

## Report on the state of assets

April 18, 2008

To All Creditors

Trustees in bankruptcy  
Bankrupt Company Nova Corporation  
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We have prepared this report on the state of assets of the Bankrupt Company Nova Corporation (hereafter referred to as "the Bankrupt Company") in place of holding a general meeting, as allowed in Article 54, Paragraph 3 of the rules relating to Bankruptcy. This report covers the circumstances that led to bankruptcy proceedings, the processes undertaken and the current status of the proceedings and other items stipulated in Article 157, Paragraph 1, as follows:

### I . Introduction

#### 1. Bankrupt Company's previous business

Management of the foreign language schools known as 'Ekimae Ryugaku', 'Ochanoma Ryugaku', and 'Nova Kids'; consultation services for studying abroad known as 'Kaigai Ryugaku Service'; and sales of study materials for foreign language education, books and other related products for foreign language conversation, studying abroad, travel; and sales of other goods.

#### 2. The time line of associated issues in this case.

##### (1) Fiscal year losses.

The Bankrupt Company declared losses in two consecutive terms ending March 2006 and March 2007. The Bankrupt Company, with disregard for profit, rapidly increased the number of conversation schools (also called 'branches') since listing on the JASDAQ stock market in 2004, resulting in decreased efficiency, profitability, and payability in its operations.

##### (2) On-site inspection

On February 14, 2007, the Bankrupt Company was subject to an on-site inspection by the Ministry of Economy, Trade, and Industry and the Tokyo Metropolitan government, on suspicion of being in violation of the Specified Commercial Transactions Act and the Metropolitan Tokyo Consumer Life Ordinance by allegedly under calculating the refund of lesson fees for contracts cancelled before the expiry date. The inspection was covered in various newspapers, on the 16<sup>th</sup> of the same month, resulting in a flurry of requests from current students, who saw the coverage, to cancel their contracts before the contract expiry date.

##### (3) The Supreme Court decision

The Bankrupt Company had a bulk discount pricing policy and the students purchased lessons in advance in units, known as 'points' (which gave the right for students to take lessons operated by the Bankrupt Company). On April 3, 2007, the Supreme Court ruled that the Bankrupt Company's price policy for refunds on contracts cancelled before the expiry date was illegal as it violated Article 49 Paragraph 2.1 of the

## Specified Commercial Transactions Act.

### (4) Administrative punishment

On June 13, 2007, the Ministry of Economy, Trade and Industry, ordered the Bankrupt Company to suspend business in each of the relevant operations for 6 months from the 14<sup>th</sup> of June 2007 to the 13<sup>th</sup> December 2007 based on Article 47 Paragraph 1 of the Specified Commercial Transactions Act, specifically, on the grounds of violating Article 42 (flawed paperwork), Article 43 (misleading advertising), Article 44 Paragraph 1 (misrepresentation of information), Article 44 Paragraph 2 (intentional failure to disclose important facts), Article 46 Clause 1 (refusing to perform or unjustly delaying performance of the obligations that occur through rescission of the contract for the rendering of services in part) and Article 46 Clause 3 (refusing to perform the obligations that occur through rescission of the selling agreement for related goods) of the same Act. On June 15, 2007, along with the order to suspend business, the Ministry of Health, Labour, and Welfare, based on the stipulation in the Employment Insurance Law Article 60-2 Paragraph 1, also cancelled the company's enrolment in the Training and Education Benefits System.

