

**ROBB EVANS**  
**Temporary Receiver of**  
**D.W. Heath & Associates, Inc.;**  
**PCM Fixed Income Fund I, LLC;**  
**Private Capital Management, Inc.;**  
**Private Collateral Management, Inc., et al.**

**REPORT OF TEMPORARY RECEIVER'S ACTIVITIES**  
**MAY 4, 2004 THROUGH MAY 14, 2004**

This is the first report to the Court. The purpose of this report is to:

- Provide preliminary financial and investor information.
- Provide a current summary of major issues confronted by the receivership estate.

This report does not constitute an audit of the financial condition of the receivership; it is intended only for the information of the Court and should not be relied upon for other purposes.

### **Company Books and Records**

On May 3, 2004, the Temporary Receiver was advised that all of the companies' records and computers that were located in the Brea, CA facility and in the Hemet, CA facility had been seized by the Riverside District Attorney's Office pursuant to a criminal search warrant. On May 4, 2004, one of the Temporary Receiver's colleagues met with the Deputy District Attorney responsible for the matter to determine the most efficient method to gain access to the seized records. The Deputy District Attorney was very cooperative and suggested the Temporary Receiver could become the custodian of records for the criminal matter. The Temporary Receiver's colleague executed an affidavit whereby the Superior Court of California, County of Riverside, subsequently appointed Robb Evans & Associates LLC as Custodian of Evidence for the criminal matter. On May 5, 2004, the District Attorney's Office delivered 204 boxes of records and computers to the Temporary Receiver's office.

### **Attempts to contact Mr. O'Brien**

The Temporary Receiver has attempted to contact Mr. O'Brien through two attorneys who apparently are not currently representing him in the underlying matter. One of the attorneys stated that he would contact Mr. O'Brien and advise him of the

Temporary Receiver's interest in interviewing him. To date, Mr. O'Brien has not contacted the Temporary Receiver.

### **Meetings with Mr. Heath**

Following this Court's May 3, 2004 hearing, Mr. Heath asked to meet with the Temporary Receiver. On May 4, 2004, the Temporary Receiver met with Mr. Heath and his attorney. Mr. Heath was cooperative and provided the Temporary Receiver with information about the history of the companies, his memory of the major assets held, and a general description of the amounts owed to investors. Mr. Heath stated to the Temporary Receiver that he would, at times, vest the ownership of assets in his name for tax or convenience purposes.

After reviewing numerous documents about loans and investments made by Private Capital Management, Inc. (PCM) to a number of entities, the Temporary Receiver asked Mr. Heath for another meeting to further explore the details about some of the transactions. That meeting occurred on May 12, 2004.

Mr. Heath was accompanied by his attorney at the May 12<sup>th</sup> meeting. At the outset of the meeting, Mr. Heath's attorney advised the Temporary Receiver's deputies that his client would not answer any questions regarding his personal investments, any past investments, or any offerings made to investors. Mr. Heath also requested access to the company records. The Temporary Receiver advised that, as custodian, this request would be subject to the terms approved by the District Attorney's Office.

Mr. Heath was asked to detail the "notes" that show as assets on the PCM Balance Sheet. In most instances, the "notes" were actually a combination of loans and equity. When asked for documentation of equity positions, Mr. Heath advised that he was unsure of the location of the files. He thought the files might be in the boxes provided to the Temporary Receiver by the District Attorney's Office or at one of the offices of several accountants or attorneys. Deputies for the Temporary Receiver had previously searched the boxes turned over by the District Attorney's Office and did not locate the "notes" or investment information.

Mr. Heath was asked if the physical notes, security agreements, and other documentation necessary to enforce or perfect the loans were held in a central, secure location. He stated that they were not and could not identify their actual location. Mr. Heath was asked if the information that he used to perform the initial due diligence on the loans could be located and whether he maintained files with updated financial statements for borrowers. On advice of counsel, Mr. Heath refused to answer these questions.

Mr. Heath was asked if the loans were current. He stated that each loan was structured differently. Mr. Heath was asked if any of the loans were over 90 days past

due, and he said that he did not know the specifics of each loan. He was asked if he thought he should know the status on loans of this size, and he could not provide an answer.

Mr. Heath was asked what he meant by “each loan was structured differently.” He replied that in many instances they took a “long term approach” and did not require payments initially. In some instances, the loans were converted to equity.

Documents reviewed by the Temporary Receiver’s deputies showed that a company called TITL Equities L.P. (TITL) had an ownership interest in at least one of the companies to which PCM loaned funds. Public records list Mr. Heath as the principal of TITL. Mr. Heath was asked about the ownership of TITL during the May 12<sup>th</sup> interview. Mr. Heath replied that TITL was his own entity. He stated that TITL held monies he loaned to it and that it was a family business. Mr. Heath confirmed that TITL owned a 10% interest in Prestige Resort Development, LLC. The Receiver’s deputies were unable to locate an investment file for TITL, or any information on whether funds may have been transferred to TITL from PCM loans or investments or from any companies related to Mr. Larre Schlarmann. The Temporary Receiver has requested and is awaiting copies of bank account records for TITL. No bank records for this entity have been located in the seized documents, nor have any of Mr. Heath’s personal bank statements been located in the seized records.

### **Investor Information**

Of the 204 boxes of documents received from the Riverside District Attorney’s Office, 35 contained individual file folders for the various investors. The Securities and Exchange Commission alleged in its complaint that there were at least 803 investors. The Temporary Receiver reviewed 20% of the investor files and will need additional time to complete the review of the investor information, reconcile it to the data base discussed later, and prepare an accurate inventory of the number of claimants and each invested amount.

Investor files were maintained in alphabetical order and included information on investments from 1991 to the date the records were seized. From the initial review, it appears that there were systematic adjustments in the characterization of various investments on IRA statements starting in late 1998. A new Fund would be included in the description of investments on the IRA statement without any additional contribution from the investor or distribution of monies to PCM. This could be a result of the desist-and-refrain orders issued by the California Department of Corporations in March 1998.

Investor funds are received either as direct investments or as rollover sums into an IRA account recommended by Heath & Associates. Three IRA custodians were

identified in the investor files. First Trust Corporation in Denver, CO was the custodian of the vast majority of IRAs; however, Trust Company of America in Englewood, CO and Lincoln Trust in Englewood, CO also served as custodians of many of Mr. Heath's investor IRA accounts.

The investor files reviewed contained a promissory note, often referred to as a Secured Corporate Note. Mr. Heath would sign most of the notes on behalf of PCM. A majority of the notes contained a six-year maturity date with an interest rate of 9% and identified either Private Capital Management or PCM Fixed Income Fund I as intended recipient of the funds. Other notes ranged in terms from three to ten years maturity with interest rates from 6% to 9%.

The investor files also contained a document titled "Security Agreement" which, without exception, included the following language in Section 3.1: "Debtor hereby assigns to Secured Party an undivided common first present and continuing security interest together and in common with all similarly situated creditors of Secured Party, (herein "Creditors") including as of the date hereto the individuals listed on Exhibit 3.1 attached hereto (the "Security Interest") in all of the following collateral (the "Collateral"): Assets & Receivables" (emphasis added). The Temporary Receiver was not able to locate one example of "Exhibit 3.1" which purportedly contained a list of all individuals also containing a similar security interest. The security interest pledged to investors pursuant to the Security Agreement was for the assets and receivables of PCM and not tied to any of the other Funds offered by Heath. The Temporary Receiver is unable to determine if the Promissory Notes, Security Agreements, or attachments were ever provided to any of the investors.

When an investor rolled funds from an existing IRA account into one of the three IRAs referred by Heath, the IRA would send a check payable to PCM. In those IRA accounts reviewed by the Temporary Receiver for the time period 1999 to present, the Temporary Receiver was not able to locate a single check from any of the IRA funds payable to any entity other than PCM. Even in those instances where an IRA statement identified one of the various private placement offerings from Mr. Heath, the incoming investor funds, from either rollover accounts or new contributions to an investor's IRA, were always funneled through PCM.

Based on a review of the timing of contributions into an investor's IRA account or direct investment account, it seems clear that Heath & Associates was very active in assisting clients in liquidating their existing investments for transfer either directly to PCM, or through the IRA to PCM.

