

**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 SECOND REPORT TO THE COURT

A. INTRODUCTION

BDO Dunwoody Limited (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").

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 agreed to extend credit to Brake Pro through the CCAA process subject to various conditions.

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.

By Order dated August 17, 2007, Justice Spence granted an extension of the stay of proceedings established in the Initial Order, to October 1, 2007.

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

- (a) Brake Pro's activities since the last report of the Monitor;
- (b) The Monitor's activities to date;
- (c) The outcome of the marketing and sale process undertaken;
- (d) Brake Pro's planned activities during the requested extension of the Stay Period to October 15, 2007.

This Report is filed in order to recommend in favour of Brake Pro's request for an extension of the Stay Period to October 15, 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:

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.

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.

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.

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

The Monitor's First Report to the Court outlined the steps taken by the Company upon the issuance of the Initial Order, in order to ensure continuance of the business through the CCAA process. Attached hereto as Appendix "I" is a copy of the First Report.

Subsequent to the issuance of the Order of Justice Spence of August 17, 2007, the Company continued to pursue its business, within the parameters contained in the Forbearance Agreement.

Brake Pro continued to perform its scheduled reporting to Wachovia in accordance with the terms of the various loan agreements and of the Forbearance Agreement, as described in the Monitor's First Report.

During the first number of weeks operating under the CCAA, the Company exceeded budget expectations with respect to its income and expenses.

However, as the business moved into September, the Company began to experience a cash shortage that significantly curtailed its ability to continue its business:

- Cash flow for the week ending 7 September 2007 was less than projected. The main cause of the variance was lower than forecasted shipments partially offset by lower than forecasted expenses. Overall, total sales, in the four weeks since 17 August 2007 were 12% lower than forecast.
- The tight cash availability continued into the week ending 14 September 2007, and was exacerbated by a significant move in the Canadian dollar, upward by \$0.02 in less than a week. Since the Company has a substantial USD credit balance with Wachovia partially offsetting the CDN dollar loan balance, the value of this balance dropped, with the effect of reducing availability.
- While cash flow for the week ending 14 September 2007 was better than projected as sales exceeded forecast and expenses were significantly less due to a lack of cash, the substantial exchange rate adjustment resulting from the significant increase in the relative value of the Canadian dollar reduced availability by approximately \$200,000.
- During the subsequent week, further strengthening of the Canadian dollar reduced availability by approximately a further \$200,000. As a result the Company had considerable cash flow difficulties. Certain disbursements for the week, e.g. professional fees, were deferred to the following week.

- Forecast sales in the week of September 14 were US\$532,950, however actual sales were only US\$415,630. Given the fairly high level of transit orders, this means that truck sales volumes had dropped significantly. Based upon discussions with competitors, this seemed to be a common trend at all North American HD friction manufacturers. We are advised by the Company that North American truck freight volume is down 8% year over year. The Company believes that it also lost some market share as customers looked for alternatives. Overall, total sales, in the four weeks after 4 August 2007; were 3% lower than forecast.
- During the week of September 14, 2007, the Company ran out of certain raw materials such as Integra plates, Dupont fibres, Durez Resin, boxes and silicates which halted the mixing and production of new product. During the week, forty-five employees were put on temporary lay-off as there were insufficient funds to purchase the necessary raw materials.
- Further changes in the exchange rate continued to exacerbate the problem. Though the Company had shipped some \$250,000 of product in the three days from 17 to 19 September, most of the resulting availability was lost as a result of continuing exchange rate changes. The Company estimated that it lost approximately \$400,000 of availability between September 10, 2007 and September 18, 2007.
- By September 25, 2007, the Company had minimal availability on its loan, and the Bank advised that it was not prepared to advance any further amounts beyond the over-advance provided for under the Forbearance Agreement. The Company was of the view that it could no longer fund operations, and determined that it was necessary to suspend production.
- As a result, all employees were provided with immediate temporary lay-off notices as of September 25, 2007.
- The Company has been advised that the employees, through their union, the USW, have filed a grievance in respect of this immediate lay-off.

