

COURT FILE NUMBER 25-2251814
25-2251817

COURT COURT OF QUEEN'S BENCH OF
ALBERTA

JUDICIAL CENTRE CALGARY

APPLICANT IN THE MATTER OF THE DIVISION I
PROPOSAL PROCEEDINGS OF
COMFORTABLE IMAGE INC. and WATCH
IT! INCORPORATED

DOCUMENT **FIRST REPORT OF THE PROPOSAL
TRUSTEE**

May 17, 2017

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INTRODUCTION

1. On May 15, 2017, Watchit! Incorporated (“**WII**”) and Comfortable Image Inc. (“**CII**” and together the “**Companies**”) each 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 “**NOI Proceedings**”). A. Farber & Partners Inc. (“**Farber**”) was appointed as proposal trustee (the “**Proposal Trustee**”) in the NOI Proceedings.

2. The NOI provides the Companies with a stay of proceedings until June 14, 2017 (the “**Initial Stay Period**”).

PURPOSES OF THE FIRST REPORT

3. The purposes of this Report (the “**First Report**”) are to provide this Honourable Court with information regarding:

- (a) a summary of certain background information about the Companies;
- (b) the objectives of the NOI Proceedings and the creditors of the Companies;
- (c) the Companies’ statements of projected cash flow for the period May 13 to August 11, 2017;
- (d) the Companies’ requests for approval of the Administration Charge as defined in the Bondar Affidavit; and
- (e) the Companies’ request for Administrative Consolidation of the estates of CII and WII.

DISCLAIMER AND TERMS OF REFERENCE

4. In preparing this First Report, the Proposal Trustee has relied upon unaudited financial information of WII and CII, the books and records of the Companies and discussions with representatives of the Companies, including their lawyers. The Proposal Trustee has not performed an audit or other verification of such information. The Proposal Trustee expresses no opinion or other form of assurance with respect to the financial information presented in this First Report.

5. Since future-oriented information is based on assumptions regarding future events, actual results will vary from the information presented even if the hypothetical assumptions occur, and variations may be material. Accordingly, the Proposal Trustee expresses no assurance as to whether projections will be achieved. The Proposal Trustee expresses no opinion or other form of assurance with respect to the accuracy of any financial information presented in this report, or relied upon by the Proposal Trustee in preparing this report.

6. Unless otherwise stated, all monetary amounts noted herein are expressed in Canadian dollars.

7. Capitalized terms not otherwise defined herein are as defined in the Companies' application materials, including the affidavit of Darren Bondar sworn May 16, 2017 (the "**Bondar Affidavit**") filed in support of this application. The First Report should be read in conjunction with the Bondar Affidavit as certain information contained in the Bondar Affidavit has not been included herein in order to avoid unnecessary duplication.

BACKGROUND

8. WII is a Canadian watch retail franchisor with 30 franchise stores operating under the "WatchIt!" banner. CII owns and operates 13 of the 30 WII franchise stores (the "**CII Franchisees**"). The WatchIt! stores sell watches, sunglasses and related accessories. All of the 30 WII franchise store locations are leased.

9. The Companies' head office, which also acts as its distribution centre, is located in a leased 2,500 square foot premises at 5740 2nd Street SW, Suite 102 in Calgary, Alberta.

10. As of May 15, 2017, CII had approximately 88 employees of which approximately 73 were full time employees and 15 were part-time employees. There are no employees in WII. The employees are not represented by a union and are not subject to a collective bargaining agreement.

11. As described in the Bondar Affidavit, lower than expected retail sales have negatively impacted the financial performance of the Companies. As a result, the

Companies are experiencing a liquidity crisis and have defaulted on various financial and other covenants with their secured creditors, Proficio and Grenville (each as defined below). Both Proficio and Grenville have each agreed to forbear from enforcing their rights and remedies, subject to certain terms and conditions, to permit WII and CII to pursue a restructuring.

12. On May 15, 2017, each of the Companies filed an NOI to allow it to pursue an orderly liquidation of its inventory and downsize its store footprint through disclaimer of leases at its underperforming stores.

