RSM Richter

First Report of RSM Richter Inc. Re: Komunik Corporation, Komunik Datamark Inc. and Komunik Intramedia Inc.

RSM Richter Inc.
Toronto, December 12, 2008

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Court File No. 500-11-034815-080

QUEBEC
SUPERIOR COURT
- COMMERCIAL DIVISION -

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

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF KOMUNIK CORPORATION, KOMUNIK DATAMARK INC. AND KOMUNIK INTRAMEDIA INC.

FIRST REPORT OF RSM RICHTER INC.
IN ITS CAPACITY AS MONITOR OF
KOMUNIK CORPORATION, KOMUNIK DATAMARK INC.
AND KOMUNIK INTRAMEDIA INC.

December 12, 2008

1. INTRODUCTION

This report is filed by RSM Richter Inc. ("Richter") in its capacity as monitor ("Monitor") of Komunik Corporation ("Komunik"), Komunik Datamark Inc. ("Datamark") and Komunik Intramedia Inc. ("Intramedia") (collectively, the "Company").

Pursuant to an order (the "Initial Order") of the Quebec Superior Court - District of Montreal (Commercial Division) (the "Court") made on November 18, 2008, the Company was granted protection under the *Companies' Creditors Arrangement Act* ("CCAA") and Richter was appointed as the Monitor in the CCAA proceedings (the "CCAA Proceedings").

1.1 Purposes of this Report

The purposes of this report ("Report") are to:

a) Provide background information concerning the Company;

b) Provide an update regarding the Company's restructuring efforts, including the sale process authorized by the Initial Order ("Sale Process"); and

c) Recommend that this Honourable Court make an order:

- Granting the Company's request for an extension of its stay of proceedings from December 18, 2008, the date that the stay of proceedings expires, to January 30, 2009;

- Approving the appointment of Mr. Claude Perrotte as the Company's Chief Restructuring Officer;

- Approving the terms and conditions of a key employee retention plan ("KERP") and sealing Confidential Appendix "1" to this Report, which provides details of the KERP;

- Approving the amended forbearance agreements entered into with HSBC Bank Canada (the "Bank") and HSBC Capital (Canada) Inc. ("HSBC Capital");

- Relieving the Monitor from its obligation to publish an advertisement in relation to the Sale Process;

- Authorizing the Company to confirm to its customers, with acknowledgement from the Monitor, that in the event that either the Sale Process or the Company's restructuring is unsuccessful, customers would be entitled to obtain their inventory and artwork from the Company immediately following payment in full by the customer for all amounts owing and coming due, without setoff, and that such entitlement is binding on a trustee in bankruptcy, if appointed, or any other party; and

- Approving the Monitor's activities, as described in this Report.

1.2 Currency

Unless otherwise noted, all currency references in this Report are to Canadian dollars.

1.3 Terms of Reference

In preparing this Report, the Monitor has relied upon unaudited financial information prepared by the Company's management, the Company's books and records and discussions with its management. The Monitor has not performed an audit or other verification of such information. An examination of the Company's financial forecasts as outlined in the *Canadian Institute of Chartered Accountants Handbook* has not been performed. Future oriented financial information relied upon in this Report is based on management's assumptions regarding future events; actual results achieved may vary from this information and these variations may be material. The Monitor expresses no opinion or other form of assurance with respect to the accuracy of any financial information presented in this Report, or relied upon by the Monitor in preparing this Report.

2. BACKGROUND

The Company is a provider of integrated document management and printing services. The Company focuses on business forms, pressure sensitive labels, tags, short to medium run commercial printing, digital printing and relationship marketing.

In June, 2007, Komunik acquired Datamark Systems Group Inc. (TSX: DMK), a significantly larger business than Komunik at the time. The subsequent amalgamation resulted in Komunik's common shares being traded on the Toronto Stock Exchange under the symbol KOM.

The location and business of the Company's three corporate entities is provided in the table below.