PCM would provide quarterly statements for all investors with entries for interest accrued on a monthly basis. Clients with direct investment accounts would receive the quarterly report directly. PCM would send quarterly statements to the various IRA custodians for each client maintaining an IRA. The quarterly reports sent to the

IRA administrator were virtually identical to the ones sent directly to investors without IRAs.

It would be extremely difficult for an investor to understand the nature of the holdings in their IRA based on the monthly statements. A majority of the investments identified on IRA statements referenced PCM Fixed Income Fund I. Many statements identified multiple funds offered by Heath & Associates, even though all funds placed in the IRA went directly to PCM.

The Temporary Receiver can find no legitimate business purpose for the way PCM characterized a client's investment as being tied to a particular Fund offering. All incoming funds were commingled in common accounts. None of the Funds have assets in the name of the Fund. The Temporary Receiver has not been able to locate any bank accounts in the name of any of the Funds. There are no financial statements for any of the Funds. During the interview on May 12, 2004, Mr. Heath was asked whether investors had invested in specific projects, or whether their investments were with PCM in general. Mr. Heath stated that some investors had invested in a specific project, and some were general investments with PCM.

The Temporary Receiver is in possession of an investor database maintained by PCM. However, the Temporary Receiver has not yet been able to reconcile the database to the bank records and cannot supply any meaningful analysis of the investors to the Court in this report.

## **Financial Information**

Mr. Heath informed the Temporary Receiver that all disbursements from company bank accounts were accounted for by an outside bookkeeper. One of the Temporary Receiver's deputies, a CPA, contacted the outside bookkeeper and made arrangements to obtain accounting records for D.W. Heath & Associates, Inc., Heath & Associates (the predecessor of D. W. Heath & Associates and now out of business), and Private Capital Management, Inc.<sup>1</sup> According to the outside bookkeeper, she maintained no other accounting records for Mr. Heath's companies or any other receivership defendants. The outside bookkeeper stated that all bank statements had been reconciled through March 31, 2004. That means that all deposits and disbursements from July 1993 through March 31, 2004 are included in the accounting records.

Under Tab 1 is the Balance Sheet for PCM. The balance sheet reflects total assets of \$93.9 million of which \$92.3 million is classified as loans and investments. The

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<sup>1</sup> All of the Balance Sheet and Profit and Loss Statement information discussed in this section were prepared by the outside bookkeeper. However, they have been reformatted for ease of review. The Temporary Receiver's deputy has not audited these statements.

balance sheet also reflects that \$144.8 million was raised from investors over the life of PCM. Of that amount, about \$13.4 million was returned to investors in the form of investment repayment (not including interest). It is important to note that the assets classified as loans and investments are on a cost basis and not a market value basis. As discussed in more detail below, many of these assets appear to be seriously troubled, and some will likely be partial losses and some total losses. Therefore, the negative equity reflected on the balance sheet as \$41.8 million is understated by an unknown amount.

Also under Tab 1 is a Profit and Loss Statement for PCM. Total income for the life of the company was about \$1 million. Total interest payments to investors over the life of the company were about \$26.2 million. PCM made commission payments to D.W. Heath & Associates of about \$12.7 million. PCM's net loss for the life of the company was about \$41.8 million. Principal and interest payments to investors totaled about \$39.6 million. Therefore, payments to investors could only have come from the money invested by other investors.

Under Tab 2 is the Balance Sheet for D.W. Heath & Associates, Inc. The only significant balance sheet item is \$2.2 million in draws Mr. Heath took from the company.

Also under Tab 2 is a Profit and Loss Statement for D. W. Heath & Associates, Inc. The seventeen non-selling employees are all listed in the personnel records of D. W. Heath & Associates, Inc. The Temporary Receiver has not located any record of other employees in any other defendant companies. Total income over the life of the company was about \$15.2 million. Of that amount, \$12.5 million commission income was received from PCM and about \$1.8 million was received from companies related to Mr. Larre Schlarmann. The Profit and Loss Statement reflects payments to Mr. Heath of about \$730,000 and payments to John Heath (Mr. Heath's father) of about \$1.4 million. Payments to Denis O'Brien and his trust entity total about \$1.9 million.

Under Tab 3 is a summary of frozen funds of Receivership Defendants and affiliates.

### **Preliminary Information on Loans and Equity Positions**

The Temporary Receiver and his colleagues spent several days reviewing the 204 boxes of records seized by the District Attorney's Office, particularly the files relating to specific companies in which PCM made investments. From the review, the Temporary Receiver's colleagues identified outstanding loans or equity investments totaling approximately \$92 million. At least \$50 million in loans and investments appear to involve a third party, Mr. Larre J. Schlarmann, and his company, Schlarmann and Associates, Inc. Notably, the Temporary Receiver has been unable to locate any records of signed notes or investment agreements with Mr. Schlarmann

or his company. The Temporary Receiver has subpoenaed Mr. Schlarmann for a deposition and has also subpoenaed all records relating to investments with the Temporary Receivership entities from his corporation, Schlarmann and Associates, Inc. As set out below, Mr. Heath indicated that many of the records of investments by PCM might be held by Mr. Schlarmann and that Schlarmann should have the details concerning repayment of investments made to or in connection with Schlarmann and Associates.

#### Key Observations:

- Due to the total lack of transaction documents and records, it has not yet been possible to determine the composition of PCM's investment and loan portfolio. The portfolio seems to consist of short/long-term commercial finance without any evidence of UCC filings, mezzanine financing (sometimes with equity kickers), and straight equity investments. The Temporary Receiver has been unable to verify the exact nature of many of the loans or investments, due to Mr. Heath's assertion of his privilege against self incrimination in response to questions about specific investments and loan repayment agreements, and the lack of documentation for the investment loans.
- A review of a limited amount of old financial data indicates that PCM was engaged in financing many start-up companies, as well as providing large amounts of loan funds to prop up a negative capital position of its borrowers. Mr. Heath stated that some of the signed notes might be held by the accountants or the Chief Executive Officers of the companies to which the loans were made.
- Mr. Heath stated that many of the investments made by PCM were "long-term" and that he was not sure of any specific terms of repayment.
- An obvious characteristic of the portfolio is the extremely high concentration of risk in a few borrowers. Based on the May 12, 2004 PCM balance sheet obtained from the accounting records turned over from the outside bookkeeper, 13 groups of borrowers/investments made up \$86 million or over 90% of the total. There are several individual loans and investments that exceed \$10 million.

A recurring factor in the portfolio is the role played by Larre Schlarmann and his investment management firm. Directly or indirectly, he seems to be involved in PCM loans and investments amounting to approximately 50% of the entire portfolio. When asked by the Temporary Receiver's colleagues why such a large percentage of the loans were made to or through Mr. Schlarmann's company, particularly in light of

the fact that the loans appeared to be high-risk loans to unprofitable borrowers, Mr. Heath replied that he has known Mr. Schlarmann for 20 years and it was based on this longstanding relationship. When asked by the Temporary Receiver's colleagues whether there were any profitable investments with Mr. Schlarmann, Mr. Heath replied that, strategically, PCM's position with Mr. Schlarmann was long-term. Given the foregoing, the Temporary Receiver's staff is unable to form a precise opinion on the quality of PCM's investments/loans and their recovery prospects at this time. However, as set out below, the presently available data indicates that PCM's loans and investments to its two largest groups, Prestige Resort Development and Quizno related entities, are highly problematic at this time.

Notwithstanding the seizure of Mr. Heath's records and documents by the Riverside County District Attorney's office, it seems highly probable that any original loan documents (loan agreements, notes, security agreements, etc.) and investment agreement documents including stock certificates, may be held elsewhere. As indicated, these documents have not yet been located by the Temporary Receiver. Mr. Heath was unable to assist in identifying whether these records existed or where they are held.

The subsections below describe the currently known status of PCM's balance sheet assets of \$1 million or greater. The amount shown as disbursed by PCM is the amount carried on the PCM balance sheet. That amount does not always agree with the available records of the payee or borrower. The Temporary Receiver will need additional time to complete reviewing balance sheet assets of less than \$1 million.

