

Court File No.: 500-11-052101-173

**QUEBEC
SUPERIOR COURT
(COMMERCIAL DIVISION)**

**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, ARRANGEMENT AND
REORGANIZATION OF ALLIANCE HANGER INC. ON THE APPLICATION OF ERA
GROUP INC.**

**SECOND REPORT OF THE MONITOR
KPMG INC.**

DATED MARCH 27, 2017

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INTRODUCTION AND PURPOSE OF THE MONITOR'S SECOND REPORT

1. On February 16, 2017, ERA Group Inc. (the “Applicant”), a creditor of Alliance Hanger Inc. (the “Debtor”) filed an application (the “Application”) with regards to the Debtor before the Quebec Superior Court, Commercial Division (the “Court”) under the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended (the “CCAA”). On the same day, KPMG Inc. (“KPMG”), in its then capacity as proposed monitor, provided the Court with a pre-filing report dated February 14, 2017 (the “Pre-Filing Report”) in connection with the Application.
2. On February 16, 2017, the Court granted an initial order (the “Initial Order”) which provides for, among other things, the appointment of KPMG as monitor of the Debtor (in such capacity, the “Monitor”) in these CCAA proceedings (the “CCAA Proceedings”) and a stay of proceedings until March 17, 2017, or such later date as the Court may order (the “Stay Period”).
3. On February 16, 2017, the Court also granted an order allowing the commencement of a claims process (the “Claims Procedure Order”).
4. On March 9, 2017, the Court granted an order for the filing of the amended plan of compromise, arrangement and reorganization, the calling of a creditors’ meeting and the extension of the stay period until May 31, 2017 (the “Plan and Meeting Order”).
5. KPMG provided the Court with its first report dated March 9, 2017 (the “First Report”) in connection with the Applicant’s motion relating to the Plan and Meeting Order.
6. The purpose of this Monitor’s Second report (the “Second Report”) is to provide the Court with information on the following:
 - a. The Monitor’s activities since the date of the First Report;
 - b. The Debtor’s activities since the issuance of the Plan and Meeting Order;
 - c. The Debtor’s actual receipts and disbursements for the two (2)-week period ended March 17, 2017, as compared to the corresponding period reflected in the updated cash flow forecast for the period March 4 to June 2, 2017 (the “Updated Cash Flow”) filed in support of the Plan and Meeting Order;

- d. An update on the claims process pursuant to the Claims Procedure Order (the “Claims Process”);
- e. An overview of the Amended Plan of Compromise and Arrangement (the “**Plan**”) filed by the Applicant with the Court’s authorisation;
- f. The estimated distribution under the Plan; and
- g. The Monitor’s observations and recommendations.

TERMS OF REFERENCE

- 7. In preparing this Second Report, the Monitor has been provided with and has relied upon, unaudited financial information, books and records prepared by certain senior management of the Debtor (“Senior Management”), and discussions with Senior Management (collectively, the “Information”). Except as further described in this Second Report:
 - a. The Monitor 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 Canadian Auditing Standards (“CASs”) pursuant to the Chartered Professional Accountants Canada Handbook and accordingly, the Monitor expresses no opinion or other form of assurance contemplated under CASs in respect of the Information; and
 - b. Some of the information referred to in this report consists of financial forecasts and projections. An examination or review of the financial forecasts and projections, as outlined in the Chartered Professional Accountants Canada Handbook, has not been performed.
- 8. Future oriented financial information referred to in this Second Report was prepared based on Senior Management’s estimates and assumptions. Readers are cautioned that since projections are based upon assumptions about future events and conditions that are not ascertainable, the actual results will vary from the projections. Even if the assumptions materialize, the variations could be significant.

9. The information contained in this Second report is not intended to be relied upon by any prospective purchaser or investor in any transaction with the Debtor or the Applicant.
10. Unless otherwise stated, all monetary amounts contained in this Second report are expressed in Canadian dollars, which is the Debtor's common reporting currency.

