

Court File No. CV-17-11672-00CL

**ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST**

**APPLICATION UNDER SUBSECTION 243(1) OF THE *BANKRUPTCY AND
INSOLVENCY ACT*, R.S.C. 1985, c. B-3, AS AMENDED, AND SECTION 101 OF THE
COURTS OF JUSTICE ACT, R.S.O. 1990, c. C.43, AS AMENDED**

HSBC BANK CANADA

Applicant

- and -

2SOURCE MANUFACTURING INC.

Respondent

**FIRST REPORT OF THE RECEIVER
DATED MARCH 23, 2017**

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INTRODUCTION

1. By Order of the Ontario Superior Court of Justice (Commercial List) (the “**Court**”) dated January 23, 2017 (the “**Appointment Order**”), Deloitte Restructuring Inc. (“**Deloitte**”) was appointed as the receiver (the “**Receiver**”) of all of the assets, undertakings and properties of 2Source Manufacturing Inc. (“**2Source**” or the “**Debtor**”) acquired for, or used in relation to the business carried on by the Debtor, including all proceeds thereof (the “**Property**”). At the time of the Appointment Order, Robert Glegg (“**Glegg**”) was the sole officer and director of 2Source. A copy of the Appointment Order is attached hereto as **Appendix “A”**.
2. The Debtor is an Ontario corporation which manufactured components for the aerospace, industrial and oil & gas industries. The Debtor operated out of leased premises containing office space and a warehouse comprising an area of approximately 35,000 square feet (the “**Leased Premises**”) located at 5261 Bradco Boulevard, Mississauga, Ontario (the “**Bradco Property**”). The Debtor’s principal assets were machinery and equipment used in the manufacturing process, inventory and accounts receivable.
3. The Appointment Order authorized the Receiver to, among other things, take possession of, and exercise control over the Property and any and all proceeds, receipts and disbursements, arising out of, or from, the Property. In addition, the Receiver was authorized to sell, convey, transfer, lease or assign the Property or any part thereof out of the ordinary course:

- (a) without the approval of the Court in respect of any transaction in which the purchase price exceeds \$250,000 or the aggregate purchase price for all such transactions exceeds \$500,000; and
 - (b) with the approval of the Court in respect of any transaction in which the purchase price or the aggregate purchase price exceeds the applicable amount set out in the preceding clause.
- 4. The Appointment Order, together with related Court documents, the Notice to Creditors and this First Report have been posted on the Receiver's website at www.insolvencies.deloitte.ca/en-ca/2Source.
- 5. The purpose of this first report of the Receiver (the "**First Report**") is to:
 - (a) update the Court on the Receiver's actions to take possession and secure the Property;
 - (b) seek the Court's approval of the activities of the Receiver as described in the First Report including, without limitation, the steps taken by the Receiver in the collection of accounts receivable, the sale of inventory, dealing with various equipment lessors, discussions with GPM Real Property (10) Ltd. and GPM (10) GP Inc. (collectively, the "**Landlords**") and the conduct of the marketing and sale process;
 - (c) seek a Court order (the "**Approval and Vesting Order**") approving the transaction (the "**Transaction**") detailed in the asset purchase agreement dated March 16, 2017 (the "**APA**") between the Receiver and Daniel Chai, in trust for a company to be incorporated ("**Chai**") or to be assigned by Chai to the company that will close the Transaction (the "**Purchaser**"), together with any further amendments thereto deemed necessary by the Receiver in its sole opinion, for the sale of the Property detailed in and listed in Appendix "A" to the APA (the "**Purchased Assets**") and vesting the Debtor's right, title and interest, if any, in and to the Purchased Assets in and to the Purchaser upon closing of the Transaction;

