

**GORDON SMITH MARKETING PTY LTD  
RODNEY CLARK PTY LTD  
RODNEY CLARK RETAIL PTY LTD  
(All Administrator Appointed)  
(Collectively 'the Companies')**



**Report by Administrator pursuant to  
Section 439A of the Corporations Act 2001**

**Andrew Schwarz**

**8 September 2016**

## TABLE OF CONTENTS

	Glossary	iv
1.	Executive Summary	4
2.	Introduction	14
	2.1 Appointment of Administrator	14
	2.2 Object of Voluntary Administration	14
	2.3 First Meetings of Creditors	14
	2.4 Committee of Creditors	14
	2.5 Extension of convening period	15
	2.6 Second Meetings of Creditors and purpose of this Report	16
	2.7 Remuneration	17
	2.8 Independence	17
	2.9 Disclaimer	18
3.	Companies' business property and affairs	19
	3.1 Statutory information	19
	3.2 Companies' history and background	22
	3.3 Decision to appoint Administrator and Reasons for Failure	27
	3.4 Statement about the Companies' business, property, affairs and financial circumstances	29
4.	Historical financial performance and position	30
	4.1 Books and Records	30
	4.2 Preparation of Financial statements	30
	4.3 Historical financial performance	34
	4.4 Historical financial position	36
	4.5 Review of Financial performance	38
	4.6 Review of financial position	41
5.	Administration trading and Actions	52
	5.1 Licence Agreement	52
	5.2 Indooroopilly store	52
	5.3 Trading under Licence	53
	5.4 Actions since Appointment	53
6.	Sale of Business	55
	6.1 Sale Campaign	55
	6.2 Sale Contract	56
	6.3 Impact if Companies are placed in liquidation	58
	6.4 Administrator's opinion of sale	59
7.	Deed of Company Arrangement Proposal	60
	7.1 Proposal Received	60
	7.2 Key Features of DOCA	60
	7.3 Order of Distribution	61
	7.4 Estimated Return to Creditors	62
	7.5 Administrator's Opinion	62

8.	Investigations	63
8.1	Insolvent trading	64
8.2	Adequacy of books and records	86
8.3	Voidable transactions	86
8.4	Director's and officers' responsibilities	94
8.5	Offences	95
8.6	Summary of potential recoveries by liquidator	96
9.	Estimated Return to Creditors	96
10.	Options available to creditors	97
10.1	Administrator's Opinion	97
11.	Administrator's remuneration	99
12.	Second Meetings of Creditors	100

*Annexure A – Administrator's statement pursuant to Section 439A(4)(b)*

*Annexure B – Summary of Financial Performance FY 2008 to 27 June 2016*

*Annexure C – Summary of Financial Position FY 2008 to 27 June 2016*

*Annexure D – Group Structure*

*Annexure E – Trademarks*

*Annexure F - Receipts and Payments as at 31 August 2016*

*Annexure G – ASIC Information Sheets Listing*

*Annexure H – Estimated Returns*

*Annexure I – Scale of Rates and Relevant Experience*

*Annexure J – Remuneration Request Approval Report*

*Annexure K – Notice of Meetings of Creditors*

*Annexure L – Appointment of Proxy*

*Annexure M – Informal Proof of Debt*

## GLOSSARY

Defined term	Definition
<b>ACN</b>	Australian Company Number
<b>Act</b>	<i>Corporations Act 2001</i> (Cth)
<b>Administrator</b>	Mr. Andrew Schwarz
<b>ARITA</b>	Australian Restructuring Insolvency and Turnaround Association (formerly known as the Insolvency Practitioners Association of Australia)
<b>ASIC</b>	Australian Securities and Investments Commission
<b>Asset Sale Agreement</b>	Asset Sale Agreement dated 27 June 2016 between the Companies and the Purchaser
<b>ATO</b>	Australian Taxation Office
<b>DEEWR</b>	Department of Education, Employment and Workplace Relations
<b>Director</b>	Mr. Gordon Smith
<b>DIRRI</b>	Declaration of Independence, Relevant Relationships and Indemnities
<b>DOCA</b>	Deed of Company Arrangement
<b>ETI</b>	Shanghai Establishing Textile International Limited
<b>FEG</b>	<i>Fair Entitlements Guarantee Act 2012</i>
<b>First Meeting</b>	Meeting pursuant to 436E of the Corporations Act held on 7 July 2016 concurrently for the Companies at Wesley Conference Centre, 220 Pitt Street Sydney 2000.
<b>GSM / Gordon Smith Marketing</b>	Gordon Smith Marketing Pty Ltd
<b>GST</b>	Goods and Services Tax
<b>KWM</b>	King & Wood Mallesons (Lawyers for the Administrator)
<b>Licence</b>	Licence Agreement between the Administrator and the Purchaser dated 27 June 2016
<b>PBB</b>	Palm Beach Brands Pty Ltd
<b>PPSA</b>	<i>Personal Property Securities Act 2009</i>
<b>PPSR</b>	Personal Property Securities Register
<b>Proof of Debt Form</b>	Informal Proof of Debt Form
<b>Proxy Form</b>	Form 532 Appointment of Proxy
<b>Purchaser</b>	Brands For Us Pty Ltd
<b>RC / Rodney Clark</b>	Rodney Clark Pty Ltd
<b>RCR / Rodney Clark Retail</b>	Rodney Clark Retail Pty Ltd
<b>SAINTY</b>	Sainty International Co Ltd
<b>Second Meetings of Creditors</b>	Second Meeting of Creditors convened pursuant to Section 439A of the Corporations Act to be held on 20 September 2016
<b>Secured Creditor / Nab</b>	National Australia Bank Limited
<b>SSH Textiles</b>	SSH Textiles Co Limited
<b>Statements</b>	Statements about the Companies' business, property, affairs and financial circumstances
<b>the Companies / Group</b>	Gordon Smith Marketing Pty Ltd (ACN 003 840 168) Rodney Clark Pty Ltd (ACN 088 072 244) Rodney Clark Retail Pty Ltd (ACN 138 806 256)
<b>this Report</b>	The Report pursuant to Section 439A of the <i>Corporations Act 2001</i> for
<b>Trust</b>	Gordon Bruce Smith Family Trust (ABN 84 494 635 364)
<b>YQ &amp; LZ</b>	YQ & LZ International Trading (Australia) Pty Limited

## 1. EXECUTIVE SUMMARY

### 1.1 APPOINTMENT

Andrew Schwarz of AS Advisory was appointed Administrator of Gordon Smith Marketing Pty Ltd, Rodney Clark Pty Ltd and Rodney Clark Retail Pty Ltd (collectively 'the Companies') on 27 June 2016 by the Director Mr. Gordon Smith, pursuant to Section 436A of the Corporations Act 2001 ('the Act').

Just prior to my appointment the Companies, entered into an Asset Sale Agreement with Brands For Us Pty Ltd on 27 June 2016 to acquire the Companies' assets and businesses. On the same day Brands For Us Pty Ltd also entered into a share sale agreement with Palm Beach Brands Pty Ltd ('PBB') (not in Administration) an entity owned by the director Mr. Gordon Smith. PBB owns a number of fashion brands and trade-marks used by the Companies.

Due to the interdependent relationship of the entities within the Group, I have prepared this Report on a consolidated basis, although where possible individual company information is noted. This enables stakeholders to fully appreciate the business, operations, financial affairs and my investigations of the Companies as a whole.

This Report has been prepared in accordance with Section 439A of the Act and is based on information obtained from the Companies' books and records, discussions with the director and senior management, discussions with staff, discussions with the external accountant and from my own enquiries and investigations.

Creditors should note that this Report is based on my preliminary investigations to date. Although those investigations have been more substantive than an Administrator would normally conduct having regard to requests from creditors they are still preliminary in nature, accordingly, the views formed in this Report are not final and may be subject to change. In particular, should a liquidator be appointed they would conduct further more extensive investigations. Any additional material issues that are identified subsequent to this Report may be subject to a further written report and/or tabled at the forthcoming Second Meetings of Creditors.

### 1.2 SECOND MEETINGS OF CREDITORS

As Administrator I am required to hold a meeting of creditors within five business days of the end of the statutory convening period.

As reported to creditors (circular dated 25 July 2016) on the 21 July 2016 I obtained an order from Justice Yates of the Federal Court of Australia to extend the statutory convening period to 15 September 2016. Accordingly, the Second Meetings of Creditors is required to be held within five business days of 15 September 2016.

The principal purpose of the Second Meetings of Creditors is for creditors to decide the future of each individual company in Administration, by choosing one of the following three options for each company:

1. The company executes a Deed of Company Arrangement ('DOCA'). A proposal has been received from the Director Mr. Gordon Smith which is detailed in this Report;
2. The company be wound up; or

3. The administration of the company ends (and control of the company reverts to its director(s)).

The Second Meetings of Creditors for the Companies will be held on a concurrent basis as follows:

Second Meeting	Details
Date	20th September 2016
Time	11.00am (AEST)
Registration	30 Minutes before commencement of the meeting
Location	Wesley Mission Conference Centre, 220 Pitt Street, Sydney NSW 2000
Proxies	Please return no later than 4pm on Friday 16 <sup>th</sup> September 2016
Proof of Debts	POD's submitted for first meeting are valid for Second Meetings of Creditors.

### 1.3 ADMINISTRATOR'S OPINION AND RECOMMENDATION

The director initially proposed a deed contribution over and above the sale proceeds of \$350,000. This was then subsequently increased to \$750,000 and then further increased to \$1,700,000 including the debt owed of \$192,000 on the Director's acquisition of the Koolabah farm.

Accordingly, the current proposal for creditors consideration is:

- A DOCA pool be established covering all Companies and all creditors to consist of the following:
  - Surplus funds from asset recoveries made by the administrators (cash and debtors) along with the proceeds of the Asset Sale Agreement after allowance for the costs of the administration; and
  - The Director's contribution of \$1,700,000, which includes the net sale proceeds received from the PBB Share Sale Agreement. To be payable as follows:
    - \$650,000 following completion of the PBB Share Sale Agreement;
    - \$350,000 by 15 November 2016 (from sale of personal property);
    - \$350,000 by 15 February 2017 (personal contribution); and
    - \$350,000 by 15 April 2017 (personal contribution incl \$192,000 owed on acquisition of Koolabah property).
- Outstanding Employee entitlements will be assumed by the Purchaser and will not be a claim against the Companies (c \$700,000 in leave entitlements and \$984,000 in redundancy).
- Related party creditors will not claim in the Deed totaling approximately \$1,500,000.
- The Director will provide a personal guarantee together with security over real property.

The Administrator is of the opinion that creditors should accept the proposed DOCA because:

- The estimated return to unsecured creditors (although lower than the high case scenario under liquidation) is likely to be more certain than in an orderly winding up of the Companies, noting that the actual return in liquidation could be nil;

- A DOCA avoids the risks to the Asset Sale Agreement not completing and therefore limits the crystallisation of employee claims (with the exception of unpaid superannuation);
- The DOCA provides for a return to all employees, whereas under a liquidation scenario within Rodney Clark there is likely to be a shortfall to employees, resulting in their superannuation entitlements not being paid in full;
- It provides certainty to unsecured creditors and employees. In a liquidation scenario, any dividend will be contingent on antecedent recoveries (i.e. preference recoveries, insolvent trading, compensation for breach of director's duties etc.) and notwithstanding the merits of these claims, recovery costs are likely to be high, they will require Court proceedings which are uncertain and ultimately will be impacted by the capacity of the parties to meet any significant judgments which may be obtained; and
- The DOCA will enable a dividend to be paid to creditors earlier than what may be available under a liquidation scenario where a dividend is likely dependent on antecedent recoveries which are uncertain.

## 1.4 ESTIMATED RETURN TO CREDITORS

### 1.4.1 Creditors holding registrations on the Personal Property Security Register

Nab is the major secured creditor and holds a priority registered security interest over all the Companies. It is entitled to the proceeds of all asset sales in priority to later registered security interests and general unsecured creditors, but will rank behind the claims of priority creditors (eg employees) in regard to circulating assets (previously known as floating charge) (eg debtors, stock and cash).

As at the date of my appointment the Companies were indebted to the Nab for approximately \$900,000.

This consisted of the following:

- Debtor factoring facility – Balance as at appointment \$619,338
- Bank Guarantee facility supporting store leases - \$276,874
- Overdrawn Bank account - \$1,572

Following my appointment, the Director, Mr. Gordon Smith, on the 11 July 2016 paid out the debtor facility which by this time had reduced to \$356,367 and assumed the Nabs ownership of those debts. The debtors balance at this time was \$506,197 resulting in equity of \$149,830. However, approximately \$249,000 in rebates and credits had not been processed against the ledger. Accordingly, there is likely to be a shortfall on debtor collections. Under the law of subrogation, the Director would assume the position of the Nab and would have a priority claim for any shortfall. At the time of writing the Director has indicated that any shortfall is likely to be minimal and not result in a secured claim.

With regard to bank guarantees on store leases at the time of writing, \$105,911 of bank guarantees supported by Nab facilities had been called. Having regard to the quantum of outstanding store rent against guarantees provided by Nab, at the date of appointment I estimate a further \$23,000 will be called resulting in Nab having a priority claim for \$130,500 (Bank Guarantees \$129,000 and OD \$1,500) on the basis that the sale of business is consummated and no further Bank Guarantees are called and paid.

In addition to the Nab a number of creditors hold registrations on the Personal Property Security Register (refer section 3.1.4 of this Report). Having regard to the registrations held and the claims outstanding I estimate additional secured creditor claims of approximately \$27,000. Should the Asset Sale Agreement not complete, these claims will increase as a result of the termination of various finance agreements.

#### 1.4.2 Priority creditors (Employees)

Priority claims comprise amounts owed to employees for unpaid wages, unremitted superannuation, annual and long service leave and termination entitlements.

A summary of the employee claims as at the date of appointment is detailed below:

Employee Entitlements	Gordon Smith Marketing	Rodney Clark	Total
Number of Employees	29	63	92
Wages Outstanding \$ (Note paid by administrator following appointment)	5,600	32,400	38,000
Annual Leave \$	226,200	72,200	298,400
Long Service Leave \$	353,500	52,100	405,600
Termination Entitlements \$	632,000	352,000	984,000
Superannuation \$	94,300	63,000	157,300
<b>Total Employee Entitlements</b>	<b>\$1,311,600</b>	<b>\$571,700</b>	<b>\$1,883,300</b>

As noted above should the Asset Sale Agreement complete annual & long service leave and termination entitlements will be assumed by the purchaser.

Should the Companies be placed in liquidation and the Asset Sale Agreement does not complete, then employees would have a priority claim for the total employee entitlements (c \$1.8m). Under a liquidation scenario the Federal Government Scheme the Fair Entitlements Guarantee Scheme ('FEG') would be available to employees subject to certain limits. This scheme does not cover Superannuation. Creditors should note however, that if FEG advances funds to cover employee entitlements then FEG steps into the 'shoes' of the employees and would have a priority claim in the liquidation. Accordingly, if the Asset Sale Agreement does not complete creditor claims will increase by approximately \$1.8 million as a result of the crystallisation of employees' claims noted in the table above.

#### 1.4.3 Ordinary Unsecured Creditors

Ordinary unsecured creditors based on the Companies' records and proofs of debt lodged at the time of writing, are estimated as follows:

Estimate of Creditors claims \$	GSM	RC	RCR	Group
Trade Creditors	10,256,598	246,909	24,213	10,527,720
Statutory Liabilities	335,195	265,483	-	600,678
Intercompany Creditors		1,041,920		1,041,920
Related Parties	444,565			444,565
Contingent creditor claims	146,057			146,057
<b>Total Estimated creditors</b>	<b>11,182,415</b>	<b>1,554,312</b>	<b>24,213</b>	<b>12,760,940</b>

#### 1.4.4 The estimated return to creditors

The estimated return to creditors under the different scenarios is as follows:

*Deed of Company Arrangement (Pooled DOCA covering all Companies and all Creditors)*

Creditors	Estimated dividend rate (Cents in \$)	Estimated dividend rate (Cents in \$)
	High	Low
Priority	100	100
Secured	100	100
Unsecured	14	13
Related party	Nil	Nil

*Liquidation*

Gordon Smith Marketing Creditors	Estimated dividend rate (Cents in \$)	Estimated dividend rate (Cents in \$)
	High	Low
Priority	100	100
Secured	100	100
Unsecured	20	Nil
Related party	20	Nil

Rodney Clark Creditors	Estimated dividend rate (Cents in \$)	Estimated dividend rate (Cents in \$)
	High	Low
Priority	23	15
Secured	100	100
Unsecured	0	0
Related party	0	0

Rodney Clark Retail Creditors	Estimated dividend rate (Cents in \$)	Estimated dividend rate (Cents in \$)
	High	Low
Priority	n/a	n/a
Secured	n/a	n/a
Unsecured	78	35
Related party	n/a	n/a

The above dividend rates are estimates only. The final dividend rate will be dependent on a number of factors, including actual realisations, actual realisation costs and the level of creditor claims once formal proofs of debt have been received and adjudicated. Please refer to commentary in the body of the report.

#### 1.5 ADMINISTRATOR'S OVERVIEW

I make the following overview comments in relation to my investigations into the Companies' operations and financial position.

### 1.5.1 Background

The Companies operate a wholesale and retail business across the east coast of Australia within the women's fashion industry.

The Companies' operations are interlinked with each company conducting the following operations:

- Gordon Smith Marketing– Wholesaler
- Rodney Clark– Retailer
- Rodney Clark Retail– Holds the majority of the store leases

Gordon Smith Marketing commenced operations in 1992 with a few development orders and small range of products for Myer. Over the years it has developed and promoted a number of brands and labels to the major retailers in Australia and New Zealand as well as to other retailers.

Turnover peaked at approximately \$27 million in FY 2008 before falling consistently to \$13.9 million in FY 2016.

In 1999 the business acquired Rodney Clark via a debt for equity swap with one of its customers. At the time the business operated four retail stores and was owned by both Gordon Smith (current owner and director) and his business partner Michael Ridley. In 2005 the business came under the sole control of Mr. Gordon Smith.

From inception the Rodney Clark business grew rapidly to a peak in FY 2009 comprising 34 stores with a turnover of approximately \$15 million. At the time of my appointment the number of stores had fallen to 17 (15 stores & 2 outlets) with turnover of \$7.8 million.

While the Gordon Smith Marketing business has been profitable the Rodney Clark has been loss making since FY 2007 and has been a significant drain on the group.

Rodney Clark Retail was established in 2009 as a non trading entity with the sole purpose of holding the majority of the Rodney Clark store leases.

At the time of my appointment the Companies employed approximately 90 staff and operated from 15 retail stores and two outlet stores located in Queensland, New South Wales and Victoria along with a head office and warehouse located in Waterloo, New South Wales.

### 1.5.2 Sale of Business and Licence Agreement

Prior to my appointment the Director ran a sale campaign which resulted in him reaching an agreement to sell the businesses to the Purchaser (Brands For Us Pty Ltd).

The Purchaser is part of a women's fashion group which operates stores under the 'Sorbet' business name and has a number of brands including Sorbet, Threadz and Clarity.

Just prior to my appointment on 27 June 2016, the Companies entered into an Asset Sale Agreement comprising all assets with the exception of the Indooroopilly store located in Queensland.

The Asset Sale Agreement is subject to a number of conditions precedent, one of which is approval by creditors at the Second Meetings of Creditors. Details regarding the Asset Sale Agreement are outlined at Section 6 of this Report.

Following my appointment I conducted an urgent assessment of the financial position of the Companies and formed the view that given the size of the payroll and lease commitments and having regard to the limited liquid assets available, in particular minimal cash at bank, I could not trade the Companies in administration.

Accordingly, in order to preserve value and to keep the prospects of the Asset Sale Agreement completing, I entered into a Licence with the Purchaser.

Under the terms of the Licence agreement the Purchaser is responsible for the day-to-day management of the Companies' businesses with the exception of the Indooroopilly store.

In relation to the Indooroopilly store, I traded this business for approximately one week during the rent free period afforded to me under the Act and then sold the remaining stock to the Purchaser. During the Administration and following the store closure, the landlord of Indooroopilly made contact with the Purchaser and offered new rental terms that were acceptable to the Purchaser resulting in the store re-opening under the control of the Purchaser.

### 1.5.3 Financial Information

A summary of the Companies' recent financial results based on the financial accounts including a number of adjustments (refer section 4 of this Report) is summarised below and detailed in **Annexure B & C**.

#### *Financial Performance*

Company	Reported Profit / (Loss)				
	FY 2012 \$000's	FY 2013 \$000's	FY 2014 \$000's	FY 2015 \$000's	Mgt Acc 27 June 2016 \$000's
Gordon Smith Marketing	1,455	827	844	507	135
Rodney Clark	(873)	(256)	(491)	(250)	(910)
<b>Consolidated</b>	<b>582</b>	<b>571</b>	<b>353</b>	<b>257</b>	<b>(775)</b>

#### *Financial Position*

Company	Reported Net Assets				
	FY 2012 \$000's	FY 2013 \$000's	FY 2014 \$000's	FY 2015 \$000's	Mgt Acc 27 June 2016 \$
Gordon Smith Marketing	\$10	\$10	\$10	\$10	(806)
Rodney Clark	(420)	(125)	(167)	(196)	(1,106)
Consolidated	(420)	(125)	(167)	(196)	(1,912)

I note the following in relation to the financial history of the Companies:

- GSM sales have fallen by \$13 million or 49% between FY 2008 and 27 June 2016;
- although GSM continued to remain profitable, profit has fallen since FY2011;
- GSM gross profit has fallen by \$7.9 million or 60% between FY 2008 and 27 June 2016;
- Notwithstanding this, GSM gross profit margin remained around 42% to 45%
- RC has always been loss making since FY 2007;

- RC sales have fallen by \$6.3 million or 45% over the period FY 2008 to 27 June 2016 with gross profit falling \$5.4 million or 56%.
- Similarly, RC gross profit margin has remained around the 65% to 67%

#### *Estimated Creditor position*

At the time of writing, the Companies creditors' claims are estimated to be approximately \$13.1m as follows:

Estimate of Creditors claims \$	GSM	RC	RCR	Group
Secured Creditor (Nab)	130,256			130,256
Other creditors secured on PPSR	17,649	9,064		26,713
Trade Creditors	10,256,598	246,909	24,213	10,527,720
Statutory Liabilities	335,195	265,483	-	600,678
Intercompany Creditors		1,041,920		1,041,920
Related Parties	444,565			444,565
Priority Creditors (employees)	109,900	102,400		212,300
Contingent creditor claims	146,057			146,057
<b>Total Estimated creditors</b>	<b>11,440,220</b>	<b>1,665,776</b>	<b>24,213</b>	<b>13,130,209</b>

Note: The above table is based on the books and records and informal proof of debts received at the date of this report

#### 1.5.4 Reason for failure

The Administrator's preliminary view is that the Companies failure was due to:

- General downturn and increased competition in the retail market;
- Significant decrease in sales;
- High level of debt and accelerated debt reduction over recent years;
- Inability to secure competitive product pricing and ultimately supply for summer 2016;

These factors resulted in the Companies experiencing a significant decrease in profitability.

#### 1.6 INVESTIGATIONS

I note my investigations, although substantive, are preliminary in nature and should the Companies be placed in liquidation a liquidator would undertake further more detailed investigations before forming any final opinions on these matters. My initial findings indicate that:

- Prima facie, the Companies are likely to have been insolvent from May or September 2014;
- Payments totaling \$2.37 million were paid to creditors of the Companies in the six months leading up to the appointment of the Administrator which may be preferential in nature and potentially recoverable by a liquidator pursuant to Section 588FE of the Act; and
- I have identified a number of transactions involving related parties that may be uncommercial in nature and potentially recoverable by a liquidator.
- I have identified instances of breaches of director's duties.

Further details on the above is contained at Section 8 of this Report.

## 1.7 PROGRESS OF ADMINISTRATION

As noted above following my appointment I licensed the business operations of the Companies to the Purchaser.

During the Administration my staff and I have attended to a number of tasks which include but not limited to the following:

- Met with the Director and the external accountant following my appointment to discuss the administration and the Companies finances and operations generally;
- Met with the Purchaser to discuss and facilitate the licensing arrangements;
- Held discussions with the staff and provided regular updates during the administration;
- Prepared a cashflow and implemented control processes to monitor the businesses under Licence;
- Regular meetings and discussions with the Purchaser regarding progress of the satisfaction of the conditions precedent under the Asset Sale Agreement, in particular assignment of store leases;
- Continued the employment of staff and key services during the Licence period;
- Communicating with the landlords to continue the various store leases during the administration;
- Weekly reconciliation of cash takings and sales; including monitoring of expenses incurred and indemnity position with the Purchaser;
- Correspondence and discussions with debtors regarding amounts owed;
- Reported to the Nab as secured creditor;
- Various discussions with the Nab regarding its facilities;
- Assisted the Nab with the collection of factored debtors and subsequent payout of facility by the Director;
- Convened and held the First Meetings of Creditors on 7 July 2016;
- Made application to the Federal Court of Australia to extend the convening period;
- Convened and held meetings of the Committee of Creditors;
- Attendance to creditors' enquiries and questions, which have been extensive;
- Updating of the Companies' creditor records to reflect correct address and debt outstanding;
- Liaison with the Director and his advisors regarding the history, financial position and activities of the Companies including the DOCA proposal;
- Numerous discussions with the Administrator's solicitors regarding legal issues impacting on the administration;
- Initial trading and subsequent closure of the Indooroopilly store;
- Discussions with the Companies' external accountants regarding tax matters and information requests;
- Data imaging of the Companies' computer systems and files;
- Review of Companies' records and investigations into its operations and reasons for failure which has been significant and substantive;
- Review of the Companies' insurance policies;
- Correspondence with the Companies' financiers regarding loan facilities and leased plant and equipment;
- Correspondence with other creditors holding PPSR registrations;
- Investigation and actioning of Retention of Title Claims;
- Investigation into the Trust status and assets of the Trust;
- Preliminary investigations into insolvent trading, preference claims, voidable transactions & Director and officer responsibilities and offences; and

- Preparation of this report and convening of the second meetings of creditors.

**The Executive Summary is designed to give creditors basic information pertaining to the Companies. I encourage creditors to read the Report in full.**

## 2. INTRODUCTION

### 2.1 Appointment of Administrator

Mr. Andrew Schwarz was appointed Administrator of the Companies on 27 June 2016 pursuant to Section 436A of the Act.

### 2.2 Object of Voluntary Administration

Pursuant to Section 435A of the Act, the object of a Voluntary Administration is to provide for the business, property and affairs of an insolvent company to be administered in a way that either:

- Maximises the chances of the company, or as much as possible of its business, continuing in existence, or
- If it is not possible for the company or its business to continue in existence, results in a better return for the company's creditors and members than would result from an immediate winding up.

On the date of my appointment I sought to maximise the chances of the Companies' business continuing in existence by:

- Entering into a licensing arrangement with the purchaser to enable the trading operations of the Companies to continue.
- Securing all assets and arranging insurance cover.
- Continued employment of the staff under the licensing arrangement.
- Communicating with the landlord for the continued occupation of the trading premises.

### 2.3 First Meetings of Creditors

On 7 July 2016, the first meetings of creditors of the Companies were held concurrently pursuant to Section 436E of the Act to determine:

- Whether creditors wish to remove the Administrator and appoint someone else as Administrator of the Companies.
- Whether to appoint a committee of creditors and, if so, who are to be the committee's members.

The creditors did not nominate an alternative Administrator to replace Mr. Schwarz. However, they did resolve to appoint a Committee of Creditors.

### 2.4 Committee of Creditors

As noted above at the first meetings of creditors, creditors resolved to appoint one Committee of Creditors to represent all creditors across all three companies. The members of the committee consist of the following:

Creditor Name	Representative
SSH Textiles Co Ltd	Ms Taline Chater of Minter Ellison
Alex Tyler (Employee)	Self
Annie Redden (Employee)	Self
YQ & LZ International Trading Ltd	Mr John Boyle - J.B. Solicitors
Birmingham Distribution Centre P/L (In Liquidation)	Mr Adam Lysle of Veritas Advisory
Li, XIAO Hong	Self - Lily Hong
Comely Creations Ltd	Mr Sze Wye Yee
Shanghai Establishing Textile International Limited	Mr Sze Wye Yee
Sainty International Co Ltd	Mr Sze Wye Yee
Shanghai Qixin Import Export Co Ltd	Mr Runqin Tao

## 2.5 Extension of the Convening Period

On the 21 July 2016 I made an application in the Federal Court of Australia to extend the convening period up to 15 September 2016 so as to enable the following:

- a) The Purchaser time to complete negotiations with the various landlords in relation to the continuation of the leases;
- b) The Administrator to complete his investigations which are ongoing specifically in relation to the conduct of the director prior to my appointment; and
- c) Sufficient time for interested parties to propose a DOCA (the DOCA proposal of the Director is outlined in section 7 of this Report).

