

Court No. 25-1124513
Estate No. 25-1124513
Affidavit of Rick Souther
Sworn November 20, 2008

**IN THE COURT OF QUEEN'S BENCH OF ALBERTA
JUDICIAL DISTRICT OF CALGARY**

IN BANKRUPTCY

IN THE MATTER OF THE PROPOSAL OF

DUNN TRUCKING LTD.

OF THE TOWN OF TABER, IN THE PROVINCE OF ALBERTA

AFFIDAVIT

I, Rick Souther, of the Town of Taber, Businessman, MAKE OATH AND SAY:

1. I am the President, and director of The Diamond Bullet Corporation ("**Diamond**"), Premiere Manufacturing Ltd. ("**Premiere**"), Hat Bit Supply Ltd. ("**Hat Bit**"), Dunn Trucking Ltd. ("**Dunn**"), DBC International Inc. ("**DBC**"), R Environmental Labs Ltd. ("**Labs**") (collectively referred to as the "**Debtor Companies**") and as such have personal knowledge of the matters to which I depose in this Affidavit, except where such matters are stated to be based on information and belief, in which case I verily believe such information to be true.

A. Introduction

2. This Affidavit is made in support of an application by the Debtor Companies for an Order granting certain relief under the *Bankruptcy and Insolvency Act* (Canada) (the "**BIA**"), including the following:

- (a) an extension of time for the Debtor Companies to file their proposals to January 10, 2009;

- (b) leave to return for authorization and direction for Diamond to enter into an agreement with a proposed auction house or other purchaser to dispose of its assets;
- (c) authorizing Premiere to enter into a Commercial Real Estate Purchase Contract, selling its industrial plant building property located in Taber, Alberta; and
- (d) procedurally consolidating the Estates of the Debtor Companies, set out in the table below:

| <u>Debtor Company</u> | <u>Estate No.</u> |
|--|-------------------|
| THE DIAMOND BULLET CORPORATION, PREMIERE MANUFACTURING LTD. and HAT BIT SUPPLY LTD | 25-1124515 |
| DBC INTERNATIONAL INC. | 25-1124511 |
| R ENVIRONMENTAL LABS LTD. | 25-1124514 |
| DUNN TRUCKING LTD | 25-1124513 |

B. Overview of the Debtor Companies

- 3. From 1991, the Debtor Companies have been manufacturing, distributing and selling drill bits used for drilling on oil and gas sites.
- 4. On October 27, 2008, the Debtor Companies filed Notices of Intention to Make a Proposal (the “NOI”) under subsection 50.4(1) of the BIA. Meyers Norris Penny Ltd. (the “Trustee”) consented to act as trustee under the Debtor Companies’ NOI.
- 5. Each of the Debtor Companies are privately-held companies incorporated in Alberta with their offices in Taber, Alberta. A copy of the Diamond, Premiere, Hat Bit, DBC, Labs and Dunn corporate search results are attached and marked as Exhibits “A.1”, “A.2”, “A.3”, “A.4”, “A.5” and “A.6”, respectively, to this Affidavit.
- 6. Diamond is a holding company for shares of Premiere and Hat Bit.

7. Premiere is a manufacturer, distributor and vendor of tri-cone and poly-crystalline diamond compact drill bits (“**Bits**”) used for drilling on oil and gas sites.. Primarily, Premiere’s Bits are sold to drilling companies operating in British Columbia, Alberta and Saskatchewan.
8. Hat Bit was a distributor of Premiere’s Bits but as of September 2007, it became a division of Premiere.
9. DBC is a distributor of Premiere’s Bits.
10. Labs is a manufacturer of repair parts for Premiere’s Bits which it sells to Premiere. Additionally, Labs has started to enter the waste water treatment and air purification businesses. In respect of waste water treatment, Labs offers products and services to reclaim sewer water, allowing it to be returned safely to the environment. Labs is working towards obtaining approval of its processes from the Alberta Government. In respect of air purification, Labs produces tri-oxide which can be used to clean mould and prevent crop spoilage. Labs’ equipment are valued at \$1,300,000. While contracts for services have been put on hold to deal with the issues addressed in this Affidavit, parties have expressed interest in Labs’ products and services and in the event that the Debtor Companies are able to formulate viable proposals under the BIA, Labs will continue to operate its air and water purification business and on a reduced scale and will continue to manufacture and repair Bits.
11. Dunn is a holding company for shares of Diamond.
12. Together the Debtor Companies employ 10 people in the Taber, Alberta.
13. On March 3, 2006, Hat Bit entered into a credit facility with HSBC Bank Canada (the “**Bank**”) in the amount of \$73,685, guaranteed by Diamond, Premiere and Labs. A copy of the Hat Bit credit facility is attached and marked as **Exhibit “B”** to this Affidavit.
14. Also on March 3, 2006, Labs entered into a credit facility with the Bank in the amount of \$160,875, guaranteed by Diamond, Premiere and Hat Bit. A copy of the Labs credit facility is attached and marked as **Exhibit “C”** to this Affidavit.

