

CANADA
PROVINCE OF QUÉBEC
DISTRICT OF QUÉBEC
DIVISION NO.: 01-MONTREAL
COURT NO.: 500-11-035190-095
ESTATE NO.: 41-1149267

SUPERIOR COURT
(Commercial Division)

IN THE MATTER OF THE PROPOSAL OF:

Polychem Products Canada Inc.

a body politic and corporate, duly incorporated
according to law and having its head office and its
principal place of business at:
1501 des Futailles Street
Montréal, Quebec H1N 3P1

Debtor

**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*)

On the 5th day of February 2009, Polychem Products Canada Inc. (hereinafter referred to as the "Debtor" or "Polychem" or "Company") filed a Proposal to its creditors. We have enclosed herewith the Proposal of the Company to its creditors, a proof of claim form, a voting form, a proxy as well as a Notice of the time and place of the meeting of creditors ("First Meeting of Creditors") to consider the Proposal. The highlights of the Proposal can be summarized as follows.

PROPOSAL

The following is a summary only of the terms of the Proposal and the **creditors are advised to review the legal version as well as associated definitions of the Proposal for complete details of the terms of the Proposal.**

A) Amounts to be paid as a priority

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

- All secured claims shall be paid in accordance with existing agreements or as may be otherwise arranged with each of the Secured Creditors. For greater certainty, the Debtor acknowledges that the Proposal is not made to and shall have no effect on the rights of the holders of secured claims;
- All Crown Claims, as defined in paragraph 3 of the Proposal, to the extent not already paid by the Debtor in the ordinary course of the Debtor's business, shall be paid in full, within six (6) months after approval of the Proposal by the Court;
- Amounts owing to employees and former employees, that they would have been entitled to receive under Paragraph 136(1)(d) of the *Bankruptcy and Insolvency Act* (hereinafter referred to as the "Act ") if the employer became bankrupt on the date of filing of the Notice of Intention, as well as amounts due for wages, salaries, commissions or compensation for services rendered after that date and before the approval of the Proposal by the Court, will be paid in full immediately after approval;
- The Proposal costs shall be paid in priority to all unsecured preferred claims (the "preferred claims") and all claims of ordinary creditors (the "ordinary claims");
- The preferred claims other than those of employees previously referred to, without interest or penalty, shall be paid in their entirety in priority to ordinary claims, within sixty (60) days of the approval of the Proposal;
- Post-filing obligations shall be paid in full in the ordinary course of business and according to usual commercial terms or according to agreements between the Debtor and suppliers.

B) Amounts to be disbursed to ordinary creditors

The Proposal provides for the Debtor to remit to the Trustee for distribution to ordinary creditors in full and final payment of their ordinary claims, without interest or penalty, the following:

- Sixty (60) days following the approval of the Proposal by the Court:
 - i) the lesser of the value of each ordinary claim or \$500; and
 - ii) on the remaining balance of the ordinary creditors' claims, after payment of the amount contemplated above in B i), the following:
 - if the total of the remaining ordinary claims does not exceed \$4,000,000, 10% on the remaining ordinary claims; or
 - if the total of the remaining ordinary claims exceeds \$4,000,000, an amount of \$400,000 to be distributed pro rata amongst the remaining ordinary creditors;
- Forty-five (45) days following each of the Company's fiscal years ending 2009, 2010 and 2011, 20% of the net proceeds of realization in such fiscal years of the carbon credits existing as of December 31, 2008, to be distributed pro rata amongst the remaining ordinary creditors' claims.

C) Other

- Subject to approval of the Proposal, Renewplast Inc. and Solplast Inc., related parties, agree to subordinate and postpone their unsecured claims, and shall not be entitled to receive payment from the Debtor of any principal or interest unless and until all of the dividends have been fully paid to the ordinary creditors under the Proposal.
- The Proposal provides that the statutory terms of Sections 91 to 101 of the Act, and similar Civil Code of Quebec provisions (settlements, preferences, reviewable transactions), shall not apply.
- The Proposal will constitute a compromise of all claims against directors and will operate as a full and complete discharge in favour of such directors with respect to such claims.

D) Creditors' Committee

The Debtor consents to the creation of a committee which shall be comprised of, at most, five (5) individuals (the "Committee") to be named by the creditors to authorize and advise the Trustee on matters relating to the Proposal.

