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CANADA
PROVINCE OF QUÉBEC
DISTRICT OF MONTRÉAL

No.: 500-11-058116-209

S U P E R I O R C O U R T
Commercial Division
Designated tribunal under the Companies' Creditors Arrangement Act[1]

IN THE MATTER OF THE PROPOSED PLAN OF COMPROMISE AND ARRANGEMENT OF SPECTRA PREMIUM INDUSTRIES INC., SPECTRA PREMIUM HOLDINGS (USA) CORP., SPECTRA PREMIUM (USA) CORP., SPECTRA PREMIUM PROPERTIES (USA) CORP., SPECTRA PREMIUM TAIWAN CO. LTD., SPECTRA PREMIUM (SHANGHAI) AUTOMOTIVE TECHNICAL SERVICES CO. LTD., AND SPECTRA PREMIUM (CHONGQING) AUTOMOTIVE SERVICES CO. LTD.

SECOND MONITOR'S REPORT (TRICO SALE TRANSACTION) DATED MAY 19, 2020

INTRODUCTION

1. On March 10, 2020, the Superior Court of Québec (the "**Court**") issued a first day initial order (the "**First Day Initial Order**") under the *Companies' Creditors Arrangement Act*[1] (the "**CCAA**") with respect to Spectra Premium Industries Inc. ("**Spectra**"), Spectra Premium Holdings (USA) Corp. ("**Spectra Holdings US**"), Spectra Premium (USA) Corp. ("**Spectra US**"), Spectra Premium Properties (USA) Corp. ("**Spectra Properties US**"), Spectra Premium Taiwan Co. Ltd. ("**Spectra Taiwan**"), Spectra Premium (Shanghai) Automotive Technical Services Co. Ltd. ("**Spectra Shanghai**"), and Spectra Premium (Chongqing) Automotive services Co. Ltd. ("**Spectra Chongqing**") (collectively referred to herein as the "**Spectra Group**" or the "**Debtors**"), containing among other things, a stay of proceedings in respect of the Debtors, originally until March 20, 2020 (as further extended from time to time, the "**Stay Period**"), and various other relief, including certain protections from their creditors.

2. On March 9, 2020, Ernst & Young Inc. filed a report of the proposed monitor with the Court, dated March 9, 2020 (the "**Pre-Filing Monitor's Report**").

[1] *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended.

3. Pursuant to the First Day Initial Order, Ernst & Young Inc. was appointed as monitor ("**EY**" or the "**Monitor**") of the Debtors in the present proceedings (the "**CCAA Proceedings**").

4. On March 12, 2020, the United States Bankruptcy Court for the District of Delaware (the "**U.S. Court**") issued various orders and relief under Chapter 15 of the *U.S. Bankruptcy Code* with respect to the recognition of the CCAA Proceedings in the United States, including an order granting provisional relief to recognize and effect the CCAA filing (the "**Chapter 15 Proceedings**"). EY acts as foreign representative (the "**Foreign Representative**") in the Chapter 15 Proceedings.

5. On March 24, 2020, an order was issued by the Court amending and restating the First Day Initial Order (the "**Amended and Restated Initial Order**") and extending the Stay Period until June 6, 2020.

6. On April 6, 2020, an order was issued by the Court regarding certain transactions in the normal course of business related to Truist Bank, Spectra US, Advance Stores Company, Inc. and O'Reilly Automotive Stores, Inc. authorizing the continuance of the factoring of invoices, in the normal course of business, in accordance with the agreements in place.

7. The comeback hearing and the hearing of certain objections before the U.S. Court with respect to the Chapter 15 Proceedings was initially scheduled to take place on April 8, 2020, but was postponed to May 27, 2020 by the U.S. Court following the general postponement of all non-urgent matters by the U.S. Court, considering the Covid-19 pandemic.