13. The Companies' business, affairs, financial performance and position, as well as the causes of their insolvency, are detailed in the Bondar Affidavit and are not repeated herein. The Proposal Trustee has reviewed the Bondar Affidavit and discussed the business and affairs of the Companies and the causes of insolvency with Mr. Bondar and is of the view that the Bondar Affidavit provides a fair summary thereof.

OBJECTIVES OF THE NOI PROCEEDINGS

14. The primary objectives of the NOI Proceedings are to:

- (a) ensure the on-going operations of the Companies;
- (b) restructure the Companies' operations, including the proposed closure of underperforming locations and an orderly liquidation of certain inventory;
- (c) restructure the debts of the Companies in order to provide the Companies with the necessary working capital funds to continue operations; and
- (d) complete a transactions(s) arising from a sales and investment solicitation process ("SISP") to be proposed and approved at a later date in these proceedings. It is anticipated that the proposed SISP will contemplate a stalking horse credit bid by a party related to the Companies who is arranging refinancing from certain of its existing secured creditors including Proficio Capital Partners LLC ("Proficio"), Thinking Capital Financial Corporation ("Thinking Capital") and Grenville Strategic Royalty Corporation ("Grenville").

CREDITORS

Secured Creditors of CII

15. As detailed in the Bondar Affidavit, the following are secured creditors of CII:
- (a) Proficio is owed approximately US\$1.2 million in respect of various term loans provided. The Proficio secured debt is comprised of separate loans made by individuals including Ranaan Katz, Matthew Wosk and Bob Haber in the amounts of approximately US\$845,000, US\$113,000 and US\$281,000 respectively;
 - (b) Thinking Capital is owed approximately \$198,000 in respect of a secured receivable financing;
 - (c) Darren Bondar is owed approximately \$800,000 in respect of shareholder advances made on a secured basis (the “**Bondar CII Secured Debt**”);
 - (d) 1895936 Ontario Limited (Markville) (the “**Markville VTB**”) is owed approximately \$80,000 in respect of a vendor take-back with security on the Markville store assets;
 - (e) WII is owed approximately \$580,000, after set-offs, in respect of a bonus earned by it from CII in 2016;
 - (f) Grenville is owed approximately \$3.6 million in respect of a guarantee of loans provided to WII pursuant to a royalty repayment agreement, of which \$1 million is secured and \$2.6 million is unsecured;
 - (g) Bankers Hall Landlord as defined below has registered security in respect of their lease interest;
 - (h) Nixon Inc., Bulova Watch Company Ltd., and Citizen Watch Company of Canada have all registered security in respect of inventory supplied to CII; and
 - (i) Xerox Canada Ltd. Has registered security in respect of a photocopier located at the Head Office of the Companies.

16. Searches conducted on May 12, 2017, of the Personal Property Security Registry in Alberta (and similar searches in other provinces where the Companies have stores) show registrations against CII in favour of Darren Bondar, Bankers Hall LP, BCIMC Realty Corporation, Bankers Hall GP Inc., Bankers Hall GP Trust (collectively, the “**Bankers Hall Landlord**”), Ranaan Katz, Matthew Wosk, Bob Haber, Xerox Canada Ltd., Nixon Inc., Grenville, Citizen Watch Company of Canada Ltd., Thinking Capital, Her Majesty the Queen in the Right of the Province of British Columbia, Bulova Watch Company Ltd., and 1895936 Ontario Ltd.

Sales Taxes

17. Her Majesty the Queen in Right of the Province of British Columbia is owed approximately \$38,000 for arrears and accrued obligations in respect of PST and has registered security for such amount in the Province of British Columbia; and

18. Canada Revenue Agency (“**CRA**”) is owed approximately \$88,000 for arrears and accrued obligations in respect of GST/HST.

Unsecured Creditors of CII

19. In addition to the creditor claims discussed above, CII estimates that accrued and unpaid unsecured obligations total approximately \$200,000 excluding claims by its landlords as a result of issuing lease disclaimers.

