepted Assurance Standards pursuant to the Canadian Institute of Chartered Accountants Handbook and accordingly, the Trustee expresses no opinion on or other form of assurance in respect of the Information;*
- b) Some of the information referred to in this Report consists of forecasts and projections. An examination or review of the financial forecast and projections, as outlined in the Canadian Institute of Chartered Accountants Handbook, has not been performed;*
- c) The Trustee has prepared this Report in its capacity as Trustee of the Estate of the Bankrupt, and has made a copy available to all known creditors of the Bankrupt's Estate. Parties using this Report are cautioned that it may not be appropriate for their purposes.*
- d) Any financial information referred to in this Report was prepared based on management's estimates and assumptions. Readers are cautioned that since projections are based on assumptions about future events and conditions that are not ascertainable, the actual results will vary from the projections, even if the assumptions materialize and the variations could be significant.*

Nortek Computers Ltd. (hereafter called "the **Bankrupt**") filed an assignment in bankruptcy on July 24th, 2014 and Russo Corp., the undersigned was appointed as Trustee of the Estate of the Bankrupt by the Official Receiver. Joanne Russo, CIRP, is the Trustee responsible for the administration of the estate and Evelyn Bowles, Sr. Estate Administrator is assisting with the administration.

I. BACKGROUND/ CAUSES OF INSOLVENCY

The Bankrupt was an electronics Company which provided technical expertise in the computer and technology industry. It was a privately held Ontario Corporation that was in existence for over 25 years. The sole director of the Corporation is Robert Everest.

The Bankrupt had operated its business out of premises located in North Bay, Ontario. Operations ran out of premises with over 36,000 square feet of plant space.

The Business was formerly owned by Brian McGaffney. Since the beginning of the new ownership, sales immediately began to drop.

The Trustee understands the causes of financial difficulty stems from several reasons being as follows:

1. Significant economic changes in the competitive technology business resulted in loss of revenue;
2. Business may have been purchased at an inflated price;
3. The Bankrupt's continued existence was dependent upon its ability to operate profitably. It also was significantly dependent upon the continued support of its bank, lenders, creditors;
4. The Bankrupt was unable to adhere to the conditions of a forbearance agreement;
5. Loss of significant customers/contracts. The Bankrupt received most of its business from 3 customers. Research in Motion, HP, Lenovo, Lockheed Martin, IBM and Celestica have been among the primary customers.

For fiscal February 2012 Nortek had contracted a significant project with RIM. The approximate revenue to be generated from this project was forecasted to be \$2,856,000. The Bankrupt retained additional staff to meet these requirements from RIM. When the product was received from RIM's manufacturing sites the Bankrupt was forced to reject 80% of the units due to cosmetic defects. As a result this project only yielded about \$614,000 in revenue and the Bankrupt incurred a significant increase in expenses primarily in wages.

Each of the 3 major and potential revenue stream noted for 2012 and 2013 from the significant customers lead the Bankrupt to hold on to staff longer resulting to significant losses for the tax year 2012 and 2013. Sales were not increasing and overhead costs, rental costs, payroll remained;

6. The Bankrupt did not have a strong enough balance sheet. As a result of losing the Celestica and RIM contracts, their cash flows dropped significantly and overheads remained the same;
7. The Bankrupt incurred significant losses trying to keep payroll obligations current; meet its current rental obligations and payments to the various secured creditors;
8. The Bankrupt was unable to re-negotiate its current lease arrangements;
9. The Bankrupt was unable to negotiate a settlement offer with a significant secured creditor- being Royal Bank of Canada, as such RBC received judgment in the amount of \$225,901.99 on April 24, 2014;
10. The Bankrupt was unable to find alternate lending to assist with its operational expenses;
11. Principals of the Corporation had injected significant amounts of personal resources into the business which could no longer be sustained;
12. Third Party demand issued by Canada Revenue for unpaid source deductions and the significance of the source debt made it impossible for the Corporation to remain operational;

II. TRUSTEE'S ACTIONS TO DATE

Upon the assignment in bankruptcy, in addition to the statutory duties required up to the first meeting, the Trustee has done, but not limited to, the following:

- The Trustee is currently in the process of gathering all the books and records. The Trustee has not yet conducted any investigation of any historical transactions, nor will any such investigation be done, unless the Trustee is authorized by the creditors/inspectors to do so and the creditors provide funding for such an investigation;
- Arranged for notice of the bankruptcy to appear in the Financial Post on July 29, 2014
- Notified former employees of their rights pursuant to WEPP and filed all Trustee reports to WEPPA;
- Discussions with secured creditors with respect to their security position;

- Discussions with the landlord regarding occupation rent -which is currently being funded by a third party;
- Discussions with the Secured creditors regarding the disposition of the sale of the assets;
- Discussions with parties who have expressed an interest in purchasing the business;
- Discussions with Canada Revenue Agency regarding their deemed trust claim;
- Arranged for an on-site appraisal of the equipment and physical assets;
- Discussions with Counsel representing one of the largest creditors in this Estate;
- Meeting with employees; and
- Discussions with Counsel to represent the interest of the Estate.

III. **SECURED CREDITORS**

1. **Canada Revenue Agency Deemed Trust Claim**

A proof of claim was filed with our office broken down as follows:

- A) Source- Deemed Trust Property claim in the amount of \$ 341,392.98;
- B) Source – Unsecured claim in the amount of \$ 136,504.90
- C) HST property claim for \$42,314.75 (CRA will need to amend their claim as this should not be treated as a property claim)

2. **Royal Bank of Canada, (“RBC”)**

As security, the Bankrupt had provided RBC with a General Security Agreement over all of the assets of the Bankrupt, and a guarantee and postponement of approximately \$500,000.00 in loans from shareholders.