Company	Division	Location	Product Segments
Komunik Corporation	Datamark	LaSalle, QC	Business Forms, Labels and Tags and Commercial Print
	Konversation	Montreal, QC	Head Office, Relationship Marketing and Digital Print
	Datamark	Laval, QC	Administration, Warehousing and Distribution
Komunik Datamark Inc.[1]	Datamark	Mississauga, ON	Business Forms
	Datamark	Calgary, AB	Business Forms and Labels and Tags
	Datamark	Winnipeg, MB	Business Forms and Digital Print
Komunik Intramedia Inc.[1]	Intramedia	Boucherville, QC	Commercial Print

As of the date of the Initial Order, the Company employed approximately 659 individuals, of which approximately 201 are represented by the Communications, Energy and Paperworkers Union of Canada (the "Union")[2].

2.1 Recent Performance

The Company is in the process of finalizing its most recent quarterly report (for the quarter ending October 31, 2008), which is to be released on December 12, 2008. The Company will be reporting that earnings before income taxes, depreciation and amortization for the quarter totalled approximately $1 million[3], including EBITDA of approximately $559,000[4] for the month of October, 2008. These results reflect cost-cutting and other initiatives implemented by the Company earlier in the year.

[1] Wholly-owned subsidiary of Komunik Corporation.

[2] 178 employees in LaSalle are represented by Local 145 and 23 employees in Winnipeg are represented by Locals 191 and 341.

[3] Excluding stock-based compensation expense of approximately $164,000.

[4] Excluding stock-based compensation expense of approximately $55,000.

The Company has also advised that its sales have remained strong through the CCAA period and that none of the Company's customers have resourced their business to another vendor. The Company continues to have the support of all of its customers.

2.2 Restructuring

For the past several months, the Company has been advancing and/or considering various restructuring initiatives, including the termination of the Company's operations at its Markham, Ontario, Mississauga, Ontario and Winnipeg, Manitoba facilities. The principal purpose of the Company's restructuring efforts is to discontinue those parts of the business which are unprofitable and to focus the business in Quebec and Calgary, Alberta. Consolidating the Company's operations will reduce overhead costs, eliminate surplus labour and simplify accounting systems.

In furtherance of its restructuring efforts, the Company has undertaken the following activities since the commencement of these CCAA Proceedings:

- Announced the discontinuation of its Winnipeg operations – operations at this facility are scheduled to be discontinued by the end of January, 2009. The Company intends to vacate this facility by March 31, 2009;
- Announced the discontinuation of its Mississauga operation – operations are scheduled to be discontinued by December 31, 2008. The Company intends to vacate this facility promptly thereafter;
- Reduced head count by 49 individuals;
- Repudiated its lease in Markham, Ontario; and
- Taken initial steps to sell redundant assets in Mississauga and Winnipeg.

2.3 Creditors

The Company's principal secured lender is the Bank, which was owed approximately $16.4 million as at November 17, 2008, including approximately $11.9 million[5] under revolving loans and approximately $4.5 million under a term loan facility. Pursuant to the Second Amended and Restated Forbearance Agreement dated November 17, 2008 (the "Bank Forbearance Agreement"), the Bank agreed to continue to allow the Company to utilize its existing credit facilities during the CCAA proceedings, subject to certain conditions. The Bank Forbearance Agreement was approved pursuant to the Initial Order.

HSBC Capital was owed approximately $4.3 million as at November 17, 2008[6]. On November 17, 2008, the Company and HSBC Capital entered into a Forbearance Agreement ("HSBC Capital Forbearance Agreement"), which was also approved by the Initial Order.

As at the date of the Initial Order, the Company owed its vendors approximately $13 million[7].

Further background information concerning the Company is provided in the Company's petition for the Initial Order dated November 18, 2008.

