

IN THE SUPREME COURT OF BRITISH COLUMBIA

**IN THE MATTER OF THE *COMPANIES' CREDITORS*
ARRANGEMENT ACT, R.S.C. 1985, c. C36, AS AMENDED**

AND

**IN THE MATTER OF THE *CANADA BUSINESS*
CORPORATIONS ACT, R.S.C. 1985, c. C-44**

AND

**IN THE MATTER OF A PLAN OF COMPROMISE OR
ARRANGEMENT OF PAKIT INC.**

**SEVENTH REPORT OF ALVAREZ & MARSAL CANADA INC.
IN ITS CAPACITY AS MONITOR OF PAKIT INC.
JANUARY 23, 2012**

1.0 INTRODUCTION AND PURPOSE OF THE MONITOR'S REPORT

- 1.1 Alvarez & Marsal Canada Inc. ("**A&M**" or the "**Monitor**") was appointed as Monitor pursuant to the order pronounced by this Honourable Court on July 28, 2011 in respect of the petition filed by Pakit Inc. ("**Pakit**", the "**Company**" or the "**Petitioner**"), under the *Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36*, as amended (the "**CCAA**"). The proceedings brought by the Company under the CCAA are referred to herein as the "**CCAA Proceedings**" and the order granted by this Honourable Court on July 28, 2011, as amended, is hereinafter referred to as the "**Initial Order**". Prior to July 28, 2011, Pakit filed a Notice of Intention to make a Proposal (the "**NOI**") on July 12, 2011 which was converted into a CCAA Proceedings upon granting of the Initial Order.
- 1.2 Pakit USA Company Inc. ("**Pakit US**") and Pakit International Trading Company Inc. ("**Pakit International**") are wholly owned subsidiaries of Pakit. Pakit International is incorporated under the laws of Barbados. Pakit International is the sole owner of Packaging International Technology Sweden AB ("**PIT**"), a company incorporated under the laws of Sweden. References herein to the "**Pakit Group**" are references to the global enterprise as a whole.
- 1.3 The Initial Order provides for, amongst other things, an initial stay of proceedings against Pakit until and including August 25, 2011, or such later date as ordered by this Honourable Court (the "**Stay Period**"). Subsequent Orders were granted that extended the Stay Period until January 31, 2012.
- 1.4 The Initial Order together with select motion materials and other documentation filed in the CCAA, the Monitor's previous reports (the "**Prior Reports**") and the notice to creditors as prescribed under the CCAA are posted on the Monitor's website at www.alvarezandmarsal.com/pakit (the "**Monitor's Website**").
- 1.5 This report does not repeat all of the background information regarding the CCAA Proceedings and readers of this report are encouraged to obtain copies of these documents as well as other materials relating to the CCAA Proceedings by accessing the Monitor's Website.
- 1.6 This is the Monitor's seventh report (the "**Seventh Report**") and is intended for supplemental purposes to provide this Honourable Court and the stakeholders of the Petitioners, the Monitor's comments, conclusions and recommendation on the

Company's application for a Court Order approving two transactions ("**Two Transactions**"):

- a) to pay out the Company's largest secured creditor, Fairfax Financial Holdings Limited ("**Fairfax**") as well as to address the other secured convertible debenture claims, including approving the Amendment Agreements (defined below) and making arrangements to pay in full the debt due to the other secured convertible debenture holders once their security has been determined to be valid and enforceable; and
- b) to cause Pakit International, PIT and Pakit to enter into an agreement for the sale by Pakit International of a Pakit100 machine (the "**Sales Agreement**") to a customer effecting immediate transfer of title and revised payment terms from a previously existing purchase order.

1.7 An affidavit sworn by Mr. Yaretz, Interim President of Pakit, dated January 20, 2012 (referred to as "**#12 Yaretz Affidavit**") was filed in support of the Company's application.

2.0 **TERMS OF REFERENCE**

2.1 In preparing this report, A&M has necessarily relied upon unaudited financial and other information supplied, and representations made to us, by certain senior management of Pakit ("**Senior Management**"). Although this information has been subject to review, A&M has not conducted an audit nor otherwise attempted to verify the accuracy or completeness of any of the information provided by the Company. Accordingly, A&M expresses no opinion and does not provide any other form of assurance on the accuracy of any information contained in this report, or otherwise used to prepare this report.

2.2 Unless otherwise stated, all monetary amounts contained in this report are expressed in Canadian dollars, which is the Company's common reporting currency.

