



Ernst & Young Inc.
900, boul. De Maisonneuve Ouest
Bureau 2300
Montréal (Québec) H3A 0A8

Tél./Tel: +1 514 875 6060
Télec./Fax: +1 514 879 2600
ey.com

**CANADA
PROVINCE OF QUÉBEC
DISTRICT OF MONTRÉAL**

S U P E R I O R C O U R T
Commercial Division
*Designated tribunal under the Companies'
Creditors Arrangement Act¹*

No.: 500-11-058761-202

**IN THE MATTER OF THE PROPOSED PLAN OF
COMPROMISE OR ARRANGEMENT OF ERNEST
ENTERPRISES (MTL) LTD.**

REPORT OF THE PROPOSED MONITOR – September 4, 2020

INTRODUCTION AND BACKGROUND

1. Ernest Enterprises (Mtl) Ltd. ("**Ernest**", "**Company**" or "**Applicant**") has brought a motion before this Honourable Court ("**Court**") to commence proceedings under the *Companies' Creditors Arrangement Act¹* ("**CCAA**"), seeking an order ("**Initial Order**") containing a stay of proceedings in respect of the Applicant, the appointment of Ernst & Young Inc., a licensed insolvency trustee, as monitor ("**EY**" or the "**Proposed Monitor**") and various other relief measures.
2. The present report ("**Report**") is intended to provide the Court with information relevant to the Applicant's application for an Initial Order under the CCAA ("**Motion**"), based on the information that has been made available to the Proposed Monitor. The Report is presented under the following headings:
 - Introduction and Background;
 - Appointment of monitor;
 - Terms of Reference and Disclaimer;
 - Financial position of the Applicant;
 - Cash Flow Forecast;
 - Financial Thresholds Contemplated;
 - Upcoming Restructuring Measures; and
 - Overall Comments and Conclusions.
3. The Applicant is a privately held company incorporated under the provisions of the Canada Business Corporations Act, that exploits a retail chain comprised of 37 store locations, primarily in the Province of Quebec, selling men's suits and leisure wear. The Applicant employs approximately 350 persons in total at its stores and at its administrative offices located on Meilleur Street in Montreal.

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

4. The financial difficulties are attributed to the Covid-19 pandemic, which has caused a sharp decrease in sales as stores have had to close to implement the physical distancing measures necessary to combat the coronavirus (“**Virus**”) while continuing to incur fixed operating expenses. In addition, the pandemic affected Ernest’s procurement schedules and supply chain.
5. The sales continue to be lower than historical levels, which has caused cash flow difficulties. As a result, the Applicant does not have sufficient resources to pay current expenses and is accumulating operating losses. This stark reality led the Applicant to conclude that a formal restructuring process is necessary.

APPOINTMENT OF MONITOR

6. As mentioned earlier in this Report, EY has been informed that the Applicant is seeking its appointment as monitor in the context of proceedings under the CCAA.
7. EY points out that while it fulfills the requirements of section 11.7(1) of the CCAA, it is subject to one of the restrictions set out in section 11.7(2) of the CCAA, in that Ernst & Young LLP, an affiliate of EY, has been acting as the accountant of the Applicant. Ernst & Young LLP is prepared to resign from the accounting engagement if, as the case may be, a conflict situation arises with its capacity as monitor in the proceedings under the CCAA. The board of directors of the Applicant has been informed of this possibility and has accepted that EY act as monitor in this circumstance. EY and Ernst & Young LLP have put in place an ethical wall to prevent the inadvertent communication of information between the personnel involved with the accounting review engagement and the personnel involved in the proceedings under the CCAA.
8. In view of the restrictions set out in section 11.7(2) of the CCAA, the appointment of EY, notwithstanding the prior existing relationship, must be specifically authorized by the Court.
9. With respect to this authorization, EY hereby confirms the following:
 - 9.1. EY has put in place and will maintain an ethical wall to prevent the inadvertent communication of information between the audit team and the personnel assigned to the restructuring engagement;
 - 9.2. EY is not aware of any actual conflict of interest or loss of independence arising from the previous relationship between the Applicant and Ernst & Young LLP as accountant.
 - 9.3. EY has consented to act as monitor in these proceedings, if the Court chooses to appoint it as monitor.
 - 9.4. HSBC Bank Canada, the operating lender and contemplated interim financing lender of the Applicant has advised us that it supports the appointment of EY as Monitor.
10. Norton Rose Fulbright has been retained to act as the monitor’s independent counsel in these CCAA proceedings if the Court chooses to appoint EY as monitor.

