

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

**IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C.
1985, c. C-36, AS AMENDED**

**AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF
CLOTHING FOR MODERN TIMES LTD.
A COMPANY DULY INCORPORATED IN THE PROVINCE OF ONTARIO WITH A
HEAD OFFICE IN THE CITY OF TORONTO
IN THE PROVINCE OF ONTARIO**

SECOND REPORT OF THE MONITOR

FEBRUARY 13, 2012

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INTRODUCTION

1. Clothing for Modern Times Ltd. (“**CMT**” or the “**Company**”) is an Ontario-incorporated company that designs, produces and markets trendy apparel styles under the retail businesses: Urban Behavior (“**UB**”), Costa Blanca (“**CB**”) and Costa Blanca X (“**CBX**”), with a head office premises located at 300 Supertest Road, Toronto.
2. On June 27, 2011, the Company filed a Notice of Intention to Make a Proposal (“**NOI**”) pursuant to section 50.4 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, as amended (the “**BIA**”). A. Farber & Partners Inc. (“**Farber**”) was appointed as Trustee in the Proposal of the Company (the “**Proposal Trustee**”). At the time of filing the NOI, the Company operated 116 stores and employed 1,682 employees, of which approximately 1,316 were hourly retail employees.
3. CIC Asset Management Inc. (“**CIC**”) and CMT Sourcing Group Ltd. (“**CMT Sourcing**”) are the Company’s primary secured creditors. In addition, CIC is a 5% minority shareholder of CMT and CMT Sourcing is the Company’s largest inventory supplier. CMT Sourcing is 50% owned by an arm’s length third party with the remaining shareholding owned by Mr. Arif Noor (“**Noor**”), the majority shareholder of CMT.
4. The Company determined, based on its discussions with certain landlords and other stakeholders, that the nominal amount it could afford to offer to unsecured creditors would be insufficient to obtain a requisite majority of support for its proposal.

Accordingly, the Company concluded that a going concern sale of its remaining business would be in the best interests of its stakeholders.

5. The NOI six month stay extension period expired on December 22, 2011. The Company was unable to seek a further extension to file a proposal or conduct a marketing and sales process of the CB business under the provisions of the BIA.
6. On December 16, 2011, an order (the “**Initial Order**”) was sought and granted by the Court authorizing the Company to, *inter alia*, continue its restructuring proceeding under the Companies’ Creditors Arrangement Act, R.S.C. 1985, c. C-36 (the “**CCAA**”), appointing Farber as monitor (the “**Monitor**”) and granting an initial stay of proceedings to January 23, 2012. A copy of the Initial Order and Justice Brown’s Endorsement are attached hereto as **Appendix “A” and “B”**.
7. On January 20, 2012, the Court granted an Order (the “**January 20 Order**”) authorizing an extension to the stay period set out in the Initial Order. The extension of the stay period allowed the Monitor additional time to review the offers received for the CB business and negotiate and complete an agreement of purchase and sale with a prospective purchaser. A copy of the January 20 Order is attached hereto as **Appendix “C”**.

PURPOSE OF THIS REPORT

8. The purpose of this Second Report of the Monitor (“**Second Report**”) is to:
 - a) seek approval of the proposed transaction for the remaining assets and locations of Costa Blanca;

- b) vesting such assets in the prospective purchaser free and clear of encumbrances as and particularly set out in the Approval and Vesting Order sought;
- c) sealing certain confidential appendices to the Monitor's Second Report until further order of this Court; and
- d) deeming the Cash Reserve as defined in the proposed Sale Agreement to form part of the Administrative Charge as contemplated in the proposed sale transaction and the Approval and Vesting Order sought.

DISCLAIMER

9. In preparing the Second Report, the Monitor has relied upon the unaudited financial records and financial statements of CMT, as well as other information supplied by management, accountants, auditors and financial advisors to CMT. Our procedures and enquiries did not constitute any audit or review engagement. Accordingly, the Monitor expresses no opinion or other form of assurance on the information contained in this Second Report or relied on in its preparation. Any use which any party, other than Court, makes of this Second Report or any reliance on or a decision made based upon it is the responsibility of such party.

