

Estate No.: 35-2638322
Court No.: 35-2638322

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)
(IN BANKRUPTCY AND INSOLVENCY)

IN THE MATTER OF THE NOTICE OF INTENTION TO MAKE A PROPOSAL OF
KMW ENERGY INC.
OF THE CITY OF LONDON,
IN THE PROVINCE OF ONTARIO

SECOND REPORT TO THE COURT
SUBMITTED BY MNP LTD.,
IN ITS CAPACITY AS TRUSTEE UNDER THE
NOTICE OF INTENTION TO MAKE A PROPOSAL OF
KMW ENERGY INC.

June 18, 2020

Table of Contents

I. INTRODUCTION	3
II. RESTRICTIONS.....	4
III. PURPOSE OF THIS REPORT	5
IV. BACKGROUND INFORMATION.....	6
V. CREDITORS	7
VI. CASH FLOW PROJECTIONS	7
VII. ACTIVITIES OF THE PROPOSAL TRUSTEE	10
VIII. SALE PROCESS	11
IX. SALE APPROVAL	12
XII. APPROVAL OF THE FEES AND DISBURSEMENTS OF THE PROPOSAL TRUSTEE AND ITS COUNSEL	16
XIII. CONCLUSION AND RECOMMENDATION	16

I. INTRODUCTION

1. On April 11, 2020 (the “**Filing Date**”), KMW Energy Inc. (“**KMW**” or the “**Company**”) filed a Notice of Intention to Make a Proposal (“**NOI**”) pursuant to Section 50.4 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, as amended (the “**BIA**”). MNP Ltd. was named proposal trustee in the NOI proceeding (the “**Proposal Trustee**”).
2. Notice of the NOI as prescribed by the BIA was sent via email on April 17, 2020 to all KMW’s known creditors.
3. On April 24, 2020, KMW filed Notice of Motion and a Motion Record returnable May 1, 2020, seeking, among other things, a Court Order (the “**May 1st Court Order**”) extending the time within which KMW had to file a proposal to June 25 2020, approving the interim financing of up to \$500M and authorizing the Proposal Trustee to conduct a stalking horse sale process (the “**Sale Process**”). The Proposal Trustee served its first report, dated April 29, 2020 (the “**First Report**”). A copy of the First Report, without exhibits, is attached hereto and marked as **Exhibit “A”**.
4. On May 1, 2020, the Court approved the following:
 - a. an extension of the time for the Company to make a proposal to June 25, 2020;
 - b. approved interim financing up to a maximum of \$500M (the “**DIP Loan**”) from 2751602 Ontario Inc. (the “**DIP Lender**” or “**Stalking Horse Bidder**”, as usage dictates) for the purpose of funding KMW’s activities and granting the second ranking security charge on the properties, assets and undertakings (collectively the “**Property**”) of the Company in favour of the DIP Lender over all other security interests and encumbrances (the “**DIP Charge**”), other than the Administration Charge;
 - c. a first ranking charge (the “**Administrative Charge**”) on the Property in an amount not to exceed \$150M in favor of the Company’s legal counsel, the Proposal Trustee, and Weisz Fell Kour LLP (“**WFK**”), the Proposal Trustee’s legal counsel to secure payment of their reasonable fees and disbursements;

- d. the Sale Process in respect of the Property and authorized the Proposal Trustee to conduct the Sale Process using the Asset Purchase Agreement dated April 24, 2020 (the “**Stalking Horse APA**”) between the Company and the Stalking Horse Bidder in respect of the Property to be used as the stalking horse bid; and
 - e. a third ranking charge over the Property in an amount not to exceed \$50M in favour of the Company’s directors and officers to indemnify them against obligations and liabilities that they may incur after the Filing Date (the “**D&O Charge**”).
5. Information regarding the proceedings has been posted to the Proposal Trustee’s Case website at www.mnpdebt.ca/KMWEnergy (the “**Website**”).

