

GRAFTON-FRASER INC.

**REPORT OF RICHTER ADVISORY GROUP INC.,
IN ITS CAPACITY AS PROPOSED MONITOR OF
GRAFTON-FRASER INC.**

JANUARY 25, 2017

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**ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)**

**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 OR ARRANGEMENT OF
GRAFTON-FRASER INC.**

**PRE-FILING REPORT OF RICHTER ADVISORY GROUP INC.
In its capacity as Proposed Monitor of the Applicant**

January 25, 2017

Introduction

1. Richter Advisory Group Inc. ("**Richter**") understands that Grafton-Fraser Inc. ("**Grafton**", the "**Company**" or the "**Applicant**") intends to make an application to the Court for an order (the "**Initial Order**"), among other things, granting a stay of proceedings in favour of the Company until February 23, 2017 pursuant to the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended (the "**CCAA**").
2. On the application for the Initial Order, the Applicant will also be seeking an order that Richter be appointed as the CCAA monitor (the "**Proposed Monitor**" and if appointed, "**Monitor**") of the Applicant in the CCAA proceedings.
3. Richter, in its capacity as Proposed Monitor, has reviewed the Court materials to be filed by the Applicant in support of its application. The purpose of this limited scope report of the Proposed Monitor is to provide information to this Honourable Court regarding the following:
 - (i) Richter's qualifications to act as Monitor (if appointed);
 - (ii) A limited summary of certain background information about the Applicant and the CCAA proceedings, the objectives of the CCAA proceedings and the Company's creditors;

- (iii) The Applicant's request to approve the Forbearance Agreements (as hereinafter defined) including the ability to continue to borrow and repay amounts under the ABL Credit Facility (as hereinafter defined);
- (iv) The Applicant's statement of projected cash flow for the period from January 22, 2017 to March 11, 2017;
- (v) The Applicant's request that it be authorized and empowered to obtain and borrow interim financing, including the terms of the debtor-in-possession ("**DIP**") facility;
- (vi) The Applicant's request to pay certain pre-filing amounts owing to essential service providers, and suppliers of goods essential to continuing operations;
- (vii) The proposed Key Employee Retention Plan ("**KERP**");
- (viii) The Applicant's request to approve the Lease Consulting Agreement between Grafton and Oberfeld Snowcap Inc. ("**Oberfeld**" or the "**Lease Consultant**");
- (ix) The charges proposed in the Initial Order;
- (x) Certain other relief that the Proposed Monitor understands the Applicant intends to seek at the first hearing subsequent to the granting of the Initial Order (the "**Comeback Hearing**") scheduled for January 30, 2017, including the approval of the execution of the Stalking Horse APA and the SISP as well as approval of the Liquidation Consulting Agreement and Sale Guidelines (as each are hereinafter defined); and
- (xi) The Proposed Monitor's conclusions and recommendations.

Disclaimer and Terms of Reference

- 4. Unless otherwise stated, all monetary amounts noted herein are expressed in Canadian dollars.
- 5. Capitalized terms not otherwise defined herein are as defined in the Applicant's application materials, including the affidavit of Mark Sun sworn January 25, 2017 (the "**Sun Affidavit**") filed in support of the Applicant's application for relief under the CCAA. This report should be read in conjunction with the Sun Affidavit, as certain information contained in the Sun Affidavit has not been included herein in order to avoid unnecessary duplication.

6. In preparing this report and conducting its analysis, the Proposed Monitor has obtained and relied upon certain unaudited, draft, and/or internal financial information of the Applicant, the Applicant's books and records and discussions with various parties, including Grafton's employees and certain of its directors (collectively, the "**Information**").
7. Except and otherwise described in this report:
 - (i) The Proposed Monitor 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 pursuant to the Chartered Professional Accountant Canada Handbook; and
 - (ii) The Proposed Monitor has not conducted an examination or review of any financial forecast and projections in a manner that would comply with the procedures described in the Chartered Professional Accountant Canada Handbook.
8. Since the Cash Flow Forecast (as hereinafter defined) is based on assumptions regarding future events, actual results will vary from the information presented even if the hypothetical assumptions occur, and variations may be material. Accordingly, the Proposed Monitor expresses no assurance as to whether the Cash Flow Forecast will be achieved. The Proposed Monitor expresses no opinion or other form of assurance with respect to the accuracy of any financial information presented in this report, or relied upon by the Proposed Monitor in preparing this report.

Richter's Qualifications to Act as Monitor

9. Richter Consulting Canada Inc. ("**Richter Consulting**"), an affiliate of the Proposed Monitor, was engaged by counsel to the Company and 2473304 Ontario Inc. ("**247**"), a wholly owned subsidiary of the Company, in March 2016 to provide consulting services and to assist Grafton and 247, in developing and assessing various strategic alternatives.
10. In June 2016, 247 sought and obtained protection under the CCAA to pursue an orderly liquidation of its assets. Richter was appointed as Monitor of 247. 247's CCAA administration is in its final stages. As at the date of this report, 247 no longer has any business operations or non-management employees. As noted in the Sun Affidavit, it is expected that 247 will eventually file an assignment in bankruptcy to effect an orderly wind-down of the company. Further information and materials related to 247's CCAA proceedings may be obtained from Richter's website at www.richter.ca/en/folder/insolvency-cases/0-9/2473304-ontario-inc.

11. Richter is a trustee within the meaning of subsection 2(1) of the *Bankruptcy and Insolvency Act* (Canada). The senior Richter professional personnel with carriage of this matter have acquired knowledge of the Applicant and its business since the engagement of Richter Consulting as consultant. Richter is, therefore, in a position to immediately assist the Applicant in its CCAA proceedings.
12. Richter is not subject to any of the restrictions on who may be appointed as Monitor set out in section 11.7(2) of the CCAA and, in particular, neither Richter nor any of its representatives has been at any time in the two preceding years;
 - (i) A director, an officer or an employee of the Applicant;
 - (ii) Related to the Applicant or to any director or officer of the Applicant; or
 - (iii) The auditor of the Applicant.
13. Richter has consented to act as Monitor, should the Court grant the Applicant's request to commence the CCAA proceedings.

