

Royal Aviation Inc., a Bankrupt

Trustee's Preliminary Report to Creditors

May 15, 2002

**IN THE MATTER OF THE BANKRUPTCY OF ROYAL AVIATION INC.
Of the City of Toronto in the Province of Ontario**

TRUSTEE'S PRLIMINARY REPORT TO CREDITORS

**SUBMITTED BY PRICEWATERHOUSECOOPERS INC. IN ITS CAPACITY AS
TRUSTEE**

INTRODUCTION

1. On November 11, 2001 Royal Aviation Inc. (the "Company") made an assignment in bankruptcy pursuant to Section 49 of the Bankruptcy and Insolvency Act and Deloitte & Touche Inc. was appointed as the trustee in bankruptcy.
2. On December 3, 2001 the Ontario Supreme Court of Justice substituted PricewaterhouseCoopers Inc. as the trustee in bankruptcy (the Trustee).

BACKGROUND

3. The Company was founded in 1979, had 13 aircraft in its fleet, employed 1,400 people, and carried more than 2.0 million passengers annually. The head office was located in Montreal, Canada and its offices were set up at most major airports it flew to in Canada and the United States. A large domestic flying program was offered as an alternative to Air Canada. The Company also had a large flying program to Britain, Europe, USA, Mexico and the Caribbean. Conifair, a division of the Company had a maintenance facility based in Quebec City, for the maintenance of Company-owned aircraft and to perform maintenance for third parties. The Company also had an interest in Canada 3000 Cargo, a cargo company developed to distribute cargo for third parties.
4. The Company was acquired by Canada 3000 Inc. on March 22, 2001.

5. Given the close inter-relationship between the affairs of the Company and Canada 3000 Airlines Limited, it was deemed appropriate that the first meeting of creditors be postponed in conjunction with the postponement sought for Canada 3000 Airlines Inc. An application was made and the Order granting an extension of time was made on November 30, 2001. The principal reason for this postponement was to allow time to deal with the claims of ticket holders and credit card companies through whom ticket holders had purchased tickets. This was accomplished through the use of a web site which received in excess of 243,000 hits and a call center which handled in excess of 42,000 calls.

CAUSES OF BANKRUPTCY

6. On November 8, 2001 the Company applied for protection under the Companies' Creditors Arrangement Act ("CCAA") and Deloitte & Touche Inc. was appointed monitor (the "Monitor").
7. Subsequent to the CCAA protection being granted, the Company ceased operations on November 9, 2001.
8. On November 11, 2001, the Monitor filed an assignment in bankruptcy on behalf of the Company, and Deloitte & Touche Inc. was appointed as the trustee in bankruptcy. On December 3, 2001 The Ontario Superior Court of Justice substituted PricewaterhouseCoopers Inc. as the trustee in bankruptcy.
The financial/economic causes of the business failure were:
 - Operating losses in the period of acquisition by Canada 3000 Airlines Limited caused in part by:
 - High fuel prices during the last two years; and
 - Relatively low Canadian dollar discouraged travel to the United States.
9. Other contributing factors were:
 - The cost of integrating the operations with those of Canada 3000;

- The September 11, 2001 terrorist attack which caused the shutdown of air travel for five days and a reduction in bookings afterwards; and
- Competitive forces including the introduction by Air Canada of Tango Airlines.

FINANCIAL POSITION OVERVIEW

10. A preliminary statement of affairs, as at November 11, 2001, was prepared by the Monitor.

11. This statement indicates the following:

Assets

Inventory	\$800,000
Accounts Receivable (book value 6,193,000)	1,000,000
Deposits in financial institutions	300,000
Machinery, equipment & plant	36,000,000
Real property	3,000,000
Furniture	600,000
Total Assets	<u>\$41,700,000</u>

Liabilities

Secured Creditors	\$32,736,930
Unsecured Creditors	<u>34,788,035</u>
Total Liabilities	<u>67,524,965</u>
Deficiency	<u>\$25,824,965</u>

The Secured Creditors shown were:

C.I.B.C.	\$4,736,930
First Security Bank	1,500,000
Celcius Amtrk Corp	1,500,000
Airbus Service Co.	25,000,000
	<u>\$32,736,930</u>