II. RESTRICTIONS

6. In preparing this Report and making the comments herein, the Proposal Trustee has been provided with, and has relied upon, certain unaudited, draft and/or internal financial information, the affidavits of Eric B. Rosen, dated April 24, 2020 and June 17, 2020 (the “**Rosen Affidavits**”), KMW’s books and records, discussions with KMW’s management (“**Management**”) and information from other third-party sources (collectively, the “**Information**”). Except as specifically noted in this Report, the Proposal Trustee has not audited, reviewed or otherwise attempted to verify the accuracy or completeness of the Information in a manner that would wholly or partially comply with Generally Accepted Assurance Standards of the Chartered Professional Accountants of Canada.
7. The Proposal Trustee also bases its report on the Company’s cash flow projections and underlying assumptions and notes that its review and commentary thereon were performed in accordance with the requirements set out in the Canadian Association of Insolvency and Restructuring Professionals’ Standards of Professional Practice No. 9 (Cash Flow Statement). Certain of the Information referred to in this Report consists of financial forecasts and/or projections. An examination or review of financial forecasts and projections and procedures, in accordance with standards set by the Chartered Professional Accountants of Canada, has not been performed. Future oriented financial Information referred to in this Report was prepared based on estimates and assumptions provided by

Management. Readers are cautioned that since financial forecasts and/or projections are based upon assumptions about future events and conditions that are not ascertainable, actual results will vary from the projections, and such variations could be material. On March 17, 2020, the Province of Ontario declared a state of emergency due to the COVID-19 pandemic. The effect of this declaration along with other federal, provincial and municipal actions regarding the COVID-19 pandemic on the Company's business and the economy in general has yet to be determined. In developing the Cash Flow Projections (as defined below), Management has reflected its current view of the potential impact of the COVID-19 pandemic on its cash flow. However, the ongoing uncertainty and instability caused by the COVID-19 pandemic and various government regulatory actions in response thereto, may cause actual results to differ from the projected amounts and these variations may be material.

III. PURPOSE OF THIS REPORT

8. The purpose of this Report is, *inter alia*, to:
 - a. Update the Court with respect to:
 - i. the activities of the Company and the Proposal Trustee since the First Report;
 - ii. the results of the Sale Process; and
 - iii. report on the Company's actual cash flows for the period April 27, 2020 to June 7, 2020;
 - b. provide the Court with the Proposal Trustee's recommendation for an order, *inter alia*,
 - i. approving the Stalking Horse APA and the transaction (the "**Transaction**") contemplated therein pursuant to which the Stalking Horse Bidder agreed to purchase substantially all of the Company's right, title and interest in and to the Purchased Assets (as such term is defined in the Stalking Horse APA);

- ii. vesting title in and to the Purchased Assets (as such term is defined in the Stalking Horse APA) in the Stalking Horse Bidder or as it may direct, free and clear of any encumbrances, save and except as otherwise contemplated by the Stalking Horse APA;
- iii. approving the fees and disbursements of the Proposal Trustee and WFK as described herein; and
- iv. approving the activities of the Proposal Trustee as set out in this Report.

IV. BACKGROUND INFORMATION

- 9. KMW is an Ontario corporation that carries on business out of its leased premises in London, Ontario. KMW designs, develops and supplies components of biomass combustion system boilers and heaters.
- 10. As detailed in the First Report, the Company attributes its financial difficulties primarily to a contract the Company entered into with Georges River Energy, LLC (“**GRE**”) dated December 6, 2016 (the “**GRE Contract**”) for the design and supply of a complete biomass energy system to generate 8.5MW of electric power, including turbine, generation and cooling tower (the “**GRE Project**”). At GRE’s request and in order to reduce the cost of the GRE Project, the Company sourced the turbines from a new supplier to the Company. The turbine, delivered in May 2018, did not function properly. Thereafter, the Company spent an additional US\$1.558MM trying to repair the turbine. To date, the turbine has not functioned to GRE’s satisfaction. In spite of diligent efforts, the parties have been unable to come to terms on an agreeable settlement, which has resulted in the Company’s liquidity constraints.
- 11. Additional information in respect of the Company, including its assets and liabilities, is set out in the First Report and the Rosen Affidavits. The Proposal Trustee has not repeated such details in this Report.

