District of Ontario
Division No. 09 - Toronto
Estate File Nos. 31-1191419

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

IN THE MATTER OF THE PROPOSAL OF PHARMENG TECHNOLOGIES INC. A COMPANY DULY INCORPORATED PURSUANT TO THE LAWS OF THE PROVINCE OF ONTARIO, WITH A HEAD OFFICE IN MARKHAM, IN THE PROVINCE OF ONTARIO

TRUSTEE'S REPORT TO THE CREDITORS

TO THE CREDITORS OF PHARMENG TECHNOLOGIES INC.

This report is prepared in conjunction with the Proposal under Part III, Division I, of the *Bankruptcy and Insolvency Act* ("**BIA**") which has been lodged with A. Farber & Partners Inc. (the "**Trustee**"), filed with the Official Receiver, Toronto, Ontario, on June 26, 2009.

The following is an outline of the background and financial position of the PharmEng entities comprising Keata Pharma, Inc. ("**Keata**") PharmEng International Inc. ("**PII**") and PharmEng Technologies Inc. ("**PTI**") including relevant information that the Trustee feels will be of assistance to creditors in considering their position with respect to the Proposal filed for PTI. All three entities are referred to in this report as the secured creditors' loans and debt obligations are largely cross collateralized across all of these entities and overall recoveries will depend on realizations from those entities. The three entities will be referred to collectively as the "**Debtors**" or "**PharmEng.**"

Unless otherwise indicated herein, capitalized terms in this report have the same meaning as in the Proposal.

1. Summary of Recommendations

As described in greater detail below, a Court Approved sales process has not generated acceptable offers effective June 30, 2009 to conclude sales transactions for the majority of the businesses and underlying assets save and except for the consulting business, which is subject to Court approval. Toward the end of the court approved sales process, the Trustee worked with the Debtors' management team and senior secured creditors to put in place a plan to effect an orderly wind down of the businesses, in consultation with the major customers, while efforts continue to consummate one or more transactions with a potential purchaser or purchasers of the Debtors' property and assets.

More time is required to allow various realization options to be pursued under the Proposal Process.

Given the level of uncertainty that exists, it is the Trustee's recommendation that the Creditors' Meeting be adjourned to: (i) allow the various realization options to be pursued further; (ii) allow for determination of secured creditor claims; and (iii) allow for the Debtors to further explore options for contributions from secured creditors or third parties. The Unsecured Creditors may by ordinary resolution at the Creditors' Meeting adjourn the meeting to a date when items (i), (ii) and (iii) above are better known. An adjournment of three months is recommended.

In the event there is no adjournment, the Trustee would recommend that the Proposal be accepted. While the Proposal does not guarantee any recoveries for Unsecured Creditors, the Proposal is not prejudicial to the recoveries. It provides no worse recoveries than in a bankruptcy scenario, wherein the Unsecured Creditors will not receive any dividend, and it preserves the possibility that the Unsecured Creditors may receive distributions from a going concern sale or transaction(s), or contributions from a secured creditor or a third party, or a combination of these.

A vote by the Unsecured Creditors that does not result in the acceptance of the Proposal will cause the Debtor to be deemed bankrupt.

2. Disclaimer

We caution the reader that we have conducted neither an audit nor an investigation of the books and records of the Debtors. Consequently, we cannot render an opinion as to the accuracy of the financial information contained in this report. The information discussed herein has been obtained from the books and records of the Debtors and from discussions with management of the Debtors ("Management").

3. Background

On April 14, 2009, PII, Keata, and PTI filed Notices of Intention to make a Proposal ("**NOI**") under Section 50.4 of the Bankruptcy and Insolvency Act (the "**BIA**"). By Court Order dated May 13, 2009 further time was provided by the Court for the Debtors to formulate and file a Proposal with the creditors to June 28, 2009.

On June 26, 2009, Keata, PII and PTI lodged proposals with Farber in its capacity as Proposal Trustee, which were in turn filed with the Official Receiver on June 26, 2009.