General Background to the Proposed CCAA Proceedings

14. The Applicant is a leading Canadian menswear retailer that operates 158 stores in Canada under various banners, including "Tip Top Tailors" (107 stores), "George Richards Big & Tall", "Mr. Big and Tall", and "Kingsport Big and Tall Clothier" (collectively 51 stores). All of the Company's store locations are leased.
15. Grafton's head office and main distribution centre is located in a 38,000 square foot facility at 44 Apex Road, Toronto, Ontario where it receives, stores and ships inventory to its various store locations. The Company also leases a secondary distribution centre located at 21 Hafis Road, Toronto, Ontario.
16. As of January 21, 2017, the Company had approximately 1,226 employees of which approximately 526 were full time employees and 700 were part time employees. The Company's employees are not represented by a union and are not subject to a collective bargaining agreement.
17. The Company sells certain brands of menswear in Canada pursuant to various licence agreements, including "Jones New York" and "Daniel Hechter".
18. As described in the Sun Affidavit, the adverse effects of 247's CCAA proceedings on the Company combined with, among other things, lower than expected retail sales, increased overhead costs, delays in receiving seasonal inventory and turnover of key personnel have negatively impacted the Company's

financial performance. As a result, the Applicant is experiencing a liquidity crisis and has defaulted on various financial and other covenants with its two primary secured lenders, Canadian Imperial Bank of Commerce (“**CIBC**”) and entities related to GSO Capital Partners LP (“**GSO**”) which, subject to the Court’s approval of the Initial Order (and the Forbearance Agreements), will continue to forbear from enforcing their rights and remedies, subject to certain terms and conditions, to permit Grafton to pursue its restructuring.

19. The Applicant’s business, affairs, financial performance and position, as well as the causes of its insolvency, are detailed extensively in the Sun Affidavit and are, therefore, not repeated herein. The Proposed Monitor has reviewed the Sun Affidavit and discussed the business and affairs of the Applicant and the causes of insolvency with senior management personnel of the Applicant and is of the view that the Sun Affidavit provides a fair summary thereof.

Objectives of CCAA Proceedings

20. The primary objectives of the Applicant’s CCAA proceedings are to: (i) ensure the ongoing operations of the Company; (ii) ensure that the Company has the necessary working capital funds to maximize the ongoing business for the benefit of the Applicant’s stakeholders; (iii) restructure the Applicant’s operations, including the proposed closure of underperforming locations; and (iv) complete a transaction(s) arising from the proposed sale and investment solicitation process (“**SISP**”), which, if no superior offers come forward during the SISP is intended to be the transaction represented by the Stalking Horse APA. The Stalking Horse APA contemplates a ‘credit bid’ by a party related to GSO who has arranged, subject to certain conditions being fulfilled, to obtain financing from CIBC. The approval of the execution of the Stalking Horse APA, the SISP and the Liquidation Consulting Agreement, will be matters for which approval will be sought by the Company at the Comeback Hearing, subject to the granting of the Initial Order.

Creditors

Secured Creditors

21. As detailed in the Sun Affidavit, CIBC and GSO are secured creditors of the Company that, as at January 21, 2017, are owed approximately \$12.8 million and \$39.4 million respectively.

22. Pursuant to an intercreditor agreement between CIBC and GSO dated February 12, 2016 (the “**Intercreditor Agreement**”), CIBC has a first ranking security interest in and to the ABL Priority Collateral to the extent of the ABL Obligations (as defined in the Intercreditor Agreement) being generally the inventory, accounts receivable, bank accounts, cash and securities (to the extent they are not proceeds of the Term Priority Collateral) of the Applicant, and GSO has a first ranking security interest in and to the Term Priority Collateral to the extent of the Term Obligations (as defined in the Intercreditor Agreement) being generally the intellectual property, insurance proceeds (related to the Term Priority Collateral) furniture, fixtures and equipment of the Applicant.
23. Searches conducted on January 11, 2017 of the Personal Property Security Registry in Ontario (and similar searches in the other provinces where the Company has stores) show registrations against the Applicant in favour of CIBC and GSO. The search results for Ontario also show registrations in favour of (i) Canadian Dealer Lease Service Inc. and Bank of Nova Scotia (together, “**CDLS**”) in respect of a leased vehicle, and (ii) Xerox Canada Ltd. (“**Xerox**”) in respect of certain specific equipment.
24. The Proposed Monitor has instructed its independent legal counsel, Cassels Brock & Blackwell LLP (“**Cassels**”) to review the security of CIBC and GSO with respect to the Applicant in the following jurisdictions: Ontario, British Columbia, Alberta, Manitoba, and Nova Scotia. Although a security opinion has not yet been provided, at this time, the Proposed Monitor has been advised that Cassels has not identified any concerns with the security held by CIBC or GSO.

CIBC

25. CIBC and the Applicant (along with 247 as co-borrower) are parties to a credit agreement dated February 12, 2016, as amended (“**ABL Credit Agreement**”) pursuant to which CIBC provides a revolving asset-based loan facility to the Applicant (and previously 247) (the “**ABL Credit Facility**”).
26. As a result of, among other things, 247’s poor performance leading up to the commencement of 247’s CCAA proceedings, the Applicant and 247 breached certain of their financial and other covenants under the ABL Credit Facility.

