

Court File No.:20-00647824-00CL

HEMATITE GROUP

**FIRST REPORT OF KPMG INC.,
IN ITS CAPACITY AS MONITOR**

SEPTEMBER 25, 2020

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**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
HEMATITE HOLDINGS INC., HEMATITE MANUFACTURING INC.,
HEMATITE INDUSTRIAL PRODUCTS INC., CANADIAN PAVACO INC.,
PAVACO HOLDINGS U.S. INC., HEMATITE, INC. AND
HEMATITE AUTOMOTIVE PRODUCTS INC.
(collectively "Hematite Group")**

Applicants

**FIRST REPORT OF KPMG INC.
In its capacity as Monitor of the Applicants**

SEPTEMBER 25, 2020

I. INTRODUCTION

1. On September 18, 2020, Hematite Holdings Inc. (“**Hematite Holdings**”) and the other Applicants (together, the “**Hematite Group**”, the “**Company**” or the “**Applicants**”) were granted relief under the *Companies’ Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended (the “**CCAA**”) by Order (the “**Initial Order**”) of the Ontario Superior Court of Justice (Commercial List) (the “**Court**”), The relief granted under the Initial Order included a stay of proceedings in favour of the Applicants and a limited stay of proceedings in favour of their affiliate Hematite R.E. 1, Inc. (“**RE1**”) for cross-defaults, from September 18, 2020 until September 28, 2020 (the “**Initial Stay Period**”); the appointment of KPMG Inc. as Monitor (“**KPMG**” or the “**Monitor**”); and, other related relief. The Applicant’s CCAA proceedings are referred to herein as the “**CCAA Proceedings**”.
2. In accordance with the Initial Order, the Court is scheduled to hear a motion by the Applicants for further relief on September 28, 2020 (the “**Comeback Motion**”).
3. Capitalized terms used but not defined in this report are as defined in the Initial Order.

II. PURPOSE OF REPORT

4. In preparing this report (the “**First Report**”) the Monitor has reviewed the Court materials filed by the Applicants in connection with the Comeback Motion and had reference to the Information (defined below). The purpose of this First Report is to provide information to this Honourable Court pertaining to:
 - (a) the Monitor’s activities since its appointment;
 - (b) the Applicants’ communications with stakeholders and operations since the date of the Initial Order;
 - (c) the Applicants’ proceedings under Chapter 15 of Title 11 of the United States Code (the “**Chapter 15 Proceedings**” and the “**Bankruptcy Code**”, respectively);

- (d) the Applicants’ Comeback Motion for an Order (the “**Amended and Restated Initial Order**”) amending and restating the Initial Order to provide for, among other things:
 - (i) the extension of the Stay Period, as defined in the Initial Order, to November 27, 2020;
 - (ii) the increase of borrowings permitted under the DIP Loan Agreement and secured under the DIP Lender’s Charge to \$6.0 million;
 - (iii) the increase of the maximum amount of the Directors’ Charge to \$500,000;
 - (iv) the increase of the maximum amount of the Administrative Charge to \$500,000;
 - (v) the priority of the Charges over those Encumbrances exempted from priming under paragraph 42(a), (b) and (c) of the Initial Order;
 - (vi) the inclusion of certain typical restructuring powers and authorizations; and,
 - (vii) inclusion of provisions permitting but not requiring payment of amounts owing for goods and services supplied to the Applicants before the date of the Initial Order up to an aggregate limit of \$700,000, with the consent of the DIP Lender and the approval of the Monitor, to the extent necessary for the ongoing operations of the Applicants and required to ensure continued supply;
- (e) Monitor’s conclusions and recommendations.

III. TERMS OF REFERENCE

5. In preparing this First Report, the Monitor has relied solely on information and documents provided by the Applicants and their advisors, including unaudited financial information, declarations and the Nadeau Comeback Affidavit (defined below) (collectively, the “**Information**”). In accordance with industry practice, except as otherwise described in

this First Report, KPMG has reviewed the Information for reasonableness, internal consistency and use in the context in which it was provided. However, the Monitor has not audited or otherwise attempted to verify the accuracy or completeness of the Information in a manner that would wholly or partially comply with Generally Accepted Auditing Standards (“GAAS”) pursuant to the *Chartered Professional Accountants of Canada Handbook* and, accordingly, the Monitor expresses no opinion or other form of assurance contemplated under GAAS in respect of the Information.

