

CANADA)
PROVINCE OF SASKATCHEWAN)

IN THE COURT OF QUEEN'S BENCH FOR SASKATCHEWAN
JUDICIAL CENTRE OF SASKATOON

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

AND IN THE MATTER OF A PROPOSED PLAN OF ARRANGMENT FOR THE
CREDITORS OF ADVANCE ENGINEERED PRODUCTS LTD.

FIRST REPORT OF THE MONITOR

ERNST & YOUNG INC.

MAY 6, 2015

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INTRODUCTION

1. On April 10, 2015, Advance Engineered Products Ltd. (the “**Applicant**” or “**AEPL**”) filed for and obtained protection from their creditors under the *Companies’ Creditors Arrangement Act*, R.S.C. 1985 c C-36, as amended, (the “**CCAA**”) pursuant to an order of this Honourable Court dated April 10, 2015 (the “**Initial Order**”).
2. Pursuant to the Initial Order, Ernst & Young Inc. (“**EYI**”) was appointed monitor of the Applicant in these CCAA proceedings (the “**Monitor**”). As described in the Initial Order, EYI was granted enhanced powers to develop and implement a restructuring which may include the sale of some or all of AEPL’s business and/or assets and other alternatives, all with a view to maximizing value for AEPL’s stakeholders.
3. The Initial Order established a Stay of Proceedings until May 8, 2015 (the “**Stay Period**”).
4. The purpose of this first report of the Monitor (the “**First Report**”) is to advise this Honourable Court with respect to the following:
 - a. the background pertaining to AEPL;
 - b. the activities undertaken by the Monitor in accordance with the provisions of the Initial Order and CCAA;
 - c. the Monitor’s steps to comply with statutory obligations;
 - d. the Monitor’s review of the Initial 13-Week Cash Flow (defined below);
 - e. an operations update;
 - f. AEPL’s updated cash flow forecast for the period of May 2, 2015 to July 31, 2015 (the “**Updated Forecast Period**”)
 - g. The realization process and restructuring considerations;

- h. the basis and requirement for the Applicant's request for an extension of the Stay Period to June 19, 2015 (the "**Extended Stay Period**"); and
 - i. the Monitor's Recommendations.
- 5. Capitalized terms not defined in this First Report are as defined in the Initial Order. All references to dollars are in Canadian currency unless otherwise noted.

TERMS OF REFERENCE

- 6. In preparing this First Report, the Monitor has been provided with, and in making the comments herein relied upon, unaudited financial information, the Applicant's books and records, financial information prepared by the Applicant, and discussions with management of the Applicants. The Monitor has not audited, reviewed or otherwise attempted to verify the accuracy or completeness of such information and, accordingly, the Monitor expresses no opinion or other form of assurance in respect of such information contained in this First Report.
- 7. Certain information referred to in this First Report consists of forecasts and projections. 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 Generally Accepted Assurance Standards pursuant to the Chartered Professional Accountants Canada Handbook and, accordingly, the Receiver expresses no opinion or other form of assurance in respect of the Information
- 8. Future oriented financial information referred to in this report was prepared based on management's estimates and probable and hypothetical assumptions. Readers are cautioned that since projections are based upon assumptions about future events and conditions that are not readily and currently ascertainable, the actual results will vary

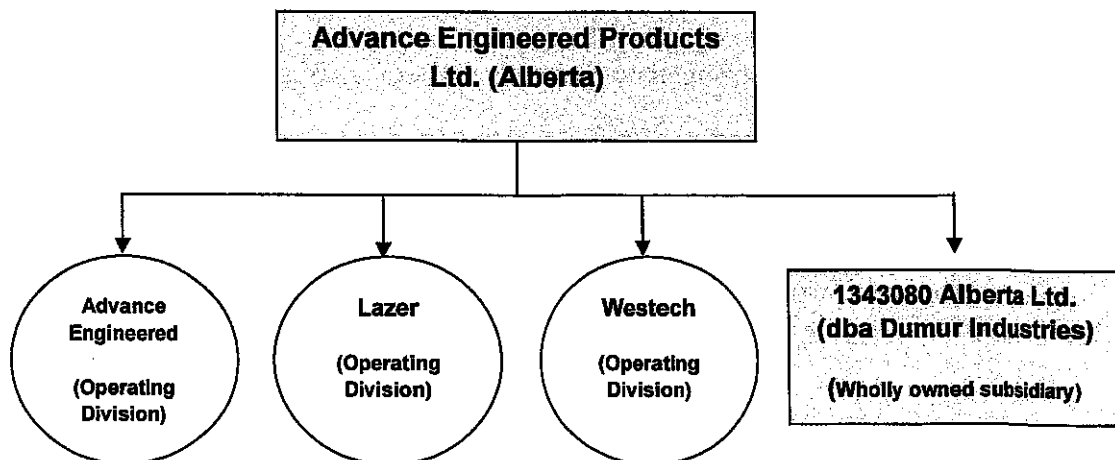
from the projections, even if the assumptions materialize, and the variations could be material.