### **Practice Golf Management \$2.2 million disbursed by PCM**

On March 24, 2004, Menifee P.G.C Equities LLC sold a golf course and practice range, the Practice Golf Center, located at 31750 Antelope Road, Menifee, CA. According to the escrow company records, the sale price was \$4,200,000. Proceeds payable to the seller were \$3,008,243. The Grant Deed shows that the property was sold to Reserve Partners, LLC, a California Limited Liability Company. Reserve Partners, LLC is located at 3935 Harney Street, Ste 100, San Diego, CA. The Managing Partner is JPB, LLC. There is a Deed of Trust for First National Bank (Lender) to Reserve Partners, LLC (Beneficiary) for \$4.8 million, signed by James P. Brennan, Managing Director of JPB, LLC, a Nevada Limited Liability Company.

The Temporary Receiver requested and received records from the escrow company showing that the sales proceeds in the amount of \$3,008,243 were wired to First Mountain Bank. Escrow records listed the account holder at First Mountain Bank as Menifee PGC Equities, LLC. The Temporary Receiver immediately notified the bank upon receipt of the wire transfer records, and all funds remaining in the account, totaling about \$642,000, have been frozen.

Documents in possession of the Temporary Receiver show that Mr. Heath exercised control over Menifee PGC Equities, LLC. Specifically, Mr. Heath signed the grant deed on behalf of the seller, Menifee P.G.C. Equities, LLC, on September 18, 2003. He also signed several escrow documents on behalf of the seller. On October 16, 2003, he signed an Escrow Amendment Supplement. On September 18, 2003, Mr. Heath signed a memorandum prepared by the real estate broker stating that documents subject to review by the buyers were held at the Practice Golf Center. On or about September 9, 2003, Mr. Heath signed sale escrow instruction documents. On April 29, 2003, he signed the listing agreement, along with Larre J. Schlarmann, as the seller of the property.

The registration records, signed by Mr. Heath and filed with the Secretary of State, list Larre J. Schlarmann and Mr. Heath as the two managers of Menifee PGC Equities, LLC.

Records also show that invoices for legal services performed in relation to the sale of the golf course and the registration of Menifee PGC Equities with the State of California were sent to Menifee P.G.C. Equities, c/o Daniel W. Heath, Heath & Associates, One Point Drive, Suite 330, Brea, CA 92821. Mr. Heath signed the Limited Liability Company Statement of Information, for filing with the Secretary of State, on November 13, 2003.

On May 12, 2004, Mr. Heath was asked about the sale of the golf course during his meeting with the Temporary Receiver. PCM records list a \$2.2 million loan to Practice Golf Management. Mr. Heath stated that the Practice Golf Management was the Managing Partner of Menifee PGC Equities, LLC. Records show Practice Golf Management was incorporated on April 17, 1996, with Larre Schlarmann as President and Daniel W. Heath as CFO and Secretary. On April 8, 2004, Daniel W. Heath signed as Secretary for the sale of a liquor license held by Practice Golf Management.

The Receiver's staff asked whether the \$2.2 million loan had been repaid out of the sales proceeds. Heath replied that Menifee PGC Equities was a Schlarmann offering. Mr. Heath initially refused to answer questions about the distribution of the sales proceeds. He then stated the owner of the property was a Schlarmann group, and that he was a "secondary officer." When shown a document showing he signed escrow instructions on behalf of Menifee PGC Equities, he stated that he executed that document because Mr. Schlarmann was out of town.

Mr. Heath then stated that the \$2.2 million loan was not fully repaid. He said there were separate investors, not PCM investors, who were repaid first. He said PCM was paid on a pro rata basis and received only \$500,000 from the sales proceeds. Another \$200,000 was supposed to be paid but he did not know whether or not it had been paid and that it might have come in later. The Temporary Receiver's staff asked if

the rest of the loan was a bad debt write-off. Mr. Heath said possibly, he didn't recall who else got paid, and the Temporary Receiver should ask Mr. Schlarmann. In response to a question from the Temporary Receiver's staff, Mr. Heath said he did not recall having any personal investment in Menifee PGC Equities LLC or Practice Golf Management. He said he did not receive any of the sale proceeds.

Mr. Heath also stated there was a "cross-over" of investors. Mr. Schlarmann's group of investors invested in Antelope Road Mortgage Group. This was a Schlarmann entity that had a First Trust Deed on the property. Some of the PCM investors were also investors in Antelope Road Mortgage Group. Mr. Heath again stated that the Antelope Road investment was a Schlarmann offering and he didn't know who the investors were.

Based on Mr. Heath's explanation, it appears that \$1.7 million of the loan to Practice Golf Management is in jeopardy.

#### **Fitness Care, Inc. (FCI) \$5.2 million disbursed by PCM**

FCI operated as a start-up incubator to acquire, restructure, and spin off companies which included following:

Valley of the Sun Cosmetics  
Magnum Sports International  
Novelties USA  
TechNiGlove, Intl.

No financial information on FCI is available. Mr. Heath has advised the Temporary Receiver that PCM owns 50% of FCI.

#### **Valley of the Sun Cosmetics, LLC (VSC) \$1.2 million disbursed by PCM**

This company was spun off by FCI. It was incorporated in California on June 30, 2003, and its organizers and founders are Mr. Heath and Ajmal Shehzad. In addition to the founders, another director is Rick Caporale, a consultant. It is located at 19520 Rancho Way, Suite 205, Rancho Dominguez, CA 90220.

VSC is in the business of manufacturing and distributing beauty products targeted for Persian Gulf countries: the UAE, Iran, Pakistan, Lebanon, Saudi Arabia, Egypt, etc. The three main brands are Natural Fitness, American Beauty, and Spanish Garden. The company is in its 5<sup>th</sup> year of operations and appears to be still in a start-up mode.

The financial statement for the 9-month period ending September 2003 reported total sales of \$575,000 and net operating losses of \$442,000. The balance sheet for the same date showed total assets of \$62,000 and PCM notes payable of \$1.1 million,

with negative equity of \$1.4 million. The 2003 fiscal year-end profit and loss statement reported total sales of \$950,000 and net operating losses of \$413,000. No balance sheet available for this period could be located.

**TechNiGlove International, Inc. (TI) \$2.5 million disbursed by PCM**

TI was incorporated on July 1, 1998. The directors are Janine Gass, Mr. Heath, and James Sullivan, Jr. The officers are Roger Gass, president, Janine Gass, secretary, and Daniel Heath, chief financial officer. The exact ownership of this business is not clear, but Mr. Heath's personal financial statement dated December 31, 2002 showed a 50% ownership in this company.

TI is in the business of manufacturing various industrial high-grade latex gloves for export to North America, Japan, and Europe. The plant is located in Malaysia with a work force of 270.

The profit and loss statement for three-month period ending March 31 2004 showed year-to-date sales of \$634,000 and net operating losses of \$55,000. A current balance sheet could not be located, but nine-month interim financials for the period ending September 30, 2003 reported total sales of \$1.7 million, and net operating losses of \$302,000. The balance sheet on the same date showed total assets of \$1.3 million and negative equity of \$3 million.

No evidence of any due diligence performed by Mr. Heath or documentation for PCM's involvement as a lender or as an investor has been located.

**Mastermind Distribution, Inc. (MD)\$6.1 million disbursed by PCM**

MD appears to have significant investments in trademarks and, reportedly, in nationally recognized stars in the skateboard industry. Mr. Heath's December 31, 2002 personal financial statement showed a 44% ownership interest in MD. According to Mr. Heath, the Chief Executive Officer of MD was recently terminated, and Rick Caporale, a consultant, has been asked to manage the company. Mr. Heath stated in the May 12, 2004 meeting that PCM is the primary shareholder of MD.

PCM's balance sheet also shows a \$1.8 million loan outstanding to Lethol Elements. According to Mr. Heath, Lethol Elements has been merged into MD, therefore bringing the total investment/loan balance to MD to \$7.9 million. Mr. Heath stated he did not know the repayment arrangement for these loans; that the skateboard industry was in a slump, and that this was a "long term" investment, which, like many of PCM's investments, was based on the "dynamics of the market." Mr. Heath also confirmed that PCM holds a 50% interest in a trademark that is collateral for part of the MD loan.