3. THE COMPANY'S ACTIVITIES

The Company continues to operate in the normal course. Following the issuance of the Initial Order, the Company, with the assistance of the Monitor (where necessary), communicated with each of the Company's major stakeholder groups, including customers, suppliers and employees. The business has operated with minimal disruption since the date

[5] Excludes cash on hand at that date of approximately $2.6 million; includes accrued interest.
[6] Includes accrued interest.
[7] Including lessors.

of the Initial Order. The Company is now focusing on improving its business, implementing operational efficiencies, working to advance restructuring activities and working with the Monitor to advance the Sale Process. In this regard, the Company's activities have included the following:

- Convening meetings with its employees at all of its locations;
- Convening meetings and conference calls with major customers;
- Negotiating with suppliers and service providers regarding the terms on which goods and services are to be provided to the Company and paid for by the Company during the CCAA Proceedings;
- Corresponding with and reporting to HSBC Capital, the Bank and its consultant, PricewaterhouseCoopers LLP ("PWC"), as contemplated by the Bank Forbearance Agreement and the HSBC Capital Forbearance Agreement;
- Corresponding with the Union to provide it with information related to the CCAA Proceedings;
- Addressing various issues and inquiries made by creditors of the Company;
- Undertaking the restructuring activities detailed in Section 2.2 above; and
- Working with the Monitor to advance the Sale Process, including, *inter alia*, providing information for a confidential information memorandum ("CIM") and the data-room assembled for the Sale Process.

4. SALE PROCESS

The Sale Process was approved by the Court pursuant to the Initial Order. Since the date of the Initial Order, the Monitor performed the following activities related to the Sale Process:

- Preparing an interest solicitation letter and confidentiality agreement ("CA") and working with the Company and its legal counsel in this regard;
- Preparing a CIM providing information concerning the Company;

- Sending the interest solicitation letter and the CA to 180 "targets", including targets identified by the Company and those identified by Richter's corporate finance group;
- Negotiating the terms of CAs with interested parties;
- Sending the CIM to those parties which executed the CA;
- Assembling information for an electronic data room, containing financial, product and other Company information; and
- Communicating extensively with prospective purchasers and investors regarding this opportunity.

Interested parties are being provided an opportunity to perform due diligence, including touring the Company's facilities and attending management meetings. These presentations will be conducted by members of the Company's senior management team, with representatives of the Monitor in attendance. Pursuant to the Initial Order, the deadline for submitting offers is January 15, 2009.

Paragraph 19(b) of the Initial Order required that the Monitor place an advertisement seeking expressions of interest in the sale of the Property and/or the Company's businesses in *La Presse* and the national edition of *The Globe and Mail* on or before November 25, 2008. Subsequent to the issuance of the Initial Order, the Company's management determined that publishing the advertisement could adversely impact its business. The Monitor spoke with the Bank and HSBC Capital to obtain their views with respect to the need for the advertisement and both confirmed that they were indifferent to its publication. Accordingly, an advertisement was not published. The Monitor is satisfied that the market will be extensively canvassed based on the Monitor's market research, the Company's knowledge of interested parties (which it has provided to the Monitor), and word-of-mouth in the industry concerning the CCAA Proceedings. Accordingly, in the Monitor's view, there is no need to publish the advertisement.

4.1 Sale of Surplus Equipment

The Company's restructuring plans include the shutdown of its Winnipeg, Manitoba and Mississauga, Ontario facilities and the transfer of these operations to its Quebec and Calgary facilities. The Company advises that it has identified certain equipment at these facilities which will not be required when the businesses are transitioned. Accordingly, the Company intends to solicit offers for these assets. This process is to commence imminently.

5. FORBEARANCE AGREEMENTS

On November 17, 2008, the Company entered into the Bank Forbearance Agreement and the HSBC Capital Forbearance Agreement, which establish the terms pursuant to which the Bank and HSBC Capital agreed to support the business during the CCAA Proceedings. Both agreements expire on December 19, 2008.

As at the date of this Report, the Company was finalizing the terms of the extensions of the forbearance agreements with each of the Bank and HSBC Capital.

6. CHIEF RESTRUCTURING OFFICER

The Initial Order requires that the Company retain a Chief Restructuring Officer ("CRO") by December 8, 2008.

Claude Perrotte is the Company's Vice-President, Executive Sales. Mr. Perrotte has been active in the Company's industry for over 40 years. He has been with the business since the early 1980s and helped to grow annual revenues from $1 million to in excess of $100 million. Mr. Perrotte has strong relationships throughout the Company and, importantly, with the Company's major customers. It is the Company's view, and the Monitor concurs, that retaining Mr. Perrotte as CRO during the CCAA Proceedings will facilitate these proceedings, including the Company's restructuring efforts, the Sale Process, customer retention and sales staff retention.