Secured Creditors of WII

20. As detailed in the Bondar Affidavit, the following are secured creditors of WII:

(a) Grenville is owed approximately \$3.6 million in respect of loans provided pursuant to a royalty repayment agreement, of which approximately \$1 million is secured and the remaining \$2.6 million is unsecured; and

(b) Darren Bondar is owed approximately \$77,500 in respect of secured shareholder loans (the “**Bondar WII Secured Debt**”)

21. Searches conducted on May 12, 2017, of the Personal Property Security Registry in Alberta (and similar searches in other provinces where the Companies have stores) show registrations against WII in favour of CII, Darren Bondar, the Bankers Hall Landlord, Alberta Treasury Branches, Nixon Inc., Grenville, Falls Management Company, the Toronto Dominion Bank, and The Bank of Nova Scotia.

22. The Proposal Trustee has requested an opinion from its independent legal counsel, McMillan LLP (“**McMillan**”) with respect to the validity and enforceability of the above secured claims. The Proposal Trustee expects to be in a position to provide this Honourable Court with the results of this opinion at the next court appearance when it seeks approval of a transaction.

Unsecured Creditors of WII

23. In addition to the creditor claims discussed above, WII estimates that accrued and unpaid unsecured obligations total approximately \$1.2 million excluding claims by its landlords as a result of issuing lease disclaimers.

CASH FLOW STATEMENTS

24. CII and WII, with the assistance of the Proposal Trustee, have each prepared a cash flow forecast of its receipts and disbursements for the period May 13 to August 11, 2017 (the “**CII Forecast**” and “**WII Forecast**” respectively, collectively the “**Cash Flow Forecasts**”). The Cash Flow Forecasts are attached as **Appendix “A”** to this report and are summarized below:

WATCHIT! INCORPORATED**May 13 - Aug 11, 2017****Total****13 Weeks****CASH FLOW FORECAST****Receipts:**

Royalty Receipts	187,441
Advertising Receipts	47,661
Overhead recovery receipts	<u>(53,710)</u>
Total Receipts	181,392

Disbursements:

Occupation costs	20,031
Overhead Costs	29,580
Total Disbursements	49,611

**Net Cash Flow Before Professional Payments
and Secured Creditor Payments****131,781**

Professional fee payments

60,000

**Net Cash Flow After Professional Payments
and Secured Creditor Payments****71,781****Opening Cash Balance****5,730****Ending Cash Balance****77,510**

25. The WII Forecast estimates that during the period of the projection approximately \$78,000 will be generated in surplus cash in WII.

COMFORTABLE IMAGE INC.**May 13 - Aug 11, 2017****Total****13 Weeks****CASH FLOW FORECAST****Receipts:**

Inventory Sales (excluding sales taxes)	2,261,537
Overhead recovery receipts	75,894
Total Receipts	2,337,431

Disbursements:

Inventory payments	632,308
Credit card charge payments	29,891
GST and PST Payments	68,000
Occupation Costs	182,315
Salaries, Wages, Benefits	405,301
Overhead Costs	56,678
Royalty payments	82,459
Advertising payments	20,615
Total Disbursements	1,477,567

**Net Cash Flow Before Professional Payments
and Secured Creditor Payments****859,864**

Professional fee payments	218,495
Proficio principal repayments	400,000
Thinking capital - royalty of Metrotown	51,744
Shareholder Advances (including cash operating balances)	188,347
Total Above Payments	858,586

**Net Cash Flow After Professional Payments
and Secured Creditor Payments****1,278**

Opening Cash Balance

-**Ending Cash Balance****1,278**

26. The CII Forecast provides that during the period of the projection, CII will remain cash neutral by managing payments to CII's secured creditors.