27. On June 6, 2016, the Applicant, 247 and CIBC agreed on the terms of a forbearance agreement (the “**ABL Forbearance Agreement**”), pursuant to which CIBC agreed to forbear from enforcing its rights and remedies, subject to certain terms and conditions, to permit 247 to complete a Court-supervised liquidation of its assets. The ABL Forbearance Agreement has been amended and restated pursuant to an amended and restated forbearance agreement dated as of January 24, 2017 (the “**Amended and Restated ABL Forbearance Agreement**”).
28. The Amended and Restated ABL Forbearance Agreement modifies and amends the existing ABL Credit Facility to, among other things, (i) terminate any commitment of CIBC to 247 and deem any amounts owing by 247 to CIBC to be amounts owing by Grafton; (ii) provide additional financing to the Applicant during the CCAA Proceedings and require a priority charge (the “**ABL Lender’s DIP Charge**”) to secure such additional borrowings; (iii) provide that Canadian Prime Rate Loans and Base Rate Loans to the Applicant shall be made at the Canadian Prime Rate plus 3% per annum and the Base Rate plus 3% per annum, respectively (the loan interest rates were increased by 2% from the ABL Forbearance Agreement); and (iv) provide that the Applicant shall pay an unused Line Fee in the amount of 0.5% per annum and the Letter of Credit Fee is increased to 1.75% (for documentary letters of credit) and 2.50% (for standby letters of credit), which rates have been in effect since June 6, 2016. A copy of the Amended and Restated ABL Forbearance Agreement is attached to the Sun Affidavit as Exhibit “I”.
29. As a condition of the Amended and Restated ABL Forbearance Agreement, the Applicant must be granted an Initial Order in form and substance satisfactory to CIBC, which order shall include the ABL Lender’s DIP Charge. In addition, the Applicant is required to pay an amendment and forbearance fee in the aggregate amount of \$125,000.
30. It is required under the Amended and Restated ABL Forbearance Agreement that the Company seek and obtain an Order of the Court authorizing and directing it to pay amounts owing to CIBC prior to the date of the Initial Order from amounts received by the Applicant following the date of the Initial Order. Further borrowings will be available under the ABL Credit Facility such that the total commitment shall be the lesser of \$25,000,000 million and the Applicant’s borrowing base following the granting of the Initial Order.
31. The Amended and Restated ABL Forbearance Agreement also requires the payment by the Applicant of the expenses incurred by GSO and CIBC prior to and following the Applicant’s filing under the CCAA.

32. Unless terminated sooner, due to (i) the failure to obtain the Initial Order or the Court's approval of the SISP or Stalking Horse APA (as defined below); (ii) a terminating event; or (iii) another event of default, CIBC agrees to forbear from enforcing its rights and remedies against the Applicant and/or its business and assets until June 15, 2017.
33. Terminating events under the Amended and Restated ABL Forbearance Agreement include (the following is not an exhaustive list):
- (i) Certain negative variances from the Approved Cash Flow (as defined in the Amended and Restated ABL Forbearance Agreement);
 - (ii) The granting of any court-ordered charges ranking in priority to the Liens granted in favour of the ABL Lender other than the Administration Charge (as hereinafter defined);
 - (iii) Termination of the CCAA proceedings, without the prior consent of CIBC;
 - (iv) A report by the Monitor that there has been a material adverse change in respect of the Applicant or the CCAA proceedings;
 - (v) A Terminating Event or Event of Default (both as defined in the Amended and Restated GSO Forbearance Agreement) occurs; and
 - (vi) An advance requested by the Applicant to the DIP Lenders (as hereinafter defined) in accordance with the terms of the DIP Agreement (as hereinafter defined) is not made by the DIP Lenders the business day following the date of the requested advance.
34. Upon the termination of the forbearance period, the form of requested Initial Order provides that CIBC will be entitled to immediately cease making advances to the Applicant, and will be entitled to immediately set off or consolidate amounts owing by CIBC to the Applicant against the obligations of the Applicant to CIBC. Further, upon not less than five (5) Business Days' notice to, among others, the Applicant and the Monitor, CIBC may, subject to the terms of the Intercreditor Agreement, exercise any and all additional rights and remedies against the Applicant provided that provision has been made for the payment of Specified Priority Payables (as defined in the Initial Order) other than sales tax and HST during the five (5) day period and provided availability under the ABL Credit Facility exists.

GSO

35. GSO and the Applicant are parties to an amended and restated credit agreement dated June 16, 2009 (as amended from time to time (collectively, the “**GSO Credit Agreement**”)) pursuant to which GSO provides a term credit facility to the Applicant in the principal amount of \$32 million (the “**GSO Credit Facility**”).
36. As noted in the Sun Affidavit, in the period leading up to the Applicant seeking protection under the CCAA, Grafton projected that it would have a liquidity shortfall of approximately \$3 million due, in part, to rent obligations due January 1, 2017. To address the Applicant’s projected cash needs, Grafton and GSO, among others, entered into an amending agreement dated December 23, 2016, in which GSO agreed to amend the GSO Credit Agreement to increase the size of the GSO Credit Facility and provide an additional advance to the Applicant in the amount of \$2.5 million (CIBC also agreed to certain amendments to the ABL Credit Agreement to make an additional \$0.5 million of liquidity available to the Applicant).
37. As with CIBC, at the time leading up to the commencement of 247’s CCAA proceedings, the Applicant (and 247) had breached certain of their financial and other covenants under the GSO Credit Facility.
38. On June 6, 2016, the Applicant, 247 and GSO agreed on the terms of a forbearance agreement (the “**GSO Forbearance Agreement**”), pursuant to which GSO agreed to forbear from enforcing its rights and remedies, subject to certain terms and conditions, to permit 247 to complete a Court-supervised liquidation of its assets. The GSO Forbearance Agreement has been amended and restated pursuant to an amended and restated forbearance agreement dated as of January 24, 2017 (the “**Amended and Restated GSO Forbearance Agreement**”, and together with the Amended and Restated ABL Forbearance Agreement, the “**Forbearance Agreements**”). A copy of the Amended and Restated GSO Forbearance Agreement is attached to the Sun Affidavit as Exhibit “E”.
39. Under the Amended and Restated GSO Forbearance Agreement, the loan continues to accrue interest at 17% per annum being the existing interest rate of 15% per annum, plus default interest at 2%. This rate has been applied since June 6, 2016.
40. As a condition of the Amended and Restated GSO Forbearance Agreement, the Applicant must be granted an Initial Order in form and substance satisfactory to GSO.

