

District of Ontario
Division No.: 07 - Hamilton
Estate No. 32-1871307
Court No. 32-1871307

IN THE MATTER OF THE BANKRUPTCY OF
SILICON KNIGHTS INC.
OF THE CITY OF ST. CATHARINES
IN THE REGIONAL MUNICIPALITY OF NIAGARA
IN THE PROVINCE OF ONTARIO

Trustee's Preliminary Report to the Creditors

SECTION A: BACKGROUND

Silicon Knights Inc. ("Silicon" or the "Company") is an Ontario corporation that carried on business as a video game developer. The Company was founded in 1992 and operated from leased premises located at 1 St. Paul Street in St. Catharines, Ontario. Silicon developed video games for game consoles including the Sony Playstation, Nintendo and Xbox 360.

Causes of Insolvency

In 2007, Silicon sued Epic Games Inc. ("Epic") for failure to provide a working game engine, which caused the Company to experience considerable losses. Epic counter-sued Silicon, claiming that Silicon was using its engine without paying royalties. In 2012, a U.S. Court ruled against Silicon and awarded Epic more than USD \$9 million for copyright infringement, misappropriation of trade secrets, breach of contract, and costs, and ordered Silicon to destroy all game code derived from the Epic game engine, and recall and destroy all unsold games built with the Epic game engine code.

According to the Company, the loss of its court case against Epic in 2012 led to the collapse of the Company's business. The Trustee was advised that the Company's software and technology were tainted by the court case as Silicon did not have software that was not connected to the Epic technology. As such, Silicon was unable to continue operations and meet its financial obligations as they came due. All of the employees were laid off in 2012. Silicon appealed the Court's decision but lost the appeal, which was heard in December 2013. Consequently, on May 16, 2014, the Company filed an assignment in bankruptcy.

The Company's recent financial results for the last three years ended December 31 are set out below. The litigation with Epic had a devastating impact on the Company's business. Sales went from \$4.2 million in 2011 to \$0 in 2012 and 2013. Over the three year period, the Company incurred legal fees of more than \$3 million and net losses of almost \$15 million before tax credits (\$4.5 million after tax credits).

	2013	2012	2011
Revenue			
Sales	\$ -	-	4,222,372
Interest income	19,977	31,379	55,505
Other	122	216	672
Total revenue	\$ 20,099	31,595	4,278,549
Expenses			
Accounting	\$ (17,500)	52,137	48,359
Contract work	98,750	158,820	118,948
Computer expenses	18,132	29,307	58,402
Depreciation	-	44,225	339,417
Legal	232,607	1,461,128	1,765,649
Other	64,430	235,285	477,577
Payroll	120,261	3,272,361	6,820,026
Rent	369,025	516,536	430,812
Software expense	259	61,673	170,550
Write down of capital	93,944	1,994,986	-
Total expense	\$ 979,908	7,826,458	10,229,740
Loss before tax refunds	(959,809)	(7,794,863)	(5,951,191)
Federal tax refunds	1,831,578	3,177,995	5,121,099
Net income (loss)	\$ 871,769	(4,616,868)	(830,092)

Source: Unaudited internal financial statements.

SECTION A: PRELIMINARY EVALUATION OF ASSETS

According to the Statement of Affairs sworn by Mr. Michael Mays, in his capacity as an officer of the bankrupt, the assets of Silicon as at the date of bankruptcy consist of the following:

Cash on hand	\$118,071.70
Accounts receivable	312,303.69
Retainer paid to Legal Counsel	<u>34,000.00</u>
	<u>\$464,375.39</u>

1) Cash

As of May 16, 2014, the Company had cash on hand of \$118,071.70. The Trustee has written to BMO Bank of Montreal where the Company's account is held to notify it of the bankruptcy and to request that the funds in Silicon's account be transferred to the Trustee.

2) Accounts Receivable

The Company's accounts receivables as of the date of bankruptcy consisted of the following:

2012 tax credit	\$297,959.00
HST refund	<u>14,344.69</u>
	<u>\$312,303.69</u>

\$297,959 is the estimated amount of a tax credit receivable by the Company arising from an Ontario Interactive Digital Media Tax Credit (OIDMTC) for the 2012 tax year. The claim was submitted to the Ontario Media Development Corporation (OMDC) in summer 2013 and it is expected that it will take one year for OMDC to process it. Once OMDC has reviewed and audited the claim, it will issue a tax certificate to the Company, and an amended 2012 tax return for the Company would need to be filed by the Trustee in order to claim the OIDMTC.