ACTIVITIES OF THE MONITOR SINCE THE DATE OF THE FIRST REPORT

11. The Monitor established a website for the CCAA Proceedings at www.kpmg.com/ca/alliancehanger (the "Monitor's Website"). Copies of the Monitor's reports, issued orders to the current service list and other Court materials filed in connection with these CCAA Proceedings are available on the Monitor's Website.
12. Terms not defined herein shall have the meaning attributed in the Initial Order, the Claims Procedure Order and the Plan and Meeting Order.
13. Pursuant to the issuance of the Plan and Meeting Order granted on March 9, 2017 by the Court which provided for a Creditors' Meeting to be called and held on or before April 30, 2017, or such later date as the Court may order (the "Meeting Call Date"), the Monitor:
 - a. Published the Meeting Materials on its website;
 - b. Mailed via regular mail at least 10 days before the Meeting Call Date, a notice of the Creditors' Meeting and Meeting Materials to each Affected Creditor which filed, or has been deemed to have filed, a Proof of Claim in respect of an Affected Claim or in respect of any amount in excess of its Affected Claim Amount, in compliance with the Claims Procedure Order. The notice of the Creditors' Meeting was also sent via regular mail to the Debtor's shareholders who are not Affected Creditors; and
 - c. Prepared and posted on the Monitor's Website a list of the Stayed Parties.
14. The Monitor has responded to telephone calls, emails and inquiries, addressing concerns from creditors and other stakeholders regarding the effect of the CCAA Proceedings.

ACTIVITIES OF THE DEBTOR SINCE THE ISSUANCE OF THE INITIAL ORDER

15. Since the date of filing, the Monitor notes that the Debtor has:
- a. acted and continues to act in good faith and with due care and diligence;
 - b. continued to provide the Monitor with its full cooperation, and access to its premises, as well as its books and records;
 - c. continued to pay its employees (and making the related government remittances) in the ordinary course; and
 - d. continued to pay Unaffected Creditors in the ordinary course.

ACTUAL CASH FLOWS FOR THE TWO-WEEK PERIOD ENDED MARCH 17, 2017

16. Cash receipts and disbursements for the two-week period ended March 17, 2017 (the “Reporting Period”), as compared to the corresponding period of the Updated Cash Flow Forecast (which was filed in conjunction with the First Report) are summarized in the table below:

Cintre Alliance Inc. / Alliance Hanger inc.			
Summary of Actual Receipts and Disbursements			
For the period March 4, 2017 to March 17, 2017			
in CAD \$000's			
	Actual	Projected	Variance
Cash Receipts	340	317	24
Cash Disbursements			
Supplier Payments	540	393	(147)
Payroll and Benefits	132	125	(7)
Occupancy Costs	55	35	(20)
Operating Costs	45	49	4
Professional and Restructuring Fees	6	77	71
Interest & Capital Repayment	8	-	(8)
Capital Expenditure	18	-	(18)
Total Disbursements	805	678	(108)
Net Cash Flow	(464)	(361)	(103)
Bank indebtedness			
Opening Bank Indebtedness	(1,443)	(1,443)	-
DIP Loan Injection	-	-	-
Net Cash Flow	(464)	(361)	(103)
Closing Bank Indebtedness	(1,908)	(1,805)	(103)

17. As at March 17, 2017, the Debtor's operating bank indebtedness, which includes the amounts drawn pursuant to the DIP Facility, totaled approximately \$1.91 million.
18. The unfavourable variance in the Debtor's net cash flow during the Reporting Period amounts to \$103,000. The more significant variance items are summarized below:
 - a. Total cash receipts were \$24,000 higher than projected primarily due to timing of collections;
 - b. Total disbursements during the period were approximately \$108,000 higher than projected, mainly due to a catch-up of \$147,000 in supplier payments, occupancy cost payments and non-forecasted capital expenditures of \$18,000, offset by \$71,000 of favourable timing difference related to the payment of professional fees.
19. The Monitor notes that the cash balance as at March 17, 2017 is fairly consistent with the projected bank indebtedness balance.
20. The Monitor also notes that the DIP Loan is in place and that it remains available to the Debtor in order to fund the ongoing operations during the CCAA Proceedings as the Debtor continues to respect the terms of the DIP Loan Term Sheet.

UPDATE ON THE CLAIMS PROCESS

21. The Monitor has complied with its statutory obligations pursuant to the terms of the Claims Procedure Order.
22. As per the terms of the Claims Procedure Order, the Claims Bar Date was March 3, 2017 (5:00 PM) in respect of outstanding Affected Claims in excess of the Affected Claim Amount, as at February 16, 2017 (the "Determination Date").
23. Affected Claims means the following Claims totalling \$3,900,000 owing by the Debtor to the following Creditors, (which are deemed Proven Claims hereunder), namely:
 - a. \$950,000 owing by the Debtor to the Applicant as a result of the "Asset Purchase Agreement" executed between the Debtor and the Applicant on January 1, 2014;
 - b. \$950,000 owing by the Debtor to Polinex as a result of the "Asset Purchase Agreement" executed between the Debtor and the Polinex on January 1, 2014;