ROLE OF PRICEWATERHOUSECOOPERS INC. AS RECEIVER

12. On December 21, 2001 PricewaterhouseCoopers Inc. was appointed as Receiver by the Canadian Imperial Bank of Commerce (“CIBC”).
13. The draft statement of affairs dated November 11, 2001 showed that the amount owed to CIBC was \$4,736,930. The amount now claimed by CIBC, as a secured creditor, is approximately \$5,702,000. The significant part of the discrepancy is in regard to letters of credit which were drawn down subsequent to the Bankruptcy.
14. The assets under the control of the Receiver include:
- The interest of the Company in Canada 3000 Cargo Inc., which has been sold by Order of the Court as a potentially wasting asset. (The allocation of the value of this asset remains disputed as between the Company and Canada 3000 Airlines Limited);
 - Cash and accounts receivable;
 - Sales tax recoverable;
 - Insurance claims;
 - Receivables of the Conifair division;
 - Parts and other inventories;
 - Equipment;
 - Interests in aircraft; and
 - Potential value of tax losses.
15. The Trustee remains in possession of the Quebec real property.

CONSERVATORY AND PROTECTIVE MEASURES

16. Measures taken by Deloitte & Touche Inc. and PricewaterhouseCoopers Inc. as Trustee in Bankruptcy included:
- Securing assets and bank accounts;
 - Placing insurance coverage;
 - Inventory counts at all locations, together with appraisals;

- Control bank accounts and open new trust accounts; and
- Arrange for security at all locations, subsequently revised to only locations where there were significant assets vulnerable to wrongful seizure or pilfering.

17. The books and records, including electronic records, were secured both in Toronto, where the bulk of the records subsequent to the acquisition were maintained, and in Montreal where the pre –acquisition records were maintained. PricewaterhouseCoopers Inc. as Trustee and subsequently as Receiver made arrangements for the Company staff to update these to the date of bankruptcy in so far as possible and to file the statutory returns.

PROVABLE CLAIMS

18. Steps were taken to notify creditors to file claims as ordered by the Court as follows:

- Mailing to known creditors;
- Web site set up for the specific purpose;
- Advertisements in newspapers; and
- Employee claims were generated on behalf of employees by staff.

19. The following is a summary of the claims as shown on the draft statement of affairs and those filed as at the date of this report:

	<u>Claims per Draft S/A</u>	<u>Claims filed to Date</u>
Secured Creditors	\$32,736,930	\$32,309,947
Unsecured Creditors	34,788,035	19,469,679
Preferred Creditors	NIL	2,641,172
Total	<u>\$67,524,965</u>	<u>\$54,420,798</u>

20. A draft Statement of Affairs was prepared by Deloitte & Touche Inc., however no Officer of the Company was prepared to sign the document. Accordingly, the Trustee considers this unofficial document as a reference only.

21. The claims from Preferred creditors related primarily to claims from the FAA (\$1.85 million), employee and other miscellaneous claims filed subsequent to the drafting of Deloitte & Touche's preliminary Statement of Affairs.

SECURED CLAIMS

22. CIBC holds an interest in the assets of the Company registered in both Ontario and Quebec, but not including real property. This security has been reviewed by the Trustee's solicitor and found to be valid and enforceable.
23. Canada 3000 Inc. holds security over advances to the Company. The amount under this claim is not confirmed and no claim has yet been filed.
24. Airbus Service Co. holds an interest in an aircraft located in France at the time of the Bankruptcy that was held against maintenance fees. This security has been reviewed and found to be valid and enforceable.
25. Air France had a registered inventory supply agreement, through which it retained title to parts and rotables located in both Toronto and Montreal. This has also been reviewed and found to be valid and enforceable.
26. There are two financed 737-200 aircraft which were appraised, with a resulting conclusion that there was no prospect of generating a net recovery for the benefit of CIBC. The aircraft are still on the ground in Toronto, as the lessors have not yet paid the costs of safekeeping nor have they posted security against the Nav Canada claims, as required by the court. Nav Canada claimed a priority interest which was contested. In a ruling issued this week the Court has denied the priority of Nav Canada which permits the release of these aircraft.