TERMS OF REFERENCE AND DISCLAIMER

11. In preparing this Report and making the comments herein, the Proposed Monitor has been provided with and has relied upon certain unaudited, draft and/or internal financial information, company records, management prepared financial information and projections, information from other third-party sources, and has engaged in discussions with the Applicant's directors, senior management team ("**Management**") and the Applicant's legal advisors (collectively, the "**Information**"). Except as described in this Report:
 - 11.1. The Proposed 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 Proposed Monitor that would cause it to question the reasonableness of this assumption.
 - 11.2. The Proposed Monitor has requested that Management bring to its attention any significant matters which were not addressed in the course of its specific inquiries. Accordingly, this Report is based solely on the Information (financial or otherwise) provided by the Applicant.
 - 11.3. The Proposed Monitor has reviewed the Information for reasonableness, internal consistency and use in the context in which it was provided. The Proposed 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 Proposed Monitor expresses no opinion or other form of assurance in respect of the Information.
 - 11.4. In view of the purpose of the Report, some of the financial information therein may not comply with generally accepted accounting principles.
 - 11.5. This Report does not take into account all future impacts of COVID-19 (SARSCoV-2) ("**Covid-19**", "**Coronavirus**" or "**Virus**") on the forecasts or projections or other actions taken by the Applicant as a result of the evolving Virus situation. Any references made to the impact of the Coronavirus on the Applicant 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 Applicant's operations), future decisions that the Applicant 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 Coronavirus. The full impact of the Virus is not capable of being qualitatively or quantitatively assessed at this time.
 - 11.6. Some of the information referred to in this 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.

12. This Report has been prepared by the Proposed Monitor in order to provide additional information to the Court in connection with the Applicant's motion for the issuance of the Initial Order and the current status of the Applicant's financial affairs and prospects. This Report may not be appropriate for any other purpose and consequently should not be used for any other purpose.
13. Unless otherwise stated all monetary amounts contained herein are expressed in Canadian dollars.

FINANCIAL POSITION OF THE APPLICANT

14. The most recent available internally prepared financial statements are the statements as at July 31, 2020 and for the six months then ended. The most recent available year end financial statements are draft financial statements at January 31, 2020 and for the year then ended. These statements are attached as **Appendix A** and **Appendix B** respectively.
15. EY will review the Applicant's financial position at a later date, if it is appointed as monitor in the CCAA proceedings. However, the following observations can be made from the financial statements:
 - 15.1. The financial statements for the year ended January 31, 2020 indicate an EBITDA² of \$1,347K for the year, on a sales volume of \$47,054K (or 2.9%). However, the financial statements indicate that the Applicant had an EBITDA loss of \$3,631K for the 6 months ended July 31, 2020, on a sales volume of 7,519K (or 48.3%). The sales level in the first 6 months of the Company's fiscal 2021 year³ ("F21") are 63.5% lower than the sales for the equivalent period in the previous year, and while the Company was able to decrease its expenses, the decrease was not in proportion with the downturn in sales. This has led to the EBITDA loss of \$3,631K for the first 6 months of F21, compared with an EBITDA loss of \$254K for the same period in the previous year.
 - 15.2. The EBITDA loss of \$3,631K causes a substantial strain on the Company's cash flow. The Company was able to alleviate some of the cash flow pressure by obtaining a \$2 million term loan from the Business Development Bank in July 2020 to enhance the working capital, however the Company does not have sufficient resources to pay the amounts that are currently due and purchase new goods for the Fall season.

² Earnings before interest, taxes, depreciation and amortization.

³ The current fiscal year, i.e. the year ending January 31, 2021.