9. This First Report has been prepared for the use of this Honourable Court and AEPL's stakeholders as general information relating to the Applicants and their operations. Accordingly, the reader is cautioned that this First Report may not be appropriate for any other purpose. The Monitor assumes no responsibility or liability for losses incurred by the reader as a result of the circulation, publication, reproduction or use of this First Report contrary to the provisions of this paragraph.

BACKGROUND

10. AEPL was founded in Regina in 1984 with the objective of becoming a state of the art manufacturer of truck tanks, trailers and vacuum truck equipment. From its premises in Regina, the company has operated a specialised plant for over 30 years.
11. Maintaining its head office in Regina, AEPL has grown significantly since it was founded through a combination of acquisitions and organic growth.
12. AEPL presently carries on business in the following three divisions:
 - a. the Advance Engineered Productions division, which consists of:
 - i. the manufacturing operations (Regina, Saskatchewan), which produce aluminum based tanks and trailers; and
 - ii. the parts and service operations, which repair and service tanks and trailers in facilities located in the following cities:
 - Surrey, B.C.;
 - Calgary, Alberta;

- Edmonton, Alberta;
 - Lloydminster, Alberta; and
 - Regina, Saskatchewan.
- b. the Westech Vac Systems ("**Westech**") division (located in Nisku, Alberta), which is the largest manufacturer of mobile vacuum systems in Canada; primarily for the domestic market (and related service operations);
- c. the Lazer Inox ("**Lazer**") division (located in St. Germain-de-Grantham, Quebec), which manufactures tanks and trailers with a specialty in stainless steel products.
13. In addition, AEPL owns all of the issued and outstanding shares of 1343080 Alberta Ltd., carrying on business as Dumur Industries ("**Dumur**"). Dumur, which is located in White City, Saskatchewan, is a leader in the precision metal machining and fabrication industry and is a supplier to businesses in the defence and aerospace industry.
14. Dumur is not a direct party to these CCAA proceedings and its stakeholders are unaffected in that regard; although Dumur is, from time to time, dependant on financing from AEPL.
15. For greater clarity, Advance's organization chart is as follows:

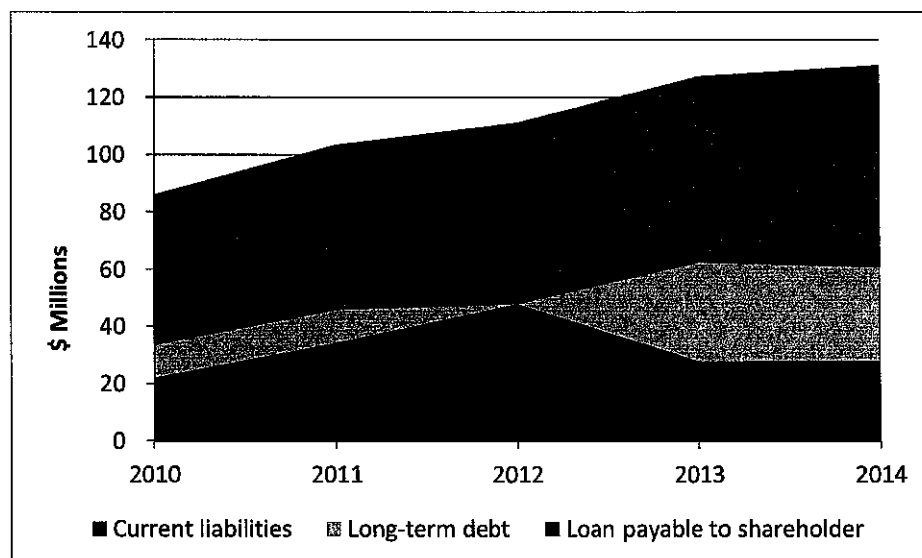


16. Historically, AEPL's customers have been highly concentrated in the oil and gas and petroleum industries, primarily in Western Canada.
17. Further background to AEPL and its operations are contained in the materials filed relating to the Initial Order including the April 9, 2015 affidavit of Mr. Darrell Zwarych (the "**April 9, 2015 Zwarych Affidavit**"). These documents, together with other information regarding this CCAA proceeding, including the Initial Order, have been posted by the Monitor on its website at: www.ey.com/ca/aepl.

CAUSES OF INSOLVENCY

Accumulation of leverage

18. In recent years, AEPL accumulated significant financial liabilities in order to finance acquisitions as well as other balance sheet related activities with the intent of enhancing shareholder value. The accumulation of liabilities as per review of AEPL's audited financial statements for the years end September 30, 2010 through September 30, 2014 is depicted in the following table:



19. In addition to the foregoing, per the Monitor's review of AEPL's audited financial statements, in healthier times, AEPL made significant payments to its shareholders on account of dividends and interest on shareholders loans, as well as debt service payments to third party lenders, which depleted equity from AEPL's balance sheet and left it vulnerable to an extraneous market shock.

