Court File No. CV-10-8991-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

IN THE MATTER OF THE RECEIVERSHIP OF 2110458 ONTARIO LIMITED O/A LORETTA FLOUR, 2131413 ONTARIO LIMITED O/A LORETTA FOODS, 787755 ONTARIO LIMITED O/A NEW DURHAM TRADING, AND O/A NDT FOOD SERVICE AND O/A SKYWAY WHOLESALE AND TARBRAC HOLDINGS INC.

IN THE MATTER OF SECTION 243 OF THE *BANKRUPTCY AND INSOLVENCY ACT*, R.S.C. 1985, c. B-3, as amended, and SECTION 101 OF THE *COURTS OF JUSTICE ACT*, R.S.O. 1990, c. C. 43, as amended

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FIRST REPORT TO THE COURT OF ERNST & YOUNG INC., AS RECEIVER

January 10, 2011

BACKGROUND

1. On November 10, 2010, Bank of Montreal ("**BMO**") made an application to the Court for an order, and the Court made an order, appointing Ernst & Young Inc. ("**EYI**") as interim receiver (in such capacity, the "**Interim Receiver**") pursuant to section 47(1) of the *Bankruptcy & Insolvency Act* ("BIA") and pursuant to section 101 of the *Courts of Justice Act* ("CJA") of the assets, undertakings and properties of 2110458 Ontario Limited ("**211**") o/a Loretta Flour, 2131413 Ontario Limited ("**213**") o/a Loretta Foods, 787755 Ontario Limited ("**787**") o/a New Durham Trading, and o/a NDT Food Service and o/a Skyway Wholesale, and Tarbrac Holdings Inc. ("**Tarbrac**") (collectively, the "**Debtors**").

2. On November 26, 2010, EYI was appointed as receiver and receiver and manager (the "**Receiver**") of the Debtors pursuant to section 243 of the BIA and section 101 of the CJA. A copy of the issued Receivership Order is attached as Appendix "**A**" to this Report.

3. The Receivership Order, among other things, authorizes and empowers the Receiver to:

   (a) market any or all of the Property, including soliciting offers in respect of the Property and negotiating such terms and conditions of sale as the Receiver in its discretion may deem appropriate;

   (b) sell the Property or any parts thereof outside the ordinary course of business:

      (i) without the approval of the Court in respect of any transaction not exceeding $250,000, provided that the aggregate consideration for all such transactions does not exceed $1,000,000; and

      (ii) with the approval of the Court in respect of any transaction in which the purchase price or the aggregate purchase price exceeds the applicable amount set out in the preceding clause;

   and in each such case notice under subsection 63(4) of the Ontario *Personal Property Security Act* shall not be required, and in each case the Ontario *Bulk Sales Act* shall not apply; and

   (c) carry out the sale process developed by EYI, in its capacity as Interim Receiver, for the Food Services (as defined below) business of the Debtors substantially in accordance with the timeline annexed as Schedule "E" to the First Report of the Interim Receiver dated November 25, 2010, with such changes as the Receiver considers necessary in its sole discretion, acting reasonably.

PURPOSE

4. This is the first report of the Receiver. The purpose of this First Report is to:

   (a) Report to the Court on the status of the sale process for the Food Services (as defined below) business of the Debtors;

   (b) Report to the Court on the Receiver's development of a plan to market and sell the Loretta Flour (as defined below) and Loretta Foods (as defined below) businesses; and

   (c) request that the Court grant an Order:

      (i) authorizing the Receiver to market and sell the Loretta Flour and Loretta Foods businesses pursuant to the plan developed by the Receiver; and

      (ii) approving the actions of the Receiver as described in this Report.

Terms of Reference

5. In preparing this Report, the Receiver has relied upon the books and records of the Debtors, conversations with operating management and employees of the Debtors, and other information from various sources. The Receiver has assumed that the information it has been provided is accurate and complete. The Receiver has not audited, reviewed or otherwise verified such information.