A HST refund of \$14,344.69 is due to the Company for the filing period January 2014 to April 2014.

On June 4, 2014, the Trustee received a copy of correspondence sent to the Company from Industry Canada advising that the Crown would be exercising its right of set-off for pre-bankruptcy debts owed to the Crown in the amount of \$618,919.71. The total debt owed to the Federal Economic Development Agency was reflected on the Statement of Affairs at \$3,750,000 and Industry Canada has since filed a proof of claim for \$3,707,979.71

Accordingly, the Trustee anticipates that the realization on the accounts receivable will be \$Nil.

3) Retainer

The Company paid a \$75,000 retainer to its legal counsel, Beard Winter LLC, of which approximately \$34,000 has not been utilized.

The Trustee will be contacting Beard Winter LLC to notify of the bankruptcy and to request that the unutilized portion of the retainer be transferred to the Trustee.

SECTION B: CONSERVATORY AND PROTECTIVE MEASURES

The Trustee's representative attended at the leased premises occupied by the bankrupt at 1 St. Paul Street, Suite 402, St. Catharines on May 21, 2014, to take stock of the fixed assets on the premises. The fixed assets were comprised of desks, chairs, two printers, and other miscellaneous items, which the Trustee's representative estimated would have a realizable value of approximately \$300. Given the low value of the fixed assets and potentially higher costs that might be incurred to realize on them, the Trustee did not take possession of the fixed assets.

There were no books and records found on the leased premises. The Trustee attended at the offsite storage locker used by the Company to store its books and records and took possession of the records required by the Trustee.

The officer of the Company will be taking possession of any other accounting records that Silicon is required to retain under the Income Tax Act, and the Estate will pay for the destruction of the remaining books and records.

The Trustee did not take possession of the Company's leased premises and has notified the landlord that it has no interest in the lease and issued a disclaimer of any lease(s) that may be in effect.

SECTION C: LEGAL PROCEEDINGS

The Trustee is not involved in any legal proceedings at this time.

SECTION D: PROVABLE CLAIMS

The Trustee is not aware of any material changes in the nature of liabilities from that shown on the creditors' list circulated with the notice of the First Meeting of Creditors.

The Claims Register showing proofs of claim filed in this Estate up to the close of business on June 4, 2014 is attached hereto. Certain USD claims have been converted to CAD using an exchange rate of 1.0882 as of the date of bankruptcy rather than the date the liability was incurred, resulting in a higher claim amount than was originally recorded on the Statement of Affairs.

SECTION E: SECURED CREDITORS

No secured creditors were identified by the Officer of the Company as at the date of bankruptcy.

A search of the Personal Property Security Act Registration System (PPSA) identified three parties which had registered their security interests against the Company: Dell Financial Services Canada Limited, IBM Canada Limited, and BMW Canada Inc. in respect of equipment/vehicle. As of the date of bankruptcy, the bankrupt had returned the vehicle to BMW Canada Inc. The Company has advised that the Dell leases were fully paid by 2012 and that Silicon did not have possession of the equipment under lease from IBM as of the date of bankruptcy, as the equipment had been left behind at their former office location and locked up by the landlord.

SECTION F: ANTICIPATED REALIZATIONS AND PROJECTED DISTRIBUTION

The Trustee estimates that, based on the anticipated net proceeds of realization from the Company's assets, after the costs of the bankruptcy administration and taking into account the quantum of unsecured claims against the Company as per the Statement of Affairs (approximately \$18 million), there may be only a minimal distribution to the unsecured creditors.

SECTION G: TRANSFERS AT UNDERVALUE AND PREFERENCE PAYMENTS

Based on information reviewed to date, the Trustee has not identified any transactions that warrant further investigation by the Trustee. The Trustee will review this further with the Inspectors to be elected at the First Meeting of Creditors.

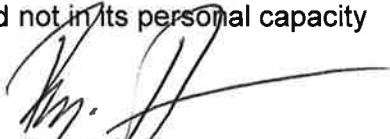
SECTION H: OTHER MATTERS

In addition to the foregoing, the Trustee has the following to report:

1. The Trustee has received a retainer of \$22,600 from the Company.

Dated at Toronto, Ontario, this 5th day of June, 2014.