More or less coincident with the NOI process, on May 5, 2009 by Order of the Court (the "**Receivership Order**"), Farber was appointed Interim Receiver of the property of Keata, PII and PTI, with powers limited to the marketing for sale of the Debtors' property, substantially in accordance with a sales process described in the Trustee's Report to Court as proposed Interim Receiver dated April 30, 2009 (the "**Sales Process**"). The Sales Process deadline for submission of offers was, pursuant to an Order of the Court dated June 2, 2009, extended from June 3 to June 17, 2009. The Sales Process was undertaken through May and June 2009 with results effective June 30, 2009 set out below.

4. PharmEng Background and Causes of Financial Difficulties

PharmEng, headquartered in Toronto, Canada, is a full-service consulting and contract manufacturing company that serves the pharmaceutical and biotechnology industries in North America and internationally.

Consulting services include project management, engineering, GMP, validation, calibration, regulatory compliance and certified traning (hereinafter referred to as the "**Consulting Business**"). The Consulting Business is held by PTI and PharmEng USA Inc ("**PUSA**"). PUSA is not part of the NOI Proposal proceedings.

Contract manufacturing includes pharmaceutical support, formulation development laboratory testing, and finished solid dosage and liquid products. The Contract manufacturing business is carried on from an 85,000 square foot facility located in Arnprior, Ontario (the "**Arnprior Facility**") and a 46,000 square foot facility located in Sydney, Nova Scotia (the "**Sydney Facility**"). Both the Arnprior Facility and the Sydney Facility are owned and operated by Keata.

The contract manufacturing business has had annualized revenues of close to $30 million, the majority of this generated out of the Arnprior Facility ($28 million), while the Consulting Business has in the recent past had annualized revenues tracking in the $8 million to $10 million range.

PharmEng took on substantial debt in 2007 and 2008 to finance the acquisition of the Arnprior Facility from Pfizer Canada Inc. ("**Pfizer**") in December 2007 and the construction of the Sydney Facility through 2007 and 2008, under the assumption that sufficient supply contracts would be secured from customers to fully utilize this capacity. Due to a combination of failure to secure those contracts, cost overruns and delays in the start up of the Sydney Facility and the market downturn through 2008 negatively impacted the Consulting Business, PharmEng incurred significant losses and

was unable to service its debt through 2008. PharmEng was left with debt levels (excluding trade obligations) of close to $25 million on its balance sheet, significantly out of line for operations of its size.

Management had embarked on a number of restructuring initiatives, including the decision made in late 2008 to attempt to sell the Sydney Facility. Through January, February and March 2009, PharmEng had, with the consent of senior secured lenders, been endeavouring to finalize a transaction for a sale of this facility to an interested party, in exchange for a release from Enterprise Cape Breton Corporation and the Cape Breton Growth Fund (collectively "**ECBC**") debt, which has a first charge over the Sydney Facility real property. However, effective April 14, 2009, the NOI filing date, no agreement was able to be finalized with an interested party. As a result of the significant ongoing losses at the Sydney Facility, PharmEng made the decision to temporarily close down its operations by May 8, 2009.

5. Sales Process Overview

In order to expose the PharmEng businesses to the marketplace and to explore the possibility of securing competing offers that would maximize realizations for creditors, the Interim Receiver has conducted a Court approved Sales Process.

The Sales Process was conducted through May and June 2009 with, in essence, three businesses marketed for sale as follows:

(i) the Arnprior Facility, the primary contract manufacturing business located close to Ottawa, Ontario;

(ii) the Sydney Facility, the second contract manufacturing facility; and,

(iii) the Consulting Business headquartered in Markham, Ontario.

Despite an extensive process, which included dealing with close to 50 interested parties, no offers to purchase the assets and property of Keata, PII and PTI have been accepted by Farber, (in consultation with the senior secured creditor Labki Finance Inc ("**Labki**")

in accordance with the Receivership Order), other than an offer accepted for the assets associated with the Consulting Business, which remains subject to Court approval. As the Sales Process was reaching its completion, and as a contingency measure, PharmEng and Farber, in concert with major contract manufacturing customers, developed a plan to effect an orderly wind down of the businesses (in particular the Arnprior Facility Business), while also working with the senior secured creditor on the Sydney Facility, regarding the ongoing strategy for its maintenance and sale, while further attempts are made to locate a purchaser or purchasers of the remaining property and businesses of PharmEng (hereinafter defined as "**Orderly Wind Down**").

