

COURT FILE NUMBER 2101-14684
COURT COURT OF QUEEN'S BENCH OF ALBERTA

JUDICIAL CENTRE CALGARY

APPLICANTS IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c C-36, AS AMENDED

C120762

AND IN THE MATTER OF A PLAN OF ARRANGEMENT OF KAISEN ENERGY CORP.

JP

DOCUMENT **PRE-FILING REPORT OF ERNST & YOUNG INC. IN ITS CAPACITY AS THE PROPOSED MONITOR OF KAISEN ENERGY CORP.**

December 3, 2021

ADDRESS FOR SERVICE AND CONTACT INFORMATION OF PARTY FILING THIS DOCUMENT

PROPOSED MONITOR

ERNST & YOUNG INC.
Calgary City Centre
2200, 215 - 2nd Street SW
Calgary, Alberta T2P 1M4
Attention: Neil Narfason / Christopher Keliher
Telephone: 403-206-5067 / 403-206-5661
Fax: 403-206-5075
Email: neil.narfason@parthenon.ey.com
christopher.keliher@parthenon.ey.com

PROPOSED MONITOR'S COUNSEL

Norton Rose Fulbright Canada LLP
400 3rd Avenue SW, Suite 3700
Calgary, Alberta, T2P 4H2
Attn: Howard Gorman, QC
Telephone: 403-267-8144
Email: howard.gorman@nortonrosefulbright.com



TABLE OF CONTENTS OF THE PRE-FILING REPORT OF THE PROPOSED MONITOR

INTRODUCTION..... 3

PURPOSE..... 3

TERMS OF REFERENCE AND DISCLAIMER 3

OVERVIEW OF KAISEN AND CAUSES OF INSOLVENCY..... 4

PLAN SPONSOR & THE COMMENCEMENT OF THE CCAA PROCEEDINGS 5

PROPOSED MONITOR..... 5

CASH FLOW STATEMENT 6

AMOUNT AND PRIORITY OF COURT ORDERED CHARGES 9

CONCLUSIONS..... 10

APPENDIX

**APPENDIX A CASH FLOW STATEMENT FOR THE PERIOD DECEMBER 12, 2021
 THROUGH TO MARCH 5, 2022**

INTRODUCTION

1. On December 8, 2021, Kaisen Energy Corp. (“**Kaisen**”, the “**Company**”, or the “**Applicant**”) is scheduled for an application (the “**Initial Application**”) before this Honourable Court to seek relief pursuant to the *Companies’ Creditors Arrangement Act*, R.S.C. 1985, C-36 (the “**CCAA**”) and to establish an initial stay of proceedings (the “**Initial Stay of Proceedings**”) in favour of the Applicant.
2. In addition, the Company has scheduled a come-back hearing on December 17, 2021 with this Honourable Court for an Amended and Restated Initial Order (“**ARIO**”).
3. Ernst & Young Inc. (“**EYI**”, or the “**Proposed Monitor**”) anticipates its proposed appointment as Monitor of the Company as part of the Initial Application, to be decided by this Honourable Court.

PURPOSE

4. The purpose of this report (the “**Pre-filing Report**”) is to provide this Honourable Court and the Applicants’ stakeholders with information and the Proposed Monitor’s comments with respect to the following:
 - a) An overview of the Applicant’s business and the cause of insolvency;
 - b) The commencement of the CCAA Proceedings and information about the Plan Sponsor;
 - c) The qualifications of EYI to act as Monitor in the CCAA proceedings;
 - d) A cash flow statement (the “**CFS#1**”) for the 13-week period ending on March 5, 2022 and the key assumptions on which CFS#1 is based;
 - e) The amount and priority of the proposed court-ordered charges during the Initial Stay of Proceedings for:
 - i. An administration charge for the Monitor, counsel to the Monitor, and counsel to the Company; and,
 - ii. A Directors and Officers charge.

TERMS OF REFERENCE AND DISCLAIMER

5. In preparing this Pre-filing Report, the Proposed Monitor has been provided with, and has relied upon certain information, including audited and unaudited financial information of the Company, books and records, and discussions with Kaisen’s Management (collectively, the “**Information**”).

6. Except as described in this report, the Proposed Monitor has not audited, reviewed or otherwise attempted to verify the accuracy or completeness of the Information in a manner that would comply with Canadian auditing standards pursuant to the Chartered Professional Accountants of Canada Handbook.
7. Future oriented information referred to in this Pre-filing Report was prepared based on Management's estimates and assumptions. Readers are cautioned that since projections are based upon assumptions about future events and conditions that are not ascertainable; the actual results may vary from the projections and the variances may be materials.
8. All references to dollars are in Canadian dollars.
9. Capitalized terms not defined herein are as defined in the Initial Order.