MD's three-month interim profit and loss statement for the period ending March 31, 2004 reported total revenues of \$186,000 and net operating losses of \$329,000. The balance sheet on the same date showed total assets of \$918,000, and notes payable to PCM of \$7.6 million, resulting in negative equity of \$7 million.

**Kenneth Hafker-Hafker Drywall, Inc. (HD) \$2.1 million disbursed by PCM**

HD was incorporated on January 3, 2002 in California. Kenneth Hafker is the Chief Executive Officer and Mr. Heath is the Chief Financial Officer and Secretary.

The profit and loss statement for a five-month period ending June 4, 2003 reported total revenues of \$901,000 and net operating losses of \$619,000. The May 6, 2003 balance sheet showed total assets of \$136,000, notes payable to PCM of \$948,000 (which does not agree with the PCM balance sheet entry), and negative equity of \$973,000. Documents reviewed by the Temporary Receiver's colleagues show that Hafker Drywall also considered setting up a Bahamian corporation. Mr. Heath was asked whether this had occurred and whether Hafker Drywall had set up any offshore accounts. Mr. Heath stated that he was unaware of any offshore accounts, and that he had not made any payments to any offshore accounts. Mr. Heath stated he did not know when Hafker Drywall was obligated to repay the loan, and that Hafker Drywall was looking for an equity partner to take the company to the next level and pay off the PCM loan. There was a deal that was supposed to close, but he did not know whether that had occurred.

**Prestige Resort Development, LLC (PRD) \$15.8 million disbursed by PCM**

PRD is the developer for a timeshare resort known as The Club at Big Bear Village located at 4067 Village Drive, Big Bear, California. The Club is a luxurious, gated residence club and high-end resort, with a total of 180 units, each with 1/10 undivided, deeded ownership interest. This represents the largest single investment of the receivership estate.

PRD owners are: PCM 80%, TITL 10%, Pamela Jandt 10%. Mr. Heath's December 31, 2002 personal financial statement showed a 37% personal interest in PRD.

Financing has been provided by the owners in the form of equity injections totaling \$25 million and by Capital Source Finance, LLC (Maryland), through a \$25 million long-term credit facility.

When the Temporary Receiver learned of the amount invested in this project, he made immediate arrangements to visit the project. On May 7, 2004, the Temporary Receiver met with Thomas Johnson, a principal of the Alderwood Group LLC. The Alderwood Group has a management contract to oversee construction and sales. Mr. Johnson expressed concern because the current construction costs to complete the

shell units range from \$250 to \$300 per square foot. The high construction costs combined with the location of the project have resulted in a dismal absorption rate of 1.2 sales of the 1/10<sup>th</sup> interests per month. Mr. Thompson expressed the view that the direction of the remaining portion of the project should be altered with the objective of reducing the construction costs by about 20%. The Big Bear area generally and this project specifically have suffered as a result of a series of natural disasters that have impacted the area since the initial commitments to develop the project. Those factors, combined with high costs, have resulted in the low sales figures. A total of 56 fractional shares have been sold over the last four years.

The 180 units consist of 18 three and four-bedroom townhouse units. As of now, 14 units have been completed and furnished. Four units have the exterior complete with the interiors unfinished and not furnished. The general contractor is scheduled to finish the interior portion at an estimated cost of \$800,000 to \$1 million. The contractor is also owed about \$600,000 for completed exterior work.

The April 30, 2004 four month interim financial statements show total assets of \$43.5 million, consisting of less than \$2,000 in cash, \$583,000 in accounts receivable, \$50,000 in fixed assets, and \$43 million in capitalized construction costs in progress, inventory, land and buildings, and other capitalized expenses.

PRD's asset composition shows no liquidity, as all borrowed and equity funds have already been spent. The exact status of construction progress is not known at this time. In-depth study will be necessary to determine what additional funds may be needed to complete the project.

There are serious questions regarding the ultimate recovery of the full \$15.8 million investment in this project. Given the large amount of capitalized costs, additional equity or loan funds will be needed to sustain the project.

On May 7, 2004 Capital Source declared its note in default and issued a demand for the immediate payment of \$17,281,822.55. On May 12, 2004, the Temporary Receiver met with representatives of Capital Source.

Capital Source is a New York Stock Exchange listed financial company that provides debt financing for a variety of enterprises, including a number of timeshare developments. Capital Source appears to be secured by a first trust deed on the project and cross guarantees from various Heath-related entities and a personal guaranty from Mr. Heath.

The meeting focused on how to maintain the project, complete the work in progress and generate cash flow from sales. All agreed that the project is in jeopardy. Capital Source executives expressed the view that they are not completely confident that there is enough real equity in the project to protect their loan, let alone provide any

coverage for the Heath investors. They are fully cognizant of the obligations imposed on all parties by the Court and are anxious to be cooperative with the Temporary Receiver in seeking an approach that will minimize the damage to all parties. It was mutually recognized that additional cash to sustain the project would have to come from Capital Source. Its executives indicated they were prepared to advance additional funds immediately, once a plan of action was agreed on. The Temporary Receiver assigned one of his senior deputies and one of his construction specialists to visit the project the following day, commence more detailed evaluation of its status and communicate with Capital Source executives on an ongoing basis.

The financial affairs of the project are interwoven with the personal interests of Mr. Heath and other related parties. The immediate priority, in addition to evaluation of the project's condition and status, is to untangle the finances and determine the exact ownership position of various parties and examine any potential for claims by the receivership estate against third parties.

**Hotel Management, Inc. (HMI) \$13.2 million disbursed by PCM**

Hotel Management, Inc. is the General Partner and 1.5% owner of Northwoods Resort Holdings, LP (NRHLP) and operates Northwoods Resort Hotel and Conference Center located in Big Bear, CA. The hotel has 150 rooms and a complete conference center. Mr. Heath's December 31, 2002 personal financial statement shows a 37% ownership interest in Northwoods through TITL Equities, L. P. The Agreement of Limited Partnership shows the ownership of NRHLP as: NADM Equities 38%, TITL 38%, Thomas Johnson 12.5%, Barney Family Trust 10%, and Hotel Management, Inc. 1.5%)

The parties involved in NRHLP are:

Schlarmann and Associates, developer, president of Hotel Management, Inc.

Oakley & Oakley, architect and engineer

Heath & Associates, finance

Thomas Johnson, operator, a partner of NRHLP, owner of Alderwood Resort Management Group

There was no financial information in the file other than December 31, 2002 operating statements covering the year 2002, which showed total revenues of \$5.4 million and a net operating loss of \$2.9 million.

According to Mr. Heath, the \$13.2 million is a long-term multi-purpose loan, and Northwoods Resort may have used a portion of PCM loan proceeds. HMI is Schlarmann managed entity. Mr. Heath stated that PCM was the primary source of capital for Hotel Management, Inc. He did not know if Mr. Schlarmann had other investors. According to Mr. Heath, PCM has no equity interest in Hotel

Management, Inc. In a brief discussion Thomas Johnson, 12.5% owner in NRHLP, and manager of the facility, has no record of a \$13.2 million investment by PCM.

**Investments Management/Schlarman \$3.5 million disbursed by PCM**  
**Investments Management \$17.2 million disbursed by PCM**

According to Mr. Heath, Investments Management is a subsidiary of Mr. Schlarman's company, and these are all Schlarman related loans. The Temporary Receiver has not been able to locate any information about these transactions. As noted, the Temporary Receiver has issued a subpoena to Schlarman & Associates for all records relating to the investments made by the receivership entities.

**NADM Equities Limited Partners \$3.2 million disbursed by PCM**

According to Mr. Heath, this is an accounting error. There is no PCM loan outstanding to NADM. NADM is supposed to be non-business Schlarman family entity, which owns 38% of Northwoods Resort Holding LP.

**QCAL Management Inc. \$2.2 million disbursed by PCM**  
**QIE Development, LLC \$3.7 million disbursed by PCM**  
**P.S. Restaurant Management \$5.5 million disbursed by PCM**

These are all Quizno-related entities, managed by Mr. Schlarman. Mr. Heath claims no knowledge on the ownership of these entities, but admits that these loans are in jeopardy.

**Summary**

Based on the preliminary analysis of the major assets, the Temporary Receiver believes that significant additional time and effort will be needed to review and analyze the viability of each asset and to immediately establish plans to maximize the resolution and potential return on these assets.