Senior Secured Debt

20. AEPL is indebted to a syndicate of senior lenders comprised of the Royal Bank of Canada, Bank of Montreal and Canadian Western Bank (together, the "**Senior Lenders**") pursuant to a Credit Agreement between the Senior Lenders, RBC as agent (the "**Agent**") and AEPL dated August 1, 2007 and amended and restated as of July 18, 2013.
21. As at the date of the CCAA filing (April 10, 2015), AEPL was indebted to the Senior Lenders in the amount of \$29,061,236 CDN and \$1,600,000 US plus accruing interest and all other charges and expenses of enforcement (the "**Senior Indebtedness**"). The Senior Indebtedness is secured by, *inter alia*, a security interest in all of the property, assets and undertakings of AEPL that generally ranks as a first charge against all the assets of AEPL, including the shares of Dumur.
22. The Senior Indebtedness is also guaranteed by Dumur and Dumur has granted the Agent a security interest in all of its property, assets and undertaking in support of that guarantee.

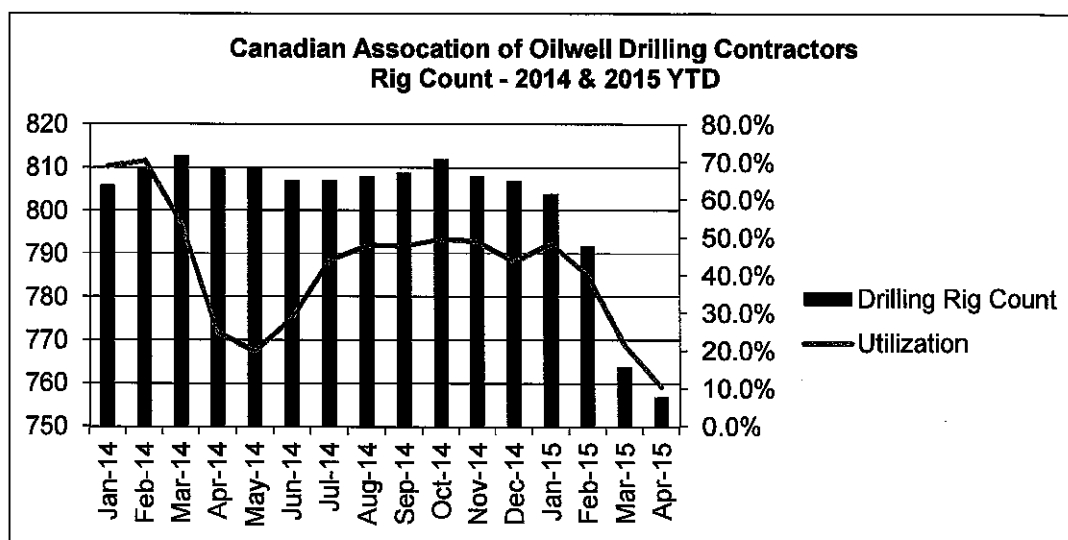
Shareholder Debt

23. In addition to the Senior Indebtedness, AEPL is currently indebted to an affiliate of Tricor Pacific Capital Partners in the amount of approximately \$72 million (the "**Tricor Indebtedness**").

24. The Tricor Indebtedness is subordinate to the Senior Indebtedness and ranks *pari passu* with the indebtedness to the unsecured creditors.

Downturn in Global Energy Markets

25. Recent volatility in global energy markets, starting in the fall of 2014, caused a sudden and severe downturn in the energy industry, and in particular those companies that supply oil producers. AEPL was clearly subject to these market forces.
26. The following table illustrates the sharp fall-off in drilling rigs since 2014, a metric which is widely viewed as a barometer for investment spending by oil and gas producers.



27. Beginning in 2015, AEPL's customers either cancelled or failed to place anticipated new orders, which resulted in a significant erosion of AEPL's manufacturing order book and the emergence of extreme liquidity constraints.
28. In February and March, 2015, AEPL issued layoff notices to approximately 150 employees, primarily in the Regina manufacturing centre. This downturn affected the entire tank and trailer industry, including AEPL's competitors, and resulted in broad layoffs through the industry.

29. Given its liquidity constraints, AEPL accumulated significant unsecured trade debt during this period, and as of the date of filing, AEPL had accounts payable and other accrued liabilities, excluding the related party indebtedness described above, totalling approximately \$17 million.
30. In February 2015, AEPL engaged Richter Advisory Group Inc. ("**Richter**") as its financial advisor to assist it in evaluating its restructuring alternatives.
31. By the end of March, 2015, the majority of AEPL's critical suppliers had stopped supplying goods and services to AEPL, which further strained its ability to operate in the normal course.
32. On March 27, 2015, representatives of AEPL, including Richter, met with representatives of the Agent to inform the Senior Lenders of AEPL's financial difficulties.
33. Following discussions among AEPL and the Agent, Richter and legal advisors, the Agent advised AEPL that:
 - a. AEPL was in default of its commitments and no further credit would be granted to AEPL;
 - b. for a short interim period AEPL could apply cash balances on hand to necessary ordinary course operating expenses while the Senior Lenders considered their options; and
 - c. it would retain EYI as financial advisor.
34. Following further discussions and consultations between AEPL and its advisors and the Lenders and their advisors, on April 1, 2015 the Agent made demand for immediate repayment of the Senior Indebtedness and gave notice of its intention to enforce its security pursuant to s. 244 of the BIA.