15. On April 27, 2007, Diamond entered in to a credit facility for an operating line of credit with the Bank in the amount of \$1,600,000 (the "**Operating Loan**"), guaranteed by Hat Bit, Premiere, Labs and DBC. A copy of the Diamond credit facility is attached and marked as **Exhibit "D"** to this Affidavit.
16. Also on April 27, 2007, Premiere entered into a credit facility for a term loan with the Bank in the amount of \$1,900,000 (the "**Term Loan**"), guaranteed by Diamond, Hat Bit, Labs and DBC. A copy of the Premiere credit facility is attached and marked as **Exhibit "E"** to this Affidavit.

C. Events Leading to Filing of the Notice of Intention to File a Proposal

17. For the past two years, sales of Premiere's Bits have been slowed by a decreased amount of drilling activity in the oil and gas industry and a cheaper competitor's product manufactured in China and imported to Canada and North America.
18. Despite those factors, on or about July 2008, the Term Loan had been paid down to approximately \$1,370,000 and the Operating Loan had been paid down to approximately \$1,570,000.
19. Pursuant to the financial covenants set out in the Operating Loan, it should have been paid down to approximately \$1,350,000.
20. On or about July 2008, the Debtor Companies and the Bank negotiated an amendment to the credit facilities to increase the Term Loan by \$300,000, the proceeds of which increase would be applied to reduce the Operating Loan and permit the Debtor Companies to remain in compliance with their financial covenants. In respect of this amendment, an appraisal of the Bits was conducted and a payment of \$5,000 was made to the Bank by the Debtor Companies.
21. Additionally, the Debtor Companies' auditor, BDO Dunwoody in Lethbridge, Alberta, failed to provide the Debtor Companies and the Bank with the audited financial statements for the financial year end of September 30, 2007 until June 2008, thereby not complying with a reporting condition set out in the Term Loan and Operating Loan.

22. On September 24, 2008, the Bank's legal counsel, Fraser Milner Casgrain LLP, demanded on behalf of the Bank, repayment in full of all of the indebtedness of the Debtor Companies (the "Demand") and issued notices of intention to enforce its security. Copies of the Bank's demand letters are attached and marked as Exhibits "F.1", "F.2", "F.3", "F.4" and "F.5" to this Affidavit.
23. At present, there is approximately \$3,050,000 owing by the Debtor Companies to the Bank (the "Bank Indebtedness").
24. Other creditors of the Debtor Companies and an estimate of the amount owed to each are set out in the following table:

| Debtor Company | Creditor | Estimate of Amount Owed |
|----------------|-------------------------|-------------------------|
| Dunn | BDO Dunwoody | \$1,280.00 |
| | Bow River Gas Co-op | \$1,200.00 |
| | Epcor | \$800.00 |
| | Town of Taber | \$2,500.00 |
| | Sub-total | \$5,780.00 |
| Labs | Alta health & wellness | \$568.00 |
| | BDO Dunwoody | \$3,675.00 |
| | Canada Revenue | \$673.00 |
| | Epcor | \$3,631.00 |
| | Receiver General (gst) | \$7,539.00 |
| | Town of Taber | \$9,033.00 |
| | TSG Insurance | \$2,511.00 |
| | UFA Co-op | \$1,095.00 |
| | Workers Comp | \$530.00 |
| | Emcap | \$750.00 |
| | CITI Finance | \$2,116.00 |
| | Morneau Sobeco | \$750.00 |
| | Sub-total | \$32,871.00 |
| Premiere | Alberta Health Wellness | \$748.00 |
| | AXA Insurance | \$2,209.00 |
| | B & S Publications | \$300.00 |
| | BDO Dunwoody | \$113,052.00 |
| | BFI Canada | \$1,233.00 |
| | Dennis mobile Glass | \$420.00 |
| | Direct Energy | \$412.00 |