**Recent Transactions Completed or In Process**

**Restorative Health**

Mr. Heath owns 25% of Restorative Health. The Chief Financial Officer of the company is currently working on a stock redemption plan that would net in excess of \$600,000. Two outside lenders are evaluating the loan to accomplish this.

The Temporary Receiver contacted the attorney for the shareholder orchestrating the transactions and advised him that no funds are to be disbursed to Mr. Heath.

Similar stock redemptions are contemplated for National Nursing and Rehab and Direct PT. The attorneys handling these transactions have also been contacted by the Temporary Receiver and each is in possession of the TRO.

### **Aquatic Rehab**

This company was funded by Mr. Heath, but the loan amount is unknown. Ownership was held by Mr. Heath and Ed Sullivan, each with a 50% interest.

In April 2003 Aquatic was sold to Rivian Health. The purchase price was \$37.3 million for 60 facilities. The terms were \$20 million cash and seller financing of \$17 million at 4% for 36 months. The note contains a provision for a 4% increase in October 2004 and an additional 4% six months later. Based on prevailing interest rates, it is anticipated that the buyer will refinance this note with an outside lender and payoff the interests of Mr. Sullivan and Mr. Heath.

There is an earn-out provision that provides the seller will be paid a multiple based on 2003 sales. Deloitte & Touche is reported to be currently performing an audit and the payout is scheduled for May 31, 2004. The broker that handled the transaction expects the amount to be in the range of \$1-2 million.

### **Coast Energy Management**

Documentation provided by the SEC revealed two notes to Heath and Associates from Coast Energy Management, totaling \$400,000.

Coast is negotiating the sale of their inventory to a third party. Their attorney has been in contact with Mr. Heath and confirmed a price of \$400,000. The funds have not been disbursed. The Temporary Receiver provided the attorney a copy of the TRO and instructed him not to release the funds to Mr. Heath.

### **Investor Communications**

The Temporary Receiver has established a website which is [heath-receiver.com](http://heath-receiver.com). That website also as an email address to communicate with those investors who have access to the Internet. To date, in excess of 50 investors have sent email inquires to the Temporary Receiver.

On May 4, 2004 the Temporary Receiver was contacted by an attorney for First Trust Corporation. One of the Temporary Receiver's deputies coordinated with First Trust who sent a notice to their clients informing them of the Temporary Receivership and how to contact the Temporary Receiver, which included a reference to the website.

## **Conclusion**

As discussed above, PCM's balance sheet reflects negative equity of about \$41.8 million. Investments in companies with net operating losses and negative equity total about \$11.9 million. Based on this information and without any other adjustments that will likely occur, the Temporary Receiver believes the true negative equity of PCM is at least \$53.7 million.

As noted above, all of the \$144.8 million raised from investors was deposited in PCM's bank account. Also, all of the income generated from all sources totaling about \$1 million was deposited in PCM's bank account. That income was more than consumed paying commissions to D.W. Heath & Associates and by payments to others. Principal and interest payments to investors totaled about \$39.6 million. Therefore, payments to investors could only have come from the money invested by other investors.

Respectfully submitted,

Robb Evans  
Temporary Receiver

**PRIVATE CAPITAL MANAGEMENT**

**Balance Sheet**

As of April 29, 2004

**Apr 29, 04**

**ASSETS**

**Current Assets**

**Checking/Savings**

Bank of America/Executive NEW

1,483,302.31

Bank of American/Disb/NEW

3,396.39

Transfer

**(174,685.16)**

**Total Checking/Savings**

**1,312,013.54**

**Total Current Assets**

1,312,013.54

**Other Assets**

**Investment Loans/Asset Purchase**

Accomodation By Reservations,

232,515.49

Advanced Medical Systems

153,359.53

Alligator Smoke Wood

286,127.17

Antelope Road Mortgage Fund

80,000.00

BMC Mtg. Fund

4,703.44

Chicago Title

15,000.00

CSI Technologies Inc.

200,000.00

Design Solutions

587,405.00

Direct P. T. Inc.

Helios Nursing Svc.

20,512.51

Direct P. T. Inc. - Other

372,062.55

**Total Direct P. T. Inc.**

**392,575.06**

**E. S. Management**

500,000.00

**Fitness Care, Inc.**

Novelties USA

220,745.00

Valley of the Sun

1,213,039.00

Fitness Care, Inc. - Other

5,241,070.84

**Total Fitness Care, Inc.**

**6,674,854.84**

**Fixed Income Mortgage Fund**

18,750.00

**Foam Technologies, Inc.**

239,800.00

**Hotel Management Inc.**

13,157,614.48

**Intergrated Financial Company**

Surgery Pro

**(65,000.00)**

Intergrated Financial Company - Other

879,010.00

**Total Intergrated Financial Company**

**814,010.00**

**Investments Management**

17,240,407.95

**Investments Management/Schlarma**

3,501,760.51

**Kenneth Hafker**

2,057,906.16

**KHS Enterprises**

Market Master Legal

50,000.00

Med Legal Consulting

91,699.00

Texas Community Legal Associati

23,535.32

KHS Enterprises - Other

751,925.37

**Total KHS Enterprises**

**917,159.69**

**Laird Holdings**

**(2,908.92)**

**Lakeview**

12,000.00

**Lone Star Family Health**

241,253.66

**MasterMind Distribution**

Industry Threat

91,552.18

Kubic Marketing

90,080.56

# PRIVATE CAPITAL MANAGEMENT

## Balance Sheet

As of April 29, 2004

|  | <b>Apr 29, 04</b>    |
|--|----------------------|
| Lethol Elements                              | 1,858,791.00         |
| MasterMind Distribution - Other              | 6,077,619.66         |
| <b>Total MasterMind Distribution</b>         | <b>8,118,043.40</b>  |
| <br>   |                      |
| Mortgage Loan Income Fund                    | 44,000.00            |
| Mtn. Top Escrow                              | 326,374.00           |
| NADM Equities Limited Partners               | 3,234,692.04         |
| National Nursing & Rehab                     |                      |
| National Extended Care                       | 279,186.32           |
| National Nursing & Rehab - Other             | 74,583.34            |
| <b>Total National Nursing &amp; Rehab</b>    | <b>353,769.66</b>    |
| <br>   |                      |
| Newport Mortgage                             | (430,171.63)         |
| Northwoods                                   | 431,723.00           |
| P. S. Restaurant Managment                   | 5,549,145.24         |
| Physical Therapy Dynamics                    |                      |
| Aquatic Rehab, Inc.                          | 116,000.00           |
| Physical Therapy Dynamics - Other            | (608,509.20)         |
| <b>Total Physical Therapy Dynamics</b>       | <b>(492,509.20)</b>  |
| <br>   |                      |
| Practice Golf Management                     | 2,191,280.21         |
| Prestige Resort Development, LL              |                      |
| Capital Source Finance LLC                   | 163,164.98           |
| The Alderwood Group                          | 897,000.00           |
| Prestige Resort Development, LL - Other      | 14,807,935.00        |
| <b>Total Prestige Resort Development, LL</b> | <b>15,868,099.98</b> |
| <br>   |                      |
| Progressive Rehab, Inc.                      | 792,102.49           |
| QCal Management, Inc.                        | 2,195,600.00         |
| QIE Construction                             | 10,000.00            |
| QIE Development, LLC                         | 3,674,344.91         |
| QSD Corporate Income Fund                    | 10,000.00            |
| Restorative Healthcare                       | 12,015.07            |
| Restore Physical Therapy                     | 25,000.00            |
| Schlarmann & Associates                      | 284,012.09           |
| TechNiglove Int'l.                           |                      |
| Flexitech                                    | 193,877.01           |
| TechNiglove Int'l. - Other                   | 2,482,446.00         |
| <b>Total TechNiglove Int'l.</b>              | <b>2,676,323.01</b>  |
| <br>   |                      |
| The Alderwood Group                          | 21,594.38            |
| The BikeBoard Company, LLC                   | 399,800.00           |
| Title Equities                               | (977,995.00)         |
| Toxler Enterpirses, Inc.                     | 135,045.12           |
| United Medical Group                         | 50,000.00            |
| Unknown                                      | 129,696.66           |
| Valley of the Sun LLC                        | 315,000.00           |
| <b>Total Investment Loans/Asset Purchase</b> | <b>92,271,279.49</b> |
| <br>   |                      |
| <b>Long Term Loans</b>                       |                      |
| Arter & Hadden Trust Fund Accou              | 105,202.14           |
| fbo Eagle Summitt Escrow                     | 81,376.00            |
| General Collision                            | 7,000.00             |
| Kaufman, Victor                              | 15,945.91            |
| Lucille Martin                               | 10,000.00            |
| Resource Financial Company                   | 10,500.00            |

