Court File No. CV-14-10667-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

IN THE MATTER OF AN APPLICATION UNDER SECTION 101 OF THE COURTS OF JUSTICE ACT, R.S.O. c. C.43 (as amended)

AND IN THE MATTER OF HANFENG EVERGREEN INC.

SUPPLEMENT TO SECOND REPORT OF THE RECEIVER DATED JULY 22, 2015

PURPOSE

1. This supplement to the Second Report of the Receiver (the "**Supplemental Second Report**") is provided in reference to the Receiver's Second Report dated July 17, 2015 (the "**Second Report**"). The purpose of the Supplemental Second Report is to provide this Court with information with respect to the following:

   a) new information concerning certain Lawsuits (as defined below) against Hanfeng Evergreen Inc.'s (or the "**Company**") wholly owned subsidiary, Hanfeng Slow-Release Fertilizer Co., Ltd (the "**Chinese Subsidiary**");
   b) information on the Settlements (as defined below) purportedly entered into by the Chinese Subsidiary with Industrial Bank (as defined below) in respect of these Lawsuits; and
   c) outlining the basis for an additional relief requiring Mr.Yu Xinduo, the current legal representative of the Chinese Subsidiary, and the Local Management Team operating under Mr. Yu's authority to obtain the Receiver's written approval prior to causing the Chinese Subsidiary to make any payments (including Settlement payments) or any transfers out of any bank accounts in the name of

the Chinese Subsidiary, including but not limited to the bank account no. 23001866251050505638 with the China Construction Bank.

TERMS OF REFERENCE

2. In preparing this Supplemental Second Report and making the comments herein, the Receiver has been provided with, and has relied upon, certain unaudited, draft and/or internal financial information, prepared by the Company's books and records, discussions with employees of the Company and information from other third-party sources (collectively, the "**Information**"). Except as described in this Supplemental Second Report:

   a) the Receiver 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 the Generally Accepted Assurance Standards pursuant to the *Canadian Institute of Chartered Accountants Handbook* and, accordingly, the Receiver expresses no opinion or other form of assurance in respect of the Information; and

   b) terms not described herein are as defined in Second Report or prior reports of the Receiver.

3. The Receiver has prepared this Supplemental Second Report in its capacity as a court-appointed officer solely for the use of this Court and the stakeholders in these proceedings and will make a copy of this Supplemental Second Report available on the Receiver's website at www.ey.com/ca/hanfeng.

4. All monetary amounts contained herein are expressed in Canadian dollars, unless otherwise stated.

GENERAL BACKGROUND

5. As described in greater detail in the Second Report, the Company has no independent operations and exists solely as a holding company for certain fertilizer

producing companies located in China. By mid-August 2014, the Company's principal remaining un-monetized asset was all the issued and outstanding shares of the Chinese Subsidiary (the "**Shares**"). The Chinese Subsidiary is a Wholly Foreign-Owned Enterprise ("**WFOE**") that was established and is registered in China.

6. As discussed in the Second Report, Mr. Yu is the current legal representative of the Chinese Subsidiary, a position that, under Chinese law, makes him responsible for the overall activities of the Chinese Subsidiary. The Chinese Subsidiary is managed by Mr. Yu and a team of individuals designated by him (collectively, the "**Local Management Team**").

7. The Receiver has been advised by Mr. Yu, on several occasions, that the Chinese Subsidiary's operations have been dormant since around April 2014.

8. As at June 30, 2015, the Chinese Subsidiary held cash of approximately RMB 72 million (approximately $14.4 million) based on bank statements provided by the Local Management Team.

NEW INFORMATION ON LAWSUITS AND SETTLEMENTS

9. As discussed in the Second Report and described in greater detail below, the Receiver has uncovered through its ongoing investigations three lawsuits against the Chinese Subsidiaries (the "**Lawsuits**") filed by a Chinese bank in relation to loan agreement disputes and contract disputes.

10. At a meeting on July 10, 2015 (the "**July 10 Meeting**"), when the Receiver asked Mr. Yu about the Lawsuits, Mr. Yu denied any knowledge and dismissed the Lawsuits as "Beidahuang's issues" (note: Beidahuang was formerly the largest customer of the Chinese Subsidiary). Further, Mr. Yu denied that the Chinese Subsidiary was subject to any such Lawsuits.