### 3. The scale of administration of property in this case (at the time of filing for Corporate Rehabilitation proceedings)

(1) Number of students: Approximately 300,000

(2) Number of employees: Approximately 6,600 (approximately 4,200 of these were foreign employees)

(3) Number of leased schools: Approximately 670

(There were also a considerable number of schools for which the decision to close had already been made before October 26, 2007, the day on which the commencement of the Corporate Rehabilitation proceedings was filed, but were still running business operations without vacating the premises)

(4) Number of leased company accommodations: Approximately 1,000

(5) The quantity of unused tickets already issued: Approximately 56 billion yen

(6) Unpaid taxes and public dues: Approximately 2.5 billion yen

(7) Unpaid labor costs: Approximately 6 billion yen

## II . General company information

### 1. Establishment.

After several changes in its history, the Bankrupt Company established the private limited company Nova Kikaku (Hereafter referred to as 'Nova Kikaku') in August, 1981, opening LL Shinsaibashi school, its first foreign language school in Shinsaibashi, Chuo-ku, Osaka; following this it successively opened Umeda school, Shibuya School, and Shinjuku School, and promoted the steady expansion of its business. Nova Kikaku then established Nova Corporation (株式会社 NOVA) on August 1990 and took over the operation of Nova Kikaku with the aim of integrating the expanded group businesses. The Bankrupt Company then changed its corporate name to Nova Corporation (株式会社ノヴァ) on February 3, 1993, and by the absorption merger of Nova Corporation (株式会社 NOVA) on April 1, 1996 it started to operate its present business.

### 2. The shares of the Bankrupt Company and the amount of capital etc.

#### (1) Going public

The company was listed on the JASDAQ stock market in December 2004 through the registration of the OTC market in November 1996.

#### (2) Composition of shareholders

The Bankrupt Company's shareholders were primarily composed of related parties to

the former owner Nozomu Saruhashi (hereafter referred to as 'the former president') who owned a total of 77.34% shares (36.02% were held by Nova Kikaku – a company 100% controlled by the former president, 35.55% were held by the former president himself etc.) and there is a strong suggestion that the company was more like a private concern of the former president. (Immediately before filing for the Corporate Rehabilitation Proceedings, the former president and Nova Kikaku transferred part of their shares as of 30<sup>th</sup> of September, 2007 reducing the ownership percentage considerably.)

3. The Bankrupt/company and board members (at the point of filing for the Corporate Rehabilitation Proceedings)

Chief executive officers : Anders Lundqvist, Hitomi Yoshizato, Shoichi Watanabe

Auditors: Masaru Utsuki, Toshio Toshima (external auditor), Kaoru Takagi (external auditor)

Accounting Auditors: Active Kansa Hojin

On October 25, 2007, the former president who kept ignoring this serious situation, was dismissed by the board members, who could not passively observe the increase in liabilities and increased number of victims, at a board meeting and the above three new CEOs were instated.

### **III. The cause of the bankruptcy and obscure expenditure**

1. Drastic expansion of business and the fragile profit structure

(1) Expansion of branch numbers

After establishing LL Shinsaibashi School in September 1981, the bankrupt Company expanded the number of branches to 100 during the 12 years until 1993, and at its peak, in March 2005, the number of branches reached 994.

Without sufficient regard for profitability etc, there was an earmarking and outpouring of funds for this development of branches as the expansion was subject to contracts with extremely expensive guarantee money deposits and lease fees, which generated many unprofitable branches. When this became obvious, it gradually came to press the business management of the Bankrupt Company.

(2) Profit structure

Along with the rapid increase of the branches mentioned above, the Bankrupt Company injected vast amounts of money into mass media advertisement such as TV, magazines, etc. to raise the profile of the company; the business had soaring growth, to the extent that the company's single sales result in the fiscal year ending in March, 2005 exceeded 70 billion yen.

However, this resulted in the drastic increase in the ratio of fixed costs such as the huge expense for the expansion of the branches, advertising, rent and personnel costs. The expansion of sales did not lead to increased profit, and the ratio of profit for the current term (return rate on sales) in each financial term remained at a low level, and the working capital ratio was reduced to much lower than 100 %, which led to a bad cycle in which there was no other choice but to keep expanding the business in order to pay the huge fixed costs, while not being able to secure the necessary liquid funds, and internal reserves.

