Court File No. CV-22-00688966-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

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

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF THE FLOWR CORPORATION, THE FLOWR CANADA HOLDINGS ULC, THE FLOWR GROUP (OKANAGAN) INC., AND TERRACE GLOBAL INC.
(each an **"Applicant"** and collectively, the **"Applicants")**

SECOND REPORT OF THE MONITOR DATED NOVEMBER 2, 2022

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INTRODUCTION

1. On October 20, 2022, the Applicants brought an application (the "**Initial Application**") before the Ontario Superior Court of Justice (Commercial List) (the "**Court**") under the *Companies' Creditors Arrangement Act,* R.S.C. 1985, c. C-36, as amended (the "**CCAA**") to, among other things, obtain a stay of proceedings to allow them an opportunity to restructure their business and affairs.

2. On October 20, 2022, the Court granted an Initial Order, as amended by the Amended and Restated Initial Order granted on October 28, 2022 (the "**Initial Order**") in these CCAA proceedings (the "**CCAA Proceedings**") that, among other things:

    a. appointed Ernst & Young Inc. as monitor of the Applicants (in such capacity, the "**Monitor**");

    b. ordered a stay of proceedings in favour of the Applicants through to January 13, 2023 (the "**Stay Period**");

c. granted certain Court-ordered charges, including a charge of $800,000 in favour of certain beneficiaries under a key employee retention plan (the "**KERP**"); and,

d. approved an interim financing facility up to $2 million (the "**DIP Facility**") provided by 1000343100 Ontario Inc. (the "**DIP Lender**").

3. On October 28, 2022, the Court granted an Order (the "**SISP Order**"), authorizing the Monitor to conduct a sale and investment solicitation process (the "**SISP**") in respect of the Applicants.

PURPOSE

4. The purpose of this second report of the Monitor (the "**Second Report**") is to provide information to the Court on the Applicants' motion for an order approving the proposed Stalking Horse Purchase Agreement (defined and discussed herein).

TERMS OF REFERENCE

5. In preparing this Second Report and making the comments herein, the Monitor has been provided with, and has relied upon, audited and unaudited financial information, books and records prepared by the Applicants, discussions with management of the Applicants ("**Management**"), and information from other third-party sources (collectively, the "**Information**").

6. The Monitor has reviewed the Information for reasonableness, internal consistency and use in the context in which it was provided. However, the Monitor has not audited or otherwise attempted to verify the accuracy or completeness of such information in a manner that would wholly or partially comply with Canadian Auditing Standards ("**CAS**") pursuant to the Chartered Professional Accountants Canada Handbook and, accordingly, the Monitor expresses no opinion or other form of assurance contemplated under CAS in respect of the Information.

7. Unless otherwise indicated, the Monitor's understanding of factual matters expressed in the Second Report concerning the Applicants and their business is based on the Information, and not independent factual determinations made by the Monitor.

8. Unless otherwise stated, all monetary amounts contained herein are expressed in Canadian dollars.

9. Further information regarding the CCAA Proceedings, including all of the Monitor's reports to the Court previously filed, is available on the Monitor's website at https://ey.com/ca/flowr (the "**Monitor's Website**").

10. Capitalized terms not otherwise defined herein have the meanings attributed to them in the Initial Order, the SISP Order and the Stalking Horse Purchase Agreement, as applicable.

BACKGROUND INFORMATION WITH RESPECT TO APPLICANTS

11. Detailed background information in respect of the Applicants was provided in the Monitor's previous reports to the Court, which are available on the Monitor's Website.

12. The Flowr Corporation ("**Flowr**"), a public entity listed on the TSX Venture Exchange under the ticker symbol "FLWR", is a holding company.

13. The Applicants' operations are conducted substantially through Flowr's indirect subsidiary, The Flowr Group (Okanagan) Inc. ("**Flowr Okanagan**"), which is the main operating entity that holds the necessary licenses and certifications to operate and leases a cultivation facility in Kelowna, British Columbia as further described below.

14. There are four Applicants in these CCAA proceedings. In addition to Flowr and Flowr Okanagan, the other two Applicants are The Flowr Canada Holdings ULC ("**Flowr Holdings**") and Terrace Global Inc.

THE SISP

15. The First Report of the Monitor dated October 27, 2022 (the "**First Report**") describes the SISP in detail, a copy of which was attached as Appendix "A" thereto. For the ease of reference, a summary of the key dates of the SISP is set out below.

