

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

**IN THE MATTER OF THE PROPOSAL 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 PROPOSAL TRUSTEE

JULY 20, 2011

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INTRODUCTION

1. On June 27, 2011, Clothing for Modern Times Ltd. (“**CMT**” or the “**Company**”) filed a Notice of Intention to Make a Proposal (“**NOI**”) under 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**”). A copy of the Certificate of Filing a Notice of Intention to Make a Proposal is attached hereto as **Appendix “A”**.
2. CMT is an Ontario-incorporated company that has designed, produced and marketed trendy apparel styles for ‘fashion forward’ men and women since 1989 under the retail banners: Urban Behavior (“**UB**”), Costa Blanca (“**CB**”) and Costa Blanca X (“**CBX**”). At the date of the NOI filing, CMT operated 116 leased store locations throughout Canada.
3. CMT leases its head office premises, which are located at 300 Supertest Road, Toronto, Ontario.
4. At the time of filing the NOI, the Company employed 1,682 employees, of which approximately 1,316 are hourly retail employees.
5. A corporate search conducted on CMT indicates that the Company has two active directors: Arif Noor and Chris Johnson. Mr. Noor is the majority (95%) shareholder of CMT.
6. CMT has experienced declining sales and reduced profit margins over the past three years attributed mainly to the poor economic climate for retail operations and the

entry of direct competitors to the UB banner in the Canadian marketplace, such as H&M and Forever 21.

7. In contemplation of the impending restructuring proceedings and its participation therein, on June 24, 2011, the Company's primary secured lender, Roynat Asset Finance, a Division of Roynat Inc. ("**Roynat**") demanded repayment of its loans and issued a Notice of Intention to Enforce Security under Section 244 of the BIA. CMT consented to the immediate enforcement of Roynat's security.
8. In addition, Roynat, CMT and other related entities to CMT, as guarantors, entered into a forbearance agreement dated June 24, 2011 (the "**Forbearance Agreement**"), whereby Roynat agreed to forbear from taking certain actions under its security and agreed to maintain its credit facilities pursuant to the Roynat Loan (as defined below), subject to the terms and conditions contained in the Forbearance Agreement. A copy of the Forbearance Agreement is attached hereto as **Appendix "B"**.
9. Pursuant to an Order of the Honourable Madame Justice Hoy dated July 11, 2011 (the "**July 11 Order**"), the Court approved, *inter alia*, (i) the post-filing advances and Over-Advances to the Company by Roynat, (ii) a super-priority charge in favour of Roynat to secure payment of the money advances by Roynat post-filing, (iii) an Administration Charge to secure the reasonable fees and disbursements of CMT's legal and financial advisors, the Proposal Trustee and its legal counsel; (iii) a self liquidation plan by CMT of 21 stores identified for closure in the affidavit of Chris Johnson dated July 5, 2011 (the "**Liquidation Stores**"); and (iv) a key employee retention and incentive plan for certain key employees of CMT working in the

Liquidation Stores during the liquidation period. Copies of the July 11 Order and Justice Hoy's endorsement (the "**July 11 Endorsement**") are attached hereto as **Appendix "C"**.

PURPOSE OF THIS REPORT

10. The purpose of this Second Report of the Proposal Trustee ("**Second Report**") is to:

- a) generally inform the court of activities of the Proposal Trustee since the date of the first report dated July 6, 2011 ("**First Report**"). A copy of the First Report is attached as **Appendix "D"**;
- b) advise the Court and request approval for the Company to self-liquidate inventory and fixtures at seven additional poor performing stores (the "**Additional Stores**");
- c) support the Company's request to seek approval to extend the key employee retention plan approved in the July 11 Order to the Key Store Employees (as defined in the First Report) employed at the Additional Stores;
- d) advise the Court of the guidelines for the sale and removal of furniture, fixtures and equipment in the Liquidation Stores (as defined below) and the Additional Stores and recommend that the Honourable Court approve such guidelines;

- e) support the Company's request to seek approval of the process for the Company to market and sell the Urban Behavior and Costa Blanca X chains;
- f) seek approval of the establishment of a charge on all of the assets, undertakings and properties of CMT in favour of CMT's real property landlords to secure payment of base and additional rent under the real property leases; and
- g) recommend that the Company be granted an extension for 45 days of the deadline for the filing of its Proposal pursuant to the BIA.

