

CANADA  
PROVINCE OF ONTARIO  
DISTRICT OF ONTARIO  
DIVISION NO.: 12-OTTAWA  
COURT NOS.: 33-1884683  
ESTATE NOS.: 33-1884683

ONTARIO  
SUPERIOR COURT OF JUSTICE  
In Bankruptcy and Insolvency

IN THE MATTER OF THE PROPOSAL OF:

K. F. S. Limited, 2726556 Canada Inc. and  
Nathar Limited, corporations having their head  
office and principal place of business at 27 First  
Street East, in the City of Cornwall, Province of  
Ontario, K6H 1K5

Debtor

- and -

Richter Advisory Group Inc.

Trustee

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**REPORT OF THE TRUSTEE ON THE FINANCIAL SITUATION  
OF THE DEBTOR AND ON THE PROPOSAL  
(Sections 50(5) and 50(10)(b) of the *Bankruptcy and Insolvency Act*)**

The purpose of the First Meeting of Creditors is to consider the Proposal filed jointly on October 31, 2014 (hereinafter referred to as the "Proposal") by K. F. S. Limited, 2726556 Canada Inc. and Nathar Limited (hereinafter referred to collectively as the "Debtor").

Pursuant to Sections 50(5) and 50(10)(b) of the *Bankruptcy and Insolvency Act* (hereinafter referred to as the "Act"), and in order to assist the Ordinary Unsecured Creditors in considering the Proposal, the Trustee is hereby submitting its report on the financial situation of the Debtor and on the Proposal.

**The Trustee cautions the reader that it has neither conducted an audit nor a verification of the books and records of the Debtor. Consequently, the Trustee cannot render an opinion as to the accuracy of the information contained therein. The information discussed herein emanates from the books and records of the Debtor, as well as from discussions with the Management of the Debtor.**

**All the terms that are not otherwise defined herein shall have the meaning ascribed thereto in the Proposal.**

## INTRODUCTION

On June 24, 2014, K. F. S. Limited, 2726556 Canada Inc. and Nathar Limited, each filed a Notice of Intention to File a Proposal pursuant to the Act (hereinafter referred to as the "NOI"), the whole as appears from the documents filed into the court records.

On July 2, 2014, documents were sent by regular mail to all creditors of the Debtor, as they were identified by it, which included a copy of the Debtor's NOI, the whole as appears from the documents filed into the court records.

On July 22, 2014, the Court granted a first extension of time of 45 days for the filing of a Proposal to September 8, 2014, in order to allow the Debtor to complete its dealings regarding the implementation of its restructuring plan.

On September 8, 2014, the Court granted a second extension of time of 45 days for the filing of a Proposal to October 23, 2014, in order to allow the Debtor to complete its dealings regarding the implementation of its restructuring plan.

On October 23, 2014, the Court granted a third extension of time of 15 days for the filing of a Proposal to November 7, 2014, in order to allow the Debtor to obtain the administrative consolidation of the NOI proceedings and to finalize the terms of a viable proposal that will maximize the dividends to be paid to the Debtor's Ordinary Unsecured Creditors.

On October 27, 2014, the Court ordered that the NOI proceedings of the Debtor be consolidated and that, as a result thereof, only one common Proposal be filed.

On October 31, 2014, the Debtor filed a Proposal to its creditors. We have enclosed herewith the Proposal made by the Debtor to its Creditors, a proof of claim form, a voting form, a proxy and a notice indicating the place and time of the Creditors' meeting to address the Proposal.

