

**ONTARIO SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST**

**IN THE MATTER OF THE *COMPANIES' CREDITORS*
ARRANGEMENT ACT, R.S.C. 1985, c. C-36, AS AMENDED**

**AND IN THE MATTER OF A PROPOSED PLAN OF COMPROMISE OR
ARRANGEMENT WITH RESPECT TO
BRAKE PRO, LTD.**

MONITOR'S FIRST REPORT TO THE COURT

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A. INTRODUCTION

BDO Dunwoody Ltd. (the "Monitor") was appointed Monitor of Brake Pro, Ltd. (also referred to as "Brake Pro", the "Applicant" or the "Company") by an Initial Order of the Honourable Mr. Justice Stinson of the Ontario Superior Court of Justice on 24 July 2007 (the "Initial Order"), pursuant to the application (the "Application") to the Court by the Applicant for protection from its creditors under the *Companies' Creditors Arrangement Act* (the "CCAA"). The Applicant was granted protection for an initial period of 24 days until 17 August 2007 (the "Stay Period"). A copy of the Initial Order is attached as Appendix I. Capitalized terms not otherwise defined are as defined in the Initial Order and/or in the Affidavit of Russell Armer, sworn 23 July 2007. Unless otherwise stated, all monetary amounts contained herein are expressed in Canadian dollars.

The Application was made on notice to the Applicant's major secured creditor, Wachovia Capital Finance Corporation (Canada) ("Wachovia" or the "Bank"), which did not oppose the Initial Order. Pursuant to the Initial Order, Wachovia is an unaffected creditor. On 23 July 2007, Brake Pro entered into a Forbearance Agreement with Wachovia (the "Forbearance Agreement"), pursuant to which Wachovia has agreed to extend credit to Brake Pro through the CCAA process.

In addition to the Stay Period, the Initial Order authorized Brake Pro and the Monitor to undertake a sale process (the "Sale Process") whereby the assets of the Company would be marketed for sale as a going concern.

The role of the Monitor is set out in the Initial Order and the provisions of the CCAA and includes the following duties and responsibilities:

- (a) monitor the Applicant's receipts and disbursements;
- (b) report to this Court at such times and intervals as the Monitor may deem appropriate with respect to matters relating to the Property, the Business, and such other matters as may be relevant to the proceedings herein;

- (c) assist and advise the Applicant in its preparation of the Applicant's cash flow statements and reporting required by the Bank, and any other projections or reports, which information shall be reviewed with the Monitor and delivered to the Bank and its counsel on a periodic basis, as agreed to between the Applicant and the Bank;
- (d) advise the Applicant in its development of a Plan and any amendments to a Plan;
- (e) assist the Applicant, to the extent required by the Applicant, with the holding and administering of creditors' or shareholders' meetings for voting on the Plan;
- (f) supervise the Sale Process, and otherwise assist the Applicant in carrying out the Sale Process, and any transaction arising therefrom including without limitation taking such steps in consultation with the Applicant as it considers necessary or desirable with respect thereto;
- (g) report to the Court on any sale by the Applicant of the Property and Business, or any part thereof;
- (h) have full and complete access to the books, records and management, employees and advisors of the Applicant and to the Business and the Property to the extent required to perform its duties arising under this Initial Order;
- (i) be at liberty to engage independent legal counsel or such other persons as the Monitor deems necessary or advisable respecting the exercise of its powers and performance of its obligations under this Initial Order;
- (j) be at liberty to serve as a "foreign representative" of the Applicant in any proceedings outside of Canada;
- (k) consider, and if deemed advisable by the Monitor, prepare a report and assessment on the Plan; and
- (l) perform such other duties as are required by this Initial Order or by this Court from time to time.

The purpose of this report is to advise the Court on the following:

- (a) Background information related to Brake Pro;

- (b) Causes of financial difficulty and events leading up to the filing for protection;
- (c) Brake Pro's activities since the commencement of the CCAA proceedings;
- (d) The Monitor's activities to date;
- (e) Brake Pro's cash flow during the period from 16 July 2007 to 10 August 2007;
- (f) Brake Pro's projected cash flow for the months of August, September and October 2007;
- and
- (g) Brake Pro's planned activities during the requested extension of the Stay Period.

This Report is filed in order to recommend in favour of Brake Pro's request for an extension of the Stay Period to 1 October 2007, and to obtain an order approving the activities of the Monitor to date, as set out in this Report.