Concurrent with and as part of the Orderly Wind Down, updated cash flow projections have been prepared by Management, which are currently subject to ongoing review by Labki and the Trustee, and will be the basis for the ongoing monitoring of the businesses in the short term. Our preliminary review indicates these projections generate positive cash flow, which is consistent with the Debtors' cash flow performance since the initial filing of the NOI.

An assessment of the anticipated realizations to creditors from the Proposal as compared to a bankruptcy liquidation is set out in section 8 and confirms amongst other factors that the Orderly Wind Down and concurrent continuation of efforts to identify purchasers is no worse than bankruptcy, and provides the prospect of recoveries for Unsecured Creditors under a Proposal.

6. The Proposal

Please note that the following is a summary of the Proposal, and is only a guide to the contents of the Proposal. It is not intended to encompass all the terms and conditions of the Proposal, and the creditors should refer to the Proposal in determining how they choose to vote regarding the Proposal.

PROPOSAL SUMMARY

Given the Sales Process has not resulted in all of the Debtors' businesses and property being sold and the Debtors, Labki and ECBC are negotiating terms to allow the Debtors to continue the business in the short term under the Orderly Wind Down scenario, while options for realizing on the Debtors' businesses and property are being pursued. This will include efforts to identify a purchaser or purchasers of the Companies' underlying businesses.

More time is required to pursue these avenues of potential recovery and to preserve the possibility that Unsecured Creditors may receive a distribution.

The Proposal provides for the possibility of a recovery to Unsecured Creditors depending on the results of the Orderly Wind Down or sale of other property of the Debtors, by way of issuance of Creditor Certificates (see Article 7.1 of the Proposal) to the Unsecured Creditors, which shall entitle Unsecured Creditors to be paid their pro rata share of the net Proposal proceeds. Upon the distribution of the certificates to the Unsecured Creditors as contemplated in Article 7.1, the Proposal shall be fully performed and the Trustee shall deliver a certificate as contemplated by the BIA.

Proposal Proceeds means the sum of:

> "all remaining net proceeds, if any, from the sale of assets and property of the Debtor after distributions to Secured Creditors of (Y) assets and property of the Debtor in kind and (Z) proceeds from the sale of assets and property of the Debtor, and
>
> all amounts that may be contributed to this Proposal by any Secured Creditor or third party;"

<u>(a) Secured Creditors</u>

Subject to any arrangements made between PharmEng and any secured creditor, if any, secured creditors shall be permitted to realize on their security and to proceed fully in

accordance with their rights as secured creditors. For distribution purposes to the extent the Collateral or proceeds realized from the Collateral is not sufficient to satisfy the Proven Claim of a Secured Creditor, that Secured Creditor shall be an Unsecured Creditor for any portion of the Secured Creditor's Claim that remains outstanding.

(b) Preferred Claims

The Claims of the Preferred Creditors are to be paid without interest, in accordance with the priorities of the BIA.

(c) Unsecured Creditors

Claims for the purpose of this Proposal shall be included in a single Class, which shall be the Unsecured Creditors class.

On the Implementation Date, the Trustee shall issue a certificate to each Unsecured Creditor, aside from the Preferred Creditors identified in paragraph 1.1 (u) (i) and (ii) of the Proposal which shall be paid at the time contemplated in the Proposal, for the full value of their Proven Claims. Upon the distribution of the certificates to the Unsecured Creditors as contemplated in Article 7.1, the Proposal shall be fully performed and the Trustee shall deliver a certificate as contemplated by the BIA (i.e. The certificate shall be issued for the full amount of the Proven Claim, and that amount in turn will form the basis for any pro rata sharing of funds among Unsecured Creditors, if any, ,after satisfaction of secured and preferred claims).

The Proposal makes provision for up to five Inspectors to be elected at the meeting of creditors who shall have the power to advise the Trustee with respect to any dispute which may arise as to the validity of claims of Unsecured Creditors, as well as any other matter the Trustee may refer to them.

Paragraph 8.6 of the Proposal addresses the ongoing conduct of the business, which includes the provision that the Debtor shall incur and pay obligations only in accordance with cash flow projections which are to be agreed upon by the Debtor and Labki, in consultation with the Proposal Trustee. These cash flow projections are subject to ongoing negotiations and agreement.