DISCLAIMER

11. Farber has relied upon the 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. Farber assumes no responsibility or liability for loss or damage occasioned by any party as a result of the circulation, publication, re-production or use of this Second Report. 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.

ACTIVITIES OF PROPOSAL TRUSTEE

12. Farber's activities since the filing of its First Report include the following:

- a) continuing discussions with the Company's landlords and their legal counsel;
- b) answering queries from suppliers, landlords and employees regarding the operation of the NOI and the impact of this filing on the stakeholders and the business of CMT;
- c) monitoring and reviewing the continuing affairs of the Company in accordance with its obligations pursuant to the BIA; and
- d) generally advising the Company on available options and matters related to the BIA process.

RESTRUCTURING AND PROPOSED SALES PROCESS

13. The Company initially determined that a restructuring around its profitable store locations was the best method to maximize value for all its stakeholders and would enable the Company to formulate a viable proposal to its creditors. Accordingly, the Company planned to proceed with a “dual track” approach of self liquidating the Liquidation Stores while at the same time proceeding with a process for soliciting liquidation offers.

14. As detailed in the affidavit of Chris Johnson dated July 19, 2011 (the “**Second Johnson Affidavit**”), the Company engaged in discussions with landlords of certain Liquidation Stores resulting in favourable concessions being offered by them to the Company. Accordingly, the Company has decided to remove store numbers 136 and 217 from the Liquidation Stores listing.

15. In addition, the Company has identified seven Additional Stores that it intends to self-liquidate as part of its restructuring, subject to approval of this Honourable Court.
16. On July 15, 2011, the Company sent notices of lease disclaimers to the landlords for the balance of the Liquidation Stores not yet disclaimed and the Additional Stores.
17. With the removal of two stores from the Liquidation Store list and the addition of seven Additional Stores, the Company has now identified 26 stores that it intends to self-liquidate as part of its restructuring (collectively, the “**Closing Stores**”). A copy of the Closing Stores listing is attached hereto as **Appendix “E”**.
18. The Proposal Trustee has further been advised by CMT that, in consultation with its advisors, it wishes to restructure its business around the CB business, but that in addition to considering liquidation proposals for the UB and CBX chains, it wishes to canvass the market to determine whether these chains could generate more value by being sold on a going-concern basis.
19. The Company believes that commencing a “dual track” sales process for going concern and liquidation offers would achieve maximum recovery for its stakeholders. Further, the Company will continue to self liquidate the Liquidation Stores as approved in the July 11 Order and the Additional Stores (subject to approval of this Honourable Court).
20. CMT, with the assistance of its financial advisor, RSM Richter Corporation (“**Richter**”), has developed a sales and marketing process for the UB and CBX chains (the “**Sales Process**”).

21. The Company has proposed the following terms for the Sales Process, including:

- a) Compiling a list of prospective financial and strategic purchasers and liquidators (with Richter's assistance) to participate in the Sales Process. The prospective purchasers list will be augmented by parties that have contacted or may contact the Proposal Trustee directly as well as any other bona fide parties that contact the Company and/or Richter in the future;
- b) On or around July 19, 2011, Richter will distribute to prospective purchasers a solicitation letter including a confidentiality agreement ("CA") that prospective purchasers are required to sign in order to gain access to confidential information. The solicitation letter will advise prospective purchasers that the Company intends to seek Court approval of the Sales Process on July 22, 2011, and accordingly, the Sales Process may be amended by the Court;
- c) CMT has prepared a confidential information memorandum ("CIM") to be made available to prospective purchasers that execute a CA;
- d) Prospective purchasers that have executed a CA will be provided with an opportunity to review information in CMT's online data room and will also be provided with an opportunity to visit store locations and meet with CMT's management;
- e) An asset purchase agreement (in the case of going-concern buyers) and an agency agreement (in the case of the liquidators) will be provided to those

prospective purchasers who execute a CA. Prospective buyers will be requested to submit offers in these formats (or substantially in these formats), as appropriate. The forms of agreements will be provided to prospective bidders following the motion for approval of the Sale Process on July 22, 2011;

f) The proposed offer deadline is August 22, 2011 (the “**Offer Deadline Date**”). Richter has advised the Company that it believes this timeline is sufficient to allow prospective purchasers time to complete their due diligence and to submit an offer and is consistent with Richter’s experience selling distressed companies of this size.

22. The Company has advised that it is in the stakeholder’s best interests to allow prospective purchasers the opportunity to commence their due diligence a few days prior to June 22, 2011 so that they may have more time to complete their due diligence and submit an offer by the Offer Deadline Date.