**PRIVATE CAPITAL MANAGEMENT**

**Balance Sheet**

As of April 29, 2004

|   | <u>Apr 29, 04</u>               |
|---|---------------------------------|
| Sickles, Dane                             | 8,925.78                        |
| Silver Pines Escrow, Inc.                 | 63,437.00                       |
| Total Long Term Loans                     | <u>302,386.83</u>               |
| <br>Total Other Assets                    | <br><u>92,573,666.32</u>        |
| <br><b>TOTAL ASSETS</b>                   | <br><b><u>93,885,679.86</u></b> |
| <br><b>LIABILITIES &amp; EQUITY</b>       |                                 |
| Liabilities                               |                                 |
| Current Liabilities                       |                                 |
| Accounts Payable                          |                                 |
| Accounts Payable                          | 32,521.62                       |
| Total Accounts Payable                    | <u>32,521.62</u>                |
| <br>Total Current Liabilities             | <br>32,521.62                   |
| <br>Long Term Liabilities                 |                                 |
| Loan Payable                              |                                 |
| Investments                               |                                 |
| Client Investments                        |                                 |
| Client Closing Account                    | (3,784,438.87)                  |
| Client Withdrawal                         | (9,707,513.33)                  |
| Client Investments - Other                | 144,864,916.04                  |
| Total Client Investments                  | <u>131,372,963.84</u>           |
| <br>Total Investments                     | <br>131,372,963.84              |
| <br>Short Term                            |                                 |
| Daniel and Leslee Heath                   | 414,788.46                      |
| Troxler                                   | 1,487.90                        |
| Total Short Term                          | <u>416,276.36</u>               |
| <br>Title Equities L.P.                   | <br>3,831,509.00                |
| Loan Payable - Other                      | 4,000.00                        |
| Total Loan Payable                        | <u>135,624,749.20</u>           |
| <br>Total Long Term Liabilities           | <br><u>135,624,749.20</u>       |
| <br>Total Liabilities                     | <br>135,657,270.82              |
| <br>Equity                                |                                 |
| Opening Bal Equity                        | (1,130.09)                      |
| Retained Earnings                         | (39,250,724.93)                 |
| Net Income                                | (2,519,735.94)                  |
| Total Equity                              | <u>(41,771,590.96)</u>          |
| <br><b>TOTAL LIABILITIES &amp; EQUITY</b> | <br><b><u>93,885,679.86</u></b> |

PRIVATE CAPITAL MANAGEMENT

TAB 1

Profit & Loss

January 1, 1994 through April 29, 2004

Jan 1, '94 - Apr 29, 04

Ordinary Income/Expense

Income

Interest Income

|                                       |                 |
|---------------------------------------|-----------------|
| Interest Income - Other               | 347,072.68      |
| Progressive Rehab & Sports Med        | 181,000.00      |
| P. S. Restaurant Mgt.                 | 154,821.80      |
| TechNiGlove Int'l.                    | 119,000.00      |
| National Nursing & Rehab              | 57,604.23       |
| John S Moreiko                        | 34,605.74       |
| Hunters Hall                          | 25,200.00       |
| Coastal Diagnostic Services           | 18,071.85       |
| Lone Star Family Health               | 16,000.00       |
| Restorative Health Care               | 11,006.89       |
| Physical Therapy Dyn.                 | 10,500.00       |
| Direct PT, Inc.                       | 10,470.81       |
| National Extended Care Nursing Client | 6,187.51        |
| June Bushong                          | 3,966.78        |
| Client - Other                        | 1,050.00        |
| <b>Total Client</b>                   | <u>5,016.78</u> |

|                        |          |
|------------------------|----------|
| General Collision      | 2,000.00 |
| Airport Medical Clinic | 1,800.00 |

**Total Interest Income** 1,000,358.29

Lease Income

|                       |          |
|-----------------------|----------|
| QCal Management, Inc. | 6,000.00 |
|-----------------------|----------|

**Total Lease Income** 6,000.00

Commission Income

|                     |          |
|---------------------|----------|
| The Alderwood Group | 2,000.00 |
|---------------------|----------|

**Total Commission Income** 2,000.00

Reimbursed Expenses 1,750.00

Investments

|                   |      |
|-------------------|------|
| Investment Income | 0.00 |
|-------------------|------|

**Total Investments** 0.00

**Total Income** 1,010,108.29

Expense

Client

|                               |               |
|-------------------------------|---------------|
| Client Interest Paid          | 26,057,115.38 |
| RMD                           | 249,156.08    |
| Client - Other                | 12,394.17     |
| Refund                        | 9,861.00      |
| Sweep                         | 4,598.88      |
| Fees Paid                     | 766.13        |
| Client Bonus                  | 559.16        |
| Client Early W/Draw Penalties | (113,158.90)  |

**Total Client** 26,221,291.90

Commission Expense

# PRIVATE CAPITAL MANAGEMENT

## Profit & Loss

January 1, 1994 through April 29, 2004

|  | <u>Jan 1, '94 - Apr 29, 04</u> |
|--|--------------------------------|
| <b>D.W. Heath &amp; Associates</b>       |                                |
| D.W. Heath & Associates - Other          | 8,227,999.30                   |
| Heath & Associates                       | 4,528,652.61                   |
| <b>Total D.W. Heath &amp; Associates</b> | <u>12,756,651.91</u>           |
| <br>                                     |                                |
| Cafe Red.                                | 50,508.79                      |
| John W. Heath                            | 17,500.00                      |
| Alipia Samson                            | 6,620.00                       |
| Daniel Heath                             | 4,000.00                       |
| <b>Total Commission Expense</b>          | <u>12,835,280.70</u>           |
| <br>                                     |                                |
| <b>Professional Fees</b>                 |                                |
| Legal Fees                               |                                |
| Legal Fees - Other                       | 635,517.06                     |
| I. David Small                           | 6,000.00                       |
| <b>Total Legal Fees</b>                  | <u>641,517.06</u>              |
| <br>                                     |                                |
| Accounting                               | 15,282.48                      |
| Professional Fees - Other                | 12,100.00                      |
| <b>Total Professional Fees</b>           | <u>668,899.54</u>              |
| <br>                                     |                                |
| <b>Outside Services</b>                  |                                |
| Design Solutions, Inc.                   | 193,700.00                     |
| Outside Services - Other                 | 115,284.73                     |
| Mel Rabow                                | 60,000.00                      |
| Caporale Consultants, Inc.               | 18,500.00                      |
| Robert Mortensen                         | 11,487.63                      |
| <b>Total Outside Services</b>            | <u>398,972.36</u>              |
| <br>                                     |                                |
| <b>Uncategorized Expenses</b>            | 170,256.00                     |
| <b>Note Payment</b>                      |                                |
| Aquatic Rehab                            | 55,000.00                      |
| Dustin Martinez                          | 52,850.24                      |
| <b>Total Note Payment</b>                | <u>107,850.24</u>              |
| <br>                                     |                                |
| <b>Cash</b>                              | 75,000.00                      |
| <b>Contract Labor</b>                    |                                |
| Jim Sullivan                             | 25,100.00                      |
| Contract Labor - Other                   | 20,775.80                      |
| Aaron Heath                              | 150.00                         |
| <b>Total Contract Labor</b>              | <u>46,025.80</u>               |
| <br>                                     |                                |
| <b>Construction Expense</b>              | 45,880.00                      |
| <b>Lease</b>                             | 45,400.00                      |
| <b>Miscellaneous</b>                     | 43,982.47                      |
| <b>Taxes</b>                             |                                |
| Property                                 | 17,557.50                      |
| State                                    | 15,660.85                      |
| <b>Total Taxes</b>                       | <u>33,218.35</u>               |
| <br>                                     |                                |
| <b>Bank Service Charges</b>              | 29,920.89                      |
| <b>Escrow Fees</b>                       | 10,000.00                      |
| <b>Printing and Reproduction</b>         | 7,809.99                       |