3.0 **MONITOR'S COMMENTS REGARDING THE COMPANY'S APPLICATION TO APPROVE THE TWO TRANSACTIONS**

3.1 The Monitor has considered the following with respect to Pakit's request for the Court's approval of the Two Transactions:

Payment to Certain Convertible Debenture Holders

- a) Pakit has agreed with Fairfax that it would not seek a further extension of the Stay Period, and would not oppose Fairfax's pending receivership application, if Fairfax is not

paid on in full on or before January 31, 2012. Fairfax holds a 12% secured convertible debenture with a principal face value of \$5 million (the “**Fairfax Debenture**”) and with accrued interest and estimated fees to January 31, 2012 is owed approximately \$5.85 million;

- b) As noted in the Prior Reports, Pakit has received a subscription agreement from Coronado Capital Partners LP (“**Coronado**”) for equity funding of US\$10 million to be paid by January 30, 2012 in exchange for shares of Pakit;
- c) The net proceeds of the US\$10 million share subscription are intended to be applied as follows:

	CDN\$000s
Proceeds (Coronado - US\$10 million) (.99 exchg)	\$ 10,101
Less:	
Financing Fees (4.5%)	455
Funds held in trust (pending review of senior debenture holders security and Court approval)	3,375
CRA pre-filing payroll deductions (estimate)	88
Fairfax (interest and estimated fees to Jan 31)	5,850
	<u>9,767</u>
Estimated net available funds	\$ 334

- d) The Monitor’s legal counsel, Borden Ladner Gervais LLP (“**BLG**”), has reviewed the Fairfax security and has confirmed that, subject to customary assumptions and proviso, the security has been perfected by registration and is valid and enforceable in respect of the proceeds of the US\$10 million share subscription. The Fairfax Debenture provides that the security interest granted therein is subordinated and postponed to the “**Senior Indebtedness**”. The Senior Indebtedness includes a demand revolving credit card facility in favour of HSBC Bank of Canada (“**HSBC**”) and the “**Existing Debentures**”. HSBC’s security interest is registered in the British Columbia Personal Property Registry (“**BC PPR**”) prior to the Fairfax registration, and the Monitor is advised by the Company that the Company has provided cash collateral to HSBC in the amount of \$21,000, which is in excess of the amount due to HSBC.
- e) BLG has searched the Company’s name in the BC PPR. In addition to the registrations of Fairfax and HSBC, other registered parties include two equipment vendors/lessors that may have a Purchase Money Security Interest (“**PMSI**”) in respect of the assets they have financed as well as ATS Automation Tooling System (“**ATS**”). The Company and its

legal counsel have advised the Monitor that ATS does not have a security interest in the proceeds of the share subscription. The Monitor's legal counsel has requested ATS' legal counsel to confirm the information provided by the Company and its counsel.

- f) BLG is in the process of reviewing the security granted in favour of the holders of Existing Debentures. The Monitor has been advised that the Existing Debentures are widely held (approximately 100) and are owed \$4 million. As at January 23, 2012, holders of \$548,000 (principal value) of the Existing Debentures have unilaterally agreed to subordinate and postpone their claims in favour of Fairfax pursuant to amendment agreements distributed by email to the holders of the Existing Debentures on November 10 and 16, 2011 (the "**Amendment Agreements**") which are subject to Court approval. Copies of the Amendment Agreements, including related email communications, are attached as Exhibits "E" to "I" to the Yaretz Affidavit #12. On January 20, 2012, Pakit provided copies of the Notice of the Application for the January 23, 2012 Court hearing and the Yaretz Affidavit #12 by electronic mail to the holders of the Existing Debentures.
- g) Pakit is seeking the Court's approval to place sufficient funds (approximately \$3.5 million comprising \$3.375 million due to the holders of the non-subordinating Existing Debentures and \$88,000 due to CRA) from the US\$10 million share subscription in trust with the Monitor's legal counsel. The Company intends to pay in full the amounts owing to the non-subordinating Existing Debenture holders, subject to the Monitor's review of and satisfaction with the validity and priority of the security interests of such Existing Debenture holders and further Order of the Court. This arrangement is necessary to ensure that Fairfax can be paid, in accordance with its agreement with the Company, without prejudice to the interests of Existing Debenture Holders who may rank in priority to Fairfax.
- h) The Company has advised the Monitor that the potential statutory liabilities of Pakit which may result in statutory priority claims in the CCAA are limited to claims of Canada Revenue Agency ("**CRA**"). CRA's legal counsel recently contacted Pakit requesting that payment of approximately \$88,000 be made to CRA for pre-filing payroll deductions in priority to Fairfax and the Existing Debentures. We understand that Pakit intends to include this amount in the funds proposed to be held by the Monitor's counsel, pending further review and confirmation of the amount owing to CRA.