- (d) seek the Court's approval to vary the Appointment Order so that it authorizes the Receiver to assign the Debtor into bankruptcy;
- (e) seek the Court's approval to make a distribution in the amount of \$400,000 to Elliott-Matsuura Canada Inc. ("**Elliott-Matsuura**") from the proceeds of the APA;
- (f) approving the Receiver's Interim Statement of Receipts and Disbursements for the period from January 23 to March 17, 2017;
- (g) approving the professional fees and disbursements of the Receiver set out herein, and authorizing the Receiver to pay all such fees and disbursements from available funds;
- (h) authorizing and directing the Receiver, *nunc pro tunc*, to redact from the version of the First Report served on any other party other than this Court, (i) the commercially sensitive information contained therein: (ii) the Confidential Information Summary dated February 2017 (the "**CIS**"), attached as **Confidential Appendix "A"**; (iii) the Receiver's Comparison of Offers (as defined herein), attached as **Confidential Appendix "B"**; (iv) the unredacted version of the APA, attached as **Confidential Appendix "C"**; and (v) the UTAS Litigation Arrangement (as defined herein), attached as **Confidential Appendix "D"**;
- (i) sealing the unredacted version of the First Report, including **Confidential Appendices "A", "B" and "C"**, filed with this Court from the public record until the closing of the Transaction or further order of this Court; and
- (j) sealing the **Confidential Appendix "D"**, filed with this Court from the public record pending further order of this Court.

TERMS OF REFERENCE

6. In preparing this First Report, the Receiver has been provided with, and has relied upon unaudited, draft and/or internal financial information, the Debtor's books and records,

discussions with former management of the Debtor, and information from third-party sources (collectively, the “**Information**”). Except as described in this First Report:

- (a) the Receiver has reviewed the Information for reasonableness, internal consistency and use in the context in which it was provided. However, the Receiver 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 Canadian Auditing Standards (“**CAS**”) pursuant to the Chartered Professional Accountants Canada Handbook and, accordingly, the Receiver expresses no opinion or other form of assurance contemplated under CAS in respect of the Information; and
 - (b) the Receiver has prepared this First Report in its capacity as a Court-appointed officer to support the Court’s approval of the APA and the other relief being sought. Parties using the First Report other than for the purposes outlined herein are cautioned that it may not be appropriate for their purposes.
- 7. Unless otherwise stated, all dollar amounts contained in the First Report are expressed in Canadian dollars.
 - 8. Unless otherwise provided, all other capitalized terms not otherwise defined in this First Report are as defined in the Appointment Order.
 - 9. The Receiver has sought the advice of Dentons Canada LLP (“**Dentons**”), counsel to the Applicant, for general legal matters that have arisen in respect of the receivership to avoid additional legal expense. Where the Receiver has required independent legal advice, the Receiver has sought the counsel of Thornton Grout Finnigan LLP (“**TGF**”).

BACKGROUND

- 10. 2Source was incorporated on October 17, 2002 under the name Wolverhampton Inc., which was subsequently changed to Trilete Corp. on January 12, 2004 and then changed to 2Source on March 11, 2004.

11. 2Source has operated from the Premises since it became 2Source. The Landlords are the owners of the Bradco Property. The Receiver has been provided with a Lease Agreement dated March 23, 2012 (the “**Original Lease**”) between 2Source and the Landlords that provided for a lease term of three years and expired on December 31, 2015. By Lease Extension and Amending Agreements dated March 3, 2015 and February 29, 2016 made between the parties (collectively, the “**Lease Extensions**” and together with the Original Lease, the “**Lease**”), the term of the Original Lease was extended to its current expiry date of December 31, 2017 (the “**Lease Expiry Date**”). A copy of the Lease is attached hereto as **Appendix “B”**.
12. The Receiver understands that 2Source operated profitably for a number of years. However, since the fall of 2015, 2Source lost two of its largest customers which, taken together, represented approximately 80% of its revenue base. The Debtor was unable to replace the lost revenue leading to cash flow problems and defaults on its loans provided by the Applicant which resulted in the eventual appointment of the Receiver.
13. In the period immediately prior to the receivership, the Company employed 71 non-union, full-time and part-time employees. The operations of 2Source in the ordinary course ceased prior to the appointment of the Receiver on January 23, 2017.
14. On March 10, 2017, Glegg notified the Receiver that he had resigned as both an officer and director of 2Source, leaving the entity with no remaining officer and director.