B. EXECUTIVE SUMMARY

In summary, the Monitor reports as follows:

- Operating receipts for the Applicant are projected to exceed the budget for the reporting period. Disbursements are slightly under budget for the reporting period. To date, Brake Pro appears to have met the requirements of the Forbearance Agreement between itself and Wachovia;
- The projected cashflow for the months of August through October 2007 indicates that Brake Pro will be able to operate within the terms of the Forbearance Agreement;
- As part of the Sale Process authorized by the Initial Order, 11 parties have been contacted. To date the Confidential Information Memorandum, the Confidentiality Agreement and Detailed Information Memorandum have been prepared and distributed. Meetings are being scheduled with interested parties; and
- The Monitor is of the view that Brake Pro is acting in good faith and with due diligence. Based on the information currently available, the Monitor believes that creditors would not be

materially prejudiced by an extension of the Stay Period and recommends that this Honourable Court approve an extension of the Initial Stay of Proceedings until 1 October 2007.

The Monitor has reported on the compliance of Brake Pro with the terms of the Forbearance Agreement, particularly with respect to reporting on the cash flow and with respect to the sales process.

Terms of Reference

The information contained in this report has been obtained from the accounting records of Brake Pro and is based on discussions with, and representations made by management, including in particular Mr. Russ Armer, President.

The Monitor assumes no responsibility or liability for any loss or damage occasioned by any party as a result of the circulation, publication, re-production or use of this report. Any use which any party, other than the Court, makes of this report, or any reliance on or decision made based on it, is the responsibility of such party.

C. BACKGROUND

A detailed description of Brake Pro and its operations is contained in the materials filed with the Court in support of the Application on 24 July 2007, specifically in paragraphs 3 through 21 of the Affidavit of Russell Armer, sworn 23 July 2007. A copy of the affidavit is attached hereto as Appendix II.

On July 23, 2007, Brake Pro and Wachovia entered into a Forbearance Agreement, which was authorized by the Initial Order. The Forbearance Agreement contains terms under which Wachovia has agreed to provide continued credit to the Company, by way of the existing Accounts Receivable and Inventory margining calculation and an over-advance. The Forbearance Agreement requires regular financial reporting to Wachovia by the Company. It also sets out a timeline for the conduct of a sale of the Company as a going concern. If the Company fails to meet the terms and conditions of the Forbearance Agreement, Wachovia is in a position to take steps under its security.

D. CAUSES OF FINANCIAL DIFFICULTY AND EVENTS LEADING UP TO THE FILING FOR PROTECTION

In paragraph 4 of his Affidavit, Mr. Armer commented on the causes of Brake Pro's financial difficulty. These difficulties include the following:

- In the past four years, global commodity prices in oil, copper, steel and other base components of friction material have seen record levels of price increases. Brake Pro, and its competitors, have not been entirely successful in passing these price increases on to customers;
- In the past, Brake Pro's Canadian-based manufacturing has provided it with a distinct cost advantage for labour and production costs over its US-based North American competitors. However, due to the rising Canadian dollar, much of this advantage has been lost, leading to a decrease in margins;

- Brake Pro's capital structure as a result of the 1995 leveraged purchase of the business has limited cash available for reinvestment and made the Company less able to weather fluctuations in the market; and
- Off-shore competitors with significantly lower labour and overhead costs have made inroads into the North American market. Since labour is a significant proportion of the total cost of production, meeting the price competition of these competitors has been a significant challenge to Brake Pro and its North American competitors.

Management has attempted to market the Company and had stepped up its efforts in 2006 and 2007. Many expressions of interest were received but no firm offers had been received at the time of the Initial Order.

E. BRAKE PRO'S ACTIVITIES SINCE THE ISSUANCE OF THE INITIAL ORDER

Since obtaining the Initial Order on July 24, 2007, Brake Pro has taken steps to ensure the continuation of its business. The following is a summary of the Company's activities to date:

Sales and marketing

- A letter was sent to all customers advising them of the filing;
- Sales managers have visited and/or spoken to all customers to inform them of the current status and to retain their confidence;
- Senior management has negotiated continuing arrangements with key customers; and
- Brake Pro has continued to fill orders and to provide customer service to its customers.

Operations

- Brake Pro has continued production in accordance with its planned production schedule;
- The annual summer two week maintenance shutdown took place as scheduled from 24 July 2007 to 10 August 2007. Management reports that the maintenance shutdown went

according to plan, with most planned maintenance and upgrade projects completed as scheduled;

- Prior to the maintenance shutdown, Brake Pro implemented a reduction in work force from three shifts per day to two, effective on start up on 13 August 2007. As a result, 43 hourly employees were given temporary layoff notices. This layoff will save costs during the projected period;
- By and large, suppliers have agreed to continue to supply the Company. Management has encountered difficulties with some suppliers and has had to find alternate suppliers or to negotiate new arrangements with them. Of particular note:
 - The Monitor has recently received a letter from the landlord's counsel claiming damages to the building, and alleging default of the lease. The Monitor is investigating and this matter has been referred to counsel for the Company.
- As authorized by the Initial Order, and as consented to by Wachovia, the Company has entered into agreements with certain key employees to ensure their continued service to the Company through the CCAA process. The Company is placing \$20,000 in trust weekly to ensure payment of this obligation; and
- Brake Pro has maintained all post-filing obligations to creditors and suppliers in accordance with the requirements of the Initial Order.