Milestone	Deadline
Deadline to publish notice of SISP and deliver Teaser Letter and NDA to Known Potential Bidders	November 7, 2022
Bid Deadline	November 25, 2022
Auction Date	December 1, 2022
Hearing of the Sale Approval Motion (as defined below)	No later than December 16, 2022, subject to the availability of the Court

16. As at the date of this Second Report:

a. the Monitor, in consultation with the Applicants, has developed a list of potential bidders (the "**Known Potential Bidders**");

b. the Monitor, in consultation with the Applicants, has prepared:

   i. a process summary (the "**Teaser Letter**") describing the opportunity, outlining the process under the SISP and inviting recipients of the Teaser Letter to express their interest pursuant to the SISP; and

   ii. a non-disclosure agreement ("**NDA**") in the form and substance satisfactory to the Applicants and the Monitor;

c. on and around November 1, 2022, the Monitor sent the Teaser Letter and the NDA to all the Known Potential Bidders;

d. on November 1, 2022, the Monitor, with assistance of the Applicants, sent out a press release through Canada Newswire;

e. the notice of the SISP (the "**Notice**") was added to the Monitor's Website on November 1, 2022 and the Notice is scheduled to be published in The Globe & Mail (National Edition) on November 4, 2022; and

f. a virtual data room has been initiated.

17. Paragraph 13 of the SISP sets out the requirements that bids must comply with to be a Qualified Bid. Due to the projected tight liquidity situation facing the Applicants, a bid must include confirmation that the bidder will advance funds to address the Applicants' cash requirements in excess of the amounts available under the DIP Facility to get to a closing of the transaction in a manner that does not impair the priority of the DIP Facility or otherwise is satisfactory to the DIP Lender.

18. Following the Bid Deadline of November 25, 2022, the Monitor, in consultation with the Applicants, and with the approval of the Applicants, will designate the most competitive bids that comply with the foregoing requirements to be "Qualified Bids".

19. The SISP contemplates that a stalking horse bid, if approved by the Court, would be automatically accepted as a Qualified Bid.

THE STALKING HORSE PURCHASE AGREEMENT

20. The DIP Facility term sheet provides the DIP Lender with an exclusive option to negotiate a stalking horse bid with the Applicants (the "**Stalking Horse Bid**").

21. As described in the Affidavit of Darren Karasiuk sworn October 31, 2022 (the "**Karasiuk Affidavit**"), the Applicants, in consultation with the Monitor, have negotiated and entered into a stalking horse purchase agreement (the "**Stalking Horse Purchase Agreement**") between Flowr Holdings, as vendor (the "**Vendor**"), Flowr Okanagan, and the DIP Lender, as purchaser (the "**Purchaser**"), subject to Court approval. A copy of the Stalking Horse Purchase Agreement is attached as Exhibit "A" to the Karasiuk Affidavit.

22. Pursuant to the Stalking Horse Purchase Agreement, the Purchaser has agreed to acquire all of the issued and outstanding shares of Flowr Okanagan holding only the Retained Assets (which may, for greater certainty, include certain Transferred Assets from other Applicants) and Assumed Liabilities following a Pre-Closing Reorganization (all as defined and discussed herein).

23. The material terms of the Stalking Horse Purchase Agreement are summarized as follows. [1]

a. *Purchase Price* - $3,888,888.88 plus the Closing DIP Loan (as defined below) and Assumed Liabilities, subject to certain adjustments provided in the Stalking Horse Purchase Agreement.

The Purchaser will satisfy the Purchase Price in the form of: (i) a credit bid equivalent to all outstanding amounts under the DIP Facility including any amounts that are owing under the Closing DIP Loan as of the closing of the transaction ("**Closing**"); (ii) subject to the below, cash consideration for the balance of the Purchase Price ("**Cash Purchase Price**"); and (iii) Assumed Liabilities.

A portion of the Purchase Price is intended to satisfy the KERP payments through either:

i. a portion of the proceeds of sale comprising the Cash Purchase Price, provided that if necessary, any Terminated Employees KERP Payments may be satisfied through funding from the Closing DIP Loan; or

ii. if elected by the KERP beneficiaries in their own discretion, non-cash consideration provided by the Purchaser in lieu of cash payments based on the KERP entitlements.

In circumstances where a portion of the KERP entitlements are satisfied through (i) funding from the Closing DIP Loan; or (ii) non-cash consideration, the Cash Purchase Price shall be reduced on a dollar for dollar basis by the aggregate of such amounts, with no other adjustment to the quantum or manner of payment to the Purchase Price. Further, in the event that funds under the Closing DIP Loan are used to make a Terminated Employee KERP Payment, such amounts shall not increase the Purchase Price and as a result the Cash Purchase Price will not be reduced by such amounts.

