RICHTER

CANADA **PROVINCE OF QUÉBEC** **DISTRICT OF QUÉBEC** **DIVISION NO.: 01-MONTREAL** **COURT NO.: 500-11-044334-130** **ESTATE NO.: 41-1726928**	**SUPERIOR COURT** **(Commercial Division)** ***Bankruptcy and Insolvency Act*** **IN THE MATTER OF THE BANKRUPTCY OF:** **EFFIGI INC.** a corporation duly incorporated having its head office at 1155 Autoroute Chomedy, Laval, QC H3A 0G6 **Bankrupt**

TRUSTEE'S REPORT TO THE FIRST MEETING OF CREDITORS

On March 1, 2013, an Initial Order under the *Companies' Creditors Arrangement Act* ("CCAA") was issued by the Honourable Justice Mark Schrager of the Quebec Superior Court (Commercial Division), in respect of Effigi Inc. ("Effigi" or the "Company") and Richter Advisory Group Inc. ("Richter") was appointed as Monitor.

Following the CCAA filing, the Company's attempts to obtain Debtor In Possession financing was unsuccessful and it determined that it that it would not be able to formulate a viable Plan of Arrangement to its creditors and consequently, on March 20, 2013, the Company made a voluntary Assignment in Bankruptcy under s. 49 of the *Bankruptcy and Insolvency Act ("BIA")*. On the same day, Richter was appointed as Trustee to the Bankrupt Estate of the Company (the "Trustee").

On March 21, 2013, pursuant to an order of the Quebec Superior Court (Commercial Division), at the request of Wells Fargo Capital Finance Corporation Canada ("Wells Fargo"), Richter in addition to acting as Trustee, was named as Receiver to the property of the Company pursuant to Section 243 of the BIA.

The purpose of this report is to inform all interested parties about our preliminary administration and findings.

The information contained in this Report has been prepared based on the books and records of the Company and from discussions with the Company's management. The books and records have not been audited or verified by the Trustee. Consequently, the Trustee expresses no opinion

whatsoever with respect to the validity, the exactness or the reliability of the information contained herein.

I. OVERVIEW AND BACKGROUND

The Company was founded in 1991 and specialized in the design, development and distribution of clothing and fashion accessories as well as a full range of products for home decoration. Effigi operated both a wholesale and retail division from its head office and distribution centre, both of which are located in Laval, Quebec. The wholesale division dealt with independent retailers throughout Canada (with Quebec being its largest market) as well as international customers. The retail division consisted of nine (9) retail stores located in Ontario, Alberta and Nova Scotia. An additional retail store in New Brunswick was constructed but never opened.

As a result of financial losses in 2006, Effigi restructured and in 2007, Effigi became a wholly-owned subsidiary of 4379225 Canada Inc. (hereinafter "Canada Inc."). The shares of Canada Inc. are owned by Hilco Equity Partners LP (hereinafter "Hilco"), Investment Partnership (2007) LP (Genuity) (hereinafter "Genuity") and Corpora Inc. (hereinafter "Corpora"). Hilco holds 13.37% of the ordinary shares of Canada Inc., Genuity holds 40.12% of the ordinary shares of Canada Inc. and Corpora holds 46.51% of the ordinary shares of Canada Inc.

Over the past three fiscal years, sales have been in the range of $98 million to $101 million, well below its peak sales level of $130 million. Further, Effigi has incurred operating losses approximating $24 million over its most recent two fiscal years (F2011 and F2012) and reported a further $3.2 million loss for the quarter ended January 31, 2013.

As a result of its appointment as Receiver, the Trustee, while acting as Trustee, has acted for or assisted and shall act for and assist Wells Fargo (a secured creditor of the Company) to realize or otherwise deal with security that Wells Fargo holds. In such regard, the Trustee confirms that:

(i) prior to its appointment as Receiver, the Trustee obtained written opinions from independent legal counsel that Wells Fargo's security is valid and enforceable against the Bankrupt Estate, copies of which opinions will be provided by the Trustee, upon request, to the Superintendent of Bankruptcy and to any creditor; and

(ii) Wells Fargo, the secured creditor, has agreed to remunerate the Trustee and the Receiver for all fees, disbursements and expenses incurred by them as Trustee and Receiver in respect of the Company and has provided the Trustee and Receiver with an indemnity.

