

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

**IN THE MATTER OF THE PROPOSAL OF XAGENIC INC. OF THE CITY OF
TORONTO, IN THE PROVINCE OF ONTARIO**

**SECOND REPORT OF THE PROPOSAL TRUSTEE AND THE PRE-FILING REPORT
OF THE PROPOSED RECEIVER**

SEPTEMBER 22, 2017

INTRODUCTION

1. On August 1, 2017, Xagenic Inc. (“**Xagenic**” or 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**”, and Xagenic’s BIA proposal proceedings are referred to as the “**NOI Proceedings**”). A. Farber & Partners Inc. (“**Farber**”) was appointed as proposal trustee (the “**Proposal Trustee**”) in the NOI Proceedings. A copy of the Certificate of Filing a Notice of Intention to Make a Proposal is attached as **Appendix “A”**.
2. On August 8, 2017, this Court made an Order in the NOI Proceedings (the “**Court Order**”), *inter alia*^a:
 - (a) approving the interim financing of Xagenic by the DIP Lenders to maximum amount of \$750,000, and granting the Priority DIP Charge and Subordinate DIP Charge;
 - (b) granting the following charges (in the following priority):
 - (i) the Priority Administration Charge in favour of the Proposal Trustee, counsel for the Proposal Trustee, and counsel for Xagenic (to a maximum of \$40,000);
 - (ii) the Priority DIP Charge (to a maximum amount of \$150,000)

^a In this paragraph, capitalized terms used but not otherwise defined in this Second Report are as defined in the Court Order.

- (iii) the SVB Charge;
 - (iv) Subordinate Administration Charge (to a maximum amount of \$150,000);
 - (v) Subordinate DIP Charge; and
- (c) extending the time within which a Proposal must be filed with the Official Receiver to October 16, 2017.
3. A copy of the Court Order is attached as **Appendix “B”**.
4. The purpose of this report (the **“Second Report”**) is to:
- (a) advise the Court of the status of Xagenic proposal activities to date;
 - (b) advise the Court on the anticipated realization plan in respect of Xagenic’s assets; and
 - (c) comment on Silicon Valley Bank’s (**“SVB”**) application to appoint Farber as Receiver of Xagenic’s property, assets and undertaking, pursuant to the form of order attached at Tab 3 of SVB’s application record (the **“Proposed Receivership Order”**).

BACKGROUND

5. Xagenic, a privately-held company, developed the Xagenic X1™ platform (the **“Product”**), a diagnostic system designed to allow physicians to perform lab-quality molecular diagnostic tests within the confines of their office or clinic.
6. Xagenic is developing infectious disease diagnostic tests that will provide quick, clinically actionable results that dramatically improve patient care and reduce health care costs. Xagenic is incorporated under the Ontario *Business Corporations Act* and domiciled in Canada with its head office at 55 York Street, Suite 1000, Toronto, Ontario (**“Premises”**).
7. Xagenic does not earn any revenue. Funding for research, development and general administration was financed by raising debt and equity. In mid-2017, Xagenic commenced its latest round of financing, and the debenture-holders elected to withhold providing Xagenic with further financing.
8. Xagenics was in discussions with strategic partners to invest in the business and/or purchase the intellectual property. The extension of time for Xagenic to file a proposal was necessary to provide Xagenic with sufficient time to continue these discussions with

one globally recognized company (the “**Interested Party**”), which if successful would allow the Company to formulate a viable Proposal.

9. After an extensive due diligence period by the Interested Party, the Proposal Trustee was notified on September 13, 2017 by Xagenic that the Interested Party would not be pursuing the opportunity.
10. Accordingly, the DIP Lenders advised the Company they would not provide further DIP funding. Without this funding source, Xagenic does not have the financial resources to continue operations.
11. On September 19, 2017, Farber filed a material adverse charge report (the “**MAC Report**”) with the Official Receiver and mailed the MAC Report to all known creditors of Xagenics. A copy of the MAC Report is attached as **Appendix “C”**.

DISCLAIMER

12. In preparing this Second Report, the Proposal Trustee has relied upon unaudited financial information of Xagenic, the books and records of Xagenic and discussions with representatives of Xagenic, 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 Second Report.