TAKING POSSESSION AND SAFEGUARDING ASSETS

15. The Receiver has undertaken the following activities in accordance with the terms of the Appointment Order:
 - (a) attended the Premises and took possession of the Property located on site;
 - (b) met with Glegg, the President of 2Source, and the employees on site to advise them of the receivership and that pursuant to paragraph 14 of the Appointment Order, their employment by the Debtor had been terminated;

- (c) established the Receiver's website and issued the Notice and Statement of Receiver pursuant to subsections 245(1) and 246(1) of the *Bankruptcy and Insolvency Act* (Canada) ("BIA");
- (d) ensured that the Debtor's bank accounts with HSBC Bank Canada ("HSBC"), the first registered secured creditor of the Debtor, were frozen and that only deposits were to be accepted;
- (e) retained TGF as its independent legal counsel to, among other things, conduct a review of the HSBC Security (as defined in paragraph 32) and the security of the other secured creditors of the Debtor;
- (f) engaged certain former employees on an hourly basis to assist with taking inventory, analysis of work-in-process, assembly of books and records, collection of accounts receivable, and assistance with the marketing and sale process;
- (g) as access to the building was via key card, terminated key card access to all former employees and issued new key cards only to those individuals engaged by the Receiver;
- (h) restricted access of non-authorized external users to 2Source's computer systems and servers;
- (i) arranged for the backing up of computer hard drives;
- (j) provided notice of the Receiver's appointment to Hub International HKMB, the Debtor's insurance broker, who arranged for continued insurance coverage through the Debtor's insurer, Allianz Global Corporate & Specialty Auto, Travellers Aviation and XL Specialty Insurance Company. Additionally, the Receiver was added as a named insured and loss payee on the Debtor's policies;
- (k) arranged for a complete inventory to be made of the Property, including the Debtor's fixed assets;
- (l) compiled invoice data and issued demand letters with respect to the Debtor's accounts receivable and undertook the collection efforts described below;

- (m) prepared cash flow forecasts for the receivership period and arranged to borrow \$70,000 by way of Receiver's Certificate from HSBC to fund the receivership proceedings;
- (n) met with representatives of the Landlord and arranged for payment of occupation rent owing pursuant to the Lease commencing as of the date of the Appointment Order;
- (o) made arrangements with Canada Revenue Agency to conduct a payroll audit and an HST audit;
- (p) coordinated the delivery of Records of Employment and T4 slips to the former employees of the Debtor;
- (q) calculated *Wage Earner Protection Program Act* (Canada) claims for former employees and forwarded the appropriate information to eligible employees and Service Canada;
- (r) conducted a marketing and sale process as described in more detail below, including negotiating the terms of the APA;
- (s) communicated with legal counsel concerning certain litigation in which the Debtor is plaintiff;
- (t) reviewed the Debtor's environmental records;
- (u) sought to monetize the inventory on hand as of the date of the Appointment Order; and
- (v) provided status updates to HSBC on the progress of the receivership.

MARKETING AND SALE PROCESS

16. Given that the Debtor (i) terminated/lost contracts from its two largest customers representing approximately 80% of its business resulting in negative EBITDA over the past two years, and (ii) had essentially ceased production prior to the appointment of the Receiver, the Receiver was of the view that given the significant operating costs associated

with maintaining the facility in its current state, a long-drawn out sale process was not appropriate in the circumstances. The Receiver was of the view that a short, focussed sale process that targeted both strategic parties (competitors, former customers, suppliers, manufacturing participants and private equity) and auctioneers/liquidators would be appropriate to sufficiently market the assets and maximize proceeds in a reasonable timeframe.

17. The marketing and sale process established by the Receiver was designed as a request for offers (“**Request for Offers**”). The Request for Offers package consisted of the Request for Offers, the Terms and Conditions of Sale of Assets, the Confidentiality Agreement (the “**CA**”) and the Offer Form. The Receiver allocated the Property into lots and interested parties seeking to make an offer (“**Interested Parties**”) were permitted to submit an *en bloc* offer or an offer for individual lots. *En bloc* or combined lot offerors were directed to allocate their offer price among the lots they wished to purchase. A copy of the Request for Offer Package is attached hereto as **Appendix “C”**.
18. In order to properly market the Property, the Receiver, with the assistance of Deloitte Corporate Finance Inc. (“**DCF**”), prepared a Teaser document and CIS that set out the business, its history and past financial performance and listed the assets available for sale. A copy of the Teaser document is attached hereto as **Appendix “D”**. A copy of the CIS is attached hereto as **Confidential Appendix “A”**.