The application was made in light of the objectives in Section 435A of the Act and in the interests of creditors, including:

- a) it is in creditors best interests that the business continues to trade with a view to the going concern sale of the Companies' business and assets completing;
- b) an extension of the convening period would retain the benefit of the moratoria allowing the Companies to remain in possession of the retail outlets and continue to trade pending the Purchaser's negotiations with landlords and completion of the sale.
- c) this maximises the flexibility for the Purchaser, and the Director to propose a deed of company arrangement and the options available to creditors to determine the future of the Companies; and
- d) enable the Administrator to complete comprehensive investigations and provide a considered opinion to creditors pursuant to Section 439A of the Act.

Justice Yates of the Court granted the orders sought on 21 July 2016 including an extension of the convening period through to 15 September 2016 along with various orders in relation to the delivery of information to creditors via email and the ability to circulate this report through placement on AS Advisory website. Saving creditors significant printing and distribution costs.

## 2.6 Second Meetings of Creditors and purpose of this Report

The Second Meetings of Creditors pursuant to Section 439A of the Act for the Companies will be held concurrently and has been convened for **11.00am on 20 September 2016 to be held at Wesley Conference Centre, 220 Pitt Street Sydney 2000.** ('the Second Meetings of Creditors').

Attached to this Report are the following:

- Notice of Meetings (**Annexure K**)
- Proxy Form 532 (**Annexure L**)
- Informal Proof of Debt form for voting purposes only (**Annexure M**)

I request that creditors arrive at least 30 minutes prior to the meeting to enable orderly registration.

Creditors wishing to attend and/or vote at the Second Meetings of Creditors should complete and return the relevant Proxy Form and Informal Proof of Debt Form as instructed, by no later than **4.00pm on Friday 16 September 2016** to enable timely processing. Please note the proxies submitted for the First Meetings of Creditors are **NOT** valid for the Second Meetings of Creditors.

Amongst other things, the Second Meetings of Creditors will determine the future of the Companies.

Pursuant to Section 439A(4) of the Act, the purpose of this Report is to inform creditors about the Companies' business, property, affairs and financial circumstances and to provide a statement to creditors and give reasons for my opinion with respect to the following matters:

- whether it would be in creditors' interests for the Companies to execute a DOCA, or
- whether it would be in creditors' interests for the Administrations to end and control of the Companies be returned to the Director, or
- whether it would be in creditors' interests for the Companies to be wound up.

I have received a DOCA proposal from the Director. Details on the proposal are contained at Section 7 of this Report.

My opinion with regard to each company, as disclosed in Section 9 and **Annexure A** of this Report, is summarised in the table below:

Company	Administrator Opinion
Gordon Smith Marketing Pty Ltd	it is in creditors' interests to accept the DOCA proposal
Rodney Clark Pty Ltd	it is in creditors' interests to accept the DOCA proposal
Rodney Clark Retail Pty Ltd	it is in creditors' interests to accept the DOCA proposal

## 2.7 Remuneration

At the Second Meetings of Creditors, I will be seeking approval of the Administrator's remuneration for the Companies as follows:

Period	GSM	RC	RCR
	\$ ex GST	\$ ex GST	\$ ex GST
Voluntary Administration 27 June 2016 to 31 August 2016	157,811.75	82,261.50	13,071.50
Voluntary Administration 1 September to end of the voluntary administration period	50,000.00	25,000.00	5,000.00
<b>Total Voluntary Administration</b>	<b>207,811.75</b>	<b>110,261.50</b>	<b>18,071.50</b>
DOCA (If applicable) Execution of DOCA to completion	60,000.00	45,000.00	10,000.00
Liquidation (If applicable) Commencement to an initial capped amount	150,000.00	60,000.00	10,000.00

Please refer to my Remuneration Request Approval Report at **Annexure J** for details of the key tasks undertaken throughout the course of the administration along with a summary of receipts and payments to date.

Time costs have been higher than the estimate provided to creditors in the first circular dated 28 June 2016 for the following reasons:

- It is difficult to estimate at the start the complexities that may be encountered during an administration;
- Extended timeframe of the administration as a result of the extension to the convening period, refer section 2 of this report;
- The number of creditors and significant level of creditor enquiries and engagement;
- Extensive investigations undertaken as a result of creditor requests refer section 8 of this Report;
- Time required to interpret and analysis the financial accounts having regard to the difficulties identified refer section 4 of this report; and
- The fact that Gordon Smith Marketing is a trust that contains assets outside of the Companies.

## 2.8 Independence

As stated in my first circulars to creditors dated 28 June 2016, I have adopted the Code of Professional Practice in relation to independence on the appointment of an Administrator as released by the ARITA, which is applied by members of the ARITA.

Section 448C of the Act lists the circumstances whereby a person is disqualified and unable to seek or consent to be appointed as, or act as, Administrator of a company. I do not believe that I am prohibited from accepting the positions of Administrator of the Companies pursuant to the Act.

Pursuant to the ARITA Code of Professional Practice, I have had no prior involvement with the Companies, its officers, or any related party which would preclude me from accepting the appointments. Up to the date of my appointments, my only involvement with the Companies had been to meet with the Director to discuss the Companies' financial position and advise of the options available to the Director. In addition, in the lead up to my appointment I conducted some

limited pre-planning which involved meeting with the Companies' lawyers and the Purchaser to discuss the terms of the sale contract and to negotiate a Licence agreement. There has been no change to the Disclosure Statement provided in the First Circular to Creditors.

## 2.9 Disclaimer

This Report, the statements herein and the investigations of the Companies' affairs has been prepared and conducted from available books and records and information provided by the Companies' Officers, key personnel where applicable and from my own enquiries.

Whilst I have no reason to doubt any information contained in this Report, I reserve the right to alter my conclusions should the underlying data prove to be inaccurate or materially change from the date of this Report.

The statements and opinions given in this Report are given in good faith and in the belief that such statements and opinions are not false or misleading. Except where otherwise stated, I reserve the right to alter any conclusions reached on the basis of any changed or additional information which may become available to me between the date of this Report and the date of the Second Meetings of Creditors.

Neither A.S. Advisory Pty Ltd, nor any member, employee or consultant thereof undertakes responsibility in any way whatsoever to any person in respect of any errors in this report arising from incorrect information provided to me. Should creditors have information that may assist my investigations into the Companies' affairs, please forward details to my office.

### 3 THE COMPANIES' BUSINESS, PROPERTY AND AFFAIRS

#### 3.1 STATUTORY INFORMATION

A summary of the Statutory information in relation to each entity in the Group based on a search of the Australian Securities and Investments Commission ('ASIC') database is disclosed below:

##### 3.1.1 Registration

Company	Registration Date	Registered Office	Principle place of business
Gordon Smith Marketing Pty Ltd	6 July 1989	N.W. Elliott & Associates Suite 4, 200 Victoria Road, Drummoyne	207 – 229 Young Street Waterloo NSW 2017
Rodney Clark Pty Ltd	15 June 1999	N.W. Elliott & Associates Suite 4, 200 Victoria Road, Drummoyne	207 – 229 Young Street Waterloo NSW 2017
Rodney Clark Retail Pty Ltd	11 Aug 2009	N.W. Elliott & Associates Suite 4, 200 Victoria Road, Drummoyne	207 – 229 Young Street Waterloo NSW 2017

##### 3.1.2 Directors and Secretary

Gordon Smith Marketing Pty Ltd	Office Held	Date Appointed	Date Ceased
Gordon Bruce Smith	Director	19/9/1989	Current
Neil William Elliott	Secretary	15/1/1993	Current
Gordon Bruce Smith	Secretary	19/9/1989	Current
Nathan Smith	Director	11/5/2011	19/11/2013
Julianne Smith	Director	19/9/1989	11/5/2011
Peter Truelove	Director	6/7/1989	19/9/1989
Ross Dalgleish	Director	6/7/1989	19/9/1989
Peter Truelove	Secretary	6/7/1989	19/9/1989
Rodney Clark Pty Ltd	Office Held	Date Appointed	Date Ceased
Gordon Bruce Smith	Director	9/7/1999	Current
Neil William Elliott	Secretary	9/7/1999	Current
Michael Ridley	Director	16/6/1999	9/7/1999
Julianne Smith	Director	16/6/1999	9/7/1999
John Andrews	Director	15/6/1999	16/6/1999
John Andrews	Secretary	15/6/1999	16/6/1999
Julianne Smith	Secretary	16/6/1999	9/7/1999
Rodney Clark Retail Pty Ltd	Office Held	Date Appointed	Date Ceased
Gordon Bruce Smith	Director	17/8/2009	Current
Neil William Elliott	Secretary	17/8/2009	Current
Neil William Elliott	Director	11/8/2009	17/8/2009
Neil William Elliott	Secretary	11/8/2009	17/8/2009

##### 3.1.3 Shareholders

Company	Issued Capital	Shareholder	Shares Held
Gordon Smith Marketing Pty Ltd	\$2.00 (2 x \$1.00)	Gordon Bruce Smith	2
Rodney Clark Pty Ltd	\$100 (100 x \$1.00)	Gordon Bruce Smith	100
Rodney Clark Retail Pty Ltd	\$1.00 (1 x \$1.00)	Gordon Bruce Smith	1

### 3.1.4 Registered security interests

The Personal Property Securities Register ('PPSR') discloses a number of registered security interests as follows:

Gordon Smith Marketing Pty Ltd		
Secured Party	Registration Date	Collateral Class
NATIONAL AUSTRALIA BANK LIMITED ACN 004 044 937	30/01/2012	All Pap No Except
DE LAGE LANDEN PTY LIMITED ACN 101 692 040	30/01/2012	All Pap No Except
NATIONAL AUSTRALIA BANK LIMITED ACN 004 044 937	30/01/2012	All Pap No Except
MARTIN & SAVAGE PTY LTD ACN 00 000 020 235	30/01/2012	Other Goods
NATIONAL AUSTRALIA BANK LIMITED ACN 004 044 937	30/01/2012	All Pap With Except
NATIONAL AUSTRALIA BANK LIMITED ACN 004 044 937	03/02/2012	Other Goods
NATIONAL AUSTRALIA BANK LIMITED ACN 004 044 937	03/02/2012	Other Goods
NATIONAL AUSTRALIA BANK LIMITED ACN 004 044 937	08/02/2012	Motor Vehicle
NATIONAL AUSTRALIA BANK LIMITED ACN 004 044 937	08/02/2012	Motor Vehicle
NATIONAL AUSTRALIA BANK LIMITED ACN 004 044 937	10/02/2012	Other Goods
NATIONAL AUSTRALIA BANK LIMITED ACN 004 044 937	10/02/2012	Other Goods
MARTIN & SAVAGE PTY LTD ACN 00 000 020 235	15/03/2012	Other Goods
Charles Parsons (NZ) Ltd	26/04/2012	Other Goods
Charles Parsons (NZ) Ltd	23/05/2012	Other Goods
BMW AUSTRALIA FINANCE LIMITED ACN 007 101 715	23/08/2013	Motor Vehicle
FINRENT PTY LIMITED ACN 103 796 201	10/01/2014	Other Goods
NATIONAL AUSTRALIA BANK LIMITED ACN 004 044 937	24/01/2014	All Pap No Except
BMW AUSTRALIA FINANCE LIMITED ACN 007 101 715	15/04/2014	Motor Vehicle

Rodney Clark Pty Ltd		
Secured Party	Registration Date	Collateral Class
NATIONAL AUSTRALIA BANK LIMITED ACN 004 044 937	30/01/2012	All Pap No Except
NATIONAL AUSTRALIA BANK LIMITED ACN 004 044 937	30/01/2012	All Pap No Except
SUNDAY'S-JUMP PTY. LTD. ACN 00 005 102 287	30/01/2012	Other Goods
NATIONAL AUSTRALIA BANK LIMITED ACN 004 044 937	25/01/2014	All Pap No Except
CONDURA PTY LTD ACN 002 874 660	26/01/2014	Other Goods
CONDURA PTY LTD ACN 002 874 660	26/01/2014	Other Goods
SUNDAY'S-JUMP PTY. LTD. ACN 00 005 102 287	12/02/2014	Other Goods

The Gordon Bruce Smith Family Trust		
Secured Party	Registration Date	Collateral Class
FUJI XEROX FINANCE LIMITED ACN 001 419 807	08/11/2012	Other Goods
WESTPAC BANKING CORPORATION ACN 007 457 141	08/01/2014	Motor Vehicle
NATIONAL AUSTRALIA BANK LIMITED ACN 004 044 937	24/01/2014	All Pap No Except
WESTPAC BANKING CORPORATION ACN 007 457 141	23/01/2015	Other Goods
NATIONAL AUSTRALIA BANK LIMITED ACN 00 004 044 937	02/03/2016	All Pap With Except

I have written to all parties with registered financing statements on the PPSR in relation to their security interest. I comment below on the specific registrations:

#### ***National Australia Bank Limited***

Nab was the main banker to the group providing the following facilities:

- Commercial Bill Facility
- Debtor Finance Facility
- Trade Finance Facility
- Overdraft
- Mortgage Finance on Koolabah Farm
- Bank Guarantees

At the time of my appointment the only facilities outstanding were the following:

Facility	Balance Outstanding \$
Debtor Finance Facility	619,338
Bank Guarantee	276,874
Overdrawn Nab Account	1,572
<b>Total Debt outstanding</b>	<b>897,784</b>

Following my appointment, the Director paid out the Debtor Finance Facility and assumed the debtors outstanding under that facility.

Should there be a shortfall on this facility, the Director would have a priority claim in the administration pursuant to the security held by the Nab and the rules of subrogation.

#### ***De Lang Laden Pty Ltd***

I have not received any response to my correspondence to De Lang Laden regarding their registration. However, I understand this relates to a farm tractor located at the Koolabah farm which is fully owned with the debt having been fully paid out. Accordingly, I expect this registration will be cancelled.

#### ***Martin & Savage Pty Ltd***

I have not received any response to my correspondence to Martin & Savage regarding its registration. I understand Martin & Savage supply the Companies with material used in production in China. There is currently one invoice outstanding for \$8,331.

#### ***Charles Parsons (NZ) Ltd***

Provide material samples. There is currently an invoice outstanding for \$1,000.

#### ***BMW Finance***

I have not received any response to my correspondence to BMW Finance. However, I understand this relates to two motor vehicles used by the Director and his wife as follows:

- 2010 BMW X5 Wagon
- 2009 335i Convertible

Following my appointment these two leases were paid out personally by the Director. The payouts were as follows:

- 2010 BMW X5 Wagon - \$37,117
- 2009 335i Convertible - \$19,681

Additionally, following my appointment I disclaimed these leases.

I have obtained a valuation from Hyman Auctioneer and Valuers which indicates there is no equity in the X5 Wagon. With regard to the 335i Convertible my investigations indicate that there may be equity in this vehicle in the vicinity of \$14,319. However, although the lease was in the name of

Gordon Smith Marketing Pty Ltd the payments made were allocated against the Director's loan account and accordingly this may have the effect of these payments being made personally. Should the Companies be placed in liquidation a liquidator would need to investigate this further.

### ***Finrent Pty Limited***

I have not received any response to my correspondence to Finrent. However, I understand this relates to some old shop fittings. Following my appointment, I determined that there was no equity in these items and disclaimed the lease.

### ***Sundays Jump Pty Ltd***

Sundays Jump supplies clothes to the Companies, at the date of my appointment there was no stock on hand and no amounts owing.

### ***Condura Pty Ltd***

Condura supply the Rodney Clark hats, bags and scarfs. At the date of my appointment Rodney Clark's records indicated Condura was owed \$13,614 with stock on hand of \$4,878. Codura have submitted an informal proof of debt form claiming they are owed \$12,076.34. Following confirmation that Condura held a valid retention of title claim which was registered I returned stock on hand at that time totalling \$3,012.70. Accordingly, Condura will have a priority claim in the administration for \$9,063.64

### ***Fuji Xerox***

This registration relates to the lease of a photo copier at head office. The Company's records indicate that Fuji is owed \$8,318. Following my appointment, the Purchaser determined they did not require this machine resulting in me terminating the agreement and returning the copier.

### ***Westpac***

This registration relates to a motor vehicle lease relating to a Toyota Ute used on the Koolabah Farm. Following my appointment, the Director paid out this lease in the sum of \$6,244. Based on my investigation I estimate this vehicle has equity in the sum of \$14,552 for which I have written to the Director and requested payment.

Additionally, Westpac funded the office and warehouse fit out at the Companies' head office in Waterloo in January 2015. The finance was provided via a Commercial Loan Agreement in the sum of \$150,000. The Purchaser has contracted to take over this finance.

## **3.2 COMPANIES' HISTORY AND BACKGROUND**

The following background information has been derived from the Administrator's preliminary investigations including discussions with the Director, Mr. Gordon Smith, management, external accountants and staff.

### **3.2.1 Group Structure**

Attached as **Annexure D** is a chart depicting the structure of the Companies. I make the following comments in relation to the Companies:

### 3.2.2 Gordon Smith Marketing

Gordon Smith Marketing operates a wholesale women’s fashion business designing and producing women’s fashion products for major retailers such as David Jones, Myer and Farmers in New Zealand along with a number of other retailers including the Group’s own retail chain Rodney Clark. The Wholesale business employs approximately 29 staff.

Additionally, Gordon Smith Marketing is the trustee of the Gordon Bruce Smith Family Trust. The trust is a discretionary family trust with the main beneficiaries being, Mr. Gordon Smith personally, members of Mr. Gordon Smith’s family, Rodney Clark Pty Ltd and other related or associated entities (refer table below).

The trust holds a mix of business and personal assets. These include the following:

- The business and assets of the wholesale business operated by Gordon Smith Marketing
- The lease to the head office and warehouse located in Waterloo NSW
- The trust held an 89% interest in the Koolabah farm located in Lidster NSW comprising:
  - 229.75 hectare farm
  - 4 bedroom renovated 1880’s homestead
  - 2 bedroom cottage
  - Various farm and machinery sheds
  - 8 dams
  - Stock yards
- Various motor vehicles and farm machinery
- Farm stock (cattle and sheep)
- Some trademarks

Prior to my appointment, the 89% interest the trust held in the farm property along with associated machinery and livestock was sold to the Director for \$1.967 million on 16 June 2016. Please refer to Section 8.3.2 of this Report for details regarding this transaction.

Gordon Smith Marketing was appointed trustee pursuant to a trust deed executed on 5 September 1989 (‘the Trust Deed’) which grants various powers to the Trust including the power to carry on or dispose of a business.

The key members of the Trust are summarised in the table below:

Party	Member
Trustee	Gordon Smith Marketing Pty Ltd
Appointor	Gordon Bruce Smith
Beneficiaries	a. Gordon Bruce Smith; b. persons related to Gordon Bruce Smith (including spouse, parents, siblings, children and their spouses and descendants); c. any corporation of which the (a) or (b) is a member; d. the Trustee of any trust of which (a) or (b) has an interest; and e. any other individuals, corporations, trusts or other entities nominated to be beneficiaries from time to time.

### *Investigations of Trust*

One of the matters I have investigated during my appointment is which of the assets, to which Gordon Smith Marketing holds legal title, are held beneficially in its capacity as trustee of the Trust and which are held beneficially in its personal capacity.

My preliminary investigations have revealed that:

- from the books and records available to me, certain business assets appear to be held by Gordon Smith Marketing in its personal capacity, while other assets appear to be held by Gordon Smith Marketing in its capacity as trustee of the Trust.

The characterisation of assets as either assets of Gordon Smith Marketing or assets of the Trust is relevant to determining:

- which assets are subject to the asset sale agreement (i.e., which assets will pass out of the estate if the asset sale agreement completes and whether the consideration that the buyer has agreed to pay for those assets is adequate); and
- which assets are outside the scope of the asset sale agreement and may be available to be realised for distribution to creditors of Gordon Smith Marketing.

There is a related issue of whether creditors that have lodged informal proofs of debt for voting purposes are creditors of Gordon Smith Marketing or creditors of the Trust (or a combination). All of those issues are relevant to the interests of creditors and to this Report. These investigations have identified the following:

- The Companies' accountant has advised that the accounts of Gordon Smith Marketing were prepared on the basis that the entirety of the assets of Gordon Smith Marketing were held in the Trust.
- I note that the Companies' books and records are inconclusive with respect to this issue. My preliminary investigations indicate that whilst a number of assets are recorded as Trust assets, others are not.
- I sought legal advice on the proper characterisation of the assets for the purposes of my review and consideration of the Asset Sale Agreement and in preparing this Report.
- I have also considered whether I should make an application to Court for directions under the Act or under section 63 of the *Trustee Act 1925* (NSW) (Trustee Act) to assist me in opining on the correct characterisation of ownership of the relevant assets for the purpose of this Report. On balance, I decided to defer approaching the Court at this time, in the interests of preserving funds available to creditors. Should a liquidator be appointed to Gordon Smith Marketing they would be in a better position to assess whether a Court direction may be necessary to determine the question of the respective entitlements of creditors and beneficiaries of the Trust to distributions from assets.

### *Impact on the Asset Sale Agreement*

The Companies which are parties to the Asset Sale Agreement include Gordon Smith Marketing in its personal capacity and in its capacity as trustee of the Trust. Accordingly, for the purpose of

assessing the implications of the decision to complete the Asset Sale Agreement, all business assets of both Gordon Smith Marketing and the Trust are capable of being sold under the Asset Sale Agreement, should it complete on its current terms, unless expressly excluded under the terms of the Asset Sale Agreement.

#### *Impact on Liquidation*

A question does arise in relation to the entitlement of creditors or beneficiaries of the Trust to the proceeds of the Asset Sale Agreement should the Companies be placed in liquidation. The settlement proceeds and other realisations would need to be allocated between assets relating to the trust and assets relating to Gordon Smith Marketing in its own capacity. The proceeds would then be held pending distribution to creditors of the seller companies or beneficiaries of the Trust, depending on their respective entitlements.

If Gordon Smith Marketing is wound up, a liquidator would be in a position to conduct further investigations in relation to the Trust, including to call for additional books and records and to conduct examinations of directors and officers of Gordon Smith Marketing to ascertain additional facts relevant to that review.

An option available to a liquidator of Gordon Smith Marketing would be to seek a Court direction under section 479(3) of the Act and under section 63 of the Trustee Act 1925 (NSW) to assist in properly characterising the entitlements of creditors and beneficiaries of the Trust before making distributions.

#### *Impact on DOCA*

A key term of the DOCA is that the claims of all creditors of the Companies are pooled into a single deed fund, comprising of all realised assets of the Companies, the purchase price pursuant to the Asset Sale Agreement and the Director's contribution.

In the event that creditors vote in favour of the DOCA, similarly to the liquidation scenario, further investigation into the entitlement of creditors or beneficiaries of the Trust to the proceeds of the Asset Sale Agreement would need to be performed by a deed administrator prior to any distribution to creditors.

The deed administrator would be able to seek a Court direction under section 447D of the Act and section 63 of the *Trustee Act 1925 (NSW)* to assist in properly characterising the entitlements of creditors and beneficiaries of the Trust prior to making a distribution.

### 3.2.3 Rodney Clark

Rodney Clark operates the retail business comprising 15 retail stores and 2 clearance outlets located in New South Wales, Queensland and Victoria.

The company employs 25 full time staff and 38 casual staff.

Rodney Clark is owned by Mr. Gordon Smith.

### 3.2.4 Rodney Clark Retail

Rodney Clark Retail does not trade as such, its sole purpose is to hold the majority of the store leases from which the Rodney Clark retail business operates.

The company does not prepare financial accounts as the lease costs are taken up within the books of Rodney Clark Pty Ltd.

### 3.2.5 Background

The Gordon Smith Marketing business was established by Mr. Gordon Smith in 1992 as a designer of product for Myer. The business progressed to become a large product developer of house brand product to Myer and other retailers including Wombat Stores. In addition to sourcing and designing product Gordon Smith Marketing was developing and promoting their own label Basic by Gordon Smith Marketing.

In 1999 the Director purchased the Rodney Clark retail business which at the time consisted on 4 retail stores. This business grew to a peak in 2008/2009 when it operated from 34 stores with a turnover of approximately \$15 million. At this time the business was a standalone operation with its own design team, however Gordon Smith Marketing produced and warehoused the product and charged Rodney Clark a small fee for doing so.

The wholesale business continued to grow with new sales opportunities opening up with Myer, David Jones and Farmers in New Zealand. During this time the Group continued to develop and acquire new brands. In 2002/03 Gordon Smith Marketing acquired a licence to the brand Trent Nathan. This brand along with others grew significantly to a point where in 2008 wholesale sales reached a peak of \$27 million. Following this the business experienced difficulties with the cancelation of the Trent Nathan licence which significantly impacted sales with sales in the following two years falling to approximately \$23 million.

Around the same time the Rodney Clark business in FY 2009 experienced a loss of \$1.9 million which impacted group profitability significantly, resulting in the Group experiencing its first loss (and only loss until FY 2016) on a consolidated group basis.

At the time the Group held significant bank debt (\$11.5m) and carried a large overhead structure. Following the loss, the Nab engaged McGrath Nicol to conduct an investigative accountant's review. This review highlighted a number of issues and resulted in the Group restructuring to reduce store numbers, staff and debt. Following the review, the Nab also removed a \$1 million factoring facility which Rodney Clark had enabling the Group to factor inter-company debtors.

As a result of the loss Rodney Clark immediately exited 11 stores and disbanded the design team bringing the product side of Rodney Clark within Gordon Smith Marketing. Following which Rodney Clark purchased product from Gordon Smith Marketing at cost plus 30% of retail value.

The Group reduced bank debt aggressively over the next couple of years through the sale of property with bank debt more than halving to \$4.8m by the end of FY 2011.

The wholesale business worked on a number of different brands in an attempt to replace the success of Trent Nathan. In 2009 it released the Hammock and Vine range to replace Trent Nathan. In 2012/13 Gordon Smith Marketing was given the rights to produce the Agenda brand which was owned by David Jones.

This brand proved very successful and sales increased significantly with a guaranteed first margin of 70%.

Over the next few years brands were added and closed in an effort to continue to grow sales. For Myer the La Vie Woman brand was added into the plus size department, however this was de-ranked the following year due to poor performance. In FY 2014 the Group purchased the Kamiko

and Mixit brands from the Dolina group, this opened up new sales into the Farmers department stores in New Zealand, these brands were successful until recently.

As a result, of efforts to maintain sales in the wholesale business and the sale of non-core assets to reduce bank debt, the Group reduced debt and returned to profitability on a consolidated basis during the period FY 2010 to FY 2013. However, throughout this time the Rodney Clark retail stores continued to be a drain on Group profitability with sales falling and losses mounting. Between FY 2010 and FY 2013 the Rodney Clark business closed a further five stores. Sales continued to fall from \$12.7 million in FY 2011 to \$9.2 million in FY 2013.

During the period FY 2013 to FY 2015 group profitability reduced significantly from approximately \$400,000 to \$200,000 on a consolidated basis with Rodney Clark continuing to be a significant drain. Between FY 2013 and FY 2015 a further four Rodney Clark stores were closed and sales fell from \$9.2 million to \$8.3 million with further losses of approximately \$1 million. Sales for FY 2016 reduced further to only \$7.9 million.

At this time the Group's wholesale business also came under pressure due to increased competition, aging styles and increased rebates and performance hurdles imposed by the major retailers. Sales fell from \$22.4 million in FY 2013 to \$17 million in FY 2015 and for FY 2016 sales were \$13.9 million.

During this time the Myer business underwent tremendous changes as brands were deleted, including 'Gordon Smith Petites' brand, 'Nouvelle Woman' and in the last two years the 'Gordon Smith' brand has been slowly exited from Myer stores, starting at 65, then 45, 25 and now for Summer 16 is only in 10 stores. Similar changes occurred with David Jones and Farmers with the 'Gordon Smith' brand being deleted in FY 2015.