The following table summarizes the Company's results for the past three (3) fiscal years:

Effigi Inc. Summary Operating Results For the year ended October 31 ($000's)	2012 (Unaudited)	2011 (Audited)	2010 (Audited)
Sales	$ 97,540	$ 101,389	$ 100,334
Cost of goods sold	78,495	77,938	72,505
Gross Margin	19,045	23,451	27,829
	20%	*23%*	*28%*
Product and design	5,962	8,046	7,805
Selling	10,338	8,879	7,767
Adminstrative	8,723	9,584	8,368
Total Operating Expenses	25,023	26,509	23,940
	(5,978)	(3,058)	3,889
Other Expenses	9,132	5,685	1,900
(Loss) earnings before income taxes	(15,110)	(8,743)	1,989
Income taxes	-	-	-
Net (loss) earnings	**$ (15,110)**	**$ (8,743)**	**$ 1,989**

II. CAUSES OF INSOLVENCY

The Trustee understands that the Company's financial difficulties were attributable to the following:

- Erosion of in sales attributable to weather and general economic conditions, resulting in significant excess inventory which had to be liquidated at lower than normal margins;
- Losses resulting from the high start-up costs of the retail division;
- The loss of several major customers in F2012 and F2013 (Les Magasins C.P.C., Boutique Le Pentagone Inc. and The Bargain! Shop) who restructured and/or are in the midst of restructuring their operations, causing Effigi to write off significant accounts receivable as well as generating losses of future revenue; and
- The inability to reduce fixed costs, in particular high fixed head office costs to compensate for the reduction in sales and margin.

III. EVENTS LEADING UP TO THE BANKRUPTCY

On March 1, 2013, Wells Fargo, the Company's primary secured lender having a first ranking security on the majority of the Company's assets issued its Notice of Intention to Enforce its security under s. 244 of the BIA ("s. 244 Notice") and demanded the repayment of its loans. The Company consented to the immediate enforcement of the security. On the same day, the Company and Wells Fargo entered into a Forbearance Agreement which stipulated amongst other things that Wells Fargo would delay its enforcement procedures on the basis that no later than March 15, 2013, the Company would submit to Wells Fargo a firm commitment from another lender to provide financing to the Company to enable it to repay Wells Fargo in full by March 29, 2013.

As noted above, also on March 1, 2013 an Initial Order was issued granting the Company protection under the CCAA. The Company continued its negotiations with a third party lender who had provided it with a signed term sheet to provide new financing. Unfortunately, the Company's financing requirements could not be met by the potential new financing source and the Company was therefore unable to meet its obligations under the forbearance with Wells Fargo and was thus left with no alternative but to file an Assignment in Bankruptcy on March 20, 2013.

The operations of the Company were continued by Richter in its capacity as Receiver while the process to sell the assets was completed, as more fully described below.

IV. SALE OF ASSETS

As part of its efforts to restructure under the CCAA, the Company, with the cooperation of Richter, then acting as Monitor, set up a virtual data room on March 4, 2013 containing information pertaining to Effigi's operations and assets. Fifty-one (51) potential interested parties were identified and invited to sign non-disclosure agreements to access the information in the data room. Of these, forty-three (43) signed the non-disclosure agreements and performed various due diligence, which included visits to the stores, head office and the distribution centre.

On March 20, 2013, Richter, then acting as Trustee, delivered a request for proposals ("RFP") to the interested parties specifying 2pm on March 24, 2013 as the bid deadline ("Bid Deadline"). In accordance with the Receivership Order, after March 21, 2013, the solicitation process was handled by Richter in its capacity as Receiver. Twelve (12) separate entities submitted offers by the Bid Deadline. After analysis of the offers, the Receiver determined that the highest and best offer, which encompassed substantially all of the Debtor's assets (inventory, fixed assets and receivables) was submitted by a joint venture consisting of GBRP, Inc. and Merchant Trading Services, ULC (collectively the "Agent"). Merchant Trading Services, ULC is owned by or related to Hilco Merchant Resources. As noted above, one of the shareholders of Canada Inc. is Hilco, which is also owned by or related to Hilco Merchant Resources.