8. On April 28, 2020, the Debtors filed a motion in the CCAA Proceedings for declaratory judgment and for the issuance of a safeguard order with regard to a leased property in Indiana, United States, and the expiration date of said property lease. The hearing to adjudicate this matter has been postponed sine die by consent from the parties.

9. On April 30, 2020, Ernst & Young Inc. filed its first report with the Court, dated April 28, 2020, which essentially reports about a material adverse change (Covid-19 pandemic), and presents an update of the financial situation and cash-flow projections of Spectra Group (the "**First Monitor's Report**").

10. On May 19, 2020, the Debtors filed a motion in the CCAA Proceedings for the issuance of an approval and a vesting order on a bulk sale transaction to Trico Group, LLC ("**Trico**" or the "**Purchaser**") of certain inventories, the whole as more detailed below (the "**Trico Sale Motion**"). The hearing of this matter is planned to be held on Thursday May 21, 2020.

11. The Monitor has established a website to post information relating to the CCAA Proceedings, as well as the Chapter 15 Proceedings. The address of the Monitor's website is www.ey.com/ca/spectra.

PURPOSE

12. The present report (the "**Second Monitor's Report**") has been prepared to provide the Monitor's position on the Trico Sale Motion in accordance with section 36(3)(c) CCAA. The Second Monitor's Report is presented under the following headings:

- Introduction
- Purpose
- Terms of reference and disclaimer
- Background
- Bulk sale of a certain inventory (fuel pumps and parts product lines destined to the US market) to Trico:
    i. Trico contemplated sale transaction (Trico Sale Transaction)
    ii. Grounds to justify the approval by the Court to sell the Purchased Assets (Fuel Pump Inventory) and issue a vesting order
- Conclusions and Monitor's recommendations

TERMS OF REFERENCE AND DISCLAIMER

13. Capitalized terms not defined herein have the meaning ascribed to them in the Pre-Filing Monitor's Report and the First Monitor's Report, as the case may be.

14. In preparing the Second Monitor's Report and making the comments herein, the Monitor has been provided with and has relied upon certain unaudited, draft and/or internal financial information, Debtors' records, management prepared financial information and projections, information from other third-party sources, and has engaged in discussions with the Debtors' directors, senior management team ("**Management**") and the Debtors' legal advisors (collectively, the "**Information**"). Except as described in this Second Monitor's Report:

– The Monitor has assumed the integrity and truthfulness of the Information and explanations provided to it, within the context in which it was presented. To date, nothing has come to the attention of the Monitor that would cause it to question the reasonableness of this assumption;

– The Monitor has requested that Management bring to its attention any significant matters which were not addressed in the course of its specific inquiries. Accordingly, the Second Monitor's Report is based solely on the Information (financial or otherwise) provided by the Debtors;

– The Monitor has reviewed the Information for reasonableness, internal consistency and use in the context in which it was provided. The 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 or generally accepted standards for review engagements and, accordingly, the Monitor expresses no opinion or other form of assurance in respect of the Information;

- In view of the purpose of the Second Monitor's Report, some of the financial information therein may not comply with generally accepted accounting principles; and,
- Some of the information referred to in this Second Monitor's Report consists of forecasts and projections that were prepared based on Management's current estimates and assumptions. Such estimates and assumptions are, by their nature, not ascertainable and as a consequence, no assurance can be provided regarding any such forecasted or projected results. Actual results will vary from the forecasts or projections, even if the estimates and assumptions are accurate, and the variations could be significant.

15. This report does not take into account all future impacts of Covid-19 pandemic on the forecasts or projections or other actions taken by Spectra Group as a result of the evolving virus situation. Any references made to the impact of the Covid-19 on Spectra Group in this report are based on preliminary enquiries and are not to be interpreted as a complete commentary or as an accurate assessment of the full impact of the virus. The potential for unknown ramifications on consumers, supply chains, commercial counterparties (both direct and indirect to the Spectra Group's operations), future decisions that the Spectra Group may make as a result of the evolving virus situation and potentially adverse geopolitical outcomes, means that the forecasts or projections may be impacted by the Covid-19. The full impact of the virus is not capable of being qualitatively or quantitatively assessed at this time.