27. The Proposal Trustee has reviewed the Cash Flow Forecasts to the standard required by section 50(6)(b) of the BIA. Section 50(6)(b) requires the Proposal Trustee to review the debtor's cash flow statement as to its reasonableness and to file a report with OSB on the Proposal Trustee's findings. The Canadian Association of Insolvency and Restructuring Professionals' standards of professional practice include a standard for

Proposal Trustees fulfilling their statutory responsibilities under the BIA in respect of a Proposal Trustee's report on the Cash Flow Forecast.

28. Pursuant to this standard, the Proposal Trustee's review of the Cash Flow Forecast consisted of inquiries, analytical procedures and discussion related to information supplied to it by certain key members of the management of the Companies. Since the probable and hypothetical assumptions need not be supported, the Proposal Trustee's procedures with respect to them were limited to evaluating whether they were consistent with the purpose of the Cash Flow Forecasts. The Proposal Trustee also reviewed the support provided by the Companies for the probable and hypothetical assumptions and the preparation and presentation of the Cash Flow Forecast.

29. Based on the Proposal Trustee's review, nothing has come to its attention that causes it to believe, in all material respects, that:

- (a) the probable and hypothetical assumptions are not consistent with the purpose of the Cash Flow Forecasts;
- (b) as at the date of this report, the probable and hypothetical assumptions are not suitably supported and consistent with the plans of the Companies or do not provide a reasonable basis for the Cash Flow Forecasts, given the probable and hypothetical assumptions; or
- (c) the Cash Flow Forecasts do not reflect the probable and hypothetical assumptions.

30. Since the Cash Flow Forecasts are based on assumptions regarding future events, actual results will vary from the information presented even if the probable and hypothetical assumptions occur, and the variation could be material. Accordingly, the Proposal Trustee expresses no assurance with respect to the accuracy of the financial information presented in the Cash Flow Forecasts, or relied upon by the Proposal Trustee in preparing this report.

31. The Cash Flow Forecasts have been prepared solely for the purpose described above, and readers are cautioned that it may not be appropriate for other purposes.

LEASE DISCLAIMER AND INVENTORY LIQUIDATION

32. The CII Franchisees operate under direct lease agreements with their respective landlords. WII holds the head lease with the landlords for the remaining 17 WII franchisees who in turn operate under sublease agreements with WII.

33. As set out in the Bondar Affidavit, CII with the assistance of its advisors and in consultation with the Proposal Trustee, has concluded that a restructuring focusing on profitable stores, while vacating unprofitable locations, will maximize value for all stakeholders.

34. CII, with the assistance of the Proposal Trustee, is identifying stores that are to be closed (the “**Closing Stores**”). Certain stores may need to be closed depending on the CII’s ability to negotiate adequate rent concessions.

35. The average value of inventory on hand at the Closing Stores is approximately \$50,000. Given the narrow scope of inventory, the low quantities on hand at the Closing Stores and the low cost to move inventory to stores that are to remain open, CII is liquidating its own inventory and has not sought engagement of a liquidator or liquidation proposals.

36. WII is discussing the potential restructuring of some of its franchise and related agreements. The outcome of those discussions may result in the termination or disclaimer of additional leases.

ADMINISTRATION CHARGE

37. Given the constrained Cash Flow Forecasts, which have been described above and have been attached as **Appendix “A”**, it is impracticable for the Companies to pay retainers to the Proposal Trustee, McMillan and counsel to the Companies, McCarthy’s LLP (“**McCarthy’s**” or “**Debtors Counsel**”). The Proposal Trustee, McMillan and McCarthy’s have agreed to delay payment for a significant portion of pre-filing fees

incurred in recent weeks on the understanding that the Companies would seek Court authorization for payment of such fees and charges together with an order granting a charge securing payment of such fees and charges. In this regard, the Companies are seeking approval of an Administration Charge over all of the property, assets and undertaking of CII and WII in priority to all other security interests, trusts, liens, charges and encumbrances, claims of secured creditors, statutory or otherwise, in an amount not to exceed \$225,000 and \$75,000 respectively for each of CII and WII, in favour of the Proposal Trustee, McMillan and McCarthy's in order to secure payment of their respective reasonable fees and disbursements incurred at their standard rates and charges.