2. The road to the company failing

(1) Problems with customers

'Ekimae Ryugaku', the main business of the Bankrupt Company, continued to gain customers steadily and climbed to the No. 1 market position in the English conversation school business field, achieving approximately 51% national share (sales base) in 2004 (according to the information made by the Bankrupt company), far outdistancing the runner-up. On the other hand however, rulings made by the Tokyo district court on

September 26, 2005 and by the Kyoto district court on January 30, 2006 were in favor of customers who made complaints about the monetary refunds in cases where their contracts were cancelled before the expiry date. Also, following these rulings, there was some critically toned media articles claiming that this was an 'illegal business practice'

(2) On-site inspections by the administrative government agencies

After the on-site inspections mentioned above, the number of newly enrolled students fell to less than half compared with the same month the year before. With this the lesson fee income dropped sharply, which rapidly deteriorated the Bankrupt Company's cash flow.

(3) The order of the suspension of business

As mentioned above, following the order of the suspension of business, the bankrupt company experienced a situation in which, not only was it virtually not able to sign new student contracts but also it was being inundated with requests for the cancellation of the lesson fee contracts. The sales figures in April 2007 dropped to approximately 1/6 of the same month of the previous year and for May 2007, sales fell to approximately 1/4 of the same month of the previous year. From June 2007 onwards, when the order of the suspension of business was issued, there was an abnormal situation where the amount of money to be refunded for contract cancellations exceeded the amount of new income. The Bankrupt Company's financial condition became such that although there was no income, the large amount of fixed costs had to be paid. The liquidity at hand that was 11.63 billion yen in March, 2006 had decreased sharply to 1.751 billion yen at the time of bankruptcy. (It can be said that, considering that 1.2 billion yen or less of this was a derivative deposit, the liquidity at hand had almost dried up)

(4) Delayed/unpaid salary

Firstly, approximately 800 million yen of funds for the rent of the branches etc. was not able to be procured in June, 2007, and these payments fell behind. Neither the summer bonuses of 800 million yen that were scheduled to be paid July 19, 2007 nor the regular salaries for Japanese staff of 500 million yen that were scheduled to be paid on the 27th of the same month could be paid. Although the regular salaries were managed to be paid on August 1 of the same year, there was delayed payment of regular salaries that were scheduled to be paid on August 27. These were managed to be paid in batches up until September 5. After this, the Bankrupt Company did not pay any salaries to employees at all. The situation became such that the foreign instructors' salaries were not able to be paid either from September 14 of the same year onwards.

3. Unclear expenditure

In the period immediately before bankruptcy the accounting books of the Bankrupt Company show unspecified expenditures and the remittance of funds from unknown sources; none of the directors other than the former president, nor personnel in charge of accounting had been told about the use of these funds. From now there will be a pressing need for a detailed investigation of these unaccounted expenditures; however the whereabouts of the former president, who knows about these expenditures, is unknown. He has disappeared without even apologizing to the customers or the employees.

#### **IV. The management ruling and the reality of the situation**

As mentioned above, the former president was the founder of the Bankrupt Company and the majority of the stocks of bankrupt company were owned privately by himself and his private company. He autocratically ruled the company under the name of "Honbucho". As a matter of course, the Bankrupt Company's important decision making had been done at the former president's own discretion. Therefore, important business maneuvers and the

spending of funds were individually managed by the former president without going through board meeting resolutions and the business operation structure was such that the former president gave directions directly to each department and section. Moreover, although the bankrupt company had a board of auditors and two of the three auditors were external auditors, it appears that there was no engagement by the auditors except for the sections in charge of taxation, and there was no operational auditing for the Bankrupt company by auditors, and it is thought that the compliance system of the Bankrupt company was extremely weak.

## **V. Responsibility of the directors**

### **1. Former president's responsibility**

Although it is still under investigation, there is a suspicion that the related companies ruled by the former president, in order to procure the funds for repayment of the enormous debts owed to financial institutions, signed contracts between the Bankrupt company and related companies that were extremely disadvantageous for the Bankrupt Company, and made the Bankrupt Company's funds flow outside by purchasing a large number of goods at inadequate prices and/or by paying a large amount for lease fees. The former president is mostly responsible for these illicit dealings.