6. Future orientated financial information contained in any Cash Flow Forecast or other statement is based on the Applicants’ estimates and 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 Monitor expresses no assurance as to whether any Cash Flow Forecast or other projection will be achieved.
7. Unless otherwise stated, all monetary amounts noted herein are expressed in Canadian dollars.

IV. BACKGROUND

8. Detailed information with respect to the Applicant’s business, operations, products and causes of insolvency is set out extensively in the Affidavit of Jacques Nadeau sworn September 17, 2020, previously filed with the Court.
9. This First Report should be read in conjunction with the Affidavit of Jacques Nadeau sworn September 24, 2020 (the “**Nadeau Comeback Affidavit**”), as certain information contained therein has not been included here in order to avoid unnecessary duplication.

V. MONITOR’S ACTIVITIES SINCE APPOINTMENT

10. The Monitor has established a website (www.home.kpmg/ca/en/home/services/advisory/deal-advisory/creditorlinks/hematite-group.html) (the “**Monitor’s Website**”) and an e-mail address (hematitegroup@kpmg.ca) and hotline (416-777-3978) for stakeholders to obtain information from the Monitor.

11. In accordance with the Initial Order, the following notices and documents have been posted on the Monitor's Website and/or sent to the Applicants' stakeholders by the Monitor since the date of the Initial Order:
 - (a) the Application Record of the Applicants dated September 18, 2020;
 - (b) the Report of KPMG in its capacity as Proposed Monitor dated September 17, 2020 (the "**Pre-Filing Report**");
 - (c) the Service List;
 - (d) a list showing the names and addresses of creditors of the Applicants' with claims greater than \$1,000 and the estimated amount of those claims;
 - (e) notices sent by mail of the CCAA proceedings to every creditor appearing in the Applicants' books and records as at the date of the Initial Order (excluding individual employees, former employees with pension or retirement savings plan entitlements, and retirees and other beneficiaries who have entitlements under any pension or retirement savings plan).

12. Also in accordance with the Initial Order, the Monitor published a notice in the *Globe and Mail* (National Edition) concerning the CCAA Proceedings, which ran on September 23, 2020 and will run again on September 30, 2020.

VI. COMMUNICATIONS AND OPERATIONS

13. The Monitor has been assisting the Applicants and working with their management and employees with respect to the following:
 - (a) developing communications documents to assist suppliers and customers and answer frequently asked questions from these stakeholders;
 - (b) assisting with employee communications and information sessions;
 - (c) supporting discussions with suppliers to help maintain stability and continuity in the supply chain;

- (d) communicating with the DIP Lender/proposed plan sponsor Woodbridge Foam Corporation (“**Woodbridge**”) and assisting in the preparation of necessary financial information; and,
 - (e) working cooperatively with Woodbridge and the Company to ensure that customer needs and interests are being addressed appropriately.
14. As anticipated and in accordance with the Applicants’ cash flow forecast for the period from September 14, 2020 to December 11, 2020 (the “**Cash Flow Forecast**”), the Applicants drew on the debtor-in-possession facility provided for under the DIP Loan Agreement (the “**DIP Facility**”) up to the amount permitted under the Initial Order, being \$2.3 million (the “**Interim DIP Facility Limit**”). With the liquidity provided by this advance, the Applicants have been able to meet their current needs and maintain their operations without disruption. As set out below and based on the Cash Flow Forecast, access to the further funding provided for under the DIP Loan Agreement is critical to permitting the Applicants to continue to meet their ongoing needs and provide the liquidity required to maintain their business as they pursue a restructuring.
15. Based on information provided by the Applicants and Woodbridge, the Monitor understands that Woodbridge is providing consulting services related to the operation of the business of the Hematite Group during the term of the Plan Sponsor Agreement until the implementation of the CCAA Plan is complete. Such services will be subject to a Services Agreement effective as of September 18, 2020 between Woodbridge and each member of the Hematite Group. Such consulting services include advising on the commercial, operational, technical, material handling, production scheduling, purchasing, management, lean manufacturing, financial planning and forecasting aspects of the business of the Hematite Group and providing support for the plant and corporate offices of the Hematite Group. It is anticipated that 7 to 10 employees of Woodbridge will be involved in providing the Services commencing immediately.
16. The Monitor further understands that the compensation for the consulting services provided by Woodbridge to the Hematite Group are a fixed monthly amount of \$100,000 plus applicable taxes, of which \$75,000 shall be paid in advance on the first day of each month,