38. In the event that the Companies do not file proposals or proposals filed are not approved by the Companies' creditors or the Court, then the Companies will be deemed to have made assignments in Bankruptcy. Farber would be named Trustee in Bankruptcy and would have to comply with certain statutory duties. If the assets of the Companies are fully encumbered by secured claims, then without the benefit of the Administration Charge, Farber would be at risk of non-payment of its fees.

39. The secured creditors, most directly impacted by the proposed charge, either consent to or do not oppose the granting of the charge.

RECOMMENDATIONS

40. Based on the foregoing, the Proposal Trustee respectfully recommends that this Honourable Court issue an order:

- Approving the Administration Charge; and
- Approving the Administrative Consolidation of CII and WII.

All of which is respectfully submitted this 17th day of May, 2017.

A handwritten signature in black ink, consisting of several overlapping loops and a long horizontal stroke.

A. FARBER & PARTNERS INC.,
In its capacity as Trustee under the
Notice of Intention to Make a Proposal of
Watchit! Incorporated and Comfortable
Image Inc., and not in its personal
capacity

Appendix A



Prepared May 16, 2017

WATCHIT! INCORPORATED

	Week 1 19-May-17	Week 2 26-May-17	Week 3 2-Jun-17	Week 4 9-Jun-17	Week 5 16-Jun-17	Week 6 23-Jun-17	Week 7 30-Jun-17	Week 8 7-Jul-17	Week 9 14-Jul-17	Week 10 21-Jul-17	Week 11 28-Jul-17	Week 12 4-Aug-17	Week 13 11-Aug-17	18-Aug-17	Total 13 Weeks
CASH FLOW FORECAST															
Receipts:															
Royalty Receipts			83,726					69,521				34,193			187,441
Advertising Receipts			21,146					17,704				8,811			47,661
Overhead recovery receipts	(6,774)	(6,774)	(5,839)	(3,500)	(3,500)	(3,500)	(3,500)	(3,387)	(3,387)	(3,387)	(3,387)	(3,387)	(3,387)		(53,710)
Total Receipts	(6,774)	(6,774)	99,034	(3,500)	(3,500)	(3,500)	(3,500)	83,838	(3,387)	(3,387)	(3,387)	39,617	(3,387)	-	181,392
Disbursements:															
Occupation costs	1,400	1,400	1,486	1,700	1,700	1,700	1,700	1,519	1,519	1,519	1,519	1,468	1,400	1,400	20,031
Overhead Costs	2,627	2,627	2,531	2,294	2,294	2,294	2,294	1,917	1,917	1,917	1,917	2,253	2,701	2,701	29,580
Total Disbursements	4,027	4,027	4,017	3,994	3,994	3,994	3,994	3,436	3,436	3,436	3,436	3,721	4,101	8,202	49,611
Net Cash Flow Before Professional Payments and Secured Creditor Payments	(10,801)	(10,801)	95,017	(7,494)	(7,494)	(7,494)	(7,494)	80,402	(6,823)	(6,823)	(6,823)	35,896	(7,488)	(8,202)	131,781
Professional fee payments	10,000	-	25,000	-	-	-	-	25,000	-	-	-	-	-	-	60,000
Net Cash Flow After Professional Payments and Secured Creditor Payments	(20,801)	(10,801)	70,017	(7,494)	(7,494)	(7,494)	(7,494)	55,402	(6,823)	(6,823)	(6,823)	35,896	(7,488)	(8,202)	71,781
Opening Cash Balance	35,730	14,929	4,128	74,145	66,651	59,157	51,663	44,169	99,571	92,748	85,925	79,102	114,998	107,510	5,730
Ending Cash Balance	14,929	4,128	74,145	66,651	59,157	51,663	44,169	99,571	92,748	85,925	79,102	114,998	107,510	99,308	77,510

COMFORTABLE IMAGE INC.