OVERVIEW OF KAISEN AND CAUSES OF INSOLVENCY

10. Kaisen is a privately held upstream oil & gas energy company, based in Calgary, Alberta. The Company primarily focuses on heavy oil development and production and has operations in both Alberta and Saskatchewan, primarily in the areas of Lloydminster and Edam, Saskatchewan.
11. Prior to the advent of the global COVID-19 pandemic, Kaisen was producing approximately 727 barrel of oil equivalents per day ("**BOE/d**"). However, due to the impacts of COVID-19 and significant commodity price volatility, Kaisen was obligated to shut-in a significant portion of its operations to reduce costs. Kaisen's BOE/d production dropped to as low as 55 BOE/d in January 2021, before eventually rebounding to approximately 50% production capacity (approx. 390 BOE/d) in November 2021.
12. In addition to these operational challenges, Kaisen: (a) suffered material losses in 2018 and 2019 in connection with a hedging plan it then had in place (the "**Hedging Program**"), and (b) has had its credit facilities significantly reduced by its senior secured lender resulting in its available credit decreasing from \$5.5M in Q4 2017 down to \$1.85M in Q4 2020.
13. The reduced production capacity of Kaisen, in conjunction with historically depressed commodity prices, losses associated with the Hedging Program, and the reduction in available credit have created a liquidity crisis for the Company. As a consequence, Kaisen deferred payments to many of its trade vendors in an effort to sustain operations.
14. The business and affairs of the Applicant and the causes of its insolvency are described in further detail in the Affidavit of Chris McGinnis, sworn on December 2, 2021 (the "**McGinnis Affidavit**").

PLAN SPONSOR & THE COMMENCEMENT OF THE CCAA PROCEEDINGS

15. Despite attempting to resolve its liquidity crisis through multiple out of court methods, such as attempting to merge with another oil and gas company in early 2020, entering into debt settlement proposals with certain of its creditors, and running a sales process for the business in 2017-2018, Kaisen has been unable to successfully restructure its affairs.
16. In June 2021, Kaisen entered into discussions with Durum Capital Inc. (the “**Plan Sponsor**”) to enter into a strategic relationship with the goal of reorganizing and recapitalizing the Company. To further that goal, the Plan Sponsor has entered into a restructuring support agreement with the Company, has made arrangements to acquire the debt obligations of the senior secured lender (effectively making the Plan Sponsor the senior secured lender of Kaisen (subject to a security review)), and has agreed to provide Kaisen interim financing, should it be required as part of these CCAA proceedings, among other items.
17. To facilitate the reorganization and recapitalization of the Company, Kaisen, its majority shareholder (Azimuth Capital Management IV Ltd. (“**Azimuth**”)), and the Plan Sponsor have agreed that proceedings under the CCAA are required to provide the company with stability in order to prepare and present a plan of arrangement to its creditors.

PROPOSED MONITOR

18. EYI is a trustee within the meaning of section 2 of the BIA and has provided its consent to act as Monitor in these CCAA Proceedings, a copy of which is attached as Exhibit 26 to the McGinnis Affidavit.
19. With respect to subsection 11.7(2) of the CCAA, EYI states that it is subject to a restriction as set out in that subsection, and in particular, subsection 11.7(2)(a)(iii). As a result, the appointment of EYI as Monitor must be specifically authorized by this Honourable Court.
20. Details giving rise to the restriction as set out in subsection 11.7(2)(a)(iii) of the CCAA include:
 - a) Ernst & Young LLP (“**EY LLP**”), an affiliate of EYI, was previously engaged as the auditor of the Company;
 - b) The most recent financial statements reviewed by EY LLP are for the period ending December 31, 2019, and the opinion associated with that audit was released by EY LLP on April 17, 2020; and,
 - c) EY LLP has not prepared or audited any financial statements of the Company since that time and, in the spring of 2021, the relationship between the parties terminated.