and with the balance of \$25,000 being deferred until the implementation of the CCAA Plan.

17. Overall, during the early stages of this restructuring the Monitor believes that the Applicants have been managing their operations and their entry into these CCAA Proceedings effectively.

VII. CHAPTER 15 PROCEEDINGS

18. In accordance with the Initial Order and as advised in the Pre-Filing Report, on September 22, 2020 Hematite Holdings in its capacity as foreign representative for the Applicants filed petitions for relief under Chapter 15 of the Bankruptcy Code in the United States Bankruptcy Court, District of Delaware (the “**US Court**”). These filings commenced the Chapter 15 Proceedings as proceedings ancillary to those pending in this Court. In addition to the petitions, Hematite Holdings filed certain motions for provisional and ancillary relief (the “**First Day Motions**”).
19. On September 23, 2020, the First Day Motions came on for a hearing before the Honourable Judge Walrath, who granted the orders sought. In particular, orders were granted:
 - (a) authorizing the joint administration of the Chapter 15 cases of all of the Applicants;
 - (b) provisionally recognizing and enforcing the Initial Order under Chapter 15 of the Bankruptcy Code, including the provisions approving the DIP Facility and the DIP Lender’s Charge, and providing that the automatic stays arising under the Bankruptcy Code apply to the Applicants;
 - (c) scheduling a hearing on the provisional recognition and enforcement of the proposed Amended and Restated Initial Order for October 1, 2020; and,
 - (d) scheduling a final hearing on the recognition of the Initial Order and the CCAA Proceedings for October 19, 2020 and setting certain deadlines for objection;

20. Copies of the materials filed and orders made in the Chapter 15 Proceedings will be made available on the Monitor's Website.

VIII. STAY EXTENSION

21. Under the Initial Order, the stay expires on September 28, 2020. The Applicants are currently requesting an extension of the Stay Period to November 27, 2020.
22. The Monitor is of the view that the requested extension of the Stay Period is appropriate for the following reasons:
- (a) the Applicants have been focussed on maintaining stability in their business since the date of the Initial Order and have succeeded in avoiding any disruptions to their ongoing operations thus far;
 - (b) the Applicants continue to benefit from the customer support and consent agreements which are in place with their key OEM customers;
 - (c) the Applicants continue to benefit from the support of Woodbridge as proposed plan sponsor and the cooperative arrangements in place with their key secured creditors Toronto-Dominion Bank (“**TD**”) and BDC Capital Inc. (“**BDC**”); and,
 - (d) based on the Cash Flow Forecast and with the financing provided under the DIP Facility, if the increase in permitted borrowing sought by the Applicants is approved by this Court, the Applicants are projected to have sufficient liquidity to operate during the proposed extension of the Stay Period.
23. Extending the Stay Period to November 27, 2020 should allow the Applicants time to commence and progress a claims process, develop a plan of arrangement and engage with stakeholders. Further, the Monitor notes that the milestones established for these steps in the Plan Sponsor Agreement between Hematite and Woodbridge require them to be significantly progressed over this period of time.