41. The Amended and Restated GSO Forbearance Agreement also requires the payment by the Applicant of the expenses incurred by GSO and CIBC prior to, and following, the Applicant's filing under the CCAA.
42. The forbearance period, conditions precedent and Terminating Events under the Amended and Restated GSO Forbearance Agreement are substantively similar to those in the Amended and Restated ABL Forbearance Agreement and, as such, are not repeated herein.
43. Upon the occurrence and continuation of a Terminating Event, the form of requested Initial Order provides that GSO will be entitled to immediately set off or consolidate amounts owing by GSO to the Applicant against the obligations of the Applicant to GSO. Further, upon not less than five (5) Business Days' notice to, among others, the Applicant and the Monitor, GSO may, subject to the terms of the Intercreditor Agreement, exercise any and all additional rights and remedies against the Applicant provided that provision has been made for the payment of Specified Priority Payables (as defined in the Initial Order) less HST and sales tax during the five (5) day period and provided availability under the DIP Credit Facility exists and to the extent of the available funds only.
44. As noted above, an affiliate of GSO, 1104307 B.C. Ltd. (the "**Stalking Horse Purchaser**"), and the Applicant propose to enter into an Asset Purchase Agreement (the "**Stalking Horse APA**"), pursuant to which the Stalking Horse Purchaser will acquire Grafton's business on the terms set out in the Stalking Horse APA, subject to the SISP (discussed further later in this report).

Unsecured Creditors

45. In addition to the amounts owed by the Applicant to CIBC and GSO, the Applicant estimates that they have accrued and unpaid unsecured obligations totaling approximately \$8 million (excluding intercompany and related party indebtedness).

The Applicant's Cash Flow Statement

46. The Applicant, with the assistance of the Proposed Monitor, has prepared a cash flow forecast of its receipts, disbursements and financing requirements for the period January 22, 2017 to March 11, 2017 (the "**Cash Flow Forecast**"). A copy of the Cash Flow Forecast is attached as **Appendix "A"** to this report and is summarized below:

**Grafton-Fraser Inc.
Cash Flow Forecast
For the Period January 22 - March 11, 2017
(\$000's)**

Receipts	
Retail Receipts	\$ 16,475
GSO DIP Funding	5,500
Total Receipts	\$ 21,975
Disbursements	
Merchandise	(12,741)
Payroll	(3,791)
Rent	(6,622)
Sales Tax	(1,708)
Store Expenses and Other	(1,942)
Supplier & Other Deposits	(250)
Capex	(100)
Interest	(175)
Forbearance Fee	(200)
Professional Fees	(2,366)
JNY Payments	(1,283)
Vacation Escrow	(800)
Total Disbursements	(31,978)
Net Cash Flow	(10,003)
Opening Revolver	\$ 12,826
Draw (Repayment)	10,003
Closing Revolver	\$ 22,829
Opening DIP Term Loan	\$ -
Draws	5,500
Interest (PIK'd)	72
Ending DIP Term Loan	\$ 5,572
Ending Total DIP Financing	\$ 28,401

47. The Cash Flow Forecast (see **Appendix "A"**) estimates that during the period of the projection, the additional financial support required by the Applicant will peak at approximately \$5.5 million during the week ended March 11, 2017.

48. The Proposed Monitor has reviewed the Cash Flow Forecast to the standard required of a Court-appointed monitor by section 23(1)(b) of the CCAA. Section 23(1)(b) requires a monitor to review the debtor's cash flow statement as to its reasonableness and to file a report with the Court on the monitor's findings. The Canadian Association of Insolvency and Restructuring Professionals' standards of professional practice include a standard for monitors fulfilling their statutory responsibilities under the CCAA in respect of a monitor's report on the Cash Flow Forecast.
49. Pursuant to this standard, the Proposed Monitor's review of the Cash Flow Forecast consisted of inquiries, analytical procedures and discussion related to information supplied to it by certain key members of management and employees of the Applicant. Since the probable and hypothetical assumptions need not be supported, the Proposed Monitor's procedures with respect to them were limited to evaluating whether they were consistent with the purpose of the Cash Flow Forecast. The Proposed Monitor also reviewed the support provided by the Applicant for the probable and hypothetical assumptions and the preparation and presentation of the Cash Flow Forecast.
50. Based on the Proposed Monitor's review, nothing has come to its attention that causes it to believe, in all material respects, that:
- (i) The probable and hypothetical assumptions are not consistent with the purpose of the Cash Flow Forecast;
 - (ii) As at the date of this report, the probable and hypothetical assumptions are not suitably supported and consistent with the plans of the Applicant or do not provide a reasonable basis for the Cash Flow Forecast, given the probable and hypothetical assumptions; or
 - (iii) The Cash Flow Forecast does not reflect the probable and hypothetical assumptions.
51. Since the Cash Flow Forecast is based on assumptions regarding future events, actual results will vary from the information presented even if the probable and hypothetical assumptions occur, and the variation could be material. Accordingly, the Proposed Monitor expresses no assurance as to whether the Cash Flow Forecast will be achieved. In addition, the Proposed Monitor expresses no opinion or other form of assurance with respect to the accuracy of the financial information presented in the Cash Flow Forecast, or relied upon by the Proposed Monitor in preparing this report.
52. The Cash Flow Forecast has been prepared solely for the purpose described above, and readers are cautioned that it may not be appropriate for other purposes.

The Applicant's Request for Interim Financing

53. The Applicant's continuing losses have virtually eliminated its liquidity, leaving it without funds to operate or restructure. Without funding from the DIP Facility the Company will not have sufficient funding to make the rent payments due on February 1, 2017.
54. As shown in the Cash Flow Forecast, it is estimated that for the period ending March 11, 2017, the Applicant will require additional financial support in the amount of approximately \$5.5 million. Accordingly, the ability to borrow additional funds, in the form of a Court-approved DIP facility, secured by the Term Lenders' DIP Charge (as hereinafter defined), is vital to providing the stability to, and the necessary cash flow for, Grafton's business so that its value can be preserved while the Applicant pursues its restructuring plan.