11. Further to the issuance of the Second Report, the Receiver has obtained from its Chinese counsel, certain court materials regarding the Lawsuits (the "**Harbin Court Materials**") in Chinese. At this time, the Receiver has not incurred the expense of translating the Harbin Court Materials, however, a summary is set out as follows:

a) the Chinese Subsidiary had obtained approximately RMB 170 million from the Harbin Branch of Industrial Bank Co., Ltd ("**Industrial Bank**") pursuant to various loan and accounts receivable factoring agreements entered into between November 2013 and July 2014 (the "**Loans**");

b) the Chinese Subsidiary has subsequently defaulted on these Loans. As a result, Industrial Bank launched three Lawsuits in March 2015 (as opposed to May and June, 2015 as described in the Second Report[1]) with the Harbin Intermediate People's Court (the "**Harbin Court**") against:

   - the Chinese Subsidiary;
   - other entities which are liable for the Loans or have pledged collateral/guarantees for the Loans; and
   - Mr. Yu, who provided a personal guarantee for the Loans;

c) Based on information from the ongoing investigations, the Receiver understands certain of the other defendants are entities that are affiliated with Mr. Yu;

d) the Harbin Court Materials indicate:

   - one Lawsuit was filed on March 18, 2015 (the "First Lawsuit") for an order requiring, among other things, the Chinese Subsidiary to repay RMB 80 million (approximately CDN$16 million) in principal plus interest in connection with a working capital loan executed on March 31, 2014;
   - a second Lawsuit was filed on March 18, 2015 (the "Second Lawsuit") for an order requiring, among other things, the Chinese Subsidiary to repay RMB 40 million (approximately CDN$8 million) in principal plus

[1] The Receiver has confirmed the correct filing dates of the Lawsuits based on Harbin Court Materials obtained after the issuance of Second Report.

interest in connection with a working capital loan agreement executed on July 23, 2014; and

- a third Lawsuit was filed on March 19, 2015 (the "Third Lawsuit") for an order requiring, among other things, the Chinese Subsidiary to repay RMB 36.8 million (approximately CDN$7.4 million) in principal and interest due to its defaults under a factoring arrangement executed on November 12, 2013;

e) on June 4, 2015, the Chinese Subsidiary and other defendants, represented by Mr. Liu Jiechang at Goodwell Law Firm ("**Goodwell**"), have settled all the Lawsuits with Industrial Bank (the "**Settlements**"). The Harbin Court approved the Settlements on June 4, 2015 as follows:

- Settlement case no. 76 for the Third Lawsuit;
- Settlement case no. 77 for the Second Lawsuit; and
- Settlement case no.78 for the First Lawsuit; and

f) under the Settlements, the Chinese Subsidiary has agreed to, among other things, repay in total approximately RMB 161 million (approximately CDN$32 million) in principal, interest and legal costs to Industrial Bank by August 31, 2015 (the "**Settlement Amount**s"). Should the Chinese Subsidiary fail to pay the Settlement Amounts, Industrial Bank is authorized to enforce against any one or all of the defendants.

12. The above new findings from the Harbin Court Materials contradict representations made by Mr. Yu and the Local Management. In addition:

a) given the size, nature and impact of the Settlements on the Chinese Subsidiary and the involvement of other entities affiliated to Mr. Yu, it is likely Mr. Yu was involved in and authorized the Settlements;

b) Goodwell (the Chinese counsel that acted for the Chinese Subsidiary in the Settlements) was Mr. Yu's preferred choice of Chinese counsel to the Company in negotiating the STA dated August 8, 2014 to sell the Shares;

c) none of the Loans appear to have been recorded or disclosed in the draft financial statements for the year ending June 30, 2014 (the "**Draft FY2014 Statements**") or monthly internal financial statements for the period July 2014 to May 2015 as provided to the Receiver by the Local Management Team. A copy of the Draft FY2014 Statements attached as Exhibit B to the Pollack Affidavit is attached hereto as **Appendix "A"**; and

d) certain of the Loans were incurred shortly before or during the period that the Chinese Subsidiary was purportedly dormant.