35. In addition, on April 2, 2015, the Agent made demand for immediate payment by Dumur of its liabilities pursuant to its guarantee of the Senior Indebtedness owed by AEPL.
36. Negotiations between the parties ensued and on April 8, 2015, with the consent of AEPL, representatives of EYI attended AEPL's corporate head office for the first time in anticipation of a pending CCAA filing.
37. On April 9, 2015, each of the Directors and Officers of AEPL and Dumur resigned from the office held, resulting in the need for an immediate Court mandated process that permitted EYI enhanced powers, as an officer of this Honourable Court, to serve the capacities required to continue to operate the business of AEPL and Dumur.
38. On April 10, 2015, in order to protect and preserve the value of AEPL and its property, assets and undertaking, AEPL, with the consent of the Senior Lenders, sought and obtained relief under the CCAA. EYI was appointed as the Monitor within the CCAA proceeding for the purpose of exercising restructuring powers.

MONITOR'S ACTIVITIES AND COMPLIANCE WITH STATUTORY OBLIGATIONS

39. Pursuant to the terms of the Initial Order and Section 23 of the CCAA, the Monitor has completed the following notice and service requirements:
 - a. published in the Regina Leader Post, the Saskatoon Star Phoenix, and the Globe and Mail National edition newspapers, once a week for two consecutive weeks, being April 16 and 23, 2015, a notice containing the prescribed information under the CCAA (copies of which are attached as **Appendix "A"** to this First Report);
 - b. within five days after the date of the Initial Order:

- i. made the Initial Order publicly available by posting a copy on the Monitor's website (www.ey.com/ca/aepi) (the "Website");
 - ii. sent, by mail, notice to every known creditor advising them that the Initial Order is publicly available on the Monitor's website (a copy of the notice is attached as **Appendix "B"** to this First Report); and
 - iii. prepared a list of creditors including the names, addresses, and estimated amounts owed and made the list publicly available on the Website; and
- c. made the service list publicly available on the Website.

40. In addition to the foregoing statutory obligations and those matters outlined elsewhere in the First Report, the Monitor has, *inter alia*:

- a. met with management to explain its obligations during the CCAA proceedings and to highlight the payment provisions in the Initial Order to assist management in compliance with these provisions;
- b. coordinated with management a sizable employee termination protocol and attended the Advance, Westech and Lazer manufacturing facilities, where the bulk of the terminations occurred to:
 - i. assist in the delivery of those termination notices (as is discussed in more detail below); and
 - ii. explain to the affected and unaffected employees the status of the CCAA proceedings and its impact on operations;
- c. arranged for a security service over the weekend at each of the manufacturing facilities where sizable terminations were undertaken to mitigate the risks of property loss or damage resulting from the terminations;

- d. conducted meetings with representatives from the union to discuss the effect of the CCAA, the scale back in manufacturing (as discussed in greater detail below), the desire to preserve long term productivity and value, and the need for cooperation;
- e. advised the financial institutions involved with AEPL and requested that they put an immediate freeze on all deposit accounts in the name of, or in trust for, AEPL;
- f. worked with management to set up new accounts to mirror the old accounts, and arranged to transfer the funds from the previous bank accounts to the new accounts and then closed the old accounts;
- g. worked with management to freeze all vendor payable balances effective the date of the Initial Order and set-up new accounts with key suppliers for the post-filing activity;
- h. engaged in difficult negotiations with critical suppliers respecting the continuing supply of goods and services, on terms acceptable to the parties;
- i. prepared a weekly cash flow projection for monitoring purposes and monitored the disbursements of AEPL to ensure compliance with the provisions of the Initial Order;
- j. assisted senior management in the development of a communication protocol to various stakeholders including creditors, employees and investors (a copy of this protocol is attached as **Appendix "C"**);
- k. responded in a timely manner to thousands of inquiries from affected stakeholders including creditors, shareholders and terminated employees;
- l. reviewed and provided feedback on a press releases issued by AEPL during these proceedings (a copy of which is attached as **Appendix "D"**);

- m. prepared and filed the debtor company information summary with the Office of the Superintendent of Bankruptcy;
- n. assisted senior management with respect to the CCAA process, including the necessary procedural aspects of the proceedings;
- o. logged stakeholder demands for notice of these
- p. translated statutory and other material into the French language for the benefit of AEPL's French speaking stakeholders (primarily Quebec based); and
- q. commenced a sale process as outlined below.