Pursuant to Sections 50(5) and 50(10)(b) of the Act, and to assist the creditors in considering the Proposal, the Trustee is submitting its report on the financial situation of the Debtor and on the Proposal.

We caution the reader that we have neither conducted an audit nor a verification or investigation of the books and records of the Debtor. Consequently, we cannot render an opinion as to the accuracy of the information contained herein. The information discussed herein emanates from the books and records of the Debtor as well as from our discussions with the Management of the Debtor.

INTRODUCTION

On January 6, 2009, Polychem filed a Notice of Intention to Make a Proposal (hereinafter referred to as the "Notice of Intention") to its creditors and RSM Richter Inc. (hereinafter referred to as "Richter") was appointed Trustee. On February 5, 2009, the Debtor filed the present Proposal to its creditors. Richter was also appointed as consultant to Canadian Imperial Bank of Commerce ("CIBC"), the Company's bankers.

The following summarizes the relevant information and key elements that may assist the creditors in evaluating the Debtor's affairs and the Proposal.

BACKGROUND

The Debtor is a privately held company owned by Renewplast Inc., itself owned 2/3 by Capvest Industrial Holdings Inc. and 1/3 by Icegate Holdings Inc. Renewplast Inc. is as well the sole shareholder of Solplast Inc. ("Solplast"), which, concurrently with Polychem, filed a Notice of Intention to Make a Proposal on January 6, 2009 and a Proposal on February 5, 2009. The two companies, Polychem and Solplast, are independent legal entities.

In November of 2007, the Company acquired the assets of and took over the operations formerly carried on by Polychem Products Ltd.

Polychem Products Ltd. operated independently for over 20 years and is a pioneer in the recycling of post industrial and post consumer plastics with sales of \$25,000,000 annually. Polychem is a key supplier to major corporations with programs in both the pipe and blow mould industries, which are utilized in the building of infrastructure.

Polychem's head office is located in Montréal, Quebec, and has its main operating facility in a Company owned property located at 725 rue Gaudette in St-Jean-sur-Richelieu, Quebec.

CAUSES OF INSOLVENCY AND EVENTS SUBSEQUENT TO THE FILING OF THE NOTICE OF INTENTION

Management attributes the causes of the insolvency to the following confluence of events:

- During the second and third quarters of 2008, sharp increases in the price of mixed colour and clear bottles combined with a decline in resin prices, with the inability to pass on sufficient price increases to customers;
- From September 2008, steep decline in the price of feedstock which eroded a significant portion of the Company's inventory value and working capital;
- Rise of US dollar vs. Canadian dollar, further eroding working capital;
- Dumping of "virgin" resin by producers at prices approximating the Debtor's processing costs;
- Decrease of the ability of municipalities to separate the streams of recycled products due to low prices they were being paid.

The Company ceased production on December 19, 2008 for an undetermined period of time. Solplast has remained in production.

Since the filing of the Notice of Intention, the Company has maintained a limited staff and has continued to sell its finished goods inventory.

FINANCIAL INFORMATION

The following financial data was extracted either from the Statement of Affairs dated February 4, 2009 filed with the Official Receiver, 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 representations or warranty as to the accuracy of said financial information.

A) Historical Results

Statement of Operations

Polychem Products Canada Inc.		
Summary of Historical Results		
(Unaudited)		
(in 000's)		
	12/31/2008	09/30/2008
	(3 months)	(12 months)
Sales	\$4,536	\$28,171
Cost of goods sold	5,013	27,588
Gross Margin (Loss)	<u>(477)</u>	<u>583</u>
Operating expenses		
Administrative	268	1,215
Selling	62	368
Research and development	60	295
Foreign exchange gain	(760)	-
Financial	160	311
Net operating expenses	<u>(210)</u>	<u>2,189</u>
Net loss	<u>\$(267)</u>	<u>\$(1,606)</u>

The above results are based on the Company's internal financial statements. As discussed previously in this report, due to numerous factors, the Company incurred significant losses in the last fifteen (15) months, including by way of a substantial erosion of the value of its inventory of raw materials and finished goods.