By order of the Honourable Justice Mark Schrager of the Quebec Superior Court (Commercial Division) dated April 5, 2013, the Receiver was authorized to enter into an Agency and Sale Agreement ("Agreement") with the Agent. Pursuant to the terms of the Agreement, the Agent commenced the liquidation of the inventory and fixed assets on April 5, 2013.

Richter, in consultation with Wells Fargo, did not accept any of the offers received by the Bid Deadline for the sale of the intellectual property, including, the Company's order book and rights to the goods in transit (the "Intellectual Property"), judging them to be insufficient. Consequently, a second Request for Proposals ("Second RFP") was issued on March 26, 2013 requesting bids by March 28, 2013 (the "Second Bid Deadline"). Thirteen (13) parties received this Second RFP and six (6) of these parties submitted offers by the Second Bid Deadline. Based on an analysis of the offers received, the Receiver has agreed to accept one of the bids and an asset purchase agreement is being prepared. Once completed, the asset purchase agreement will be submitted to Court for approval.

V. STATEMENT OF AFFAIRS FILED WITH OFFICIAL RECEIVER

The following table summarizes the Company's Statement of Affairs [estimated unaudited balance sheet] as at March 20, 2013, as filed with the Official Receiver.

Effigi Inc. Summary Statement of Affairs Filed on March 20, 2013 ($000's)	
Assets	
Inventory	$ 9,000
Accounts Receivable	7,000
Machinery and Equipment	500
Intellectual Property	3,000
Other Receivable	500
Total Assets	**20,000**
Liabilities	
Secured Liabilities	
Employee - Vacation Pay	264
Wells Fargo	18,500
Investissement Quebec	1,236
	20,000
Unsecured Liabilities	42,886
Preferred Creditors	705
Total Liabilities	**63,591**
Deficiency	**$ (43,591)**

A) Liabilities

It is important to note that the actual amount of the liabilities as at March 20, 2013, the date of bankruptcy, will only be determined once Proofs of Claim are submitted by the creditors and compiled by the Trustee.

i) Secured Claims ($20,000,000)

As per the Statement of Affairs, the following are the Company's secured creditors:

- Employees - $264,000 (security interest over the Company's inventories and accounts receivable by virtue of s. 81.3 of the BIA). Amount based on the maximum secured portion per employee ($2,000) to be adjusted based on the actual amounts owed;
- Wells Fargo - ~$18,500,000 (security on all property, including inventories, accounts receivable, fixed assets and Intellectual Property). For the purposes of the Statement of Affairs, the Debtor has estimated the claim of Wells Fargo to be fully secured;
- Investissement Quebec - ~$7,686,000 (second ranking security on all property, including inventories, accounts receivable, fixed asset and Intellectual Property along with a first ranking charge on certain design tax credits). For the purposes of the Statement of Affairs, the Debtor estimated the secured portion of this claim at approximately $1.2 million;
- Roynat Capital Inc. - ~$2,650,000 (third ranking security on all property, including inventories, accounts receivable, fixed asset and Intellectual Property including a first ranking charge on fixed assets in certain store locations). For the purposes of the Statement of Affairs, the Debtor treated this claim as unsecured; and
- 4379225 Canada Inc. - ~$24,800,000 (fourth ranking security on all property, including inventories, accounts receivable, fixed asset and Intellectual Property). For the purposes of the Statement of Affairs, the Debtor treated this claim as unsecured.

The above amounts reflect the estimated claims from the Company's secured creditors. Based upon the offers received for the assets, the corresponding realization value in fact will likely be less than the amount owed to Wells Fargo, thereby increasing the total of the Unsecured Creditors.

While the Trustee has obtained written opinions from independent legal counsel as to the validity and enforceability of Wells Fargo's security, the security of Investissement Quebec, Roynat Capital Inc. and 4379225 Canada Inc. has yet to be received or reviewed by the Trustee or its legal counsel. Accordingly, all of the above information in respect of security other than Wells Fargo's security is subject to the Trustee's determination as to the validity and enforceability thereof.

ii) Unsecured Creditors ($42,886,000)

The amount is based on the Company's books and records and consequently claims received from unsecured creditors may differ from the amounts reflected in the Statement of Affairs. In addition, as mentioned above, the value of unsecured creditors includes a preliminary estimate of the shortfall (unsecured portion) to be suffered by the Company's secured creditors upon realization of the assets comprising their security.

iii) Preferred Creditors ($705,000)

The amount comprises the estimated unpaid rent to landlords for February 2013. The actual amount may vary once proofs of claim are received.

iv) Property of Others

The Trustee has received or has been notified of potential property claims including 30 day goods amounts. The Trustee will report to the Inspectors in respect of any such claims.