| | | |
|--|------------------------|----------------|
| | Enmax | \$3,087.00 |
| | Globalstar | \$784.00 |
| | London Life | \$5,850.00 |
| | Master Card | \$6,378.00 |
| | Midwest Communications | \$368.00 |
| | Overhead Door | \$303.00 |
| | Receiver General | \$10,795.00 |
| | Labs | \$1,100,000.00 |
| | Richard Low | \$730.00 |
| | Shell Canada | \$20,995.00 |
| | Superior Propane | \$1,000.00 |
| | Taber temp | \$279.00 |
| | Telus Com. | \$2,507.00 |
| | Telus Mobility | \$10,755.00 |
| | TNS Business centre | \$1,266.00 |
| | Town of Taber | \$6,227.00 |
| | TSG Insurance | \$4,634.00 |
| | UFA Co-op | \$2,985.00 |
| | Unifirst Canada | \$345.00 |
| | Water Pure & Simple | \$583.00 |
| | Western Canada Welding | \$5,090.00 |
| | Workers Comp. | \$3,785.00 |
| | Xerox Canada | \$3,472.00 |
| | GE Equipment | \$1,125.00 |
| | GMAC Finance | \$5,210.00 |
| | Toyota Finance | \$345.00 |
| | Morneau Sobeco | \$2,951.00 |
| | Merril Insurance | \$4,975.00 |
| | Subtotal | \$1,325,198.00 |
| | Total | \$1,363,849.00 |

25. In addition, there is a contingent claim against the Debtor Companies by a shareholder, Lorna Moores and Three Cloud Properties Ltd., who has commenced an action against the Debtor Companies and I, in respect of a shareholders loan. A defence to that claim has been filed by the Debtor Companies and I.

D. Current Financial Position of the Debtor Companies

26. Unaudited Financial Statements for the year ending September 30, 2007 for Premiere, DBC, Labs and a draft version for Hat Bit are attached hereto and marked as Exhibits “G”, “H”, “I” and “J”, respectively, to this Affidavit.

27. The most recent financial information available for Diamond, Premiere, Hat Bit, DBC and Labs are internally prepared, unaudited Financial Statements attached hereto and marked as **Exhibits "K", "L", "M", "N" and "O"**, respectively, to this Affidavit.

Dunn

28. The financial statements of Dunn remain with its former accountant, BDO Dunwoody. I am informed by the Trustee and do verily believe that Dunn's former accountants have set out in Dunn's tax records for the year 2006, that it had assets totalling \$1,098,412 including investments in related corporations totalling \$875,187, an aircraft with a cost of \$130,000 and a building on leased land with a cost of \$39,038.
29. I verily believe that the aircraft was a personal asset and require further information from Dunn's former accountant, BDO Dunwoody to understand its inclusion in Dunn's tax records.

Diamond, Premiere and Hat Bit

30. Diamond, Premiere and Hat Bit's Financial Statements show that as at October 30, 2008 they had cash on hand of \$39,203.15, accounts receivable of \$464,146 and inventory of \$5,408,361 versus total secured and unsecured liabilities, excluding the Bank Indebtedness, inter-company debt, contingent claims and shareholders loans, of approximately \$746,246.
31. Diamond, Premiere and Hat Bit's primary secured creditor is the Bank. The remaining are secured loans to related companies and vehicle leases. The Personal Property Registry search results for Diamond, Premiere and Hat Bit are attached and marked as **Exhibits "P", "Q", and "R"** to this Affidavit.

DBC

32. DBC's Financial Statements show that as at September 30, 2008 they had cash on hand of \$13,318, accounts receivable of \$183,876 and inventory of \$574,995 versus total secured and unsecured liabilities, excluding the Bank Indebtedness, inter-company debt, contingent claims and shareholders loans of approximately \$400.

33. DBC's sole secured creditor is the Bank. The Personal Property Registry search result for DBC is attached and marked as **Exhibit "S"** this Affidavit.