The Company's Board of Directors ("Board") has approved of Mr. Perrotte's appointment as CRO.

The Bank and HSBC Capital have consented to Mr. Perrotte's retention as CRO and to his retention plan.

Given the support of the Bank and Capital and the approval of the Board, the Monitor respectfully requests this Honourable Court's approval of the appointment of Mr. Perrotte as CRO.

7. KEY EMPLOYMENT RETENTION PLAN

The Company has identified certain employees, including the CRO, which it believes are integral to the successful implementation of its restructuring activities in these CCAA Proceedings. In the Monitor's view, each of these individuals is critical to the performance of the business and each is working diligently to assist the Company in its restructuring efforts. It is proposed that these employees be entitled to participate in a KERP, the terms of which are provided in Confidential Appendix "1".

The Monitor has assisted in the development of the KERP and supports its implementation.

The Board has approved the KERP.

The Bank and HSBC Capital have consented to the terms of the KERP.

Given the support of the Bank and Capital and the approval of the Board, the Monitor respectfully requests this Honourable Court's approval of the KERP.

7.1 Confidentiality

For privacy reasons, including those pursuant to *Personal Information Protection and Electronic Documents Act* legislation, the Monitor is providing the Court with information relevant to the KERP in Confidential Appendix "1" to this Report. The Monitor respectfully requests that this Honourable Court seal Confidential Appendix "1" to this Report.

8. CUSTOMERS

In the normal course, the Company warehouses printed inventory for a large percentage of its customers. The customers have not paid for this inventory, although it has been produced specifically for them according to their specifications/design. The Company also produces and maintains artwork for its customers.

As with any restructuring proceeding, there is a risk that the Company's restructuring efforts will not be successful. Certain customers have requested confirmation that in the event that the Company is not sold and/or restructured, that they be entitled to take immediate possession of such inventory and artwork. The customers have bona fide concerns that failing to obtain this inventory and artwork in a timely manner could cause them to incur unnecessary costs.

The Company has advised the Monitor that its customers' requests are acceptable to it, provided that prior to the release of the inventory and artwork to the customers, they pay in full any amounts owing to the Company or coming due to the Company, without setoff or deduction of any kind, except for certain agreed setoffs, such as short shipments, defects, billing errors, or the like. Damage claims would not be recognized by the Company. The Monitor believes that delivery of such inventory and artwork to customers is appropriate in the circumstances and that such terms should be binding on a trustee in bankruptcy, if appointed, and other parties.

9. CASH FLOW

The Company's cash flow projection for the extension period is attached as Appendix "A". The cash flow projection reflects that the Company will be in compliance with the terms of the forbearance agreements with the Bank and HSBC Capital through to January 30, 2009.

10. COMPANY'S REQUEST FOR AN EXTENSION

The current stay of proceedings expires on December 18, 2008. The Company is seeking an extension of the stay of proceedings to January 30, 2009.

The Monitor supports the Company's request for an extension of the stay of proceedings for the following reasons:

- The Company is acting in good faith and with due diligence in its restructuring efforts;
- An extension of the stay of proceedings would allow the Company, with the assistance of the Monitor and the CRO, the time required to advance the restructuring of the business and the Sale Process;
- The granting of the extension should not prejudice any employee or creditor, as arrangements are in place to pay for post-filing services and supplies;
- The Bank and HSBC Capital have advised that they support the requested extension; and
- In the absence of an extension of the stay, the value to be generated from a sale of the business, or a restructuring of the business, would not be maximized.