In reaction to the difficult trading conditions the Group made the decision to start a new brand aimed at a more modern and discerning customer. The 'And She Was' brand was relaunched with a 12 month business plan of one million dollars in sales along with a new refreshed 'Hammock & Vine' brand. This strategy appeared to be getting some traction with orders strong for the Summer 2016 range, however given the Group's financial difficulties this did not eventuate as the business was ultimately sold and an administrator appointed.

Having regard to the above, profitability of Gordon Smith Marketing has fallen from \$1.7 million in FY 2011 to \$135,000 in FY 2016. Meanwhile trading within the Rodney Clark retail business continued to experience ever increasing losses with sales falling from \$14.2 million in FY 2008 to \$7.9 million in FY 2016. Losses generated over this period within the retail business totalled \$6.3 million

### **3.3 DECISION TO APPOINT ADMINISTRATOR AND REASONS FOR FAILURE**

The decision of the Director to appoint an Administrator to the Companies was due to:

- Inability to fund summer 2016 product supply as the supply chain had lost faith in the Companies. Despite Gordon Smith Marketing having over \$7 million in orders from the major retailers for the summer season the Companies could not fund the acquisition due to the major suppliers requiring COD;
- Increased complexities in trading with major retailers as a result of changes in supply terms including responsibility to achieve required sell through, guarantee closing stocks and a return on the dollars invested. This resulted in significant strains on the business through increased rebates and marketing subsidies;

- Inability to obtain product supply at prices that would enable the product to be competitive at a retail level resulting in lost sales to competitors;
- Significant level of secured creditor debt and aggressive repayment timeframe imposed on the Companies;
- Recent fluctuations in AUD/USD exchange rates making competitive supply and budgeting difficult; and
- Ultimately the decision of the Director that he could no longer support the business with external funding resulted in his decision to sell, in the hope of the businesses going forward, with summer supplies paid and employees' employment maintained.

In addition to the above, the Administrator's preliminary view is that the Companies' failure was due to:

- A history of decreasing sales and trading performance and the inability to reset the cost structure (group sales have fallen by \$8.9m or 29% over last 5 years);
- The retail business was a significant financial drain on the group (losses of \$6.3m between FY 2008 and 27 June 2016);
- Inability to get product style and pricing right to attract market support resulting in the major retailers exiting the Companies' brands; and
- High debt levels and accelerated debt reduction.

As a result of the above the Director attempted to re-capitalise the business via the following:

- June 2015 – Entered into an arrangement to freeze debt of major suppliers and pay ongoing orders on 45-60 day terms;
- Early 2016 - attempted a debt for equity swap with the major supplier SSH Textiles. This was to involve the establishment of a new holding company which would own the wholesale and retail businesses. SSH Textiles was offered 40% of the business based on 40 shares @ \$50,000 each. Refer Section 8.1.6 of this Report for further details;

When this proved unsuccessful and following the decision that the Director could no longer fund the business from personal resources, the Director placed the businesses on the market. While the sale campaign was underway he:

- May 2016 – Injected additional cash funds of \$135,000 to pay down commercial bill and overdraft; and
- attempted to re-finance the Nab debt via Scottish Pacific.

Following the acceptance of an offer to purchase the businesses and entering into an Asset Sale Agreement, the Director appointed an Administrator.

### 3.4 STATEMENT ABOUT THE COMPANIES' BUSINESS, PROPERTY, AFFAIRS AND FINANCIAL CIRCUMSTANCES ('RATA')

Pursuant to Section 438B of the Act, a director is required to provide me with the Statement within five (5) days of receipt of my request. The Statement represents a summary of the book value of the assets and liabilities of the company and the director's estimate of the realisable values ('ERV') of the assets and liabilities as at the date of appointment.

I received the Director's Statements for the Companies on 4 August 2016. Notwithstanding this during the Administration the Director has provided full disclosure and has been available to provide assistance and field any questions in relation to the Companies' operations. I have also had full access to the Companies' accounting departments and accounts staff throughout the Administration.

The Director's Statements detail the Companies' assets and liabilities at book value and Estimated Realisable Value ('ERV').

The following table summarises the Director's Statements for the Companies:

Director's Report as to Affairs	Gordon Smith Marketing		Rodney Clark		Rodney Clark Retail		Consolidated	
	Book Value \$'000	Director ERV \$'000	Book Value \$'000	Director ERV \$'000	Book Value \$'000	Director ERV \$'000	Book Value \$'000	Director ERV \$'000
<b>Circulating assets (net of PMSI claims)</b>								
- Cash at bank and on hand	1	1	68	68			69	69
- Bank guarantees							-	-
- Debtors	3,177	900	22	22			3,199	922
- Stock	613	-	869				1,482	-
<b>Total circulating assets (net of PMSI claims)</b>	<b>3,791</b>	<b>901</b>	<b>959</b>	<b>90</b>			<b>4,750</b>	<b>991</b>
<i>Less: Priority creditors (employee entitlements)</i>	674	674	187	187			861	861
<b>Balance of circulating assets (after priority claims)</b>	<b>3,117</b>	<b>227</b>	<b>772</b>	<b>- 97</b>			<b>3,889</b>	<b>130</b>
<b>Non-circulating assets (net of PMSI claims)</b>								
- Property plant & equipment	356	-	405	-			761	-
- Motor vehicles								
- Loan to Director (farm purchase)	192	192					192	192
- Security Deposit			15	-			15	-
- Assets subject to security interest (Mez Floor Lease)	75	-						
<b>Total non-circulating assets (net of PMSI claims)</b>	<b>623</b>	<b>192</b>	<b>420</b>	<b>-</b>			<b>968</b>	<b>192</b>
<i>Less: Secured creditors</i>								
- Bank (Mez Floor)	75	75					75	75
- Factored Debtor Finance	600	600					600	600
<b>Net assets available for unsecured creditors</b>	<b>3,065</b>	<b>(256)</b>	<b>1,192</b>	<b>(97)</b>			<b>4,182</b>	<b>(353)</b>
<i>Less: Unsecured creditors</i>	7,063	7,063	2,981	2,981			10,044	10,044
<i>Less: Contingent liabilities</i>								
<b>Total creditors</b>	<b>7,063</b>	<b>7,063</b>	<b>2,981</b>	<b>2,981</b>			<b>10,044</b>	<b>10,044</b>
<b>Estimated surplus / deficiency</b>	<b>(3,998)</b>	<b>(7,319)</b>	<b>(1,789)</b>	<b>(3,078)</b>			<b>(5,862)</b>	<b>(10,397)</b>

My comments in relation to the financial performance and position of the Companies is detailed below at Section 4.

## 4. HISTORICAL FINANCIAL PERFORMANCE AND POSITION

Attached as **Annexure B & C** are summaries of the statutory financial performance and financial position of the Companies for FY 2008 to FY 2015 along with management accounts for FY 2016. There are no financial accounts for Rodney Clark Retail Pty Ltd as this entity only holds store leases and is included within the accounts of Rodney Clark Pty Ltd.

### 4.1 BOOKS AND RECORDS

The financial books and records of Gordon Smith Marketing and Rodney Clark are maintained independently, by separate employees responsible for preparing monthly financial statements and other accounting functions such as, budget forecasts, cash flow forecasts and preparation and lodgement of the Business Activity Statement returns (BAS).

The accounting system adopted by Gordon Smith Marketing is AP 21, whilst Attaché is the preferred system for Rodney Clark.

The Gordon Smith Marketing financials are reported as part of the Gordon Bruce Smith Family Trust whereas Rodney Clark is a standalone corporate entity.

The maintenance of the Companies' Registers and other corporate secretarial compliance work is outsourced to the Group's external accountants, Elliott Chee & Associates.

Section 286 of the Act requires a company to keep written financial records that correctly record and explain the company's transactions, so as to enable true and fair financial statements to be prepared. The financial records must be retained for a period of seven years.

The failure to maintain books and records in accordance with Section 286 provides a rebuttable presumption of insolvency which might be relied upon by a liquidator in an application for compensation for insolvent trading.

Based on my preliminary review of the Companies' books and records it is my opinion that the Companies have maintained books and records in accordance with Section 286 of the Act.

### 4.2 PREPARATION OF FINANCIAL STATEMENTS

The internally prepared management accounts are prepared on a divisional basis enabling the Group to monitor individual profit and cost centres. As a result of this, extensive analysis is required to determine basic performance variables. i.e. addition of multiple sales lines and cost lines and ultimately where profit or loss has been made (i.e. account aggregations). Further, as previously stated, Gordon Smith Marketing results are reported as part of the Gordon Bruce Smith Family Trust, which holds other assets and liabilities.

There are a number of year-end adjustments that are made to the management accounts to produce the year-end statutory financial statements. These include the following:

- Trust distributions;
- Consolidation of other business activities within the trust (Koolabah farm and distributions from other entities);
- Year-end journal entries between Gordon Smith Marketing and Rodney Clark including adjustments to the inter-company debtor/creditor position, loan account and rebates;
- Adjustments to related party loan accounts;

- Record the \$US/AUD profit/loss on overseas trade suppliers; and
- Bring to account rebates levied on Gordon Smith Marketing by David Jones & Myer.

In addition to the above, my review has identified a number of inconsistencies between the management accounts and statutory accounts and within different years in relation to the following:

- Inconsistency of presentation in respect of expense item classification.
- Differences in classification of items as current or non-current
- With Rodney Clark the accounts payables ledger consistently has a large percentage of unallocated credits or debits.
- The trade creditor amount within Gordon Smith Marketing is recognised at a standard \$US rate determined at the start of each season. Accordingly, within a one-year cycle invoices from the same supplier could be recorded at completely different exchange rates. At year-end the creditors and stock are re-valued at the prevailing exchange rate with any loss or gain recognised in cost of goods sold.

The above items have made year on year comparisons along with interpretation difficult and time consuming.

In addition, notwithstanding the individual businesses prepare separate accounts it is clear from the way the Companies operate that the operations are effectively treated as one. Accordingly, when reviewing the financial performance and position of the Companies it needs to be done on a consolidated basis.

I elaborate further on the above below:

#### 4.2.1 Corporate Structure

Gordon Smith Marketing, is a company which acts as trustee for the Gordon Bruce Smith Family Trust (“the trust”), a discretionary family trust, with a number of beneficiaries including, Gordon Smith personally, other Smith family members and associated or related companies, one of which is Rodney Clark.

The corporate structure was likely designed to legitimately reduce the income tax impost on the Group. One of the consequences of this structure is that the profitable wholesale business makes a yearly distribution to the underperforming retail business bolstering its financial performance (albeit still resulting in a loss in the majority of years).

The trust was also the beneficiary of other entities such as the McEvoy trust and also contains assets outside of the wholesale business. These include the farm property and related stock and plant and equipment, motor vehicles and finance commitments in relation to these items. This has required reconstruction to enable the identification of the wholesale business financial performance and position.

#### 4.2.2 Trust distribution to Rodney Clark

Rodney Clark, as a beneficiary of the Gordon Bruce Smith Family Trust, regularly has its trading performance bolstered by distributions from the trust at year end. Rodney Clark typically received the majority of the trust distributions with the exception of FY 2014 where it only received 23% of total distributions. The distributions are classified in Rodney Clark’s profit and loss as other income. These trust distributions have the effect of inflating the company’s actual performance. For the

period FY 2012 to FY 2015 trust distributions amounted to \$2.32m or an average of \$580k per annum. For the purpose or my review of the financial performance of Rodney Clark I have excluded the trust distributions in order to reflect the financial performance of Rodney Clark.

#### 4.2.3 Adjustment of intercompany debtor/creditor position to loan account

In addition to the trust distribution to Rodney Clark (as referred to above), subsequent to year end when the statutory financial statements are being prepared, two significant journals are processed in the books of both Gordon Smith Marketing and Rodney Clark. The first journal, in the books of Gordon Smith Marketing offsets the trade debtor balance in respect of Rodney Clark against the Rodney Clark intercompany loan account. Simultaneously a corresponding journal is processed in the books of Rodney Clark offsetting the trade creditor balance in respect of Gordon Smith Marketing to the Gordon Smith Marketing intercompany loan account.

As a consequence, the trade debtors are reduced in the balance sheet of Gordon Smith Marketing and likewise trade creditors are reduced in the balance sheet of Rodney Clark (i.e. removal of the balance of the intercompany sales account).

In the case of Gordon Smith Marketing the journal entry reduces the debtors balance, impacting working capital and liquidity ratios adversely, due to re-classifying a current asset i.e. Rodney Clark debtor to a non-current asset being the Rodney Clark intercompany loan account.

Conversely however in the case of Rodney Clark the journal entry has a beneficial effect on the working capital and liquidity ratios as it re-classifies the Gordon Smith Marketing trade creditor current liability figure to the non-current Gordon Smith Marketing intercompany loan account.

The effect of this transaction is that the intercompany debtor balance is removed and ultimately Rodney Clark does not pay Gordon Smith Marketing for product supplies provided. I note that Rodney Clark does provide a weekly sum which is off-set against the loan account to cover a portion of the Gordon Smith Marketing's wages bill.

The second of the journals, in both Companies' books is the rebate to Rodney Clark from Gordon Smith Marketing to take out the profit margin that Gordon Smith Marketing records on the sale to Rodney Clark. This is processed because ultimately Rodney Clark does not fully pay for the stock sold to it by Gordon Smith Marketing.

In the books of Gordon Smith Marketing, the journal to record the rebate is a debit against sales and a credit to the Rodney Clark inter-company loan account. In the books of Rodney Clark the entry is recorded as a credit to cost of goods sold and a debit to the Gordon Smith Marketing inter-company loan account.

The above two journals are only processed at the time the statutory financial statements are being prepared by the external accountants, which may be several months after year end. Accordingly, when reviewing management accounts for the period ended 27 June 2016 these adjustments have not been made, resulting in the following:

##### *Profit and Loss Impact*

- Gordon Smith Marketing's sales are overstated by the amount of the rebate
- COGS within Rodney Clark is overstated by the amount of the rebate
- Gross profit margin is therefore impacted positively in Gordon Smith Marketing and negatively in Rodney Clark

### *Balance Sheet Impact*

- Gordon Smith Marketing's debtor balance is overstated by the balance of the unpaid sales to Rodney Clark
- Creditors within Rodney Clark are overstated by the balance of the unpaid purchases from Gordon Smith Marketing.
- Impact on the inter-company loan account is negated

Further evidence of the inter-related nature of the operations.

#### 4.2.4 Trade Creditor Balance

A significant amount of overseas purchases are made in USD and recorded in the books of Gordon Smith Marketing at a predetermined fixed exchange rate determined at the start of each season. Depending upon the prevailing exchange rate at any point in time the overseas creditor's balance may be either overstated or understated. It is noted, however that at year-end an adjustment is made to revalue stock, creditors and cost of goods sold based on the actual exchange rate at year end. Given that overseas suppliers make up a substantial proportion of the trade creditors and the significant ageing of this debt, the trade creditors figure reported may vary significantly with actual due to movements in the AUD/USD exchange rate. This is a contributing factor to the creditor balance reported in the balance sheet at the date of my appointment being incorrect.

#### 4.2.5 Major retailer trade rebates

Another year end adjustment of significance in books of Gordon Smith Marketing is the annual rebate against sales for rebates paid to David Jones and Myer. For the FY2012 to FY 2015 period these rebates amounted to \$6.39m in respect of David Jones and \$5.87m in respect of Myer. Respectively the rebates accounted for an average 35.30% of sales (\$17.60m) to David Jones and 27.56% of sales (\$20.76m) to Myer.

Within the management accounts the group provisions an amount in respect of these rebates, typically 25% to 27% of sales which understates the actual cost.

#### 4.2.6 Inter-Company Rebate

Gordon Smith Marketing sells product to Rodney Clark at cost plus a margin of 30% of retail price. Accordingly, within the management accounts, Gordon Smith Marketing carries a profit on sales to Rodney Clark and Rodney Clark carries a cost of goods sold for product purchased from Gordon Smith Marketing. At year end, in view of the fact that Rodney Clark does not pay for the goods, a journal entry is raised to reverse the profit on inter-company sales. Within Gordon Smith Marketing's books, the journal is a debit to sales and a credit to Rodney Clark intercompany loan account. Within Rodney Clark's books the journal is a credit to cost of goods sold and a debit to the Gordon Smith Marketing inter-company loan account.

### 4.3 HISTORICAL FINANCIAL PERFORMANCE – FY 2012 to YTD June 2016

A summary of the period FY 2012 to 27 June 2016 for each Company based on their reported results excluding non-core activities is provided below:

#### 4.3.1 Gordon Smith Marketing

Gordon Smith Marketing Financial Performance					Mgt 27.6.16
	FY 2012	FY 2013	FY 2014	FY 2015	
	\$000's	\$000's	\$000's	\$000's	\$000's
<b>Revenue</b>	<b>21,519</b>	<b>22,444</b>	<b>20,872</b>	<b>17,700</b>	<b>13,970</b>
COGS	11,202	12,653	12,144	9,648	8,711
<b>Gross Profit</b>	<b>10,317</b>	<b>9,791</b>	<b>8,728</b>	<b>8,052</b>	<b>5,259</b>
	<b>47.94%</b>	<b>43.62%</b>	<b>41.82%</b>	<b>45.49%</b>	<b>37.64%</b>
<i>Expenses:</i>					
Advertising	149	183	370	694	112
Commissions	411	357	350	368	310
Discount allowed	498	655	455	391	178
Freight & Cartage	290	502	287	288	264
Interest paid	387	373	300	283	218
Rebates	2,481	2,155	1,444	1,250	209
Rent	503	562	510	364	341
Salaries & wages	2,474	2,512	2,382	2,431	2,218
Superannuation	261	266	239	252	126
Warehouse distribution	503	507	500	415	450
Other	905	892	1,047	809	698
<b>Total Expenses</b>	<b>8,862</b>	<b>8,964</b>	<b>7,884</b>	<b>7,545</b>	<b>5,124</b>
<b>NET PROFIT (LOSS)</b>	<b>1,455</b>	<b>827</b>	<b>844</b>	<b>507</b>	<b>135</b>

I note the following with respect to the above and **Annexure B**:

- Sales have declined significantly from \$21.5m in FY 2012 to \$13.9m FY 2016 reflecting a decrease in revenue of \$7.5m or 35.08%.
- In FY 2008 sales were \$27.2m resulting in a total decrease to 27 June 2016 of 56%.
- Gross Profit for the period FY 2012 to 27 June 2016 has declined by \$5m or 48.77%.
- Despite the significant fall in sales Gordon Smith Marketing has been able to maintain its gross margin with the exception of year to 27 June 2016 where there has been heavy discounting to clear stock.
- Despite the significant fall in sales, the company has not been able to reduce expenses in line with the decline in sales resulting in falling profit. Given the predominately fixed nature of retail costs this is not unusual.

- It is noted that expenses in the period to 27 June 2016 have reduced significantly, however as these are management accounts and for the reasons previously stated I do not place great reliance on the management figures.

#### 4.3.2 Rodney Clark

<b>Rodney Clark</b>					
<b>Financial Performance</b>	<b>FY 2012</b>	<b>FY 2013</b>	<b>FY 2014</b>	<b>FY 2015</b>	<b>Mgt 27.6.16</b>
	<b>\$000's</b>	<b>\$000's</b>	<b>\$000's</b>	<b>\$000's</b>	<b>\$000's</b>
<b>REVENUE</b>	<b>9,235</b>	<b>9,246</b>	<b>9,430</b>	<b>8,316</b>	<b>7,853</b>
COGS	3,169	2,935	3,281	2,683	3,570
<b>GROSS PROFIT</b>	<b>6,066</b>	<b>6,311</b>	<b>6,149</b>	<b>5,633</b>	<b>4,283</b>
	<b>65.68%</b>	<b>68.26%</b>	<b>65.21%</b>	<b>67.74%</b>	<b>54.54%</b>
<i>Expenses:</i>					
Advertising & Promotion	415	490	620	475	213
Creditcard Merchant Fees	-	80	83	73	78
Depreciation	449	243	246	218	141
Electricity	69	67	96	61	75
Freight & Cartage	41	37	44	37	27
Insurance	76	61	84	67	64
Packing Materials	55	67	57	30	45
Payroll Tax	107	105	98	100	81
Rent	2,613	2,432	2,357	2,106	1,985
Superannuation	216	210	198	199	178
Wages & salaries	2,437	2,406	2,323	2,195	1,953
Other	461	369	434	322	353
<b>Total Expenses</b>	<b>6,939</b>	<b>6,567</b>	<b>6,640</b>	<b>5,883</b>	<b>5,193</b>
<b>NET PROFIT (LOSS)</b>	<b>(873)</b>	<b>(256)</b>	<b>(491)</b>	<b>(250)</b>	<b>(910)</b>
<b>(prior trust dist)</b>					

I note the following with respect to the above and **Annexure B**:

- Sales have fallen by approximately \$1.4m or 15% over the period FY 2012 to 27 June 2016.
- With the exception of the period to 27 June 2016 gross margin has been maintained. In the lead up to the administration, significant discounting was occurring in an effort to clear stock and generate cash. Additionally, the year-end adjustment to reduce COGS in relation to the margin on purchases from Gordon Smith Marketing has not been made over inflating COGS as at 27 June 2016.
- Expenses have reduced between FY 2012 and 27 June 2016 mainly because of reductions in depreciation, rent and salaries. This is a result of store closures approximately 4 were closed during this time.
- Despite the improved performance between FY 2012 and 27 June 2016 the company did not make a profit with accumulated losses for the period amounting to \$2.8m. Rodney Clark has not recorded a profit in its own right since FY 2007 (profit of \$16k).

#### 4.4 HISTORICAL FINANCIAL POSITION – FY 2012 to 27 June 2016

Detailed below is a summary of the financial position of Gordon Smith Marketing and Rodney Clark for the period FY 2012 to 27 June 2016:

##### 4.4.1 Gordon Smith Marketing

Gordon Smith Marketing - Balance Sheet					
	FY 2012	FY 2013	FY 2014	FY 2015	Mgt Acc
	\$000's	\$000's	\$000's	\$000's	27-June-2016
					\$000's
<b>CURRENT ASSETS</b>					
Cash and Cash Equivalents	16	8	60	82	58
Trade and Other receivables	3,457	3,663	1,911	1,812	2,291
Inventories	2,722	2,644	2,807	2,581	1,967
Prepayments/ Other	313	254	437	319	540
<b>TOTAL CURRENT ASSETS</b>	<b>6,508</b>	<b>6,569</b>	<b>5,215</b>	<b>4,794</b>	<b>4,856</b>
<b>NON CURRENT ASSETS</b>					
Financial Assets	1,425	1,182	1,289	1,158	1,042
Inter-Company Loans					497
Property Plant and Equipment	2,459	2,445	2,453	2,657	1,026
<b>TOTAL NON CURRENT ASSETS</b>	<b>3,884</b>	<b>3,627</b>	<b>3,742</b>	<b>3,815</b>	<b>2,565</b>
<b>TOTAL ASSETS</b>	<b>10,392</b>	<b>10,196</b>	<b>8,957</b>	<b>8,609</b>	<b>7,421</b>
<b>CURRENT LIABILITIES</b>					
Trade and Other Payables	4,541	5,337	5,350	5,792	7,755
Borrowings	4,010	3,018	1,310	1,125	660
Employee Provisions	497	496	504	607	560
Unpaid Trust Distributions	-	-	468	-	
<b>TOTAL CURRENT LIABILITIES</b>	<b>9,048</b>	<b>8,851</b>	<b>7,632</b>	<b>7,524</b>	<b>8,975</b>
<b>NON CURRENT LIABILITIES</b>					
Directors loans					(748)
Borrowings	1,345	1,345	1,325	1,085	-
<b>TOTAL NON CURRENT LIABILITIES</b>	<b>1,345</b>	<b>1,345</b>	<b>1,325</b>	<b>1,085</b>	<b>(748)</b>
<b>TOTAL LIABILITIES</b>	<b>10,393</b>	<b>10,196</b>	<b>8,957</b>	<b>8,609</b>	<b>8,227</b>
<b>NET ASSETS</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(806)</b>

I note the following with respect to the above and **Annexure C**:

- As Gordon Smith Marketing financials are incorporated within the Gordon Bruce Smith Family Trust the net asset position should always equate to the settlement sum of \$10. I note in period ended 27 June 2016, as there these are management accounts year end journals have not been completed resulting in a negative net asset position.
- The increase in the trade debtor balance during the period to 27 June 2016 is a result of the inter-company debtor which as noted above is journaled at year end to the loan account. As these are management accounts this has not been processed.
- Similarly, the inter-company loan accounts are adjusted at year end.

- Inventory levels have reduced in line with reduction in sales and tightening of supply particularly during the lead up to the administration.
- Trade creditors have increased by approximately \$2.6m from FY 2012 to 27 June 2016 based on the company's records. However, the balance of creditors within Gordon Smith Marketing's books is lower than creditor claims advised to the Administrator (refer section 4.6.6 below)
- External borrowings have reduced by approximately \$4m over the review period.

#### 4.4.2 Rodney Clark

Rodney Clark - Balance Sheet Summary					
	FY 2012	FY 2013	FY 2014	FY 2015	Mgt Acc 27-June-2016
	\$000's	\$000's	\$000's	\$000's	\$000's
<b>CURRENT ASSETS</b>					
CASH AT BANK & ON HAND	59	16	21	45	96
LAYBUYS OUTSTANDING	20	18	17	16	20
BONDS (leases)	21	4	4	10	66
ANZ TERM DEPOSIT	-	145	145	94	60
INVENTORY	841	827	798	839	845
PREPAYMENTS	106	181	266	203	236
<b>Total Current Assets</b>	<b>1,046</b>	<b>1,190</b>	<b>1,252</b>	<b>1,206</b>	<b>1,323</b>
<b>NON CURRENT ASSETS</b>					
PLANT & EQUIPMENT at cost	3,132	1,337	1,431	1,155	1,208
Less Accumulated Depreciation	(2,454)	(728)	(672)	(534)	(701)
<b>Total Non Current Assets</b>	<b>679</b>	<b>609</b>	<b>758</b>	<b>621</b>	<b>507</b>
<b>TOTAL ASSETS</b>	<b>1,725</b>	<b>1,799</b>	<b>2,010</b>	<b>1,828</b>	<b>1,830</b>
<b>CURRENT LIABILITIES</b>					
ACCOUNTS PAYABLE- TRADE CREDITORS	188	269	493	310	145
ACCRUALS	32	181	32	53	135
GST PAYABLE	118	107	101	214	300
ASSET PURCHASE LIABILITY	180	7	7	-	-
SUPERANNUATION UNPAID	-	-	52	106	68
EMPLOYEE PROVISIONS	185	172	196	171	176
SECURITY DEPOSIT HELD	17	7	7	7	-
<b>Total Current Liabilities</b>	<b>719</b>	<b>742</b>	<b>888</b>	<b>862</b>	<b>824</b>
<b>NON CURRENT LIABILITIES</b>					
INTERCOMPANY - LOAN GB SMITH TRUST	1,425	1,182	1,289	1,162	2,111
<b>Total Non Current Liabilities</b>	<b>1,425</b>	<b>1,182</b>	<b>1,289</b>	<b>1,162</b>	<b>2,111</b>
<b>TOTAL LIABILITIES</b>	<b>2,144</b>	<b>1,924</b>	<b>2,177</b>	<b>2,024</b>	<b>2,935</b>
<b>NET ASSETS</b>	<b>(419)</b>	<b>(125)</b>	<b>(167)</b>	<b>(196)</b>	<b>(1,105)</b>

I note the following with respect to the above and **Annexure C**:

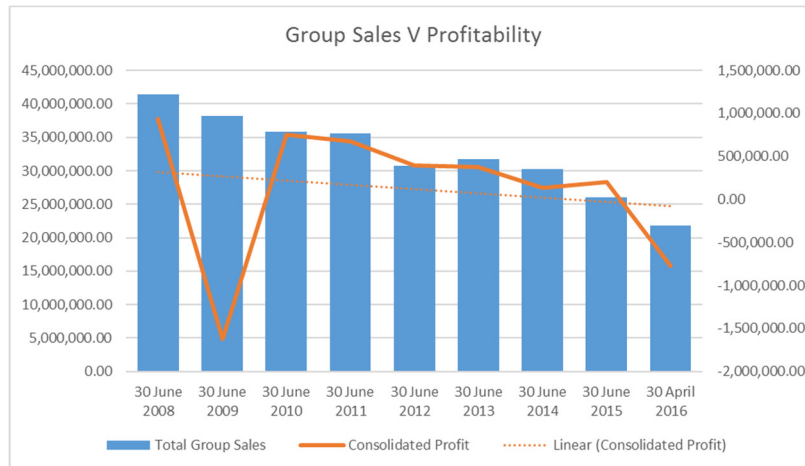
- Rodney Clark's asset position has changed over the review period as a result of store closures, write off of shop fit-out costs and ongoing depreciation charges.
- Current liabilities have increased mainly due to the non-payment of statutory liabilities namely superannuation and GST.

