

**No. S-088488**  
**Vancouver Registry**

**IN THE SUPREME COURT OF BRITISH COLUMBIA**

**IN THE MATTER OF THE COMPANIES' CREDITORS ARRANGEMENT ACT,**

**R.S.C. 1985, c.C-36**

**and**

**IN THE MATTER OF THE CANADA BUSINESS CORPORATION ACT**

**and**

**IN THE MATTER OF HYDROXYL SYSTEMS INC.**

**Monitor's Second Report**

**February 3, 2009**

## **INTRODUCTION AND OVERVIEW**

On December 5<sup>th</sup>, 2008 (the “Filing Date”), Hydroxyl Systems Inc. (the “Company” or “Hydroxyl”) filed an application pursuant to the provisions of the *Companies Creditors Arrangement Act* (“CCAA”) and was granted an order (the “Initial Order”) by the Supreme Court of British Columbia (the “Court”). A copy of the Initial Order was sent to every known creditor of Hydroxyl on or about December 15<sup>th</sup>, 2008. In addition, a copy of the Initial Order has been posted on the Monitor’s website.

The details of the circumstances surrounding the Company’s filing under the CCAA, the causes of its financial difficulties, and the events leading up to the CCAA application are contained in the Petition and the Affidavit of Charles Croft filed in these proceedings. A copy of the Petition and the Affidavit were included in the creditor information sent to the creditors and are also available on the Monitor’s website.

The Initial Order provided for a Stay of Proceedings until January 5<sup>th</sup>, 2009, the date of the “Comeback Hearing”. At the January 5<sup>th</sup>, 2009, hearing a Confirmation Order was pronounced that confirmed the provisions of the Initial Order with some minor amendments and extended the Stay of Proceedings to February 5<sup>th</sup>, 2009. The 30 day extension was granted to provide the Company with sufficient time to prepare longer-term financial projections, have further discussions with prospective investors, collect an account receivable due from Aker Yards Oy and begin developing a Plan of Arrangement.

## **ACTIVITIES OF THE MONITOR**

Since the date of our Initial Report, the Monitor has:

- Monitored the Company’s daily cash inflows and outflows;

- Responded to creditor inquiries;
- Met with the Summit Group (“Summit”) to discuss the Company’s cash flow projections, the status of the prospective investors, and the development of a Plan of Arrangement;
- Had discussions with the Company’s management with respect the ongoing operations and the restructuring process;
- Reviewed the Company’s cash flow projections and underlying assumptions; and
- Prepared and distributed the Monitor’s Second Report to the Court in these CCAA proceedings.

For the purposes of this Report, the Monitor has relied on information provided by the Company and/or Summit.

## **POST FILING OPERATIONS**

Since the date of the Initial Order, the Company has continued its operations in the normal course. The Company has reduced its expenses, including a reduction in its workforce, and has been able to enter into new contracts with its customers. Further, suppliers are continuing to provide goods and/or services to the Company without delay.

We enclose as Appendix “A” the Company’s weekly cash flow schedule that provides a comparison between actual versus projected cash flow for the period from January 5 to 30, 2009.

Since the date of the Comeback Hearing, Hydroxyl has met its cash flow projections and has continued to operate within its \$500,000 operating line facility with the Royal Bank of Canada. Following are our comments with respect to the Company's cash flow:

**Cash Inflows:**

- Hydroxyl received approximately \$1,779,000 (invoiced amount for €1,129,000) from Aker Yards Oy ("Aker") on January 30, 2009. The Monitor's First Report dated January 2, 2009, projected the Aker receivable at \$1,914,000. The difference of approximately \$135,000 is due to the decline of the Euro against the Canadian dollar in the month of January 2009.
- With the exception of a \$40,000 account receivable due from Agropur, the Company has received all anticipated payments, including a \$150,000 contract deposit from Letter Kenny.

**Cash Outflows:**

- As at the date of this Report, the Company owed its suppliers approximately \$273,000 for goods and/or services supplied post-filing. Of this amount, approximately \$208,000 is owed to Steel Master Oy for materials delivered in respect of the Aker contract.
- Hydroxyl has paid its operating expenses, including statutory remittances, in accordance with the Initial Order and its cash flow projections.

**PROJECTED CASH FLOWS FROM FEBRUARY 2 TO MARCH 20, 2009**

We enclose as Appendix "B" the Company's Projected Cash Flows for the period from March 20, 2009 (also attached to the Affidavit #3 of David Gray sworn February 2,

2009). The projections were prepared by the Company with the assistance of Summit and in the Monitor's opinion, appear reasonable.

Management has advised that it intends to pay the Royal Bank's Export Loan of \$985,000 in full with the Aker proceeds.

With the exception of the Puerto Rico Brewery, all of the Company's projected cash flows relate to executed contracts.

### **RESTRUCTURING EFFORTS TO DATE**

Summit has provided the Monitor with a detailed memo summarizing the six prospective investors that have expressed interest in investing in the Company. Several of these prospective investors have performed some preliminary due diligence with the Company and have now requested further information.

The amount of any future investment raised by the Company will determine how much will be paid to the Company's creditors under a Plan of Arrangement.

In discussions with management and Summit, based on the Company's projected cash flows and contingent on a fresh capital injection, it could possibly have \$2 million (profits earned on existing contracts) to distribute to its creditors under a Plan of Arrangement.

### **RECOMMENDATIONS**

The Monitor has had discussions with creditors and other stakeholders, assisting the Company in updating its financial information, and participating in strategic discussions

with management and Summit regarding ongoing operations and the Company's preliminary Plan of Arrangement.

It is the Monitor's opinion that the Company is acting in good faith and with due diligence and has been cooperative in providing the Monitor with information requested. Assuming that all of the Company's post-filing obligations are paid, no creditor would be materially prejudiced if an extension of time is granted to allow Hydroxyl to prepare its Plan of Arrangement.

Given operations to date, and the Company's ongoing discussions and meetings with the prospective investors, it is the Monitor's view that an extension of 45 days is required to allow the Company time to finalize a deal with one of the prospective investors and to file its Plan of Arrangement.

Dated at Vancouver, British Columbia, this 3<sup>rd</sup> day of February, 2009.

**CAMPBELL, SAUNDERS LTD.**

Monitor

Per: Steve Lum, CGA, CIRP