REVIEW OF THE INITIAL 13-WEEK FORECAST

41. The Monitor is apprised that Richter advised AEPL in its various options respecting the ongoing operations of AEPL and modelled cash flow forecasts to reflect those options. Attached as Appendix "C" to the April 9, 2015 Zwarych Affidavit is a 13-week cash flow statement (the "**Initial 13-Week Forecast**"), which assumed that AEPL would:
- a. cease all manufacturing activities immediately following the date of the CCAA filing, on the basis of Richter's view that the majority of the WIP being converted would most likely not have any customer certainty associated with it;
 - b. continue the parts and service business in all locations; and
 - c. fund Dumur's ongoing cash flow requirements.
42. Given that the suspension of manufacturing activities would prevent: a) the conversion of work-in-progress ("**WIP**") inventory into finished goods inventory for sale, and b) AEPL from taking on new customer orders; the forecast for cash receipts consisted primarily of the collection of outstanding accounts receivable.

43. Based on the foregoing, the Initial 13-Week Forecast projected:
- a. negative net cash flow of approximately \$4.3 million;
 - b. accessing the Debtor-in-Possession ("DIP") financing of approximately \$1 million over the 13-Week period; and
 - c. an ending cash deficiency of \$700,000.
44. Immediately upon its arrival on April 8, 2015, and in the two day period leading up to the CCAA filing, the Monitor reviewed the Initial 13-Week Forecast in detail, including the underlying assumptions and strategic direction contemplated therein, and in consultation with Mr. Darrell Zwarych (the head of AEPL) and the remainder of AEPL's executive management team, evaluated the best course of action going forward.
45. Specifically, as at the date of the initial order, AEPL had WIP of approximately \$7.7 million as well as \$10.5 million of raw materials, much of which represented parts that were acquired for specific customer orders. The tanks and trailers manufactured by AEPL require certification by a professional engineer and various regulatory inspections before delivery can complete, and accordingly, any of the units in WIP that AEPL was unable to complete risked being liquidated for scrap metal value. In addition, the Monitor was specifically concerned that missing key customer delivery dates could materially deplete the value of the WIP inventory and those parts purchased should AEPL be unable to convert that WIP into saleable finished goods inventory. Finally, the Monitor was concerned that not completing customer units, as contractually obligated, could result in a damages claim against which customers may seek to exercise a right of set off to outstanding accounts payable due to AEPL (an account receivable of AEPL).
46. Additionally, the Monitor was concerned that:

- a. the cessation of manufacturing activities would significantly increase funding requirements under a DIP facility;
 - b. a complete shutdown of manufacturing operations would:
 - i. prevent AEPL from accepting and fulfilling new profitable customer orders; and
 - ii. materially jeopardized the long-term goodwill associated with AEPL's business enterprise and harm its going concern value.
47. Based on the foregoing, AEPL, in consultation with the Monitor, calculated that maintaining a skeleton manufacturing operations would require additional payroll funding of approximately \$75,000 per week (relative to a go-dark scenario), and that deviating from the strategy set-out in the Initial 13-Week Cash flow was warranted, at least in the interim, to: a) complete the WIP in inventory, b) improve intermediate term cash flows, and c) preserve AEPL's going concern enterprise value.
48. AEPL, with the assistance of the Monitor, altered its plans to maintain a significantly reduced workforce at each of its manufacturing plants as outlined above.
49. As a result of the early successes of this program, including securing new customer orders and accelerating the completion of existing orders, AEPL has since marginally increased its manufacturing crew at the Regina, Saskatchewan manufacturing facility to include a second line of manufacturing and certain additional employees at each of the Alberta and Quebec manufacturing plants (increased payroll funding cost of approximately \$20,000 per week).

OPERATIONS UPDATE

Employee Terminations

50. As a result of the severe downturn in the tank and trailer industry, AEPL, as of the date of CCAA filing, was suffering from excess and idle capacity in each of its manufacturing facilities and ongoing payroll costs were unsustainable in light of AEPL's financial position. Accordingly, in consultation with the Monitor, AEPL's senior management team identified a key list of employees on the manufacturing side of its business that were required to:
- a. convert the WIP to finished goods inventory; and
 - b. enable AEPL and the Monitor to develop and implement a restructuring plan that would likely involve the sale of part or all of AEPL's assets on a going concern basis.
51. Immediately following the CCAA filing, AEPL issued a total of 393 termination notices to the manufacturing oriented and management and corporate office employees that were not deemed necessary to achieving the objectives described above.
52. This headcount reduction affected nearly one half of AEPL's 800 employees and impacted all areas of AEPL's manufacturing operations, including hourly plant workers, sales and administration in all locations as well as management and corporate office employees. AEPL's service business was largely unaffected by the substantive headcount reduction.
53. In the week that followed the headcount reduction, the Monitor caused AEPL to distribute \$516,000 from the current assets of AEPL to the terminated employees for unpaid wages through the date of the CCAA filing.

54. The effect of the employee terminations was a reduction in the weekly payroll run rate by approximately \$425,000.

Retention of an Interim CFO

55. Upon its appointment, the Monitor caused the termination of the existing Interim CFO and retained Mr. Canute Tagseth as AEPL's Interim CFO on a go-forward basis. Mr. Tagseth has extensive experience in a number of senior finance roles in scenarios involving turnarounds and insolvency proceedings.

