

**IN THE COURT OF QUEEN'S BENCH OF ALBERTA
IN BANKRUPTCY & INSOLVENCY
JUDICIAL DISTRICT OF EDMONTON**

**IN THE MATTER OF THE PROPOSAL OF
TRANSGLOBAL COMMUNICATIONS GROUP INC.**

Trustee's Report

Introduction and Purpose

Transglobal Communications Group Inc. ("Transglobal", the "Company") filed a Notice of Intention to Make a Proposal ("Notice of Intention") on May 20, 2008, and Meyers Norris Penny Limited consented to act as Trustee under Proposal. A Cash Flow Projection was prepared and filed on May 30, 2008.

It is our view that Transglobal will not be in a position to file a definitive Proposal by June 19, 2008.

Background

Transglobal began its business in 1989 and was incorporated in 2000. Steven Prescott is the sole Director. Search results conducted of the Alberta Corporate Registry lists shareholders as Steven Prescott (50%), and 833497 Alberta Ltd. (50%). Steven Prescott and Dawn Prescott (wife of Steven Prescott) each own 50% of 833497 Alberta Ltd.

The Company designs and distributes such items as children's books, stationery, greeting cards, gift bags and gift wrap to major retailers primarily in the United States, as well as in Canada. The Company outsources the production of these goods to factories located in China. Transglobal has offices located in Edmonton, California, and Hong Kong, and employs fifteen full-time employees in Canada, ten full-time employees in the United States, and four full-time employees in Hong Kong.

We are advised by management that the business has been profitable over its years of operations. Consolidated financial statements prepared for the year ended December 31, 2007 and December 31, 2006, report Sales of approximately \$19M and \$18.5M respectively, with reported Income before Income Taxes of \$20,000 and \$82,000 respectively. The consolidated financial statements include the Company's wholly-

owned subsidiary corporations: TransGlobal Communications Group USA Inc. and TransGlobal Communications Group Ltd. (Hong Kong). Management advises us that all revenue is generated by Transglobal, and all assets are owned by Transglobal.

The Company's current financial difficulties arose out of two significant events: the alleged embezzlement of Company funds by Transglobal's former Controller, and litigation involving two entities named "Stone Sapphire".

We are advised by management that Josh Kulbaba, the Company's former Controller, misappropriated over \$600,000 from the Company over a four year period, beginning in 2004 until April 2008 when it came to light. We are further advised that the Company commenced an action against Mr. Kulbaba for recovery of the funds, and obtained a Court Order freezing Mr. Kulbaba's property until the outcome of the litigation. The Trustee does not have an independent valuation of the seized property.

With respect to the Stone Sapphire litigation, it is our understanding that Stone Sapphire Ltd., a company incorporated in Hong Kong, commenced an action in Edmonton against Transglobal, claiming approximately \$2.3M USD was owed by Transglobal pertaining to an agreement between the parties for shipment of Transglobal's inventory manufactured in China. Transglobal brought a counterclaim for damages including approximately \$4M in specified damages pertaining to various claims, including defective product. Further, Transglobal commenced an action in California against Stone Sapphire Limited, a British Virgin Island Company, for copyright infringement.

In April 2007, the Court found in favor of Stone Sapphire Ltd. in the Edmonton action, in the amount of approximately \$1.53M USD. Due to the counterclaim, the Court ordered that a stay of execution on the judgment be granted upon payment of the judgment amount into Court. Transglobal paid \$1.53M USD as ordered, and the funds remain in Court.

Subsequent to the summary judgment, Transglobal alleged that the Plaintiff was improperly named because Transglobal had learned that there were two "Stone Sapphire" companies. Transglobal alleges that the Plaintiff, Stone Sapphire Ltd., a company incorporated in Hong Kong was not the company that they were doing business with. An application for reconsideration of the summary judgment was heard in Court in April 2008; however, reasons for judgment in respect of the reconsideration have not yet been issued.

We are advised that the payment of these funds into Court caused the Company to be out of covenant with its primary secured lender, HSBC Bank Canada ("HSBC"), who issued demand and Notice of Intention to Enforce Security on May 8, 2008. Further, the Company's operating facilities with HSBC were frozen. It is our understanding that the foregoing precipitated the Company's filing a Notice of Intention on May 20, 2008.