19. The timing of the marketing and sale process was initially established as follows:

Transaction Process	Timing
Circulation of CIS	Feb. 6, 2017
Review of materials, tour of the facility, management meetings and receive draft of the APA	Feb. 6-17, 2017
Final offers due at 12:00 pm (EST) (the “ Initial Offer Deadline ”)	Feb. 21, 2017
Negotiate and execute the APA	Feb. 22-24, 20
Seek Court approval for the transaction(s)	Mar 7, 2017
Close of transaction(s)	Mar 8, 2017

20. Notwithstanding the proposed timing set out above, due to delays in completing the CIS, DCF did not begin contacting potential Interested Parties until February 8, 2017. Those parties contacted were provided with the Teaser document and the CA. In total, 98 parties were contacted and were provided with the Teaser document and the CA. Of those 98 parties, 22 executed the CA and were provided with the CIS and access to the virtual data room. Of those 22 parties, 9 were auctioneer/liquidator firms.
21. Due to the later than expected commencement of the sale process and initial feedback from Interested Parties who indicated that the tight time frame for the due diligence period may preclude them from submitting a well-considered offer, on February 15, 2017, the Receiver advised the Interested Parties that the deadline for submission of offers had been extended to 5:00 pm on February 27, 2017 (the “**Revised Offer Deadline**”).
22. Prior to the Revised Offer Deadline, DCF informed the Receiver that it had inadvertently advised one Interested Party that the Revised Offer Deadline was 5:00 pm on February 28, 2017 (24 hours after the Revised Offer Deadline). After contacting that party to alert them of the correct Revised Offer Deadline, that party advised DCF that it intended to submit an *en bloc* offer but it had been working towards a submission prior to 5:00 pm on February 28, 2017 and would not be able to submit their offer prior to the Revised Offer Deadline.

As such, the Receiver further extended the Revised Offer Deadline to 5:00 pm on February 28, 2017 (the “**Offer Deadline**”).

23. By the Offer Deadline, the Receiver had received seven offers from Interested Parties. Five (5) of the offers were from auctioneers/liquidators and two were from strategic parties. The Receiver’s comparison of the seven offers received in respect of the Assets (“**Receiver’s Comparison of Offers**”) pursuant to the Request for Offers process is attached hereto as **Confidential Appendix “B”**.
24. The Receiver identified the *en bloc* offer from Chai, in trust for a company to be incorporated (the “**Chai Offer**”), as being the best offer in terms of price and conditions. In addition, Chai has advised the Receiver that he proposes that the Purchaser will hire back certain staff and restart the business.

CHAI OFFER AND APA

25. The APA provides for the Purchaser to purchase the Purchased Assets on an “as is, where is” and “without recourse” basis. A redacted copy of the APA is attached hereto as **Appendix “E”**. An unredacted copy of the APA is attached hereto as **Confidential Appendix “C”**. All other capitalized terms not otherwise defined in this section of the First Report are as defined in the APA.
26. Essentially, the Purchased Assets comprise all of the inventory and fixed assets at the Leased Premises as of the date of the Chai Offer. The Purchased Assets do not include accounts receivable, the Excluded Litigation (as defined in paragraph 52 below), and various personal property leased assets with respect to which the Purchaser will either elect to assume the lease or the asset will be returned to the applicable lessor.
27. One of the conditions in the APA in favour of the Purchaser is the Landlords’ consent with respect to the assignment of the Lease to the Purchaser, or an assignment of the Lease as otherwise authorized by applicable law. Despite numerous discussions with the Landlords and its counsel, the Receiver has been unable to obtain the Landlords’ consent to the assignment of the Lease. As a result and as discussed further below, in order to fulfill this

condition under the APA, the Receiver is seeking the Court's approval to vary or amend the Appointment Order to authorize the Receiver to assign the Debtor into bankruptcy in order that a Trustee in Bankruptcy can effect an assignment of the Lease to the Purchaser.