Comprehensive Manufacturing Review

56. In the week that followed the CCAA filing, AEPL management, with the assistance of the Monitor, performed a comprehensive review of the outstanding customer orders in each of the three manufacturing facilities, contacted the customers in respect of those orders and re-evaluated those commitments, and prepared a comprehensive production schedule for the delivery of those units as well as a revised 13-week cash flow forecast (the "**Revised Initial Forecast**") that accounted for this manufacturing activity.
57. Attached as **Appendix "E"** to this First Report is a copy of the Revised Initial Forecast, which, as at the time of its preparation, forecast the following over the subsequent 13-week period:
- a. positive net cash flow of approximately \$3 million;
 - b. no requirement for a Debtor-in-Possession ("**DIP**") financing; and
 - c. ending cash availability of approximately \$8.2 million.
58. For greater clarity, the Monitor is of the view that AEPL will have sufficient organic cash flow to sustain operations for the foreseeable future and will not require access to DIP financing.

Manufacturing Update

59. Since the CCAA filing, AEPL has continued manufacturing, albeit on a more limited basis. However, AEPL recently added a second line (approximately 20 employees) at the Regina plant and re-hired plant workers in Westech and Lazer (described above) to ensure that existing customer orders complete on an acceptable timeline to the customers. At current staffing levels, AEPL has no capacity to accept new customer orders until July in both Westech and Lazer, and until October in Regina. AEPL, in consultation with the Monitor, continues to assess equilibrium between manufacturing capacity and customer demand, with a view of further alterations in the future to optimize cash flow and meet the needs of its customers.
60. The management team is actively working with the Monitor in evaluating prospective new orders, and specifically whether those orders are value accretive to AEPL and may further increase the scope of manufacturing operations should circumstances permit.

Parts and Service Update

61. Leading up to the CCAA filing, the parts and service division was constrained by AEPL's inability to procure goods and services from its critical supplier. However, the CCAA has provided AEPL with immediate cash availability to make payments for the supply of goods and services post-filing.
62. In light of current market conditions, AEPL's customers have deferred the acquisition of new tank and trailers (sizable capital outlays) and have opted to service existing equipment; and despite the CCAA filing, the parts and service division exceeded its operation budget for the month ended April 30, 2015.

RECEIPTS & DISBURSEMENTS SINCE THE INITIAL ORDER

63. Attached hereto as **Appendix "F"** to this First Report, and summarized below, is a statement of receipts and disbursements of the Applicant for the period April 10, 2015 to May 1, 2015 (inclusive). This statement reflects actual cash receipts and disbursements, and has not been prepared on an accrual basis.

Opening Cash Balance	\$ 5,941,308
<i>Cash Receipts¹</i>	
Manufacturing department	2,740,240
Parts & Service department	4,073,043
Other	<u>28,092</u>
	6,841,376
<i>Cash Disbursements</i>	
Payroll	2,600,142
Supplies and Materials	2,100,020
Other expenses	<u>301,843</u>
	5,002,005
Excess of Receipts over Disbursements	<u>1,839,371</u>
Distributions on account of unpaid wages	<u>(516,603)</u>
Ending Cash Balance	\$ <u>7,264,076</u>

¹ Cash receipts consist primarily of the collection of outstanding Accounts Receivable balances.

64. As is noted above, the ending cash balance at May 1, 2015 is approximately \$7.26 million, which compares to the Initial 13-Week Forecast that projected an ending cash deficiency of approximately \$1.1 million at May 1, 2015.

UPDATED CASH FLOW FORECAST

65. AEPL, with the assistance of the Monitor, has prepared a forecast for the Forecast Period, which is attached as **Appendix "G"** to this report (the **"Updated Forecast"**). The Updated Forecast has been prepared for the purpose described in the notes accompanying the statement of projected cash-flow, using the probable and hypothetical assumptions set out in the notes. The table below summarizes cash flow for the Updated Forecast Period:

	<u>Projected through July 31, 2015</u>
Cash receipts from operations	26,717,591
Disbursements	
Payroll, sales commissions and benefits	9,325,482
Supplies and materials	7,205,101
Other operating expenses	3,169,503
Non-operating expenses and restructuring costs	<u>3,800,000</u>
	23,500,086
Net Cash Flow	3,217,505
Opening cash on hand	<u>7,125,000</u>
Ending Cash Balance	<u>10,342,505</u>

Major assumptions

66. The major assumptions underpinning the Updated Forecast include the following:
- AEPL preserves a skeleton manufacturing crew at the Regina, Lazer and Westech manufacturing facilities for the purpose of converting the WIP to finished goods;

- b. receipts from operations consist of collections of outstanding accounts receivable, receipts from the sale of WIP when converted to finished goods inventory and parts and service operations, which remain uninterrupted;
 - c. no new customer orders or sale of finished goods inventory;
 - d. Dumur remains outside of these CCAA Proceedings and its cash flow requirements are funded by AEPL;
 - e. supplies and materials are based on budgets for the conversion of WIP to Inventory as well as normal purchasing requirements for Dumur and the parts and service division; and
 - f. operating and other expenses in line with historical averages.
67. Based on the foregoing, the Monitor is firmly of the view that AEPL will have sufficient cash availability to sustain operations for the foreseeable future and meet all post-filing obligations as they become due.

