
First Report of
Duff & Phelps Canada
Restructuring Inc.
as Receiver of
Precision-Tech Limited

July 9, 2012

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**ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)**

COMERICA BANK

Applicant

-and-

PRECISION-TECH LIMITED

Respondent

**FIRST REPORT OF DUFF & PHELPS CANADA RESTRUCTURING INC.
AS RECEIVER OF
PRECISION-TECH LIMITED**

July 9, 2012

1.0 Introduction

Comerica Bank ("Comerica") has made an application to the Ontario Superior Court of Justice (the "Court") for an order (the "Receivership Order") appointing a receiver ("Receiver") over the property, assets and undertaking of Precision-Tech Limited (the "Company") pursuant to Subsection 243(1) of the *Bankruptcy and Insolvency Act* R.S.C. 1985, c. B-3, as amended. Duff & Phelps Canada Restructuring Inc. ("D&P") has consented to act as receiver.

The primary purpose of these receivership proceedings is to provide a stabilized environment in which the Company's business and assets can be marketed for sale and to allow the Company to produce parts for customers pursuant to accommodation agreements, as detailed herein.

1.1 Purposes of this Report

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

- a) Provide background information about the Company, including its creditors and the present state of its business;

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- b) Summarize an accommodation agreement (the "Accommodation Agreement") among the Receiver, Comerica and Meritor Heavy Vehicle Systems, LLC ("Meritor"), the Company's major customer, including a transaction involving the sale of certain of the Company's inventory to Meritor ("Inventory Sale Transaction");
- c) Provide an overview of D&P's activities in connection with the receivership filing and summarize its anticipated next steps, if appointed; and
- d) Recommend that this Court make an order approving the:
- Accommodation Agreement;
 - Receiver's execution of the Accommodation Agreement as well as authorization for it to execute all other ancillary documents and agreements required to complete the transactions contemplated by the Accommodation Agreement;
 - Inventory Sale Transaction contemplated by the Accommodation Agreement and vesting the Company's right, title and interest in and to the purchased inventory in Meritor upon the filing of a Receiver's Certificate; and
 - Sealing the Confidential Appendix to this Report.

1.2 Restrictions

In developing this Report, D&P has relied upon unaudited financial information prepared by the Company and/or its advisors and certain of the Company's books and records. D&P 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 assumptions regarding future events; actual results achieved may vary from this information and these variations may be material. D&P expresses no opinion or other form of assurance with respect to the accuracy of any financial or other information presented in this Report, or relied upon by D&P in preparing this Report.

1.3 Currency

All references to dollar amounts are to Canadian dollars unless otherwise specified.

2.0 Background

The Company is a CNC machined component manufacturer supplying parts to original equipment manufacturers and Tier 1 and Tier 2 suppliers to the automotive and industrial sectors. The Company operates from two facilities in Cambridge, Ontario. The Company owns its main production facility, at which its head office is located, and leases a smaller production facility.

The Company employs 82 individuals. The workforce is non-unionized and the Company does not maintain any pension plans.

Further background information concerning the Company is provided in the affidavit of Cynthia B. Jones, a Vice-President of Comerica's Special Assets Group, filed in connection with Comerica's receivership application (the "Affidavit").

3.0 Creditors

3.1 Comerica

Comerica is the Company's principal secured creditor pursuant to the credit facilities, mortgage, loan and security documents detailed in the Affidavit. According to the Affidavit, Comerica was owed approximately \$10.5 million as June 29, 2012. As detailed in the Affidavit, the Company is in default under Comerica's credit facilities.

3.2 Other Secured Creditors

The Company's other major secured creditor is its parent, Unitec Inc. ("Unitec"). D&P understands that Unitec's security is subordinate to Comerica's. According to the Company's most recent internal financial statements (May 31, 2012), the Company owes Unitec approximately \$1.6 million.

The Company leases equipment from the following parties, each of which has registered financing statements against the Company: National Leasing Group Inc., De Lage Landen Financial Services Canada Inc., Ally Credit Canada Limited, GE Canada Equipment Financing G.P. and Xerox Canada Ltd. The application materials in these proceedings were sent to each of these parties by overnight courier on July 6, 2012.

3.3 Unsecured Creditors

According to the Company's accounts payable listing dated July 3, 2012, the Company's unsecured obligations total approximately \$1 million at that date.

4.0 Accommodation Agreement¹

The Company's major customer is Meritor. D&P understands that historically Meritor accounts for approximately 60% to 65% of the Company's revenue.