- 15.3. The financial statements at July 31, 2020 indicate that the Company's shareholders' equity is not completely depleted. The Company's financial statements indicate that the shareholders' equity decreased from \$8.2 million in January 2020, to \$4 million in July 2020. However, the equity at July 31, 2020 is substantially all represented by leasehold improvements that are essentially a deferred charge that has value only in a going concern context, and cannot be monetized or be relied on to provide cash flow. In fact, absent a going concern, the leasehold improvements would have little or no value, and it is likely that the Company's other assets would be overvalued by a significant amount.
16. In summary, the Company has incurred and is continuing to incur substantial losses from operations, and its capital base has been eroded, to the point where the Company is insolvent or will become insolvent imminently.
17. The Company has two secured creditors of note:
 - 17.1. The main secured creditor is HSBC Bank Canada ("HSBC"), the Company's main operating lender. HSBC has provided the Company with a \$5 million operating line of credit, although the ability to draw against this credit facility is limited by financial thresholds. The amount drawn on the line of credit and due at September 3, 2020 was approximately \$2.9 million. HSBC has security over all assets of the Company.
 - 17.2. As indicated earlier herein, the Company borrowed \$2 million from BDC in July 2020, to fund working capital. The BDC's term debt is secured by all assets of the Company. EY understands that the BDC security is first ranking over all assets other than current assets, and that the HSBC security is first ranking over the inventory.

CASH FLOW FORECAST

18. The Applicant prepared a statement of projected cash flow (the "**Cash Flow Forecast**"), on a weekly basis, for the 13 weeks ending November 28, 2020. The Cash Flow Forecast is accompanied by the representations of the Applicant as prescribed, and by notes outlining the significant assumptions made in preparing the Cash Flow Forecast. The Cash Flow Forecast, the representations of the Applicant and the notes outlining the assumptions are attached to this Report as **Appendix C**.
19. The Proposed Monitor's review consisted of inquiries, analytical procedures and discussion related to information supplied by the Applicant. Since hypothetical assumptions need not be supported, the procedures with respect to them were limited to evaluating whether they were consistent with the purpose of the Cash Flow Forecast. The Proposed Monitor also reviewed the support provided by Management for the probable assumptions, and the preparation and presentation of the Cash Flow Forecast.

20. Based on this review, nothing has come to the Proposed Monitor's attention that causes it to believe that, in all material respects:
 - 20.1. the hypothetical assumptions are not consistent with the purpose of the projection;
 - 20.2. as at the date of this Report, the probable assumptions developed by the Applicant are not suitably supported and consistent with the plans of the Applicant or do not provide a reasonable basis for the projection, given the hypothetical assumptions; or
 - 20.3. the Cash Flow Forecast does not reflect the probable and hypothetical assumptions.
21. Since the Cash Flow Forecast is based on assumptions regarding future events, actual results will vary from the information presented even if the hypothetical assumptions occur, and the variations may be material. In particular, but without limiting the generality of the foregoing, the Proposed Monitor reiterates the note of caution stated in paragraph 11.5 of this Report.
22. Accordingly, the Proposed Monitor expresses no assurance as to whether the Cash Flow Forecast will be achieved. The Cash Flow Forecast has been prepared solely for the purpose described in the notes accompanying the Cash Flow Forecast, and readers are cautioned that it may not be appropriate for other purposes.

Overall comments on the Cash Flow Forecast

23. The Applicant contemplates continuing payments, including arrears due at the date of filing, in respect of employees and employee benefits, and certain residual amounts due to trade suppliers. The Applicant justifies this proposed continuation of such payments as a form of hardship payment and as a way to ensure that the resources will be available, and to limit potential disruption to the operations.
24. The Proposed Monitor understands the rationale behind the proposed payments of these amounts and supports this decision.
25. The Cash Flow Forecast suggests that the Applicant will need additional funds beyond the current draws on its line of credit with the HSBC. The Cash Flow Forecast suggests the additional funding needs total approximately \$2,000,000 million at their peak during the upcoming 13 weeks. EY understands the Applicant has been in communication with HSBC and that the Bank is supportive of the restructuring initiative and is prepared to advance additional funds to the Company subject to the repayment of all existing advances pursuant to the sale of inventory subject to its security and then by way of interim financing for all new requirements and disbursements on terms consistent with the existing credit facility, with a first ranking security subject only to the Administration Charge (described later in this Report).

