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ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

**IN THE MATTER OF THE PROPOSAL OF
PROSPERITY FOODS LTD.**

FIRST REPORT OF THE PROPOSAL TRUSTEE

DECEMBER 9, 2016

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LIST OF EXHIBITS

“A” Proposal Trustee’s Certificate of Appointment dated December 2, 2016

Confidential Exhibits

“1” Asset Purchase Agreement dated December 1, 2016

“2” Comparison Analysis of the Purchase Price under the Asset Purchase Agreement to the Estimated Realizable Value in a Forced Liquidation

“3” December 1, 2016 Appraisal from Hilco Asset Sales Canada

“4” December 2, 2016 Appraisal from Asset Services

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December 9, 2016

A. Farber & Partners Inc. ("**Farber**"), in its capacity as the trustee in the proposal of Property Foods Ltd. ("**Prosperity**" or the "**Company**"), hereby reports to the Ontario Superior Court of Justice (Commercial List) (the "**Court**") as follows:

INTRODUCTION

1. Prosperity, incorporated on April 21, 1997, is an importer and distributor of food ingredients based in Toronto, Ontario. Prosperity operates out of leased premises consisting of a 24,000-square foot facility located at 474 Attwell Drive, Toronto, Ontario (the "**Premises**").
2. The Premises were originally owned by a related company to Prosperity. In or around December 2015, the Company's principal, Mr. Ira Day ("**Day**") mortgaged the Premises in order to finance the purchase of his partner's interest in the Company. Day sold the Premises to a third party purchaser (the "**First Purchaser**") in August 2016 in a sale by the owner of the Premises and a leaseback arrangement to the Company in order to raise funds for working capital of the Company. The Company and First Purchaser signed a

lease to December 31, 2016 with the understanding that a longer term lease would be entered into.

3. The Proposal Trustee has been advised by Day that the First Purchaser then sold the Premises to another third party purchaser (the “**Second Purchaser**”) who required the Premises for its own use and was not prepared to extend the term of Prosperity’s lease past December 31, 2016.
4. The Company has sought alternate leased premises, but due to its liquidity issues, operating losses and personal covenants noted below, it has been unwilling to commit to a new lease on terms acceptable to the Company and the guarantors.
5. Prosperity’s clients include customers in the bakery and confectionary manufacturing sectors, bulk food stores, food processors and pastry and chocolate manufacturers. Currently, Prosperity employs approximately 20 employees, and has annual revenues in the range of \$14 million, although in its best years, company revenues were in the range of \$19 million, and the company employed, at one time, as many as 30 to 40 employees.
6. In May 2016, the Company lost one of its major customers, Costco. As a result, the Company has been operating at unsustainable monthly losses.
7. Soon after the loss of the Costco account, Day, with the assistance of a business advisor, commenced an informal search for a potential purchaser of the business. On November 11, 2016, Day entered into a non-binding offer with a third party purchaser (the “**Purchaser**”) to purchase the equipment, intellectual property and inventory of the Company. The Company would retain ownership of the accounts receivable. The purchase price for this non-binding offer was to be “...held in escrow until the Vendor has fulfilled its undertaking and provide evidence of compliance under the *Bulk Sales Act* legislation...”. As a result of the Company’s liquidity concerns, it realized it would be unable to comply with the *Bulk Sales Act*.
8. The Company retained Farber to provide assistance and in conjunction with the Company, counsel to the Company, Torkin Manes LLP (“**Torkin Manes**”), the Purchaser

and its counsel (collectively the “**Representatives**”), an asset purchase agreement (the “**APA**”) was finalized and entered into on December 1, 2016 to purchase all the assets of the Company, including the outstanding accounts receivable (the “**Purchased Assets**”). The APA is attached as **Confidential Exhibit 1**.

9. On December 2, 2016, the Company filed a Notice of Intention to Make a Proposal (“**NOI**”) pursuant to the *Bankruptcy and Insolvency Act* (Canada) (the “**BIA**”), and named Farber as proposal trustee (“**Proposal Trustee**”). The Certificate of Appointment from the Superintendent of Bankruptcy is attached as **Exhibit A**.