**PRIVATE CAPITAL MANAGEMENT****Profit & Loss**

January 1, 1994 through April 29, 2004

|                             | <u>Jan 1, '94 - Apr 29, 04</u> |
|-----------------------------|--------------------------------|
| Office Supplies             | 6,635.55                       |
| Insurance                   | 3,000.00                       |
| Phil Heath                  |                                |
| Lu Hwa Wong                 | 1,200.00                       |
| Total Phil Heath            | <u>1,200.00</u>                |
| <br>                        |                                |
| Dues and Subscriptions      | 521.69                         |
| Postage and Delivery        | 100.18                         |
| Licenses and Permits        | 85.00                          |
| Dividend Distribution       |                                |
| The Alderwood Group         | <u>(2,000.00)</u>              |
| Total Dividend Distribution | <u>(2,000.00)</u>              |
| <br>                        |                                |
| Penalty                     | (6,436.54)                     |
| Deposit                     | (106,830.37)                   |
| Total Expense               | <u>40,636,063.75</u>           |
| <br>                        |                                |
| Net Ordinary Income         | (39,625,955.46)                |
| <br>                        |                                |
| Other Income/Expense        |                                |
| Other Income                |                                |
| Savings                     | 140.89                         |
| Total Other Income          | <u>140.89</u>                  |
| <br>                        |                                |
| Other Expense               |                                |
| Write Off Bad Debt          | 2,144,646.30                   |
| Total Other Expense         | <u>2,144,646.30</u>            |
| <br>                        |                                |
| Net Other Income            | <u>(2,144,505.41)</u>          |
| <br>                        |                                |
| Net Income                  | <u><u>(41,770,460.87)</u></u>  |

**D. W. HEATH & ASSOCIATES, INC.**  
**Consolidated Balance Sheet**  
As of April 29, 2004

**TAB 2**

**ASSETS**

**Current Assets**

**Checking/Savings**

|                                 |                  |
|---------------------------------|------------------|
| Bank of America/Executive/New   | 15,407.81        |
| Bank of America/General         | 10,915.66        |
| Bank of America/Sav 12023-06631 | 1,736.06         |
| <b>Total Checking/Savings</b>   | <b>28,059.53</b> |

**Other Current Assets**

**Advance**

|                      |                 |
|----------------------|-----------------|
| Betty Mayo           | 1,500.00        |
| Pedro Romero         | 1,829.29        |
| Steven J. Wilder     | 3,000.00        |
| <b>Total Advance</b> | <b>6,329.29</b> |

**Deposits**

|                       |                 |
|-----------------------|-----------------|
| Olen Properties       | 3,603.60        |
| Petty Cash            | 100.00          |
| <b>Total Deposits</b> | <b>3,703.60</b> |

**Investments**

|                              |                   |
|------------------------------|-------------------|
| Fitness Care, Inc.           | 130,423.50        |
| Health partners/CWD Partners | 100.00            |
| Lethol                       | 12,548.00         |
| Novelties U.S.A.             | (1,733.71)        |
| Progress Rehab               | 1,200.00          |
| Title Equities               | 5,105.00          |
| Two-Step Productions         | 18,000.00         |
| <b>Total Investments</b>     | <b>165,642.79</b> |

|                                   |                   |
|-----------------------------------|-------------------|
| <b>Total Other Current Assets</b> | <b>175,675.68</b> |
|-----------------------------------|-------------------|

|                             |                   |
|-----------------------------|-------------------|
| <b>Total Current Assets</b> | <b>203,735.21</b> |
|-----------------------------|-------------------|

**Fixed Assets**

**Fixed Assets**

|                           |                  |
|---------------------------|------------------|
| Accumulated Depreciation  | 584.00           |
| Brea/Furniture & Fixture  | 40,386.34        |
| Furniture & Fixtures      | 4,683.26         |
| <b>Total Fixed Assets</b> | <b>45,653.60</b> |

|                           |                  |
|---------------------------|------------------|
| <b>Total Fixed Assets</b> | <b>45,653.60</b> |
|---------------------------|------------------|

**Other Assets**

**Company Personal Loans**

|                |           |
|----------------|-----------|
| Bill Shearin   | 2,000.00  |
| Doreen May     | 200.00    |
| James Sullivan | 18,900.00 |

**D. W. HEATH & ASSOCIATES, INC.****Consolidated Balance Sheet**

As of April 29, 2004

|  |                     |
|--|---------------------|
| Kenneth W. Hafker                      | (1,782.41)          |
| Rick Costamagna                        | 7,000.00            |
| <b>Total Advance</b>                   | <b>26,317.59</b>    |
| <b>Total Other Assets</b>              | <b>26,317.59</b>    |
| <b>TOTAL ASSETS</b>                    | <b>275,706.40</b>   |
| <b>LIABILITIES &amp; EQUITY</b>        |                     |
| <b>Liabilities</b>                     |                     |
| <b>Current Liabilities</b>             |                     |
| <b>Accounts Payable</b>                |                     |
| Accounts Payable                       | 190,164.95          |
| <b>Total Accounts Payable</b>          | <b>190,164.95</b>   |
| <b>Other Current Liabilities</b>       |                     |
| Overdraft Protection                   | 4,369.77            |
| Payroll Liabilities                    | 103.99              |
| <b>Total Other Current Liabilities</b> | <b>4,473.76</b>     |
| <b>Total Current Liabilities</b>       | <b>194,638.71</b>   |
| <b>Long Term Liabilities</b>           |                     |
| <b>Loan Payable</b>                    |                     |
| Bank Credit Line                       | 1,500.00            |
| Clients Investments                    | 110,084.72          |
| Investment Management                  | 1,235.29            |
| Private Capital Management             | 485,572.22          |
| <b>Total Loan Payable</b>              | <b>598,392.23</b>   |
| <b>Total Long Term Liabilities</b>     | <b>598,392.23</b>   |
| <b>Total Liabilities</b>               | <b>793,030.94</b>   |
| <b>Equity</b>                          |                     |
| Draw                                   | (2,248,191.85)      |
| Opening Bal Equity                     | 1,302.24            |
| Retained Earnings                      | 1,674,626.45        |
| Net Income                             | 54,938.62           |
| <b>Total Equity</b>                    | <b>(517,324.54)</b> |
| <b>TOTAL LIABILITIES &amp; EQUITY</b>  | <b>275,706.40</b>   |

**Income**

|   |                      |
|---|----------------------|
| <b>Private Capital Management</b>         | <b>12,507,571.91</b> |
| <b>Investmens Management - Schlarmann</b> | <b>1,638,580.02</b>  |
| <b>Schlarmann&amp;Associates</b>          | <b>201,391.13</b>    |
| Midland Annuity                           | 115,160.73           |
| QSD Corporate Income Fund                 | 75,032.14            |
| QIE                                       | 29,992.43            |
| Shearin & Wortman                         | 29,983.73            |
| Proactive Money Management                | 29,861.30            |
| American Life                             | 28,898.68            |
| PGC                                       | 22,000.00            |
| Antelope Mortgage Fund                    | 20,530.52            |
| SaltCreekSvcTrust                         | 12,878.58            |
| Salt Creek Services                       | 12,515.06            |
| Beneficial Standard                       | 9,545.00             |
| Mass. General                             | 8,894.73             |
| Prideaux                                  | 8,356.37             |
| A.M.S.                                    | 6,218.00             |
| Lincoln Benefit                           | 5,275.48             |
| JVS Partners LLC                          | 5,250.00             |
| I. David Small                            | 5,000.00             |
| P.D.R.                                    | 5,000.00             |
| TechNiGlove                               | 2,277.96             |
| Fees Paid                                 | 2,213.00             |
| LTC                                       | 1,647.00             |
| Physical Therapy                          | 1,500.00             |
| PFL                                       | 1,046.27             |
| PTD                                       | 1,000.00             |
| Lincoln Benefit                           | 290.05               |
| Unknown/Income                            | 217,713.71           |
| Other                                     | 90,912.33            |
| Fitness Care, Inc.                        | 50,321.63            |
| Reimbursed Expenses                       | 31,900.00            |
| Deposit                                   | 27,192.38            |
| Net Uncategorized Income                  | 20,107.04            |
| Other Fees                                | 7,131.84             |
| Loan Payment                              | 5,837.28             |
| Consulting Income                         | 5,375.00             |
| Novelties USA                             | 4,000.00             |
| Alligator Smoke Wood                      | 3,277.82             |
| Other Regular Income                      | 1,609.60             |

|                     |                      |
|---------------------|----------------------|
| <b>Total Income</b> | <b>15,253,288.72</b> |
|---------------------|----------------------|