IX. DIP FACILITY INCREASE

24. The Cash Flow Forecast projects borrowings after the Initial Stay Period (after September 28, 2020) that exceed the Interim DIP Facility Limit. As set out in the Pre-Filing Report and based on the Cash Flow Forecast, the Monitor remains of the view that borrowings under the DIP Facility up to the maximum principal amount of \$6.0 million are necessary and appropriate to ensure that the Applicants have sufficient liquidity to maintain their operations over the proposed extension of the Stay Period.
25. Based on the Applicants' operations to the date of this First Report, the Monitor believes that access to the full amount of the DIP Facility will be required to ensure that the Applicants have the wherewithal to pursue a restructuring and give suppliers and customers confidence in their ongoing dealings with the Company.
26. The Monitor is of the further view that the Cash Flow Forecast and the need for the full amount of the DIP Facility which it implies remains consistent with and reflects the probable and hypothetical assumptions which it sets out. Nothing has come to the Monitor's attention that would cause it to believe that the probable and hypothetical assumptions applicable to the Cash Flow Forecast do not continue to be suitably supported and consistent with the restructuring plans of the Applicants or do not provide a reasonable basis for the Cash Flow Forecast.
27. The Monitor notes that the Applicants, with the support of Woodbridge, continue to benefit from the support of their major creditors and stakeholders, including their senior secured creditors, major customers and significant suppliers. In particular, the Monitor notes that both TD and BDC are on notice of and do not object to the increase to the amounts secured by the DIP Lender's Charge. The Monitor is therefore of the view that the increase of the DIP Facility and the amounts secured by the DIP Lender's Charge to \$6.0 million should enhance the prospects that a viable restructuring will emerge.
28. As set out in the Nadeau Comeback Affidavit and the draft Amended and Restated Initial Order, the Applicants also seek to have the DIP Lender's Charge elevated such that it enjoys priority over the claims of equipment lessors, parties who may have purchase-

money security interests and claims under statutory deemed trusts and liens, including the claims of municipalities or local governments for property taxes and utilities (the “**Potential Priority Claimants**”).

29. The Monitor is advised by the Applicants that the Potential Priority Claimants whose interests are recorded in public registry systems have been given notice of the Comeback Motion by way of a letter describing the relief being sought with respect to the Charges. The Monitor is further advised by the Applicants that Her Majesty in Right of Ontario, Her Majesty in Right of Canada and municipal authorities where the Applicants own real estate have also been given such notice of the Comeback Motion.
30. Based on the foregoing, the Monitor believes that the increase of the borrowings permitted under the DIP Loan Agreement and secured by the DIP Lender’s Charge to \$6.0 million and the granting of priority for the DIP Lender’s Charge over the Potential Priority Claimants are appropriate in the circumstances.

X. DIRECTORS’ AND ADMINISTRATIVE CHARGE INCREASES

31. The Initial Order provides for a charge in the maximum aggregate amount of \$300,000 to indemnify the current director and officer of the Applicants (the “**Director and Officer**”) against obligations and liabilities that they may incur as directors or officers of the Applicants after the commencement of these CCAA proceedings (the “**Directors’ Charge**”).
32. As set out in the Pre-Filing Report, the Monitor understands that the Applicants maintain little or no directors’ and officers’ liability insurance and is not aware that any such coverage is available to the Applicants in present circumstances at a reasonable cost. The Monitor continues to be of the view that the Applicants’ sole director and officer is unwilling to continue his services and involvement in the CCAA Proceedings without the protection of the Directors’ Charge and that his participation is necessary to facilitate the successful completion of the CCAA Proceedings, including participation in the formulation of a Plan.