16. All references to currency are in Canadian dollars unless otherwise noted.

BACKGROUND

17. Spectra Group is one of Quebec's largest manufacturers and distributors of automotive products, generating annual revenues of approximately $500.0M for the year ended January 31, 2020, which resulted in an EBITDA of $7.0M and a net loss of $13.3M.

18. As of the commencement of the CCAA Proceedings, Management has attributed the Debtors' financial difficulties to both the strain placed on the cash flow as a result of Spectra Group's venture in Sweden, as well as a general decrease of profitability in their North American activities over the past few years. This decreased profitability was apparently caused by a shift in customer demand towards products that have a lower price (and quality) as compared with the Debtors' products, over capacity of production for the US market for particular products which creates a downward pressure on prices, and the impact of tariffs imposed in the US on goods imported from China. These factors affected most particularly what is referred as the aftermarket division.

19. As stated in the Pre-Filing Monitor's Report, the difficulties encountered by the Debtors and the resulting cash flow strain rendered the Debtors insolvent, which led to initiation of the proceedings under the CCAA.

20. The corporate structure of the Spectra Group, description of activities, causes of financial difficulties and various other issues relevant to the restructuring proceedings of the Debtors are described in greater detail in the Pre-Filing Monitor's Report. The Pre-Filing Monitor's Report, the First Monitor's Report and other relevant and accessory documents in the present matter are accessible through the Monitor's website, at www.ey.com/ca/spectra.

21. As indicated in the Amended motion for the issuance of (i) a first day initial order and (ii) an amended and restated initial order, dated March 23, 2020 (the "**Initial Order Amended Motion**") regarding the proposed operational restructuring of Spectra Group:

    – At paragraph 78 "*… it has already been determined by the Petitioners, with the assistance of the Proposed Monitor, that at least part of the solution resides in an important downsizing of the aftermarket in the US in order to ultimately stop supplying clients with certain products that are less profitable, notably the fuel pumps and cooling products*";

    – At paragraph 79 "*Such a downsizing cannot be made overnight as it is in the interest of the Spectra Group's business (and therefore of all stakeholders involved) to manage the relationship with the US clients and ensure that the client base remains for the profitable products of the aftermarket division that the Spectra Group intends to continue selling*"; and,

    – At paragraph 91 "*Spectra Group has in fact undertaken discussions with a third party for a possible sale of its Aftermarket division, in part or as a whole. However, discussions are at an early stage and it is impossible at this time to speculate on the results of these early discussions*".

22. Consequently, as part of the implementation of its restructuring plan, Spectra Group intends to execute a bulk sale of certain inventories related to their fuel pumps and parts product lines destined to the US market outside the ordinary course of business, to Trico, and which are part of its aftermarket division. In line with the restructuring plan, the proposed transaction allows Spectra Group to divest from certain US operations (i.e. abandon certain products line in the US aftermarket business), a market in which it no longer wishes to operate.

BULK SALE OF A CERTAIN INVENTORY (FUEL PUMPS AND PARTS PRODUCT LINES DESTINED TO THE US MARKET) TO TRICO

Trico contemplated sale transaction

23. As explained in the Trico Sale Motion, at the commencement of the CCAA Proceedings, Spectra Group had already been in discussions with a third party regarding the potential sale of its US aftermarket division, in whole or in part.

24. Prior to the CCAA Proceedings, Spectra Group received certain offers to purchase inventories of US aftermarket division from Trico. After discussions and negotiations throughout the evolution of the Covid-19 pandemic, Trico submitted a non-binding letter of intent, dated March 23,2020 for Spectra Premium's fuel pumps and parts product lines earmarked to the US aftermarket business of Spectra Group (the "**Fuel Pump Inventory**"), which was accepted by Spectra Group on March 24, 2020 (the "**LOI**" or "**Trico Sale Transaction**"). The LOI is attached to the Trico Sale Motion under seal as Exhibit R-3.