**Expenses**

|                                 |                     |
|---------------------------------|---------------------|
| <b>O'Brien Ent. Trust</b>       | <b>1,817,402.72</b> |
| <b>John W Heath - father</b>    | <b>1,426,476.65</b> |
| <b>Daniel W Heath</b>           | <b>730,033.02</b>   |
| James L. Sullivan Jr.           | 352,254.86          |
| JDCC Financial Consultants, Inc | 343,069.74          |
| Corporation Force, Inc.         | 264,040.55          |
| Cafe Rendez-vous                | 248,754.78          |
| Belloscar Insurance & Financial | 245,237.08          |
| Bill Dowdell                    | 192,553.75          |
| Dennis McGilvery                | 189,193.53          |
| Salt Creek Service              | 128,000.00          |

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| D. W. Heath & Associates, Inc<br>Consolidated Income & Expenses Downloaded from Qbooks<br>July 1, 1993 to April 29, 2004 |
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|  |                  |
|--|------------------|
| Russell Floan                          | 104,005.58       |
| <b>Denis T. O'Brien</b>                | <b>79,557.36</b> |
| Trinity Financial Services, Inc        | 67,539.90        |
| Rick Caporale                          | 59,988.81        |
| <b>Sarah Heath Szemerei - daughter</b> | <b>52,968.30</b> |
| McGilvery Financial Service            | 52,817.73        |
| Raul Jordon                            | 19,700.00        |
| Karen MC Manus                         | 18,836.36        |
| Samson Alapia                          | 16,545.00        |
| Samson Alapia                          | 15,340.00        |
| <b>Elizabeth Heath</b>                 | <b>14,620.65</b> |
| Jason David Martinez                   | 13,900.00        |
| Suzanne Scott                          | 13,675.00        |
| Kelly Maddon                           | 13,500.00        |
| Russ Millard                           | 11,050.00        |
| Tamara Long                            | 10,993.80        |
| Joe Cooley                             | 8,235.00         |
| Bryan Cave LLP                         | 7,500.00         |
| <b>Aaron Heath</b>                     | <b>4,735.86</b>  |
| Abigail Abbott                         | 3,494.01         |
| Cathy A Smith                          | 2,674.90         |
| Tamara D Zamora                        | 2,100.00         |
| <b>Esther Heath</b>                    | <b>1,960.00</b>  |
| Georgina Humphreys                     | 1,824.00         |
| Kelly Maddon                           | 1,550.00         |
| Tiffany Jensen                         | 1,464.60         |
| <b>Jason Schlarmann</b>                | <b>1,000.00</b>  |
| Tonette Vioria                         | 847.55           |
| Estevan Rangel                         | 814.14           |
| Andrea Wells                           | 685.00           |
| Christina M. Cadwell                   | 620.00           |
| Efren Negrete                          | 558.00           |
| Ronnie Baltazar                        | 406.00           |
| Rafael Perez                           | 346.50           |
| <b>Leslee Heath</b>                    | <b>300.00</b>    |
| Richard Baltazar                       | 186.96           |
| Nicolas Rangel                         | 174.36           |
| Erin Will                              | 173.75           |
| N Monique Garcia                       | 150.00           |
| Darshanna Manning                      | 143.36           |
| Damien Robins                          | 110.13           |
| Misty Ortig                            | 100.00           |
| Kelsey Ciancia                         | 86.49            |
| Liviu Balajel                          | 79.80            |
| David A. Taboda                        | 75.46            |
| Petti A. Johnson                       | 74.34            |
| Anna-Marie Mendez                      | 69.58            |
| Sharon Nash                            | 64.00            |
| Lauri Adams                            | 63.00            |
| Kenneth C. Brooks                      | 61.74            |
| Linda Brown                            | 50.00            |
| Brett Beasley                          | 46.41            |
| Kimberly a. Alwin                      | 41.44            |
| Peggy Nood                             | 36.42            |
| Payroll Bonus & Benefits               | 2,927,366.76     |
| Rent & Equipment Maitenance            | 961,115.19       |

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| D. W. Heath & Associates, Inc<br>Consolidated Income & Expenses Downloaded from Qbooks<br>July 1, 1993 to April 29, 2004 |
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|                                    |                      |
|------------------------------------|----------------------|
| Seminar Expenses                   | 464,218.64           |
| Telephone                          | 341,178.89           |
| Business Promotion                 | 274,586.17           |
| Automobile Expenses                | 259,958.59           |
| Office Supplies                    | 237,374.09           |
| Legal Fees                         | 218,147.78           |
| H. M Moller                        | 147,691.54           |
| Postage & Delivery                 | 125,916.41           |
| Insurance & Medical Expenses       | 96,019.89            |
| Travel & Entertainment             | 95,379.87            |
| Contributions                      | 87,456.15            |
| Taxes - other                      | 84,945.46            |
| Juanita D. Dougherty Trust         | 64,000.00            |
| Printing & Reproduction            | 59,763.38            |
| Taxes - Federal                    | 55,697.71            |
| American Express                   | 54,999.77            |
| Profesional Fees - other           | 52,066.14            |
| Other Outside/Consulting Services  | 45,014.21            |
| Utilities                          | 48,643.38            |
| <b>Legal Fees paid for P Heath</b> | <b>38,600.00</b>     |
| Due & Subscription                 | 35,802.14            |
| Client Expenses                    | 33,729.74            |
| ATM/Cash Expenses                  | 28,114.80            |
| Miscelleous                        | 24,249.22            |
| Credit Line                        | 24,189.00            |
| Marketing                          | 15,397.30            |
| Leads                              | 15,322.95            |
| Transfer                           | 11,195.00            |
| Bank Charges                       | 9,978.86             |
| Taxes - State                      | 7,431.82             |
| Taxes - Business Property          | 6,801.20             |
| Advetising                         | 5,726.12             |
| <b>Roth IRA for Aaron Heath</b>    | <b>5,000.00</b>      |
| <b>Roth IRA for Sarah Heath</b>    | <b>5,000.00</b>      |
| Interest Expenses                  | 3,582.72             |
| License & Permits                  | 3,494.20             |
| Roth IRA for Gloria Kubota         | 2,000.00             |
| Orange County Credit               | 1,760.00             |
| Taxes - Property                   | 906.56               |
| Taxes - TITL Equities              | 800.00               |
| Boat Payment                       | 142.72               |
| Shipping                           | 123.50               |
| <b>Total Expenses</b>              | <b>13,525,845.84</b> |
| <b>Net Income</b>                  | <b>1,727,442.88</b>  |

Robb Evans, Temporary Receiver of D. W. Heath & Associates, Inc. et al.  
Assets Frozen by Bank

| Bank                | Account Name               | Amount Frozen       |
|---------------------|----------------------------|---------------------|
| Bank of America     | D.W. Heath & Associates    | 12,579.35           |
| Bank of America     | D.W. Heath & Associates    | 3,053.71            |
| Bank of America     | Private Capital Management | 52,268.76           |
| Bank of America     | Private Capital Management | 618,382.26          |
| Bank of America     | TITL Equities              | 134.74              |
| Bank of America     | TITL Equities              | 5,098.20            |
| First Mountain Bank | Manefee P.G.C. *           | 642,000.00          |
| <b>Total</b>        |                            | <b>1,333,517.02</b> |

\* First Mountain Bank has frozen the account, and gave the approximate balance in the account. The Bank informed the Temporary Receiver that the account name is not Manefee P.G. C.