

CANADA

DISTRICT OF QUÉBEC  
DIVISION NO.: 01-MONTREAL  
COURT NO.: 500-11-034874-087  
ESTATE NO.: 41-341678

SUPERIOR COURT  
(Commercial Division)

IN THE MATTER OF THE PROPOSAL OF:

**Direct Source Special Products Inc.**

a body politic and corporate, duly incorporated  
according to law and having its head office and its  
principal place of business at:  
2695 Dollard Street  
Lasalle QC H8N 2J8

**Debtor**

- and -

**RSM Richter Inc.**

**Trustee**

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**TRUSTEE'S REPORT ON THE STATE OF THE INSOLVENT PERSON'S  
BUSINESS AND FINANCIAL AFFAIRS  
(Pursuant to 50.4(7)(b)(ii) and 50.4(9) of the Bankruptcy and Insolvency Act)**

I, Yves Vincent, FCA, CIRP, of RSM Richter Inc. ("Richter"), Trustee, with respect to the Notice of Intention to Make a Proposal ("Notice of Intention") filed by Direct Source Special Products Inc. (the "Company" or "Debtor"), an insolvent person, do hereby report to the Court the following:

1. On November 21, 2008, the Debtor filed a Notice of Intention to Make a Proposal in accordance with the *Bankruptcy and Insolvency Act* (the "Act"), a copy of which is annexed hereto as **Exhibit "A."**
2. On November 27, 2008, documents were sent by regular mail to all creditors of the Debtor, as identified by it, which included a copy of the Debtor's Notice of Intention, as annexed hereto as **Exhibit "B."**
3. On November 27, 2008, the Debtor filed with the Official Receiver a Statement of Projected Cash Flow ("Forecast") together with his report pursuant to Section 50.4(2)(c) of the Act, covering the period from November 24 to December 19, 2008, which included the major Assumptions used in the preparation of the aforementioned Forecast. Concurrently therewith, the Trustee filed its Report on the reasonableness of the Forecast in accordance with Section 50.4(2)(b) of the Act, all of which is annexed hereto as **Exhibit "C"**.

4. In order to monitor the affairs and finances of the Debtor, the Trustee has been provided with access to the books, records and other important documents of the Company.
5. The Trustee has compared the actual results to those forecasted from November 24 to December 12, 2008, which is annexed as "**Exhibit D**". The actual results to date have been favourable. The Company has been paying its suppliers and employees, on a timely basis, for goods and services provided subsequent to the date of the filing of the Notice of Intention, according with the current business terms.
6. The Company is engaged in the distribution of music CDs, DVDs, videos and other products and focuses on a market niche within the music industry selling and repackaging low or modest priced motion pictures and non major labels music discs. In the past years, the Company has experienced a sharp and long term decline of their sales and reported significant losses. Management attributes this decline in sales volume to various factors, in particular to both legal and illegal downloads of music and movies coupled with the major music labels decreasing the prices of their products in an attempt to adapt to this trend, thus making these products more competitive with those sold by the Company.
7. The Company has suspended, on a temporary basis, its operations which resulted in layoffs of approximately 15 employees. Since the filing of the Notice of Intention to Make a Proposal, the Debtor has work diligently with the Trustee to identify key elements to deal with, which can be summarized as follows:
  - Reduce of the operating expenses;
  - Establish a scenario to maximise the collection of remaining accounts receivable;
  - Determine the best course of action to reduce and dispose of the inventory;
  - Analyze royalty exposure, including the review and validation of the current royalty liability and reporting requirements;
  - Pursue negotiation efforts to recover inventory located in the United States;
  - Update of the Company's books and records.
8. The Debtor has filed a Motion to Extend the Delay for the Filing of a Proposal, in order to allow it to complete its dealings with regards to the above-mentioned key elements and to determine its financing requirements as well as to enable the formulation of a viable proposal to its creditors.
9. The Debtor has prepared an additional Cash Flow Forecast for the period ending February 6, 2009. Annexed hereto as **Exhibit "E"** is the Statement of Projected Cash Flow covering the period from December 15, 2008 to February 6, 2009 which includes the major Assumptions used in the preparation of the aforementioned Forecast, the Trustee's Report on the reasonableness of the Forecast in accordance with Section 50.4(2)(b) of the Act and the Debtor's Report pursuant to Section 50.4(2)(c) of the Act.
10. If the extension is granted, we are not aware of any facts indicating that any creditor would suffer a prejudice.
11. In the event that the extension is not granted and a Bankruptcy ensues, any reorganization efforts of the business would cease. Given the quantum of the secured debts, the piecemeal disposition of the Company's assets would likely result in a no dividend to the unsecured creditors. Consequently, the creditors' best opportunity to maximize recovery in this matter is to allow the Company time to continue its reorganization efforts and attempt to formulate a proposal.

12. Given the foregoing, the Trustee hereby recommends the granting of the extension by the Court to February 3, 2009.

DATED AT MONTREAL, this 17<sup>th</sup> day of December 2008.

**RSM Richter Inc.**

Trustee

A handwritten signature in black ink, appearing to be 'YV', written over a horizontal line.

Per: Yves Vincent, FCA, CIRP