- c. an additional \$100,000 owing by the Debtor to the Applicant as a result of such amount having been loaned and advanced by the Applicant to the Debtor;
 - d. an aggregate of \$1,550,000 owing by the Debtor to Shapiro General Partnership as a result of such aggregate amount having been loaned and advanced by Shapiro General Partnership to the Debtor;
 - e. an aggregate of \$100,000 owing by the Debtor to 3903460 Canada Inc. as a result of such aggregate amount having been loaned and advanced by 3903460 Canada Inc. to the Debtor;
 - f. an aggregate of \$250,000 owing by the Debtor to 4511531 Canada Inc. as a result of such aggregate amount having been loaned and advanced by 4511531 Canada Inc. to the Debtor; and
 - g. any amounts in excess of the above which may become Proven Claims of any of the above enumerated Persons, and “Affected Claim” means any of them;
24. As at March 3, 2017, the Monitor had not received any claims in excess of the Affected Claims Amount totaling \$3.9 million.

AMENDED PLAN OF COMPROMISE AND ARRANGEMENT

25. The Plan and Meeting Order granted by the Court authorized the filing of the Plan under the CCAA Proceedings. Capitalized terms not otherwise defined in this section are as defined in the Plan.
26. Through continuous communication with the Applicant’s counsel, the Monitor has been kept abreast of the aspects of the Plan.
27. We have summarized below the significant aspects of the Plan:

General

28. In particular, the Plan provides for the following:
 - a. the compromise of the Affected Claims in accordance with the terms of the Plan; and
 - b. an equity investment of \$3.7 million in the Debtor by way of a reorganization of the Debtor's equity and the subscription by some or all of the Debtor's shareholders of new shares for such amount, the whole pursuant to Section 191 CBCA and the relevant provisions of the CCAA Proceedings (the "Equity Restructuring").

29. The Plan is not addressed to any of the Debtor's creditors other than the Affected Creditors, which Affected Creditors are either shareholders of the Debtor or are related to some of the Debtor's shareholders (but none of the Affected Creditors are related to the Debtor in the sense of Section 4 of the BIA). Pursuant to the Plan, all of the Affected Creditors are included in one class of creditors.

30. Additionally, the Plan is only addressed to the Affected Creditors and not to the Debtor's other creditors, in general, and Toronto Dominion Bank ("TD Bank"), Roynat Inc. ("Roynat"), Business Development Bank of Canada ("BDC") and the Debtor's trade creditors, in particular.

31. The implementation of the Plan is subject to certain conditions precedent occurring or being waived by 5:00 PM on the 30th day following the issuance of an order sanctioning the Plan (the "Sanction Order"), or such later date as may be agreed to by the Applicant and the Monitor or ordered by the Court, including, inter alia, the following:
 - a. the Plan being approved by the Affected Creditors;
 - b. the issuance by this Honourable Court of the Sanction Order; and
 - c. the implementation of the Equity Restructuring.

Treatment of Affected Claims

32. No later than 25 days following the Sanction Date (“Payment Date”), the aggregate sum of \$10,000 (the “Aggregate Distribution”), without any interest whatsoever thereon, shall be paid by the Company to the Monitor and shall thereafter be distributed by the Monitor to the Affected Creditors, according to the amount of their respective Proven Claims. The Payment Date may be extended by the Company with the consent of the Monitor, by an additional period not exceeding 60 days.

Treatment of the DIP Claim

33. On the date on which the DIP Claim becomes payable pursuant to the provisions of the DIP Facility Documents, the DIP Lender shall receive full payment of any remaining DIP Claim.

Treatment of Excluded Claims and Unaffected Claims

34. All Excluded Claims (other than the Administration Claim and the DIP Claim) and all Unaffected Claims will remain in full force and effect in accordance with their terms after the Plan Implementation Date, and will have been or will be paid in full by the Debtor in the normal course of its business as and when they become due.

Treatment of Administration Claims

35. All Administration Claims, if any, will have been paid or will be paid in full by the Debtor as and when they become due, and any remaining balance will be settled as soon as practicable after the Plan Implementation Date.

Treatment of Certain Crown Priority Claims

36. All Crown Priority Claims described in Section 6(3) of the CCAA, if any, will be paid in full by the Debtor within 6 months immediately following the Sanction Date.