25. Trico, headquartered in Cleveland, Ohio USA, is a leading North American manufacturer and distributor of both aftermarket and original equipment parts for the automotive and industrial markets. Trico is a competitor of the Debtors in the wholesale distribution of fuel pumps in the US aftermarket business.

26. The LOI provides for a due diligence period which has now been completed. The parties have negotiated the terms of an Asset Purchase Agreement (the "**Trico APA**") which was executed on May 12, 2020, subject to the approval of the Court. The Trico APA is attached to the Trico Sale Motion under seal as Exhibit R-4.

27. The Trico APA represents a commitment to purchase (Guaranteed Purchases as described in paragraph 3.03 of the Trico APA) the Fuel Pump Inventory through successive sale transactions over a period up to six (6) months following the date of the APA (the "**Sale Period**").

28. These sale transactions are to be implemented as follows: upon receipt of a Trico purchase order, Spectra Group will invoice Trico, prepare the order, receive payment in full prior to the shipment of the order, and finally release the goods to Trico pick up at one of the main distribution centers of Spectra Premium (Boucherville, Indiana or California). The transfer of ownership of the inventory purchased will occur only after the payment in full has been received by Spectra Group from Trico and once Trico has physically taken possession of the goods in question.

29. The sale transactions noted above are similar to current inventory sale to Spectra Group customers in the normal course of business, with the exception that the Trico transactions represent a bulk sale of a complete product lines (destined to US market) to a competitor of Spectra Group and not a "normal" customer, which are sold at a heavier discount than those normally offered to Spectra Group's customers.

30. Additional relevant aspects of the Trico APA are listed below:

    - The purchased assets are the Fuel Pump Inventory as described in the Exhibit 1 of the Trico APA, which have an estimated book value of US$15,917,676, subject to some adjustments (the "**Purchased Assets**");
    - The Purchased Assets represents approximately 17.6% of the actual inventory of Spectra Group;
    - The purchase price will be an amount representing a defined percentage of the book value of the Purchased Assets indicated in the Trico APA, for each successive sale to be completed between the parties over the Sale Period (the "**Purchase Price**");

- All sales related to the Trico APA are on "as is, where is" basis;
- The vendor of the Trico APA transactions will be Spectra US, while some of the Purchased Assets are owned by Spectra (approximately US$3.6M) and will be transferred from Spectra to Spectra US before the successive sales to Trico over the Sale Period. This sale transaction is described in the Trico Sale Motion as the "Interco APA" and will be executed in the same manner as the usual transfer of inventory between Spectra and Spectra US, in the normal course of business, at a pricing equivalent to the Purchase Price for the said transferred inventories;
- The Purchase Price proceeds will be deposited in the Spectra US blocked account, which will subsequently be applied to the Wells Fargo combined line of credit of Spectra and Spectra US; and,
- In accordance with the structure of the contemplated transaction, the Purchased Assets will vest in Trico progressively as they are paid and delivered to Trico.

31. As mentioned in the Trico Sale Motion (paragraphs 23 to 25), Wells Fargo and LBC as the main secured creditors of Spectra Group, have been consulted. Wells Fargo has indicated that they are in agreement with the sale of the Purchased Assets in accordance with the Trico APA.