Moreover, the former president, to maintain his expansion strategy, led the business management of the Bankrupt Company through the forcible solicitation of customers and non-payment of cancellation refunds. This led to the suspension of business order from the Ministry of Economy, Trade and Industry for violation of the Specified Commercial Transactions Act etc. We are led to believe that the former president is also responsible for the Bankrupt Company receiving the above-mentioned business suspension order from the Ministry of Economy, Trade and Industry, and the Bankrupt Company's management failing rapidly.

### **2. The other Directors' responsibilities**

We are carefully examining the responsibilities of the directors other than the former president. While the directors were negligent in their supervision as they were unable to stop the former president's dogmatic acts, the reality of the situation is that these three people did not have the authority and the responsibilities that was needed and this is a problem that we also consider needs further careful examination.

## **VI. The present state of assets and state of assets available for dividends**

The balance of assets on the books of the Bankrupt Company, show that the total of cash and other current assets are approximately 12.4 billion yen; real estate, guarantee money deposits and other fixed assets are a total of approximately 27.3 billion yen; and the overall total of these is approximately 39.7 billion yen. However, taking into account the actual existence or nonexistence and worth of these as assets, the possibility of offsetting and actual collecting, and making available for sale etc. the liquidation value will have to be considerably depreciated. Especially since we consider that although the deposits with landlords and the guarantee money deposits have been reported at approximately 14 billion yen on the books, most parts of this has been used on settling rents which were in arrears for a long time, and to restore premises to their original condition. Taking this into consideration the bankrupt company's assets at liquidation value, the balance of assets after off-setting and foreclosing is expected to be around three billion yen.

## **VII. State of the liabilities**

As for the state of the Bankrupt Company's liabilities at the time of the decision to commence bankruptcy proceedings, tax and public dues were approximately 2.5 billion yen and outstanding labor claims (unpaid wages, severance payment, and payment in lieu of dismissal notice) were approximately 6 billion yen in total. These have priority as

obliged by estate claims (these claims are to be reimbursed prior to any other general claims as prescribed in bankruptcy proceedings).

On the other hand, the general claims and liabilities of the Bankrupt Company, excluding estate claims and the value of security rights etc. are approximately 76.4 billion yen in total, including approximately 56.4 billion yen in total in credit claims from students. In this case, we have to say that there is no possibility for dividend payments for general claims (claims in bankruptcy), and for the creditor students. This leaves no alternative but to suggest that students take preferential treatment in the form of discounted tuition at G.education Co., Ltd. (Hereafter, referred to as "G.education"), the company that has taken over the business.

## **VIII. State of the progress in works of the estate**

### **1. State of disposal of the assets**

We are making preparations for converting real estate into cash by appropriate methods such as foreclosure by auction. It is planned to dispose of other assets properly after obtaining permission of the court.

### **2. Actions for students**

#### **(1) Relief by preferential treatment from the sponsoring company**

As mentioned above, as there is no prospect for dividends for creditor students, we asked the sponsor for preferential treatment for the students, and as a result, G.education decided that it would offer a 75% discount in tuition until the amount corresponds to the students' credit of unused points. This was offered as a measure to provide students who want to continue taking foreign language conversation classes, with the opportunity to keep taking lessons at a cheap price. Currently there are approximately 50,000 former students from Ekimae Ryugaku who transferred to G.education and we received a report that around 10,000 students are taking Ochanoma Ryugaku.

#### **(2) Continued application of the Training and Education Benefits System**

The Bankrupt Company had been disqualified from offering eligible courses for the Training and Education Benefit System by the Ministry of Health, Labour and Welfare as mentioned above. The trustees in bankruptcy negotiated with the Ministry of Health, Labour and Welfare, and took the necessary measures to give evidence of the content of the courses the students had completed, so that the students are now able to receive the educational training benefits from the Ministry of Health, Labour and Welfare by continuing their courses at G.education or other English conversation schools.