Administration and financial reporting

- Brake Pro has continued its scheduled reporting to Wachovia in accordance with the terms of the various loan agreements and of the Forbearance Agreement; and
- Mr. Dennis Bolden, Director of Finance, had resigned prior to the Initial Order, with effect on 25 July 2007. Mr. Lloyd Williams, formerly Chief Accountant, has been named Director of Finance and Mr. Bolden has been retained as a consultant to the Company.

Restructuring and refinancing efforts

Management has outlined the following timetable for the sale of Brake Pro, in accordance with a timetable established in agreement with Wachovia, under the terms of the Forbearance Agreement:

Task	Target Completion Date
<ul style="list-style-type: none"> • Prepare Confidential Information Memorandum and Confidentiality Agreements • Commence contacting potential purchasers 	27 July 2007
<ul style="list-style-type: none"> • Identify interested parties • Complete Confidentiality Agreements • Distribute Detailed Information Memoranda 	10 August 2007
<ul style="list-style-type: none"> • Receive non-binding Expressions of Interest from potential investors 	24 August 2007
<ul style="list-style-type: none"> • Short list potential investors • Invite them to participate in the next round of due diligence • Commence initial negotiations 	29 August 2007
<ul style="list-style-type: none"> • Selected next round investors to submit binding offers 	19 September 2007
<ul style="list-style-type: none"> • Present the selected offer to the Court 	5 October 2007

The sale process is well underway:

- The Monitor and Management have established a target list and established the strategy for proceeding;
- Mr. Armer and/or the Monitor have contacted 11 parties which are believed to have interest in the Company. Most of the parties contacted had already conducted some due diligence prior to the Initial Order as a result of the Company's earlier marketing of itself;
- Six of the contacted parties have already expressed an interest in conducting additional due diligence;
- Mr. Armer has met with three of the potentially interested parties;
- Three of the parties have signed a Confidentiality Agreement and been sent the Detailed Information Memorandum;

- A conference call meeting was held on 14 August 2007 with one of the interested parties;
- Another party has scheduled a conference call for 15 August 2007 and a site visit on 20 August 2007;
- The Monitor is scheduling site visits and meetings with other interested parties; and
- Management, with the assistance of the Monitor, has assembled the Data Room materials.

F. THE MONITOR'S ACTIVITIES SINCE THE ISSUANCE OF THE INITIAL ORDER

Pursuant to the Initial Order, the Monitor was required to mail out notices related to the Initial Order. In conjunction with Brake Pro's own letter to suppliers, the Monitor issued a letter to all known creditors with claims exceeding \$500. In accordance with paragraph 52 of the Initial Order, the Monitor informed creditors of a website set up by the Monitor at www.bdo.ca/brakepro which contains a copy of the Initial Order, the letter to creditors and the Application Record. This Monitor's First Report to Court, as well as all subsequent reports, will also be posted on the website.

In accordance with the Forbearance Agreement, the Monitor and Brake Pro have issued weekly reports to Wachovia with respect to all relevant issues of Brake Pro's operations, activities, and restructuring efforts. In particular, the Monitor has reported on adherence to the terms of the Forbearance Agreement and the marketing programme.

The Monitor has assisted the Company in negotiating payment arrangements with suppliers and ensuring that the normal operations are not disrupted.

The Monitor assisted Brake Pro, and its counsel, in the preparation of a "Questions and Answers" sheet for communicating with employees, suppliers and customers. The Monitor attended the meetings with employees, including each shift at the plant, and with the Union local committee and worked with the Company in responding to questions raised.

In addition, the Monitor attended at Brake Pro's premises to review the books and records, obtain information pertaining to its assets and liabilities, and instituted a cash flow reporting system in order to assist the Monitor in determining whether Brake Pro is meeting its cash flow projection.

The Monitor has worked with the Company to identify and to contact potential interested parties; to develop a Short-form Confidential Information Memorandum, the Confidentiality Agreement and a Detailed Information Memorandum; and the contents of a Data Room. The Monitor met regularly with Brake Pro to co-ordinate the sales effort.

G. FORECAST TO ACTUAL RESULTS FOR THE PERIOD 16 JULY 2007 TO 1 AUGUST 2007

Attached as Appendix III to this report is a Statement of Cash Flow comparing actual cash flow for the period 16 July 2007 to 10 August 2007 to the initially budgeted cash flow for the period. Though the Initial Order was granted on 24 July 2007, the Forbearance Agreement required reporting to commence effective 16 July 2007. For the purposes of this report, the same reporting periods are used.