Grounds to justify the approval by the Court to sell the Purchased Assets and issue a Vesting Order

32. The circumstances and justifications of the Trico Sale Transaction are the followings:

- Spectra has already identified in their proposed restructuring plan that they intend to exit the US market for the fuel pumps and parts product lines earmarked for the US market, which consists of the Purchased Assets in the Trico Sale Transaction. The Trico Sale Transaction is in line with Spectra Group restructuring plan;
- The market uncertainty created by the Covid-19 pandemic justifies a part of the discount on the book value of the Purchased Assets;
- The list of potential strategic purchasers for such a bulk sale (US$15.9M on inventory at book value) of this type is limited;
- According to Management, the Trico Sale Transaction will assure a continued supply to the Spectra Group US customers, avoiding any interruption in the supply chain and thus preserving good relationships with these customers. This is necessary to maintain the sale of the other product lines of the Spectra Group to these customers;
- Per Management, the sale of all the Inventory in the ordinary course of business with the actual base of Spectra Group's customers would otherwise take more than 18 months;

- Per the information received by the Management, on average, approximately 42% of the Fuel Pump Inventory represent fast moving SKU's, which generate the top 80% of the sales of this product lines. Consequently, 58% of the Fuel Pump Inventory represent lower moving SKU's, which generate the remaining 20% of the sales of this this product lines and obsolescence products in this product lines. Considering that the Fuel Pump Inventory is comprised of inventory of different ages, the price that a purchaser would be willing to pay for the complete inventory for this product line is mainly related to its capacity to resell such inventory on the market. This fact had an impact on the discount on the book value of the Purchased Assets;
- This sale process was overseen by Management, who represents that the Trico Sale Transaction and its pricing are fair and reasonable in the circumstances. Consequently, no formal sale and solicitation process has been initiated by Spectra Group for the sale of the Fuel Pump Inventory, which represents approximately 17.6% of the actual inventory of Spectra Group. Management believes that the Purchase Price, which is based on a discount on the book value of the Purchased Assets, is reasonable, and that a formal solicitation process, in this case and in the context of the Covid-19 pandemic, would have been cash and time consuming without any reasonable expectation of a better result. Management also indicated that time was of the essence and that a sale process would have taken at least an additional 30-45 day period, during which there could have been an interruption in the supply to the US customers which would have negatively impacted the relationship between these customers and the Spectra Group; and,
- Wells Fargo has consented to the sale of the Purchased Assets in accordance with the Trico APA.

33. For the reasons above, the Monitor is of the view that given the particular nature of the assets being sold, the limited scope of potential purchasers, the volume of Fuel Pump Inventory of different ages, the challenge resulting from the sale of such a volume of inventory to end-customers, the challenging economic circumstances due to the Covid-19 pandemic, and finally due to the fact that discussions were already going on with Trico prior to the CCAA Proceedings, to conduct a formal sale process would be costly and would most likely not result in a better outcome for the sale of the Purchased Assets. As such, the Monitor is of the view that the Trico Sale Transaction does maximize the Purchased Assets as assets of the Debtors.

34. Moreover, the consideration to be received by Spectra Group pursuant to the Trico Sale Transaction appears to be reasonable considering the fact that Wells Fargo consents to the transaction and support it.

35. Given the foregoing, we believe that this sale transaction would be more beneficial to the creditors as a hole than a sale or disposition under a forced liquidation.

36. We believe that all conditions of section 36 CCAA are met regarding the Trico Sale Transaction.

CONCLUSIONS AND MONITOR'S RECOMMENDATIONS

37. In light of the foregoing and notably the agreement of Wells Fargo to the Trico Sale Transaction, the Monitor believes that this sale transaction is appropriate and to the benefit of the Debtors' stakeholders as a whole. Consequently, the Monitor supports the Trico Sale Motion for an order authorizing the sale of a certain inventory (fuel pumps and parts product lines earmarked for US aftermarket) of the Debtors and the vesting of these assets, and recommends that the Court grant the relief sought therein.

All of which is respectfully submitted this 19th day of May 2020.

ERNST & YOUNG INC.,
Licensed Insolvency Trustee
in its capacity as the Monitor in the matter of the proposed compromise and arrangement of Spectra Premium Industries Inc. *et al*

Per: Éric St-Amour, CPA, CA, CIRP, LIT Senior Vice-President	Per: Mario Denis, CPA, CA, CIRP, LIT Senior Vice-President