### **3. Transfer of business and its settlement**

As the degree of the deterioration of business at the Bankrupt Company was tremendous, immediately after the court order for preservative administration with the filing for the commencement of Corporate Rehabilitation proceedings was announced, we decided to look for a company in which to assign the business of the Bankrupt Company, and after obtaining the permission of the court, we decided to assign a part of the Bankrupt Company's business to G. education. In the contract for assigning the business, we decided to include the following policies:

- (1) Although G.education. will not succeed any obligation, including the obligation incurred for advance payments received from students, it aims to protect students by offering substantial opportunities for taking lessons with considerably reduced tuition compared to other general foreign language schools for a certain period of time.
- (2) In principle employ the employees promptly, including foreign instructors who want to join the company as the financial situation permits so as to re-open schools.
- (3) Soon after determining the schools for which succession is possible, promptly start negotiations on the assignment of leaseholds with lessors. Up to now, 126 branch contracts have been confirmed as being succeeded, and in addition, according to the

G.education, it is planned to increase the number of schools further.

The transfer price and mutual confirmations continue to be calculated with G.education. Although it is expected that a certain amount of time is required for the calculation and confirmation of the price, we would like to finalize it shortly.

4. Succession/non-succession of the schools and their settlement

As for the schools that were not succeeded by G.education, we have been cancelling their contracts and vacating them and at present; we have completed the processing for 380 of the approximately 1,000 contracts. It is estimated that the amount of deposit to be refunded by landlords (except those foreclosed due to delinquency of taxes etc.) is approximately 680 million yen in total.

5. Succession/non-succession of the company apartments and their settlement

As far as we know, there are total of 1,023 company apartments and G. education announced the succession of 173 of these and is successively undertaking the succession procedure. As for the 850 company apartments that have been determined not to be succeeded, we are currently cancelling the contracts and successively vacating and negotiating settlements.

6. Tax refund

In the bankrupt company, conventionally 45% of advance tuition income received from the students would have been recognized as revenue when it was received, and the final installment of consumption tax has been filed in line with this. This was the accounting method based upon the premise it is an ongoing concern, however, as this premise has been lost as of October 26, 2007, we decided to file for the refund of tax collected on unrealized revenues, by deducting approximately 55 billion yen or more which is equivalent to the unused tickets as the amount of revenue to be returned. With this, we expect to receive a tax refund of one billion yen or more together with national and regional taxes.

7. Dealing with consumer credit companies

Up to now, consumer credit companies and G. education have had a conference regarding the handling of credit contracts, and, as a result, credits company have taken the basic policy stance that (1) Money already paid in installments will be not be returned. (2) The claim for credit installment payments from now on will be made only for 'the students who have used all the services' (more specifically, only for students who had agreed to have the amount debited monthly from a designated bank account in the 'Agreement' could be resumed); according to these policies, it was decided that after January 25, 2008, a notification was to be sent out to every student who had any part of their credit contract remaining.

According to above policy each credit company sent off the notice to all students who had part of their credit contract remaining from the end of January to the beginning of February in the same year, and it seems they have already started the collection of money in some parts, however, because there was a problem in the accuracy of the list of the students' used points, currently each credit company notes the students who have made complaints, provides their information to the trustee, and then the trustees recheck the status of any used points with each student in question and return the information to each credit company successively. It seems that there are some credit companies that do not take the basic policy '(2) claim for credit installment payments from now on but they will be made only for "students who have used all the services"', but are making a claim for payment to students who have unused points as well. (However, this is made only for students whose usage of points has exceeded the money already paid in installments and they are asked to pay the difference only.)