Equity Restructuring

37. The Debtor is insolvent and, as a consequence thereof, has sought the application of the relevant provisions of the CCAA. The Debtor has no shareholders’ equity and, as a consequence, the Existing Shares have no value. Therefore, the Equity Restructuring is an essential part of the Debtor’s restructuring plan in order to preserve its going concern viability for the benefits of all stakeholders.

38. Once the Affected Creditors have approved the Plan by a Resolution of the Required Majorities at the Creditors' Meeting, the Applicant will present a motion to the Court seeking the Sanction Order, which Sanction Order will order, inter alia, all of the following (collectively the "Equity Restructuring"), namely:
- a. the creation and authorization of the New Common Shares and New Redeemable Shares;
 - b. the conversion of each and every one of the Existing Common Shares and the Existing Preferred Shares into New Redeemable Shares (on a one share-to-one share basis);
 - c. the cancellation for all purposes of any and all existing options, warrants, pre-emptive rights or any other entitlements or rights to acquire shares in the Debtor's capital stock;
 - d. the replacement of all Existing Directors with new directors;
 - e. the cancellation and termination for all purposes of any and all agreements between the Existing Common Shareholders and/or the Debtor in respect of the Debtor, as envisaged by s. 146 CBCA or otherwise;
 - f. such other amendments to and/or restating of the Existing Articles as set forth in the Articles of Reorganization; and
 - g. the subscriptions for and purchases, issuance and allotment of the Available New Shares.
39. Within 15 days following the Implementation Date of the Plan, an aggregate \$3.7 million equity investment (the "New Equity Investment") shall be made in the Debtor by some or all of the Existing Common Shareholders subscribing for and purchasing an aggregate of 1,000 New Common Shares from the Debtor's capital stock at the issuance price of \$3,700 0 per New Common Share (the "Available New Shares"). In accordance with such subscriptions and purchases, such Available New Shares shall be issued and allotted by the Debtor to the subscribers therefor as fully paid and non-assessable New Common Shares in the Debtor's capital stock. Such New Equity Investment and the Available New Shares' subscription, purchase, issuance and allotment shall be effected in the following manner, namely:

- a. within 10 days following the Implementation Date, each of the Existing Common Shareholders will be entitled to subscribe for and purchase the full amount (and not less than the full amount) of its/his Proportion of the Available New Shares. Any subscription by any Existing Shareholder(s) for less than its/his full Proportion of the Available New Shares shall be considered invalid and of no effect. Any Existing Shareholder(s) failing to effect such full subscription and purchase within such 10-day delay shall be “Defaulting Existing Shareholder(s)”; and
 - b. within 5 days following the expiry of the 10-day delay, the Plan Sponsors shall be entitled to subscribe for and purchase all the Proportions of the Available New Shares of the Defaulting Existing Shareholder(s).
40. The Plan Sponsors have agreed and confirmed to the Monitor to:
- a. subscribe and pay for each of their respective Proportions of the Available New Shares within the delay set forth in the Plan; and
 - b. subscribe, pay for and purchase all the Proportions of the Available New Shares of the Defaulting Existing Shareholders within the delay set forth in the Plan.
41. The implementation of the Equity Restructuring is a condition precedent to the performance of the Plan, and any approval by the Affected Creditors of the Plan pursuant to a Resolution shall include approval of the Equity Restructuring. In the event that the Sanction Order does not order the Equity Restructuring, then the Plan shall be deemed, for all purposes, to have not been sanctioned pursuant to the relevant provisions of the CCAA.

ESTIMATED DISTRIBUTION UNDER THE AMENDED PLAN

42. As indicated previously, the total amount to be distributed to the Affected Creditors under the Plan amounts to \$10,000 while the Affected Claims total \$3.9 million.
43. The Plan is not addressed to any of the Debtor’s creditors other than the Affected Creditors, which Affected Creditors are either shareholders of the Debtor or are related to some of the Debtor’s shareholders (but none of the Affected Creditors are related to the Debtor in the sense of Section 4 of the BIA). Pursuant to the Plan, all of the Affected Creditors are included in one class of creditors.