23. Concurrently with the Sale Process, CMT intends to commence a marketing process for certain of CMT’s real property leases, which may be sold on a piecemeal basis in the event a going concern transaction for UB and/or CBX is not achieved.

24. The Proposal Trustee is advised that CMT is attempting to engage a commercial broker specializing in retail leases to assist CMT with marketing certain of its real property leases. Further, if the Company succeeds in retaining a commercial broker, the details of the terms of the engagement will be provided to the Court.

25. The Proposal Trustee has been advised by the Company that the terms of the Sales Process are supported by the Company's principal secured creditors, being Roynat, CIC Asset Management Inc. ("**Crown**") and CMT Sourcing Inc.

26. The Proposal Trustee believes that the proposed terms of the Sales Process are reasonable and appropriate in the circumstances.

FURNITURE, FIXTURES AND EQUIPMENT

27. The July 11 Order provides approval for the Company to liquidate its furniture, fixtures and equipment ("**FFE**"), however it did not provide a process for marketing the FFE or removal of the FFE from the various locations.

28. The Company is seeking approval from this Honourable Court of proposed guidelines for the liquidation of its FFE from the Closing Stores, as follows:

- a) CMT may sell any FFE owned by CMT during the liquidation and may advertise the sale of the FFE. The purchasers of any FFE shall only be permitted to remove the purchased FFE either through the back shipping areas designated by the landlord or through other areas after regular business hours of the store or the shopping centre.
- b) CMT will provide the relevant landlords with notice of its intention to remove or sell any FFE from any store at least three days prior to the date of the intended removal or sale. The relevant landlord shall be entitled to have a representative present in the store to observe such removal and, if the relevant landlord disputes the entitlement to remove any such FFE

under the provisions of the lease, such FFE shall remain in the store and shall be dealt with as agreed between the landlord and CMT, or by further order of the Court on application by CMT on at least two days' notice to such landlord.

- c) If a lease has been disclaimed, CMT shall not be deemed to be in occupation or required to pay rent pending resolution of any FFE dispute and the disclaimer of any lease shall be without prejudice to CMT's claim to any FFE at issue in the dispute.
- d) CMT may abandon any FFE not sold in the liquidation at the store premises at the conclusion of the liquidation. Any FFE left in a store after a lease is disclaimed shall be deemed abandoned with the landlord having the right to dispose of the same as the landlord chooses.
- e) No permanent fixtures may be removed without the relevant landlord's written consent unless otherwise provided by the applicable lease. No property of the landlord in a store shall be removed or sold during the liquidation.

29. The Proposal Trustee has been advised by the Company's legal counsel that discussions have been held with the landlords' counsel representing approximately 100 out of 116 stores (the "**Landlords**") to obtain their approval of the above guidelines. The Company's counsel has advised that language for the removal of the FFE has been agreed by the Landlords. The Proposal Trustee has reviewed the above guidelines and supports the motion for removal of the FFE.

SECURITY OPINION UPDATE

30. As referred to in the First Report, Farber has engaged Norton Rose OR LLP (“**NRLLP**”) as counsel to conduct a review of the Security that was granted to Roynat, and to provide an opinion with respect to its validity and perfection.
31. As reported therein, NRLLP had provided a favourable opinion on Roynat’s security subject to the assumptions and qualifications contained therein for the Provinces of Ontario and Quebec. Following on from these initial investigations, NRLLP was required to opine through agent counsel on the remaining jurisdictions where the substantial portion of the Company’s assets are located. These Provinces are British Columbia, Alberta, Manitoba, New Brunswick and Nova Scotia. Such opinions conclude that subject to the assumptions and qualifications contained therein, the interests created by the security instruments in the collateral described therein have been perfected under the relevant personal property security regime (to the extent required) and rank in priority to the interest of a trustee in bankruptcy in the property, assets and undertaking of the Company which are described in the security instruments. These additional opinions are available for review upon request.
32. A review of the security interests held by the other principal secured creditors of the Company has been completed.
33. The Proposal Trustee has received favourable opinions from each jurisdiction where registrations have been effected including the Provinces of Ontario, Quebec, British Columbia, Manitoba, New Brunswick, Nova Scotia and Alberta pertaining to the

security held by CIC Asset Management Inc, a purported assignee of Crown Life Insurance Company.