21. Notwithstanding EY LLP's prior relationship with the Company, EYI believes that it would not be inappropriate for this Honourable Court to appoint EYI as monitor in these CCAA proceedings given that:
- a) The prior audit relationship involved the audit of financial statements from 2019;
 - b) All amounts owing from the Company in connection with that audit that remain outstanding, i.e., approximately \$42,000, will be addressed as part of the Company's claims process, which the Proposed Monitor anticipates will result in only a nominal payment being made to EY LLP;
 - c) The Proposed Monitor will utilize separate personnel in this matter who are independent of the former audit team, and the Proposed Monitor has put in place and will maintain an ethical wall to prevent any inadvertent communication of information between the former audit team and the personnel assigned to the restructuring engagement;
 - d) The potential conflict has been disclosed by EYI to the Company, Azimuth, and the Plan Sponsor, who in turn have advised EYI that they are not opposed to EYI acting as the Monitor;
 - e) EYI is not aware of any actual conflict of interest or loss of independence arising from the previous relationship between Kaisen and EY LLP as auditor;
 - f) EYI is familiar with the business and operations of the Company and are in a position to provide certain efficiencies to the CCAA process, including cost efficiencies; and,
 - g) Senior EYI personnel in the matter are Chartered Insolvency and Restructuring Professionals and Licensed Insolvency Trustees who have acted in restructuring matters of this nature and scale.

CASH FLOW STATEMENT

22. The Company has prepared the CFS#1 for anticipated receipts and disbursements for the weekly period ending December 8, 2021 through to March 5, 2022 (the "**Forecast Period**").
23. The table below summarizes the cash flows during the Forecast Period:

Kaisen Energy Corp.			
Statement of receipts and disbursements			
For the 13-week period ending March 5, 2022			
\$000's	Notes	Initial Stay Period¹	Forecast Period
Operating receipts	A	-	2,101
Disbursements			
Freehold and Crown royalties	B	(118)	(424)
Operating expenses	C	(22)	(591)
Oil & Gas processing	D	-	(373)
Property taxes		-	(24)
Surface lease payments		-	(144)
General & administrative		(35)	(281)
Miscellaneous disbursements		-	(76)
Professional fees	E	-	(350)
Contingency	F	-	(150)
Total operating disbursements		(175)	(2,414)
Net change in cash from operations		(175)	(313)
Financing			
DIP - principal		-	-
DIP - interest / fees		-	-
DIP - legal fees		-	-
Net change in cash from financing		-	-
Net change in cash		(175)	(313)
Opening cash		248	248
Ending cash		73	(65)

¹ For two-week period from December 8 to December 22, 2021

24. A copy of the signed CFS#1 and accompanying notes are attached hereto as **Appendix "A"**.
25. The CFS#1 is based on the following key assumptions:

Operating Receipts

- a) Operating Receipts – Kaisen estimates that production will average 377 BOE/d during the Forecast Period. Revenues are estimated based on forward strip pricing as of November 30, 2021. Kaisen does not utilize a hedging strategy and all sales are completed at prevailing spot prices.

Disbursements

- b) Royalties – Royalties are estimated based on 19% of revenues, which is consistent with the historical average royalties as a percentage of revenues through 2021;

- c) Operating Expenses – Operating expenses are forecast to be incurred at normal operating levels based on a 377 BOE/d production level;
- d) Oil and Gas Processing – Oil and gas processing is expected to average \$124,000/month throughout the Forecast Period. These costs are consistent with stable production of an average of 377 BOE/d;
- e) Professional Fees – Professional fees are forecast to be approximately \$350,000 during the Forecast Period and include the fees of Kasien’s legal counsel, the Monitor, the Monitor’s legal counsel, and the Plan Sponsor’s legal counsel; and,
- f) Contingency – A negative contingency has been incorporated into the Forecast to account for potentially higher than anticipated supplier pre-payment demands or operating expenses and to account for commodity price volatility.

26. Pursuant to subsection 23(1)(b) of the CCAA and in accordance with the Canadian Association of Insolvency and Restructuring Professionals Standard of Practice 9. “Cash-Flow Statement”, the Proposed Monitor hereby reports as follows:

- a) The CFS#1 has been prepared by Management for the purpose described in the notes to the Cash Flow Statement, using the probable assumptions and the hypothetical assumptions set out in the accompanying notes;
- b) The Proposed Monitor’s review consisted of inquiries, analytical procedures and discussion related to information supplied by Management and employees of the Applicant. The Proposed Monitor’s procedures with respect to the hypothetical assumptions were limited to evaluating whether they were consistent with the purpose of the CFS#1. The Proposed Monitor has also reviewed the support provided by Management for the probable assumptions, and the preparation and presentation of the CFS#1;
- c) Based on its review, nothing has come to the attention of the Proposed Monitor that causes it to believe that, in all material respects:
 - i. The hypothetical assumptions are not consistent with the purpose of the CFS#1;
 - ii. As at the date of this Pre-Filing Report, the probable assumptions developed by management are not suitably supported and consistent with the plans of the Company or do not provide a reasonable basis for the CFS#1, given the hypothetical assumptions; or

- iii. CFS#1 does not reflect the probable and hypothetical assumptions.
27. Since the CFS#1 is based on assumptions regarding future events, actual results may vary from the information presented even if the hypothetical assumptions occur, and the variations may be material. Accordingly, the Proposed Monitor expresses no assurance as to whether the projections outlined in the CFS#1 will be achieved. The Proposed Monitor expresses no opinion or other form of assurance with respect to the accuracy of any financial information presented in this report or relied upon in preparing this report.
28. The CFS#1 has been prepared solely for the purpose described above, and readers are cautioned that it may not be appropriate for other purposes.