28. The APA is subject to the Court issuing an Approval and Vesting Order that approves the APA and vests in and to the Purchaser, all of the Debtor's right, title and interest in and to the Purchased Assets free and clear of all encumbrances (save for those encumbrances that the Purchaser agrees to assume) on and subject to the terms and conditions set out in the APA, in the form to be agreed to between the Parties.
29. The APA provides that the Approval and Vesting Order shall have been granted, and the Transaction completed, by March 31, 2017, unless the Parties agree in writing to extend the Closing Date. For closing of the Transaction to occur, the Receiver is to deliver the Receiver's Certificate (in the form attached to the form of Approval and Vesting Order included in the Motion Record accompanying this First Report) to the Purchaser which will certify that all of the conditions in the APA have been satisfied or waived or are to be fulfilled on a post-closing basis and that the balance of the Purchase Price, including applicable taxes, has been paid in full by the Purchaser.
30. The Receiver is of the view that the Chai Offer is the best transaction in the circumstances. The Applicant has advised the Receiver that it approves of the Transaction. In addition, Elliott-Matsuura has advised the Receiver that it approves of the Transaction with respect to the equipment over which it has a purchase-money security interest ("**PMSI**") (as set out in Schedule A - Exhibit "5" to the APA, the "**EM Equipment**"), subject to receiving an immediate distribution of the proceeds in respect of the Transaction relating to the EM Equipment. As such, the Receiver is seeking the Court's approval for issuance of the Approval and Vesting Order and an order authorizing the Receiver to distribute a portion of the sale proceeds to Elliott-Matsuura.

SECURED CREDITORS

31. A Summary Report of the secured creditor registrations filed pursuant to the *Personal Property Security Act* (Ontario) (the “PPSA”) having a file currency date of February 26, 2017 (the “PPSA Report”) is attached hereto as **Appendix “F”**. The following paragraphs discuss the registrations in the PPSA Report and, where applicable, their relative priorities.

HSBC Bank Canada

32. HSBC is the first registered secured creditor of the Debtor and is the Applicant in this proceeding. Among other security granted to HSBC, HSBC holds a general security agreement dated June 5, 2006 and a general assignment of book debts dated June 3, 2006 (collectively, the “**HSBC Security**”) securing the indebtedness and obligations of the Debtor to HSBC. A copy of the HSBC Security is attached hereto as **Appendix “G”**.
33. As at March 6, 2017, HSBC advised the Receiver that the Debtor’s outstanding indebtedness to HSBC totals in excess of \$4.0 million, inclusive of interest and costs incurred to date.
34. The Receiver has obtained a security opinion from TGF in respect of the HSBC Security. The opinion confirmed that, subject to the validity of equipment collateral PMSIs including the PMSI in favour of Elliott-Matsuura as detailed below, and the usual and customary assumptions and qualifications, the HSBC Security is in first priority position with respect of the Property in the Province of Ontario.

2006905 Ontario Inc.

35. 2006905 Ontario Inc. (“**2006905**”) registered a PPSA financing statement on June 13, 2008 in respect of the Debtor’s collateral classes of inventory, equipment, accounts, and 2006905 also executed a postponement agreement dated July 22, 2014, in favour of HSBC, limited to the amount of \$4,127,786 (the “**Postponement Agreement**”). A copy of the Postponement Agreement is attached hereto as **Appendix “H”**. The Postponement Agreement specifically provides for 2006905’s agreement to postpone the debt owing to it by 2Source in favour of the indebtedness owing by 2Source to HSBC, including, without

limitation, in respect of the fees and expenses of any receiver sought to be appointed by HSBC in connection with the enforcement of its security.

Elliott-Matsuura

36. The Debtor executed and delivered to Elliott-Matsuura a Conditional Sales Agreement dated December 1, 2015 (“CSA”) for the purchase by the Debtor of the EM Equipment. According to a statement of account dated February 7 2017, Elliott-Matsuura is owed \$446,890 by the Debtor.
37. The Receiver has obtained a security opinion from TGF that confirms that, subject to the usual and customary assumptions and qualifications, the CSA constitutes valid and enforceable PMSI security over the EM Equipment ranking in priority to all other secured creditors.
38. As set out in Schedule C to the APA, \$400,000 of the purchase price has been allocated to the EM Equipment by the Purchaser. As such, given Elliott-Matsuura’s PMSI security over the EM Equipment, the Receiver is seeking an order that upon the closing of the APA and the receipt of the net proceeds, the Receiver is authorized to distribute \$400,000 to Elliott-Matsuura.