This report summarizes the relevant information and key elements that may assist the creditors in evaluating the Debtor's affairs and the Proposal. The report is presented with the following sections:

- I. Overview of the Debtor
- II. Causes of Insolvency
- III. Restructuring Measures
- IV. Financial Information
- V. Proposal
- VI. Estimated Distribution to the Ordinary Unsecured Creditors
- VII. Conclusion and Recommendation

## **I. OVERVIEW OF THE DEBTOR**

The Debtor, in operation since 1955, operated a chain of 21 retail stores in Ontario, Nova Scotia, New Brunswick and Newfoundland, specializing in ladies' and men's fashions, kitchenware, home accessories and gourmet foods. The Debtor operates under various banners including Tweed & Hickory, Kastners Menswear, Flotron's Tweed & Hickory, Bucovetsky's, Dover's Menswear, Buckland's Fine Clothing, Shaw's of Perth, The Village Green, Jacobson's Ladies' Wear, Yazer's Men's Wear, Bellissima and Moe's Menswear.

At the time of the filing of the NOI, the Debtor had over 200 employees working in its stores, warehouse and head office. The Debtor's head office is located in Cornwall, Ontario.

## **II. CAUSES OF INSOLVENCY**

In the past two years, the Debtor has experienced a sharp decline of its sales and reported significant losses. Management attributes this decline in sales to the following:

- Decrease in sales volume;

- Aging inventory;
- Unfavorable economic conditions in the retail industry;
- General economic downturn; and
- Highly competitive market.

Pursuant to the assessment of its financial situation, the Debtor began implementing, in early 2014, certain corrective measures, with the intent of ensuring its long-term profitability. However, the decrease of its sales continued to exceed the Debtor's forecasts and it became evident that such measures would be insufficient to reverse the negative impact of the sales decline, thus necessitating a formal restructuring through NOI proceedings.

### **III. RESTRUCTURING MEASURES**

After the filing of the NOI, the Debtor has been developing and implementing, with the help of its financial and legal advisors, a restructuring plan with a view of maximizing the dividends to be paid to the Ordinary Unsecured Creditors. The key elements of this plan included:

- The identification and closure of underperforming stores. Between the filing of the NOI and September 30<sup>th</sup>, 2014, three stores were closed and the relevant notices to disclaim leases were sent to the landlords. In addition, Management will be closing additional underperforming stores in the upcoming weeks and has already sent notices to disclaim those leases;
- The negotiation of more favorable leases terms with its landlords;
- The search for potential investors;
- The orderly liquidation of its slow-moving and excess inventory (ongoing); and
- The reduction of operating and overhead expenses.

### **IV. FINANCIAL INFORMATION**

The following financial data was extracted either from the books and records of the Debtor, the unaudited financial statements or from discussions held with Management. This information is submitted solely to assist the reader in assessing the current financial position of the Debtor.

The Trustee makes no representation or gives no warranty as to the accuracy of said financial information.

**A) Operating Results**

K. F. S. Limited, 2726556 Canada Inc. and Nathar Limited. (Note 1)			
Key financial information			
	F2015	F2014	F2013
	(7 months)	(12 months)	(12 months)
(in 000'S)	Estimated	Preliminary	Reported
<b>Sales</b>	<b>8 869</b>	<b>21 356</b>	<b>25 874</b>
<b>COGS</b>	<b>(6 696)</b>	<b>(12 418)</b>	<b>(15 096)</b>
<b>Gross profit</b>	<b>2 173</b>	<b>8 938</b>	<b>10 778</b>
<b>Gross margin %</b>	<b>25%</b>	<b>42%</b>	<b>42%</b>
<b>Operating expenses</b>	<b>4 139</b>	<b>9 180</b>	<b>10 423</b>
<b>Administrative expenses</b>	<b>924</b>	<b>1 552</b>	<b>1 735</b>
	<b>5 063</b>	<b>10 732</b>	<b>12 158</b>
<b>Other income</b>	<b>-</b>	<b>37</b>	<b>21</b>
	<b>5 063</b>	<b>10 695</b>	<b>12 136</b>
<b>Net loss</b>	<b>(2 890)</b>	<b>(1 757)</b>	<b>(1 358)</b>

(1) Includes the results of K.F.S. Logistics Inc. which had nominal business activities.

The above table shows the poor financial performance of the Debtor for the last two (2) fiscal years and the most recent year-to-date period (the latest internal financial statements available).