Pursuant to paragraph 9.1 of the Proposal, sections 91 to 101 of the BIA, (which relate to the avoidance of certain pre-filing transactions of the Debtors, referred to as preferences and settlements) will not apply in respect of the Debtor or this Proposal. Although the Proposal Trustee's preliminary review of this area has not identified any transactions of concern to date, the Trustee has not yet completed its comprehensive review.

Pursuant to the BIA, acceptance of the Proposal requires the affirmative vote of a majority in number (50% +1) and 2/3 in value of the proofs of claim of creditors present in person or by proxy and voting letter at the Creditors' Meeting (the Required Majority). Thereafter the Proposal has to be approved by the Court. There is only one class of Creditors that votes on the Proposal and that is the Unsecured Creditors.

The implementation of the Proposal will be conditional on acceptance of the Proposal by the Unsecured Creditors and Court approval with all Claims becoming Proven Claims. Pursuant to paragraph 8.5 of the Proposal, the effect of the Proposal will amongst other factors, provide an absolute release and discharge of all indebtedness, liabilities and obligations of the Debtor of or in respect of the Claims.

7. Loan and Debt Facilities

Summarized below are loan and debt facilities as reported by the Debtors. The Proposal Trustee has not yet obtained a legal opinion as to the validity or enforceability of any of

the security supporting the loans and debt facilities, which remain subject to completion of that review:

	In Millions (Note 1)
Labki Finance	$14.00
BHC (USD @ 1.15)	$5.75
ECBC	$4.40
2186822 Ontario Inc.	$1.00
Total	$25.15

Note 1: Balances are subject to accrual of interest and costs to the extent provided for in the underlying agreements.

Note 2: The condensed assets and liabilities included in the mailing references $27.2 million of debt obligations for the above creditors. The difference is attributed to preferred shares held by ECBC of $1.75 million and exchange rate differences on US dollar denominated debt.

(i) Effective April 13, 2009, PharmEng owed Labki $14 million (plus interest and costs) on revolver and term loan facilities secured over all PharmEng assets and property. Labki is the primary secured creditor over most of the assets and property of PharmEng.

(ii) BHC Interim Funding II, L.P. ("**BHC**") had loan amounts owing of $5 million U.S. (plus interest and costs).

(iii) ECBC extended loans to PharmEng of $4.4 million, which are reported as secured against PharmEng's assets and properties, including a first mortgage charge on the Sydney Facility of $2.25 million. In addition, EBCB holds preferred shares totalling $1.75 million which are reported by the Debtor as not secured against the assets of PharmEng

(iv) 2186827 Ontario Inc. ("**218**"). PharmEng granted 218 convertible debentures for $1 million in gross proceeds, over which security was intended to be granted to secure obligations owing to 218 under the convertible debentures. 218 takes the position that notwithstanding the parties to its loan and security documents, it was intended to have

security over certain assets of both PTI and Keata and has brought a motion to "rectify" its security.

The majority of this debt is cross collateralized across all of the PharmEng entities. Subject to obtaining independent legal opinion as to the validity and enforceability of the security, there exist substantial secured loan and debt obligations that need to be satisfied prior to any recovery to Unsecured Creditors flowing. In addition to awaiting efforts to consummate one or more transactions with potential purchasers of the businesses, the Proposal also provides for secured creditors, if they so elect, to forego some secured creditor entitlement to provide the prospect of some recovery to Unsecured Creditors. Additionally, the Proposal provides the potential for third parties to provide funding, to fund the Proposal.

As the Proposal was made to the Unsecured Creditors only, the stay of proceedings ceased to apply to secured creditors. The Proposal Trustee understands that the Debtors and Labki are in the process of negotiating a forbearance agreement to permit the Proposal process to continue and that all other secured creditors are subject to contractual standstill provisions.

8. Financial Position and Estimated Realizations

Currently, in addition to the debt obligations profiled above of approximately $25 million, trade creditor obligations reported for PTI by the Debtor were approximately $200,000. Against this the condensed assets and liabilities statement for PTI reflects assets with $1.36 million in net book value. However, the majority of the property and asset value of the PharmEng entities appears to reside in Keata, which has assets at a reported net book value of $18.5 million.