Ministry of Economic Development and Innovation

39. Her Majesty the Queen in Right of the Province of Ontario as represented by the Minister of Economic Development and Innovation (“**MEDI**”) registered a PPSA financing statement on December 18, 2008 in respect of the Debtor’s collateral classes of equipment and other. The Receiver has obtained a security opinion from TGF that confirms that, subject to the usual and customary assumptions and qualifications and based on the documentation provided to TGF, the security granted to MEDI appears to be subordinate to the HSBC Security.

Honda Canada Finance Inc.

40. Honda Canada Finance Inc. (“**Honda**”) registered a PPSA financing statement in respect of the Debtor on April 17, 2013 in respect of a lease of a 2013 Acura MDX (“**Acura**”) by

2Source. TGF has reviewed the leasing documentation and PPSA registration and is of the view that, subject to confirmation of the timing of delivery of the Acura, Honda has a valid PMSI with respect to the Acura. The Purchaser has advised the Receiver that it is not seeking to purchase the Acura, and as such, the Acura is listed on the Excluded Asset Schedule of the APA. The Receiver has determined that there is no equity in the Acura lease. As a result, it is the Receiver's intention to make arrangements to return the Acura to Honda.

National Leasing Group Inc.

41. National Leasing Group Inc. registered a PPSA financing statement in respect of the Debtor on January 28, 2014 in respect of certain Microsoft Software and Licences (the "**Software**") under Lease No. 2654707N (the "**National Lease**"). The Receiver has been advised that all payments under the National Lease have been made, that the purchase option was executed, and that title to the Software had been transferred to the Debtor. The Software has been included in the Purchased Assets.

Cisco Systems Capital Canada Co.

42. Cisco Systems Capital Canada Co. ("**Cisco**") registered a PPSA financing statement in respect of the Debtor on January 28, 2014 in respect of certain telecommunications equipment (the "**Cisco Equipment**") under Lease No. 547623 (the "**Cisco Lease**"). TGF has reviewed such PPSA registration and the Cisco Lease in respect thereto and has concluded that Cisco appears to have a valid PMSI with respect to the Cisco Equipment. Cisco advised the Receiver that one payment totaling approximately \$1,623 plus HST remained to be paid in respect of the Cisco Lease. The Receiver has made the final payment and Cisco has acknowledged that title to the telecommunications equipment has passed to 2Source. The Cisco Equipment has been included in the Purchased Assets.

Roynat Inc.

43. Roynat Inc. ("**Roynat**") registered a PPSA financing statement in respect of the Debtor on July 28, 2014 in respect of certain laser marker equipment (the "**Laser Equipment**") under Lease No. 368468 (the "**Roynat Lease**"). TGF has reviewed the Roynat Lease and such PPSA registration and has concluded that it appears that Roynat has a valid PMSI with

respect to the Laser Equipment. The Laser Equipment has been listed as an Excluded Asset in Schedule “B” to the APA. The Purchaser has advised the Receiver that it is seeking an assignment of the Roynat Lease.

TRADE ACCOUNTS RECEIVABLE

44. Upon its appointment, the Receiver obtained a detailed listing of accounts receivable which indicated that \$712,361 remained owing to 2Source from various customers. The Receiver engaged the former collections staff at 2Source to assist in contacting 2Source customers in order to obtain payment of such accounts receivable. As of March 17, 2017, the Receiver has received payments totalling \$278,111 on account of pre-Appointment Order accounts receivable.
45. On February 28, 2017, the Receiver issued demand letters to all 2Source customers with outstanding accounts receivable. The Receiver is continuing with its collection efforts and will assess the need to institute formal collection proceedings in respect of amounts that remain unpaid.

SALE OF INVENTORY

46. The Receiver engaged former 2Source staff to prepare an analysis of the inventory on hand that was subject to current purchase orders, or that could potentially be sold to current customers, previous customers or other parties. As a result of that analysis and their efforts, the Receiver was able to contract for ordinary course sales of inventory generating a total value of \$416,602 on an “as is, where is” basis with no representations or warranties. As a result of not being in a position to provide customers with any representations or warranties on sales, in certain instances, the Receiver has negotiated pricing for less than the book value of the inventory. As of March 17, 2017, the Receiver has collected \$278,807 of its sales with the balance remaining to be collected. Subject to the Court’s approval of the Receiver completing the APA, the balance of the inventory will be transferred to the Purchaser; however, the unpaid accounts receivable will remain for the Receiver to collect for the benefit of the stakeholders in these receivership proceedings.