B) Statement of Affairs

As at the date of the proposal, the Debtor's estimated financial position was the following (more fully described on the following pages):

Polychem Products Canada Inc. Condensed Statement of Affairs As at February 4, 2009	
	Amount
Liabilities	
Secured Creditors	\$ 7,985,169
Preferred Creditors	197,327
Ordinary Creditors (note)	<u>6,858,237</u>
	<u>\$15,040,733</u>
Assets (encumbered)	
Accounts receivable	\$ 482,000
Inventory *	1,154,000
Machinery and equipment *	2,203,000
Carbon credits	1
Immoveable *	<u>3,501,000</u>
	<u>\$ 7,340,001</u>
Deficiency	<u>\$(7,700,732)</u>
*(at estimated net book value)	
Note: The Statement of Affairs reflected total unsecured creditors of \$7,503,405 which included the estimated unsecured portion of the secured creditors' claims.	

Assets

i) **Accounts Receivable** – The book value of accounts receivable totalled approximately \$1,273,000 as at February 4, 2009. This includes uncollectible amounts from Solplast, contra accounts and accounts in dispute totalling approximately \$791,000. As per the Statement of Affairs, Management has estimated the realization value of accounts receivable at \$482,000. The accounts receivable are secured by a first charge in favour of CIBC as well as subsequent ranking security in favour of HSBC Guyerzeller Bank S.A. ("HSBC") and 177960 Canada Inc.

ii) **Inventory** – The book value of the inventory as at February 4, 2009 is estimated at \$1,154,000 and consists of the following:

Raw Materials	\$ 115,000
Finished Goods	<u>\$1,039,000</u>
Total inventory	<u>\$1,154,000</u>

This inventory amount reflects substantial write-downs due to fallen prices.

The inventory is secured by a first charge in favour of the CIBC and subsequent ranking security in favour of HSBC and 177960 Canada Inc.

iii) **Machinery and Equipment** – The books and records of the Company indicate a net book value of machinery and equipment amounting to \$2,203,000. On February 6, 2009, an appraisal of the equipment was received and the forced liquidation value (net of estimated liquidation costs) approximates \$1,070,000. The appraisal value is significantly lower than the book value due, in part, to the current severe economic conditions.

The machinery and equipment is secured by a first charge in favour of the CIBC as well as subsequent ranking security in favour of HSBC and 177960 Canada Inc.

iv) **Carbon Credits** – In order to mitigate the effects of global warming, a carbon credit system was instituted by various governmental authorities whereby a business receives carbon credits resulting from its ability to reduce greenhouse gas emissions, which result in a potential fiscal benefit. A business can exchange, buy or sell carbon credits in an open market. Management has reported the value of the carbon credits at \$1 in the Statement of Affairs as they only have value to the extent that they can be

verified, certified and marketed to parties that can benefit from them. An expert report was prepared in August 2008 to assist the Company in quantifying the amount of greenhouse gas emission reductions. The report indicated that the total emission reductions accumulated during the period 2002 to 2007 amounts to 349,025 metric tons. It is estimated that an additional 50,600 metric tons were accumulated in 2008. The current prevailing market price in North America is approximately \$2.05USD per metric ton (source - Climate financial instruments market price on the Chicago Climate Exchange as at February 9, 2009). This price is subject to variances and there is no assurance as to the availability of purchasers.

Management is in the process of attaining Voluntary Carbon Standard accreditation required to permit the Company to sell the carbon credits on the international market which, according to management, could yield greater returns than in North America.

The Company is unable at the present time to estimate the amounts for which the carbon credits can be monetized.

The carbon credits are subject to the security of the secured creditors. However, as noted above, the Proposal provides for 20% of the net proceeds of realization in fiscal 2009, 2010 and 2011 of the carbon credits to be paid to the ordinary creditors.

- v) **Immoveable Property** – The estimated net book value of the property located at 725 rue Gaudette, at St-Jean-sur-Richelieu, Quebec, amounts to approximately \$3,501,000. A recent appraisal obtained by the Company indicates a liquidation value of \$2,600,000 (prior to liquidation and carrying costs).

The immoveable property is secured by a first charge in favour of CIBC as well as subsequent ranking security in favour of HSBC and 177960 Canada Inc.

Liabilities

The Debtor has provided the Trustee with a list of its creditors. Notices have been sent to the known creditors and, to date, the Trustee is unable to comment on whether the Debtor's records agree with those of its creditors. As proofs of claim are received, the Trustee shall record the specific amounts claimed by the creditors and, prior to paying any dividend, the Trustee shall reconcile the differences.