Labs

34. Lab's Financial Statements show that as at October 30, 2008 they had cash on hand of \$22,993, accounts receivable of \$524,474 and inventory of \$116,242 versus total secured and unsecured liabilities, excluding the Bank Indebtedness, inter-company debt, contingent claims and shareholders; loans of approximately \$114,334.
35. Lab's primary secured creditor is the Bank. The remaining secured loans are vehicle leases. The Personal Property Registry search result for Labs is are attached and marked as **Exhibit "T"** to this Affidavit.
36. Due to the timing of the Bank's Demand, the Debtor Companies do not have sufficient cash to pay their liabilities; however, the Debtor Companies' assets are valued in excess of the Debtor Companies' liabilities.
37. The significant assets of the Debtor Companies are as follows:
- (a) An 11,200 square foot warehouse and office building located in Taber, Alberta, (the "Warehouse") owned by Labs, appraised on October 12, 2006 to be worth between \$475,000 and \$525,000. A copy of the Warehouse appraisal is attached and marked as **Exhibit "U"** to this Affidavit;
 - (b) An 8,700 square foot industrial plant building located in Taber, Alberta, (the "Plant") owned by Premiere, appraised on October 12, 2006 to be worth between \$375,000 and \$415,000. A copy of the Plant appraisal is attached and marked as **Exhibit "V"** to this Affidavit;
 - (c) Inventory and shop equipment, made up primarily of thousands of Bits, appraised on June 2, 2008 by Century Services Inc. to be worth between \$8,924,840 on a liquidation basis and \$11,337,250 on a fair market value basis (the "**Century Appraisal**"). Century Services Inc. was retained by the Bank in order to provide

the Century Appraisal. A copy of the Century Appraisal is attached and marked as **Exhibit "W"** to this Affidavit; and

- (d) Federal Scientific Research and Experimental Development ("SR&ED") Tax Credits, the value of which and ownership of are currently being evaluated by a contractor specializing said SR&ED Tax Credits.
38. In respect of the Bits, it is my experience based on over 35 years in the oilfield services industry that when the price of oil and gas decreases, the amount of drilling activity increases because the production companies change their focus from difficult areas like the oil sands to more conventional sources of oil and gas. Conversely, when the price of oil and gas increases, the amount of drilling activity decreases as companies focus on heavy oil production.
39. Confirming my experience is the fact that over the past couple of months, Premiere has seen an increase in its sales orders and the value of the orders.
40. Based on the foregoing, I believe that the Bits are either worth what was appraised by the Century Appraisal or more.

E. Extension of Time to Make a Proposal

41. After filing the Debtor Companies' NOI, I, as the sole director and executive officer of the Debtor Companies, undertook the following tasks:
- (a) Preparing cashflow statements for all six corporations, as required by the BIA;
 - (b) Cataloguing Premiere's inventory of approximately 6,000 Bits for the purpose of enclosing in a Request for Proposals sent to auction houses for the best method of sale and greatest recovery; and
 - (c) Contacting auction houses and potential purchasers to purchase the Bits. Those auction houses and potential purchasers contacted include: Ritchie Bros. of Edmonton, Alberta, Century Services of Calgary, Alberta, Maynards of Kelowna, B.C., Adobe Drilling Equipment of Odessa, Texas, Givens International of

Illinois, Stark Bit of Midland, Texas, USA Rock Bit of Archer City, Texas, Comanche Bit of Oklahoma, Atlas Rock Bit of Oklahoma, Hi Jet Bit of Oklahoma, Liberty Bit of Oklahoma, Brock Bit of Tylertown, Missouri, Bitco of Roseburg, Oregon, Duncan Bit of Houston, Texas, INC Engineering of Los Angeles, California, and Global Vision of Oklahoma.

42. Last December, I had to terminate the Debtor Companies' accountant and as a result, being the sole director and executive officer of the Debtor Companies meant that I could not delegate the preparation of cashflow statements, a requirement of the BIA. I carried out this task with the assistance of the Trustee.
43. I could not delegate the extremely complex and time consuming task of the cataloguing of inventory. The cataloguing of the inventory, consisting of thousands of drill bits, was time consuming but, in my opinion, necessary for the viable proposal to the Debtor Companies' creditors. To leave the inventory to a person without experience in industrial drill bits could result in errors and mistakes which may prejudice the Debtor Companies' creditors. Unfortunately, this task took a great deal of my personal time which I had hoped to spend on finalizing agreements with potential purchasers or auctioneers but was necessary in order to have an orderly disposition of the assets. I believe that completing this task was beneficial to both the Debtor Companies and the creditors, including the Bank.
44. While additional time is still needed for the Debtor Companies' to analyze and prepare their proposal to creditors, in the interim it is the intention of the Debtor Companies to dispose of the majority of the diamond drill bit inventory and to sell the Premiere Warehouse and Plant. Based upon the Century Appraisal, the proceeds of sale should repay the Bank Indebtedness in full and may be sufficient to pay all of the other secured and unsecured creditors of the Debtor Companies in full. In the event that the proceeds of sale, after repayment in full of the Bank Indebtedness, are insufficient to repay the unsecured creditors in full, the unsecured creditors will be subject to a proposal under the BIA. This would permit some or all of the Debtor Companies to continue to develop the

water and air purification business and, on a more limited basis, continue selling diamond bits to oil and gas production companies.