V. CREDITORS

Secured Creditors

12. As noted in the First Report:

- a. 462673 Ontario Inc. operating as Nor-Arc Steel Fabricators (“**Nor-Arc**”) was, until April 17, 2020, KMW’s only secured creditor registered under the Ontario *Personal Property Security Act* (“**PPSA**”) ¹.
- b. As of the Filing Date, KMW’s indebtedness to Nor-Arc was approximately \$2.778MM, which indebtedness was secured via KMW executing a general security agreement in favour of Nor-Arc dated April 12, 2011 (the “**Secured Indebtedness**”) ². Pursuant to an assignment agreement dated April 20, 2020, the DIP Lender, who is a party related to Nor-Arc, took an assignment of the debt and security owed by KMW to Nor-Arc; and
- c. WFK has provided the Proposal Trustee with an opinion confirming that, subject to certain standard assumptions and qualifications, Nor-Arc has valid and enforceable security over the Property, with such security agreement having now been assigned to the Stalking Horse Bidder.

VI. CASH FLOW PROJECTIONS

13. To date, KMW has provided the Proposal Trustee with its full cooperation and unrestricted access to its premises, and books and records.

14. In accordance with the provisions of the BIA, the Company filed with the Official Receiver a projected cash flow statement dated April 20, 2020, which was reviewed and signed by

¹ Based on a search conducted under the PPSA registry with a file currency as of April 10, 2020. On April 17, 2020, Liberty Mutual registered a security interest under the PPSA.

² This amount does not include the contingent liability under the Performance Bond, plus any interest, costs and fees as may be applicable as an indemnitor of KMW under the Performance Bond

the Proposal Trustee and the Company (the “**Cash Flow Projections**”). The Cash Flow Projections cover the period starting on April 6, 2020 and ending on July 5, 2020.

15. The Proposal Trustee has implemented procedures for monitoring the Company’s receipts and disbursements and has kept in close contact with Management to ensure that operations are continuing in the normal course of business and in accordance with the Cash Flow Projections.

16. A summary of the Company’s actual receipts and disbursements as compared to the those presented in the Cash Flow Projections for the period April 27, 2020 to June 7, 2020 (the “**Monitored Period**”) are as follows (subject to rounding errors):

KMW Energy Inc.			
Actual Receipts and Disbursements			
For 6 week period ending June 7, 2020			
(Unaudited, in \$ CAD)			
	<i>Cumulative Six-Week Period Ended June 7, 2020</i>		
	<u>Actual</u>	<u>Budget</u>	<u>Variance</u>
Receipts	77,005	195,577	(118,572)
Disbursements			
Payment to suppliers	(54,451)	(87,303)	32,852
Payments for operating expenses	(64,757)	(52,292)	(12,465)
Payroll (inc. contractors)	(151,707)	(140,716)	(10,991)
Tax	(23,435)	(17,627)	(5,809)
Total Disbursements	(294,350)	(297,937)	3,587
Operating Net Cash Flow	(217,346)	(102,361)	(114,985)
Administrative Fees	(70,417)	(145,000)	74,583
Net Cash Flow	(287,763)	(247,361)	(40,402)
Beginning Cash	43,503	(33,598)	77,101
Net Cash Flow	(287,763)	(247,361)	(40,402)
Interim Financing/(repayment)	335,340	-	335,340
Ending Cash	91,080	(280,959)	372,039

17. Overall, KMW realized an unfavorable net cash flow variance of approximately \$40.4M during the Monitored Period. The key components of the variance are as follows:

- a. Receipts: Unfavorable variance of approximately \$118.57M is attributable to: (i) a customer (the “**Non-Paying Customer**”) suspending payment of approximately \$89M due to KMW under its contract given its concerns over KMW (or its successor’s) ability to fulfill the terms of the contract in view of the NOI filing and the Sale Process, following KMW’s delay in fulfilling the customer’s requirements; and (ii) delays in a \$15M payment due from a customer. In addition, KMW also anticipated receiving an HST refund of approximately \$20M in the third week of April 2020. KMW understands that Canada Revenue Agency (“**CRA**”) is holding payment of the refund as a result of KMW’s failure to file its corporate tax return. KMW’s accountant is refusing to release the corporate tax return on the grounds that its account is unpaid. The foregoing unfavorable variances are partially offset by an inflow of \$50M from Nor-Arc as an advance payment for a new contract.
- b. Payment to suppliers: The favorable variance of \$32.85M is primarily attributable to KMW’s decision to not acquire certain parts in connection with its contract with the Non-Paying Customer. This favourable variance was partially offset by an advance payment of approximately \$3M to 5M for certain spare parts orders which were not projected in the Cash Flow Projections.
- c. Payment for operating expenses: The unfavorable variance of approximately \$12.46M is largely a reversal of the previously reported favourable timing difference relating to payment of certain employment expenses, partially offset by non-payment of May and June, 2020 rent of \$15.6M and lower than anticipated operating expenses. The landlord of KMW’s leased premises is evaluating whether it can obtain benefits of Canada Emergency Commercial Rent Assistance while KMW is undergoing NOI proceedings.
- d. Payroll (incl. contractors): Approximately \$5M of the \$10.9M unfavourable variance is a result of higher than anticipated payroll costs; the balance of the