PROPOSAL ACTIVITIES TO DATE

13. Following its appointment as Proposal Trustee, Farber reviewed and discussed with Xagenic management its efforts to date to solicit investors/strategic partners. Farber concluded that Xagenic made extensive and exhaustive efforts, with little or no success.
14. Farber contacted several prospective purchasers from its contact database in the life sciences industry to elicit interest in Xagenic. Farber was ultimately advised that the time constraints set as a result of the Company’s limited funding and the cost and timeline to bring the Product to market, estimated to be 18 to 24 months, was prohibitive.
15. The Interested Party, as noted above, conducted its due diligence with the assistance of Xagenic’s former staff through on-site meetings, online testing, numerous conference calls and internal intellectual property review and diligence.
16. Xagenic houses a Biosafety Level 2 (“**BSL-2**”) laboratory at its Premises. The BSL-2 laboratory is required to test the Product and requires personnel have specific training for

handling pathogenic agents. Access to the BSL-2 laboratory is restricted and extreme precautions are taken to ensure the lab remains 'clean'.

17. Xagenic began to decommission its BSL-2 laboratory, pursuant to the Human Pathogens and Toxins Regulations and under the guidance of a former staff member who is certified by Health Canada to oversee the decommission of the laboratory. The Company estimates that the decommission period will take approximately 2 weeks to complete.

APPOINTMENT OF THE RECEIVER AND REALIZATION OF ASSETS

18. The Proposal Trustee has reviewed the affidavit of Mark Rosshirt ("**Rosshirt Affidavit**") of Silicon Valley Bank ("**SVB**"), sworn in support of SVB's application to appoint Farber as Receiver of all of Xagenic's property, assets and undertakings, which includes office furniture and laboratory equipment (the "**Office and Laboratory Equipment**") and, subject to approval by the Canada Revenue Agency, a tax refund (the "**SRED Refund**") in respect of the Scientific Research and Experimental Developmental Tax ("**SRED**").

SRED Refund

19. It is anticipated that the Receiver, if appointed, will appoint a liquidator to sell the Assets and take all necessary steps to submit the necessary documentation to receive the SRED Refund.
20. With respect to the SRED Refund, Farber has had discussions with representatives of PriceWaterhouseCoopers LLP ("**PWC**"), Xagenic's external accountant, and Xagenic continues to retain certain employees on a contract basis to aid in completing the SRED Refund documentation. The SRED claim is anticipated to be for \$750,000.
21. PWC has provided a fee estimate to complete the SRED Refund documentation, which includes the completion of Xagenic's final tax return. Farber is of the view the fee estimate is reasonable. Accordingly, if appointed as Receiver, Farber intends to retain PWC to aid Farber in completing the SRED Refund documentation. Farber is of the view that the retention of PWC for this mandate, as opposed Farber, as Receiver, completing the documentation itself without the assistance of Xagenic's external accountant, is a more efficient and cost-effective approach.

Office and Laboratory Equipment

22. The Proposed Receivership Order authorizes Farber to enter into a liquidation agreement with Infinity Asset Solutions Inc. ("**Infinity**").

23. Farber has requested and received auction proposals with net minimum guarantees from various liquidators, including Infinity (the “**Infinity Liquidation Proposal**”). The Infinity Liquidation Proposal includes a net minimum guarantee that is higher than the other proposals received.
24. After reviewing the submitted proposals and based on its extensive experience in similar insolvency proceedings, Farber is of the view that:
 - (a) the Infinity Liquidation Proposal provides for the best recovery to the estate, and further solicitation of auction proposals is not required;
 - (b) the value of the Office and Laboratory Equipment does not justify the cost of a formal sales process within the receivership proceedings, and, in any event, the estate has insufficient resources to conduct a formal sales process; and
 - (c) liquidation by Infinity of the Office and Laboratory Equipment will provide greater realization to the estate.

Intellectual Property

25. At the time of this Second Report, Farber is considering the available options and opportunities to maximize realization of Xagenic’s intellectual property, which will primarily depend on available resources and forecasted market value.

APPOINTMENT OF RECEIVER

26. Farber has received verbal confirmation from its independent counsel that, subject to customary assumptions and qualifications, SVB has a valid, binding and enforceable security interest in the collateral of Xagenics upon which SVB seeks to appoint Farber as Receiver. Farber understands from its counsel that a formal security opinion will be finalized in the very near term.
27. Farber understands from its counsel that the loan and security documents governing the indebtedness owing by Xagenic to SVB expressly authorize the appointment of a Receiver.
28. Farber has consented to acting as Receiver.

RECOMMENDATIONS

29. Based on the foregoing, the Proposal Trustee is of the view that the Proposed Receivership Order sought by SVB is appropriate.

All of which is respectfully submitted this 25th day of September, 2017.

A. FARBER & PARTNERS INC.
The Trustee acting in re the proposal of
Xagenic Inc.

A. Farber & Partners Inc.

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Proceeding commenced at Toronto

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**A Farber & Partners Inc.
Trustee acting *in re* the
proposal of Xagenic Inc.**

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