AMOUNT AND PRIORITY OF COURT ORDERED CHARGES

29. The proposed Initial Order provides for two Court-ordered charges that rank in priority to all other charges and security interests of the Applicants. The proposed charges and the rank in priority of those charges include:
- a) an administration charge (the “**Administration Charge**”);
 - b) a director and officers’ charge (the “**D&O Charge**”)

Administration Charge

30. The proposed Initial Order proposes an Administration Charge in an amount not to exceed \$100,000 charging the Property of Kaisen to secure the professional fees and disbursements incurred both before and after the granting of the Initial Order, in connection with services rendered by legal counsel to the Applicant, the Proposed Monitor and the Proposed Monitor’s legal counsel.
31. The Proposed Monitor believes it is appropriate for the beneficiaries to be afforded the Administration Charge as they will be undertaking a necessary and integral role in the CCAA proceedings.

D&O Charge

32. The Initial Order proposes a D&O Charge over the Property of Kaisen in favour of the directors and officers of the Applicant as security for an indemnity contained in the Initial Order against obligations and liabilities that the directors and officers of Kaisen may incur after the commencement of the CCAA proceedings. The D&O Charge will not exceed an aggregate amount of \$100,000 and will rank subordinate to the Administration Charge.

33. It is the Proposed Monitor's view that the continued support and service of the directors and officers of the Applicant during the CCAA Proceedings would be beneficial to the Applicant's efforts to preserve value and maximize recoveries for stakeholders through the completion of the CCAA proceedings. The Proposed Monitor has reviewed the underlying assumptions upon which the Applicants have based the estimate of the potential liability in respect of the directors' statutory obligations and is of the view that the D&O Charge is reasonable in relationship to the quantum of the estimated potential liability and is appropriate in the circumstances.

CONCLUSIONS

34. The Initial Order and Stay of Proceedings will provide the Applicant with stability while it preserves Kaisen's assets and an opportunity to formulate and finalize a restructuring strategy.
35. The Applicant has available liquidity for the period of the Initial Stay of Proceedings and is planning to seek Court-approval of an interim financing arrangement, an extension of the Initial Stay of Proceedings, and other related relief, at a subsequent comeback hearing to be held on December 17, 2021. If appointed, the Proposed Monitor anticipates filing a further report prior to the return application.

Dated at Calgary, this 3rd day of December, 2021.

ERNST & YOUNG INC.

Licensed Insolvency Trustee

acting solely in its capacity as the Proposed Monitor of Kaisen Energy Corp.
and not in its personal or corporate capacity

per:




Neil Narfason, CPA, CA, CIRP, LIT, CBV
President, Ernst & Young Inc.



Christopher Keliher, JD, MBA, CIRP, LIT
Vice President, Ernst & Young Inc.

Appendix A: Cash flow statement for the period December 12, 2021 through to March 5, 2022