FOOD SERVICE SALE PROCESS

6. As set out above, the Receivership Order authorizes the Receiver to carry out the sale process developed by the Interim Receiver for the Food Service and Catering ("**Food Services**") business of the Debtors substantially in accordance with the timeline annexed as Schedule "E" to the First Report of the Interim Receiver dated November 25, 2010 (the "**Food Services Timeline**"), with such changes as the Receiver considers necessary in its sole discretion, acting reasonably.

7. The Receiver remains of the view, as initially expressed in the First Report of the Interim Receiver, that the Food Service business should be marketed for sale forthwith, and that such an approach is unlikely to impair realizations from the remaining Property.

8. In preparing the Confidential Information Memorandum for distribution to potential purchasers of the Food Services business (the "**Food Services CIM**"), the Receiver experienced difficulty in obtaining separate financial information for Food Services due to the following:

   (a) The financial statements of the Debtors, or any of them, have not been audited since the year ended December 31, 2008, and based on the information obtained to date by the Receiver, it is not certain whether the auditor at that time was in fact independent from the Debtors;

   (b) The operating results of Food Services and the spice trading business formerly conducted by 787 (the "**Spice Trading Business**") were combined in the accounting records of 787;

   (c) To the best of the Receiver's knowledge, separate financial statements or operating results for Food Services have never been prepared, and the current operating management for Food Services has never had visibility into the recorded operating results of Food Services; and

   (d) Due primarily to the resignation of the Former Controller before the appointment of the Interim Receiver, there have been no personnel available at the Debtors who were capable of assisting to isolate the operating results of Food Services.

9. The contract controller engaged by the Receiver has attempted to isolate the results of Food Services by identifying all revenue and expenses in the accounting records of 787 for the years in question that are reasonably believed to relate to the Spice Trading Business, and separating those items from the accounting records of 787 for the years in question. However, there is no certainty that the resulting financial information completely or accurately reflects the stand-alone revenues and expenses of Food Services. The Receiver has included the estimated stand-alone financial information in

the Food Services CIM but has provided substantial caveats highlighting the limitations of the information and the reasons thereof, all as described above.

10. As a result of the time required to estimate stand-alone financial information, the Receiver did not begin to contact prospective purchasers, and distribute Food Services CIMs, until the week beginning December 20, 2010, which was approximately one week later than contemplated in the Food Services Timeline. The Receiver has nonetheless requested that prospective purchasers submit offers by January 14, 2011, which was the date indicated in the Food Services Timeline.

11. To date, the Receiver has:

    (a) Identified 21 parties that the Receiver's research indicates are likely to have an interest in acquiring Food Services;

    (b) Approached all of the prospective offerors and distributed the Food Services CIM to 10 of those parties, and

    (c) Started providing facilities tours for the prospective purchasers that have expressed interest in touring the Food Services facility, with a view to completing all requested tours before the January 14 offer deadline described above.

12. The Receiver will provide the Court with further updates on the Food Services sale process in future reports.

LORETTA FLOUR AND LORETTA FOODS MARKETING PLAN

Loretta Flour Background

13. The primary assets of 211 are flour milling and sugar packing machinery (collectively the "**Flour Mill**") which are located in premises leased by the Debtors in Whitby, Ontario (the "**Whitby Premises**"). 211 operates under the registered trade name "**Loretta Flour**" and is also known as the "Loretta Flour Division" of the Debtors' operations. 211, in the past, produced various types of hard wheat flour from wheat sourced from Ontario and Western Canada. The Receiver understands that in the past the Flour Mill has produced flour to be sold under the Loretta brand name to various retailers by 213's

Loretta Foods business, as well as to wholesalers and bakeries in bulk. However, for a number of months before the appointment of the Receiver, all of 211's flour production was sold to Quality Food Brands, Inc. ("**QFB**"), an operating subsidiary of Synergy Brands, Inc. ("**Synergy**"), located in the United States, as discussed in greater detail below.