DIP Agreement

55. As noted above, based on the Cash Flow Forecast, the Applicant will require interim financing to continue operations and implement its restructuring initiatives.
56. Following extensive negotiations, GSO, as lender and agent for other lenders (the "**DIP Lenders**"), and the Applicant agreed upon the terms of the DIP Agreement in the form of a new non-revolving credit facility with GSO (the "**DIP Credit Facility**") during the CCAA Proceedings, secured by the GSO Security, as amended, to the extent required, and any additional security as it may be requested under the DIP Agreement. A copy of the DIP Agreement is attached as Exhibit "F" to the Sun Affidavit.
57. The principal terms of the DIP Agreement include (the following is not an exhaustive list):
 - (i) The maximum loan amount under the DIP Credit Facility is \$5.5 million;
 - (ii) The interest rate on the DIP Credit Facility is CDOR plus 14%, compounded daily and paid monthly in arrears, or added to the outstanding loan balance in the form of PIK interest, at the Applicant's discretion;
 - (iii) The payment of (i) a facility fee of \$55,000; (ii) a US\$15,000 annual administration fee; and (iii) the DIP Lenders' reasonable out of pocket fees and expenses in connection with the DIP Agreement and enforcement of rights and remedies thereon;
 - (iv) The DIP funds are to be used, by the Applicant, in accordance with the Approved Cash Flow (as defined in the DIP Agreement);

- (v) The DIP funds are to be advanced upon written request to the DIP Lenders and in line with the Approved Cash Flow (as may be updated with the DIP Lenders' approval);
- (vi) The conditions precedent to advancing funds under the DIP Credit Facility include (i) the payment of all fees and expenses payable to the DIP Lenders, (ii) entering into the Liquidation Consulting Agreement, (iii) the granting of the Initial Order as well as the granting of the Order approving the execution of the Stalking Horse APA and SISP that, among other things, are the subject matter of the Comeback Hearing, both in form and substance acceptable to the DIP Lenders, and (iv) an commitment letter from CIBC establishing the terms upon which CIBC will make a new revolving credit facility available to the Stalking Horse Purchaser immediately following the closing of the transaction contemplated by the Stalking Horse APA.
- (vii) The repayment and maturity date is the earliest of the following occurrences (i) 150 days following the first advance of funds; (ii) conversion of the CCAA proceedings to a proceeding under the *Bankruptcy and Insolvency Act* (Canada); (iii) disposal or liquidation of the Applicant's property outside of the ordinary course of business (and exceeding certain thresholds) without the prior consent of the DIP Lenders; or (iv) any Event of Default (as defined in the DIP Agreement) in which the DIP Lenders elect, in their sole discretion, to demand repayment; and
- (viii) The DIP Agreement is conditional upon, *inter alia*, the DIP Lenders being granted a charge against the assets of the Applicant (the "**Term Lenders' DIP Charge**"), as noted above, in an amount equal to the aggregate of any and all advances of funds by the DIP Lenders to the Applicant subsequent to the issuance of the Initial Order, ranking ahead of any and all encumbrances on the assets of the Applicant other than the Administration Charge (as hereinafter defined), and subject to the terms of the Intercreditor Agreement. As previously noted, the terms of the Amended and Restated ABL Forbearance Agreement contemplate that funds will continue to be advanced to the Applicant during the CCAA proceedings, and as such, any funds received by the Applicant post-filing shall be used to first repay the ABL Credit Facility.

58. The Proposed Monitor has inquired into the marketing process for the DIP financing and has been advised by the Applicant that the DIP financing requirement was not marketed externally or to other potential lenders. In its assessment of the potential DIP lenders, the Applicant considered the GSO proposal as advantageous, as GSO was already familiar with the Applicant's business and financial profile as well as its restructuring plan as a result of its pre-existing relationship with the Applicant,

discussions with the Applicant and its advisors throughout the Applicant's strategic review process and the fact that an affiliate of GSO is the Stalking Horse Purchaser.

59. Likewise, the Proposed Monitor understands that a DIP financing alternative to the ABL Credit Facility was not explored, given the constraints of the Intercreditor Agreement and since the Amended and Restated ABL Forbearance terms were considered amenable to the Applicant. In addition, CIBC was already familiar with the Applicant's business, financial profile, and its restructuring plan as a result of its pre-existing relationship with the Applicant, and therefore CIBC was willing to support a going concern sale of the business by providing the Stalking Horse Purchaser with post-closing financing, under certain terms and conditions, in the event of a transaction.
60. The Applicant has advised the Proposed Monitor that to solicit DIP term sheets from other lenders would have required a great deal of time and expense to pursue and there was no commercial advantage to pursuing other financing options. The Applicant has further advised the Proposed Monitor that, given the constraints of the Intercreditor Agreement, in its view, the DIP Credit Facility, together with the funding provided by the ABL Credit Facility, represents the only viable alternative to the Applicant to ensure the continuation of the Applicant's operations at this time.
61. Taking into consideration the above, the Proposed Monitor is supportive of the DIP Agreement for the following reasons:
 - (i) The Applicant is facing an imminent liquidity crisis and Grafton is without the cash needed to continue operations and implement its restructuring plan – short term funding is needed urgently. The Proposed Monitor understands that the Applicant will be unable to pay rents owing to landlords as they become due absent the DIP financing;
 - (ii) If the DIP financing is not available, the Applicant's operations will likely cease and the Applicant will have virtually no prospect of completing its restructuring plan;
 - (iii) Further delays attempting to source alternative interim financing is not justified in the circumstances. The Applicant's poor financial performance and highly levered balance sheet make it unlikely that the Applicant would be able to secure alternative interim financing and, even if it could, the funding would likely be insufficient and/or expensive;
 - (iv) Having the existing secured lenders, being CIBC and GSO provide the ABL Credit Facility and the DIP Credit Facility in a manner consistent with the existing Intercreditor Agreement

between those parties avoids complications associated with potential priming of existing secured lenders; and

- (v) The Proposed Monitor has compared the principal financial terms of the DIP Credit Facility, together with the ABL Credit Facility, to a number of other recent DIP financing packages with respect to pricing, loan availability and certain security considerations. Based on this comparison, the Proposed Monitor is of the view that, in the circumstances, the terms of the DIP Credit Facility and the ABL Credit Facility appear to be commercially reasonable.