As part of the overall assessment of recoveries for creditors, Farber as Proposal Trustee, has with input from Management completed an immediate shut down liquidation

assessment under a bankruptcy situation for all the PharmEng entities (hereinafter "**Liquidation**"), and compared this to the outcome under the Orderly Wind Down scenario.

Due to the fact that the Debtors and the Interim Receiver are still in ongoing negotiations with interested parties for the purchase of the property or businesses, Farber is not providing detailed information so as to maintain confidentiality and not prejudice those negotiations. The analysis does however confirm that at an indicative level, the realizations to the creditors in the Orderly Wind Down are materially better than under the Liquidation scenario.

Under the Liquidation scenario, the Unsecured Creditors will not receive any recovery or dividend.

Additionally, the Orderly Wind Down does not necessarily capture all of the potential outcomes, as concurrent with the plan to embark on an Orderly Wind Down, efforts will continue to consummate one or more transactions with potential purchasers of the Debtors' businesses or underlying assets that may generate going concern recoveries.

While the Proposal does not guarantee any recoveries for Unsecured Creditors, it provides no worse recoveries than a Bankruptcy and preserves the possibility that Unsecured Creditors may receive distributions based on going concern sales of businesses or assets, contribution from a secured creditor, or contributions from a third party or a combination of these sources.

In summary, given the current situation, it is too early for the Proposal Trustee to provide a view as to what if anything Unsecured Creditors will receive in terms of a distribution under the Proposal. Unsecured Creditors should be advised that more accurate information on this will not be available by the scheduled date of the Creditors'

Meeting. The intention is that the Unsecured Creditors will be treated no worse than in a bankruptcy, while at the same time preserving the possibility for greater recovery. The Orderly Wind Down amongst other factors provides more time to negotiate a potential going concern sales transaction, which to be acceptable, would likely make the recovery from the assets greater than the projected Orderly Wind Down realization.

9. Creditors' Claims

The Notice to Creditors of the meeting of creditors indicated in this package provides detailed instructions for completion and submission of the Proof of Claim, Proxy and Voting Letter.

10. Remuneration of the Trustee

Administrative Fees and Expenses of the Trustee will be directly related to hours spent on the engagement and out-of-pocket expenses incurred. Such Administrative Fees and Expenses are paid out of the Proposal Proceeds after the secured creditor Claims. The Debtor has previously provided the Trustee with a total retainer of $40,000 for all three entities that filed NOIs, namely Keata, PII and PTI. Paragraph 7.3 of the Proposal provides for a further retainer of $20,000 be paid by each of the Debtors to the Trustee in respect of the Administrative Fees and Expenses to implement the Proposal.

11. Recommendations and Summary

The Companies made the determination to file the Proposal and pursuant to the BIA, there is the requirement to convene a meeting of the creditors within 21 days. Given the level of uncertainty that exists, it is the Trustee's recommendation that an adjournment of the Creditors' Meeting be obtained to allow the various realization options to be pursued further.

The Trustee notes that the marketing process is ongoing as is the intention to implement the Orderly Wind Down. Given the level of uncertainty that exists, it is the Trustee's recommendation that the Creditors' Meeting be adjourned to: (i) allow the various realization options to be pursued further; (ii) allow for determination of secured creditor claims; and (iii) allow for the Debtors to further explore options for contributions from secured creditors or third parties. The Unsecured Creditors may by ordinary resolution at the Creditors' Meeting adjourn the meeting to a date when items (i), (ii) and (iii) above are better known. An adjournment of three months is recommended.

In the event there is no adjournment, the Trustee would recommend that the Proposal be accepted. While the Proposal does not guarantee any recoveries for Unsecured Creditors at this time, the Proposal is not prejudicial to the recoveries. It provides no worse recoveries than in a bankruptcy scenario, wherein the Unsecured Creditors will not receive any dividend, and it preserves the possibility that the Unsecured Creditors may receive distributions from a going concern sale or transaction(s), or distributions from a Secured Creditor or a third party or a combination of these sources.

A vote by the Unsecured Creditors that does not result in the acceptance of the Proposal will cause the Debtor to be deemed bankrupt.

DATED AT TORONTO this 7th day of July, 2009.

A. FARBER & PARTNERS INC.
IN ITS CAPACITY AS TRUSTEE IN RE
THE PROPOSAL OF PHARMENG TECHNOLOGIES INC.

Per: Paul Denton