Liabilities indicated below are based on the books and records of the Debtor as well as management's representations, estimated as follows:

i) **Secured Creditors**

All assets of the Debtor are encumbered in favour of various secured creditors. The Trustee has received an independent legal opinion confirming the validity of the security of CIBC, Polychem's first ranking secured creditor. The CIBC loans are a solidary obligation of both Polychem and Solplast. CIBC also has a first ranking security position on the assets of Solplast. HSBC and 177960 Canada Inc. are both secured creditors in subsequent positions. HSBC also holds subsequent ranking security on the assets of Solplast.

As per the Debtor's books and records, \$7,985,169 of secured claims as at February 4, 2009 can be summarized as follows:

Polychem Products Canada Inc. Secured creditors As at February 4, 2009		
	Amount	Security
CIBC	\$1,898,169	First ranking security over all the assets, including the immoveables. CIBC loans are a solidary obligation of both Polychem and Solplast.
HSBC Guyerzeller Bank S.A. ("HSBC")	5,537,000	Subsequent ranking security over the assets situated at 725 Gaudette St., St-Jean-sur-Richelieu. HSBC loans are a solidary obligation of both Polychem and Solplast. HSBC also holds security on the assets of Solplast.
177960 Canada Inc.	550,000	Subsequent ranking security, over all the assets.
	<u>\$7,985,169</u>	

The Proposal does not affect the secured creditors.

ii) Unsecured Creditors

The amounts owed to preferred creditors (\$197,327) represent salaries (\$35,000) and vacation pay (\$162,327) owed to employees.

The unaudited books and records of the Debtor, as of February 4, 2009, reflect \$6,858,237 of unsecured ordinary creditors (hereinafter the "ordinary creditors").

For dividend distribution purposes, this amount is to be reduced by \$2,800,000 owing to Renewplast, which under the Proposal is subject to a postponement.

We caution that this amount may change as proofs of claim are received.

REVIEW OF BOOKS AND RECORDS

The Trustee has commenced but has not yet completed its review of the Company's transactions with suppliers in the three (3) months prior to the filing of the Notice of Intention and in the twelve (12) month prior period in respect of related parties. The Trustee will conclude its review and report at the First Meeting of Creditors. As previously mentioned, conditionally upon approval of the Proposal, the statutory terms of Sections 91 to 101 of the Act, and similar *Civil Code of Quebec* provisions, shall not apply.

VOTING ON THE PROPOSAL

The Proposal shall be deemed to be accepted by the creditors if, and only if, the unsecured creditors vote for the acceptance of the Proposal by a majority in number and two-thirds in value of the unsecured creditors present, personally or by proxy, at the First Meeting of Creditors and voting on the resolution or by voting letter on or before the said First Meeting of Creditors.

CONCLUSION AND RECOMMENDATIONS

As noted in this Report, in the event of a Bankruptcy and an ensuing liquidation of the Company's assets, the secured creditors will suffer a loss with **NO** dividend available to the unsecured creditors.

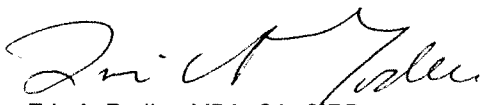
Accordingly, the Trustee therefore recommends that the ordinary creditors accept the Proposal for the following reasons:

- A dividend of approximately ten cents on the dollar (\$0.10) is to be paid sixty (60) days following approval of the Proposal by the Court;
- 20% of the net monetized value of the carbon credits realized by the Company are to be paid forty-five (45) days following each of the fiscal years ending 2009, 2010 and 2011;
- The Proposal will position the Company for the possible continuation of operations and the resulting employment of staff and the resumption of purchasing from suppliers;
- The claims of its shareholder Renewplast Inc. of approximately \$2,800,000 and its affiliate Solplast will be postponed until all dividends due under the Proposal have been paid.

As previously noted, creditors may remit their voting letters to the Trustee in advance of the forthcoming Meeting of Creditors or, alternatively, may attend at said Meeting of Creditors to make such further inquiries as they deem necessary and to vote at the meeting.

Dated at Montréal, Province of Quebec, this 16th day of February 2009.

RSM Richter Inc.
Trustee



Eric A. Rodier, MBA, CA, CIRP
Administrator