REALIZATION PROCESS CONSIDERATIONS

Background

68. Given the high profile nature of these CCAA proceedings, numerous parties approached the Monitor immediately following the date of the Initial Order with expressions of interest to either acquire or finance the restructuring of AEPL.
69. In recognition that a sale of part or all of AEPL, or a restructuring thereof, would require the approval of this Honourable Court, and with the intent in restoring stakeholder confidence in AEPL, the Monitor initiated an informal process to solicit interest of these parties to acquire the assets or shares of AEPL within the context of a "Stalking Horse

Sales Process” or an alternative process (collectively, the “**Solicitation Process**”), and to facilitate the foregoing, the Monitor:

- a. with the assistance of counsel, prepared a form of non-disclosure agreement (“**NDA**”);
- b. with the assistance of counsel, prepared a form of letter of intent (“**LOI**”) in which interested parties were asked to identify an indicated purchase price for the assets of AEPL, allocated between:
 - i. the value attributed AEPL’s business enterprise including goodwill and plant, property and equipment;
 - ii. inventory (including raw materials, WIP, and finished goods);
 - iii. accounts receivable;
 - iv. AEPL’s investment in Dumur; and
 - v. other value attributes;
- c. in consultation with management, prepared a management presentation (the “**Management Presentation**”), which addressed, *inter alia*:
 - i. an overview of AEPL’s locations and physical presence;
 - ii. health and safety considerations;
 - iii. a summary of cash flow enhancement opportunities; and
 - iv. an overview of market opportunities and long term strategic planning;
- d. populated an electronic data room (the “**Data Room**”) with the Management Presentation, the form of LOI, and other key financial, operational and other information, including quarterly reports to the Board of Directors, for interested parties to evaluate an acquisition opportunity involving AEPL;

- e. made direct contact with potential strategic acquirers, including competitors and large manufacturing conglomerates, financial acquirers and those that may have a specific and distinctive interest in acquiring the shares of Dumur;
 - f. obtained approval of the Senior Lenders to offer the shares of AEPL, which are pledged to the Senior Lenders, for sale on terms satisfactory to the Senior Lenders; and
 - g. provided interested parties with access to the Data Room upon the execution of the NDA.
70. The Monitor has also fielded a number of inquiries from parties in respect of a potential investment or acquisition of AEPL that ultimately elected not to proceed with the execution of an NDA given their objective to acquire the assets of AEPL on either: a) a piecemeal basis or, b) at extremely distressed valuations.
71. To date, the informal process initiated by the Monitor to identify investors and/or purchasers pursuant to a Solicitation Process has resulted in seventeen parties having executed an NDA and provided access to the Data Room.
72. The parties that have executed the NDA cover a broad range of investment targets, including:
- a. strategic investors, both domestic and U.S. based;
 - b. institutional funds;
 - c. private equity firms; and
 - d. manufacturing conglomerates.
73. Throughout this process, the Monitor has supplemented the Data Room with additional documents based on the further inquiries of interested parties; and indicative of the level

of interest observed thus far, several of these interested parties have conducted site tours and attended management presentations, and several more have arranged site tours in the coming two weeks.

74. Given: a) the publicity of these CCAA proceedings, and b) the Monitor's direct contact with potential strategic investors, the Monitor is of the view that a sufficient number of parties have been identified by the Monitor that have the credibility, capacity and interest in facilitating a sale or restructuring of AEPL to develop a formal competitive sale process and to ensure a maximum recovery to AEPL's stakeholders in light of the current situation and the potential of an actual restructuring of some or all of its business.

Go-forward Timeline

75. It is the Monitor's intent to provide those parties that are currently active in due diligence a deadline of Friday, May 29, 2015 to complete their analysis, preliminary due diligence and submit to the Monitor for its consideration a formal non-binding LOI.
76. The LOIs received from interested parties will be reviewed by the Monitor in regard to, *inter alia*, the following criteria:
- a. indicative values for AEPL's assets; i.e. the overall purchase price;
 - b. the purchase price allocation, and specifically, values attributed to AEPL's business enterprise including goodwill and plant, property and equipment and AEPL's various working capital assets;
 - c. the value attributed to AEPL's investment in Dumur;
 - d. closing conditions; and
 - e. the timeline for closing.