- 62. In light of the foregoing, it is the Proposed Monitor's view that further time spent attempting to source alternative DIP financing would (i) not be in the interest of the Applicant and/or its stakeholders; (ii) not result in the finalization of DIP financing on more favourable terms; and (iii) would severely, and potentially fatally, compromise the Applicant's ability to continue operations and complete its restructuring plan.

Payment of Certain Pre-Filing Amounts

- 63. As noted in the Sun Affidavit, the Company does not manufacture any of its products. The Company's entire inventory is purchased from third party suppliers and, as such, the Company is dependent on the continued supply of product from its manufacturers to ensure that it has sufficient inventory to operate effectively and meet the needs of its customers.
- 64. In recognition of the above, the proposed form of Initial Order grants the Applicant the authority to pay certain expenses incurred prior to the commencement of the CCAA Proceedings, subject to the prior approval of the Monitor or the Court.
- 65. The Proposed Monitor has been advised that the majority of these expenses relate to amounts owed to the Applicant's suppliers of essential merchandise, transportation providers, customs brokers and other essential service providers.
- 66. As detailed in the Sun Affidavit, the Applicant is of the view that there is a significant risk that the Applicant's key merchandise vendors, freight forwarders and other essential service providers will not continue to provide services to the Applicant if their respective pre-filing amounts owing are not paid. As such, the proposed form of the Initial Order grants Grafton the authority to pay these vendors up to a maximum of \$1 million, subject to the Approved Cash Flow, with the prior approval of the Monitor or the Court.

67. The Proposed Monitor agrees with the Applicant's view that an interruption of goods and services provided by certain essential suppliers could have a significant and immediate detrimental impact on the business, operations and cash flows of Grafton. However, the Proposed Monitor also recognizes that the Applicant's funding is limited and will work with the Applicant to ensure that payments to service providers in respect of pre-filing liabilities are minimized.
68. The Proposed Monitor supports the Applicant's request to allow it to pay, to a maximum aggregate amount of \$1 million, certain pre-filing amounts to service providers that are critical to the continued operations of Grafton, but only with the prior approval of the Monitor or the Court.

Key Employee Retention Plan

69. To facilitate and encourage the continued participation of senior and operational management and other key personnel during the CCAA proceedings (the "**KERP Participants**"), the Applicant is seeking approval of (i) a KERP for certain employees who are considered by the Applicant to be critical to the successful completion of the CCAA Proceedings, and (ii) the creation of a related charge (the "**KERP Charge**") to secure the payments due under the KERP.
70. Under the provisions of the KERP, each of the KERP Participants will receive a set amount, payable upon the earlier of their termination by the Applicant (provided such termination is not for cause) or the closing of a transaction(s) pursuant to the SISP.
71. A true copy of the form of letter that the Company proposes to issue to the KERP Participants, which has been redacted to protect their personal information is attached as Exhibit "A" to the Sun Affidavit.
72. The KERP was developed by the Applicant, in consultation with the Proposed Monitor. The Proposed Monitor supports the creation of the KERP as (i) it will provide stability to the Applicant and facilitate the successful completion of Grafton's CCAA proceedings by encouraging senior and operational management and other key personnel to remain with Grafton, as required, and (ii) the KERP Participants are considered to be key to the SISP and their participation will assist in maximizing realizations for the benefit of all stakeholders.
73. CIBC and GSO have been provided with the details of the proposed KERP and both CIBC and GSO have advised the Company that they have no objection to the proposed KERP.

The Lease Consulting Agreement

74. As set out in the Sun Affidavit, the Applicant, as part of its internal review process, engaged Oberfeld in late November 2016 to act as its exclusive real estate consultant to, among other things, assess Grafton's retail lease portfolio. The Lease Consultant was selected, as part of a competitive process run by the Applicant, in consultation with the Proposed Monitor, based on the Lease Consultant's familiarity with Applicant's retail lease portfolio, the Lease Consultant's extensive knowledge and experience in retail lease renegotiations, and the Lease Consultant's competitive fee structure. Oberfeld's consulting agreement with the Applicant is due to expire on January 31, 2017.
75. The Applicant is seeking an order expanding the mandate of the Lease Consultant to assist Grafton renegotiate the lease terms for certain of its retail locations in an effort to make those retail leases more attractive to participants in the contemplated SISP and other interested parties. A copy of the agreement between the Applicant and Oberfeld (the "**Lease Consulting Agreement**") is attached as Exhibit "M" to the Sun Affidavit.
76. The key terms of the Lease Consulting Agreement include:
- (i) The Lease Consultant will act as consultant for the purpose of reviewing/assessing Grafton's retail lease portfolio and providing advice thereon, renegotiating Grafton's existing retail leases for some or all of its locations, and assisting with any assignment of leases that may be required in connection with the SISP;
 - (ii) The engagement will commence on or about January 23, 2017 to June 15, 2017 (unless otherwise extended by the parties in writing);
 - (iii) The fee structure is as follows: (i) \$100,000 work fee payable in two (2) instalments (upon the granting of the Initial Order and on February 15, 2017); and (ii) 2% fee on annual rent savings (the "**Savings Fee**") negotiated on the Applicant's retail leases, the amount of which is to be no less than \$75,000 and no more than \$200,000. Amounts due in respect of the Savings Fee will be invoiced for payment upon the completion of the engagement; and
 - (iv) The Lease Consulting Agreement is subject to the approval of the Court.
77. The Proposed Monitor is supportive of the engagement of the Lease Consultant and the Lease Consulting Agreement for the following reasons:

- (i) The Lease Consultant has extensive experience reviewing/assessing retail lease portfolios and renegotiating retail leases;
- (ii) The renegotiation of retail leases will enhance the value of the Applicant's restructured business for all stakeholders, including participants in the contemplated SISP;
- (iii) The Proposed Monitor understands that the Lease Consultant, as part of its current engagement, has been working with the Applicant to develop a strategic plan with respect to the Grafton's retail lease portfolio. As part of this work, the Proposed Monitor understands that the Lease Consultant has engaged in preliminary discussions with landlords in preparation for future negotiations; and
- (iv) The consideration payable to the Lease Consultant is, in the Proposed Monitor's experience, fair and reasonable in the circumstances.