**B) Assets**

The Debtor's statement of affairs reflects the following as at September 30, 2014, based on information provided by Management:

K. F. S. Limited, 2726556 Canada Inc. and Nathar Limited.	
Assets	
As at September 30, 2014	
(in 000'S)	
	<b><u>Book value</u></b>
Accounts receivable	137
Inventory	4 808
Capital assets	320
	<b><u>5 265</u></b>

**Accounts Receivable (\$137,000)**

The accounts receivable amount to \$137,000. They relate to customers that have credit terms in the various stores. The accounts receivable are subject to a first ranking hypothec in favour of the Royal Bank of Canada, the Debtor's secured operating lender.

**Inventory (\$4,808,000)**

K. F. S. Limited, 2726556 Canada Inc. and Nathar Limited. Inventory As at September 30, 2014 (in 000'S)	
<b>Season</b>	<b>Book value</b>
Pre-F2011	1 261
F2011	276
F2012	368
F2013	578
Spring 2014	459
Fall 2014	795
"Basics"	899
Prepaid inventory (not yet received)	173
	<u>4 808</u>

The inventory is comprised of finished goods located in the Debtor's warehouse and in the various stores. Of the inventory, over \$2.9M relate to prior seasons. The inventories are subject to a first ranking hypothec in favour of the Royal Bank of Canada, the Debtor's secured operating lender.

**Capital Assets (\$320,000)**

The Debtor's fixed assets consist mostly of leasehold improvements (\$175,000), furniture and fixtures (\$90,000), as well as computer equipment (\$15,000).

**C) Liabilities**

The Debtor has provided the Trustee with a list of creditors. Proof of claim forms will be sent to the known creditors. However, at the present date, the Trustee is unable to determine if the Debtor's records are consistent with those of its creditors. Upon reception of the proofs of claim, the Trustee will review them with Management and deal with any discrepancies for purposes of collocation of claims.

K. F. S. Limited, 2726556 Canada Inc. and Nathar Limited. Liabilities As at September 30, 2014 (in 000'S)	
<b>Liabilities per the books and records of the Debtor</b>	
Secured debt	1 730
Unsecured creditors (367)	<u>3 602</u>
	5 332
Unsecured creditors - Related parties	<u>1 539</u>
	<u>6 871</u>
<b>Estimated unsecured liabilities resulting from lease cancellations / employees layoff</b>	
Landlord damages (estimated)	1 600
Employees termination and severance pay (estimated)	<u>400</u>
	<u>2 000</u>
	<u>8 871</u>

The secured creditor is the Royal Bank of Canada for the operating lines of credit (secured by all the assets of the Debtor) for a total amount of \$1,730,000.

Based on the information provided by the Debtor, there are no known preferred creditors.

Ordinary Unsecured Creditors (\$3.6M) were identified through the Debtor's books and records, and include trade suppliers, sales taxes and accrued liabilities.

Moreover, related parties to the Debtor (\$1.5M), were identified through the Debtor's books and records and relate mostly to loans from Lang Investments, Jaymore Inc., Magshar Holdings Inc. and 3528626 Canada Inc. The Proposal is not addressed to such related parties and they will not be bound by its terms.

The Trustee calculated the potential amounts that could be claimed as damages following the disclaimer of leases as well as the termination and severance pay following the layoff of the workforce. The Trustee estimates for these potential liabilities total \$2.0M.

The Trustee cautions that these amounts may change as proofs of claims are filed and such changes may be significant.

## V. PROPOSAL

### A) Summary

**The Trustee notes that the following is only a summary of the Terms of the Proposal. Creditors are advised to read the Proposal for complete details of the Terms of the Proposal.**

The Terms of the Proposal provide that the Ordinary Unsecured Creditors shall be paid from the remittance of \$425,000 (hereinafter referred to as the "Cash Consideration"), to be paid to the Trustee by the Debtor at the latest on February 24, 2015.