It is our understanding that Stone Sapphire Ltd. is seeking to have the stay of proceedings lifted as against Transglobal, such that the funds in Court could be paid to them. However, HSBC takes the position that they hold security over those funds by virtue of their General Security Agreement executed with the Company. On May 23, 2008, HSBC appeared in Court and obtained an Order authorizing them to bring an application for determination of its claim and the priority to the funds in Court. The date for the hearing of this application was ordered to not be before June 30, 2008.

Secured Creditors

As previously reported, the Company's largest secured creditor is HSBC who provided working capital by way of operating loans. The operating loans were margined against the Company's accounts receivable, to a maximum of \$2,000,000. HSBC holds general security over all of the Company's assets, and registered a financing statement in the Alberta Personal Property Registry on February 25, 2005. Pursuant to the Notice of Intention to Enforce Security, HSBC made demand for payment pertaining to a Canadian dollar operating loan with a balance of \$1,046,766.42, and a U.S. dollar operating loan with a balance owing of \$1,091,838.88, as well as outstanding credit card facilities.

On March 2, 2004, Business Development Bank of Canada ("BDC") registered security over all of Transglobal's assets. On March 21, 2005 HSBC and BDC registered notice of a priorities agreement executed between the parties, such that HSBC holds a priority security position. Management has advised us that the Company has two terms loans with BDC, which are currently at a total balance of approximately \$129,000. Our review of the Company's banking activity indicates that the two term loan payments, totaling approximately \$8,500, were directly debited from the Company's account in June 2008. Management advises that they will be speaking with BDC concerning discontinuing repayment of these secured loan obligations during the current stay of proceedings in an effort to conserve working capital.

There are a number of lessors that have registered financing statements pertaining to leased office equipment, computer equipment, and vehicles. The Company has postponed repayment of financing contracts with respect to equipment during this period of stay of proceedings. Our review of the Company's banking activity indicates that two cheques were written on May 27th, 2008 to Chrysler Credit totaling approximately \$2,000.

Assets

Accounts Receivable

The Company reports Account Receivable as at June 13, 2008, totaling \$69,533 CAD and \$2,731,071 USD, for a combined CAD total of \$2,949,108 (using an exchange rate of \$1.054376 CAD/USD). From the Trustee's review of this report, we note that \$737,043 CAD is reported to be due from Stone Sapphire Limited, a customer with whom the Company is currently involved in litigation, and is also listed as a creditor at the time of the filing of the Notice of Intention. Accordingly, it is our opinion that it is unlikely this account would be collected in the normal course.

Of the remaining balance of \$2,212,065, \$1,304,114 (or 59%) is less than 60 days outstanding, \$147,900 (or 6%) is 61 - 120 days outstanding, and \$760,051 (or 35%) is greater than 120 days outstanding. We have reviewed these accounts with management, and the Company anticipates that all accounts are fully collectable. However, we note that two additional accounts receivable were also listed as creditors at the time of the filing of the Notice of Intention, and accordingly, may assert a right of set-off. The potential set-off pertaining to these two accounts total \$174,412 CAD.

We note that annual Bad Debts reported in the year end consolidated financial statements for 2007 and 2006 total approximately \$31,400 and \$43,300 respectively.

Certain of the Company's Accounts Receivable are insured by Export Development Canada ("EDC") to a maximum coverage of \$3,000,000 USD. We have reviewed recent documents pertaining to the Accounts Receivable Insurance Policy, and note that USD accounts are insured to a maximum of 90%, subject to restrictions pertaining to credit limits and credit term periods which have been determined on an individual account basis. We also note from our review that it does not appear that CAD accounts are insured by EDC. We have compared the Accounts Receivable listing as at June 13, 2008 to the listing of current USD credit approvals, and estimate that of the USD accounts, approximately \$1,273,000 USD receivables are eligible for insurance. Accordingly, we estimate that based on insurance coverage of 90%, \$1,145,700 USD would be collectable through the Company's insurance policy.

Inventory

Management has provided an Inventory Valuation Report as at May 31, 2008, which values the Company's inventory at \$1.9M at average cost. Consolidated financial statements for the year ended December 31, 2007 reports inventory totaling \$555,000, valued at lower of cost or net realizable value. Management advises that a large number of inventory returns occurred in the current fiscal period, specifically pertaining to one of the Company's largest unsecured creditors, QVC Inc. The Trustee is unaware at this time

what realization could be anticipated from the Company's inventory on a liquidation basis.

