

District of Alberta
Division No: 01-Edmonton
Court No: 24-1071018
Estate No: 24-1071018

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

**IN THE MATTER OF THE DIVISION I PROPOSAL OF
Transglobal Communications Group Inc.**

TRUSTEE'S REPORT TO THE CREDITORS

A. INDEPENDENCE OF TRUSTEE:

The Trustee is not aware of any independence issues.

B. BACKGROUND:

Transglobal Communications Group Inc. (the "Company" or "Transglobal") designs and distributes such items as children's books, stationary, greeting cards, gift bags and gift wrap to major retailers primarily in the United States, as well as Canada and the United Kingdom. The Company outsources the production of these goods to factories located in China. Transglobal has offices located in Edmonton, California and Hong Kong.

C. CAUSE OF FINANCIAL DIFFICULTY:

The Company has been involved in an ongoing litigation action whereby a Summary Judgement was issued in April, 2007 requiring Transglobal to pay \$1.534 million USD into Court. The Company contests this judgement on a number of bases and it is currently the subject of a pending appeal. The money paid into Court, however, significantly reduced the Company's cash resources, causing them to overdraw their operating line with HSBC by approximately \$120,000 CAD. HSBC, upon reviewing the Company's account, apparently determined that covenant's had been breached and issued a Notice to Enforce Security on May 8, 2008.

Since filing the Notice of Intention to Make a Proposal, global economic factors (specifically in the US) have resulted in a massive decline in sales and difficulty collecting some outstanding accounts receivable.

Further, the Company claims that their former controller is liable to Transglobal in the approximate amount of \$600,000 for which there is ongoing litigation.

The combination of all the forgoing are the primary causes of the initial and ongoing financial difficulty of the Company.

D. CONDUCT OF THE DEBTOR:

The Company filed a Notice of Intention to Make a Proposal ("NOI") on May 20, 2008, and has remitted payment on the following pre NOI debts as management deemed it necessary to make the payments for the continued operations of the business:

- Yun Choy Ltd. – a supplier in China was paid \$453,822.28 USD as Letters of Credit issued by the Company's customers were initially set up to have portions transferred directly to Yun Choy Ltd. once the goods were completed and shipped. These transactions were set up prior to the filing of the NOI and could not be reversed;
- Zhe Jiang Ruyi Gifts & Crafts Co. – a supplier in China was paid \$211,986.13 USD as they had ceased work on all current orders and demanded payment before they would agree to complete. Management decided to pay the pre NOI debt in order to have the orders completed and delivered generating additional accounts receivable;
- Colorado Distribution Group – a warehouse in the United States utilized by the Company refused to ship product until their pre NOI debt of \$4,386.36 USD was paid. Management decided to pay the pre NOI debt in order to have product delivered and generate accounts receivable;
- QVC Inc. – a customer of the Company who had returned a substantial amount of product, and there by becoming a creditor, withheld 10% (i.e. \$13,600 USD) of an invoice payable to the Company resulting in \$13,600 USD being paid to QVC Inc. for a pre NOI debt. Payment was by way of Letter of Credit and the holdback of 10% had been initiated prior to the filing of the NOI which the Company was unable to prevent.

E. FINANCIAL POSITION:

Based upon the Company's current outstanding accounts receivable of approximately \$4.3 million USD, approximately \$2.6 million USD will be utilized to pay factories in China (in some cases payment is made directly by diverting a portion of the existing Letter of Credit pledged by the Company's customer, a transaction that can not be reversed) and operating costs. Approximately \$700,000 USD is an accounts receivable from Stone Sapphire which is deemed uncollectable due to ongoing litigation. The remaining approximate \$1.0 million USD is to be utilized to satisfy the terms of the Proposal and cover additional operating expenses of the Company. Using a conservative exchange rate of \$1.10 CAD/USD (the spot rate as at October 15, 2008 is \$1.145 CAD/USD), the \$1.0 million USD available to satisfy the terms of the Proposal converts to \$1,100,000 CAD.

F. IDENTIFICATION AND EVALUATION OF ASSETS:

A listing of assets and the respective values has been reported in the Statement of Affairs as at October 9, 2008. The accounts receivable have been recorded to indicate the net amount to be collected by the Company, as in some instances customers of the Company have secured their orders with Letters of Credit, of which a portion has been set up to be transferred directly to the factory supplying the product. In these cases the Company only receives the net value (or the margin) on the accounts receivable. The doubtful accounts have been recorded as 60% of those accounts under 90 days identified as a high likelihood of collection. The bad accounts consist of the portion of the gross accounts receivable being transferred directly to the factories via the Letters of Credit and other accounts receivable identified as low likelihood of collection.

G. CREDITOR'S CLAIMS:

The list of creditors and the amounts of their claims as at May 20, 2008 (date the NOI was filed with Office of the Superintendent of Bankruptcy) is included in the Statement of Affairs.