The Cash Consideration shall be payable by the Debtor in the following manner:

- i. Each of the Ordinary Unsecured Creditors having a Proven Claim of less than \$500 will be paid the full amount of its Ordinary Unsecured Claim without interest or penalty, within 30 days after the payment by the Debtor of the Cash Consideration; and
- ii. Each of the Ordinary Unsecured Creditors having a Proven Claim of at least \$500 shall receive a minimum payment of \$500. For the balance of its Proven Claim, after the distribution provided at paragraphs 8.1 and 8.2i) of the Proposal and within 30 days after the payment by the Debtor of the Cash Consideration, each of the Ordinary Unsecured Creditors shall also receive, in full and final payment of its Ordinary Unsecured Claim, without interest or penalty, its *pro rata* share of any amount remaining from the Cash Consideration.

**B) Funding**

The financing of the Proposal will be contingent on the successful liquidation of the excess and slow-moving inventory by Management, which should be completed by the end of January 2015.

**C) Amounts to be Paid as a Priority**

According to the terms of the Proposal, the following amounts must be paid in priority, from the Cash Consideration:

- Crown Claims, which shall be limited to the claims of Her Majesty in right of Canada or a province described in subsection 60(1.1) of the Act that were outstanding on the Date of the Proposal, shall be paid in full, within six (6) months of the approval of the Proposal by the Court, or as may otherwise be arranged with the Crown;
- Employees Claims (amounts that employees would be qualified to receive under paragraph 136(1)(d) of the Act if the Debtor became bankrupt), if any, will be paid in full, immediately after the approval by the Court of the Proposal. It should be noted that with respect to all of the employees creditors who are currently employed by the Debtor, all of their employees' claims, excluding severances, have been or shall have been paid in full by the Debtor to such employees in the normal course of business;
- Preferred Claims shall be paid, without interest or penalty, in full, in priority to all claims of Ordinary Unsecured Creditors upon approval of the Proposal by the Court or as may be otherwise arranged with the Preferred Creditors or in accordance with clause 2 hereof if such Preferred Claim is also an Employee's Claim;
- Secured Creditors, if any, shall be paid in accordance with existing contracts, or as may otherwise be arranged with the Secured Creditors. For greater certainty, the Proposal is not addressed to the Secured Creditors and they shall not be bound by the Proposal in respect of their Secured Claim;
- The claims arising in respect of goods supplied, services rendered or other consideration given to the Debtor subsequent to the Date of the Proposal, including (without limitation) salaries and other compensation of employees, if any, shall be paid in full by the Debtor in the normal course of business, and on regular trade terms;
- Professional Fees shall be paid in full by the Debtor in the normal course of business.

Management estimates that Crown Claims, Employees Claims and Preferred Claims will have been paid in full prior to the remittance of the Cash Consideration to the Trustee.

**D) Other**

The Proposal provides that the statutory terms of Sections 91 to 101 of the Act, and similar provincial provisions, shall not apply as permitted by Section 101.1 of the Act.

The Proposal will constitute a compromise of all claims against directors and will operate as a full and complete discharge in favor of such directors with respect to such claims.

The proposal shall be deemed to be accepted by the creditors if, and only if, the Ordinary Unsecured Creditors vote for the acceptance of the Proposal by a majority in number and two thirds in value of the Ordinary Unsecured Creditors present, personally or by proxy, at the meeting and voting on the resolution.

## VI. ESTIMATED DISTRIBUTION TO ORDINARY UNSECURED CREDITORS

In the event that the creditors reject the Proposal, the Debtor will automatically be bankrupt and the net proceeds from the liquidation of the assets (after payment of the Trustee's fees and expenses) will be distributed to the creditors in the order provided for under the Act. The following information is to inform the creditors on the estimate as to the distribution to creditors under the Proposal in comparison to the estimated distribution under a bankruptcy scenario.