44. Notwithstanding the nominal recovery for the Affected Creditors, the \$3.7 million Equity Restructuring that will be implemented under the Plan will benefit all stakeholders of the Debtor, including the Affected Creditors, in order to preserve the going concern of the Debtor.
45. If the Plan is rejected and the Equity Restructuring does not materialize, it is most likely that the Debtor will be forced to liquidate its assets for the benefit of the secured creditors, namely: TD Bank, Roynat and BDC (the “Secured Creditors”).
46. TD Bank is the Debtor’s primary operating lender, which, at the date of this Second Report is owed approximately \$1.9 million under a revolving facility secured by hypothecs ranking first over the Debtor’s accounts receivable and inventory, and second against all of the Debtor’s remaining property.
47. Roynat and BDC each granted term loans to the Debtor, with current outstanding balances of \$1.65 million and \$1.9 million respectively. The Roynat and BDC loans are both secured by hypothecs ranking first (*pari passu* as between Roynat and BDC) over all of the Debtor’s property other than accounts receivable and inventory.
48. In addition to the claims of the Secured Creditors, the current DIP Loan totaling \$3.7 million has a Court ordered charge over all of the Debtor’s assets which ranks after all existing hypothecs over any of the Debtor’s property in favor of the Secured Creditors as well as any other secured creditor as defined by the *Bankruptcy and Insolvency Act*, R.S.C., 1985, c. B-3, but before the Affected Creditors (\$3.9 million) and any other of the Debtor’s ordinary creditors (i.e. trade creditors and other payables to which it owes approximately \$1 million).
49. The claims of the Secured Creditors (\$5.45 million) and of the DIP Loan (\$3.7 million) total an aggregate of \$9.15 million.
50. As at December 31, 2016, the Debtor had total assets with a book value of approximately \$15.5 million, including advances receivable from related parties of \$392,000. It is important to note that the Debtor’s inventory, having a book value of approximately \$6 million as at December 31, 2016, requires a significant write-down resulting from the decrease in sales from one major customer.

51. The Monitor is of the view that the outcome under the Plan is more advantageous for the Debtor's stakeholders, including the Affected Creditors, than in the context of a forced liquidation or bankruptcy scenario for the following reasons:
- a. The realization value of the Debtor's assets would be significantly negatively impacted by the interruption of its operations, in particular the inventory;
 - b. The implementation of the \$3.7 million Equity Restructuring contemplated under the Plan which would not be available if the Plan is rejected by the Affected Creditors;
 - c. The additional professional fees incurred as a result of a liquidation;
 - d. The significant value of the claims of the Secured Creditors and of the DIP Loan totalling an aggregate of \$9.15 million in comparison with the book value of the Debtor's assets;
 - e. The Debtor's approximate 100 employees who would lose their employment in the context of a forced liquidation or bankruptcy scenario; and
 - f. The Debtor's ordinary creditors who would lose the benefit from future sales with the Debtor.

REVIEW OF POTENTIAL PREFERENCES AND TRANSFERS AT UNDERVALUE


52. Notwithstanding Section 36.1 of the CCAA, Section 38 and Sections 95 through 101 of the BIA shall not apply to the Plan. Accordingly, neither the Monitor, any Creditor, nor any other Person shall be entitled to exercise any right, remedy or recourse, or to commence any action, motion, application or any other proceeding against any Creditor or any other Person in relation to the Debtor, based on Section 38 and Sections 95 through 101 of the BIA.
53. Therefore, the Monitor has not performed a review of the potential preferences and transfers at undervalue.

MONITOR'S OBSERVATIONS AND RECOMMENDATIONS

54. In the current context, the Monitor believes that the terms of the Plan are fair and reasonable.
55. The Plan is not addressed to any of the Debtor's creditors other than the Affected Creditors, which Affected Creditors are either shareholders of the Debtor or are related to some of the Debtor's shareholders
56. As mentioned, while the Plan provides for a nominal recovery for the Affected Creditors, the Plan's contemplated Equity Restructuring will preserve the going concern of the Debtor for the benefit of all stakeholders, including the Affected Creditors.
57. For the reasons noted previously, it is the Monitor's view that there would likely be no realization to the benefit of the Affected Creditors and to the Debtor's ordinary creditors, which are currently not affected by the Plan, in the context of a forced liquidation or bankruptcy scenario.
58. Consequently, the expected recovery by the Affected Creditors, but more importantly the positive effect of the Equity Restructuring contemplated by the Plan for all of the Debtor's stakeholders are more advantageous than the outcome in a forced liquidation or bankruptcy scenario.

The whole respectfully submitted.

KPMG INC.
in its capacity as Court-appointed
Monitor of Alliance Hanger Inc.


Stephane De Broux, CPA, CA, CIRP
Partner