## **IX. State of progress for affiliated companies**

1. The affiliated companies whose entire stocks are directly or indirectly owned by the

## Bankrupt company

Of the affiliated companies of the Bankrupt Company, 6 companies – ①NIS Co.,Ltd, ②Nova Study Abroad Center K.K., ③Intervision. Co., Ltd, ④Nova Space Design Co.Ltd, ⑤L'ami Nova Co., Ltd., ⑥Nova Joho System Co., Ltd. , filed for voluntary bankruptcy on January 16, 2008 and the decision to commence bankrupt proceedings was made at 5:00 p.m. on the 21st of the same month. Similarly, for ①Ginga Net Co., Ltd and ②Pacific Lease Co., Ltd. that were consolidated subsidiaries of the Bankrupt Company, it is planned to file for voluntary bankruptcy with the court sequentially as soon as the necessary preparations are made. As for the business of Ginganet Co. Ltd., the operation has been assigned to Ginga System Solution Co., Ltd. (previously with the corporate name: G-com System Solutions), a subsidiary company of G. communication Co., Ltd.

2. Affiliated companies over which the Bankrupt company does not have governing power  
Other than the above, there are a number of affiliated companies over which the Bankrupt Company does not have governing power and the decision as to whether these companies will continue conducting business or not will be left to the autonomous discretion of the management of each company. We do not have any specific plans to engage in any proceedings with these companies.

## X. Future schedule

It is estimated that the assets of this estate are worth around 3 billion yen.

On the other hand, as mentioned before, it is thought that there are tax and public dues of approximately 2.5 billion yen and the outstanding labor claim of approximately 6 billion yen. As a result, there is a possibility that these estate claims will be settled on a pro rata basis, and as far as we can see, our review of the current status shows that the dividend payment for general bankruptcy claims is judged to be extremely difficult.

Nova Corporation

## Liquidation Balance Sheet

(Yen)								
Account Title	Liquidation value	The portion of collateral	Adjusted balance	Account Title	Liquidation value	Expected recoverable amount of collateral	Estate Claims	General Claims
Cash	1,616,234,831	1,180,000,000	436,234,831	Accrued amount payable	12,401,299,589	0	5,600,495,845	6,800,803,744
Accounts receivable	11,464,338		11,464,338	Advances by customers	1,152,903,942	0	0	1,152,903,942
Merchandise	130,030,000		130,030,000	Deferred Ekimae Ryugaku Service	152,366,236	0	0	152,366,236
Accrued Consumption tax	1,036,943,533		1,036,943,533	Unused lesson tuition	55,099,370,228	0	0	55,099,370,228
Other current assets	71,075,784	0	71,075,784	Other current liabilities	7,459,762,996	0	1,760,340,746	5,699,422,250
Total Current Assets	2,865,748,486	1,180,000,000	1,685,748,486	Total Current liabilities	76,265,702,991	0	7,360,836,591	68,904,866,400
Total property, plant and equipment	2,380,000,000	2,380,000,000	0	Long-term loans payable	3,294,408,977	220,000,000		3,074,408,977
Total Intangible Fixed Assets	500,000	0	500,000	Allowance for employee retirement benefits	418,951,917		418,951,917	0
Total Investments and others	1,210,025,621	0	1,210,025,621	Other Fixed Liabilities	5,937,096,754	2,160,000,000	0	3,777,096,754
Total Fixed Assets	3,590,525,621	2,380,000,000	1,210,525,621	Total Fixed Liabilities	9,650,457,648	2,380,000,000	418,951,917	6,851,505,731
Total Assets	6,489,307,392	3,560,000,000	2,929,307,392	Total Fixed Liabilities	85,916,160,639	2,380,000,000	7,779,788,508	75,756,372,131

### Expected liquidation dividend ratio

Liquidation value	6,489,307,392	
Pledged assets	3,560,000,000	
Remaining Assets	2,929,307,392	Including amount of consumption tax of 1,727,682,545 that is currently under filing for refund
Taxes and public dues	2,253,854,379	
Outstanding Labor Claims	5,525,934,129	
Other estate claims	400,000,000	Expenses for evacuation of leasing property and communication expenses borne by the estate (round figure)
Sources for general dividend	▲ 5,250,481,116	
General Claims	75,756,372,131	
Liquidation dividend ratio	0.00%	