34. A review of the security of CMT Sourcing Group Ltd is currently under way, though it would appear that all registrations necessary to perfect this security have been undertaken in those jurisdictions where the secured party has chosen to effect them.

LANDLORDS

35. The Proposal Trustee advised in its First Report that the Company wished to minimize its liquidity pressure by commencing to pay rent on a bi-weekly basis in advance. The Company's current rent payments to landlords are payable on a monthly basis (on the first day of each month) in advance.
36. The Proposal Trustee has recently been advised by the Company and the Landlords that an agreement (the "**Rent Payment Agreement**") has been reached in principle allowing CMT to pay its monthly rent obligations on the first and fifteenth of every month commencing on August 1, 2011.
37. The Rent Payment Agreement is subject to those affected landlords receiving a court-ordered charge (the "**Landlords Charge**") on the property, assets and undertakings of the Company securing payment of a maximum amount for each leased location of one half of the monthly post-filing base and additional rent (excluding damages and any other amounts recoverable as rent under the relevant lease), which charge shall rank behind the amounts set out in paragraph eight of the July 11 Order.

38. The Proposal Trustee has been advised by the Company that discussions are ongoing with the Landlords to resolve the language with respect to the Landlords Charge. The Proposal Trustee expects that the remaining issues with respect to the charge language will be resolved to the satisfaction of the parties.

NECESSITY OF AN EXTENSION

39. The initial 30-day stay period granted upon the filing of the NOI expires on Wednesday July 27, 2011.

40. Since the date of filing of the NOI, the Company has worked diligently attending to the myriad of time sensitive business issues relating to its restructuring efforts and the BIA process in an effort to work toward formulating a viable proposal.

41. As detailed in the Second Johnson Affidavit, the Company wishes to commence a Sales Process and, at the same time, continue liquidating the Closing Stores. The proposed Offer Deadline Date is set for August 22, 2011, on which date the Company will accept offers for the sale of the UB and CBX businesses on a going concern and/or liquidation basis.

42. It is anticipated that the Company, and its advisors, will assess competing offers made and thereafter will require some time to negotiate a final form of agreement with the successful bidder.

43. The Proposal Trustee is advised by the Company that it will require a 45 day extension to September 12, 2011 in order to allow the Company to complete the Sales Process, and depending on the outcome of the Sales Process, to formulate a viable

proposal to its creditors. The Company anticipates that the Sales Process will be completed by the end of September 2011 and the self liquidation will continue until mid September 2011.

44. In the event an extension is not granted and the Company is deemed bankrupt, the Company will not be able to complete its restructuring and formulate a proposal, to the detriment of all its stakeholders, including its approximately 1,682 employees.

45. The Proposal Trustee is satisfied that the Company has acted and is acting in good faith and with due diligence in the Proposal to date and if the extension sought is granted, this will allow the Company to commence and complete the Sales Process.

46. The Proposal Trustee is not aware of any creditor who would be materially prejudiced if the extension of the NOI period being requested by the Company to September 12, 2011 is granted.

47. The Company has been operating within its cash flow projections as filed by the Proposal Trustee in its First Report. It is anticipated that the relief being sought in connection with the bi-weekly rent payment terms should improve the availability of the Company under the post-filing financing arrangement with Roynat.

48. Accordingly, the Proposal Trustee recommends that a 45 day extension be granted to the Company for the reasons set out above.

RECOMMENDATIONS

49. As a result of the above, the Proposal Trustee respectfully requests that this Honourable Court:

- a) Approve the guidelines for the sale and removal of FFE in the Liquidation Stores and the Additional Stores;
- b) Approve the extension of the Key Employee Retention Plan to the Key Store Employees employed at the Additional Stores;
- c) Approve the process to self-liquidate inventory and FFE by the Company at the Additional Stores;
- d) Approve the Sales Process for the Company to market and sell the UB and CBX chains;
- e) Approve the establishment of a charge on all of the assets, undertakings and properties of CMT in favour of CMT's real property landlords to secure payment of base and additional rent under the real property leases;
and
- f) Grant the Company a 45-day extension of time for the filing of its Proposal pursuant to the BIA until September 12, 2011.

All of which is respectfully submitted this 20th day of July 2011.

**A. FARBER & PARTNERS INC.
IN ITS CAPACITY AS TRUSTEE *IN RE*
THE PROPOSAL OF CLOTHING FOR MODERN TIMES LTD.**

A. Farber & Partners Inc.