FINANCIAL THRESHOLDS CONTEMPLATED IN THE INITIAL ORDER

26. The draft Initial Order provides for a number of charges and financial thresholds that are described below.

Interim Lender's charge ("DIP" Charge)

27. As indicated earlier herein, HSBC has indicated it is prepared to advance additional funds to the Company while it undertakes its restructuring initiative, on terms consistent with the existing credit facility, subject to a charge over all assets and undertakings of Ernest, ranking in priority to the existing security, subject only to the Administration Charge.

The Proposed Monitor believes that such a charge is required and reasonable under the circumstances.

Administration Charge

28. The draft Initial Order provides for an Administration Charge for the Monitor, the Monitor's counsel, the Applicant's legal counsel, as security for the professional fees and disbursements incurred both before and after the making of the Initial Order in respect of these proceedings, in addition to the retainers already provided. The Administration Charge as described in the draft Initial Order provides for an amount of \$50,000 for the first 10 days and \$75,000 thereafter. The Administration Charge threshold has been established based on the various professionals' previous history and experience with restructurings of similar magnitude and complexity. The Proposed Monitor believes that such a charge is required and reasonable under the circumstances.

D&O Charge

29. The draft Initial Order provides for a directors and officers' charge (the "D&O Charge") to secure the indemnity for the Applicant's directors and officers provided in the Initial Order. Pursuant to the proposed Initial Order, the Applicant's directors and officers shall be indemnified in respect of all liabilities and obligations which may arise on or after the date of the Initial Order provided that the liability relates to his or her capacity as director and/or officer and is not attributable to a gross negligence or wilful misconduct of the part of the director or officer. The draft Initial Order provides for a D&O Charge in the amount of nil for the first 10 days and \$550,000 thereafter.

30. The Applicant's directors and officers do not presently benefit from an insurance policy in respect of the directors' and officers' potential liability, in view of the fact that Ernest is a privately held company and such coverage is unavailable or prohibitively expensive for companies such as Ernest. The Applicant asserts that insurance coverage would be even more difficult to obtain in the context of the Company's insolvency proceedings and is thus unavailable. The Proposed Monitor considers that this assertion is reasonable. The Proposed Monitor believes that the charge as requested is reasonable under the circumstances.

UPCOMING RESTRUCTURING MEASURES

31. At this preliminary stage, it is not possible to unveil a comprehensive restructuring strategy in respect of the Applicant, as further research, discussions and negotiations and still need to be held to determine if a going concern solution can be developed. However, the restructuring process is likely to include:
 - 31.1. Stabilize the operations to ensuring the continued supply of merchandise of the Fall season;
 - 31.2. Negotiations with landlords to determine which leased locations will be retained and which will be subject to a disclaimer or resiliation;
 - 31.3. Undertake a liquidation process to wind down operations and vacate premises for the stores where leases will have been disclaimed.
 - 31.4. Undertake a claims process.
 - 31.5. Negotiations of the terms of settlement with the creditors;
 - 31.6. Implementation of a Plan.

OVERALL COMMENTS AND CONCLUSIONS

32. Based on the Proposed Monitor's review thus far, the Applicant displayed diligence, good faith and proper intentions in pursuing these restructuring proceedings.
33. In view of the foregoing and the information received since its recent engagement, EY considers that the restructuring efforts implemented by the Applicant in the proceedings herein are reasonable. EY considers that the Applicant's motion to obtain a stay under the CCAA is necessary and appropriate in the circumstances.
34. Further to its review of the proposed Initial Order, the Proposed Monitor supports the Charges proposed in the Initial Order, including:
 - 34.1. An Interim Lender's Charge;
 - 34.2. An Administration Charge of \$50,000 for the first 10 days and \$75,000 thereafter; and
 - 34.3. A D&O Charge of nil for the first 10 days and \$550,000 thereafter.

All of which is respectfully submitted this 4th day of September, 2020.

ERNST & YOUNG INC.**Licensed Insolvency Trustee**

In its capacity as the proposed monitor
in the matter of the proposed compromise and
arrangement of Ernest Enterprises (Mtl) Ltd.



Martin P. Rosenthal, CPA, CA, CIRP, LIT
Senior Vice President

Appendix A

(Under Seal)

Appendix B

(Under Seal)

Appendix C

(Under Seal)