Court Ordered Charges

78. The proposed Initial Order provides for a number of charges (collectively, the "**Charges**"), including the Administration Charge (as defined below), the ABL Lender's DIP Charge, the Term Lenders' DIP Charge, the KERP Charge and a Directors' Charge (as defined below):

Administration Charge

79. The proposed Initial Order provides for a charge in the maximum amount of \$500,000 charging the assets of the Applicant to secure the fees and disbursements incurred in connection with services rendered to the Applicant both before and after the commencement of the CCAA proceedings by the following entities: the Monitor, the Monitor's legal counsel, independent legal counsel to the directors of the Applicant, and legal counsel to the Applicant (the "**Administration Charge**").
80. The quantum of the Administration Charge sought by the Applicant was determined in consultation with the Proposed Monitor, and meets the terms of the DIP Agreement noted above. The creation of the Administration Charge is typical in CCAA proceedings as is the proposed priority of the Administration Charge as set out in the form of Initial Order filed with the Court.

ABL Lender's DIP Charge / Term Lenders' DIP Charge

ABL Lender's DIP Charge

81. As noted above, it is a condition of the Amended and Restated ABL Forbearance Agreement that CIBC maintain its priority in the ABL Priority Collateral and receive the benefit of the ABL Lender's DIP Charge, as security for amounts advanced by CIBC to the Applicant subsequent to the granting of the Initial Order.
82. As the Applicant requires continued access to and funding from the ABL Credit Facility to operate and pursue its restructuring during the CCAA proceedings and finance its operations and working capital needs, the Proposed Monitor recommends that the Court approve the Amended and Restated ABL Forbearance Agreement and, as such, the Proposed Monitor also supports the granting of the ABL Lender's DIP Charge.

Term Lenders' DIP Charge

83. In addition to the necessary funding provided by the ABL Credit Facility, the Applicant requires further funding immediately to continue operations and pursue its restructuring during the CCAA proceedings.
84. As noted above, it is a condition of the DIP Agreement that the DIP Lenders receive the benefit of the Term Lenders' DIP Charge to the maximum amount of the aggregate of any and all advances made by the DIP Lenders to the Applicant under the DIP Agreement.
85. The DIP Agreement provides the Applicant with access to the financing required to finance its operations and working capital needs, undertake its restructuring activities, including the SISP, and complete its CCAA proceedings. The Proposed Monitor recommends that the Court approve the DIP Agreement and, as such, the Proposed Monitor also supports the granting of the Term Lenders' DIP Charge.

KERP Charge

86. The proposed Initial Order provides for a charge in the maximum aggregate amount of \$190,000 charging the assets of the Applicant in favour of the KERP Participants as security for all amounts becoming payable under the KERP.
87. The Proposed Monitor is of the view that the KERP Charge is required and reasonable in the circumstances.

Directors' Charge

88. The proposed Initial Order provides for a charge in the maximum aggregate amount of \$800,000 charging the assets of the Applicant to indemnify their directors and officers for liabilities incurred by the Applicant that result in post-filing claims against the directors and officers in their personal capacities (the "**Directors' Charge**").
89. The amount of the Directors' Charge was estimated by taking into consideration employee payroll and related expenses (including source deductions), other employment related liabilities that attract liability for directors and officers, vacation pay and sales tax.
90. As detailed in the Sun Affidavit, the Proposed Monitor understands that the Applicant maintains directors' and officers' liability insurance that provides \$10 million in primary coverage for Grafton's directors and officers.
91. The Proposed Monitor has been informed (as also noted in the Sun Affidavit) that due to the potential for personal liability, the directors and officers of the Applicant are unwilling to continue their services and involvement in the CCAA proceedings without the protection of the Directors' Charge. As the Applicant will require the participation and experience of the Applicant's directors and officers to facilitate the successful completion of Grafton's CCAA proceedings, including participating in the SISP, the Proposed Monitor believes that the Directors' Charge (both the amount and priority ranking) is required and reasonable in the circumstances.
92. As discussed in the Sun Affidavit, the Initial Order also directs the Company to deposit with the Monitor, in trust, the sum of \$772,597 (the "**Directors' Escrow**"), which funds will be held by the Monitor in trust and stand as collateral for the indemnity in respect of statutory obligations and liabilities in favour of the directors and officers as contemplated above. The Directors' Charge (for such statutory obligations and liabilities) is proposed to have first priority claim to the Directors' Escrow. It is contemplated that the Directors' Escrow will only be released upon the consent of the Monitor and the beneficiaries of the Directors' Charge, or upon further Order of the Court.
93. In addition, the Company will transfer funds to the Monitor in an amount sufficient to satisfy its projected HST remittance requirements in advance, on a weekly basis, to ensure that any amounts owing in respect of HST for each week in the post filing period will be paid by the Company.

Summary and Proposed Ranking of the Court Ordered Charges

94. It is contemplated that the priorities of the Charges sought by the Applicant will be as follows:

As it relates to the ABL Priority Collateral:

- (i) Administration Charge;
- (ii) ABL Lender's DIP Charge;
- (iii) Liens granted to the ABL Secured Parties;
- (iv) Term Lenders' DIP Charge;
- (v) Liens granted to the Term Secured Parties;
- (vi) KERP Charge; and
- (vii) Director's Charge.

As it relates to the Term Priority Collateral:

- (i) Administration Charge;
- (ii) Term Lenders' DIP Charge;
- (iii) Liens granted to the Term Secured Parties;
- (iv) ABL Lenders' DIP Charge;
- (v) Liens granted to the ABL Secured Parties;
- (vi) KERP Charge; and
- (vii) Director's Charge.

95. The Initial Order sought by the Applicant provides that the Administration Charge will rank in priority to the security interests of both GSO and CIBC, each of which the Proposed Monitor understands has consented to the Administration Charge.

96. The Charges will, however, be subordinate to the interests of CDLS, Scotiabank and Xerox, which are secured by existing Personal Property Security Act (Ontario) registrations of which the Proposed Monitor is aware.