Sale of the Pakit100 Machine

- i) Pakit is seeking Court approval for the sale by its subsidiary, Pakit International, of a Pakit100 machine to its North American customer (discussed in the Prior Reports). The Monitor has been advised that the customer requires that the terms of the Sales Agreement be approved by the Court. The customer has previously paid (in December 2011) a deposit of \$1.0 million to Pakit International for the purchase of the machine and entered into a purchase order in August 2011, which provided for a transfer of title at the conclusion of the sale and receipt by Pakit of the full purchase price. The terms of the new Sales Agreement provide for an immediate transfer of title of the Pakit100 machine to the customer. The terms contemplate a revised payment schedule commencing January 23, 2012 to the end of March 2012. Certain payments will be made directly to Pakit Inc. (less than 20% of the outstanding purchase price) and the remaining balance (in excess of 80%) will be paid directly to third party suppliers. These suppliers are creditors of either Pakit International or PIT. One Pakit International creditor, who is needed to provide equipment and supplies to complete the Pakit100 machine, is requiring payment of arrears (approximately \$600,000) prior to performing further services.
- j) The Pakit Group currently does not have sufficient funding to complete the Pakit100 machine pursuant to the terms of the existing purchase order. The Prior Reports indicated that a debtor in possession financing (“**DIP Facility**”) term sheet was received from Fairfax. However, the DIP Facility offer has subsequently been withdrawn. Senior Management has advised that given its current cash flow constraints, it wishes to enter into the Sales Agreement which allows the Pakit Group to continue to fund and complete the Pakit100 machine by the customer requested delivery date based on the new revised payment schedule.
- k) The Pakit100 machine to be sold is currently owned by Pakit International, which has indebtedness of approximately \$80 million, including \$1.5 million in unrelated third party claims outstanding as at July 12, 2011 and an intercompany debt of approximately \$78 million owing to Pakit Inc. (\$74 million) and PIT (\$4 million). There are two non-related large suppliers, Processpumpar AB and ATS, owed approximately \$632,000 and \$805,000, respectively. Senior Management has advised that the \$80 million of indebtedness excludes approximately \$3.1 million of previously advanced customer deposits.

- l) The Monitor has been advised by the Company and its counsel that the sales transaction involving the Pakit100 machine does not extend to or include a sale, transfer or licence of any proprietary intellectual property associated with the Pakit100 machine, other than a limited licence granted for the use of the machine.
- m) Senior Management believes that while the sale of the Pakit100 machine will not generate a profit margin given the outstanding costs to date and additional costs to complete the machine, it will provide the Pakit Group further opportunities to sell multiple machines to the same customer as well as to other customers on economically viable terms.

4.0 Other Matters

- 4.1 On January 19, 2012, the Monitor had a telephone discussion with Mr. Zack Easton, who is the President of Coronado Capital Management (a related party, Coronado Capital Partners LP, is the subscriber under the US\$10 million share subscription) and a recently appointed director of Pakit Inc. Mr. Easton confirmed that the US\$10 million is expected to be forthcoming by January 30, 2012. However, Mr. Easton intends to review further information and undertake further due diligence during the week of January 23, 2012 regarding the subscription for shares in Pakit.

5.0 MONITOR'S CONCLUSIONS AND RECOMMENDATION

- 5.1 The Monitor's conclusions are as follows:
 - a) The Company is continuing to act in good faith and with due diligence in its efforts to continue on-going operations and to conclude the equity financing pursuant to the US\$10 million subscription agreement with Coronado. In addition, Senior Management continues to make efforts to address funding requirements beyond January 31, 2012 to eventually emerge from the CCAA Proceedings;
 - b) Subject to sufficient funds being held in trust pending further order by the Court to pay any potential secured creditors that may rank in priority to Fairfax, the Monitor supports payment of Fairfax in full on or before January 31, 2012, as agreed between Pakit and Fairfax. A review of the validity and priority of the security of the Existing Debenture holders and the CRA claim by the Monitor's legal counsel, and a further Court Order, will be required prior to payment of such parties from the funds proposed to be held in trust;

- c) Pakit has advised that the holders Existing Debentures have received information regarding the pending receipt of the US\$10 million subscription proceeds and the Company's application to approve the Amendment Agreements. We are advised that there have been no concerns or objections raised by those parties regarding the Amendment Agreements; and
- d) The sale by Pakit International of the Pakit100 machine, including transfer of title, appears commercially reasonable despite the fact that there appears to be no meaningful profit for the Pakit Group from this sale. The sale may create future opportunities to sell additional machines to this customer (which is a substantial company in the packaging and paper distribution business) as well as to other customers. In addition, an analysis limited to cash receipts and disbursements post filing indicates that the sale of the machine has netted the Pakit Group positive cash flow to fund some of the on-going operations and to pay certain critical pre-filing subsidiary claims.

5.2 The Monitor respectfully recommends to this Honourable Court to approve the Two Transactions, including:

- a) payment of Fairfax in full to Fairfax by January 31, 2012 (upon receipt of the US\$10 million in share subscription proceeds) absent any further information that may be received prior to the Court hearing regarding potential priority creditors, such as ATS, and approval of the Amendment Agreements; and
- b) the sale of the Pakit100 machine to the North American customer on the terms agreed by the Company.

All of which is respectfully submitted to this Honourable Court this 23rd day of January, 2012.

**Alvarez & Marsal Canada Inc., in its capacity as
Monitor of Pakit Inc.**



Per: Pam K. Boparai
Vice President