- Non-current liabilities have remained consistent throughout the period with the exception of the period to 27 June 2016 where the write back of the margin applied to the purchases of stock from Gordon Smith Marketing has not been made.

#### 4.5 REVIEW OF FINANCIAL PERFORMANCE

Detailed below are my comments in relation to the financial performance of the Group. Given the inter-related nature of the entities I have reviewed the numbers on a consolidated basis.

##### 4.5.1 Revenue



The Group has experienced a significant decline in sales over the review period of approximately \$19.5m. In particular I note the following:

- Gordon Smith Marketing revenue has fallen by \$13.19m from \$27.16m to \$13.97m representing a fall of 48.5%.
- Rodney Clark revenue has fallen \$6.35m from \$14.2m to \$7.8m representing a fall of 44.7%.

The reduction in sales has been a result of the following:

- Poor performance of the Rodney Clark stores indicating store location was in wrong centres, inability to present the product in a way that attracted clientele, along with an ageing clientele who shop less frequently.
- General downturn in retail and increased competition in the market.
- Late to develop and embrace on-line sales.
- Inability of the group to provide a range of products that met the market's expectations.
- General market trend towards cheaper and lower quality products.
- Competitors ability to supply at a lower cost point than the Group resulting in brands and ranges being excluded from the major retailers.
- Loss of specific brands in particular the Agenda brand in David Jones (refer below).

##### 4.5.2 Brand Performance

As noted above, the major retailers have re-positioned the Group's brands both in terms of stocking and promoting the brands along with product location within the store. The table below highlights the significant deterioration in the Group's brands popularity in particular the Agenda brand.

GS Brands	Total Sales				
	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016
DJ AGENDA	-	3,800	1,545	433	-
ARMOIRE	-	263	435	572	837
BASIC	-	805	780	622	645
GS PETITES	853	566	758	421	216
GS TOTAL	11,870	10,898	10,135	9,107	7,317
HV TOTAL	4,146	3,160	2,520	2,486	2,488
HV DJ'S	1,388	1,203	912	911	838
KAMIKO	-	-	624	2,211	1,142
KIKI LULU	-	-	-	451	122
LA VIE MYER	714	-	-	-	-
MIXIT	-	-	-	382	-
NOUVELLE TOTAL	2,293	2,508	2,751	1,848	1,306
<b>TOTAL SALES</b>	<b>21,264</b>	<b>23,203</b>	<b>20,460</b>	<b>19,444</b>	<b>14,911</b>

Note: Sales prior to rebates and adjustments

The largest impact on sales has been with Agenda and Gordon Smith Labels.

Agenda was a brand owned by David Jones but made and promoted by Gordon Smith Marketing. Gordon Smith Marketing arranged for the product to be made by SSH Textiles and delivered to store. The range was initially very successful (FY 2013 and FY 2014) and profitable with a guaranteed retail margin of 70%. The brand support did not last however and David Jones exited the label during FY 2015.

The Gordon Smith range was progressively exited from Myer stores where the brand was initially in 65 Myers stores but by 2016 was only represented in 10 stores.

As a result of the above the Group attempted to re-position its product range during 2015 with the commencement of refreshed brands such as 'And She Was' and 'Hammock & Vine' which were aimed at a more 'modern/younger customer' for the summer 2016 season.

#### 4.5.3 Salary and Superannuation

A summary of the Companies' records is detailed below:

Salary and Superannuation	FY12	FY13	FY14	FY15	FY16
	\$000's	\$000's	\$000's	\$000's	\$000's
Gordon Smith Marketing	2,735	2,778	2,621	2,683	2,344
Rodney Clark	2,898	2,775	2,757	2,517	2,131
<b>Total</b>	<b>5,633</b>	<b>5,553</b>	<b>5,378</b>	<b>5,200</b>	<b>4,475</b>
% of Sales	18%	18%	18%	20%	22%

- Total salaries have reduced over the review period.
- However, as a percentage of sales employee costs have risen due to an inability to reduce these in line with a reduction in sales.

#### 4.5.4 Rent

A summary of the Companies' records is detailed below:

Rent	FY 2012 \$000's	FY 2013 \$000's	FY 2014 \$000's	FY 2015 \$000's	27-Jun-16 \$000's
Gordon Smith Marketing	503	562	510	364	341
% of Sales	2%	3%	2%	2%	2%
Rodney Clark	2,613	2,432	2,357	2,106	1,985
% of Sales	28%	26%	25%	25%	25%
<b>Total</b>	<b>3,116</b>	<b>2,994</b>	<b>2,867</b>	<b>2,470</b>	<b>2,326</b>
% of Sales	10%	9%	9%	9%	11%

- Rent has reduced consistently over the review period as retail stores were exited and from FY 2015 when the Gordon Smith Marketing operations were centralised at the current Young Street head office.
- The main reduction in rent has been within the Rodney Clark retail business.
- On a group basis, rent as a percentage of sales has increased slightly in FY 2016 as a result of the significant reduction in revenue.

#### 4.5.5 Rebates

A summary of the Companies' records is detailed below:

Rebates Gordon Smith Marketing				
	FY 2012 \$000's	FY 2013 \$000's	FY 2014 \$000's	FY 2015 \$000's
Rebates per accounts	2,481	2,155	1,444	1,250

Rebates for the period to 27 June 2016, had not been finalised, however my investigations indicate they may be in the vicinity of \$209k (Myer only). I note during the year arrangements were re-negotiated with David Jones to supply product at a lower margin on the basis that David Jones would not charge rebates providing Gordon Smith Marketing with more price certainty.

Detailed below is an analysis of the movement in sales and rebates to the two major department stores in Australia. This is based on Companies' internal season reports.

	Rebates - David Jones		
	Sales	Rebates	
	\$000's	\$000's	%
FY 2012	4,506	1,524	33.82%
FY 2013	3,736	1415	37.87%
FY 2014	2,833	933	32.93%
FY 2015	2,526	844	33.41%

	Rebates - Myer		
	Sales	Rebates	
	\$000's	\$000's	%
FY 2012	4,278	1,176	27.49%
FY 2013	3,944	984	24.95%
FY 2014	3,200	880	27.50%
FY 2015	3,160	787	24.91%

Rebates do not match the financial accounts exactly as some season rebate payments cross financial year-end periods.

I make the following comments:

- Sales to David Jones have fallen by \$2 million or 44% between FY 2012 and FY 2015.
- Sales to Myer have fallen by \$1.1 million or 26% between FY 2012 and FY 2015. I note sales to Myer fell \$1.9 m between FY 2011 and FY 2012 and have continued to decline each year since.
- Whilst rebates have fallen over the review period I am advised by senior staff and the Director that the major retailers became more demanding with regard to incentives, product requirements, pricing and terms.

#### 4.6 REVIEW OF FINANCIAL POSITION

##### 4.6.1 Cash Resources

A summary of the Companies' records is detailed below:

Cash on Hand	FY 2012 \$000's	FY 2013 \$000's	FY 2014 \$000's	FY 2015 \$000's	Mgt 27-June-2016 \$000's
<i>Gordon Smith Marketing</i>					
Cash on Hand	16	8	25	47	14
Koolabah Cash on Hand	-	1	35	35	44
Rodney Clark Cash on Hand	59	16	21	45	96
<b>Total Cash on Hand per accounts</b>	<b>75</b>	<b>24</b>	<b>82</b>	<b>127</b>	<b>154</b>
Less Koolabah	-	1	35	35	44
<b>Net Cash on Hand - Companies</b>	<b>75</b>	<b>23</b>	<b>46</b>	<b>92</b>	<b>110</b>

The Koolabah cash relates to the farm property held within the trust and accordingly, is excluded when reviewing the Companies' liquidity position.

The Companies had limited cash resources throughout the review period.

The Directors RATA disclosed cash at appointment of \$69,000. At my appointment, I recovered the following cash on hand:

Cash at Appointment	\$
Gordon Smith Marketing	37,175
Rodney Clark	21,744
Rodney Clark Retail	0
<b>Total Cash on Hand</b>	<b>58,919</b>

In addition to the above, in the days following my appointment I received approximately \$71,656 relating to pre-appointment credit card sales.

The difference between the Companies' records and the cash recovered by the Administrator relates to the management accounts adopting the closing bank balance on the 27 June 2016 where it should have been the closing balance on the 26 June 2016.

#### 4.6.2 Trade Debtors

A summary of the Companies' records is detailed below:

Trade Debtors	FY 2012 \$000's	FY 2013 \$000's	FY 2014 \$000's	FY 2015 \$000's	Mgt 27.6.16 \$000's
Gordon Smith Marketing	1,841	1,377	1,379	1,048	2,291
Rodney Clark	-	-	-	-	-
<b>Total</b>	<b>1,841</b>	<b>1,377</b>	<b>1,379</b>	<b>1,048</b>	<b>2,291</b>

- Debtor balance has remained fairly consistent through the review period
- The Gordon Smith Marketing debtors in the management accounts are higher due to the intercompany journal having not yet been processed. Accordingly, debtors are higher due to Gordon Smith Marketing sales to Rodney Clark (approximately \$1.04m) having not yet been removed.
- Rodney Clark does not have debtors.

The Director's RATA disclosed debtors of \$3.199 million. This includes the Rodney Clark debtor account relating to sales from Gordon Smith Marketing to Rodney Clark. This is recorded as a Financial Asset in the Balance Sheet of Gordon Smith Marketing at a value of \$1.04 million.

At the time of my appointment the debtors balance was as follows:

Debtors at Appointment	\$000's
<i>Gordon Smith Marketing</i>	
Factored Debtors	862,564
Non-Factored Debtors	267,477
<b>Total Debtors</b>	<b>1,130,041</b>

As noted previously under the Nab's debtor finance facility the Nab owns the factored debtors.

At the time of my appointment the ledger recorded equity in the ledger of \$243,226 Being the ledger balance of \$862,564 less \$619,338 that was owed to Nab against that balance. However, upon investigation approximately \$249,000 in credits and rebates were yet to be processed to the debtors. Accordingly, there is no equity in the factored debtors.

In relation to the non-Factored debtors, my investigations also indicated that the Gordon Smith Marketing was carrying a lot of debts that were either bad or had credits waiting to be processed. After allowing for the credits I wrote to all remaining debtors requesting payment of the account. At the time of writing I have received approximately \$4,000 from non-factored debtors along with a number of letters confirming that the amount is not collectable and should be 'written off'. Having regard to the above my assessment of the ledger is that there may be \$20,000 available to the administration.

### 4.6.3 Stock

A summary of the Companies' records is detailed below:

Stock	FY 2012	FY 2013	FY 2014	FY 2015	Mgt
	\$000's	\$000's	\$000's	\$000's	27-June-2016 \$000's
Gordon Smith Marketing	2,262	2,214	2,368	2,089	1,752
Koolabah Farm stock	460	430	440	492	215
Rodney Clark	841	827	798	839	845
<b>Total</b>	<b>3,563</b>	<b>3,471</b>	<b>3,605</b>	<b>3,420</b>	<b>2,812</b>
Less Farm	460	430	440	492	215
<b>Net Stock</b>	<b>3,103</b>	<b>3,041</b>	<b>3,165</b>	<b>2,928</b>	<b>2,597</b>

Stock has reduced over the review period in line with falling sales. This is predominately due to Gordon Smith Marketing.

Stock in the management accounts appears to be overstated as at 27 June 2016, as stock records along with stock testing following my appointment recorded stock at cost was as follows:

Stock on Appointment	\$000's
Gordon Smith Marketing	475,299
Rodney Clark	865,112
<b>Total Stock on Hand</b>	<b>1,340,411</b>

The Director disclosed in his RATA that stock on hand was \$1.482 million.

Stock holdings at appointment were significantly lower than normal due to the following:

- Inability to secure Summer 2016 season stock which would normally have been booked into the stock ledger in May and June.
- Significant discounting and stock clearance sales in the lead up to administration.

#### 4.6.4 Property Plant & Equipment

A summary of the Companies' records is detailed below:

Property, Plant and Equipment	FY 2012	FY 2013	FY 2014	FY 2015	Mgt
	\$000's	\$000's	\$000's	\$000's	27-June-2016 \$000's
<i>Gordon Smith Marketing</i>					
Furniture & Fittings	1,156	938	745	872	944
Less Depreciation	844	628	507	395	
	<b>312</b>	<b>310</b>	<b>238</b>	<b>477</b>	<b>944</b>
Motor Vehicles	144	154	106	119	107
Less Depreciation	78	92	24	56	
	<b>66</b>	<b>62</b>	<b>82</b>	<b>63</b>	<b>107</b>
Land & Buildings - Koolabah	1,979	1,979	1,971	1,961	
Farm Equipment & Furniture	337	261	270	253	
Less Depreciation	244	177	118	107	
Total Farm WDV	<b>2,072</b>	<b>2,063</b>	<b>2,123</b>	<b>2,107</b>	-
Total Depreciation FY 2016					<b>540</b>
<b>Total Property plant &amp; equip'</b>	<b>2,450</b>	<b>2,435</b>	<b>2,443</b>	<b>2,647</b>	<b>511</b>
<i>Rodney Clark</i>					
Plant & Equipment	3,132	1,337	1,431	1,155	1,208
Less Depreciation	2,454	728	672	534	701
<b>Total WDV Rodney Clark</b>	<b>678</b>	<b>609</b>	<b>759</b>	<b>621</b>	<b>507</b>
<b>Total WDV</b>	<b>3,128</b>	<b>3,044</b>	<b>3,202</b>	<b>3,268</b>	<b>1,018</b>
Less Farm	2,072	2,063	2,123	2,107	-
<b>Total Plant &amp; Equip WDV</b>	<b>1,056</b>	<b>981</b>	<b>1,079</b>	<b>1,161</b>	<b>1,018</b>

Note: Farm removed in June 2016 due to acquisition by Director

#### *Gordon Smith Marketing*

- Furniture and fittings appear to have been disposed and depreciation written back between FY 2012 and FY 2014.
- For the period FY 2015 to FY 2016 Gordon Smith Marketing has been acquiring furniture and fittings.
- As the period to 27 June 2016 is management accounts, depreciation has not yet been recognised.
- Any profit or loss on the disposals of assets does not appear to be recorded in the profit and loss accounts.

#### Rodney Clark

- For the period FY 2012 to FY 2013 approximately \$1.9 million of plant and equipment was disposed and a similar amount has been written back against the depreciation provision. This is attributable to the closure of four stores during this period.

The Director's RATA disclosed Plant and Equipment of \$761,000, which differs to the management accounts which records the written down value of plant and equipment at \$1.02 million.

#### 4.6.5 External Bank Debt

A summary of the Companies' records is detailed below:

	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016
	\$000's	\$000's	\$000's	\$000's	\$000's	\$000's	\$000's	\$000's
<b><i>Gordon Smith Marketing</i></b>								
Overdraft	539	703	695	428	500	482	253	2
NDF Facility	3,448	324	415	565	514	769	824	549
Trade Finance	3,480	2,096	-	-	-	-	-	-
Commercial Bill	1,865	500	1,950	2,200	2,000	-	-	-
Koolabah Commercial Bill	1,435	1,345	1,345	1,345	1,345	1,325	1,085	-
<b>Total</b>	<b>10,767</b>	<b>4,968</b>	<b>4,404</b>	<b>4,538</b>	<b>4,359</b>	<b>2,576</b>	<b>2,162</b>	<b>551</b>
<b><i>Rodney Clark</i></b>								
Overdraft	-	-	-	-	-	-	-	-
Asset Purchase Loan	720	556	376	180	7	7	-	-
<b>Total</b>	<b>720</b>	<b>556</b>	<b>376</b>	<b>180</b>	<b>7</b>	<b>7</b>	<b>-</b>	<b>-</b>
<b>Total Bank Debt - Nab</b>	<b>11,487</b>	<b>5,524</b>	<b>4,780</b>	<b>4,718</b>	<b>4,366</b>	<b>2,582</b>	<b>2,162</b>	<b>551</b>
Reduction per period		5,964	743	62	352	1,784	421	1,611
Cumulative reduction		5,964	6,707	6,769	7,121	8,905	9,326	10,936

The above table shows that the Group has significantly reduced bank debt over the review period. This has been funded by related party contributions (namely sale of property) and the non-payment of trade creditors.

The debtor factoring facility ('NDF facility') was paid out by the Director post my appointment in the sum of \$356k on the 11 July 2016 and he assumed collection of the remaining debtors. We anticipate that there may be a shortfall on this facility.

The Koolabah commercial bill facility (\$1.085m) was assumed by the Director as part of his acquisition of the Koolabah farm. In addition to which he also paid \$50k to reduce the overdraft to \$200k and assumed this amount as part of the farm transaction. There is still \$192,000 owed by the Director to the Gordon Smith Marketing in relation to this transaction.

Further comments in relation to this are contained within the Investigation Section of this Report.

#### 4.6.6 Trade and Statutory Creditors

A summary of the Companies' records is detailed below:

Trade and Statutory Creditors						Mgt	Administrator
	FY 2012	FY 2013	FY 2014	FY 2015	27-Jun-16		Estimate
	\$000's	\$000's	\$000's	\$000's	\$000's	\$000's	27-Jun-16
<i>Gordon Smith Marketing</i>							
Trade Creditors	4,204	4,685	5,109	5,550	7,664		10,528
ATO & SRO	167	252	211	76	403		335
Superannuation					6		94
<b>Total</b>	<b>4,371</b>	<b>4,937</b>	<b>5,320</b>	<b>5,626</b>	<b>8,073</b>		<b>10,957</b>
<i>Rodney Clark</i>							
Trade Creditors	188	271	517	159	145		247
ATO - GST & PAYG	118	107	101	214	300		255
Superannuation	-	-	52	106	68		63
<b>Total</b>	<b>306</b>	<b>378</b>	<b>670</b>	<b>479</b>	<b>513</b>		<b>565</b>
<i>Rodney Clark Retail</i>							
Trade Creditors							24
<b>Total</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>		<b>24</b>
<b>Total Group</b>	<b>4,676</b>	<b>5,315</b>	<b>5,991</b>	<b>6,105</b>	<b>8,586</b>		<b>11,546</b>

- Gordon Smith Marketing has had a significant increase in trade creditors over the review period which is consistent with the fact that it holds the majority of creditors for the Group (i.e. stock purchases) and as a result of the Group's liquidity problems has not been able to service creditors.
- Statutory creditors have increased during FY 2016
- Rodney Clark trade creditors peaked in FY 2014, which I am unable explain other than for the fact there was an accounting anomaly where \$84,289 in unpaid rent was entered as a creditor in that period as opposed to an accrual along with an unusually high Australia Post bill (\$32,613) following a customer mail out at the end of that month.
- Excluding FY 2014 and statutory liabilities, Rodney Clark's trade creditors have remained reasonably consistent throughout the review period.
- My investigations reveal that creditors are significantly higher than reported in the books and records of Gordon Smith Marketing as at 27 June 2016. One reason for this is the foreign exchange rate at which overseas creditors are brought to account along with claims received for summer 2016 stock purchases that were not reported in the Companies' creditors ledger.

#### 4.6.7 Employee Entitlements

The Companies' records disclose total provisions for annual leave and long service leave of \$560,000 in Gordon Smith Marketing and \$129,000 in Rodney Clark. My investigations indicate the employee entitlements are as follows:

Employee Entitlements as at appointment			
	Gordon Smith		
	Marketing	Rodney Clark	Total
	\$000's	\$000's	\$000's
Annual Leave	226	72	298
Long Service Leave	353	52	405
Notice	182	105	287
Redundancy	450	247	697
<b>Total Entitlements</b>	<b>1,211</b>	<b>476</b>	<b>1,687</b>
(assumed by purchaser if sale)			
Superannuation	94	63	157
<b>Total Entitlements</b>	<b>1,305</b>	<b>539</b>	<b>1,844</b>

Note: There was \$38k wages outstanding at appointment, which was paid by the administrator.

At the date of appointment, the Companies employed approximately 92 employees. Accordingly, if all employees were terminated employee entitlement claims would be significant (\$1.8m).

The Purchaser has contracted to assume all the employees and their entitlements with the exception of outstanding superannuation. Accordingly, if the sale completes employee claims will reduce significantly and the only claim against the Companies will be for the outstanding superannuation.

#### 4.6.8 Related Party Loans

A summary of the Companies' records is detailed below:

Related Party	FY 2012	FY 2013	FY 2014	FY 2015	Mgt
	\$000's	\$000's	\$000's	\$000's	27.6.16 \$000's
<b>Gordon Smith Marketing</b>					
<i>Assets</i>					
Osterley Limited	1,193	-	-	-	1,193
Beneficiary Advances	-	1,433	-	-	-
Design 27 loan	424	852	532	426	492
HT Clearance Loan	-	-	-	-	5
Rodney Clark	1,425	1,182	1,289	1,158	1,042
<b>Total Assets</b>	<b>3,041</b>	<b>3,467</b>	<b>1,821</b>	<b>1,584</b>	<b>2,732</b>
<i>Liabilities</i>					
Gordon Smith	366	-	-	-	445
McEvoy Loan	22	-	-	-	-
Birmingham	-	53	46	-	-
Basic Nominees	289	38	-	-	-
<b>Total Liabilities</b>	<b>677</b>	<b>91</b>	<b>46</b>	<b>-</b>	<b>445</b>
<b>Rodney Clark</b>					
<i>Liabilities</i>					
Gordon Smith Marketing	1,425	1,182	1,289	1,162	1,198
<b>Total Liabilities</b>	<b>1,425</b>	<b>1,182</b>	<b>1,289</b>	<b>1,162</b>	<b>1,198</b>

I comment on these loans below:

#### *Osterley Limited*

Is a Division 7A account relating to the Director's drawings. Up to FY 2012 this was recorded within the management and statutory accounts of Gordon Smith Marketing as an asset. From FY 2013 onwards the Osterley Limited balance is removed from the statutory accounts and recorded within the trust distribution account. As the statutory accounts have not been prepared for FY 2016, it has not yet been removed from the management accounts to the trust distribution account.

Enquiries of the Director and external accountant have indicated that this amount should be extinguished based on preliminary tax advice. Notwithstanding, the amount represents Director's drawings which have not been repaid. Should a liquidator be appointed further investigations regarding the recoverability of this debt would be warranted.

#### *Beneficiary Advances*

This represents the balance of the Director's loan account including the Osterley Limited loan as recorded in the trust distribution accounts at 30 June 2013. (refer comments under Osterley Limited above).

#### *Design 27*

Design 27 was a company established by the Director to hold 'young' labels purchased from Charles Parsons Group. I understand initially sales were strong particularly into the US market, however in FY 2013 a significant loss was incurred due to foreign exchange losses. Following which, the business never recovered. A subsequent dispute with the US distributor in 2015 led to the business being closed down and the label 'Blessed and Meek' sold for a figure of 2% of gross sales in FY 2016. The management accounts I have been provided for Design 27 as at FY 2016 disclose sales of 'Blessed and Meek' of \$641,372. Accordingly, 2% would equate to a purchase price of \$12,827.

Gordon Smith Marketing has been funding the Design 27 business over the review period with Design 27 owing Gordon Smith Marketing \$492,000 as at 27 June 2016.

I have been provided with management accounts for Design 27 as at 30 June 2016 which disclose the following asset position:

<b>Design 27 Balance Sheet 30 June 2016</b>	<b>\$000's</b>
<i>Assets</i>	
Cash at Bank	0
<b>Total Assets</b>	<b>0</b>
<i>Liabilities</i>	
Gordon Smith Loan Account	487
Statutory creditors	200
Trade Creditors	170
<b>Total Liabilities</b>	<b>857</b>
<b>Net Assets</b>	<b>(857)</b>

Note: there is a \$5k discrepancy between the books of GSM (\$492K) and Design 27 (\$487k)

Accordingly, it would appear that this amount is non-recoverable. Should a liquidator be appointed further investigation into the reasons for the advances by Gordon Smith Marketing would need to be undertaken.

#### *HT Clearance*

HT Clearance is the Harbour Town Clearance Centre. Stock is sold into the clearance centre at a flat \$17.50 per garment. Given it is an inter-company transaction it is removed when the year-end accounts are prepared.

#### *McEvoy Loan*

McEvoy was a related trust which held the previous head office and warehouse in McEvoy Street, Waterloo. The property was sold in 2014 for \$4.025m with the balance of funds (\$2.56m) after repayment of the mortgage flowing to Gordon Smith Marketing with these proceeds used to repay Nab.

#### *Birmingham Distribution*

Birmingham was a related entity which provided labour services in relation warehouse and distribution for Gordon Smith Marketing. These operations were closed and bought in house in December 2014.

Following the closure Gordon Smith Marketing assumed the employees and their entitlements (\$122K) resulting in Gordon Smith Marketing being a creditor in Birmingham Distribution for the sum of \$46,477.

Birmingham Distribution is in liquidation as a result of unpaid taxation liabilities.

#### *Basic Nominees*

Basic Nominees was the trustee of the Gordon Smith Superannuation Fund. In FY 2010 the Director withdrew the sum of \$2.425 million from the fund and advanced the funds to the Companies which then used the funds to reduce Nab debt. Following this the fund was wound down and dissolved in FY 2014.

#### *Gordon Smith Marketing / Rodney Clark Loan*

This represents the balance of the loan account between the Companies as a result of trading and the intercompany year-end journal entries discussed earlier in this section.

#### *Gordon Smith Loan Account*

The Gordon Smith loan account is listed in the management accounts under liabilities. However, in the majority of years this amount is removed from the liability section of the balance sheet and contained within the trust distribution section of the trust accounts.

As noted earlier the loan account contains a multitude of transactions and journal entries which make interpretation difficult. A summary based on the general ledger is detailed below:

<b>Gordon Smith Loan Account</b>				
<b>Period</b>	<b>Movement</b>		<b>Net Movement</b>	<b>Balance</b>
	<b>DR</b>	<b>CR</b>		
	<b>\$</b>	<b>\$</b>	<b>\$</b>	<b>\$</b>
	Opening Balance 1 July 2011			219,794
FY 2012	1,718,264	2,304,592	-586,328	-366,534
FY 2013	3,060,540	2,445,455	615,085	248,551
FY 2014	4,094,465	6,003,520	-1,909,055	-1,660,504
FY 2015	1,268,618	462,980	805,638	-854,866
FY 2016	1,083,145	672,924	410,221	-444,645
	<b>11,225,032</b>	<b>11,889,471</b>	<b>-664,439</b>	

This loan account appears to be reflected in the trust distribution section of the Gordon Bruce Smith Family Trust. A summary of the trust distribution section is detailed below (Note this is only to FY 2015 as statutory accounts have not been prepared):

<b>Gordon Smith Loan Account - Trust Distribution</b>				
	<b>FY 2012</b>	<b>FY 2013</b>	<b>FY 2014</b>	<b>FY 2015</b>
	<b>\$000's</b>	<b>\$000's</b>	<b>\$000's</b>	<b>\$000's</b>
<b>Opening Balance</b>	<b>-220</b>	<b>367</b>	<b>-240</b>	<b>1660</b>
Trust Distribution	110	40	396	50
Drawings	0	647	0	844
Capital Contributions	477	0	1,504	0
<b>Closing Balance</b>	<b>367</b>	<b>- 240</b>	<b>1,660</b>	<b>866</b>
Osterley Ltd	-1193	-1193	-1193	-1193
<b>Net position</b>	<b>-826</b>	<b>-1433</b>	<b>467</b>	<b>-327</b>

There are some slight variances between the loan account contained within the management accounts (FY 2015 \$854k) and the trust distribution account (FY 2015 \$866k) as follows:

	<b>Management Accounts</b>	<b>Trust Distribution Account</b>	<b>Variance</b>
	<b>\$000's</b>	<b>\$000's</b>	<b>\$000's</b>
FY 2012	(586)	(587)	1
FY 2013	615	607	7
FY 2014	(1,909)	(1,900)	(9)
FY 2015	805	794	11
<b>Variance</b>			<b>12</b>

The above discloses the net movement in the loan account between FY 2012 and FY 2016 was a net contribution by the Director to the Group of \$664,439. However, it also shows that he has withdrawn \$1.2 million in the last two years at a time when creditor debt was growing. It should be noted that the Director did not draw a wage and accordingly, in assessing withdrawals from the loan account this would need to be taken into consideration.