14. As noted above, the financial statements of the Debtors, or any of them, have not been audited since the year ended December 31, 2008, and, based on the information obtained to date by the Receiver, it is not certain whether the auditor at that time was in fact independent of the Debtors. In addition, the Receiver has experienced difficulty in obtaining separate financial information for 211 for the same reasons described in paragraph 8 in regards to the Food Services business as financial records of 211 include trading transactions that should be excluded from its reported operating results. According to its unaudited internal financial statements, and subject to the preceding limitations, 211 had revenues of approximately $41.2 million and net income of approximately $0.8 million for the nine months ended September 30, 2010.

15. The contract controller engaged by the Receiver has attempted to isolate the results of 211 by identifying all revenue and expenses in the accounting records of 211 for the years in question that are reasonably believed to not relate to the flour manufacturing operations with a view to backing those items out of the accounting records of 211 for the years in question. However, there is no certainty that the resulting financial information completely or accurately reflects the stand-alone revenues and expenses of 211.

16. Prior to the appointment of the Receiver, the Loretta Flour Division employed 10 people and day-to-day operations were directed by Mr. Nelipa, as Director of Operations, from the Whitby Premises. The employment of Mr. Nelipa by 211 was terminated by the Receiver after the Receiver became aware that, contrary to the Receiver's instructions to him, Mr. Nelipa directed the Flour Mill employees not to report to work the week following the Receiver's appointment. The Receiver also concurrently terminated the employment by 211 of four other employees who were not required for the level of production volume at the Flour Mill. Day-to-day operations have continued with the

assistance of the remaining employees of 211, supplemented as necessary by contract labour, under the direction of the Receiver.

17. As described above, for a number of months before the appointment of the Receiver, 211 sold all of its flour production to QFB, a subsidiary of Synergy. In developing a weekly cash flow forecast for the Debtors, the Interim Receiver had determined that the flour was in fact being sold to this customer, with which Mr. Gatti had a close business relationship, for less than its variable cost and that the customer had a large outstanding account receivable for previous flour purchases from 211. Consequently, the Interim Receiver had recommended to Mr. Gatti that 211 sell to the customer only on cash-on-delivery ("**COD**") terms, and at a price that exceeded its variable cost of production. Mr. Gatti declined to modify the sale pricing to a price exceeding its variable cost or credit terms on the grounds that the customer was of strategic importance and was a potential buyer of all assets of the Loretta Group, and that, therefore, it was important to maintain good relations with the customer.

18. The Receiver offered to continue to produce and sell flour to QFB, Synergy's subsidiary, but only (i) after QFB pays its outstanding flour invoices in the amount of approximately U.S. $344,000, dating back to early 2010, (ii) provided that all future sales to QFB are on a COD basis, and (iii) provided that all future sales occur at an increased price that would exceed 211's variable costs of production. To date the customer has refused to pay the balance owed to 211 or to agree to the other terms set out above, and, accordingly, the flour mill is currently operating only at reduced volume to produce flour for sale to wholesalers and bakery customers.

<u>Loretta Foods Background</u>

19. 213 operates from leased premises located on Sismet Drive, Mississauga, Ontario (the "**Sismet Premises**"). 213 operates under the registered trade name "**Loretta Foods**" and is also known as the "Loretta Spice Division" of the Debtors' operations. 213 is responsible for blending and repackaging spices for use in various packs and sizes, as well as redistributing food mixes for consumer and institutional customers throughout Canada. The Loretta Spice Division employs approximately 34 people and day-to-day

operations are directed by Mr. John Coticone a Director of Operations located at the Sismet Premises.

20. As with the financial results of 211 and the Food Services business , independent audited financial statements for 213 are not available and the Receiver has experienced difficulty in obtaining separate financial information for 213 for the same reasons described in paragraph 8 in regards to the Food Services business as the financial records of 213 contain trading transactions that should be excluded from its reported operating results. According to its unaudited internal financial statements, and subject to the preceding limitations, 213 had revenues of approximately $27.0 million and net income of approximately $1.3 million for the nine months ended September 30, 2010.