UNSECURED CLAIMS

27. We have not as yet reviewed or admitted the claims as filed, and will not be doing so until such time as it becomes apparent that there will be a surplus available from the

security of the CIBC encumbered assets, or until the sale of the real property located on leased land is completed.

PREFERRED CLAIMS

28. A fund was created by Order of the Court under the initial CCAA application to provide a source of payment of the obligations of the Monitor. Certain operating costs and wages were paid from this fund.

LEGAL MATTERS

29. McMillan Binch acts as solicitor to PricewaterhouseCoopers Inc. as Trustee and is independent of counsel for CIBC and its Receiver, who are represented by Blake, Cassels & Graydon LLP.

30. Orders for the return of leased aircraft have been made by the Ontario Superior Court and all non-owned aircraft have been returned pursuant to the terms of those Orders. This included compensation for the costs of securing the aircraft prior to their return.

31. On February 8, 2002 an Order was made by the Ontario Superior Court, approving the sale of all interest in Canada 3000 Cargo Inc., and terminating the Subscription Agreement dated August 1, 2001 among Canada 3000 Cargo Inc., Royal Aviation Inc., Flagship International Marketing Inc. and Canada 3000 Inc.

REVIEWABLE TRANSACTIONS & PREFERENTIAL PAYMENTS

32. We have not found any transactions that are reviewable or that might be preferential.

CONFLICTS OF INTEREST RE RECEIVERSHIP

33. The Trustee caused the security of CIBC to be reviewed by its solicitor, before undertaking any activity as Receiver. There are no outside guarantees of the fees of the Trustee.

ANTICIPATED REALIZATIONS AND DIVIDENDS TO CREDITORS

34. Anticipated realizations and potential dividends to creditors are contingent on the following:

- Outcome of negotiations for the sale of the Conifair facility in Quebec;
- Allocation of proceeds of Canada 3000 Cargo sale;
- Outcome of current negotiations for the sale of aircraft;
- Tender results on sale of aviation parts (rotables/consumables);
- Insurance claims recoveries under negotiation;
- Possible sale of tax losses; and
- Final recoveries from accounts receivable.

35. The assets of the Conifair division were advertised at the same time as other asset advertising and we had a number of expressions of interest. Included in these assets is a hangar at the airport in Quebec City, on land leased from the Crown. An appraisal has valued the building at \$2.2 million; however, this does not take into account some difficulties with the repair of the roof, nor the issue of the assignability of the underlying land lease. Therefore, the realizable value is likely less than \$2.2 million. The CIBC does not claim an interest in this property, therefore whatever value is realized will be available to the Estate.

36. We have dealt with six interested parties and received to date two offers of interest. We are currently negotiating with both parties to execute a sale transaction.

37. The tender process for Royal's aviation parts (rotables/consumables) will conclude on May 15. We are finding the market for aviation inventory to be volatile and uncertain; because of this, it is difficult to estimate the realizable proceeds from this sale. However, the carrying value of these parts is substantial at approximately \$18.7 million. The success in generating recoveries for general creditors is largely dependent on the outcome of the tender.

38. As a result of these uncertainties, in our capacity as Receiver for the CIBC interest in the assets of the Company, we have estimated that the net realizations of their security are still in a very broad range, from a potential deficit, to a potential surplus of \$3.466 million. This broad range is a result of the volatility in the market for parts, and the several transactions under negotiation, which we are not certain will close. In reality it is unlikely that the surplus over the CIBC security will be material and the CIBC may be faced with a small shortfall. Therefore the recovery to unsecured creditors before the costs and expenses of the Trustee, is likely limited to the value of the real property which we estimate to be \$1.5 million to the full appraised value of \$2.2 million.

39. In summary, given that preferred claims filed to date are slightly more than \$2.6 million, it is unlikely that there will be any distribution to the ordinary unsecured creditors.

The Trustee respectfully submits to the creditors this its Preliminary Report.

Dated this 15th day of May 2002.

Yours very truly,

**PricewaterhouseCoopers Inc., Trustee of the estate of
Royal Aviation Inc.**

Marcus A. Wide
Trustee & Senior Vice-President