Equipment

The Company owns various computer equipment associated with the Company's design operations, as well as various office equipment. There are a number of financing statements registered in the Alberta Personal Property Registry which seem to indicate that various equipment is subject to conditional sales contracts, leases, or other financing arrangements.

Artwork, Copyrights, and Patents

We are also advised that the Company owns various artwork used in the products that it distributes. We have been provided with a report dated February 20, 2008 prepared by Lando Gallery located in Edmonton, AB, which values the various artworks at approximately \$27M on a replacement value basis. The Trustee is unaware at this time what realization could be anticipated on a liquidation basis, but likely the value is significantly greater on a going concern basis. We are also advised that the Company owns various copyrights and patent items.

Post-Filing Operations

Subsequent to the Company's filing of a Notice of Intention on May 20, 2008, Transglobal has continued to carry on business. Sales for May 2008 are reported to total approximately \$939,218. Sales were projected to total \$1,158,951 in May, which is a variance of approximately \$220,000 or 19%.

We are advised by management that Transglobal is just entering its peak season, as historically the Company generates approximately 70% of its annual revenue during the months of June through September, pertaining to sales of Christmas and holiday season related goods. Management further advises that, as a result, the outstanding balance on Transglobal's operating loans were typically highest by July each year and very minimal by September and October.

Currently, the Company is paying for some goods and services on a cash basis; however, certain creditors have continued to operate with Transglobal on credit terms, which, management advises they are adhering to.

The Company utilizes a payroll service in Canada, which ensures that staff who are currently employed are paid on a regular basis, and all payroll deductions are remitted. We are advised by management that employees in the United States and Hong Kong are also being paid on a current and regular basis.

Further, management is in the process of negotiating the terms of the lease for the Company's premises in Edmonton. It is anticipated that the space the Company currently occupies will be reduced for July 2008, and the monthly rent will be reduced by approximately \$8,000. It is our understanding from management that the Company has not yet paid rent for June 2008, but anticipates that rent will be paid the week of June 16-June 20.

We are advised that the Company's principal, Mr. Prescott, provided the Company with \$195,000 USD from personal funds during April and May 2008 for working capital.

Business Plan

Management is currently reviewing all operating processes in light of the former Controller's alleged misappropriation of Transglobal's assets, and in order to implement reductions where possible concerning production costs and administrative overhead.

We are advised by management that they are currently in discussions with three lenders concerning refinancing of the Company's operating loans, as well as pre-shipment financing. Management is confident that should it be determined that HSBC has priority to the funds currently held in Court, and the funds are made available to HSBC, that the Company will be in a position to secure refinancing sufficient to pay HSBC in full and secure additional funding for operations and the funding of a Proposal to its creditors. It is unlikely that the finalization of any lending agreement will take place in forty-five days; but, it is our opinion that management should, by that time, have a clearer understanding of the terms and level of proposed financing which would facilitate filing a definitive Proposal to the Company's creditors.

We understand that at the present time, parties are able to appear in Court on August 11th, 2008 to hear the application of HSBC concerning priority to the funds held in Court. We also understand that the Court is available on that date; however, HSBC is attempting to secure an earlier date which Transglobal fully supports.

Further, the Company expects to receive some recovery of funds alleged to have been misappropriated by the former Controller. Although it is not anticipated that the related litigation will be resolved before the Company files a Proposal to its creditors, it is hoped that those proceedings can be sufficiently advanced during the extension period to enable the Company and its counsel to determine the value and timing for the resolution of the claim which will aid in the formulation of the Proposal.

An extension of time will enable the Company to continue to operate during its peak season while implementing cost saving measures, to continue discussions with potential lenders concerning refinancing, and may permit sufficient time to determine the priority

to the approximate \$1.53M USD currently held in Court. All of these steps will enable management to present a more comprehensive and definitive Proposal to its creditors than Transglobal could at the present time.

It is our opinion that:

- a) Despite the Company not forwarding the monitoring information to the Trustee on a timely basis (which the Company attributes to having no controller) the Company has and continues to act in good faith and with due diligence in formulating a Proposal,
- b) The Company would likely be able to make a viable Proposal if an extension was granted, and
- c) No creditor will be materially prejudiced if an extension is granted and the Company continues to act in good faith.

DATED this 17th day of June, 2008.

Meyers Norris Penny Limited
in it's capacity as Trustee in the Division I Proposal of
Transglobal Communications Group Inc.
and not in it's personal capacity



Grant Bazian, CIRP, Trustee
Senior Vice President