21. The contract controller engaged by the Receiver has attempted to isolate the results of 213 by identifying all revenue and expenses in the accounting records of 213 for the years in question that are not reasonably believed to relate to the spice manufacturing and food mixes distribution businesses, with a view to backing those items out of the accounting records of 213 for the years in question. However, there is no certainty that the resulting financial information completely or accurately reflects the stand-alone revenues and expenses of 213.

<u>Loretta Intellectual Property</u>

22. A review of trademark registrations by Borden Ladner Gervais LLP ("**BLG**"), independent counsel to the Receiver, indicates that:

    (a) the registered Canadian trademarks for the name Loretta, as they pertain to certain food products, are owned by 213 and that 213 also has a pending Canadian application for the Loretta design mark (the "Loretta" name surrounded by an oval and topped with leaves). These marks are collectively referred to in this Report as the "**Canadian Intellectual Property**"; and

    (b) the registered U.S. trademark for the name Loretta, as it pertains to certain food products, is owned by Gourmet Select Foods Corp., Inc., a corporation that is based in Syosset, New York and that the Receiver understands is an affiliate of Synergy.

23. In addition to sales of various spices by the Spice Business under the Loretta name and design, the Loretta name and design are also displayed on the wrapping of the various fresh foods sold by Food Services, and the Receiver understands that Loretta Flour has also sold flour packaged with the Loretta name and design directly to customers. The Receiver is not aware of any licensing or other agreement between 213 and either of 211 or 787 for the use of the Loretta name and design.

24. As discussed in the First Report of the Interim Receiver, the Food Services business does not appear to derive significant value from the Loretta brand, as the majority of its sales are made to persons such as mobile caterers that pick up products directly and to other customers who require their own label. Accordingly, the assets listed for sale in the Food Services CIM do not include the Canadian Intellectual Property.

Marketing Plan

25. Based on the above understanding of the Loretta businesses gained during the receivership described above, drawing on the experience of professionals from Ernst & Young Orenda Corporate Finance Inc. ("**EYO**", an affiliate of EYI) who specialize in the food and beverage industry, and taking into account the preliminary response from the potential purchasers of the Food Services business described above, the Receiver has now developed a detailed realization plan for the Flour and Spice businesses.

26. The Receiver is of the view that:

(a) The Spice and Flour businesses could be sold separately because:

(i) each has its own sales resources and the two businesses operate more or less independently;

(ii) neither has its own accounting or administrative resources;

(iii) the degree of automation and production complexity is substantially higher for Flour than for Spice, meaning that the Spice business might present less integration risk for a purchaser than would Flour; and

(iv) the sales volume available from Flour is limited by the production capabilities of the Flour Mill, and the Receiver understands that substantial capital investment would be required to increase available sales volume. By comparison, production volume in the Spice business is scalable with lower incremental levels of capital investment.

(b) However, some purchasers might be interested in acquiring both the Spice and Flour businesses. A number of the parties who have been approached by the Receiver in connection with the Food Services business have expressed interest in a combined purchase of this nature. A purchaser could potentially realize synergies by acquiring both the Spice and Flour businesses, most notably:

(i) the potential to increase margins by manufacturing the flour sold under the Loretta brand name instead of buying it from a third party; and

(ii) the potential ability to consolidate facilities, likely by moving the Spice operations (which entail substantially less production equipment) to the facility that contains the Flour Mill.

(c) The Receiver understands from discussion with BLG that a trademark can only be owned by one entity, although it may be licensed to another party. If the Flour and Spice businesses were sold together this presumably would not be an issue. However, if the businesses were sold separately then the Spice business, which sells numerous products under the Loretta name, appears to be the most dependent on the Canadian Intellectual Property and therefore greater value would be derived by selling the Canadian Intellectual Property with the Spice business.