PURPOSE OF THIS REPORT

10. The purpose of this First Report of the Proposal Trustee (the “**First Report**”) is to:
 - a) Report to the Court on the explanation for a sale of the assets of the Company without a formal sales process;
 - b) Request the Court’s approval of the APA selling the Purchased Assets of the Company to the Purchaser;
 - c) Request that the Court grant an order vesting the right, title and interest in the Purchased Assets in and to the Purchaser free and clear of any encumbrances, except as specifically provided for in the APA;
 - d) Authorizing the Company to make a distribution to TD Bank, following completion of the closing of the transaction contemplated by the APA (the “**Closing Date**”) and filing a Proposal Trustee Certificate (as defined below) confirming that the transaction has been completed and approving the amount to be paid to TD Bank to extinguish the outstanding indebtedness as at the Closing Date;
 - e) Seeking an Administrative Charge over the assets, subordinate to the charge of TD Bank, for the Proposal Trustee’s, the Proposal Trustee’s legal counsel and the Company’s legal counsel’s fees and expenses; and

- f) Seek the Court's approval of the activities of the Proposal Trustee as out in this First Report.
11. The information is provided in connection with a motion by Prosperity for the approval of the sale of the assets of the Company to the Purchaser pursuant to s. 65.13(1) of the BIA.

DISCLAIMER

12. Farber has relied upon the financial records and information provided by Prosperity, as well as other information supplied by management, appraisers, accountants, auditors and advisors, and Farber has not independently reviewed or verified such information. Farber assumes no responsibility or liability for any loss or damage incurred by or caused to any person or entity as a result of the circulation, publication, re-production or use of or reliance upon this First Report. Any use which any person or entity, other than the Court, makes of this First Report, or any reliance on or a decision made based upon this First Report is at such person's or entity's own risk.

INFORMAL MARKETING AND SALES PROCESS

13. Day has been in the dry food goods business for approximately 20 years and has established many contacts in the industry over those years. As a result of the loss of the Costco business in May 2016, and the unsustainable monthly losses being experienced, Day, with the assistance of a business advisor, commenced a search for a potential purchaser of the business. Day and the business advisor spent significant time in the latter part of 2016 canvassing the industry for potential purchasers.
14. The affidavit sworn by Day in support of this motion (the "**Day Affidavit**") notes that through the marketing efforts of Day and his business advisor, it became clear that a potential purchaser needed to be highly capitalized and in the same industry in order for a transaction to be completed in a timely manner.

15. The marketing efforts resulted in a non-binding offer from the Purchaser on November 11, 2016. No other parties contacted by Day and the business advisor expressed an interest to purchase the assets of the Company.
16. The non-binding offer included the purchase of all the equipment, inventory and intellectual property of the Company. The offer excluded the purchase of accounts receivable.
17. The Purchaser is a third-party company in the same industry and that competes in a number of the same lines of business with Prosperity. Upon further due diligence and as a result of the Company's financial position, the parties to the transaction realized that completing the purchase of a majority of the assets of the Company as contemplated would not comply with the *Bulk Sales Act*.
18. With a looming deadline of December 31, 2016 approaching, the Company retained Farber to assist. The APA (which is more fully described below) was negotiated between the Representatives with the understanding that a transaction would need to be concluded in a timely manner as a result of the Premises lease December 31, 2016 deadline. The Purchaser, acting in good faith, also agreed to purchase all the outstanding accounts receivable, which was not included in its previous offer.

THE ASSET PURCHASE AGREEMENT

19. The Company entered into the APA, subject to Court approval, with the Purchaser on December 1, 2016 after negotiation and consultation with the Representatives. The Company seeks the Court's authority to enter into the APA for the reasons set out below.
20. The Purchaser agrees to purchase the business and assets of the Company pursuant to the terms of the APA.
21. The key terms of the APA include, but are not limited to the following:
 - a) Purchase of the Purchased Assets including all of the Company's rights in Intellectual Property Licenses and Registrations (as defined in the APA);