13. The non-disclosure by Mr. Yu and the Local Management Team of the liabilities and Settlements are further cause for concern in respect of the deterioration of the Heilongjiang Assets and lack of support from Mr. Yu and the Local Management Team in safe guarding and preserving the assets. The Settlement Amounts are far greater than the Chinese Subsidiary's current cash position. If the Settlements are implemented, any recovery for the Company's creditors and shareholders will be materially adversely impacted.

14. At the time of preparing this Supplemental Second Report, the Receiver has requested, but has not received from Mr. Yu or the Local Management Team, the original loan and accounts receivable factoring agreements and other supporting information in respect of the Lawsuits and the Settlements.

15. The Receiver, in consultation with its Canadian and Chinese counsel, is taking steps to further investigate the current situation and preserve the Heilongjiang Assets.

16. The Receiver's counsel was contacted by counsel for Mr. Yu with respect to the motion served on July 17, 2015. The discussions are ongoing.

17. Based on the foregoing, the Receiver respectfully recommends this Court make an Order granting the relief requested in the Second Report and also requiring Mr.Yu Xinduo, the current legal representative of the Chinese Subsidiary, and the Local Management Team operating under Mr. Yu's authority to obtain the Receiver's

written approval prior to causing the Chinese Subsidiary to make any payments (including Settlement payments) or any transfers out of any bank accounts in the name of the Chinese Subsidiary, including but not limited to the bank account no. 23001866251050505638 with the China Construction Bank.

All of which is respectfully submitted this 22nd day of July, 2015.

ERNST & YOUNG INC.
In its capacity as Receiver of
Hanfeng and not in its personal or corporate capacity

Per:

Murray A. McDonald
President

Appendix “A”

HANFENG EVERGREEN INC.

DRAFT Consolidated Statements of Financial Position
(Expressed in thousands of Canadian dollars)

June 30, 2014 and 2013

	2014 (Unaudited)	2013 (Audited)
Assets		
Current assets:		
Cash	$ 17,673	$ 56,467
Trade receivables	34,014	72,468
Advances to suppliers	7,621	93,860
Inventories (note 4)	3,489	6,083
	62,797	228,878
Non-current assets:		
Intangible assets (note 5)	-	401
Deferred tax assets (note 11)	-	961
Investment in joint venture (note 7)	-	12,262
	-	13,624
Total assets	$ 62,797	$ 242,502
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	$ 1,065	$ 1,826
Advances from customers	-	260
Due to related parties (note 16)	3,734	-
Income taxes payable (note 11)	-	2,133
	4,799	4,219
Non-ccurrent liabilities:		
Deferred tax liabilities (note 11)	978	-
	5,777	4,219
Shareholders' equity:		
Share capital (note 9)	125,058	125,058
Contributed surplus	-	1,955
Accumulated other comprehensive income	25,128	20,369
Retained earnings (note 10)	(93,166)	90,901
	57,020	238,283
Going concern (note 2)		
Economic dependence (note 13)		
Subsequent events (note 19)		
Total liabilities and shareholders' equity	$ 62,797	$ 242,502

See accompanying notes to consolidated financial statements.

HANFENG EVERGREEN INC.

DRAFT Consolidated Statements of (Loss) Income
(Expressed in thousands of Canadian dollars, except per share amounts)

Years ended June 30, 2014 and 2013

	2014 (Unaudited)	2013 (Audited)
Sales	$ 14,503	$ 164,720
Cost of goods sold	39,572	149,100
Gross (loss) profit	(25,069)	15,620
Expenses:		
Selling	1,272	1,905
General and administrative	12,516	7,236
Research and development	17,874	4,111
Bad debt provisions	47,726	-
Impairment of intangible assets (notes 5)	401	-
(Reversal) impairment of property and equipment (note 6)	(1,568)	79,346
	78,221	92,598
Operating loss	(103,290)	(76,978)
Other expenses (income):		
Interest income	(327)	(192)
Other loss (income) (note 8)	63,643	(217)
Share of loss of joint ventures, net of tax (note 7)	1,215	1,255
Loss on disposal of assets held for sale	-	389
Loss on disposal of interests in joint ventures (note 7)	12,231	-
Loss on disposal of subsidiaries (note 7)	6,205	-
	82,967	1,235
Loss before income taxes	(186,257)	(78,213)
Income taxes (recovery) (note 11):		
Current	(1,165)	2,232
Deferred	978	395
	(187)	2,627
Net loss	$ (186,070)	$ (80,840)
Loss per share (note 9(c)):		
Basic and diluted	$ (3.09)	$ (1.34)

See accompanying notes to consolidated financial statements.