	Week 1 19-May-17	Week 2 26-May-17	Week 3 2-Jun-17	Week 4 9-Jun-17	Week 5 16-Jun-17	Week 6 23-Jun-17	Week 7 30-Jun-17	Week 8 7-Jul-17	Week 9 14-Jul-17	Week 10 21-Jul-17	Week 11 28-Jul-17	Week 12 4-Aug-17	Week 13 11-Aug-17	Week 16 18-Aug-17	Total 13 Weeks
CASH FLOW FORECAST															
Receipts:															
Inventory Sales (excluding sales taxes)	378,606	378,606	268,872	204,872	204,872	209,683	209,683	69,611	69,917	69,917	69,917	66,184	60,796	60,796	2,261,537
Overhead recovery receipts	8,710	8,710	6,357	5,315	5,315	5,315	5,315	5,143	5,143	5,143	5,143	5,143	5,143	5,143	75,894
Total Receipts	387,316	387,316	275,229	210,187	210,187	214,997	214,997	74,754	75,060	75,060	75,060	71,327	65,940	126,736	2,337,431
Disbursements:															
Inventory payments	96,239	96,239	68,188	51,528	51,528	51,528	51,528	15,676	15,676	15,676	15,676	29,817	73,007	73,007	632,308
Credit card charge payments	5,254	5,254	3,707	2,758	2,758	2,758	2,758	832	832	832	832	728	589	589	29,891
GST and PST Payments	44,000	-	-	-	-	24,000	-	-	-	-	-	-	-	-	68,000
Occupation Costs	16,472	17,186	18,379	21,283	21,087	21,087	21,087	8,461	8,109	8,109	8,109	7,127	5,819	5,819	182,315
Salaries, Wages, Benefits	45,781	45,781	42,836	35,473	35,473	35,473	35,473	22,133	22,133	22,133	22,133	20,996	19,481	19,481	405,301
Overhead Costs	4,176	4,176	4,215	4,315	4,315	4,532	4,532	4,404	4,434	4,434	4,434	4,434	4,277	4,277	56,678
Royalty payments	14,494	14,494	10,226	7,609	7,609	7,609	7,609	2,294	2,294	2,294	2,294	2,008	1,626	1,626	82,459
Advertising payments	3,624	3,624	2,557	1,902	1,902	1,902	1,902	574	574	574	574	502	406	406	20,615
Total Disbursements	230,040	186,754	150,109	124,868	124,672	148,889	124,889	54,374	54,052	54,052	54,052	65,612	105,205	105,205	1,477,567
Net Cash Flow Before Professional Payments and Secured Creditor Payments	157,276	200,562	125,120	85,319	85,514	66,108	90,108	20,381	21,009	21,009	21,009	5,715	(39,265)	21,531	859,864
Professional fee payments	31,888	31,888	28,404	28,243	28,243	24,208	24,208	4,751	4,751	4,751	4,751	2,171	235	235	218,495
Proficio principal repayments	12,000	12,000	12,000	36,400	36,400	36,400	36,400	36,400	36,400	36,400	36,400	36,400	36,400	-	400,000
Thinking capital - royalty of Metrotown	-	-	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	5,000	3,372	3,372	3,372	51,744
Shareholder Advances (including cash operating balances)	113,387	74,960	-	-	-	-	-	-	-	-	-	-	-	-	188,347
Total Above Payments	157,276	118,848	45,404	69,643	69,643	65,608	65,608	46,151	46,151	46,151	46,151	41,943	40,007	3,607	858,586
Net Cash Flow After Professional Payments and Secured Creditor Payments	-	81,713	79,716	15,676	15,871	500	24,500	(25,771)	(25,143)	(25,143)	(25,143)	(36,228)	(79,272)	17,924	1,278
Opening Cash Balance	-	-	81,713	161,430	177,105	192,977	193,476	217,976	192,206	167,063	141,921	116,778	80,550	1,278	-
Ending Cash Balance	-	81,713	161,430	177,105	192,977	193,476	217,976	192,206	167,063	141,921	116,778	80,550	1,278	19,202	1,278