Royal Bank of Canada had commenced legal action against the Bankrupt and was awarded judgment the amount of \$225,901.99 on April 24, 2014;

We have served Royal Bank of Canada with a Notice by Trustee Requiring filing of Proof of Security dated August 1, 2014

3. **Nutwood Holdings Inc.** - Pursuant to an assignment of security agreement dated April 19, 2013.- Roynat Inc assigned its security to Nutwood. As security, the Bankrupt had provided a fixed charge on the land, being 1954 and 2000 Main Street West, North Bay, Ontario, building and equipment, vehicles and inventory, a general security agreement covering all the assets as well as a postponement agreement of shareholders loans in the amount of \$948,000.00

The term of the loan was in default in February 2013, but the Bankrupt renegotiated the terms of the debt as per the provisions of the Forbearance Agreement, (the “Agreement”).

Under the Agreement, the total amount outstanding totaled \$2,271,651.00. The parties agreed to settle the debt for \$1,700,000.00 with a resulting debt forgiveness of \$371,657- if there was no default. The Agreement required the sale of real property for \$1,000,000.00. As a result of the sale of the Property, Nutwood Holdings Inc would reduce the amount of the indebtedness.

The bankrupt also agreed to a lease agreement until June 2019. The Remaining \$700,000 of the indebtedness was to be re-paid in blended monthly payments of interest and principal.

4. **SPECIFIC SECURITY OVER VEHICLES**

- Toyota Credit Canada Inc.- Security over a 2007 Toyota FH Cruiser
- Toyota Credit Canada Inc.- Security over a 2011 Toyota Tundra
- Toyota Credit Canada Inc.- Security over a 2006 RG4 Toyota

IV. LEGAL PROCEEDINGS

Royal Bank of Canada provided the Bankrupt with a credit facility of \$275,000.00.

The Bankrupt has defaulted under its terms arrangements and Royal Bank of Canada commenced legal action.

As discussed throughout this report, in April 2014 Royal Bank of Canada was awarded judgment. It is our understanding that the Debtor attempted to negotiate a settlement with RBC, which ultimately was not accepted.

On August 1, 2014 the Trustee made demand on RBC to prove its security and assess its claim. As of the date of the meeting, not claim has been filed by RBC.

V. EVALUATION OF ASSETS and ANTICIPATED REALIZATION

EQUIPMENT-

An appraisal obtained by the Trustee, indicates that the equipment used at this business is outdated, old and in poor condition. The “distress value” if sold on site, has been estimated at approximately \$20,750.00. This value does not factor auctioneer fees, removable costs and the like. The Definition of distress value represents the value obtainable for the assets on a forced sale basis by means of an auction.

The Bankrupt carries very little inventory. The inventory located at the premises mainly pertain to customers goods.

ACCOUNTS RECEIVABLES-

There are no realizable accounts receivables. The only accounts receivables that are generated are from royalties that the bankrupt collects pursuant to a licensing agreement for the use of its intellectual property.

INTELLECTUAL PROPERTY-

Value is unknown. The intellectual property is industry specific to any parties who may be interested in the software technology.

Pursuant to a licensing agreement dated January 29th 2014 the Bankrupt entered into a Software License Agreement with 2321793 Ontario Inc. The Bankrupt was interested in licensing certain software and 231793 had expressed an interested in exclusively licensing the software.

The intellectual property includes patents, inventions, trademarks, service marks, registered designs, copy rights, etc.

The License term for the Agreement was for a three year period commencing on April 1, 2014.

2321793 Ontario Inc. was to pay the Bankrupt a royalty payment equal to 10% of sales generated by 231793 net of HST or any other applicable taxes.

The Agreement immediately terminates if the Bankrupt becomes insolvent or admits its inability to pay its generally as they fall due.

It is estimated that the net sales to flow to the Bankrupt estate is approximately \$15,000.00

VI. REVIEWABLE TRANSACTIONS/PREFERENCE PAYMENTS/SETTLEMENTS

The Trustee has not conducted any investigation of any historical transactions, nor will any such investigation be done, unless the Trustee is authorized by the creditors/inspectors to do so and the creditors provide funding for such an investigation.

VII. PROOFS OF CLAIM(S)

Please see attached claims register on claims received to date.

VIII. OTHER MATTERS

The Trustee will also be seeking directions from the creditors/inspectors on the following matters:

- a) Approval of all of the Trustee's actions to date including the actions outlined in this Preliminary Report and affirmation of Trustee's appointment;
- b) Appointment of inspectors;
- c) Direction on the sale of the physical assets from the secured creditors and Canada Revenue Agency;
- d) Affirmation of the Appointment of legal counsel being Howard Manis, from MacDonald Sager Manis, LLP;
- e) Trustee fees are being covered by way of third party funding. There are no assets in the assets to cover the costs of the Trustee and or its legal fees ;



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- f) Trustee will be in discussions with Canada Revenue Agency with respect to entertaining any arrangements pursuant to Directive 12R;
- g) Investigation into the Bankrupt's books and records and funding for same:
- a. Preference Payments;
 - b. Reviewable Transactions;
 - c. Settlements;
- h) Any other matters which may arise at this first meeting;

DATED at Aurora, Ontario this 12th day of August, 2014.

RUSSO CORP.
Trustee of the Estate of
Norteck Computers Ltd., "the Bankrupt"
And not in its personal capacity

Per: Joanne Russo, CIRP, Trustee In Bankruptcy