THE SALES PROCESS

10. The Initial Order expressly authorized the Monitor to immediately conduct a process for the sale of the Company's business and assets used in connection with the CB retail business and substantially in accordance with the sales process (the "**Sales Process**") set out in **Schedule A** of the Initial Order.

11. The Monitor, in accordance with the Initial Order, retained Ernst & Young Orenda Corporate Finance Inc. (“**E&Y**”) to conduct the Sales Process and participated with them in the development of the Sales Process, prior to its initiation under the CCAA.
12. E&Y compiled a prospective purchaser’s distribution list identifying 98 prospective purchasers (the “**Distribution List**”). The distribution list included parties identified by E&Y, the Monitor and the Company.
13. On December 16, 2011, E&Y distributed a solicitation letter and confidentiality agreement (“**CA**”) to the Distribution List.
14. In response to E&Y’s marketing efforts, 9 parties signed the CA (the “**Interested Parties**”) and were provided access to the on-line data room. The on-line data room contained a Confidential Information Memorandum (“**CIM**”) and other pertinent financial information regarding CMT’s operations and financial results. Copies of the solicitation letter and CA are attached hereto as **Appendix “D”**.
15. E&Y tabled a form of asset purchase agreement (the “**APA**”) with the Interested Parties advising that any offers submitted should be in the form of the APA.
16. E&Y advised the Monitor that only one Interested Party toured certain retail locations as most of the parties who signed the CA were already familiar with the Company and their operations.
17. E&Y also advised the Monitor that they followed up with the Distribution List to ensure that the solicitation letter had been received and to respond to any further questions prospective parties may have had.

18. Offers from Interested Parties were requested to be received before 2:00pm E.S.T. on January 16, 2012 (the “**Offer Deadline**”).
19. E&Y received 5 offers from Interested Parties (collectively, the “**Offerors**”). 2 offers were for a sale of the CB business and assets as a going concern and 3 offers were received from known liquidators, who had approached E&Y during the Sales Process.
20. The Sales Process required that all offers be submitted by the Offer Deadline or such other date as the Monitor may permit. E&Y notified the Monitor that one going concern offer was received shortly after the Offer Deadline. Notwithstanding, the Monitor accepted this going concern offer based on its authorized discretion in conducting the Sales Process.
21. E&Y prepared a summary of the offers (the “**Offer Summary**”) received including details of the purchase price, assets being purchased, conditions to closing and other pertinent details of the offers. A copy of the Offer Summary will be filed with the Court in a confidential appendix to the Second Report (“**Confidential Appendix “A”**”), which Confidential Appendix A will be subject to a request by the Monitor that it be sealed, pending completion of a sale of the CB business.
22. The Monitor and E&Y reviewed the offers and after numerous consultations, agreed to commence negotiations with 2313329 Ontario Inc. (“**231**” or the “**Purchaser**”).
23. Farber reported in its Sixth Report as Proposal Trustee and Proposed Monitor dated December 14, 2011 that Noor, the principal shareholder of the Company, was intending to submit an offer for the property, assets and undertakings of the CB

business. The Monitor advises this Honourable Court that the principal shareholder of 231 is Noor. In addition, Noor is also a 50% shareholder of CMT Sourcing.

24. The Monitor concluded terms of an agreement with the Purchaser on February 3, 2012 (the “**Sale Agreement**”). The terms of the Sale Agreement were acceptable to the Company and the two remaining principal secured lenders, CIC and CMT Sourcing, the latter of which will suffer a shortfall to its position.

25. E&Y has prepared a chart comparing the anticipated net proceeds from the main Offerors (the “**Analysis of Offers**”). A copy of the Analysis of Offers will be filed with the Court as a confidential appendix to the Second Report (“**Confidential Appendix “B”**”), which Confidential Appendix B will be subject to a request by the Monitor that it be sealed, pending completion of a sale of the CB business.

26. The Monitor is of the view that the Sales Process has been administered with the assistance of E&Y fairly and in good faith, in a manner consistent with other approved solicitation processes in insolvency filings, and that it was designed and has been executed in a manner that exposed the bid opportunity to a broad range of prospective purchasers with a view to securing the highest and best offers from potentially interested parties.