LITIGATION

47. As at the Appointment Date, 2Source is the plaintiff in three separate claims which remain outstanding and which are described briefly below.

Messier-Dowty Inc. (“Messier”)

48. On October 7, 2015, 2Source issued a Statement of Claim (the “**Messier Claim**”) under Court File No. CV-15-537943 against Messier, et al, claiming damages for breach of contract and misrepresentation in the sum of USD 4,030,000 and punitive damages in the sum of \$500,000.
49. On November 20, 2015, Messier filed a Statement of Defence and Counterclaim denying it had breached any contractual obligations and counterclaimed for liquidated damages in the amount of \$96,000 for 2Source’s failure to deliver products in accordance with their agreement and damages in the amount of \$1,500,000 for breach of contract.
50. The Receiver has reviewed the Messier Claim pleadings and has discussed the progress with Glegg. As of the date of this First Report, the Receiver has not taken any steps to advance the Messier Claim and is continuing to assess its options.

Service Star Freightways Inc. (“Service Star”)

51. On April 5, 2016, 2Source issued a Statement of Claim (the “**Service Star Claim**”) under Court File No. CV-16-550279 against Service Star, Y7E Transport Inc. (“**Y7E**”), Royal & Sun Alliance Insurance Company of Canada and Hub International HKMB Limited claiming damages in the amount of \$300,000 as a result of costs incurred resulting from and to remediate a paint/chemical spill at 2Source’s premises caused by Service Star and/or Y7E.
52. On January 24, 2017, the Receiver reviewed the status of the Service Star Claim with 2Source’s counsel retained in connection with the Service Star Claim, Ian Kirby of Gilbert Kirby Stringer LLP (“**Kirby**”), who indicated that, with one exception, all examinations had been completed. The Receiver directed Kirby to proceed with the final examination which has since been completed.

53. A mediation of the claim is scheduled for May 1, 2017, which proceeding the Receiver plans to attend. In the meantime, 2Source has completed its undertakings from a previous examination.

United Technologies Corporation (“UTAS”)

54. On January 10, 2017, 2Source issued a Statement of Claim (the “**UTAS Claim**”, and collectively with the Messier Claim and the Service Star Claim, the “**Excluded Litigation**”) under Court File No. CV-17-567429 against UTAS, et al, claiming damages of at least \$25,000,000 for breach of the *Competition Act* (Canada), fraudulent misrepresentation, deceit, conspiracy and unlawful interference with economic interests and punitive damages in the amount of \$5,000,000.
55. UTAS has not yet filed a statement of defence in respect of the UTAS Claim (the “**UTAS Litigation**”).
56. The Receiver has previously reviewed the UTAS Claim and had agreed that the UTAS Claim can be continued with the assistance of Bennett Jones LLP (“**BJ LLP**”), as counsel of record in respect of the UTAS Claim. Borden Ladner Gervais LLP (“**BLG**”) represents UTAS in the UTAS Litigation. Discussion in respect of the UTAS Claim between BLG, Dentons and BJ LLP have been ongoing. The Receiver and 2Source had agreed to terms upon which the UTAS Litigation may be continued which are marked privileged and confidential (the “**UTAS Litigation Arrangement**”). As a result of the resignation of Glegg, the Receiver is considering the positions of the parties in respect of a continuation of the UTAS Claim. A copy of the UTAS Litigation Arrangement is attached hereto as **Confidential Appendix “D”**.

ASSIGNMENT FOR THE GENERAL BENEFIT OF THE CREDITORS OF 2SOURCE

57. As discussed in paragraph 27 above, a condition of the APA is an assignment of the Lease to the Purchaser. The Receiver has had numerous discussions with the Landlords who have advised the Receiver that it will not agree to an assignment of the Lease as it wishes to sell the Bradco Property in a vacant state, despite the fact that, absent the receivership

proceedings, the Landlords would not be in a position to obtain vacant possession of the property until the Lease Expiry Date.

58. The Purchaser has advised that the Chai's Offer was predicated on the Purchaser being able to occupy the Premises until the Lease Expiry Date.
59. As discussed above, the Receiver is of the view that the Chai Offer is the best and most reasonable offer for the purchase of the Property and is in the best interests of all stakeholders. No other offer provided for a continuation of the business, the rehiring of some of the 2Source employees, and the continued supply of parts that for some customers are critical to their manufacturing process.
60. As Glegg has resigned as an officer and director, the most cost effective and efficient manner to assign the Debtor into bankruptcy, for the general benefit of its creditors, is for the Receiver to file an assignment.