Contributions of significance which I have been able to trace through the loan account include the following:

Director Contributions Source of funds	Notes	Financial Years Funds Received	Amount \$000's
Sale of Birmingham Head Office	1	FY 2010	879
Superannuation fund	2	FY 2010	2,425
Sale of Bangalow Property	3	FY 2014	1,175
Sale of McEvoy Property	4	FY 2014	2,565
Life Insurance pay out	5	FY 2012	561
Cash Advances	6	FY 2010 – FY 2015	870
<b>Total Contributions</b>			<b>8,475</b>

Notes:

1. In 2010 Birmingham which was the trustee of the Gordon Bruce Smith Superannuation Fund, sold a property which was used at the time as the Companies' head office. The deposit on this sale was directed to the Nab to reduce debt.
2. The Director advanced funds from his superannuation fund in 2010.
3. Bangalow was a personal property of the Director that was sold in 2013 with the proceeds at settlement advanced to the Companies.
4. McEvoy was a property owned in McEvoy Street Waterloo by a trust controlled by the Director. This property operated as the Companies' head office following the sale of the Birmingham property. The full settlement proceeds after discharge of the mortgage were advanced to the Companies.
5. In March 2012 the Director received a payout under a life insurance policy following cancer. These funds were advanced to the Companies in full.
6. Represents additional advances made during FY 2010 and FY 2015 that I have been able to identify in the loan account.

These advances were predominately paid to the Nab to retire debt ultimately benefiting the Director through a reduction in his personal guarantee exposure to the Nab.

Should a liquidator be appointed a reconstruction of this account would be required to determine the exact position and enable a true assessment of the impact of withdrawals on creditors and whether these result in any recoveries under the Act.

## **5. ADMINISTRATION TRADING AND ACTIONS**

### **5.1 LICENCE AGREEMENT**

Following my appointment, I formed the view that I was unable to trade the Companies in Administration.

In order to preserve the business value, I entered into a Licence with the Purchaser to enable the continuation of the Companies' businesses so as to enable the opportunity for the future completion of the Asset Sale Agreement and the propounding of a DOCA.

Under the terms of the Licence the Purchaser is responsible for the day-to-day management of the Companies' businesses, with the exception of the Indooroopilly store which was not part of the Asset Sale Agreement. Notwithstanding, the majority of the liabilities remain with the Companies and ultimately the Administrator. Accordingly, a term of the Licence is that the Purchaser indemnifies the Administrator for any liabilities incurred in relation to the Companies' on-going trading during the Administration. To ensure that I am covered for these costs I have been obtaining a weekly cash advance from the Purchaser to cover the anticipated costs.

During the Licence period the Purchaser has been entering into their own supply agreements with a number of suppliers although the major cost items being employees and store lease liabilities have remained with the Companies pending completion of the Asset Sale Agreement.

### **5.2 INDOOROOPILLY STORE**

As noted previously, the Indooroopilly store located in Queensland was not part of the Asset Sale Agreement as the Purchaser formed the view they did not require that store. Accordingly, this store remained with Rodney Clark. Following my appointment, I continued to trade this store for approximately one week during the rent free period afforded to me under the Act with the aim of realising stock for the benefit of creditors.

Sales for the period during which I traded the business totalled \$7,930 with costs totalling \$2,880. Following the end of my rent free period I arranged to vacate the premises with the balance of stock on hand being sold to the Purchaser for a sum of \$5,000 which Hyman Auctioneers advised was a reasonable result given stock holdings and removal costs.

The closure of the store resulted in the termination of 4 staff (1 full time and 3 casuals) crystallising employee entitlement claims approximating \$8,000.

During the Administration and following the store closure, the landlord of the Indooroopilly store made contact with the Purchaser and offered new rental terms that were acceptable to the Purchaser, resulting in the store re-opening under the control of the Purchaser.

### 5.3 TRADING UNDER LICENCE

Throughout the Licence period I have been monitoring trading. A summary of the trading position of the licensee is detailed below:

<b>RODNEY CLARK</b>			
	<b>July</b>	<b>August</b>	<b>Total</b>
<b>Sales (net of GST)</b>	660,681	420,424	1,081,105
<b>COGS</b>	358,502	190,116	548,618
	302,179	230,308	532,487
Wages, Rents & Other	516,225	412,980	929,205
<b>Profit / -Loss</b>	<b>(214,046)</b>	<b>(182,672)</b>	<b>(396,718)</b>
<b>GORDON SMITH</b>			
	<b>July</b>	<b>August</b>	<b>Total</b>
<b>Sales (net of GST)</b>	18,000	847,000	865,000
<b>COGS</b>	10,000	477,950	487,950
	8,000	369,050	377,050
Wages, Rent & Other	276,450	221,160	497,610
<b>Profit / -Loss</b>	<b>(268,450)</b>	<b>147,890</b>	<b>(120,560)</b>
<b>Overall Loss</b>	<b>(482,496)</b>	<b>(34,782)</b>	<b>(517,278)</b>

As can be seen from the above the Purchaser has suffered significant cash drain over the Licence period. This is predominately due to the following:

- The Purchaser not being able to reach agreement with the major suppliers regarding the delivery of the Summer 2016 product resulting in a stock shortage within the stores as existing stock on hand is sold down;
- Retail conditions continue to be challenging
- Unseasonal weather conditions in New South Wales and Queensland.
- Trading during August for Gordon Smith Marketing was profitable as a result of the Purchaser receiving stock from their own suppliers and delivering this into David Jones and Myer.

The result of the above is that the Purchaser has effectively paid more than the contract price to secure the businesses.

### 5.4 ACTIONS SINCE APPOINTMENT

Post my appointment as Administrator I have attended to numerous matters. A summary of some of these is detailed below:

- Met with the Director and the external accountant following my appointment to discuss the administration and the Companies finances and operations generally;

- Met with the Purchaser to discuss and facilitate the licensing arrangements;
- Held discussions with the staff and provided regular updates during the administration;
- Prepared a cashflow and implemented control processes to monitor the businesses under Licence;
- Regular meetings and discussions with the Purchaser regarding progress of the satisfaction of the conditions precedent under the Asset Sale Agreement, in particular assignment of store leases;
- Continued the employment of staff and key services during the Licence period;
- Communicating with the landlords to continue the various store leases during the administration;
- Weekly reconciliation of cash takings and sales; including monitoring of expenses incurred and indemnity position with the Purchaser;
- Correspondence and discussions with debtors regarding amounts owed;
- Reported to the Nab as secured creditor;
- Various discussions with the Nab regarding its facilities;
- Assisted the Nab with the collection of factored debtors and subsequent payout of facility by the Director;
- Convened and held the First Meetings of Creditors on 7 July 2016;
- Made application to the Federal Court of Australia to extend the convening period;
- Convened and held meetings of the Committee of Creditors;
- Attendance to creditors' enquiries and questions, which have been extensive;
- Updating of the Companies' creditor records to reflect correct address and debt outstanding;
- Liaison with the Director and his advisors regarding the history, financial position and activities of the Companies including the DOCA proposal;
- Numerous discussions with the Administrator's solicitors regarding legal issues impacting on the administration;
- Initial trading and subsequent closure of the Indooroopilly store;
- Discussions with the Companies' external accountants regarding tax matters and information requests;
- Data imaging of the Companies' computer systems and files;
- Review of Companies' records and investigations into its operations and reasons for failure which has been significant and substantive;
- Review of the Companies' insurance policies;
- Correspondence with the Companies' financiers regarding loan facilities and leased plant and equipment;
- Correspondence with other creditors holding PPSR registrations;
- Investigation and actioning of Retention of Title Claims;
- Investigation into the Trust status and assets of the Trust;
- Preliminary investigations into insolvent trading, preference claims, voidable transactions & Director and officer responsibilities and offences; and
- Preparation of this report and convening of the second meetings of creditors.

A summary of receipts and payments for the Companies is enclosed at **Annexure F**.

## 6 SALE OF BUSINESS

### 6.1 SALE CAMPAIGN

As noted above after discussions with the major creditor SSH Textiles regarding a debt for equity swap which did not proceed the Director decided to place the Companies' businesses on the market for sale.

In around March 2016 the director engaged Mr. Peter Preston and Mr. Jon Howarth of Specialised Business Services Pty Ltd ('SBS') to conduct a sale campaign. I am advised by SBS that they conducted a confidential and targeted sale campaign over an eight-week period.

The campaign involved an analysis of the businesses operations and the market place to assess the likely buyers.

A 'blind teaser' was prepared and sent to approximately 50 possible interested parties which I am advised included other retailers, retail investors and private equity firms.

Drawing on Mr. Preston's retail background and industry contacts, dialogue was entered into with these parties.

Approximately 12 parties signed confidentiality agreements and were provided with a detailed Information Memorandum. Following which two parties proceeded to the due diligence phase.

I am advised the sale was hampered by the financial situation of the Companies including:

- Relationships with major suppliers having deteriorated;
- As a result, the ability to supply the new season orders was in question;
- Poor profitability of the Group and recent history of significant reduction in sales;
- Significant employee entitlements;
- Rental arrears at a number of retail stores;
- Downturn in the retail market generally; and
- The increased competition posed by new overseas entrants into the Australian market.

Notwithstanding the above, SBS was able to obtain an offer from Brand For Us Pty Ltd which was accepted by the Director and contracted, just prior to my appointment, on 27 June 2016.

I understand Brands For Us Pty Ltd is part of a group of retail businesses operated by the Sterry family. The company operates a number of retail outlets in Australia under the Sorbet name and has a range of labels including Threadz, Clarity and Essentials. The business also has operations in the US and Canada.

My investigations reveal that Brands For Us Pty Ltd is a party independent of the Director and the Director is not being offered a role with the company going forward.

Following agreement between the parties the Purchaser wished to secure supply of the Summer 2016 product range from the Chinese Suppliers. In this regard the Purchaser, with the assistance of the Director, attempted to meet with the key suppliers in Hong Kong. My investigations reveal the following:

- On 21 June 2016 the Director emailed the major Chinese suppliers advising that he had decided to sell the business and introduced the Purchaser and requested they meet the Purchaser in Hong Kong on Friday 24 June 2016.
- Included in the email was noted the terms under which the Purchaser was prepared to acquire the summer stock namely, 30% deposit and COD on shipment.
- The Purchaser along with the General manager, Kim Hancock flew to Hong Kong with a number of product samples on 24 June 2016 in anticipation of meeting with the key supplier to negotiate production and supply arrangements.
- I understand not one Chinese supplier accepted the offer to meet in Hong Kong and subsequently the Companies cancelled the summer orders.
- Notwithstanding this, the Purchaser via the Companies' staff requested details of the summer products that the suppliers were holding and offered to acquire some items.
- I understand that Comely Creations (Chinese supplier) and Indian suppliers have been willing to work with the Purchaser and have delivered summer stock on the terms noted above.

## 6.2 SALE CONTRACT

Brands For Us Pty Ltd entered into an Asset Sale Contract with the Companies on 27 June 2016 to acquire all of the Companies' retail and wholesale business operations and assets along with the assumption of certain liabilities.

The contract has not yet been consummated as it is subject to a number of condition precedents including approval by creditors at the Second Meetings of Creditors.

Under the Asset Sale Agreement, the following assets will be transferred to the Purchaser, upon the satisfaction of a number of condition precedents:

- all stock, inventory and other assets of each Company except for specified excluded assets;
- subject to consent of each counterparty to the transfer, the rights of each Company under specified contracts to which it is a party;
- specified equipment and equipment leases;
- the rights of each Company under specified leases to which it is a party other than the lease located in Indooroopilly, Queensland;
- all intellectual property owned by each Company; and
- all documents and records in the possession or under the control of the Companies relating to the assets listed or needed to operate these assets in the ordinary course of business.

The sale includes the assumption of a number of liabilities including:

- outstanding employee entitlements (excluding superannuation) for all employees except those at Indooroopilly – \$703,000.
- store Lease liabilities – Outstanding lease payments to lease expiry is approximately \$4.7 million
- plant & equipment leases – approximately \$120,000

The purchase price is \$750,000 cash plus the assumption of the above noted liabilities. A deposit of 10% has been paid and is held in KWM trust account.

Prior to the sale agreement completing the following condition precedents need to be satisfied:

- delivery by the Companies of releases of security interests granted by Gordon Smith Marketing and Rodney Clark in favour of the Nab;
- the Director tabling a DOCA proposal to creditors;
- a resolution being passed pursuant to section 439C(a) of the Act by the creditors of the Companies to the effect that those Companies execute a DOCA on terms to give effect to the DOCA proposal. Should creditors not agree to this at the upcoming meeting I am of the view that a liquidator if appointed could still complete the sale. Refer section 6.3 below; and
- that the Director and the Purchaser enter into a Share Sale Agreement in relation to Palm Beach Brands. I note this condition precedent has been satisfied.

Leases are only to be novated to the Purchaser once the Companies have

- obtained the consent of each landlord, where required, to each Lease to the novation of that Lease from the relevant Company to the Purchaser; and
- any bank guarantee has been released and any collateral posted by a Company has been returned to that Company.

In relation to the satisfaction of the condition precedents I note the following as at the time of writing:

Condition	Status
Release of PPSR Security	Work in progress
DOCA Proposal	Satisfied
Creditor Approval	Yet to be determined
Sale - Palm Beach Brands	Satisfied
Consent of Landlords	Satisfied subject to contract

As noted above one of the conditions is that the Director enter into a Share Sale Agreement in relation to Palm Beach Brands. This is a company controlled by the Director and is not subject to external Administration; it is also the owner of the majority of trade marks held by the group and used in the businesses of Gordon Smith Marketing and Rodney Clark.

I am advised that on the 27 June 2016 the Director entered into a Share Sale Agreement with the Purchaser to sell the shares in Palm Beach Brands and accordingly all relevant trademarks for a

price of \$750,000. Accordingly, if these two sale agreements are finalised, the Purchaser will be paying a total cash consideration of \$1.5 million along with the assumption of a number of liabilities.

### **6.3 IMPACT IF COMPANIES ARE PLACED IN LIQUIDATION**

As noted above, a condition precedent to the sale completing is that creditors pass a resolution pursuant to section 439C(a) of the Act at the Second Meetings of Creditors to the effect that the Companies execute a DOCA on terms to give effect to the DOCA proposal.

Creditors may choose to place the Companies and/or a Company in liquidation at the forthcoming Second Meetings of Creditors which would result in this condition not being satisfied.

I have sought advice in relation to the status of the Asset Sale Agreement and its ability to complete should creditors resolve to place the Companies in liquidation.

I am advised that under the terms of the Asset Sale Agreement a liquidator if appointed could waive this condition precedent and complete the Asset Sale Agreement (provided all other conditions precedent to the Asset Sale Agreement are satisfied or will be satisfied).

Notwithstanding, there are some risks to completion under the Asset Sale Agreement if the Companies are liquidated, being:

1. The total sale proceeds may not be available to creditors due to potential claims of the beneficiaries of the trust. Refer previous discussion on the trust noted earlier in this Report;
2. If the Companies were to be placed in liquidation prior to the leases being novated, the Companies would no longer be able to take advantage of the restrictions on the exercise of third party property rights (Section 440B of the Act). Accordingly, landlords could terminate the lease and repossess the leased premises and make a claim against the Companies for any unpaid rent or other loss resulting from the termination;
3. The liquidator may require Court directions to continue the trading operations of the businesses prior to completion;
4. Calls on Nab bank guarantees issued in favour of landlords under the leases for amounts of unpaid rent and other loss may increase, increasing Nab's secured debt diluting the return to other creditors;
5. Nab may enforce its security and frustrate the sale process;
6. A liquidation is less controlled and would likely cause the transaction to be more difficult to complete; and
7. Liquidation may present grounds for the Purchaser to not proceed with the sale.

Should the Asset Sale Agreement not complete the administrator / liquidator would have no alternative other than to close the business resulting in the termination of employees, store leases and other equipment finance contracts. Under this scenario creditors' claims against the Companies will increase significantly and as a result the likely return available to creditors will be nil before any recoveries that may be available to a liquidator.

In particular the following creditors' claims would likely crystallise if the sale does not complete:

- Employee termination entitlements would be approximately \$1.8 million;
- Landlords would possibly have a claim for the balance of rental remaining under the lease term, which approximates \$4.7m (estimate of lease term remaining) (Note landlords would have an obligation to mitigate their loss);
- Equipment finance claims of approximately \$120,000 (based on remaining lease/loan terms); and
- Debtor collections under the factoring facility would also likely be hampered through the closure of the business resulting in a likely shortfall on the factoring facility crystallising a priority claim in favour of the Director for any loss suffered.

#### **6.4 ADMINISTRATOR'S OPINION OF SALE**

In an effort to assess the reasonableness of the Asset Sale Agreement following my appointment, I engaged Mr. Graeme Lavelle of Lavelle and Co, Chartered Accountants (a forensic accounting expert) to conduct an independent valuation.

Mr. Lavelle's valuation indicates that the purchase price is reasonable.

It is the Administrator's opinion that the sale is reasonable and it is in creditors best interests for the sale to complete having regard to the following:

- the price paid is reasonable having regard to the independent valuation;
- the business was in financial distress at the time of the sale;
- recent trading history had been poor;
- ongoing supply of product was in doubt and threatened the ongoing viability of the businesses;
- given product supply problems there was no certainty that agreements in place with Myer and David Jones would continue;
- the sale provides a pool of funds for creditors and avoids the crystallisation of significant liabilities; and
- ultimately, at the time of the appointment of Administrator, the Companies were insolvent, had no ability to continue to trade, had no ability to acquire the summer 2016 season range nor supply its customers.

## 7 DEED OF COMPANY ARRANGEMENT PROPOSAL

### 7.1 PROPOSAL RECEIVED

The director initially proposed a deed contribution over and above the sale proceeds of \$350,000. This was then subsequently increased to \$750,000 and then further increased to \$1,700,000 including the debt owed of \$192,000 on the Director's acquisition of the Koolabah farm.

Accordingly, the current proposal for creditors consideration is:

- A DOCA pool be established covering all Companies and all creditors to consist of the following:
  - Surplus funds from asset recoveries made by the administrators (cash and debtors) along with the proceeds of the Asset Sale Agreement after allowance for the costs of the administration; and
  - The Director's contribution of \$1,700,000, which includes the net sale proceeds received from the PBB Share Sale Agreement. To be payable as follows:
    - \$650,000 following completion of the PBB Share Sale Agreement;
    - \$350,000 by 15 November 2016 (from sale of personal property);
    - \$350,000 by 15 February 2017 (personal contribution); and
    - \$350,000 by 15 April 2017 (personal contribution incl \$192,000 owed on acquisition of Koolabah property).
- Outstanding Employee entitlements will be assumed by the Purchaser and will not be a claim against the Companies (c \$700,000 in leave entitlements and \$984,000 in redundancy).
- Related party creditors will not claim in the Deed totaling approximately \$1,500,000.
- The Director will provide a personal guarantee together with security over real property.

### 7.2 KEY FEATURES OF DOCA

The proposed DOCA contains the following key features:

- A single Deed fund will be established comprising the assets of all Companies including the settlement proceeds from the completion of the Asset Sale Agreement, the personal contribution of the Director along with net proceeds from any other asset realisations of the Companies, less payment of the Administrator's remuneration and expenses and the Deed Administrator's remuneration and expenses;
- Related party creditors along with intercompany creditors will not claim in the DOCA.
- The DOCA would bind all creditors of the Companies and under the terms of the DOCA all assets and liabilities of the Companies would effectively be pooled.
- Following distribution of all deed funds the DOCA will conclude and control of the Companies will revert to the Director.

The Deed funds are payable as follows:

Source of Funds	Payment	Timing of Payment
Asset Sale Agreement	\$750,000	Payable upon completion of the Asset Sale Agreement. Completion will occur once all the conditions precedent in the agreement have been met. Estimated within 2 weeks of the Second Meetings of creditors
Director initial contribution Completion of PBB Share Sale Agreement	\$650,000	Payable on completion of the PBB Share Sale Agreement. Estimated within 2 weeks of the Second Meetings of Creditors
Director second contribution Sale of personal property asset	\$350,000	By 15 November 2016
Director third contribution. Personal contribution by the Director	\$350,000	By 15 February 2017
Director third and final contribution. Personal contribution of Director	\$350,000	By 15 April 2017
Total Deed Fund prior to other asset realisations and the cost of administration and deed administration	\$2,450,000	

To secure the payments from the Director, the Director will provide a personal guarantee and Deed Administrator if appointed, will be granted a registered charge over real property.

The Administrator considers that the DOCA proposal complies with Section 26.6.6 of the Code. A draft DOCA will be available for inspection at the Second Meetings of Creditors.

### 7.3 ORDER OF DISTRIBUTION

The Deed fund following receipt of the Director's contribution and realisation of the Companies assets including completion of the Asset Sale Agreement will be distributed as follows:

Order of Distribution	Creditor
Firstly	Administrator's and Deed Administrator's remuneration, disbursements and residual trading costs and expenses
Secondly	Creditors holding valid PPSR registrations
Thirdly	Priority unsecured creditors (i.e. employee entitlements not assumed by the Purchaser)
Fourthly	Unsecured creditors in proportion to their admitted debts (excluding related party debts)

## 7.4 ESTIMATED RETURN TO CREDITORS

Under the proposed DOCA all creditors across all Companies will be consolidated into one DOCA, the Administrator's estimate a likely dividend to each class of creditors is as follows:

Creditors	Estimated dividend rate (cents in the \$)	Estimated dividend rate (cents in the \$)
	High	Low
Secured (Nab & PPSR)	100	100
Priority (employees)	100	100
Unsecured	14	13
Related party	Nil	Nil

## 7.5 ADMINISTRATOR'S OPINION

The Administrator is of the opinion that creditors should accept the proposed DOCA because:

- The estimated return to unsecured creditors (although lower than the high case scenario under liquidation) is likely to be more certain than in an orderly winding up of the Companies, noting that the actual return in liquidation could be nil;
- A DOCA avoids the risks to the Asset Sale Agreement not completing and therefore limits the crystallisation of employee claims (with the exception of unpaid superannuation);
- The DOCA provides for a return to all employees, whereas under a liquidation scenario within Rodney Clark there is likely to be a shortfall to employees, resulting in their superannuation entitlements not being paid in full;
- It provides certainty to unsecured creditors and employees. In a liquidation scenario, any dividend will be contingent on antecedent recoveries (i.e. preference recoveries, insolvent trading, compensation for breach of director's duties etc.) and notwithstanding the merits of these claims, recovery costs are likely to be high, they will require Court proceedings which are uncertain and ultimately will be impacted by the capacity of the parties to meet any significant judgments which may be obtained; and
- The DOCA will enable a dividend to be paid to creditors earlier than what may be available under a liquidation scenario where a dividend is likely dependent on antecedent recoveries which are uncertain.

Please note, that if creditors resolve to execute a DOCA at the Second Meetings of Creditors, the antecedent transactions identified in section 8 of this Report would not be available for recovery.

In forming their view, creditors should seek their own legal advice as to their rights and effects of their position in entering into a DOCA. Creditors can obtain further information from the ASIC website at [www.asic.gov.au](http://www.asic.gov.au) under Regulatory Resources – Insolvency-Insolvency for creditors.

## 8 INVESTIGATIONS

The Act requires the Administrator to carry out preliminary investigations into the Companies' business, property, affairs and financial circumstances.

These preliminary investigations are focussed on transactions entered into by a company that a liquidator might seek to void or otherwise challenge where a company is wound up. Preliminary investigations allow the administrator to advise creditors about the potential recoveries that might be available to a liquidator in order for creditors to properly assess whether to accept a DOCA proposal or resolve to wind up a company.

Funds recovered would be available to unsecured creditors including any secured creditors but only to the extent of any shortfall incurred after realising their security.

A liquidator may recover funds from each type of transaction detailed in the Creditor Information Sheets provided by ASIC, a list of these sheets is provided at **Annexure G** of this report. A Deed Administrator does not have the ability to recover voidable transactions. A liquidator may also recover funds through other avenues; for example, through action seeking compensation for insolvent trading or breach of director duties.

Administrators are not obliged to carry out investigations to the same extent as liquidators. A liquidator may require many months of investigation and conduct public examinations before forming a conclusive view on recovery action.

As noted previously, creditors have requested I conduct more extensive investigations into the Companies than an administrator would normally conduct. Accordingly, I have conducted more extensive investigations; however, I note that these investigations are still preliminary in nature given the timeframe available and should a liquidator be appointed further investigations will be required.

The dividend estimate in a liquidation scenario set out in **Annexure H** and reflects the outcome of my preliminary investigations.

The administrator's knowledge of the Companies' affairs comes principally from the following sources:

- Communications with creditors;
- Discussions with the Director and his advisors.
- A search of the ASIC records relating to the Companies and any related entities.
- Searches obtained from ASIC and the Personal Property Securities Register.
- An examination of the Companies' books and records including their financial statements and management accounts.

Whilst I have no reason to doubt any information contained in this Report, I reserve the right to alter my conclusions should the underlying data prove to be inaccurate or materially change for the date of this Report.

Should creditors resolve that the Companies be wound up at the Second Meetings of Creditors, there may be transactions where money, property or other benefits can be recoverable by a liquidator. A liquidator would need to undertake further investigations into the following areas, however, I provide my initial findings into:

- Insolvent trading at Section 8.1.
- Adequacy of books and records at Section 8.2.
- Voidable transactions at Section 8.3.
- Director's and officer's responsibilities at Section 8.4.
- Offences at Section 8.5.

## 8.1 INSOLVENT TRADING

Directors have a positive duty to prevent a company from trading whilst it is insolvent. If the directors are found to have contravened section 588G of the Act they may be ordered to pay an amount of compensation to the company equal to the amount of loss or damage suffered by creditors as a result of the contravention.

A director may be personally liable to a company if the director fails to prevent a company from incurring a debt when, at the time of incurring that debt, the company is insolvent, or becomes insolvent by incurring that debt. A company is insolvent when it cannot pay its debts as and when they fall due.

An action for insolvent trading is generally undertaken by a liquidator, however, in the event that a liquidator elects not to pursue a director, creditors may be able to pursue a director for a claim for insolvent trading. Claims for insolvent trading are often difficult to prove and directors have a number of defences available to them under Section 588H of the Act.

To be successful in pursuing a claim against a director for insolvent trading a liquidator must prove that the company was insolvent at the relevant date. The basic test of insolvency relates to both the net asset position of the company (the balance sheet test) and whether the company can pay its debts as and when they fall due (the cash flow test). The assessment of a company's solvency is complex and comes down to a question of fact in the circumstances. Generally, this requires detailed examination and expert accounting advice and evidence for the ensuing court proceedings.

Pursuant to case law, there are a number of indicia of insolvency which are taken into consideration. A company may be deemed to be insolvent under a statutory presumption where books and records are not adequately maintained. Further information with respect to this matter is disclosed below at Section 8.1.2 and 8.1.3 of this Report.

### 8.1.1 Determining insolvency

Section 95A of the Act provides the following definition of 'solvency' and 'insolvency':

- 1) *A person is solvent if, and only if, the person is able to pay all the person's debts, as and when they become due and payable; and*
- 2) *A person who is not solvent is insolvent.*

Whilst I am required to consider the solvency of each of the companies within the Group, as the operations of the Companies are intermingled and linked at an operational and accounting level, I have considered the solvency of the Group on a consolidated basis for the purposes of this report. Should a liquidator be appointed a more detailed analysis of the position of each individual company would be required.

### 8.1.2 Statutory presumption of insolvency

A company can be deemed to be insolvent under a statutory presumption where books and records are not adequately maintained.

As disclosed at Section 4.1 of this Report, I believe all Companies have maintained adequate books and records pursuant to the Act and as such the statutory presumption does not apply.