- b) Contemplates a deposit of \$200,000 to be paid to the Company's counsel, Torkin Manes, to be held in trust. Torkin Manes has confirmed that they are currently holding the \$200,000 in their trust account;
 - c) The APA also requires that a consulting agreement satisfactory to Day and the Purchaser be entered into prior to closing. The consulting agreement has been drafted but is not yet finalized as at the date of this First Report;
 - d) There is no obligation in the APA for the Purchaser to assume the employees, although the Proposal Trustee understands that offers may be made to some of the 20 employees;
 - e) Conditional on the Court granting an Approval and Vesting Order; and
 - f) Closing Date agreed to be the day of the granting of an Approval and Vesting Order by the Court, or, on or before December 15, 2016 or such other date as the parties may agree.
22. The Proposal Trustee has prepared a schedule comparing the purchase price pursuant to the APA with the appraisals and the Proposal Trustee's estimate of accounts receivable collections (the "**Comparison Analysis**"). The Comparison Analysis is attached as **Confidential Exhibit 2**.
23. The Proposal Trustee, with consent from the Company, has obtained two independent appraisals of the inventory and equipment. Attached as **Confidential Appendix 3** is the December 1, 2016 appraisal of Hilco Asset Sales Canada. Attached as **Confidential Appendix 4** is the December 2, 2016 appraisal of Asset Services.
24. Both appraisals have been prepared on the basis that the equipment and inventory would have to be re-located starting December 15, 2016 in order to provide vacant occupation to the landlord on December 31, 2016.
25. Accordingly, there would be no ability to conduct a sale of the inventory and equipment in operating condition from the Premises. Significant removal costs would be incurred to relocate these assets to a new location to conduct a liquidation sale.
26. The Proposal Trustee is seeking a sealing order of the Confidential Appendices pending a further Order of the Court or closing of the transaction contemplated by the APA in order to ensure that value of the Purchased Assets is not adversely impacted if the transaction contemplated by the APA does not close.

27. The Proposal Trustee has reviewed the Company's accounts receivable aged trial balance and had discussions with the Company and Torkin Manes regarding the collectability of the accounts receivable and the available receivable insurance under a policy with Euler Hermes.
28. As noted on the Comparison Analysis, it is anticipated that the Purchase Price (as defined in the APA) on closing is expected to be sufficient to pay the TD Bank secured debt and have funds available to the unsecured creditors. In addition, future potential accounts receivable collected by the Purchaser in excess of the threshold level defined in the APA would also be available to the unsecured creditors.
29. Conversely, if the APA is not completed and the Company is forced to liquidate on a forced liquidation basis, TD Bank would likely experience a significant loss on its security and no funds would be available to the unsecured creditors. Based on the Comparison Analysis, the Proposal Trustee concludes that completing the transaction in accordance with the APA would result in significantly higher recoveries than the realizations from a forced liquidation. This would be beneficial to all the creditors of Prosperity; accordingly, the Proposal Trustee is recommending that the Court approve the APA.

INDEBTEDNESS, SECURITY AND DISTRIBUTION

30. The indebtedness owing to the TD Bank on December 8, 2016 was \$1,000,024 before accruing interest and bank costs of enforcement. TD Bank is supporting the Company's application to complete the APA and is continuing to provide an operating line to the Company on a day-to-day basis until the APA is closed.
31. The Proposal Trustee has received an independent legal opinion from Dale & Lessmann LLP (the "**Independent Legal Opinion**"). The Independent Legal Opinion opines that, subject to the customary assumptions and qualifications, the security interest of TD Bank over the property, assets and undertakings of the Prosperity, is valid and enforceable as against the Proposal Trustee.

32. The Company contemplates making a full and final distribution to TD Bank upon completion of the transaction contemplated in the APA (as approved by this Honourable Court) and subsequent to the Proposal Trustee filing a Proposal Trustee Certificate confirming that the transaction has closed and setting and approving the distribution to TD Bank in order to extinguish the outstanding indebtedness.
33. As noted above, it is estimated that some funds from the purchase price would be available to the unsecured creditors. In addition, the unsecured creditors could receive a further amount if the accounts receivable collections after the Closing Date exceed the threshold limit set out in the APA. The Company advises that it is current with its source deductions (which are remitted through a payroll service) and it's HST; accordingly, no significant debts are expected to be payable to CRA, pending their audits.

PROPOSAL TRUSTEE ANALYSIS

34. Subsections 65.13(4) of the BIA requires that a number of factors be considered by the Court in granting an authorization of the sale of assets to a third party. Below is the Proposal Trustee's analysis of these factors in this case:
 - a) Whether the process leading to the proposed sale or disposition was reasonable in the circumstances. The Company conducted an internal search for a potential partner and or purchaser over a five month period. The Proposal Trustee acknowledges that a formal marketing and sales process was not conducted, however, Day and his business advisor approached the market with a focused approach based on extensive knowledge of the industry and knowing that a lengthy sales process could not be completed prior to the December 31, 2016 deadline date. The Proposal Trustee further notes that the APA was negotiated in good faith by the Representatives.
 - b) Whether the trustee approved the process leading to the proposed sale or disposition. The Proposal Trustee was involved in negotiating the APA with the Representatives The Proposal Trustee has concluded that the focused search

conducted over a period of 5 months by Day and his business advisor was reasonable in the circumstances particularly in light of the fact that the Company only learned in or around September 2016 that the Premises lease was terminating on December 31, 2016.