variance is timing in nature and is attributable to mistakes made in the computation of certain salaries paid in May, 2020, which errors are being corrected in a subsequent payroll run.

- e. Administrative fees: The favorable variance is a timing difference and is expected to reverse.
18. Based on the foregoing and having regard to the funds currently held on deposit by KMW and available pursuant to the DIP Loan, it appears as if KMW has sufficient funds available to satisfy the operational expenses incurred since the Filing Date. The payment of certain priority payables, including payment of amounts subject to the Administrative Charge and D&O Charge are addressed below.

VII. ACTIVITIES OF THE PROPOSAL TRUSTEE

19. Since the Filing Date, the Proposal Trustee has undertaken the following activities, *inter alia*:
- a. updated the Website as necessary;
 - b. prepared drafts of written communications to assist the Company in their correspondence with suppliers, customers and employees;
 - c. responded to enquiries directed towards the Proposal Trustee at KMWEnergy@mp.ca;
 - d. discussed with KMW regarding disclaiming certain agreements, and approving one agreement disclaimer pursuant to subsection 65.11 of the BIA;
 - e. monitored KMW's actual cash flows in comparison with the Cash Flow Projections;
 - f. discussed with the Company and the Company's counsel regarding the ongoing efforts to restructure KMW's operations and the Sale Process;

- g. drafted this Report and reviewing all Court materials filed in connection with the Company's motion; and
- h. as described in greater detail below, conducted the Sale Process.

VIII. SALE PROCESS

20. The Proposal Trustee conducted the Sale Process, as approved by the Court and described in the First Report. The following steps were taken by the Proposal Trustee, with the assistance of the Company, to conduct the Sale Process:

- a. prepared a form of non-disclosure agreement (“**NDA**”);
- b. developed a teaser letter (the “**Teaser**”), a copy of which is attached as **Exhibit “B”**;
- c. prepared a Sale Process and Notice to Readers, a copy of which was included in the secure online data room (the “**Data Room**”) created by the Proposal Trustee;
- d. supplemented the list of potential purchasers provided to it by the Company, to include companies known by the Proposal Trustee and its affiliated MNP Corporation Finance practice to (i) potentially acquire or invest in assets in industries who are utilizing biomass as a source of energy or who are in the business of designing and engineering services; and (ii) selected venture capital and other investment firms;
- e. sending the teaser via email, on May 8, 2020, to approximately sixty (60) strategic and thirty-four (34) financial prospective parties;
- f. advertising the opportunity in the National Edition of the *National Post* on May 8, 2020. A copy of the advertisement is attached as **Exhibit “C”**;
- g. advertising the Sale Process in the *Insolvency Insider* e-mail publication on May 25, 2020; and

- h. establishing the Data Room.
21. The Proposal Trustee, in connection with the efforts put forth to solicit interest in the Sale Process, was contacted by seven (7) parties with respect to the acquisition opportunity. These 7 parties executed an NDA and were provided with access to the Data-Room. However, for the reasons described below, none of these parties spent a significant amount of time reviewing the documents uploaded in the Data Room and queries raised were limited to losses reported in the historical financial statements. Certain parties withdrew from the bidding process prior to the Bid Deadline (as defined below).
 22. Offers were due at 5 PM (Toronto Time) on May 29, 2020 (the “**Bid Deadline**”).
 23. Despite diligent efforts by the Proposal Trustee and the Company to find a buyer of its assets and operations on a going-concern basis, no offers were received by the Bid Deadline.
 24. Commentary from parties who conducted due diligence on their decision to not pursue the opportunity or submit a bid in the Sale Process included that, in their opinion, the Company was not of a sufficient size to make it a worthy acquisition target to satisfy their objectives.