HANFENG EVERGREEN INC.

DRAFT Consolidated Statements of Comprehensive (Loss) Income
(Expressed in thousands of Canadian dollars)

Years ended June 30, 2014 and 2013

	2014 (Unaudited)	2013 (Audited)
Net loss	$ (186,070)	$ (80,840)
Other comprehensive income:		
Items that may be classified subsequently to profit or loss:		
Gain on translation of foreign operations	4,759	12,932
Comprehensive loss	$ (181,311)	$ (67,908)

See accompanying notes to consolidated financial statements.

HANFENG EVERGREEN INC.

DRAFT Consolidated Statements of Changes in Shareholders' Equity
(Expressed in thousands of Canadian dollars)

Years ended June 30, 2014 and 2013

	2014 (Unaudited)	2013 (Audited)
Share capital:		
Balance, beginning of year	$ 125,058	$ 125,344
Repurchased and cancelled	-	(286)
Balance, end of year	$ 125,058	$ 125,058
Contributed surplus:		
Balance, beginning of year	$ 1,955	$ 1,607
Stock-based compensation expense	48	348
Stock options forfeited (note 9(b))	(2,003)	-
Balance, end of year	$ -	$ 1,955
Retained earnings:		
Balance, beginning of year	$ 90,901	$ 171,714
Shares repurchased and cancelled	-	27
Reclassification of stock options expired	2,003	-
Net loss	(186,070)	(80,840)
Balance, end of year	$ (93,166)	$ 90,901
Accumulated other comprehensive income (loss):		
Balance, beginning of year	$ 20,369	$ 7,437
Other comprehensive income	4,759	12,932
Balance, end of year	$ 25,128	$ 20,369
Treasury stock (note 9):		
Balance, beginning of year	$ -	$ (216)
Treasury stock purchased	-	(43)
Treasury stock cancelled	-	259
Balance, end of year	$ –	$ –
Total shareholders' equity	$ 57,020	$ 238,283

See accompanying notes to consolidated financial statements.

HANFENG EVERGREEN INC.

DRAFT Consolidated Statements of Cash Flows
(Expressed in thousands of Canadian dollars)

Years ended June 30, 2014 and 2013

	2014 (Unaudited)	2013 (Audited)
Cash flows from operating activities:		
Net loss	$ (186,070)	$ (80,840)
Items not involving cash:		
Depreciation and amortization	-	2,337
Deferred income taxes	978	395
Loss on disposal of property and equipment	-	389
Loss on disposal of subsidiary	6,205	-
Loss on disposal of joint venture	12,231	-
Impairment of intangible assets	401	-
Impairment (reversal) of property and equipment (note 6)	(1,568)	79,346
Stock-based compensation expense	48	348
Share of loss of joint ventures, net of tax	1,215	1,255
Income taxes	(1,165)	2,232
Interest income	(327)	(192)
Interest received	327	192
Income taxes paid	-	(2,056)
	(167,725)	3,406
Change in non-cash operating working capital (note 14)	122,528	(27,005)
Cash flows used in operating activities	(45,197)	(23,599)
Cash flows from financing activities:		
Shares repurchased and cancelled	-	(43)
Loan from related parties (note 16 (b))	3,734	-
Cash flows from (used in) financing activities	3,734	(43)
Cash flows from investing activities:		
Proceeds on disposal of assets held for sale (note 5)	-	2,727
Acquisition of property and equipment and intangible assets	-	-
Proceeds on disposal of property and equipment (note 6)	1,568	
Proceeds on disposal of subsidiaries (note 7)	422	-
Investment in Indonesian Joint Venture (note 16(c))	-	(8,275)
Decrease in short-term investments	-	711
Cash flows (used in) from investing activities	1,990	(4,837)
Effect of exchange rate changes on cash	679	(3,881)
(Decrease) in cash	(38,794)	(24,598)
Cash, beginning of year	56,467	81,065
Cash, end of year	$ 17,673	$ 56,467

See accompanying notes to consolidated financial statements.