33. Taking into consideration sales taxes, employee payroll and related expenses (including source deductions) as well as other employment-related liabilities that attract potential liability for the Director and Officer and the quantum of these potential liabilities over the period of the Cash Flow Forecast, the Monitor is of the view that it is appropriate to increase the amount of the Directors' Charge from the \$300,000 provided under the Initial Order for the Initial Stay Period to \$500,000.
34. The Initial Order also provides for a charge in the maximum aggregate amount of \$250,000 charging the assets of the Applicants to secure the fees and disbursements incurred in connection with services rendered to the Applicants both before and after the commencement of the CCAA proceedings by the following entities: the Monitor, the Monitor's legal counsel, and legal counsel to the Applicants (the "**Administration Charge**").
35. In consultation with the DIP Lender and the Applicants and based on the projected fees and disbursements incurred and to be incurred for services rendered to the Applicants, the Monitor is of the view that it is appropriate to increase the amount of the Administration Charge to \$500,000.
36. Consistent with the treatment of the DIP Lender's Charge, in the draft Amended and Restated Initial Order the Applicants also seek to give the Directors' Charge and the Administration Charge priority over the Potential Priority Claimants
37. As noted above in relation to the relief sought concerning the DIP Facility and the DIP Lender's Charge, the Monitor understands that notice of the Comeback Motion and the contemplated increases in the quantum and priority of the Directors' Charge and the Administration Charge has been given to the Potential Priority Claimants and that no objections have been received.

XI. RESTRUCTURING POWERS

38. The draft Amended and Restated Initial Order sought by the Applicants includes provisions that are typical in restructurings under the CCAA, authorizing the Applicants to take

specified actions (“**Restructuring Powers**”). The Restructuring Powers the Applicants seek to add include authority to:

- (a) prepare a plan of compromise and arrangement;
 - (b) restructure their operations; and,
 - (c) deal with leased premises.
39. As specifically set out in the draft Amended and Restated Initial Order and consistent with practice, certain of the foregoing Restructuring Powers are subject to the consent of the DIP Lender and/or the Monitor and to the Definitive Documents applicable to the DIP Facility.
40. In addition, the draft Amended and Restated Initial Order contemplates that the Applicants will be entitled but not required to pay amounts owing for goods or services actually supplied prior to the date of the Initial Order if such payment is required to ensure continued supply necessary for their ongoing operations. Payment of these pre-filing amounts is to be limited to an aggregate limit of \$700,000 and subject to the consent of the Monitor and the DIP Lender.
41. Given the nature of the Applicants’ position in the supply chain for the automotive industry the timely and reliable supply of goods and services is of extraordinary importance to their ability to serve their key customers and preserve their ongoing business. It is accordingly vital to the Applicants that they have the flexibility, in limited circumstances and subject to the controls noted, to make pay pre-filing amounts for goods and services where this is a practical necessity for ongoing supply. In seeking this power, the Applicants have advised the Monitor that they do not intend to pay pre-filing claims as a general practice.
42. The Monitor is of the view that the added Restructuring Powers are generally consistent with established practice. With respect to the provisions providing for limited payment of pre-filing amounts for goods and services where necessary for ongoing supply and operations, the Monitor is of the view that these provisions are reasonable to permit the Applicants to manage their supply chain in a practical fashion.

XII. MONITOR'S CONCLUSION AND RECOMMENDATIONS

43. Based on the Monitor's information and observations to date, the Applicants are acting with due diligence and good faith. As noted, if the requested increases to the DIP Facility are authorized the Applicants should have adequate liquidity to continue their operations and restructuring efforts over the Stay Period if it is extended. The Monitor accordingly supports the extension of the Stay Period requested.
44. For the reasons set out in this First Report, the Monitor is of the view that the balance of the relief requested by the Applicants in the Comeback Motion is also appropriate and reasonable. The Monitor is of the view that granting the relief requested will provide the Applicants the best opportunity to restructure under the CCAA, thereby preserving value for the benefit of the Applicants' stakeholders. As such, the Monitor supports the Applicants' requests set out in the proposed Amended and Restated Initial Order and respectfully recommends that the Court grant such relief on the terms sought.

All of which is respectfully submitted this 25th day of September, 2020.

KPMG Inc.
In its capacity as Monitor of
Hematite Group
And not in its personal or corporate capacity

Per:



Nick Brearton
CPA, CA, CIRP, LIT
President



Tim Montgomery
CIRP, LIT
Vice President

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 HEMATITE HOLDINGS INC. ET AL.

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SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)**

Proceeding commenced at Toronto

**FIRST REPORT OF KPMG INC.,
IN ITS CAPACITY AS MONITOR OF THE
HEMATITE GROUP
SEPTEMBER 25, 2020**

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