- c) Whether the trustee filed with the court a report stating that in their opinion the sale or disposition would be more beneficial to the creditors than a sale or disposition under a bankruptcy. The Proposal Trustee submits this First Report concluding that the proceeds from the sale of the Purchased Assets contemplated in the APA are significantly higher than the recovery under a forced liquidation sale by way of a bankruptcy or receivership for the reasons noted above, especially as the assets of the Company have to be moved out of the Premises at considerable expense prior to December 31, 2016.
- d) The extent to which the creditors were consulted. (i) Prior to filing, TD Bank was consulted by the Company and the Proposal Trustee regarding the APA. TD Bank is cooperating with the Company's application; (ii) The other registrants under the *Personal Property Security Act* (Ontario) will be served the Company's motion to approve the APA. It is anticipated that, they will either enter into new agreements with the Purchaser or the asset will be released to the lessor, so the APA will not negatively impact the lessors; (iii) To date, the Company and Proposal Trustee contacted ten key trade suppliers after the filing of the NOI and left messages for a further three to contact the Proposal Trustee. These customers make up approximately 50% of the total unsecured debt. The ten creditors that were contacted directly all acknowledged that they would not expect any funds to be available to the unsecured creditors if the APA were not approved and there was a forced liquidation sale after moving the equipment and inventory off-site. None of the contacted creditors expressed any opposition to the application to approve the APA; (iv) the Proposal Trustee has posted notice of the NOI and will be filing the motion materials for this Court hearing as the materials are served on the Proposal Trustee's website at <http://www.farberfinancial.com/insolvency-engagements/prosperity-foods->

- e) The effects of the proposed sale or disposition on the creditors and other interested parties. The proceeds from the transaction contemplated in the APA will be significantly higher than the recoveries in a forced liquidation even before considering the significant costs to remove the inventory and equipment from the Premises by December 31, 2016. It is expected that some funds will be available to unsecured creditors if the APA is completed. If the APA is not approved, there will be a shortfall to TD Bank and there will be no funds for the unsecured creditors. Further, the Purchaser has advised that it may make offers of employment to some Prosperity employees and employees are expected to receive their full accrued wages and vacation pay from the proceeds of the sale of the Purchased Assets after payment of the TD Bank position.
- f) Whether the consideration to be received for the assets is reasonable and fair, taking into account their market value. The Proposal Trustee is of the opinion that the consideration is fair and reasonable as (i) the forced liquidation value of the inventory and equipment is significantly less than the Inventory Purchase Price and Equipment Purchase Price as defined in the APA; (ii) the going concern sale to the Purchaser will continue servicing the bulk of the customer base which would be expected to generate better accounts receivable realizations than if the Company were to cease operations, even taking into consideration the accounts receivable insurance; (iii) the secured operating lender, TD Bank supports the APA; and (iv) the APA also likely provides for a realization to the unsecured creditors who would receive no distribution in a shutdown scenario.

ADMINISTRATIVE CHARGE

35. The Proposal Trustee is seeking an Administrative Charge pursuant to s. 64.2(1) of the BIA over the assets, subordinate to the charge of TD Bank, for the Proposal Trustee's, legal counsel's and the Company's legal counsel's fees and expenses.

RECOMMENDATIONS

36. The Proposal Trustee recommends that this Honourable Court:

- Approve the Company's Sale Process;
- Approve the APA as set out in this First Report;
- Grant an order vesting the right, title and interest in the Purchased Assets, excluding the capital leased assets, free and clear of any encumbrances, except as specifically provided for in the APA;
- Authorize the Company to make a distribution to TD Bank, following completion of the closing of the transaction contemplated by the APA and filing a Receiver's Certificate (as defined below) confirming that the transaction has been completed, and the amount of TD Bank's outstanding indebtedness paid (as at the Closing Date as defined in the APA);
- Grant an Administrative Charge over the assets, subordinate to the charge of TD Bank, for the Proposal Trustee's, legal counsel's and the Company's legal counsel's fees and expenses; and
- Approve the activities of the Proposal Trustee as set out herein.

All of which is respectfully submitted this 9th day of December, 2016

A. Farber & Partners Inc.

A. FARBER & PARTNERS INC.
The Trustee acting *in re* the proposal of
Prosperity Foods Ltd.

EXHIBIT A

CONFIDENTIAL EXHIBIT 1

CONFIDENTIAL EXHIBIT 2

CONFIDENTIAL EXHIBIT 3

CONFIDENTIAL EXHIBIT 4