B) Assets

i) Inventory - $9,000,000

The Company's inventories are pledged in favour of the various secured lenders and are comprised of finished goods located in the Company's distribution centre as well as its nine (9) retail locations. Inventories do not include goods in transit. The inventory values are based upon the company's perpetual records. A full physical count will be performed as part of the Agreement.

As noted above, commencing April 5, 2013, the inventories are being liquidated pursuant to the transaction entered into with the Agent. The majority of the inventory is expected to be liquidated by the end of June 2013.

ii) Accounts Receivable - $7,000,000

The Company's accounts receivable are pledged in favour of the various secured lenders. Richter has been collecting these receivables since March 20, 2013. Pursuant to the transaction entered into with the Agent, effective April 3, 2013, the Agent has purchased some, but not all of the receivables. Certain receivables will continue to be collected directly by the Receiver. The amount of $7,000,000 on the Statement of Affairs did not include any potential recovery from a receivable in the approximate amount of $4 million which is owed by The Bargain Shop, which itself is in the midst of a restructuring.

The final realization from those receivables is unknown at this point in time.

iii) Fixed Assets - $500,000

The Company's furniture, fixtures, and equipment in the head office, distribution centre and the stores are pledged in favour of the various secured lenders. The fixed assets owned by the Company have been sold to the Agent. As at the date of the commencement of the CCAA proceedings, the Company was in the process of constructing a tenth store, located in Moncton, New Brunswick. The construction was halted with the commencement of the CCAA proceedings and the store was never completed. Inventory located therein was relocated to other store locations. A creditor has filed a 30 day goods claim in respect of fixtures delivered to this location and another creditor has filed a lien in respect of unpaid construction work on this location. The Trustee has not taken possession of this location. The landlord recently notified the Trustee that it has changed the locks and is in control of this location. The Trustee, after consultation with Wells Fargo and the inspectors to be appointed will likely abandon its interest in this location. The actual amount realized may differ from the amount presented on the Statement of Affairs.

iv) Intellectual Property - $3,000,000

As noted above, the Receiver has accepted an offer to sell the Company's Intellectual Property. The proceeds of realization will be remitted to Wells Fargo who holds the first ranking security on this asset.

v) Other Receivable - $500,000

The Company's other receivable relates to the estimated recoverable design tax credits for 2011 and 2012. The Receiver, with the assistance of a former Effigi employee will work to complete the necessary forms to claim the various tax credits. Investissement Quebec has a first ranking charge on these tax credits. The actual amount realized may differ from the amount presented on the Statement of Affairs.

VI. SUMMARY OF THE PRELIMINARY ADMINISTRATION OF THE ESTATE

A) Security and Protective Measures

Since March 20, 2013, the Trustee, with the assistance of its agent, SIS Services Inc., has undertaken various security and protective measures:

- Changing locks and notifying the alarm company;
- Opening trust bank account;
- Safeguarding the available books and records;
- Adding the Trustee's name to the insurance policies covering the assets of the Company;
- An inventory of the Company's assets has not yet been performed. A complete inventory will be performed in the next few weeks as part of the Agreement with the Joint Venture; and
- The Trustee has also obtained a legal opinion on the security of Wells Fargo confirming its rank and validity.

B) Reviewable Transactions

The Trustee will perform a cursory review of the Company's books and records to identify any preferences or other reviewable transactions on the instructions of the Inspectors of the Bankrupt Estate. Following its review, the Trustee will report its findings to the Inspectors.

VII. PROJECTED DIVIDEND

As the Company's secured lenders will suffer a shortfall on their advances, the Trustee does not foresee any distribution of a dividend to the ordinary unsecured creditors.

DATED at MONTREAL this 8th day of April 2013.

Richter Advisory Group Inc.
Trustee

Andrew Adessky, CPA, CA, CIRP
Administrator of the Estate