### A) Proposal

Based on Management's representations and the aggregate amount of the Ordinary Unsecured Claims, as reflected in the Debtor's statement of affairs, at the present time, the Trustee estimates that the funds of \$425,000 available for distribution to the Ordinary Unsecured Creditors would represent an estimated recovery of 8% of the Ordinary Unsecured Claims, as follows:

K. F. S. Limited, 2726556 Canada Inc. and Nathar Limited. Proposal estimated distribution (in 000\$)	
<b>Dividend paid by the Debtor</b>	<b>425</b>
<b>Unsecured creditors subject to the Dividend</b>	
Unsecured creditors (per books and records)	3 602
Landlord damages (estimated)	1 600
Employees termination and severance pay (estimated)	400
	<u>5 602</u>
Estimated distribution percentage	8%

Management has advised that an orderly wind-down of the Debtor's affairs should generate realization values sufficient to cover the payment of the Cash Consideration.



**B) Bankruptcy**

In a bankruptcy scenario, based on the value of the assets and liabilities of the Debtor, as reflected in the statement of affairs, the Trustee estimates that the distribution would be as follows:

K. F. S. Limited, 2726556 Canada Inc. and Nathar Limited. Bankruptcy - Estimated distribution (in 000'S)		
	<u>Book value</u>	<u>Estimated realization value (1)</u>
<b>Inventory (by season)</b>		
Pre-F2011	1 261	118
F2011	276	187
F2012	368	248
F2013	578	444
Spring 2014	459	353
Fall 2014	795	993
"Basics"	899	747
Prepaid inventory (not yet received)	173	216
	<u>4 808</u>	<u>3 306</u>
<b>Capital assets</b>	<b>320</b>	<b>20</b>
<b>Accounts receivable</b>	<b>137</b>	<b>69</b>
<b>Estimated Gross realization</b>		<u><b>3 395</b></u>
<b>Less: Estimated realization cost</b>		
Direct store expenses		1 000
Overhead costs		210
Liquidators cost		250
Professional fees		225
		<u>1 685</u>
<b>Net realization value</b>		<u><b>1 709</b></u>
Secured creditor		(1 730)
Priority claims		TBD
Deficit for secured creditor		<u>(21)</u>
<b>Estimated distribution to unsecured creditors</b>		<u><b>NIL</b></u>
<b>Notes</b>		
1. As per the realization values declared in the statement of affairs.		

The above analysis indicates that the estimated realization values of the Debtor's assets would likely be insufficient to reimburse in full the Secured Claims. Therefore, there would be no amount available to distribute to the Ordinary Unsecured Creditors.

**C) Other Considerations**

The approval of the Proposal will avoid a bankruptcy and will be of benefit to the following constituents :

- Employees in the ongoing stores will have continued employment if the inventory liquidation plan generates sufficient funds; and
- Merchandise suppliers and service providers will have a going concern entity (on a reduced scale) with which to continue doing business.

## VII. CONCLUSION AND RECOMMENDATION

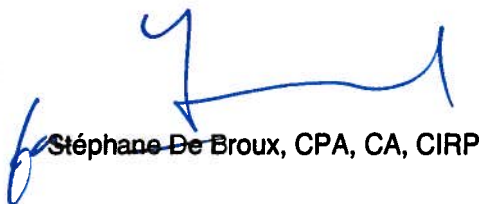
After having estimated the amount that may be available for the Ordinary Unsecured Creditors in the context of a bankruptcy, the Trustee is of the opinion that the present Proposal is more advantageous to them than a bankruptcy scenario.

It is estimated that the Proposal would provide the Ordinary Unsecured Creditors with a dividend of approximately \$0.08 on the dollar, compared to an estimated dividend of NIL in the event of a bankruptcy.

**For the foregoing reasons, the Trustee recommends the approval of the Proposal.**

Dated at Montréal, Province of Québec, this 3<sup>rd</sup> day of November 2014.

**Richter Advisory Group Inc., Trustee**



Stéphane De Broux, CPA, CA, CIRP