### 8.1.3 Indicators of Insolvency

ASIC have issued guidelines regarding what it considers are indicators of insolvency. In its regulatory guide RG 217 '*Duty to prevent insolvent trading: guide for directors*' ASIC provides a list of 15 indicators of potential insolvency. Should creditors wish to see the full list the guide can be accessed at the following link:

<http://asic.gov.au/regulatory-resources/find-a-document/regulatory-guides/rg-217-duty-to-prevent-insolvent-trading-guide-for-directors/>

I note a number of these indicators below:

- history of continued trading losses.
- cash flow difficulties.
- creditors not paid on agreed trading terms.
- arrangements with creditors regarding payment plans of COD for future deliveries.
- statutory liabilities (PAYG, GST, Superannuation) not paid when due.
- cheques being dishonoured.
- creditors threatening legal action.

The following table summarises the presence of the insolvency indicators I consider applicable to the Companies:

Presence of Insolvency Indicators	FY 08	FY 09	FY 10	FY 11	FY 12	FY 13	FY 14	FY 15	Dec Qtr 15	Mar Qtr 16	Jun Qtr 16
Trading Losses GSM											
Trading Losses RC	Y	Y	Y	Y	Y	Y	Y	Y		Y	Y
Negative Working Capital	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
Negative Net Assets	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
Creditors outside trading terms - Large % > 90 days		Y	Y				Y	Y	Y	Y	Y
Creditors on COD/Payment Plan		Y	Y					Y	Y	Y	Y
Standstill agreements		Y	Y					Y	Y	Y	Y
Legal Threats and action											Y
Difficulty collecting debts		Y									
Statutory Creditors not paid			Y					Y	Y	Y	Y
ATO Payment Arrangement/action			Y					Y	Y	Y	Y
Use of credit card								Y	Y	Y	Y
Limit on Finance facilities			Y	Y	Y	Y	Y	Y	Y	Y	Y
Financier Increasing Monitoring			Y	Y	Y	Y	Y	Y	Y	Y	Y

Set out below are the Administrator's preliminary findings in relation to the identified indicators of insolvency:

#### *Continuing losses*

While Gordon Smith Marketing has had a history of trading profitably throughout the review period. Rodney Clark has traded at a loss and has been a significant source of financial pressure for the Group.

A summary per the Companies' records is detailed below:

<b>NPBT From trading excl trust dist'</b>	<b>FY 2012 \$000's</b>	<b>FY 2013 \$000's</b>	<b>FY 2014 \$000's</b>	<b>FY 2015 \$000's</b>	<b>Mgt 27 June 2016 \$000's</b>
Gordon Smith Marketing	1,455	827	844	507	135
Rodney Clark	(873)	(256)	(491)	(250)	(910)
<b>Group Total</b>	<b>582</b>	<b>571</b>	<b>353</b>	<b>257</b>	<b>(775)</b>

#### *Negative Net Assets*

A summary of the net asset and liability position of the Companies based on their reported results is noted below:

##### *Gordon Smith Marketing – Net Assets*

Gordon Smith Marketing is the trustee of the Gordon Bruce Family Trust, accordingly it prepares trust accounts and as such the net asset position always equals the settlement sum of \$10. However, I provide the summary so that creditors can see the movement in assets and liabilities over the review period.

A summary per the Companies' records is detailed below:

<b>Gordon Smith Marketing</b>	<b>FY 2012 \$000's</b>	<b>FY 2013 \$000's</b>	<b>FY 2014 \$000's</b>	<b>FY 2015 \$000's</b>	<b>Mgt 27 June 2016 \$000's</b>
Current Assets	6,508	6,569	5,216	4,794	4,856
Non-Current Assets	3,885	3,627	3,741	3,815	2,565
<b>Total Assets</b>	<b>10,393</b>	<b>10,196</b>	<b>8,957</b>	<b>8,609</b>	<b>7,420</b>
Current Liabilities	9,048	8,851	7,632	7,524	8,975
Non-Current Liabilities	1,345	1,345	1,325	1,085	(748)
<b>Total Liabilities</b>	<b>10,393</b>	<b>10,196</b>	<b>8,957</b>	<b>8,609</b>	<b>8,226</b>
<b>Net Assets</b>	<b>\$10</b>	<b>\$10</b>	<b>\$10</b>	<b>\$10</b>	<b>(806)</b>

I note the above includes the carrying value of the farm which is as follows:

Farm Cash at Bank		1	35	35	44
Farm Land & Buildings	1,979	1,979	1,971	1,961	0
Farm Livestock	460	430	440	492	215
Farm Furniture and Fittings	92	84	152	146	140
<b>Total Farm Carrying Value</b>	<b>2,531</b>	<b>2,494</b>	<b>2,598</b>	<b>2,634</b>	<b>399</b>
Farm Liability	1,345	1,345	1,325	1,085	0
<b>Net Position</b>	<b>1,186</b>	<b>1,149</b>	<b>1,273</b>	<b>1,549</b>	<b>399</b>

Gordon Smith Marketing has experienced a decrease in its asset and liability position over the review period. This is mainly as a result of falling sales resulting in a reduction in debtors and liabilities have reduced due to a reduction in bank debt.

I am advised that farm livestock was lower in FY 2016 as a result of the drought and need to sell cattle to generate cash flow.

#### *Rodney Clark – Net Assets*

A summary per the Companies' records is detailed below:

<b>Rodney Clark</b>	<b>FY 2012 \$000's</b>	<b>FY 2013 \$000's</b>	<b>FY 2014 \$000's</b>	<b>FY 2015 \$000's</b>	<b>Mgt FY 2016 \$000's</b>
Current Assets	1,046	1,190	1,252	1,206	1,322
Non-Current Assets	679	609	758	621	507
<b>Total Assets</b>	<b>1,725</b>	<b>1,799</b>	<b>2,010</b>	<b>1,828</b>	<b>1,829</b>
Current Liabilities	720	743	887	862	824
Non-Current Liabilities	1,425	1,182	1,289	1,162	2,111
<b>Total Liabilities</b>	<b>2,145</b>	<b>1,924</b>	<b>2,177</b>	<b>2,024</b>	<b>2,935</b>
<b>Net Assets</b>	<b>(420)</b>	<b>(125)</b>	<b>(167)</b>	<b>(196)</b>	<b>(1,106)</b>

The Rodney Clark asset and liability position is fairly consistent across the review period. The major reason for the reduction in net assets is the yearly increase in the depreciation expense and movement in the inter-company loan account.

#### *Working Capital*

##### *Gordon Smith Marketing*

A summary of the working capital position per the financial accounts is detailed below for Gordon Smith Marketing:

<b>Gordon Smith Marketing</b>	<b>FY 2012 \$000's</b>	<b>FY 2013 \$000's</b>	<b>FY 2014 \$000's</b>	<b>FY 2015 \$000's</b>	<b>Mgt FY 2016 \$000's</b>
Current Assets	6,508	6,569	5,216	4,794	4,856
Current Liabilities	9,048	8,851	7,632	7,524	8,975
<b>Working Capital</b>	<b>(2,540)</b>	<b>(2,282)</b>	<b>(2,416)</b>	<b>(2,730)</b>	<b>(4,119)</b>

Throughout the review period Gordon Smith Marketing has had a negative working capital position. This is mainly due to this entity carrying the majority of the trade creditors for the Group.

I note that for the period ended 27 June 2016, the debtors are overstated due to credits and rebates not yet processed and the creditors are understated based on administrators estimate. To allow for this I have made adjustments in the following table.

<b>Gordon Smith Marketing Adjusted Working Capital</b>	<b>FY 2012 \$000's</b>	<b>FY 2013 \$000's</b>	<b>FY 2014 \$000's</b>	<b>FY 2015 \$000's</b>	<b>27-June-2016 \$000's</b>
Reported Working Capital	(2,540)	(2,282)	(2,416)	(2,730)	(4,119)
less reported debtors overstated					(2,291)
add administrators estimate of debtors collectable					20
plus reported trade creditors					7,755
less administrators estimate of trade creditors					(8,404)
<b>Revised Working Capital</b>	<b>(2,540)</b>	<b>(2,282)</b>	<b>(2,416)</b>	<b>(2,730)</b>	<b>(7,038)</b>

#### *Rodney Clark*

A summary of the working capital position is detailed below for Rodney Clark:

<b>Rodney Clark</b>	<b>FY 2012 \$000's</b>	<b>FY 2013 \$000's</b>	<b>FY 2014 \$000's</b>	<b>FY 2015 \$000's</b>	<b>Mgt 27 June 2016 \$000's</b>
Current Assets	1,046	1,190	1,252	1,206	1,322
Current Liabilities	720	743	887	862	2,034
<b>Working Capital</b>	<b>326</b>	<b>448</b>	<b>364</b>	<b>344</b>	<b>(712)</b>

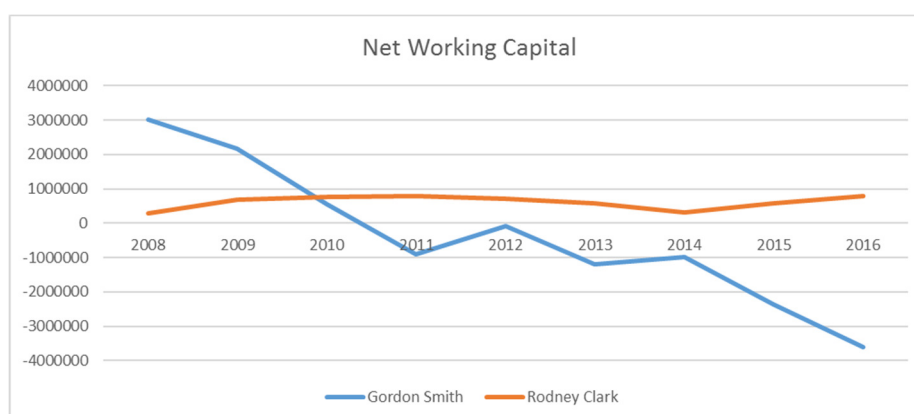
Rodney Clark has had a positive working capital position predominately as a result of the level of stock held and the fact that its product suppliers are not reported in Rodney Clark's books. These are reported with Gordon Smith Marketing's books and recognised in the inter-company loan account within Rodney Clark (non-current).

To accurately reflect working capital as at 27 June 2016, I have adjusted debtors to remove the inter-company debtor and adjusted creditors to reflect the administrator's estimate.

<b>Rodney Clark Adjusted Working Capital</b>	<b>FY 2012 \$000's</b>	<b>FY 2013 \$000's</b>	<b>FY 2014 \$000's</b>	<b>FY 2015 \$000's</b>	<b>27-June-2016 \$000's</b>
Reported Working Capital	327	448	364	344	498
less inter-company debtor					(1,042)
add administrators estimate of debtors collectable					Nil
plus reported trade creditors					513
less administrators estimate of trade creditors					(589)
<b>Revised Working Capital</b>	<b>327</b>	<b>448</b>	<b>364</b>	<b>344</b>	<b>(620)</b>

Once this adjustment is made the working capital position of Rodney Clark deteriorates dramatically.

Detailed below is a summary of the net working capital movement for both Gordon Smith Marketing and Rodney Clark (cash, debtors, stock less trade creditors) based on the Companies reported results:



While Rodney Clark has maintained a positive net working capital position Gordon Smith Marketing has seen significant reduction over an extended period. I note, after adjustment I have made for the period to 27 June 2016 Rodney Clark is also working capital deficient.

The graph for Gordon Smith Marketing clearly indicates the problems the Company was experiencing between FY 2009 and FY 2010 in funding its working capital requirements. While there was an improvement in liquidity between FY 2011 and FY 2013 as a result of improved profitability and Director contributions. The position again deteriorated significantly from FY 2014 through to the date of appointment indicating Gordon Smith Marketing had insufficient working capital to fund its trading liabilities.

#### Liquidity ratio below 1

The liquidity ratio is a financial measurement of the operating liquidity available to a business. A positive liquidity ratio of greater than 1:1 indicates that a business is able to pay its short term liabilities, whereas a liquidity ratio of less than 1:1 indicates that a business is unable to meet its short term liabilities.

The Companies had the following liquidity ratios:

Group Liquidity Ratios	FY 2012 \$000's	FY 2013 \$000's	FY 2014 \$000's	FY 2015 \$000's	27-June-2016 \$000's
Gordon Smith Marketing	0.72	0.74	0.68	0.64	0.27
Rodney Clark	1.45	1.60	1.41	1.40	0.31

I make the following comments:

- The above liquidity ratio shows that both entities were experiencing a deteriorating liquidity position.
- Gordon Smith Marketing has had a liquidity shortfall for a long time evidencing its inability to meet its debt as and when they fell due.
- The Rodney Clark figures whilst positive are not a true reflection of the business due to the intercompany adjustments which occur at year-end.

### Trade Creditors

The following tables summarise the movement in the trade creditors' ledger balance for the period FY 2009 to date of appointment:

#### Gordon Smith Marketing

Gordon Smith Marketing Trade Creditor Balance at year end Based on company's records			
Month	Amount \$	Movement	
		\$	%
Jun-09	4,022,919		
Jun-10	4,687,014	664,095	17%
Jun-11	5,286,271	599,257	13%
Jun-12	4,203,722	- 1,082,549	-20%
Jun-13	4,685,230	481,508	11%
Jun-14	5,109,148	423,918	9%
Jun-15	5,549,709	440,561	9%
Jun-16	7,663,047	2,113,338	38%

The above table indicates that Gordon Smith Marketing's creditors have increased consistently. Significant growth is evident from FY 2012 onwards.

For the period FY 2009 to FY 2013 creditor balances as at financial year end have averaged \$4.5 million, however for the period FY 2014 to 27 June 2016 the average increased to \$6.1 million.

#### Rodney Clark

Rodney Clark - Trade Creditor Balance at year end Based on company's records			
Month	Amount \$	Movement	
		\$	%
Jun-09	279,324		
Jun-10	133,967	- 145,357	-52%
Jun-11	170,051	36,084	27%
Jun-12	187,680	17,629	10%
Jun-13	271,191	83,511	44%
Jun-14	517,445	246,254	91%
Jun-15	159,409	- 358,036	-69%
Jun-16	156,401	- 3,008	-2%

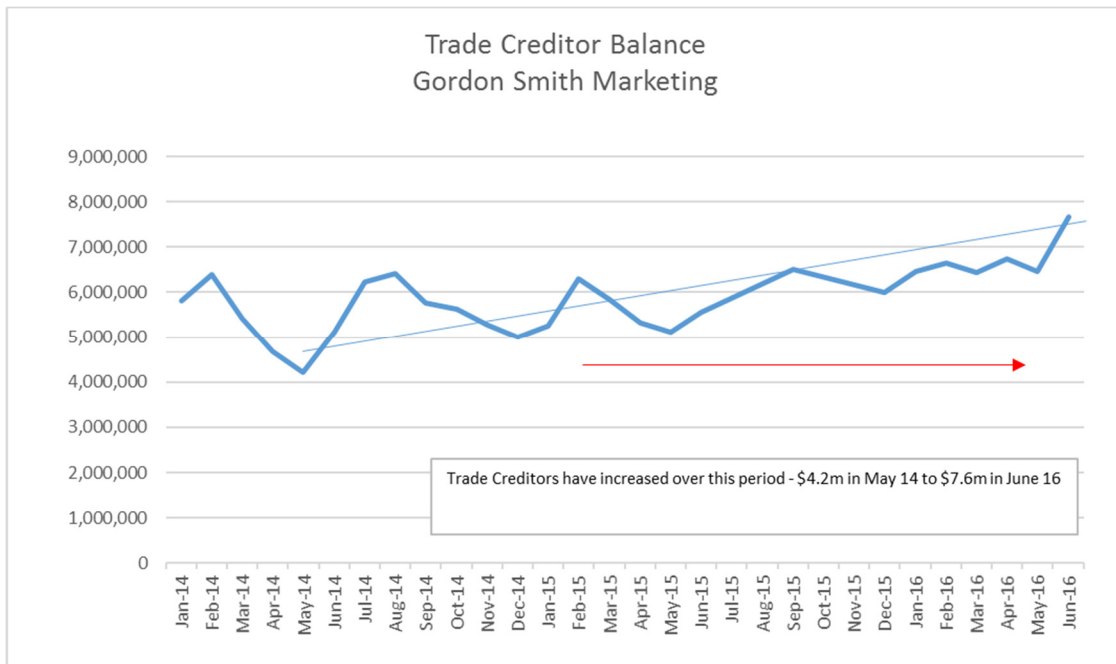
Rodney Clark's creditors have remained around the \$150,000 to \$300,000 with the exception of FY 2014 where the creditor balance was \$517,445. The balance of creditors at June 2014 is higher than other periods partially due to an accounting error where \$84,289 in unpaid rent was entered as a creditor in that period as opposed to an accrual along with an unusually high Australia Post bill (\$32,613) following a customer mail out at the end of that month.

It is clear from the above that although Rodney Clark incurred significant losses the debt built up within Gordon Smith Marketing. This is mainly due to the fact that stock was purchased through

Gordon Smith Marketing before being on-supplied to Rodney Clark and is further evidence as to the interrelated nature of the Companies.

*Gordon Smith Marketing – Creditor Growth*

The graph below highlights the growth in creditors within Gordon Smith Marketing, particularly from May 2014 onwards where creditors have increased by \$3.4 million based on the company’s records.



As noted previously in this Report, the actual trade creditor balance for Gordon Smith Marketing is likely to be significantly higher based on proof of debts received to date.

*Estimate of Group Trade Creditors (Excluding Statutory)*

Based on my investigations to date and proof of debts received to date, my current estimate of trade creditor claims (excluding statutory creditors, related party and contingent) is as follows:

Company	Amount \$
Gordon Smith Marketing	10,527,720
Rodney Clark	246,910
Rodney Clark Retail	24,213
<b>Total Trade Creditors</b>	<b>10,798,843</b>

## Ageing

Detailed below is the aged trade creditors over the period March 2014 through to appointment for both Gordon Smith Marketing and Rodney Clark based on the Companies' records.

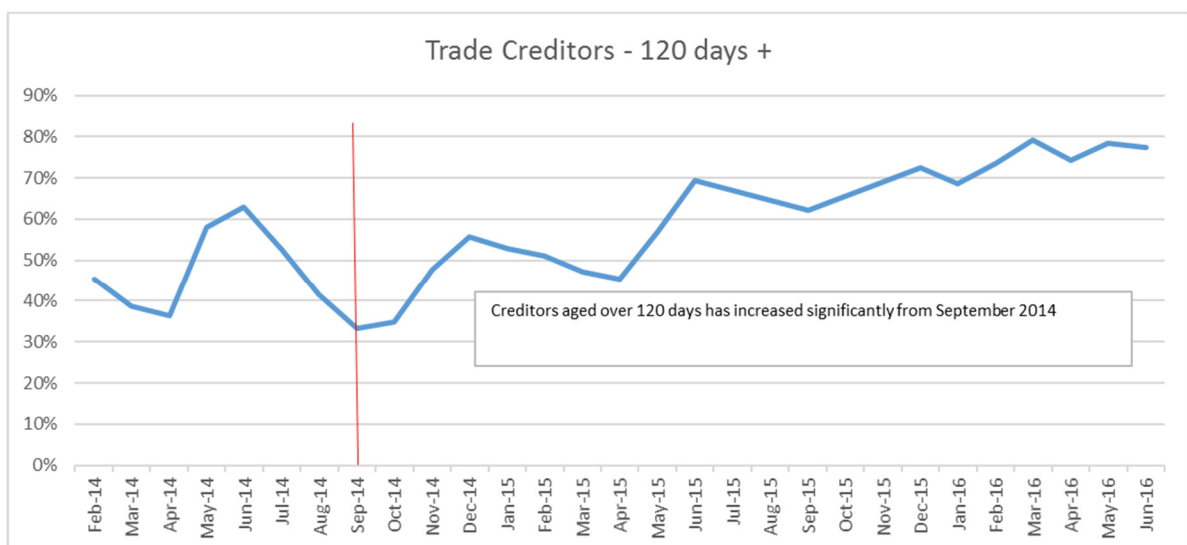
### Gordon Smith Marketing

Gordon Smith Marketing - Aged trade creditor balance											
Date	Total	Current	%	30 days	%	60 days	%	90 Days	%	120 Days +	%
Mar-14	5,428,600	460,366	8%	1,420,343	26%	1,152,898	21%	291,852	5%	2,103,141	39%
Apr-14	4,667,294	399,915	9%	403,837	9%	1,087,302	23%	1,075,341	23%	1,701,098	36%
May-14	4,208,909	246,120	6%	230,556	5%	355,564	8%	933,178	22%	2,443,491	58%
Jun-14	5,109,148	1,117,259	22%	231,772	5%	213,996	4%	329,121	6%	3,217,000	63%
Sep-14	5,762,542	993,433	17%	1,047,671	18%	1,067,082	19%	738,185	13%	1,916,171	33%
Dec-14	5,004,954	484,288	10%	405,720	8%	868,794	17%	457,846	9%	2,788,305	56%
Mar-15	5,827,460	845,089	15%	1,296,010	22%	722,906	12%	207,488	4%	2,755,967	47%
Apr-15	5,325,002	2,610,100	49%	813,619	15%	1,189,853	22%	644,168	12%	2,416,262	45%
May-15	5,128,255	229,671	4%	208,995	4%	652,770	13%	1,109,389	22%	2,927,430	57%
Jun-15	5,549,709	672,420	12%	223,697	4%	161,949	3%	643,805	12%	3,847,838	69%
Sep-15	6,507,160	707,094	11%	1,048,785	16%	398,267	6%	307,501	5%	4,045,514	62%
Dec-15	6,002,706	201,561	3%	497,818	8%	566,634	9%	386,646	6%	4,350,046	72%
Jan-16	6,458,671	976,917	15%	137,108	2%	418,252	6%	497,002	8%	4,429,392	69%
Feb-16	6,635,909	802,950	12%	485,231	7%	65,743	1%	404,053	6%	4,877,932	74%
Mar-16	6,450,304	532,498	8%	509,215	8%	258,600	4%	44,820	1%	5,105,171	79%
Apr-16	6,732,475	774,874	12%	545,538	8%	290,541	4%	124,972	2%	4,996,550	74%
May-16	6,462,209	76,988	1%	423,995	7%	637,374	10%	258,046	4%	5,065,807	78%
Jun-16	7,663,047	610,008	8%	75,776	1%	417,482	5%	623,403	8%	5,936,378	77%

I make the following comments in relation to Gordon Smith Marketing's trade creditors ageing:

- Total creditors have increased by \$3.4 million or 82% from the low point in the review period of May 2014 to Jun 2016.
- Current creditors have remained reasonably consistent evidencing the company's inability to purchase stock in the lead up to the administration.
- Creditor ageing has increased significantly over the review period with creditors outstanding over 120 days increasing from 33% in September 2014 to 77% in June 2016.

The graph below, highlights the significant increase in the ageing of the Gordon Smith Marketing ledger:



From the above analysis it is apparent that creditors greater than 120 days increases significantly from September 2014 where they represent 33% of total creditors to 77% of total creditors at date of appointment.

Detailed below is the ageing for Rodney Clark:

Rodney Clark Aged creditor balance										
Date	Total	Current	%	30 days	%	60 days	%	90 Days	%	Unallocated Credits
Jun-11	170,051	56,149	33%	41,076	24%	66,656	39%	23,065	14%	-16,895
Jun-12	187,680	70,344	37%	80,014	43%	43,533	23%	54,161	29%	-60,372
Jun-13	271,191	104,423	39%	154,056	57%	101,194	37%	346,920	128%	-435,402
Jun-14	517,445	209,658	41%	27,677	5%	159,901	31%	132,384	26%	-12,175
Jun-15	159,409	53,539	34%	10,110	6%	54,143	34%	107,517	67%	-65,900
Jun-16	156,401	60,384	39%	104,143	67%	25,044	16%	31,642	20%	-64,815

The Rodney Clark creditors have typically averaged around the \$150,000 to \$300,000 mark with ageing fairly consistent across the review period. The exceptions to this is June 2013 where a large portion of the ledger was over 90 days and again at the date of appointment.

At any point in time the ledger has a large amount of unallocated credits which makes a review of ageing problematic. I am advised the unallocated credits are credit notes which have not been taken up in a payment/allocated to an invoice, or payments that have not been applied to invoices.

This is further evidence of the books and records of the Companies not accurately reflecting the true position of the creditors ledger. Additionally, in the case of Rodney Clark the unallocated credits may represent 'round sum' payments made which are not paying specific invoices and accordingly evidence of one of the indicators of insolvent trading.

#### Creditor Mix

The table below highlights the major creditors make up within the Gordon Smith Marketing ledger and the movement in debt over the review period FY 2012 to FY 2016:

Gordon Smith Marketing									Total Majors		
Trade Creditor mix based on company records AUD\$											
	Total	SSH	%	YQ&LZ	%	ETI	%	Ryan	%	\$	%
Sep-13	5,756,169	2,807,681	49%	201,643	7%	1,422,755	25%	472,380	8%	4,904,459	85%
Jun-14	5,109,148	3,051,634	60%	232,971	8%	1,037,219	20%	225,105	4%	4,546,929	89%
Jun-15	5,549,709	2,191,421	39%	799,593	36%	1,388,812	25%	293,470	5%	4,673,296	84%
Jun-16	7,663,047	4,100,000	54%	846,261	21%	1,667,114	22%	132,931	2%	6,746,306	88%
Movement	1,906,878	1,292,319		644,618		244,359		- 339,449			

I make the following comments in relation to the above:

- The Chinese suppliers SSH, YQ&LZ and ETI make up the majority of the Company's creditors (88% 27 June 2016).
- SSH and ETI have had a large outstanding debt position for an extended period (SSH increased 46% & ETI increased 17% since September 2013) indicating that they were prepared to advance significant credit to the company for an extended period of time.
- While YQ&LZ have seen a significant increase in their debt (319% since September 2013), Ryan International has had a significant reduction (72% since September 2013)

### *Movement in debt of key supplier in the twelve months prior to administration*

A summary of the movement in the key Chinese suppliers and the major transport supplier (Ryan Transport) over the twelve months leading up to the appointment of an administrator (based on Gordon Smith Marketing's internal records) is summarised below (note in US\$ except Ryan):

	SSH	ETI	YQ&LZ	SAINTY	RYAN
	US\$000's				AUD\$000's
<b>Balance 30 June 2015</b>	<b>1,785</b>	<b>1,108</b>	<b>637</b>	<b>38</b>	<b>293</b>
<i>Movement FY 2016</i>					
Purchases	2,416	607	557	565	774
Payments	1,597	432	526	564	931
<b>Net Movement</b>	<b>820</b>	<b>174</b>	<b>32</b>	<b>1</b>	<b>(156)</b>
<b>Balance 30 June 2016</b>	<b>2,605</b>	<b>1,282</b>	<b>669</b>	<b>39</b>	<b>137</b>

In all cases (with the exception of Ryan) the suppliers' debt has continued to grow as current purchases have not been paid for and the contribution to old debt has been minimal or non-existent.

### *Payment Arrangements*

I am advised by management (although I have not found any evidence to support arrangements) that in June 2015, Gordon Smith Marketing entered into an arrangement with the major Chinese suppliers on a best endeavours basis to freeze a portion of their debt and pay future deliveries based on number of days from Bill of Lading. This involved the following suppliers:

Creditor	Debt Frozen \$AUD	Agreed Payment for future deliveries
ETI	1,580,107	45 Days from Bill of Lading
SSH Textiles	1,651,246	60 Days from Bill of Lading
YQ & LZ	863,287	45 Days from Bill of Lading
<b>Total</b>	<b>4,094,640</b>	

### *Letters of Demand*

A review of the Companies' accounts payable files disclosed that the Companies started receiving letters of demand from creditors from June 2016.

My investigations have disclosed the following correspondence:

- On the 14 June 2016 Gordon Smith Marketing received a formal legal demand letter from Boyle and Associates in relation to an outstanding debt of US\$647,010 owing to YQ & LZ. The demand sought the immediate payment of \$30,000 for a current fabric order and a repayment plan of \$60,000 per month.
- A letter from the ATO dated 18 June 2016 notifying Rodney Clark of their intention to commence debt recovery action.
- On the 18 June 2016 the ATO issued a garnishee notice against Gordon Smith Marketing.
- On the 19 June Hunter Express issued a Final Demand Notice to Gordon Smith Marketing claiming \$38.99

- On 20 June Mr. Boyle wrote again regarding his proposal in relation to the debt owed to YQ & LZ and stated that if arrangements were not put in place by 24 June 2016 a statutory demand for payment would be issued.
- On the 21 June 2016, SSH Textiles issued a letter of demand seeking payment of US\$3,082,092.33 and reserving their right to issue legal proceedings within 7 days.