PROPOSED ASSET PURCHASE AGREEMENT

27. Subject to this Court’s approval, the Monitor, on the Company’s behalf, has entered into the Sale Agreement with 231 dated February 3, 2012 that sets out the terms that 231 will purchase the assets and assume certain liabilities of the Company. A

redacted copy of the Sale Agreement is attached hereto as **Appendix “E”**. An unredacted copy will be filed separately with the Court as **Confidential Appendix “C”**.

28. Notwithstanding that the Sale Agreement was executed by the Monitor on behalf of the Company, the Company continues to remain in possession and control of its assets and property.

29. The principal terms of the Sale Agreement are summarized below. The specific terms can be found in the Sale Agreement attached as Appendix E.

a) **Assets** means:

- i. all of the Vendor's right, title and interest, in and to all of the tangible and intangible assets, cash (to a maximum amount of \$●million), properties and rights, including all intellectual property rights, wherever located or used solely in connection with the ownership, operation or conduct of the Business (but not including any Excluded Assets); and
- ii. all of the Vendor's right, title and interest in and to the shares of CMT America Holding Inc.;

b) **Assignment and Assumption Agreement** means an agreement to be entered into between the Purchaser and the Vendor, among other parties, at the Closing Time wherein the Vendor assigns the Contracts to the Purchaser and the Purchaser agrees to assume the Assumed Obligations and the Assumed Debt;

c) **Assumed Debt** means, as at the Closing Time, the amount of the Crown Debt and CMT Sourcing Debt;

d) **Cash Reserve** means cash in the amount of \$400,000 to be held and distributed by the Monitor in an amount not less than that required to satisfy all priority payable obligations to employees pursuant to sections 81.3 and 81.4 of the *Bankruptcy and Insolvency Act* (Canada), and all obligations, fees, costs and expenses of the CCAA Proceedings secured by the Administration Charge (as defined in the CCAA Proceedings), to the termination thereof and any subsequent bankruptcy proceedings arising thereafter. Such Cash Reserve shall be treated as forming part of Administrative Charge with the priority afforded to such charge;

- e) **CMT Sourcing Debt** means \$● of the secured amount owing by the Vendor to CMT Sourcing;
- f) **Crown Debt** means \$● of the secured amount owing by the Vendor to Crown;
- g) **Excluded Assets** means the assets listed on Schedule "A" as well as any additional Assets that the Purchaser elects to exclude prior to Closing, in accordance with Section 2.7 hereof
- h) Subject to the conditions and terms hereof, at the Closing Time, the Vendor shall assign to the Purchaser all of the Vendor's rights, title, benefits and interests in and to the Contracts and the Purchaser shall assume the obligations and liabilities of the Vendor under the Contracts at the Closing Time and shall cause the counterparty to those Contracts forming part of the Assumed Debt to release the Vendor from any obligation thereunder and under the security granted therefor.
- i) Notwithstanding the foregoing, this Agreement and any document delivered under this Agreement shall not constitute an assignment or an attempted assignment of any Contract contemplated to be assigned to the Purchaser under this Agreement that is not assignable without the consent of a third party if such consent has not been obtained and such assignment or attempted assignment would constitute a breach of such Contract. Any Contract in respect of which the consent of a third party is required but has not been obtained by the Closing Time shall be held in trust by the Vendor for the benefit of the Purchaser until such time as the required consent is obtained.
- j) On Closing, the Purchaser shall assume all obligations to the employees of the Vendor that accept employment with the Purchaser (arising after the Closing Time), including their wages and vacation pay (the "**Assumed Obligations**").
- k) The purchase price payable by the Purchaser to the Vendor for the Assets (the "**Purchase Price**") shall be equal to the Assumed Debt;
- l) At Closing, the Purchaser shall satisfy the Purchase Price by the assumption of the Assumed Debt

30. As the terms of the Sale Agreement constitutes a sale outside the ordinary course of business in a CCAA process, the Company requires Court authorization pursuant to section 36. (1) of the CCAA. Accordingly, the Monitor advises as follows:

- a) the Monitor, with the assistance of E&Y, conducted the Sales Process leading to the proposed sale of the assets; and the Sales Process was approved by this Honourable Court;
- b) the Sales Process leading to the conclusion of a Sale Agreement, in the Monitor's opinion, was reasonable in the circumstances;
- c) the sale of the assets would be more beneficial to the creditors than a sale or disposition in the context of a bankruptcy;

31. In forming the opinion in paragraph 30 (c) above, the Monitor notes the following:

- a) The debtor in possession nature of the sale greatly facilitates a sale of the assets as a going concern;
- b) CIC and CMT Sourcing will release their secured debt in Company in the amount of assumed debt being assigned to the Purchaser, and the Purchaser will assume all obligations of the Company's employees that accept employment with the Purchaser after closing, including wages and unpaid vacation pay which consideration is fair and reasonable in the circumstances;
- c) The administrative costs associated with a trustee in bankruptcy taking possession of approximately 40 stores and completing a sale in bankruptcy would negatively affect any realizations available to creditors.

32. The Monitor has advised the Court that the Purchaser is a related person pursuant to section 36. (5) of the CCAA. As a result, the Monitor is of the view that the Sales Process has been administered fairly and in good faith, in a manner consistent with other approved solicitation processes in insolvency filings, and that it was designed and has been executed in a manner that exposed the bid opportunity to a broad range of prospective purchasers.

33. Furthermore, the Analysis of Offers confirms that the consideration being paid by the Purchaser is superior to the consideration being offered by the other Offerors.

34. It is anticipated that the Company will make the required payments to the employees terminated through the restructuring process that would be otherwise be subject to the

employee charges under section 81.3 and 81.4 of the BIA, if this scenario were a receivership or bankruptcy.

35. Furthermore, the Sale Agreement provides for the Purchaser to assume the obligations of all the Company's employees that accept employment with the Purchaser after closing including, but not limited to, wages and unpaid vacation pay.

36. In addition, the Sale Agreement establishes a cash reserve to be held and distributed by the Monitor in an amount not less than that required to satisfy all priority payable obligations to employees pursuant to sections 81.3 and 81.4 of the BIA and all obligations, fees, costs and expenses of the CCAA Proceedings secured by the Administration Charge (as defined in the CCAA Proceedings), to the termination thereof and any subsequent bankruptcy proceedings arising thereafter.

37. Lastly, CIC has agreed to provide funding (the "**CIC Funding**") which may be required to satisfy certain obligations to complete the administration of the CCAA proceedings including any amounts to satisfy priority payable obligations to employees and all obligations, fees, costs and expenses of the CCAA proceedings. The CIC Funding is limited to the amount of an anticipated federal and corporate tax refund that the Company intends to file in the next short while.

HST / QST

38. On or around February 2, 2012, the Company advised the Monitor that it failed to make payment of HST and QST in the amounts of \$714,763.03 and \$46,280.80 respectively, due on January 31, 2012 for the period immediately prior to the commencement the these CCAA proceedings and following. Notwithstanding this

event, the Monitor believes that the CCAA proceeding must be continued in order to complete the transaction contemplated in the Sale Agreement as this is the most beneficial course of action for stakeholders generally. With respect to any issues of the process for determining the priority and remedies available to Canada Revenue Agency and the Quebec revenue authority in respect of the failure to make the required HST payment, it is the Monitor's view that any steps in this regard should await a later hearing on the matter by which time the parties have been properly briefed and have had sufficient time to prepare their respective positions for dealing with the consequences of non-payment.

RECOMMENDATIONS

39. As a result of the above, the Monitor respectfully recommends that this Honourable Court approve:

- a) the transaction contemplated by the Sale Agreement;
- b) the vesting of the Assets (as defined in the Sale Agreement) in 231;
- c) the sealing of the confidential appendices to this the Monitor's Second Report; and
- d) the deeming of the Cash Reserves (as defined in the Sales Agreement) to form part of the Administration Charge under the Initial Order.

All of which is respectfully submitted this 13th day of February 2012.

**A. FARBER & PARTNERS INC.
IN ITS CAPACITY AS MONITOR OF
CLOTHING FOR MODERN TIMES LTD.**

A. Farber & Partners Inc.