COLLINS BARROW TORONTO LIMITED in its capacity as
Trustee of the Estate of Silicon Knights Inc., a bankrupt
and not in its personal capacity



Per: Bryan A. Tannenbaum, FCPA, FCA, FCIRP
President

Collins Barrow Toronto Limited
Claims Register
 In the Matter of the Bankruptcy of
 Silicon Knights Inc.
 of the City of St. Catharines
 in the Regional Municipality of Niagara
 in the Province of Ontario

Insolvency Date: 16-May-2014

<i>Creditor Name</i>	<i>Proof of Claim?</i>	<i>Claim Status</i>	<i>Rank / Class</i>	<i>SOA Amount</i>	<i>Amount Filed</i>	<i>Admitted for Dividend</i>
Unsecured creditors						
1. 407 ETR 877287378	No					
2. Activision Publishing, Inc. Attn: Mary Tuck	Yes	Not proved		1,400,000.00	1,523,480.00	
3. Allstream 914541	Yes	Admitted		249.12	275.97	
4. AMEX Bank of Canada 3735 904835 61006	No			1,234.71		
5. AMEX Bank of Canada 3735 904875 61002	No			2,860.40		
6. BlueRange Technology 115113	No			1,158.19		
7. BMW Group Financial Services Canada	No			9,800.00		
8. Canada Revenue Agency	No					
9. Cogeco Cable Canada Inc. 70611-712596-01-1-01	No			418.18		
10. Dell Financial Services Canada Limited	No			1.00		
11. Denis Dyack	No			1.00		
12. DHL 8069	No			11.30		
13. Dimock Stratton LLP 30160003	No			632.80		
14. Encore Legal Solutions, Inc. N/A	No			37,548.26		
15. Epic Games, Inc.	Yes	Admitted		9,500,000.00	11,182,289.00	
16. Federal Economic Development Agency for Southern Ontario Attn: Scott Millie	Yes	Admitted		3,750,000.00	3,707,979.71	
17. Finance Sholars Group N/A	No			21,651.63		
18. IBM Canada Ltd. Customer No. 704819	No			3,072.18		
19. Interactive Studio Management N/A	No			86,029.46		
20. J. Mark Holland & Associates N/A	No			1,936.74		
21. Johnson-Laird Inc. N/A	No			15,242.85		
22. Jonathan P. Marvin N/A	No			21,349.53		
23. Kilpatrick Townsend N/A	No			118,609.29		

Claims Register for Silicon Knights Inc. - Concluded

<i>Creditor Name</i>	<i>Proof of Claim?</i>	<i>Claim Status</i>	<i>Rank / Class</i>	<i>SOA Amount</i>	<i>Amount Filed</i>	<i>Admitted for Dividend</i>
24. King Bay Capital Corporation N/A	No			810,368.05		
25. Kreig, Keller, Sloan, Roman & Holland LLP Attn: Stan Roman N/A	Yes	Admitted		1,212,295.14	1,413,331.55	
26. Legal Vision Inc. N/A	Yes	Admitted		42,800.05	58,364.71	
27. Morneau Shepell 111147.0001	No			723.75		
28. Niagara Regional Broadband Network N/A	No			10,597.56		
29. Ontario Ministry of Finance	No					
30. Robert Zdybel N/A	No			8,242.87		
31. Rogers AT&T 453317554	No			6,048.88		
32. Ross Lillo	No			1.00		
33. Self Management Resources Corp. SIL001	No			7.91		
34. Shred-it International Inc. 11271714	No			148.31		
35. Telefilm Canada	No			1,050,000.00		
36. Thornton Grout Finnigan LLP N/A	No			15,127.22		
37. US Bank of Canada 4715 3652 0002 0480	No			1,338.59		
38. Van Houtte Coffee Services LP 2009-138152	No			909.64		
39. Womble Carlyle Sandridge & Rice N/A	No			157,526.17		
40. Workplace Safety and Insurance Board	No					
Total : Unsecured creditors				18,287,941.78	17,885,720.94	
Contingent Creditors						
1. Ontario Media Development Corporation Attn: Patrick Dervin	No			500,000.00		
Total : Contingent Creditors				500,000.00		
Grand Total:				18,787,941.78	17,885,720.94	