Having regard to the above it is clear that the Companies' creditors have continued to grow since a low point in May 2014. The majority of creditors' claims relate to Chinese suppliers and logistics providers.

The two major suppliers, SSH Textiles and ETI, have been significant supporters of Gordon Smith Marketing allowing the company to maintain a high outstanding creditor balance for an extended period of time.

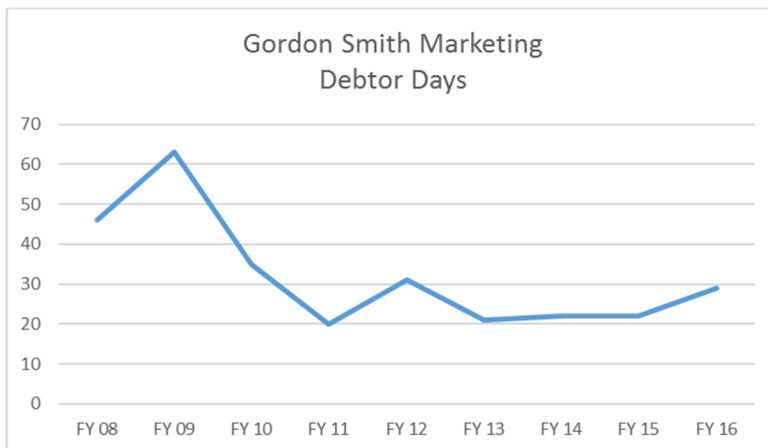
It appears these suppliers became dissatisfied with the level of their exposure about June 2015 which led to the implementation of a standstill and payment plan arrangements. Notwithstanding this they continued to supply during FY 2016 (with the exception of Summer 2016) despite further increases in indebtedness.

#### *Debtor and Creditor Days outstanding*

##### *Debtor Days*

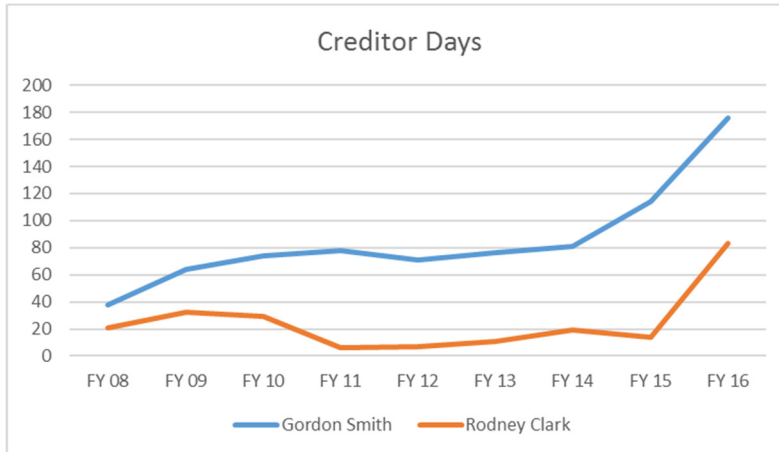
Rodney Clark has minimal trade debtors; accordingly, debtor days is not relevant.

Detailed below is a summary of debtor days for Gordon Smith Marketing:



Gordon Smith Marketing appears to have had difficulty collecting its debtors back in FY 2009, however until a spike during FY 2015, they have a good record of collecting their trade debtors.

### Creditor Days



Creditor days for both Companies have deteriorated significantly, particularly from FY 2015 through to the date of the appointment of administrator.

### Overdue Commonwealth and State taxes

#### ATO

Rodney Clark entered into two recent payment arrangements with the ATO as follows:

Arrangement Date	Amount Outstanding \$	Monthly Payment \$	Period of arrangement
10 April 2015	199,356	15,000	April 2015 to July 2015
30 April 2016	194,320	12,500	April 2016 to Aug 2016

The ATO has submitted a proof of debt in relation to amounts owed as at the appointment date as follows:

- Gordon Smith Marketing - \$255,812 in respect to BAS running account
- Rodney Clark - \$217,042 in respect to BAS running account.

The Companies' records disclose that the following amounts are outstanding in relation to Superannuation:

Company	Period	Amount Outstanding \$
Gordon Smith Marketing	March & June Qtr 2016	92,793
Rodney Clark	March & June Qtr 2016	62,963
<b>Total Outstanding</b>		<b>155,756</b>

### Payroll Tax

Payroll tax outstanding is as follows:

State	Company	Amount \$	Notes
NSW	Gordon Smith Marketing	56,618	Proof of debt received covering period Feb to Jun 2016
NSW	Rodney Clark	19,625	Proof of debt received covering period Nov 2015 to Jun 2016
QLD	Rodney Clark	28,816	Proof of debt received covering July 2015 to Jun 2016

### Use of Credit Cards

Gordon Smith Marketing had a corporate American Express credit card which had been used to make creditor payments. The use of credit cards for supplier payments appears to have commenced in February 2014 and has escalated during FY 2015 and FY 2016.

A summary of the use of the card to pay major creditors is set out below:

Gordon Smith Marketing Credit Card Payments to suppliers									
Total Payments \$	Ryan	ATO	SHH	Major Supplier Payments \$					
	ETI	Sainty	YQ&LZ	Dolina	Toll				
FY 2014	179,280	112,365							
FY 2015	971,216	300,280		399,893	26,667	72,699	72,307		22,575
FY 2016	2,211,612	318,925	802,642	841,235				45,250	32,959
	3,362,108	731,570	802,642	1,241,128	26,667	72,699	72,307	45,250	55,533

The majority of the payments made in FY 2016 were in the first half of the financial year (\$1.4m) In the six months leading up to the administration approximately \$770,000 was paid to suppliers and the ATO on credit card.

### Limit on Finance Facilities

As noted previously the major financier to the group is the Nab.

Following Rodney Clark's significant loss in FY 2009 of \$1.9 million the Nab engaged McGrath Nicol to conduct an Independent Business Review in October 2009.

I have been provided with a copy of McGrath Nicol's draft report dated 23 October 2009 which noted the following:

- The group is experiencing cash flow pressures
- Headroom of only \$6,000 in its \$500,000 overdraft facility
- Headroom of only \$44,000 in its \$3.5 million trade finance facility
- Creditor and Debtors within reasonable ageing with majority under 90 days
- ATO up to date but penalties due to late payment
- Debtors ledger does not accurately reflect ageing due to untimely recording of rebates and invoice date compared to goods dispatched.

McGrath Nicol again conducted a review following the end of the 30 June 2010 quarter. I have sighted a draft copy of their report dated 3 August 2010. The report noted the following:

- Group continues to be under cash flow pressure
- Group has remained within its overdraft limit of \$750,000 but at the expense of creditors with ageing greater than 120 days increasing by \$1 million
- Gordon Smith up to date with ATO, Rodney Clark has entered into a payment arrangement
- Payment plan in place with three major creditors totalling \$1.7 million
- Total creditors \$4.9 million with \$1.6 million greater than 90 days

Based on the above it is clear that during FY 2010 and early FY 2011 the group was experiencing cash flow difficulties as a result of the large loss in FY 2009. This was a concern to the Nab prompting the McGrath Nicol review.

I am advised by the Director (although I have not sighted any correspondence) that from this point on the Nab monitored performance closely and placed pressure on the group to close retail outlets and sell property to reduce debt.

A summary of the movement in finance facilities provided by Nab is detailed below:

	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016
	\$000's	\$000's	\$000's	\$000's	\$000's	\$000's	\$000's	\$000's
<b><i>Gordon Smith Marketing</i></b>								
Overdraft	539	703	695	428	500	482	253	2
NDF Facility	3,448	324	415	565	514	769	824	549
Trade Finance	3,480	2,096	-	-	-	-	-	-
Commercial Bill	1,865	500	1,950	2,200	2,000	-	-	-
Koolabah Commercial Bill	1,435	1,345	1,345	1,345	1,345	1,325	1,085	-
<b>Total Gordon Smith</b>	<b>10,767</b>	<b>4,968</b>	<b>4,404</b>	<b>4,538</b>	<b>4,359</b>	<b>2,576</b>	<b>2,162</b>	<b>551</b>
<b><i>Rodney Clark</i></b>								
Overdraft	-	-	-	-	-	-	-	-
Asset Purchase Loan	720	556	376	180	7	7	-	-
<b>Total Rodney Clark</b>	<b>720</b>	<b>556</b>	<b>376</b>	<b>180</b>	<b>7</b>	<b>7</b>	<b>-</b>	<b>-</b>
<b>Total Bank Debt - Nab</b>	<b>11,487</b>	<b>5,524</b>	<b>4,780</b>	<b>4,718</b>	<b>4,366</b>	<b>2,582</b>	<b>2,162</b>	<b>551</b>
Reduction per period		5,964	743	62	352	1,784	421	1,611
Cumulative reduction		5,964	6,707	6,769	7,121	8,905	9,326	10,936

The reduction in the debt owed to Nab over the review period has predominately been funded by contributions from the Director and the sale of property owned by the Director as follows:

<b>Debt Reduction Funded as Follows:</b>	
<b>Source of funds</b>	<b>Amount \$</b>
Sale of Bangalow Property	1,175
Sale of Birmingham Property	879
Sale of McEvoy Property	2,565
Life Insurance payout	561
Gordon Smith Superannuation fund	2,425
Advances by Gordon Smith	870
Assumed by Gordon Smith Personally	1,200
<b>Total Debt Reduction</b>	<b>9,675</b>

My investigations show that following the Nab's review in 2009 it has maintained pressure on the Companies to reduce debt. Although I have not sighted detailed correspondence to confirm this, my review indicates the Nab was monitoring the Companies closely with formal quarterly reviews undertaken.

The Nab's facilities' limits were reduced over time as follows:

- In 2007 the NDF Limit was \$4m, however the Nab allowed a temporary increase to \$6m
- FY 2010 – the RC NDF facility was removed reducing the facility to \$5m
- FY 2011 –the temporary limit increase was removed and the limit reduced by \$1m back to \$4m.
- FY 2012 – Further reduction in NDF facility of \$500k reducing the limit to \$3.5m
- FY 2013 – Further reduction of \$500k to \$3m
- FY 2014 – Further reduction of \$500k to \$2.5m
- FY 2015 - \$250k reduction in overdraft limit from \$500k to \$250k

Having regard to the above it appears the group did not have access to additional funding from the Nab.

In addition to the facilities provided by Nab the Companies had a number of motor vehicle leases (refer section 3.1.4 of this Report) along with a Commercial Loan Agreement with Westpac in the sum of \$150,000 relating to warehouse and office fit out at head office.

My investigations to date have not identified any breaches of Nab covenants nor non-payment of finance commitments.

#### *Access to additional Sources of Funding*

##### *Available liquidity within existing facilities*

My investigations to date indicate that the Companies had access to the following sources of liquidity in the 12 months prior to my appointment:

Sources of Liquidity - 12 months prior to appointment												
	Jul-15	Aug-15	Sep-15	Oct-15	Nov-15	Dec-15	Jan-16	Feb-16	Mar-16	Apr-16	May-16	Jun-16
	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
Nab Overdraft	79,040	46,731	113,735	228,420	62,187	84,032	-	105,017	24,062	21,938	1,646	-
Nab NDF Facility	779,862	-	-	-	20,076	1,060,160	1,329,263	862,515	487,025	202,010	1,064,740	1,725,478
Amex - credit card	15,054	-	2,607	6,346	6,912	5,678	459	5,855	15,104	150,021	140,879	150,309
<b>Liquidity Available</b>	<b>873,956</b>	<b>46,731</b>	<b>116,342</b>	<b>234,766</b>	<b>89,175</b>	<b>1,149,871</b>	<b>1,329,722</b>	<b>973,387</b>	<b>526,191</b>	<b>373,969</b>	<b>1,207,264</b>	<b>1,875,787</b>

To be able to realise the headroom in the NDF facility it is likely Gordon Smith Marketing needed to make additional sales which given recent history of falling sales and lack of product in the lead up to the administration this was unlikely.

In any case, the level of liquidity available would not have been sufficient to clear creditors that were due and payable.

##### *External Funding Available*

In early 2016 the Director entered into dialogue with Scottish Pacific regarding a refinance of the Groups banking facilities.

Scottish Pacific in correspondence provided to the Director confirmed their approval subject to credit review to provide the following facilities:

Scottish Pacific Facilities	Indicative Approval \$000's
Debtor Finance Facility	3,500
Import Finance Facility	500
Trade Finance Facility	500
<b>Total Facilities</b>	<b>4,500</b>

A preliminary review of the offer letters indicates that the terms were not onerous and no worse than current Nab facilities.

If accepted, the facilities would have provided the group with the following facility limits over and above what Nab was providing:

- Extra \$1m on debtor finance facility
- Extra \$1m in additional trade finance over and above Nab

As the approval was subject to bank credit approval, it is unclear if these funds would ultimately have been available. In any event, the additional funds would not have been sufficient to re-capitalise the Companies on a long-term basis.

#### *Director Contributions*

The Director has a history of injecting funds into the business when required via unsecured loans.

Advances by the Director have been through his loan account. As noted previously the loan account has effectively been used as a clearing account with a multitude of debits, credits and journal entries. However, it is clear that the Director has advanced funds and assumed part of the Companies' debt approximating \$9.7 million over the period FY 2009 to FY 2016. Notwithstanding, the Director has also withdrawn significant amounts through the loan account resulting in a net movement (excluding Osterley Limited) of approximately \$664k resulting in a net balance owed to him of approximately \$444k.

Additionally, I have been provided with a personal statement of assets and liabilities which indicates the Director had the capacity to advance further funds. As noted previously, in early 2016 the Director formed the view that he could no longer continue to support the business to the level required to rectify the solvency of the Companies and sought alternatives. These included a sale of the businesses, debt for equity swap and exploring re-finance options. Ultimately, forming a view that a sale was the best option.

#### *Disposal of Non-Core Assets*

The only non-core asset available to the Companies to free up liquidity was the Koolabah Farm. This farm is held within the Trust and could have been realised to free up capital for the businesses. A valuation of the property dated 7 January 2016 by Opteon Property Group determined the property had a value of \$1.89 million. Direct borrowings against this property at the time were \$1.08 million resulting in potential equity of \$890,000. However, the Trust only owns 89% of the property with the other 11% owned by the Director's sister. Accordingly, the Trust's share of the equity is \$792,100. Additionally, the bank held security over this property securing total Group borrowings.

Accordingly, it is questionable as to whether equity could be realised given the sister's interest and additionally if the Nab would have allowed this equity to be injected into the business.

#### *Special payments with selected creditors/payments to creditors of rounded sums which are not reconcilable to specific invoices*

My preliminary investigations revealed a number of round sum payments to creditors. In particular in the period from March 2015 onwards.

#### 8.1.4 Preliminary findings

As noted previously in assessing the solvency of the Companies I have conducted these preliminary investigations on a Group basis given the inter-dependency of the Companies operations. Accordingly, my preliminary investigations indicate that the Group may have become insolvent sometime between May 2014 and September 2014 where there was a significant increase in trade creditor amounts outstanding along with an increase in the ageing of the debt evidencing cashflow difficulties and an inability to pay debts as and when they fell due. This situation continued through to the 27 June 2016 when the administrator was appointed indicating the Group was insolvent throughout this period.

It is noted, however that it appears the major creditors continued to support the Companies and it was not until just prior to Administration that supply was tightened and letters of demand issued.

The increase in trade creditor debt from May 2014 and September 2014 through to the 27 June 2016, based on the Companies' records is as follows:

Group	
Increase in trade creditor debt	\$000's
May 2014 to 27 June 2016	3,454
September 2014 to 27 June 2016	1,901

Should a liquidator be appointed further investigations will be undertaken into the Companies' solvency.

I advise that in order for an insolvent trading action to be initiated a solvency report would need to be prepared and ultimately court proceedings undertaken. This is a costly exercise.

If any creditors are in possession of any documentary evidence that would suggest that the Director continued to incur debt when the Company was unable to pay its debts as and when they fell due, they should forward such evidence to my office as soon as practicable.

Considering the possible range of the identified insolvent trading claim, the need for further investigations, the preparation of an insolvency report and the fact that the claim will require litigation which is likely to be defended it is difficult to quantify what/if anything may be available to creditors from an insolvent trading claim. However, to provide creditors with an estimate of possible recoveries, based on my experience a claim of this nature may result in recoveries of \$2m.

#### 8.1.5 Directors' liability for insolvent trading

Section 588G of the Act imposes a positive duty upon company directors to prevent insolvent trading. If a director is found guilty of an offence in contravening Section 588G, the Court may order him or her to pay compensation to the company equal to the amount of loss or damage suffered by its creditors.

The Courts may also impose upon the directors one of two types of civil penalty orders, the first can include a fine or an order prohibiting the director from participating in the management of a company. The second, where there is criminal intent and conviction, a director could also be imprisoned for up to five years. This action is not a right that is available to an administrator or a deed administrator.

Applications for compensation payable to a company are usually made by a liquidator, or in specific circumstances, a creditor.

The substantive elements of Section 588G of the Act are:

- A person must be a director of a company at a time when the company incurs a debt;
- The company must be insolvent at the time or becomes insolvent by incurring the debt; and
- The director was aware of, or a reasonable person in a similar position within a similar company would have been aware of, reasonable grounds for suspecting that the company is insolvent or would become insolvent.

The defences available to directors contained in Section 588H of the Act are:

- The directors had reasonable grounds at the time the debt was incurred to expect the company was solvent and would remain solvent even after the debt was incurred;
- The directors relied on another competent and reliable person to provide information about whether or not the company was insolvent;
- The directors were ill or for some other good reason did not take part in the management of the company; and
- The directors took all reasonable steps to prevent the incurring of debt.

A liquidator must form an opinion as to the date of insolvency and determine the debts incurred from that date; thereby quantifying the loss to the company.

Notwithstanding, prima facie there appears to be a claim against the Director for Insolvent trading, the following factors need to be taken into consideration prior to the commencement of any proceedings:

- Defences available to the Director;
- The costs of proceeding with an insolvent trading action must be considered; and
- The capacity of the Director to meet any claim.

I comment on these factors below:

### 8.1.6 Defences available

My preliminary investigations indicate that any defences to insolvent trading would be difficult for the Director to rely upon because:

- the potential re-financing of the Group's Nab facilities and the attempted debt for equity swap with the major supplier, SSH Textiles, was only pursued in early 2016 – while the Group may have been insolvent from May / September 2014;
- the presentation of management accounts incorrectly reported the financial position of the Companies through inter-company transactions, delayed processing of rebates and manipulation of foreign exchange rates masks the true position of the Companies;
- the Director was at all times from 2014 taking part in the management of the Group;
- from May 2014 to the 27 June 2016 there was an increase in trade creditor debt of \$3.4m (but likely to be significantly higher), which indicates there was no monitoring of debt incurrence or steps taken to mitigate trading while insolvent;
- from FY 2014, Gordon Smith Marketing used its corporate credit card to pay over \$3m in ATO payments and supplier debt, while it continued to incur trade debts;
- the Companies paid Nab in priority to trade creditors over several years;
- notwithstanding, the Director advanced c \$9.7m (\$8.5m cash & \$1.2m assumed debt) to the Companies between 2009 and 2016:
  - this funding was not formerly available to the Group and was inconsistently advanced by the Director;
  - the existence of the ATO payment plan and increase in trade creditors from 2014 indicates that these funds were not sufficient to establish solvent trading; and
  - an estimated further \$4m - \$5m in funds would have to have been advanced by the Director from 2014 to maintain the Group's solvency; and
  - if the Companies were only able to continue to trade by receiving continual Director loans, this can be an indicator of insolvency.

The above factors indicate that the Director was acutely aware of the above indicia of insolvency but continued to trade the Companies and incur debts. Accordingly, it is unlikely the Director can rely on the defences under section 588H of the Act, because:

- the circumstances indicate that the Director did not have reasonable grounds at the times debt was incurred post May / September 2014 to expect the company was solvent;
- there is no indication, until near the time of the administration, that the Director sought or relied on another competent and reliable person to provide information about whether or not the company was insolvent;
- the Director was not ill and took part in the management of the Companies at all times from 2014; and
- the Director did not take all reasonable steps to prevent the incurring of debt.

However, as noted above, my opinion as to the recoverability of any insolvent trading liabilities of the Director is subject to a liquidator forming a conclusive view as to the recoverability of this cause of action, including conducting further investigations, assessing the costs of pursuing a claim and determining the date of insolvency. My investigations show that the Director was aware of the Companies' financial difficulties and was active in trying to resolve these issues from early 2016 (possibly earlier). This will also inform a liquidator's assessment of insolvent trading causes of action and potential recoverability.

Following is a summary of the actions the Director took in around late 2015 and early 2016. It is likely these are the facts the Director will rely on in defending any insolvent trading claim that a liquidator may bring against him should one be appointed.

#### *Cash advances*

During the period 2009 to 2016 the Director injected significant funding (vicinity of \$9m) into the business from personal resources and properties owned outside the Group. The problem for creditors has been that the Nab was aggressively seeking debt reduction during this period and the majority of these funds have gone to reduce secured creditor debt. As previously stated, this has benefited the Director through a reduction in his exposure to the Nab debt under his personal guarantees and has been insufficient to remedy the solvency position of the Companies.

#### *Sale of Business*

In November 2015, the Director was approached by Charles Parsons, a company with whom the Director had a strong relationship, to ascertain if he would be interested in selling the businesses. Given the Companies financial difficulties the Director was open to a sale as a way of re-capitalising the Companies. Discussions ensued through December and January with Charles Parsons undertaking preliminary due diligence. However, following their due diligence Charles Parsons withdraw from negotiations. The Director believes a contributing factor was the large debt the Companies were carrying.

As noted at Section 6 of this Report the Director engaged external advisors in March 2016 to conduct a marketing campaign to ascertain if there was a buyer for the businesses. This ultimately resulted in the Purchaser entering into contracts prior to my appointment as administrator.

#### *Debt for Equity Swap*

Following the failure of negotiations to sell the businesses to Charles Parsons the Director put a detailed proposal to SSH Textiles in early 2016 to convert a portion of their debt to equity.

The deal involved establishing a new entity and rolling the Gordon Smith Marketing business into this entity with a valuation of \$5 million.

One hundred shares were to be issued with a face value of \$50,000 and the equity was to comprise:

<b>Party</b>	<b>Equity %</b>	<b>Face Value \$000's</b>
Gordon Smith	50	2,500
SSH Textiles	40	2,000
Kim Hancock	10	500
<b>Total</b>	<b>100</b>	<b>5,000</b>

I am advised that Ms Hancock was to receive shares in the new structure due to the following:

- consideration for outstanding bonuses owed to her in the sum of \$98,000; and
- a request from SSH Textiles that Ms Hancock have equity.

#### *Re-Finance*

As noted above, in early 2016 the Director entered into dialogue with Scottish Pacific regarding a refinance of the groups banking facilities.

Scottish Pacific in correspondence provided to the Director confirmed their indicative approval to provide the facilities totalling \$4.5m.

At the time the Nab facilities were as follows:

- \$2.5 m Debtor facility
- \$250k Overdraft

These facilities were drawn to approximately \$800,000 (NDF \$550k & OD \$250K). Accordingly, the re-finance would have enabled additional funds to the Companies of approximately \$1.75m subject to the level of debtors.

#### 8.1.7 Cost of Insolvent Trading Action

Having regard to the difficulties highlighted previously with the financial information, it is likely a liquidator (if appointed) will need to undertake significant additional work in reconstructing financial information to determine the exact point of insolvency and the quantum of claims available on an individual company basis.

Additionally, given the businesses pending sale to the Purchaser access to accounting staff may not be readily available meaning the liquidator will be reliant on the source documents and books and records of the Companies.

As noted the Director has access to financial resources along with a management liability policy. Accordingly, any claim is likely to be defended, adding to the cost.

Having regard to these factors an insolvent trading claim is likely to be costly to run. Accordingly, notwithstanding my preliminary investigations indicate that an insolvent trading claim may be available to a liquidator and the claim may be (subject to further investigation) in the vicinity of \$2 m to \$3.5m the costs of running the action are likely to be significant resulting in realisations likely being significantly less than the gross claim of \$2m to \$3.5m.

#### 8.1.8 Director's Personal Financial Position and ability to meet a claim for Insolvent Trading

The financial position of Director and his ability to compensate for any damages awarded against him in the event proceedings are taken by a liquidator are relevant to the consideration of whether to commence further action.

I have requested a personal statement of assets and liabilities from the Director. The Director has provided a statement on a confidential basis that shows that he owns real property which has significant value after taking into account related mortgages.

A summary of the property holding based on a land title search is summarised below:

Location	Title ref	Notes
Molong	33/750141 & 34/750141	Rural property
Lidster (Pinelder)	3/572882	Rural property
Lidster (Koolabah)	3/566293	Rural property
Palm Beach	1/1123319	Residential
Clareville	11/13760	Residential

These properties reflect those listed in his statement of assets and liabilities.

This discloses that the Director potentially has the capacity (via equity in the properties) to meet the quantum of the estimated Insolvent Trading claim.

Additionally, at the date of my appointment the Companies held a Management Liability policy which provides cover in relation to a range of liabilities up to a value of \$5m. My brokers have advised that the policy does extend to cover Insolvent Trading.

## 8.2 ADEQUACY OF BOOKS AND RECORDS

Pursuant to Section 286 of the Act, companies are required to maintain financial records which correctly record and explain its transactions, financial position and performance that would enable true and fair financial statements to be prepared and audited.

Based on the books and records of the Companies provided to me, I believe that each of the Companies maintained adequate books and records pursuant to Section 286 of the Act.

## 8.3 VOIDABLE TRANSACTIONS

In the event that a company is wound up, certain transactions that occurred prior to the date of appointment where a company's property is disposed of or otherwise dealt with may be voidable pursuant to Part 5.7B of the Act. These are known as voidable transactions and may result in a requirement for a third party to return property to a company and thereby increase the assets available to a liquidator, if one is appointed.

Should the Companies be placed into liquidation further investigations would be required in order to determine whether the transactions identified during my preliminary investigations and set out below are voidable transactions that would potentially be causes of action available to a liquidator. I provide my initial findings in relation to:

- Unfair preference payments at Section 8.3.1.
- Uncommercial transactions at Section 8.3.2.
- Unfair loans at Section 8.3.3.
- Unreasonable director-related transactions at Section 8.3.4.
- Voidable circulating security interests at Section 8.3.5.
- Transactions for purpose of defeating creditors at Section 8.3.6.

### 8.3.1 Unfair preference payments

An unfair preference payment is a transaction, generally occurring in the six (6) months prior to the appointment of the liquidator (the date of the appointment of the liquidator is deemed by the Act

as the date of the appointment of the administrator) to which the company and a creditor were parties, that results in the creditor receiving more for its debt than it would if the transaction was set aside and that creditor had to prove for their debt in the winding up of the company like all other creditors.

It should be noted that a transaction can only be an unfair preference if the company was insolvent at the time the transaction took place or that the company became insolvent as a result of the transaction. It should also be noted that the period for recovering unfair preference payments is generally six (6) months prior to the relation back day. In this instance, this is the period from 28 December 2015 to 27 June 2016 ('the relation-back period'). The period is extended up to four (4) years for transactions entered into with a related entity.

If a payment by a company is proven to be an unfair preference, the relevant creditor must return the benefit they received to the liquidator and it is then available for the benefit of all creditors.

I have undertaken preliminary investigations into potential unfair preference payments including the following tasks:

- Review of correspondence with creditors.
- Review of accounting records.
- Review of bank statements for the last 6 months.