[1] This is not an exhaustive list of terms. In the event of any inconsistency between this summary and the Stalking Horse Purchase Agreement, the Stalking Horse Purchase Agreement governs.

b. *Break-fee* - A break fee in the amount of $185,000 (inclusive of HST, if any) (the "**Break Fee**") will be payable to the Purchaser in the event the Monitor, in consultation with the Applicants, does not select the Stalking Horse Bid as the Successful Bid.

c. *Pre-Closing Reorganization* – The Stalking Horse Purchase Agreement is conditional on Flowr Okanagan completing a pre-Closing reorganization (to be detailed in Exhibit "A" to the Stalking Horse Purchase Agreement, the "**Pre-Closing Reorganization**") to retain only the assets selected by the Purchaser (the "**Retained Assets**") and the Assumed liabilities, including:

    i. Certain assets owned by other subsidiaries of Flowr, which will be transferred to Flowr Okanagan as part of the Pre-Closing Reorganization;

    ii. Flowr Okanagan's equipment, assumed contracts, permits and license, books and records that are not excluded by the Stalking Horse Purchase Agreement; and,

    iii. Liabilities specifically assumed by the Purchaser (the "**Assumed Liabilities**").

   All excluded assets and liabilities of Flowr Okanagan shall be transferred to another fully owned subsidiary of Flowr as part of the Pre-Closing Reorganization ("**ResidualCo**").

d. *Other Conditions Precedent* – One notable condition is that the parties shall have obtained the approval of Health Canada in connection with the change of control contemplated by the transaction.

e. *The Closing DIP Loan* - Should the Vendor choose to close the transaction contemplated in the Stalking Horse Purchase Agreement, the Purchaser agrees to provide additional necessary funding by way of a non-revolving debtor-in-possession loan facility (the "**Closing DIP Loan**") in the event that the Applicants require liquidity in excess of the amounts available to them under the DIP Facility once fully drawn. The funding amount shall be determined in accordance with the cash flow projections approved by the Monitor and the Purchaser to fund such other costs and expenses of the Flowr Group as may be agreed to by the Purchaser, in writing, and to fund Terminated Employees KERP Payments, as necessary.

f. *Closing Date* – the closing date shall be ten (10) business days after the date upon which the conditions set forth in Article 9 of the Stalking Horse Purchase Agreement are satisfied or waived, including, but not limited to, the issuance of the Approval and Vesting Order, regulatory approval from Health Canada, and transfer or discharge of the excluded assets and liabilities to ResidualCo.

Views of the Monitor

24. The Stalking Horse Purchase Agreement will provide stability to the Applicants' business and give confidence to stakeholders (including customers, employees and suppliers) that a going-concern outcome of these CCAA Proceedings will be achieved through the SISP.

25. By providing a baseline purchase price and deal certainty, the Stalking Horse Bid will not negatively impact the conduct of the SISP.

26. Having reviewed the financial terms of the Stalking Horse Purchase Agreement, the Monitor believes that they are reasonable in the circumstances and provide a value greater than a liquidation of the Applicants' assets.

27. The Break Fee equals approximately 4.76% of the Purchase Price. This fee percentage will drop after adding any borrowings under the Closing DIP Loan to the Purchase Price. Based on a review of the quantum of the break fees for stalking horse transactions in CCAA filings over the past three years, the Monitor is of the view that the Break Fee is within the range of break fees seen in stalking horse transactions of similar nature. Although the Break Fee is close to the higher end of the range of comparable transactions, the Monitor notes that the fee percentage will drop to the extent there are draws on the Closing DIP Loan (which will be added to the Purchase Price as described earlier herein), and that consideration also needs to be given to the risk factors and the industry.

28. Based on the foregoing, the Monitor is of the view that the Break Fee will not negatively impact the canvassing of the market in the SISP, and the cost is warranted given the benefits provided by the Stalking Horse Purchase Agreement.

29. The availability of the Closing DIP Loan under the Stalking Horse Purchase Agreement is important to ensure the Applicants have sufficient funding, if required, to address all closing conditions, including obtaining the necessary Health Canada approval.

CONCLUSIONS AND RECOMMENDATIONS

30. The Monitor supports the relief sought by the Applicants and recommends the Court grant an Order approving the Stalking Horse Purchase Agreement, the Break Fee, and confirming that the Stalking Horse Purchase Agreement represents the Stalking Horse Bid under the SISP.

All of which is respectfully submitted this 2nd day of November 2022.

ERNST & YOUNG INC., in its capacity
as Court-appointed Monitor of the Applicants,
and not in its corporate or personal capacity.

per:

Alex Morrison, CPA, CA
Senior Vice-President

Karen Fung, CPA, CA
Senior Vice-President

Allen Yao, CPA, CA
Vice-President

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Proceedings commenced at Toronto

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DATED NOVEMBER 2, 2022

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