45. The Debtor Companies require time to conclude the transactions set out above. Management believes that there is a potential for the assets of the Debtor Companies to realize significant future value for its creditors through a proposal.
46. Based upon the aforementioned, the Debtor Companies have assets and a business that has value and requires protection from creditors to afford the Debtor Companies the opportunity to file a viable proposal. Specifically, Management believes that, with the benefit of a stay, the Debtor Companies will be better able to affect a sale of the businesses or key assets.
47. I believe that a failed proposal of the Debtor Companies would have a significant negative impact on numerous stakeholders, including the Debtor Companies' creditors. Further, I believe that a successful proposal creates a better prospect for a full recovery to both the secured and unsecured creditors than would a forced liquidation by a receiver appointed by the Bank.

F. Disposition of Premiere's Inventory of Bits

48. As set out in paragraph 36 above, I catalogued the Bits and completed that process on November 19, 2008. I have contacted three auction houses to sell the Bits through as well as 12 potential purchasers in the United States and provided or arranged to provide the Premiere' asset list. The United States purchasers have each shown interest in the Bits and have advised they will be travelling to the Debtor Companies' facilities to view the products.

G. Disposition of Premiere's Plant

49. On November 18, 2008, Premiere received an offer to purchase the Plant in an amount of \$400,000, conditional on the following factors:
 - (a) That the buyer's home is sold by December 21, 2008;

- (b) That the buyer's lot is sold by December 21, 2008;
- (c) That the buyer obtains financing by December 21, 2008; and
- (d) The buyer and seller reach an agreement on chattels to be included with the Warehouse by December 21, 2008.

A copy of the offer to purchase the Plant is attached and marked as **Exhibit "X"** to this Affidavit.

- 50. The offer has not been accepted and the Plant is still being marketed to potential purchasers.
- 51. Given the value of the assets of the Debtor Companies, I believe that the proposed sales of the Debtors Companies' assets are appropriate and will result in proceeds to satisfy the claims of the Debtor Companies' creditors, in full.


H. Procedural Consolidation

- 52. As discussed in this Affidavit, the facts as they relate to the Debtor Companies, their creditors and the NOI are the same and arise from the same transactions.
- 53. To allow the Debtor Companies and the Trustee to file one set of pleadings in respect of all of the Debtor Companies would avoid multiplicity of proceedings, thereby reducing time and costs of the parties involved.
- 54. The Debtor Companies have at all times maintained distinct and separate bank accounts and have operated as separate legal entities.
- 55. The Debtor Companies seek a purely procedural consolidation of the Debtor Companies' Estates and do not an order permitting the intermingling of the Debtor Companies' assets into a common pool.

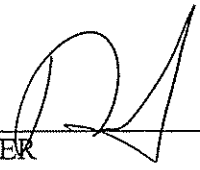
I. Conclusion

- 56. I make this Affidavit in support of an application by the Debtor Companies under the provisions of the BIA for an order extending the time in which to make a proposal, authorizing the disposition of the Debtor Companies' assets in the method and manner set out herein and procedural consolidation of the Debtor Companies' Estates to avoid a multiplicity of proceedings.

SWORN BEFORE ME at the City of)
 Calgary, in the Province of Alberta,)
 this 20 day of November 2008.)



 A COMMISSIONER FOR OATHS)
 In and for the Province of Alberta)



 RICK SOUTHER)

Court No. 25-1124513
Estate No. 25-1124513

IN THE COURT OF QUEEN'S BENCH OF
ALBERTA
JUDICIAL DISTRICT OF CALGARY

IN BANKRUPTCY
IN THE MATTER OF THE
PROPOSAL OF
DUNN TRUCKING LTD.

OF THE TOWN OF TABER, IN THE
PROVINCE OF ALBERTA

AFFIDAVIT OF RICK SOUTHER

Sworn: November 20, 2008

GOWLING LAFLEUR HENDERSON LLP
Barristers & Solicitors
1400, 700 – 2nd Street S.W.
Calgary, Alberta T2P 4V5
Responsible Solicitor:
CRAIG MCMAHON
Telephone: (403) 298-1874
Facsimile: (403) 695-3584

File No.: A114525