IX. SALE APPROVAL

25. Pursuant to the Sale Process, if no Qualified Bid is received by the Bid Deadline, the Stalking Horse APA received from the Stalking Horse Bidder (herein after referred to as the “**Purchaser**”) becomes the Winning Bid (as defined in the Sale Process) and the Company shall seek, as expeditiously as possible, approval of the Court to complete the Transaction. A copy of the Stalking Horse APA is attached hereto as **Exhibit “D”**.
26. The Stalking Horse APA provides for the sale of the Purchased Assets for a sum equal to the aggregate of the following amounts, without duplication (the “**Purchase Price**”):
 - a. the amount of \$500M;
 - b. any and all amounts secured by the DIP Charge;

- c. any and all amounts secured by the Administration Charge at Closing;
 - d. any and all amounts secured by the D&O Charge; and
 - e. any and all other amounts and claims which rank in priority to the Secured Indebtedness (as defined above), if any, including, without limitation, on account of unremitted source deductions. (collectively, the "**Priority Payables**").
27. The Purchaser is to satisfy the Purchase Price as follows:
- a. by the application of the \$100M deposit (the "**Deposit**"), to be credited against the Purchase Price;
 - b. by the cancellation of any and all amounts secured by the DIP Charge;
 - c. by the payment to the Proposal Trustee, in trust, of any and all amounts secured by the Administration Charge on closing;
 - d. by the payment to the Proposal Trustee, in trust, of any and all Priority Payables on closing;
 - e. by (i) the payment of any and all amounts secured by the D&O Charge, or (ii) the assumption of amounts secured by the D&O Charge, to be credited against the Purchase Price; and
 - f. by the cancellation of \$500M of the Secured Indebtedness.
28. The Proposal Trustee is advised by the Company that the Purchaser is not related to the Company.
29. The Stalking Horse APA is conditional on approval by this Court and the issuance of a vesting order in favour of the Purchaser.
30. The Stalking Horse APA provides that the Purchaser may, in its sole discretion, offer new employment, conditional upon closing and effective as of the day of closing, to such employees as determined by the Purchaser in its sole discretion, on terms and conditions

substantially similar to their respective terms and conditions of employment with KMW as of the closing date.

31. The Purchaser advises that that it intends to offer employment to all of the Company's current employees on substantially the same terms. Eric Rosen, as KMW's Chief Executive Officer will be retained as an independent contractor.

X. RECOMMENDATION ON THE TRANSACTION

32. The Proposal Trustee has considered the factors set out in Section 65.13 of the BIA and respectfully recommends that the Court make the order sought by the Company for the following reasons:

- a. The Company with the assistance of the Proposal Trustee has made reasonable and good faith efforts to sell the Company on a going-concern basis;
- b. a broad marketing of the Company was conducted by the Company with the assistance of the Proposal Trustee, in accordance with the May 1st Court Order. The Proposal Trustee does not believe that further time spent in marketing the Company's business and assets will result in a superior transaction, to the Stalking Horse APA;
- c. in the Proposal Trustee's view, the duration of the Sale Process was sufficient to allow interested parties an opportunity to perform their due diligence and submit offers. Accordingly, it is the view of the Proposal Trustee that Sale Process was reasonable in the circumstances and the offers or lack thereof takes into account the market value of the Company's business and the Property;
- d. the consideration offered by the Stalking Horse APA greatly exceeds the fair market value of the Company's assets, which is largely comprised of its accounts receivable with a net book value of approximately \$60M, HST refunds of approximately \$80M and limited capital assets. Accordingly, it is the position of the Proposal Trustee that the consideration under the Stalking Horse APA is reasonable and fair;