Restructuring and Refinancing efforts

While it continued to operate, the Company pursued the marketing timetable established in agreement with Wachovia, under the terms of the Forbearance Agreement, and as set out below:

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

As discussed in the First Report, the process proceeded through the establishment of a target list and a strategy for proceeding. A number of bidders were identified, and information was distributed.

Four potential bidders submitted expressions of interest or letters of intent in respect of a going concern purchase of the assets of the Company.

Two potential bidders conducted substantial due diligence. A third was interested in conducting due diligence, but was unable to meet the deadline.

The Company and the Monitor engaged in extensive discussions and negotiations with these parties, in which additional due diligence was conducted, including the testing of product and the provision of substantial financial and technical data.

However, notwithstanding the extensive due diligence conducted, no binding offers to purchaser were submitted by the September 19, 2007 deadline, and none have been received to date.

As a result, a condition of the Forbearance Agreement has not been met.

E. TRANSITION TO LIQUIDATION

The Bank is no longer prepared to fund the Company as a going concern, given that no binding offer to purchase the business has been received. The Company has determined that in the circumstances, it has had no choice but to shut down the plant and lay off all employees.

The Monitor is aware from discussions with potential purchasers that it may be possible that a going concern offer may yet be forthcoming. As a result, the Monitor believes that the Company's decision to only lay off its employees temporarily at this point, in order that they may be quickly recalled in the event of such a purchase, is a prudent one.

With the consent of the Bank, the Company has called back a small number of employees on a day to day basis in order to maintain the computer and accounting systems, to maintain the security of the plant, negotiate and collect accounts receivables, and organize the inventory and machinery and equipment for a potential liquidation sale.

On September 26, 2007, the Bank's consultants, Lissner Associates Limited, attended at the Company to review the records of the Company for purposes of assisting the Bank with its determination of what steps would be required going forward. The Company and the Monitor have spent a substantial amount of time in the last day with Lissner Associates Limited discussing the process with them and providing them with information.

In the meantime, the Company and the Monitor have been asked by the Bank to prepare a plan for the organized liquidation of the assets of the Company, and the collection of its receivables. The Bank has also asked the Company and the Monitor to prepare a detailed budget for the costs of a liquidation plan that it would be necessary for the Bank to fund.

In response, the Company and the Bank have spent substantial time since September 25, 2007 working on preparing a liquidation plan and providing figures to the Bank for consideration. While discussions are on-going, no liquidation plan has yet been finalized, and no budget has yet been finalized or approved.

F. THE MONITOR'S ACTIVITIES SINCE AUGUST 17, 2007

Since the issuance of the extension order on August 17, 2007, the Monitor has monitored the operations of the Company on a daily basis.

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

After September 25, 2007, the Monitor entered into extensive discussions and negotiations with the Bank to determine steps that should be taken in order to liquidate the Company on an orderly basis, and the expenses that would be required to undertake this process.

G. EXTENSION OF THE STAY PERIOD

An extension of the Stay Period to 15 October 2007 will allow the Applicant time to finalize arrangements for a liquidation process, in discussion with the Company and the Bank, and in the meantime receive and continue any binding offer(s) to purchase that might yet be forthcoming notwithstanding the Company shut-down.

H. 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 October 15, 2007.

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

- (a) extending the Stay Period to October 15, 2007; and
- (b) approving the activities of the Monitor to date, as disclosed in this Second Report.

All of which is respectively submitted this 28th day of September, 2007.

BDO DUNWOODY LIMITED

Monitor

Per:

A handwritten signature in black ink, appearing to read 'Uwe Manski', written in a cursive style.

Uwe Manski, FCA, FCIRP
President

IN THE MATTER OF THE COMPANIES CREDITORS ARRANGEMENT ACT, R.S.C., 1985 c. C-36
AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF
BRAKE PRO, LTD.

Court File No. 07-CL-7106

Applicant

**ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST**

Proceeding commenced at Toronto

MONITOR'S SECOND REPORT TO COURT

BLAKE, CASSELS & GRAYDON LLP
Box 25, Commerce Court West
Toronto, Ontario M5L 1A9

Susan Grundy LSUC#19898J
Tel: (416) 863-2572

Katherine McEachern LSUC#: 38345M
Tel: (416) 863-2566
Fax: (416) 863-2653

Solicitors for Brake Pro, Ltd.