Kaisen Energy Corp.															
Consolidated Cash Flow Statement															
For the 13-week period ending March 5, 2022															
See notes attached															
<i>\$000's</i>		Week 1	Week 2	Week 3	Week 4	Week 5	Week 6	Week 7	Week 8	Week 9	Week 10	Week 11	Week 12	Week 13	13-week
Week ending:	Notes	Dec-11	Dec-18	Dec-25	Jan-01	Jan-08	Jan-15	Jan-22	Jan-29	Feb-05	Feb-12	Feb-19	Feb-26	Mar-05	total
Operating receipts															
Production receipts	A	-	-	848	-	-	-	-	638	-	-	-	604	-	2,091
Miscellaneous receipts	B	-	-	-	3	-	-	-	3	-	-	-	3	-	10
Net operating receipts		-	-	848	3	-	-	-	642	-	-	-	608	-	2,101
Operating disbursements															
Freehold and Crown royalties	C	-	(118)	(40)	-	-	(118)	-	(30)	-	-	(89)	(30)	-	(424)
Operating expenses	D	-	(22)	-	(140)	(35)	(22)	-	(140)	(35)	-	(22)	-	(175)	(591)
Oil & Gas processing	E	-	-	(30)	(90)	-	-	-	(127)	-	-	-	(30)	(96)	(373)
Property taxes	F	-	-	-	(8)	-	-	-	(8)	-	-	-	(8)	-	(24)
Surface lease payments	G	-	-	(52)	-	-	-	-	(82)	-	-	-	(10)	-	(144)
General & administrative	H	-	(35)	-	(45)	(14)	(35)	-	(45)	(14)	-	(35)	(44)	(14)	(281)
Miscellaneous disbursements	I	-	-	-	(25)	-	-	-	(25)	-	-	-	(25)	-	(76)
Professional fees	J	-	-	-	(200)	-	-	-	(100)	-	-	-	(50)	-	(350)
Contingency	K	-	-	-	(50)	-	-	-	(50)	-	-	-	(50)	-	(150)
Total operating disbursements		-	(175)	(122)	(558)	(49)	(175)	-	(607)	(49)	-	(146)	(248)	(285)	(2,414)
Net change in cash from operations		-	(175)	726	(555)	(49)	(175)	-	34	(49)	-	(146)	360	(285)	(313)
Financing															
Interim Financing - Principal		-	-	-	-	-	-	-	-	-	-	-	-	-	-
Interim Financing - Interest / Fees		-	-	-	-	-	-	-	-	-	-	-	-	-	-
Net change in cash from financing		-	-	-	-	-	-	-	-	-	-	-	-	-	-
Net Change in Cash															
Opening Cash	L	248	248	73	799	244	195	20	20	55	6	6	(140)	220	248
Net change in cash from operations		-	(175)	726	(555)	(49)	(175)	-	34	(49)	-	(146)	360	(285)	(313)
Net change in cash from financing		-	-	-	-	-	-	-	-	-	-	-	-	-	-
Ending Cash		248	73	799	244	195	20	20	55	6	6	(140)	220	(65)	(65)


 Per: Chris McGinnis, VP Operations & Engineering
 Kaisen Energy Corp.

Kaisen Energy Corp.

Notes to the Consolidated Cash Flow Statement
For the 13-week period ending March 6, 2022

Overall: Management has prepared this consolidated Cash Flow Statement solely for the purpose of determining the liquidity requirements of Kaisen Energy Corp. ("KEC") during the CCAA proceedings. The Cash Flow Statement is based on the probable and hypothetical assumptions detailed below. Actual results will likely vary from performance projected and such variations may be material.

Note A - Operating receipts: Included in operating receipts are production revenues before settlement of transportation and processing costs.

Pricing: KEC does not utilize a hedging strategy and all sales are completed at prevailing spot prices. Production revenues are based on forward strip pricing as of November 30, 2021.

Production: KEC estimates that production will average 377 BOE through the 13-week period.

Note B - Miscellaneous receipts: KEC currently subleases a portion of its rented office space.

Note C - Royalties: Royalties are estimated based on 19% of revenues, which was consistent with the historical average royalties as a percentage of revenues through 2021.

Note D - Operating expenses: The cash flow forecast contemplates normal operating levels and consists of chemical purchases, equipment rentals, oil and gas handling, repairs and maintenance, operator and non-op costs (paid to joint venture partners), marketing and other miscellaneous operating expenses.

Note E - Oil and gas processing: Oil and gas processing is expected to average \$124,000/month throughout the 13-week period. These costs are consistent with stable production of an average of 377 BOE per day.

Note F - Property taxes: No new property taxes are forecast during the 13-week period.

Note G - Surface lease payments: Surface lease payments reflect actual anticipated lease payments during the 13-week period.

Note H - General and admin: General and administrative expenses are comprised of office employee and contractor payments, office rent, IT services, and miscellaneous travel expenses.

Note I - Miscellaneous disbursements: Primarily comprised of monthly installements owed on CCT and provincial sales tax balances owed to the Province of Saskatchewan.

Note J - Professional fees: Estimated fees for the Monitor, Monitor's legal counsel, KEC's legal counsel, and the Plan Sponsor's legal counsel over the Forecast Period total \$350,000.

Note K - Contingency: A minor contingency has been incorporated in the cash flow to account for any unforeseen expenditures through the 13-week period.

Note L - Outstanding cheques: Opening cash reflects balances including all outstanding cheques. The Monitor expects certain uncashed cheques to pause due to the initial stay of proceedings. As a result, opening cash is likely to reflect a higher balance than the figures documented within.