The Company was unable to reach an agreement with Meritor to amend current supply terms. Meritor has advised that it intends to resource. Negotiations have been ongoing with Meritor to agree to the terms of supply and payment during the resourcing period. Input was obtained from both Comerica and representatives of the Company. These terms, and others, are detailed in the Accommodation Agreement, as set out below:

- a) Parties: Meritor, the Receiver and Comerica.
- b) Term: October 5, 2012 but can be extended by Meritor for up to 90 days.
- c) Termination: Meritor may terminate the Accommodation Agreement on five business days notice provided it pays all amounts then owing under the Accommodation Agreement.
- d) Conditions: The Accommodation Agreement is subject to the issuance of:
 - (i) the Receivership Order; and
 - (ii) a sale approval and vesting order in connection with the Inventory Sale Transaction.
- e) Summary of business issues addressed by the Accommodation Agreement:
 - Amount that Meritor is to pay for Raw Material Inventory, WIP, finished Component Parts and Undisputed Existing Accounts Receivable owing as at the Effective Date;
 - The payment terms for Meritor's payment for the Raw Material Inventory, WIP and finished Component Parts (two business days following the final determination of the amount and value as at the Effective Date), the Undisputed Accounts Receivable (two business days following the Effective Date) and post-filing payables (7 day payment terms);
 - Limitations on Meritor's setoff rights against the Company, being for short shipments, misshipments, billing errors (including overpayments) and non-merchantable, defective or non-conforming products;
 - A mechanism by which the Disputed Accounts Receivable owing by Meritor to the Company are to be resolved;

¹ Defined terms in this section have the meaning provided to them in the Accommodation Agreement.

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- A mechanism for funding the Company's cash requirements during the term of the required resourcing period, including Meritor's portion of the funding requirement;
 - Provisions to allow Meritor access to the Company's premises and books and records for the purpose of monitoring the production of its Component Parts during the receivership period; and
 - Provisions related to the supply of Component Parts for other customers, including a ten-day period from the Effective Date during which the Receiver is to negotiate accommodation agreements with the other customers. This period can be extended by four days subject to agreement by Meritor, acting reasonably.

While the issues have in large part been settled, the final form of the Accommodation Agreement has not been finalized as of the time of filing this Report. A copy of the latest version of Accommodation Agreement is attached as Confidential Appendix "A". The Receiver will advise the Court of any further changes to the Accommodation Agreement on the return of this motion. The Accommodation Agreement includes certain sensitive business information, including production schedules and pricing information for Meritor's Component Parts. Meritor has requested that this information be sealed. The Receiver believes it is appropriate for the Accommodation Agreement to be sealed until further Order of this Court.

4.1 Recommendation re: Accommodation Agreement

The Receiver recommends that the Court issue an order approving the Accommodation Agreement for the following reasons:

- a) It provides a mechanism to maximize the value of the inventory, which is only saleable to Meritor, as well as the accounts receivable owing from Meritor, by assisting Meritor to resource its business to another vendor without disruption;
- b) It provides a mechanism to fund the Company's business during the receivership period;
- c) It provides the framework for the Company to execute an orderly wind-down of its business, including the stability required to meet its enhanced short term production plan and secure payment for Component Parts produced and shipped in the pre and post-filing periods; and
- d) Comerica consents to its terms.

4.2 Recommendation re: Inventory Sale Transaction

The Accommodation Agreement contemplates that Meritor will purchase the Raw Material Inventory, WIP and finished Component Parts at book value. This inventory is only usable by Meritor. In a liquidation, this inventory would have nominal value. The sale of this inventory, together with the continued production of Component Parts for Meritor, should assist Meritor to resource on an orderly basis, which is vital to Meritor. This enhances the collection of accounts receivable, against which Meritor is otherwise likely to assert setoff claims. Comerica has advised that it consents to the sale of this inventory at book value. For these reasons, the Receiver recommends that the Court issue an order approving the Inventory Sale Transaction and vesting clean title in this inventory to Meritor.

5.0 Funding of these Proceedings

A preliminary cash flow projection for the next three months has been prepared with input from the Company, Meritor (and its advisors) and D&P. Funding for the receivership is addressed in the Accommodation Agreement. D&P, if appointed receiver, intends to attempt to negotiate substantially similar accommodation agreements with the Company's three other major customers immediately following its appointment.

To the extent required, the Receivership Order authorizes the Receiver to borrow up to \$500,000 pursuant to Receiver's Certificates. The lender making these advances would be granted a charge on the Company's assets subject only to the Receiver's Charge.

6.0 Overview of the Receiver's Activities

D&P's activities have included:

- Reviewing and commenting on draft receivership application materials and assisting the Company to prepare a cash flow projection for the receivership period;
- Drafting a communication plan to address key stakeholders, including employees, suppliers and customers;
- Dealing extensively with the negotiation of the Accommodation Agreement; and
- Drafting this Report.

7.0 Sale Process

D&P believes that it is appropriate to commence a sale process for the Company's business and assets immediately following the making of the Receivership Order. D&P, if appointed Receiver, intends to seek the Court's approval of the process shortly following its appointment.

8.0 Conclusion and Recommendation

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

* * *

All of which is respectfully submitted,

Duff & Phelps Canada Restructuring Inc.

**DUFF & PHELPS CANADA RESTRUCTURING INC.
IN ITS CAPACITY AS RECEIVER OF
PRECISION-TECH LIMITED, IF SO APPOINTED,
AND NOT IN ITS PERSONAL CAPACITY**