97. The Proposed Monitor believes that the Charges and rankings are required and reasonable in the circumstances of the CCAA proceedings in order to preserve Grafton's going concern operations and maintain its enterprise value and, accordingly, supports the granting and the proposed ranking of the Charges.

The Comeback Hearing

98. Should the Court grant the Initial Order, the Proposed Monitor understands that the Applicant has scheduled the Comeback Hearing for January 30, 2017 to, among other things, seek the Court's approval of certain components of its restructuring plan, including:
- (i) The execution of an asset purchase agreement dated as of January 24, 2017 (the "**Stalking Horse APA**") between Grafton and 1104307 B.C. Ltd.;
 - (ii) The SISP (and the Stalking Horse APA for the purposes of being the stalking horse bid under the proposed SISP); and
 - (iii) The transactions contemplated under the liquidation consulting agreement dated as of January 24, 2017 between Grafton and a contractual joint venture of Gordon Brothers Canada ULC and Merchant Retail Solutions ULC (the "**Liquidation Consulting Agreement**"), including the sale guidelines in connection with same (the "**Sale Guidelines**").
99. Subsequent to the granting of the Initial Order and in anticipation of the Comeback Hearing, Richter (in its capacity as Monitor), will be preparing a report in connection with the above-noted matters as well as any other relief sought by Grafton at the Comeback Hearing.

Proposed Monitor's Conclusions and Recommendations

100. For the reasons set out in this report, the Proposed Monitor is of the view that the relief requested by the Applicant is both appropriate and reasonable. The Proposed Monitor is also of the view that granting the relief requested will provide the Applicant the best opportunity to undertake a going concern sale or other restructuring under the CCAA thereby preserving value for the benefit of the Applicant's stakeholders. As such, the Proposed Monitor supports Grafton's application for CCAA protection and respectfully recommends that the Court make an Order granting the relief sought by the Applicants.

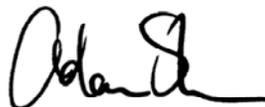
All of which is respectfully submitted this 25th day of January, 2017.

Richter Advisory Group Inc.
in its capacity as Proposed Monitor of
Grafton-Fraser Inc.

Per:



Gilles Benchaya, CPA, CA, CIRP, LIT



Adam Sherman, MBA, CIRP, LIT

Appendix “A”

Grafton-Fraser Inc.

Cash Flow Forecast for the Period January 22 to March 11, 2017

(\$000's)	28-Jan-17	04-Feb-17	11-Feb-17	18-Feb-17	25-Feb-17	04-Mar-17	11-Mar-17	Total
Receipts								
Retail Receipts	\$ 2,241	\$ 2,195	\$ 2,237	\$ 2,208	\$ 2,231	\$ 2,540	\$ 2,823	\$ 16,475
GSO DIP Funding	-	4,400	500	300	200	100	-	5,500
Total Receipts	2,241	6,595	2,737	2,508	2,431	2,640	2,823	21,975
Disbursements								
Merchandise	(734)	(1,703)	(2,203)	(2,181)	(2,216)	(1,513)	(2,191)	(12,741)
Payroll	(475)	(727)	(250)	(932)	(250)	(908)	(250)	(3,791)
Rent	-	(3,170)	(117)	-	(11)	(3,082)	(242)	(6,622)
Sales Tax	(1,708)	-	-	-	-	-	-	(1,708)
Store Expenses and Other	(201)	(390)	(389)	(238)	(219)	(308)	(196)	(1,942)
Supplier & Other Deposits	-	(250)	-	-	-	-	-	(250)
Capex	-	-	-	(100)	-	-	-	(100)
Interest	-	(100)	-	-	-	(75)	-	(175)
Forbearance Fee	-	(200)	-	-	-	-	-	(200)
Professional Fees	(875)	(386)	(335)	(180)	(180)	(180)	(230)	(2,366)
JNY Payments	(1,283)	-	-	-	-	-	-	(1,283)
Vacation Escrow	(800)	-	-	-	-	-	-	(800)
Total Disbursements	(6,075)	(6,925)	(3,295)	(3,631)	(2,877)	(6,067)	(3,109)	(31,978)
Net Cash Flow	\$ (3,834)	\$ (330)	\$ (557)	\$ (1,123)	\$ (446)	\$ (3,426)	\$ (286)	\$ (10,003)
Opening Revolver	\$ 12,826	\$ 16,660	\$ 16,990	\$ 17,548	\$ 18,671	\$ 19,116	\$ 22,543	\$ 12,826
Draw (Repayment)	3,834	330	557	1,123	446	3,426	286	10,003
Closing Revolver	\$ 16,660	\$ 16,990	\$ 17,548	\$ 18,671	\$ 19,116	\$ 22,543	\$ 22,829	\$ 22,829
Pre-Filing Revolver	\$ 9,127	\$ 2,532	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
DIP Revolver	7,533	14,458	17,547	18,670	19,116	22,542	22,829	22,829
Total CIBC Revolver	\$ 16,660	\$ 16,990	\$ 17,547	\$ 18,670	\$ 19,116	\$ 22,542	\$ 22,829	\$ 22,829
Opening DIP Term Loan	\$ -	\$ -	\$ 4,400	\$ 4,912	\$ 5,226	\$ 5,441	\$ 5,557	\$ -
Draws	-	4,400	500	300	200	100	-	5,500
Interest (PIK'd)	-	-	12	14	15	15	16	72
Ending DIP Term Loan	\$ -	\$ 4,400	\$ 4,912	\$ 5,226	\$ 5,441	\$ 5,557	\$ 5,572	\$ 5,572

Mark Sun, CFO

Court File No.: CV-17-11677-00CL

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 OR ARRANGEMENT OF GRAFTON-FRASER INC.

(the "Applicant")

**ONTARIO
SUPERIOR COURT OF JUSTICE
[COMMERCIAL LIST]**

Proceedings commenced in Toronto

**REPORT OF THE PROPOSED MONITOR
JANUARY 25, 2017**

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