Based on my preliminary investigations I have identified the following payments to creditors in the six-month relation back period that may be preferential in nature:

<b>Gordon Smith Marketing Potential Preference Payments</b>		
<b>Category</b>	<b>No. Payments</b>	<b>Amount \$</b>
Trade Creditors	17	232,435
ATO	6	381,670
Overseas Suppliers	16	1,246,667
Related Parties	4	27,000
<b>Total</b>	<b>43</b>	<b>1,887,772</b>

<b>Rodney Clark Potential Preference Payments</b>		
<b>Category</b>	<b>No. Payments</b>	<b>Amount \$</b>
Trade Creditors	71	303,200
ATO	9	37,500
Related Parties	4	150,000
<b>Total</b>	<b>84</b>	<b>490,700</b>

In addition to the above, there are a number of payments between the Companies in the relevant period. I have excluded these as all Companies are in administration. Also, as noted previously in relation the Director's loan account there was a debit movement in the balance of this account in the years FY 2015 and FY 2016 totalling \$1.215 million which would require further investigation by a liquidator, should one be appointed and may be preferential in nature (refer below under the heading '*unreasonable director related transactions*').

Creditors should be reminded that the recoverability of any potential unfair preference payments is subject to significant further investigations and there is no guarantee that a liquidator will recover any funds.

In particular I note that the recoverability of potential preference payments made to overseas creditors may be difficult given international boundaries and different legal system.

It is also important to note that if any amount is recoverable from a creditor as a preference, that creditor will have a claim against the relevant company for an equivalent amount in the liquidation.

A liquidator will also consider the following recoverability matters before commencing recovery proceedings:

- If a creditor has the ability to satisfy a successful claim; and
- The costs of pursuing voidable transactions can be considerable and may outweigh the benefit to creditors in some circumstances.

The recoverability of these payments is subject to final determination of the date of insolvency. I note that creditors can seek protection available under the Act, including the running account defence (Section 588FA(3) of the Act) and for payments received in good faith with no reasonable grounds for suspecting insolvency at the time of payments (section 588FG of the Act).

I estimate potential recovery from unfair preferences on a high case scenario may result in realisations of approximately \$400,000 having regard to the following:

- The aforementioned recovery issues;
- Recoveries against overseas creditors are unlikely to justify the commencement of proceedings due to the difficulty in enforcing judgements in foreign countries; and
- Preliminary evidence identified of creditor knowledge (or apparent reasonable suspicion) of the Companies' insolvency.

### 8.3.2 Uncommercial transactions

A transaction of a company is an uncommercial transaction if, and only if, it may be expected that a reasonable person in the company's circumstance would not have entered into the transaction having regard to the benefits and detriments to the company of entering into the transaction and the respective benefits to other parties. Further the transaction must have occurred at a time when the company was insolvent, or the company became insolvent as a result of entering into the transaction, and generally within two (2) years of the date of the commencement of the winding up.

It should also be noted that while the period for recovering uncommercial transactions payments is generally two (2) years, if the transaction is between the company and a related party, then payments can be recovered up to four (4) years before the appointment of a liquidator.

My preliminary investigations have identified certain transactions that warrant further investigation should a liquidator be appointed, these include:

- Koolabah Farm sale – potential recoveries \$192k plus
- Motor Vehicles transferred for no consideration– potential recovery \$9k
- Transfer of trade marks from GSM to PBB – potential recovery unknown
- Unreasonable Director transactions – potentially \$1.2m

I comment further on these below:

#### *Sale of the Koolabah Farm*

The Gordon Bruce Smith Family Trust held an 89% interest in a farm located at Lidster which is approximately 19km outside of Orange in NSW. The remaining 11% is held by the Director's sister Barbara Laird-Varley.

The farm has the following features:

- 229.75 Ha rural property
- Renovated 4 bedroom 1880's homestead
- Farm cottage 2 bedrooms
- Shearing shed
- Various farm buildings
- Cattle and sheep yards

On 16 June 2016, the Director transferred the trusts 89% ownership in the farm to himself. The transaction took place for valuable consideration as follows:

Items transferred	Value \$
89% Interest in the farm	1,690,000
Farm stock (sheep & cattle)	277,000
<b>Total Consideration</b>	<b>1,967,000</b>

The consideration was paid as follows:

Consideration	Value paid \$
Cash paid to Gordon Smith Marketing	575,000
Assumption of Nab Commercial Bill	1,200,000
<b>Consideration paid at Administration</b>	<b>1,775,000</b>
Balance remaining to be paid	192,000
<b>Total Consideration</b>	<b>1,967,000</b>

I have written to the Director seeking payment of the \$192,000 owed on the transaction. The Director has acknowledged he owes the amount and has stated he will pay the sum following settlement of the sale of his Palm Beach house due in October 2016. This \$192,000 will be available for distribution to creditors under a DOCA and in liquidation.

The farm was recorded in the management accounts as at May 2016 (not in June due to sale) as follows:

Balance Sheet - Farm	Value \$
Land and Buildings	1,961,007
Equipment & Furniture	140,000
Stock	215,014
<b>Value per Management Account</b>	<b>2,316,021</b>

It is unclear as to whether the book value is the 89% interest the trust holds or the full value of the farm. In the June 2016 management accounts, the above assets have been removed from the balance sheet and there is no profit or loss on disposal recorded in the Gordon Smith Marketing's books.

The sale transaction was based on a valuation of the property conducted by Opteon Property Group dated 7 January 2016. I have been provided a copy of the valuation which notes that it was prepared for Stamp Duty purposes.

The valuation provides the following basis and value for the property:

Opteon Valuation		Value \$
Land Value	229.75 x \$5,045 per ha	1,158,937
<i>Improvements</i>		
Domestic		650,000
Farm		80,000
<b>Total Value</b>		<b>1,888,937</b>

Accordingly, the trusts interest of 89% is valued at \$1,681,154.

The Director has also provided me copies of two other valuations on the property as follows:

Additional Valuations	Date	Purpose	Value \$
Saunders & Stainiforth	4 May 2011	Family Law	1,700,000
Opteon	11 April 2014	Bank	1,850,000

In addition to the above, in assessing the reasonableness of the valuation prepared by Opteon dated 7 January 2016, I spoke with a local agent, Benchmark Commercial Rural and Lifestyle and provided them with a high level overview of the Opteon Valuation. Benchmark confirmed that the valuation was reasonable on a sight-unseen basis.

Accordingly, on the face of it, this transaction appears to have been for valid consideration. However, should a liquidator be appointed further investigations would be warranted as to whether the farm has a value over and above its pure land value.

#### *Trade Marks*

At the time of my appointment the majority of trade marks that relate to brand labels used by the Companies were owned by a related entity PBB. PBB was incorporated 4 November 2009. Its sole director, secretary and shareholder (1 x \$1.00 share) is Gordon Bruce Smith.

Attached as **Annexure E** is a summary of the trademarks I have been able to ascertain that are owned by the Companies and related parties.

The following trade marks were transferred from Gordon Smith Marketing to PBB between the period October 2011 and January 2012:

Trademark	Place of Registration	Trademark Reference	Date Registered	Expiry Date	Date of Assignment Application	Date of Assignment Registration
Hammock & Vine	Australia	1298050	06.05.2009	06.05.2019	22.12.2011	27.01.2012
La Vie the Life	Australia	1338054	21.12.2009	21.12.2019	22.12.2011	27.01.2012
Nouvelle Woman	Australia	1228156	04.03.2008	04.03.2018	22.12.2011	27.01.2012
Hammock & Vine	New Zealand	812517	06.05.2009	06.05.2019	18.01.2012	24.02.2012

I have been provided with a copy of a Deed of Assignment dated 17 October 2011 which notes that the four trade marks were assigned from Gordon Smith Marketing to PBB for the consideration of \$1.00. I make the following comments in relation to this assignment:

- Consideration paid was nominal and most likely below market value;
- Notwithstanding, the deed is dated in October 2011, the actual applications to assign do not seem to have been lodged until December 2011 and January 2012; and
- Although the Companies may not have been insolvent in late October 2011 and early 2012 it was at a time when the Nab was increasing monitoring.

For the transaction to be an uncommercial one it must have occurred within 2 years of the administration date or as this involves a related party being a company owned by the director the timeframe is extended to 4 years and if it was found to be for the intention of defeating creditors then the timeframe is extended to 10 years. The transaction must have also occurred at a time when the company was insolvent.

Having regard to the above if a liquidator was appointed they would need to prove the following to void the transaction as an uncommercial one:

- 1 The transaction was uncommercial;
- 2 Gordon Smith Marketing was insolvent at the time of the transfer; and
- 3 The intention of the transaction was to defeat creditors (as it occurred longer than 4 years prior to Administration).

Accordingly, a liquidator, if appointed, would need to conduct further investigations into the above.

Notwithstanding the above, I note that the above trademarks (along with others) are part of the Share Purchase Agreement entered into on 27 June 2016 between PBB and the Purchaser. Under the DOCA proposed by the Director he is making available to creditors of the Companies the net sale proceeds from that transaction. Accordingly, should creditors approve the DOCA they will share in the net proceeds the Purchaser is paying for the trademarks.

## Motor Vehicles

Prior to my appointment the following motor vehicles were transferred out of Gordon Smith Marketing for no consideration:

Vehicle Description	Year	Date Transferred	Notes
BMW 3 Series E-46	2000	15-Jun-16	Transferred to Director
Pegasus Horse Trailer Deluxe 2X45	2002	15-Jun-16	Transferred to Director
Mazda CX9	2010	02-Jun-16	Transferred to Kym Hancock

I make the following comments in regard to the transfers:

### *BMW*

- Recorded in the books and records in the FY2013 with a cost of \$13,182
- Written down value as at appointment \$1,112
- Sight unseen valuation from Hyman Auctioneers \$2k

### *Horse Trailer*

- Registered to the Gordon Smith Marketing but not recorded in the books and records
- Motor vehicle search indicates it was acquired in 2005 for \$11,000
- Sight unseen valuation from Hyman Auctioneers \$7k

### *Mazda CX9*

- Recorded in the books and records in the FY2013 with a cost of \$64,040
- Written down value as at appointment \$10,260
- Sight unseen valuation from Hyman Auctioneers \$18k
- The Director advised that this vehicle was given to Kim Hancock in lieu of bonuses owed. The Companies' records indicate Kim was owed \$98k in outstanding bonuses.

Should a liquidator be appointed further investigation into the value transferred and the reasonableness of the transfers will need to be investigated. However, based on my preliminary investigations the BMW and the Horse trailer are claims that are worthy of further investigation with a view to potential recovery by both a liquidator and a deed administrator. There are related party transactions which may not satisfy the 'benefits/detriment' test which applies to uncommercial transactions. Additionally, the amount owing from the farm sale of \$192,000 is recoverable as a debt due to the Companies. As noted a liquidator would need to review this transaction to assess if any other amounts may be recoverable.

### 8.3.3 Unfair loans

A loan is unfair if it is made to a company at an extortionate rate of interest or with extortionate charges.

My preliminary investigations have not disclosed any unfair loans made by the Companies.

Should the Companies be wound up, further investigations will be conducted. Should creditors hold any information with respect to any possible unfair loans to the Companies, please contact my office.

### 8.3.4 Unreasonable director-related transactions

A transaction of a company is an unreasonable director-related transaction if, and only if, the transaction is a payment, conveyance or other disposition by the company of property to a director or close associate of a director. Further it may be expected that a reasonable person in the company's circumstances would not have entered into the transaction having regards to the benefits (if any) and detriment to the company of entering into the transaction. The transaction must have been unreasonable, and entered into during the four (4) years leading up to a company's liquidation, regardless of the solvency at the time the transaction occurred.

I have undertaken a preliminary review of director-related transaction, including remuneration, bonuses, loans, loan forgiveness and asset transfers to company officers within the four (4) year period ending the relation-back day.

A summary of the movements in the Director's loan account is shown below:

Gordon Smith Loan Account				
Period	Movement		Net Movement	Balance
	DR	CR		
	\$	\$	\$	\$
	Opening Balance 1 July 2011			219,794
FY 2012	1,718,264	2,304,592	-586,328	-366,534
FY 2013	3,060,540	2,445,455	615,085	248,551
FY 2014	4,094,465	6,003,520	-1,909,055	-1,660,504
FY 2015	1,268,618	462,980	805,638	-854,866
FY 2016	1,083,145	672,924	410,221	-444,645
	<b>11,225,032</b>	<b>11,889,471</b>	<b>-664,439</b>	

The above excludes the Osterley Limited's Divisional 7A loan which has been sitting in the books at a debit balance of \$1,192,827 since before 2012. The external accountant has advised that this is capable of being cleared based on legal advice. Should a liquidator be appointed this transaction would need to be investigated further.

The loan account has effectively been used as a clearing account involving receipts and payments relating to related parties including the following:

- Home loan payments
- Insurance payments
- Credit card payments
- Tax payments
- Expense payments of Gordon Smith and other family members
- Payments to the Nab

In addition to the above there are a myriad of journal entries which impact the balance and are difficult to interpret. It is likely that if a liquidator is appointed he would need to conduct a reconstruction of this account from source documents to ascertain the true position. It should also be noted that the Director did not draw a salary and accordingly this needs to be taken into consideration.

Notwithstanding this, given the significant net debit movements in the two years prior to administration amounts may be recoverable by a liquidator should one be appointed.

Should the Companies be wound up, further investigations will be conducted with respect to any director-related transactions. Should creditors hold any information with respect to any possible unreasonable director-related transactions to the Companies, please contact my office.

Based on the above debit movement in the loan account over the last two years, being the period during the period in which the Companies appear from my investigations, to have been insolvent and recover of such transactions may be available to a liquidator. I estimate recoveries may be as high as \$600,000 taking into consideration the Director did not draw a salary and likely recovery costs. Additionally, the Osterley Limited transaction may result in further recoveries, however I am unable to quantify at this time given the nature of this transaction and the need for further investigations.

### 8.3.5 Voidable circulating security interests

When a circulating security interest is created during the six (6) months ending on the relation-back day it is voidable against the liquidator, except if the company is solvent after the security interest is created and if the security interest secured subsequent advances.

The PPSR for the Trust discloses a security interest created within the six (6) month period prior to the appointment of the Administrator in favour of Nab. As noted earlier in this report the Nab is the major banker to the group and has provided a number of facilities over a long period of time. There are also facilities within the Trust that related to assets that are not the Companies. At the time of writing I am unsure as to what this security interest relates to and further investigations will be required.

### 8.3.6 Voidable where creditor defeating purpose

A transaction of a company is voidable where a transaction is entered into for the purpose of defeating, delaying or interfering with the rights of any or all of its creditors. Further, the transaction must have occurred at a time when the company was insolvent, or the company became insolvent as a result of entering into the transaction, and generally within ten (10) years of the date of the commencement of the winding up.

My preliminary investigations have not discovered any transactions of this nature.

Should the Companies be wound up, further investigations will be conducted with respect to any transactions which were entered into to defeat creditors. Should creditors hold any information with respect to any transactions entered into to defeat creditors, please contact my office.

## 8.4 DIRECTOR AND OFFICERS RESPONSIBILITIES

Pursuant to Section 180 to Section 183 of the Act, directors and officers of a company have an obligation, amongst other things, to:

- Exercise their powers and discharge their duties with care and diligence
- Discharge their duties in good faith in the best interests of the company (for a proper purpose).
- Withhold from using their position and the company's information to improperly gain an advantage for themselves or someone else (or cause detriment to the company).

I confirm that these duties extend, not only to validly appointed directors, but also to parties acting in the position of a director whose instructions or wishes are accustomed to be acted upon (also known as “de-facto” or “shadow” directors).

My preliminary investigations indicate that the Director may not have discharged his duties in the best interests of the Companies during FY 2015 and FY 2016, when it would have been clear to him that the Companies were experiencing financial difficulties and severe liquidity shortages, he has:

- Withdrawn \$1.2 million via his loan account (\$320k of this was paid to the Nab to reduce debt but the balance would appear to have benefited the Director or other related parties)
- Along with the transfer, for no consideration, of the motor vehicles mentioned previously.

Accordingly, the Director may have breached sections 180 and 181 of the Act in that he has failed to discharge his duties in good faith and care and diligence.

Given the comments made earlier in this Report in relation to the difficulties with the financial accounts and in particular the management accounts prior to year-end adjustments not accurately reflecting the true position of the Companies the Director may have breached Section 297 of the Act. Should a liquidator be appointed the involvement of the external accountant in the manipulation of the accounts would also need to be investigated.

Should the Companies be wound up, further investigations will be conducted to extend my preliminary investigations with respect to any possible breaches of the Act by the Director, Officers or other parties that may have acted in the capacity of a director notwithstanding they were not appointed as such as defined in the Act. Should creditors hold any information that may assist the investigations in this area, please contact my office.

## 8.5 OFFENCES

Pursuant to Section 438D of the Act, if I become aware of a possible offence(s) under the Act committed by officers of the Companies or that there has been a breach of trust in relation to the Trust I am required to report it to ASIC.

The administrator is only able to investigate the affairs of the Companies. Previous company failures are monitored by ASIC and ASIC has the power to disqualify persons for managing corporations for up to five (5) years if, within seven (7) years, the person has been an officer of two (2) or more company failures.

At the date of this report my preliminary investigations have disclosed possible offences committed by officers of the Companies as noted above. However, as these findings are preliminary and subject to further investigation I have not made a report pursuant to Section 438D of the Act.

In the event that the Companies are wound up a liquidator will conduct further investigations into any breaches by Officers of the Companies. If that investigation reveals that possible offences have been committed. The liquidator I will be obliged to report it to ASIC pursuant to Section 533 of the Act.

It is not an administrator’s or a liquidator’s role to proceed against officers of the Companies for offences under the Act. ASIC will take action as it deemed appropriate to the extent offences are reported to it by an administrator or liquidator.

## 8.6 SUMMARY OF POTENTIAL RECOVERIES BY A LIQUIDATOR

Set out below is a summary of the potential recoveries by a liquidator in the event the Companies are wound up. Please note that these recoveries will likely require litigation to realise and accordingly carry a level of uncertainty. Notwithstanding, my preliminary estimate of possible recoveries is noted below calculated on a group basis:

Potential Recoveries	High \$000's	Low \$000's
Unfair Preferences	400	Nil
Insolvent Trading	2,000	Nil
Compensation for Breach of Directors Duties	Unknown	Nil
Uncommercial Transactions	192+	Nil
Unfair Loans	Unknown	Nil
Unreasonable Director Related Transactions	500	Nil

Based on my preliminary investigations to date I am unable to provide any further details in relation to any potential claims that a liquidator may have. As discussed above there are a number of potential matters identified in my preliminary investigations however further investigations are required to determine the potential recovery, if any, of those matters.

It should be noted that these claims are only available to a liquidator and would not be available to a Deed Administrator.

## 9. ESTIMATED RETURN TO CREDITORS

Attached at **Annexure H** is a statement of the estimated return to creditors under both a liquidation and DOCA scenario. I summarise this below:

*Deed of Company Arrangement (Pooled DOCA covering all Companies and all Creditors)*

Creditors	Estimated dividend rate (Cents in \$)	Estimated dividend rate (Cents in \$)
	High	Low
Priority	100	100
Secured	100	100
Unsecured	14	13
Related party	Nil	Nil

*Liquidation*

Gordon Smith Marketing Creditors	Estimated dividend rate (Cents in \$)	Estimated dividend rate (Cents in \$)
	High	Low
Priority	100	100
Secured	100	100
Unsecured	20	Nil
Related party	20	Nil

Rodney Clark Creditors	Estimated dividend rate (Cents in \$) High	Estimated dividend rate (Cents in \$) Low
Priority	23	15
Secured	100	100
Unsecured	0	0
Related party	0	0

Rodney Clark Retail Creditors	Estimated dividend rate (Cents in \$) High	Estimated dividend rate (Cents in \$) Low
Priority	n/a	n/a
Secured	n/a	n/a
Unsecured	78	35
Related party	n/a	n/a

## 10. OPTIONS AVAILABLE TO CREDITORS

Pursuant to the Act I must provide creditors with a statement of my opinion about each of the courses of action. Pursuant to Section 439C of the Act, creditors are required at the Second Meetings of Creditors to vote on the outcome of the Administration. The matters requiring my opinion, with respect to the Companies are, whether it would be in creditors' interests for:

- The Companies to execute a DOCA, or
- The Administrations to end, or
- The Companies to be wound up.

### 10.1 ADMINISTRATOR'S OPINION

My opinions are contained in **Annexure A** and I make the following comments with respect to each option.

#### 10.1.1 Execution of a DOCA

A DOCA is a mechanism for dealing with creditors' claims. A DOCA, if approved by creditors, binds all creditors arising on or before the date of the appointment of the administrator unless otherwise specified.

A DOCA proposal has been propounded by the Director in relation to the Companies for consideration by creditors.

The Administrator is of the opinion that creditors should accept the proposed DOCA because:

- The estimated return to unsecured creditors (although lower than the high case scenario under liquidation) is likely to be more certain than in an orderly winding up of the Companies, noting that the actual return in liquidation could be nil;
- A DOCA avoids the risks to the Asset Sale Agreement not completing and therefore limits the crystallisation of employee claims (with the exception of unpaid superannuation);

- The DOCA provides for a return to all employees, whereas under a liquidation scenario there is likely to be a shortfall to employees of Rodney Clark, resulting in their superannuation entitlements not being paid in full;
- It provides certainty to unsecured creditors and employees. In a liquidation scenario, any dividend will be contingent on antecedent recoveries (i.e. preference recoveries, insolvent trading, compensation for breach of director's duties etc.) and notwithstanding the merits of these claims, recovery costs are likely to be high, they will require Court proceedings which are uncertain and ultimately will be impacted by the capacity of the parties to meet any significant judgments which may be obtained; and
- The DOCA will enable a dividend to be paid to creditors earlier than what may be available under a liquidation scenario where a dividend is likely dependent on antecedent recoveries which are uncertain.

The timing of likely dividend payments has been a significant consideration in forming this opinion. Under a DOCA a first dividend will be possible after receiving the initial deed contribution and the calling for Formal Proofs of Debt and adjudication of same. Given the statutory timeframe a dividend is likely within 2 to 3 months following the Second Meetings of Creditors with a final dividend likely (assuming the DOCA completes) before financial year end 2017. Whereas under a liquidation scenario, where a dividend is dependent on antecedent recoveries which will require litigation the likelihood and timing of any dividend is uncertain and most likely take up to two years to eventuate.

#### 10.1.2 Administrations to end

It is possible that creditors may consider ending the Administration which would return the Companies to the control of the Director, however this would not be in the best interests of creditors given each of the Companies are insolvent. Should creditors resolve that any of the Administrations should end, then the company for which that resolution is passed will be placed into a similar position to which existed prior to the Administrator's appointment. Accordingly, my opinion is that it is not in creditors interests for the Administration to end for any of the Companies.

#### 10.1.3 Winding up the Companies

Should creditors resolve to wind up the Companies or any individual company at the Second Meetings of Creditors, the winding up will, pursuant to Section 513C of the Act, be deemed to have commenced on the date of Administration, being 27 June 2016 for each of the Companies.

Should creditors resolve to wind up the Companies or any individual company, the company is taken to have nominated Mr. Schwarz as liquidator. In the event that an individual company is placed in liquidation the DOCA proposal will no longer be viable and all of the Companies will be placed in liquidation.

A liquidator is required to realise and distribute assets pursuant to the Act and will also be required to complete a thorough investigation into past dealings and affairs and the past actions of the Companies' officers as disclosed in Sections 8 of this Report.

The effects of the liquidation include:

- The moratorium available under the Administration process will cease.
- The liquidator will be empowered to recover voidable transactions, as disclosed in Section 8 of this Report.

- The liquidator will be required to conduct an investigation into the Companies' affairs as disclosed in Sections 8 of this Report and lodge reports with ASIC pursuant to Section 533 of the Act.

An estimate of the possible return available to employees and creditors in each of the Companies is detailed at **Annexure H**.

Creditors should note this is only an estimate of the possible return available having regard to the factors known at the time of writing. This estimate may be impacted by the following factors:

- The level of remaining asset collections including debtor collections, recoveries from the Director and completion of the Asset Sale Agreement;
- The quantum of Secured Creditors security;
- Total liabilities, once proofs of debt have been lodged and adjudicated upon;
- Likely recoveries from voidable transactions and the cost of those recoveries;
- The final cost of administration and liquidation resulting from additional issues arising;

Notwithstanding, the issues identified in section 8 of this Report, I am of the opinion having regard to the factors outlined at section 10.1.1 above that a DOCA provides the best alternative to creditors in light of the significant uncertainty associated with antecedent recoveries under a liquidation scenario.

I acknowledge that the creditors may form a different view having regard to the issues highlighted in section 8 of this Report.

My statement setting out my opinion on the above alternatives and in relation to each company is enclosed at **Annexure A** of this Report.

## 11. ADMINISTRATOR'S REMUNERATION

At the Second Meetings of Creditors convened for 20 September 2016, creditors will be asked to approve the Administrator's remuneration as disclosed below:

### Gordon Smith Marketing

Time period	External Administration	Annexure J Part	\$
			(excl GST)
27 June 2016 to 31 August 2016	Voluntary Administration	3.1	157,811.75
1 September 2016 to finalisation of VA	Voluntary Administration	3.2	50,000.00
<b>Total Voluntary Administration</b>			<b>207,811.75</b>
Commencement of DOCA to completion	DOCA	3.4	60,000.00
Commencement of liquidation to completion	Liquidation	3.3	150,000.00

### Rodney Clark

Time period	External Administration	Annexure J Part	\$
			(excl GST)
27 June 2016 to 31 August 2016	Voluntary Administration	3.1	85,261.50
1 September 2016 to finalisation of VA	Voluntary Administration	3.2	25,000.00
<b>Total Voluntary Administration</b>			<b>110,261.50</b>
Commencement of DOCA to completion	DOCA	3.4	45,000.00
Commencement of liquidation to completion	Liquidation	3.3	60,000.00

## Rodney Clark Retail

Time period	External Administration	Annexure J Part	\$
			(excl GST)
27 June 2016 to 31 August 2016	Voluntary Administration	3.1	13,071.50
1 September 2016 to finalisation of VA	Voluntary Administration	3.2	5,000.00
<b>Total Voluntary Administration</b>			<b>18,071.50</b>
Commencement of DOCA to completion	DOCA	3.4	10,000.00
Commencement of liquidation to completion	Liquidation	3.3	10,000.00

The remuneration is based on hours worked by the Administrator and his staff, calculated in accordance with the hourly rates adjusted for CPI at 1 July each year and disclosed at **Annexure I** of this Report.

My Remuneration Request Approval Report, as prepared in accordance with the ARITA's guidelines is enclosed at **Annexure J** of this Report covering each of the Companies.

## 12. SECOND MEETINGS OF CREDITORS

Pursuant to Section 439A(3) of the Act, I have enclosed Form 529 Notice convening the Second Meetings of Creditors to be held at **11.00am on 20 September 2016 at Wesley Mission Conference Centre, 220 Pitt Street, Sydney 2000**

A Form 532 Appointment of Proxy ('Proxy Form') is enclosed at **Annexure L**. If you intend on appointing another person to act on your behalf at the Second Meetings of Creditors, or you are a corporate creditor, you are required to complete and return the Proxy Form appointing your representative to AS Advisory PO Box 4038, McKinnon, Vic 3204 or by email to [email@asadvisory.com.au](mailto:email@asadvisory.com.au) by no later than 4.00pm on Friday 16<sup>th</sup> September 2016.

If you are representing a company, please ensure that your Proxy Form is executed pursuant to Section 127 of the Act or your representative is appointed pursuant to Section 250A of the Act, otherwise you will not be entitled to vote at the Second Meetings of Creditors.

Proxy Forms submitted for the purpose of the First Meetings of Creditors are not valid for the Second Meetings of Creditors.

Informal Proof of Debt ('Proof of Debt Form') is enclosed at **Annexure M** of this Report. Creditors are required to have lodged their Proof of Debt Form by no later than 4.00pm on Friday 16<sup>th</sup> September 2016. Those creditors who have already lodged a Proof of Debt Form are not required to lodge a further Proof of Debt Form (unless they wish to amend their claim).

In the event that you have any queries regarding the contents of this Report, or the Administrations in general, please do not hesitate to contact Mr. Andrew Schwarz on 0408 317 984.

DATED this 8th day of September 2016  
**Gordon Smith Marketing Pty. Ltd. ACN 003 840 168**  
**Rodney Clark Pty Ltd ACN 088 072 244**  
**Rodney Clark Retail Pty Ltd ACN 138 806 256**  
**(All Administrator Appointed)**

A handwritten signature in blue ink, appearing to read 'Andrew Schwarz', with a long horizontal flourish extending to the right.

Andrew Schwarz  
Administrator  
Enc