- e. as no offers were received in the Sale Process other than the Stalking Horse APA, the consideration received under the Stalking Horse APA is more beneficial than a sale or disposition of the Property in a bankruptcy;
 - f. given the nature and extent of KMW's business and assets, a purchaser is unlikely to pay greater than the Secured Indebtedness. Accordingly, there is insufficient value in the Company's assets to allow for any distribution to unsecured creditors;
 - g. the Purchaser has offered employment to all of KMW's employees and the Transaction allows for KMW's customers and suppliers to potentially benefit from the Transaction;
 - h. the Company's business requires the stability of a completed Transaction and a timely exit from the NOI Proceedings in order to continue to operate as a going-concern, particularly relating to its ability to satisfy certain milestones under existing contracts by procuring necessary goods and services from its supply chain; and
 - i. the Transaction is out of the ordinary course of business and complies with the criteria set out in Section 65.13 of the BIA, including the ability of the Company to pay the employee-related amounts (see further details in paragraph 33 below).
33. In compliance with Subsection 65.13(8) of the BIA, any amounts owing to employees of the Company with respect to wages and/or vacation pay, to a limit of \$2,000 per employee, will be paid prior to the closing of the Transaction from the cash flows of the Company or from the additional funds payable by the Purchaser on closing of the Transaction.

XI. VESTING ORDER

34. The Stalking Horse APA is conditional on the issuance of an order approving the Transaction and a vesting order vesting title in and to the Purchased Assets of the Company in and to the Stalking Horse Bidder upon the closing of the Transaction.

35. As at the date of filing of the NOI and based on the Proposal Trustee's review of the Company's books and records, the Company is current in its obligations to CRA on account of outstanding payroll source deductions through June 15, 2020. CRA has not conducted an audit of KMW's books and records. The Company uses a third-party payroll supplier and remits its employee source deductions with each payroll run.

XII. APPROVAL OF THE FEES AND DISBURSEMENTS OF THE PROPOSAL TRUSTEE AND ITS COUNSEL

36. MNP has issued two (2) invoices in its capacity as Proposal Trustee for the period from March 18, 2020 to May 29, 2020. Attached hereto as **Exhibit "E"** is the Affidavit of Sheldon Title sworn June 18, 2020 (the "**Title Affidavit**"), attesting to the fees and disbursements of the Proposal Trustee, in the aggregate amount of \$70,097.22 (being fees of \$62,032.94, and HST of \$8,064.28). To date, the Proposal Trustee has been paid \$44,270.28.

37. WFK has issued three (3) invoices for the period from April 10, 2020 to June 17, 2020. Attached hereto as **Exhibit "F"** is the Affidavit of Christel Paul of WFK, sworn June 18, 2020 (the "**Counsel Affidavit**"), attesting to the fees and disbursements in the aggregate amount of \$7,474.69 (being fees of \$6,449.00, disbursements of \$165.77 and HST of \$859.92). To date, WFK has been paid \$3,821.40.

38. It is the Proposal Trustee's view that its fees and disbursements described in the Title Affidavit, as well as those of WFK described in the Counsel Affidavit, are fair and reasonable in the circumstances. The Proposal Trustee therefore requests that this Court approve its fees and disbursements and the disbursement and fees of its legal counsel.

XIII. CONCLUSION AND RECOMMENDATION

39. Based on the foregoing, the Proposal Trustee respectfully recommends that the Court make an order granting the relief detailed in paragraph 8.

All of which is respectfully submitted on this 18th day of June 2020.

MNP LTD.,
in its capacity as Proposal Trustee under
the Notice of Intention to Make a Proposal of
KMW Inc.

Per:

A handwritten signature in blue ink, appearing to be 'Sheldon Title', written over a faint horizontal line.

Sheldon Title,
Licensed Insolvency Trustee

Estate No.: 35-2638322
Court No.: 35-2638322

**IN THE MATTER OF THE NOTICE OF INTENTION TIO MAKE A PROPOSAL
OF KMW INC., OF THE CITY OF LONDON, IN THE PROVINCE OF ONTARIO**

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**SECOND REPORT TO THE COURT SUBMITTED BY MNP
LTD., IN ITS CAPACITY AS PRPOSAL TRUSTEE UNDER
THE
NOTICE OF INTENTION TO MAKE A PROPOSAL OF
KMW ENERGY INC.**

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