INTERIM STATEMENT OF RECEIPTS AND DISBURSEMENTS

61. Attached as **Appendix "I"** is the Interim Statement of Receipts and Disbursements for the period January 23 to March 17, 2017 (the **"Interim R&D"**). As at March 17, 2017, the closing cash balance was approximately \$655,490, which includes a deposit with respect to the Chai Offer.
62. The Interim R&D includes receipt of \$70,000 from HSBC funded through the issuance of a Receiver's Certificate. These funds were required to ensure that the Receiver had sufficient cash to meet its obligations. The Receiver's Certificate will be repaid to HSBC, plus applicable interest, from the proceeds of the APA.

PROFESSIONAL FEES

63. The Receiver has maintained detailed records of its professional time and costs in this matter. Pursuant to paragraph 21 of the Appointment Order, the Receiver and its legal counsel were directed to pass their accounts from time to time before the Court and were granted a Receiver's Charge over the Property. The Receiver's counsel is not seeking to pass its accounts at this time but will do so at a later date.

64. The total fees of the Receiver during the period from January 11 to February 28, 2017 amount to \$258,482.50, together with expenses and disbursements in the sum of \$1,358.42 and harmonized sales tax (“**HST**”) in the amount of \$33,779.32, and total \$293,620.24 (the “**Receiver’s Fees**”). The time spent by the Receiver is more particularly described in the Affidavit of Hartley Bricks sworn March 8, 2017 (the “**Bricks Affidavit**”) in support hereof and attached hereto as **Appendix “J”**.
65. The Receiver is of the view that the fees and disbursements set out in the Bricks Affidavit are reasonable in the circumstances.

RECEIVER’S REQUEST TO THE COURT

66. The Receiver is respectively seeking an order:
- i) approving this First Report and the actions and activities of the Receiver for the period up to March 17, 2017;
 - ii) approving the APA and ratifying the Receiver’s execution of the APA;
 - iii) approving the Transaction and authorizing and directing the Receiver to carry out the terms of the APA, together with any amendments thereto deemed necessary by the Receiver in its sole discretion;
 - iv) vesting, upon the delivery of the Receiver’s Certificate to the Purchaser, the Debtor’s right, title and interest in and to the Purchased Assets in and to the Purchaser;
 - v) that, upon the closing of the Transaction and receipt of the Purchase Price, authorizing the Receiver to make a distribution to Elliott-Matsuura in the amount of \$400,000;
 - vi) varying or amending the Appointment Order to authorize the Receiver to file an assignment in bankruptcy on behalf of the Debtor;
 - vii) approving the Interim R&D;

- viii) approving the professional fees and disbursements of the Receiver as set out in the Bricks Affidavit, and authorizing the Receiver to pay all such fees and disbursements from available funds;
- ix) authorizing and directing the Receiver, *nunc pro tunc*, to redact from the version of the First Report served on any other party other than this Court, (i) the commercially sensitive information contained therein; (ii) the CIS, attached as **Confidential Appendix “A”**; (iii) the Receiver’s Comparison of Offers, attached as **Confidential Appendix “B”**; and (iv) the unredacted version of the APA, attached as **Confidential Appendix “C”**, and (v) the UTAS Litigation Arrangement, attached as **Confidential Appendix “D”**;
- x) sealing the unredacted version of the First Report, including **Confidential Appendices “A”, “B”, and “C”** filed with this Court from the public record, until the closing of the Transaction or further order of this Court; and
- xi) sealing the **Confidential Appendix “D”** filed with the Court from the public record pending further order of this Court.

All of which is respectfully submitted at Toronto, Ontario this 23rd day of March, 2017.

Deloitte Restructuring Inc.,
solely in its capacity as the
Court-appointed receiver of the assets,
undertakings and properties of
2Source Manufacturing Inc., and without
personal or corporate liability



Per: _____
Adam Bryk, CPA, CA, CIRP, LIT
Senior Vice-President



Per: _____
Hartley Bricks, CPA, CA, CIRP, LIT
Senior Vice-President