11. OVERVIEW OF THE MONITOR'S ACTIVITIES

The Monitor's activities have included:

- Attending at the Company's premises on a daily basis in order to carry out its mandate in accordance with the Initial Order;
- Assisting the Company in dealing with numerous post-filing issues, including those related to banking, suppliers, customers and employees;
- Assisting the Company in preparing letters and scripts regarding these proceedings for use in supplier, customer and employee communications/dealings;
- Attending at meetings with the Company's management;
- Attending on conference calls and corresponding with certain of the Company's customers, as requested by the Company and/or the customers;
- Corresponding with the Union in respect of its enquiries regarding its members' claims against the Company and providing it with information related to the CCAA Proceedings;
- Assisting the Company in negotiating with suppliers and service providers regarding the terms on which goods and services are provided to the Company and paid for by the Company during the CCAA Proceedings;
- Corresponding with the Bank, HSBC Capital and PWC, including providing cash flow variance analyses and update memoranda;
- Assisting the Company with the dissemination of information to the Bank, HSBC Capital and PWC;
- Reviewing and commenting on the Company's financial projections, margin position reports and other financial information;
- Monitoring receipts and disbursements in accordance with the provisions of the Initial Order;
- Assisting the Company with the repudiation of a real property lease;
- Responding to numerous creditor inquiries regarding the CCAA Proceedings;
- Causing the CCAA notice to be mailed on November 28, 2008 ("CCAA Notice");
- Performing research to identify parties that may have an interest in financing or purchasing the Company and/or its business;

- Placing on its website copies of materials filed in these proceedings, including the Initial Order and the CCAA Notice;
- Preparing the CA, interest solicitation letter and CIM;
- Assembling information for the electronic data room, including financial, product and other information;
- Advancing the drafting of a form of offer, being a draft asset purchase agreement;
- Drafting this Report and reviewing the materials to be filed by the Company contemporaneously herewith; and
- Other matters pertaining to the administration of this mandate.

12. CONCLUSION AND RECOMMENDATION

Based on the foregoing, the Monitor respectfully recommends that this Honourable Court make an order granting the relief detailed in Section 1.1 of this Report.

* * *

All of which is respectfully submitted,

RSM Richter Inc.

RSM RICHTER INC.
IN ITS CAPACITY AS CCAA MONITOR OF
KOMUNIK CORPORATION, KOMUNIK DATAMARK INC.
AND KOMUNIK INTRAMEDIA INC.
AND NOT IN ITS PERSONAL CAPACITY

Komunik Corporation
Cash Flow Forecast
For the period ending January 30, 2009
(C$, 000's)

	Week Ending								
	12-Dec-08	19-Dec-08	26-Dec-08	02-Jan-09	09-Jan-09	16-Jan-09	23-Jan-09	30-Jan-09	Total
Cash Receipts									
Accounts Receivable	1,949	1,949	1,793	394	1,968	1,837	1,837	1,837	13,561
Sale of Equipment	-	-	-	-	-	-	-	400	400
GST/QST Collected on Sales	251	251	231	51	253	236	236	236	1,746
Total Cash Receipts	2,200	2,200	2,024	444	2,221	2,073	2,073	2,473	15,707
Operating Disbursements									
Direct Material and Labour	1,168	777	956	232	1,280	740	1,005	959	7,116
Factory Expenses	445	148	445	99	398	99	398	99	2,130
Selling	271	644	271	66	249	681	219	66	2,467
Administration	228	61	228	47	199	47	199	47	1,058
GST/QST Paid on Purchases	115	115	89	44	127	106	93	133	823
GST/QST Remittances	-	-	227	-	-	-	-	440	668
Total Operating Disbursements	2,227	1,746	2,216	487	2,253	1,673	1,915	1,744	14,261
Net Cash Flow From Operations	(27)	454	(192)	(43)	(32)	400	158	729	1,447
Maintenance Capital Expenditures	25	25	25	20	20	20	20	20	175
Pension Fund	-	-	-	12	-	-	-	-	12
Vacation Pay	-	-	259	-	-	-	-	200	459
Restructuring Costs	200	150	150	100	150	200	150	200	1,300
Net Cash Flow Before Debt Service	(252)	279	(626)	(175)	(202)	180	(12)	309	(499)
Interest	-	-	-	172	-	-	-	-	172
Secured Debt Repayments	-	550	-	-	-	-	-	-	550
Total Net Cash Flow (note)	(252)	(271)	(626)	(347)	(202)	180	(12)	309	(1,221)

Note

The Company has made arrangements with its Lenders to fund the cash flow for the projection period.