27. Taking into account all of the above, it is the Receiver's recommendation that the Flour and Spice business should be marketed to (i) the parties approached in connection with

the Food Services business that have expressed an interest in the Flour or Spice businesses, (ii) entities identified by EYO that carry on businesses similar to Flour or Spice or, in the view of EYO, might be able to realize synergies by acquiring Flour or Spice, and (iii) to private equity funds and other financial investors that are known by EYO to have an interest in the food & beverage sector and would consider purchases of mid-market businesses.

28. The Receiver recommends that in order to effect a timely sale, the Flour and Spice businesses should be marketed for sale by tender (as with the Food Services business). To take into account the considerations noted above, the Receiver recommends that prospective purchasers be permitted to submit offers for:

(a) The Spice business, including the Receiver's right, title and interest (if any) in the Canadian Intellectual Property;

(b) The Flour business; or

(c) both the Spice (including the Canadian Intellectual Property) and Flour businesses.

29. In Appendix "**B**", the Interim Receiver has set out a proposed timeline for such a sales process that would allow a sale to be closed by April 1, 2011. The "required terms of sale" noted in Appendix "**B**" would include standard insolvency sale terms (as is, where is, no representations, no warranties). The timeline set out in Appendix B is longer than the timeline approved by the Court for the marketing and sale of the Food Services business because of the larger number of parties to be approached and the fact that certain of those parties may wish to evaluate two businesses rather than one.

INVESTMENT IN NORTH DAKOTA HOLDINGS LTD.

30. The Receiver does not yet have sufficient information to evaluate the realizable value, if any, of Tarbrac's investment in North Dakota Holdings Ltd. and, accordingly, it is not yet in a position to recommend a realization plan for this asset.

RELIEF SOUGHT BY THE RECEIVER

31. The Receiver respectfully requests that this Court grant an order:

  (a) authorizing the Receiver to commence the sale process for the Flour and Spice businesses, as set out above and in Appendix B to this Report, with such modifications as the Receiver, acting reasonably, considers appropriate in the circumstances; and

  (b) approving the activities of the Receiver as set out in this Report.

All of which is respectfully submitted this 10th day of January 2011.

ERNST & YOUNG INC.
Acting in its capacity as Receiver and Receiver and Manager of
2110458 Ontario Limited o/a Loretta Flour,
2131413 Ontario Limited o/a Loretta Foods,
787755 Ontario Limited o/a New Durham Trading,
and o/a NDT Food Service and o/a Skyway Wholesale
and Tarbrac Holdings Inc.
and not in its personal or corporate capacity.

Per:

Rahn Dodick, CA●CIRP
Vice-President

APPENDIX B

PROPOSED TIMELINE FOR MARKETING AND SALE OF FLOUR AND SPICE DIVISIONS

January 3 to January 14, 2011	▪ Prepare brief Confidential Information Memorandum (CIM), including required terms of sale and timeline for submission of purchase offers, and brief Investment Overview e-mail for distribution to prospective purchasers. ▪ Compile list of industry participants and financial investors that are most likely to be prospective purchasers. ▪ Accumulate available due diligence information.
January 17 to February 25, 2011	▪ Contact prospective purchasers by phone and Investment Overview e-mail. ▪ Circulate Confidentiality Agreements to interested parties. ▪ Parties executing a Confidentiality Agreement will receive the CIM and access to additional documentation. ▪ Provide facility tours as requested.
March 4, 2011	▪ Deadline for submission of purchaser offers including required terms of sale.
March 5 to April 1, 2011	▪ Analysis and negotiation of purchaser offers. ▪ Selection of successful purchaser. ▪ Application to Court for approval of sale agreement and vesting order. ▪ Closing of sale transaction.

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ONTARIO
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PROCEEDINGS COMMENCED AT TORONTO

FIRST REPORT TO THE COURT OF ERNST & YOUNG INC., AS RECEIVER

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