Sales and Collections

Sales, being the shipment of ordered product, at \$2,070,000 were 28% greater than the projected \$1,617,000. Management advises that this is due to stocking up by customers in anticipation of possible supply interruptions. It is possible that this level of orders may negatively affect sales volume in August and September. Management also advises that orders still to be filled exceed \$700,000.

Collections at \$2,210,000 exceeded projections by \$374,000. Management advises that certain customers made payments prior to their own summer shutdowns.

Disbursements

Salaries and Wages

Total salaries and wages of \$968,000 exceeds projection of \$890,000 by 9%. This difference is largely due to the payment of accrued vacation pay to employees who were given temporary layoff notices.

Materials and Overhead Purchases

Purchases of materials and overhead at \$540,000 are 15% under budget. Materials and overhead costs are under budget but are partially offset by rebate payments. The Company is making weekly payments on account of outstanding sales volume rebates to a major purchasing group in order to retain the Company's preferred supplier status.

Selling, General and Administrative ("SG&A")

The apparent savings in SG&A is due to unbilled utilities costs. Some of these are anticipated to be permanent differences with respect to utility costs incurred prior to the Initial Order.

In accordance with the Forbearance Agreement, Brake Pro is paying \$40,000 per week to its professional advisors on account of fees. The professional advisors will have their fees approved at the appropriate time.

Wachovia has permitted an over-advance, in excess of the allowable calculated borrowing limits, of \$250,000. As at 10 August 2007, the Company had borrowed \$58,000 of this over advance. Based on its cash flow forecasts, Brake Pro anticipates being able to operate within lending limits during the forecast period.

The Monitor believes that Brake Pro has been paying its post filing obligations as they fall due. Based upon the projected cash flow, the Monitor believes that Brake Pro should be able to continue to do so up to 1 October 2007, the period of the extension now being sought.

H. PROJECTED CASHFLOW FOR THE MONTHS OF AUGUST, SEPTEMBER AND OCTOBER 2007

Attached, as Appendix IV, is Brake Pro's actual and projected cashflow for the period 16 July 2007 until 3 November 2007. At this time, the Company does not anticipate any material changes to the cash flow projection that was previously provided to this court.

Over the projection period, the Company anticipates reducing inventory levels by some \$600,000.

I. EXPECTED ACTIVITIES DURING NEXT FIVE WEEKS

Management of the Company will focus on the following activities during the next five weeks:

- Continue the manufacture and sale of friction product;
- Continue to distribute Detailed Information Memoranda to interested parties which have executed the Confidentiality Agreement;
- Meet with interested parties;
- Receive non-binding expressions of interest from potential purchasers;
- Short-list potential purchasers;
- Invite short-listed parties to participate in the next round of due diligence;
- Commence initial negotiations with short-listed parties; and
- Select purchasers to submit binding offers.

The Monitor expects to monitor management's progress on all of the above activities as well as monitor the day-to-day operations of Brake Pro and to assist the Company in the sales process.

J. INDEPENDENT LEGAL ADVICE

The Monitor retained the firm of Fraser Milner Casgrain LLP as its independent legal counsel.

K. EXTENSION OF THE STAY PERIOD

The timetable for the Sale Process contemplates the receipt of binding offers by 19 September 2007. An extension of the Stay Period to 1 October 2007 will allow the Applicant time to solicit and obtain expressions of interest from potential purchasers and to negotiate binding offer(s) to purchase in accordance with this timetable.

The Monitor is also of the view that, based on the actual results compared to the forecast for the first three weeks of the Stay Period and a review of how the cashflow projection for the period 6 August 2007 to 2 Nov 2007 was prepared, inclusive of the reasonableness of the assumptions utilized, the Applicant should be able to achieve its forecasted cash flow.

L. RECOMMENDATION

The Monitor reviewed a draft copy of this Report with Brake Pro's management who concurred with the factual content of same.

The Monitor is of the view that Brake Pro is acting in good faith and with due diligence. Based on the information currently available, the Monitor believes that creditors would not be materially prejudiced by an extension of the Stay Period and recommends that this Honourable Court approve an extension of the Initial Stay of Proceedings until 1 October 2007.

The Monitor therefore makes this Report in support of an Order:

(a) extending the Stay Period to 1 October 2007; and

(b) approving the activities of the Monitor to date, as disclosed in this First Report.

All of which is respectively submitted this 14th day of August, 2007.

BDO DUNWOODY LIMITED

Monitor

Per:

Uwe Manski, FCA, FCIRP

President

The Monitor therefore makes this Report in support of an Order:

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