SECURED CLAIMS:

Class I (Operating Lines of Credit) – the secured claim of HSBC shall be paid pursuant to the terms and conditions of the security agreement in respect of the property held as security from proceeds realized in relation to the business operations or in the alternative, the secured claim shall be paid as agreed between the Company and HSBC. It is the Trustee's understanding that the Company intends to pay HSBC from all proceeds currently held in Court and from the majority of the approximate \$1.1 million CAD referenced in Paragraph E above. On September 5, 2008 the Court of Queen's Bench of Alberta ordered that HSBC held priority to the proceeds in Court under their General Security Agreement. This decision has been appealed and is expected to be heard at the Court of Appeal in February 2009;

Class II (Term Debt Financing) – the secured claim of Business Development Bank of Canada is to be repaid by its original payment terms and any arrears accumulated prior to the Court approval of this Proposal shall be repaid by additional regular monthly payments made subsequent to the scheduled expiration of the finance agreement in such amount that satisfies the entire debt obligation;

Class III (Lease Financing) – the secured claims of Key Equipment Finance Canada Ltd. and National Leasing Group Inc. are to be repaid by its original payment terms and any arrears accumulated prior to the Court approval of this Proposal shall be repaid by additional regular monthly payments made subsequent to the scheduled expiration of the finance agreement in such amount that satisfies the entire debt obligation.

The principal of the Company, Steve Prescott, currently has a \$120,000 secured position, however, he will be postponing his position in favour of all other secured creditors and unsecured creditors in the event that the Proposal is accepted by the creditors and approved by the Court.

UNSECURED CLAIMS:

Unsecured Claims will share in a prorata share of the proceeds paid to the Trustee by Transglobal. These payments are scheduled to be \$300,000 on or before January 15, 2009 with additional annual payments of the greater of \$50,000 or 30% of Net Profit (as calculated on the Company's year end accountant prepared financial statements, after tax). The initial \$300,000 Payment to the Trustee will come from the collection of the approximate \$1.1 million CAD accounts receivable as discussed in Paragraph E above.

The principal of the Company, Steve Prescott, currently has a \$1,202,000 unsecured claim, however, Mr. Prescott will not participate in any dividend distribution to the unsecured creditors.

H. REMUNERATION OF TRUSTEE:

The Trustee's fees shall be paid from time to time out of the funds already in the possession of the Trustee or as funds become available pursuant to the terms of the Proposal plus disbursements and GST. All fees will be submitted by the Trustee for approval and taxation by the Court pursuant to the Bankruptcy and Insolvency Act.

I. PROOF OF CLAIMS:

In completing a proof of claim, the creditors should include all amounts owing up to May 20, 2008 (date the Notice of Intention to Make a Proposal was filed with Industry Canada). All amounts incurred after May 20, 2008 if any, are to be paid by the Insolvent Person in the ordinary course of business.

J. ANTICIPATED DIVIDEND TO THE CREDITORS:

It is estimated that the minimum dividends payable to the unsecured creditors in the Proposal will total the sum of \$450,000 (before levy and fees), which represents a dividend of 10.13% of the total unsecured indebtedness. This minimum is based upon payments of \$50,000 per annum assuming that 30% of the Company's Net Profit is less than the \$50,000 as described in Article 16.5 of the Proposal. By comparison, it is estimated that the dividend payable to the unsecured creditors in a Bankruptcy will total the sum of \$0.00, which represents a dividend of 0% of the total unsecured indebtedness.

K. OTHER

As outlined in the Trustee's previous Reports to the Court there is ongoing litigation between the Company and Stone Sapphire Ltd. and until the litigation is concluded the Trustee cannot provide a definitive analysis on how the various claims, counterclaims, appeals and judgements will interplay. The unsecured debt of the Company may increase or decrease by amounts the Trustee cannot yet ascertain due to the as yet unknown result of this litigation, and the cashflow

of the Company may therefore deviate from present projections. These matters are extremely complicated and the outcome of the litigation will have a significant impact on the Company. The Trustee brings them to the creditors attention so that they can take these matters, albeit unquantified, into consideration upon review of the Proposal.

L. RECOMMENDATION AND CONCLUSION:

In reviewing the comparative analysis of the Projected Dividends attached as Exhibit "A" to the Proposal it is evident that the creditors will receive greater dividends in a Proposal than they would otherwise receive in Bankruptcy. Please note the rejection of this Proposal will result in an automatic Bankruptcy.

Historical trends show collection of accounts receivable within a 90 day window and with the current accounts receivable of approximately \$4.3 million averaging 45 days the bulk of it should be collected by November 30, 2008 (i.e. 90 days). This analysis indicates that the Insolvent Person is able to make the initial \$300,000 lump sum payment to the Trustee and the principal of the Company has agreed to inject personal funds into the company to ensure that the minimum \$50,000 payments per annum are made, should the Company not have the resources to do so. Accordingly, it is likely that the Insolvent Person will be able to perform the Proposal.

It is our opinion that the Insolvent Person is acting in good faith and with due diligence in its effort to restructure its unsecured debt. The Insolvent Person has demonstrated a willingness to complete the terms of the Proposal in an effort to maximize recovery for the unsecured creditors.

Based on the information provided in this Report, it is recommendation of the Trustee that the unsecured creditors accept the Proposal.

Dated at the City of Edmonton, in the province of Alberta, on October 17, 2008.

MEYERS NORRIS PENNY LIMITED

In its capacity as Trustee of the Division I Proposal of
Transglobal Communications Group Inc.
And not in its personal capacity

Per:  Grant Bazian, CRRP, Trustee
Senior Vice President