77. Following a thorough review of the LOIs received and benchmarking thereof, the Monitor expects it will require a period of approximately two to three weeks to formulate a recommendation to this Honourable Court respecting the disposition of AEPL's assets, which may include, *inter alia*, the conduct of further marketing procedures, either by way of a formal:
- a. stalking horse sales process with one or more (in the case of discrete parcels) of the parties that submitted an LOI; or
 - b. tendering process.
78. Accordingly, the Monitor anticipates that it will be in a position to provide this Honourable Court with a recommendation with respect to the foregoing within a period of no more than six weeks; and AEPL is seeking an extension of the Stay Period which mirrors that period, being up to and including June 19, 2015.

KEY EMPLOYEE RETENTION PLAN

79. The Monitor is of the view that the senior management team and the remaining employees at large are critical to the ongoing operations and the ability of the Applicant to affect a restructuring or sale of AEPL on a going concern basis. Those employees include the engineers, welders, production managers and the sales force that have specialized skill-sets and a strong knowledge of AEPL's products and manufacturing processes.
80. Certain of these employees are concerned with employment and financial security, especially in light of the headcount reduction that has already occurred, and have advised senior management of AEPL that they are considering their options, including alternative employment. A loss of key members of management or an employee exodus

at any production facility would create a knowledge and operational void and would negatively impact the viability of a successful restructuring or sale of AEPL.

81. Based on the foregoing, the Monitor is working with management on the outline of a key employee retention plan ("**KERP**").
82. A KERP is a key component of a sale or restructuring process in instances when the retention of key employees is required and where there is less than certainty that they will be employed following the completion of a transaction.
83. The Monitor anticipates that the KERP will follow a three "bucket" approach:
 - a. a "**Retention Bonus**", which is summarized as follows:
 - i. an amount of \$850 per employee (approximately \$325,000 in aggregate); payable in two installments, first on May 31, 2015 and the second on July 31, 2015; and
 - ii. all employees of AEPL, including the management team, will be eligible for the Retention bonus provided that they are employed by AEPL as of the installment dates.
 - b. a "**Management Incentive Plan**", which currently contemplates a variable success-based incentive amount linked to the value of a successful reorganization or sale of AEPL; and
 - c. an "**Executive Compensation Plan**", which is intended to compensate certain executives should, in the event of a successful reorganization or sale of AEPL, they, a) not be offered employment by any successor employer, or b) are offered employment by the any successor employer on inferior terms.

84. The Monitor advises this Honourable Court that AEPL intends to make the Retention Bonus (described above) payments from ongoing operation cash flows in the manner described above; and those payments are provided for in the Updated Forecast. The Monitor advises that it has consulted and secured the approval of the Senior Lenders for the payment of the Retention Bonus. As this is simply a temporary increase in regular compensation the Monitor believes it is able to make these payments without court approval, but wanted to apprise this Honourable Court of its intention to make those payments.
85. Given that any payments pursuant to the prospective Management Incentive Plan and the Executive Compensation Plan, when finalized, are dependent on a successful outcome to the CCAA proceedings, the Monitor anticipates that AEPL will bring an application before this Honourable Court to approve the terms of a proposed KERP and to secure those amounts by way of a charge on the assets. The Monitor anticipates such application to be consequential to the application to approve a formal sale process, as described above.

REQUEST FOR AN EXTENSION OF THE STAY PERIOD

86. Pursuant to the Initial Order, the Stay Period continues until and including, May 8, 2015. AEPL is seeking an extension of the Stay Period until and including, June 19, 2015.
87. The Monitor has considered the burden of evidence that resides with the AEPL to demonstrate that an extension of the Stay Period by this Honourable Court is warranted, having regard to:
- a. The circumstances that justify the making of an extension order;
 - b. The good faith efforts of the Applicants to effect the restructuring; and

- c. The due diligence with which the Applicants is advancing the restructuring.

Circumstances that justify Extension Orders

- 88. As is discussed in earlier sections of this First Report, AEPL requires an extension of Stay Period to June 19, 2015 to enable it develop a sale or restructuring process in order to ensure a maximum recovery its stakeholders in light of the current situation.
- 89. The Monitor is also firmly of the view that AEPL will have sufficient organic cash flow to sustain operations throughout the Extended Stay Period.

Good Faith Efforts and Due Diligence

- 90. In the Monitor's view, AEPL is acting in good faith and with due diligence in these proceedings, as evidenced by the following:
 - a. AEPL is compliant with their statutory obligations under the CCAA and have complied with the provisions of the Initial Order;
 - b. AEPL and the Monitor have maintained on-going discussions with key stakeholders;
 - c. AEPL, with the assistance of the Monitor, has undertaken numerous activities in developing a sale or restructuring process as is documented in this First Report;
and
 - d. AEPL continues to focus on operational improvements and value enhancement initiatives.
- 91. It is the view of the Monitor that the Applicants have been pursuing the advancement of its restructuring efforts in good faith and with due diligence.
- 92. Based on the forgoing, the Monitor recommends that this Honourable Court grant an Order extending the Stay Period to June 19, 2015.

MONITOR'S RECOMMENDATIONS

93. Based on the foregoing, the Monitor recommends that that this Honourable Court grant an Order approving an extension of the Stay Period as outlined in the Initial Order from May 8, 2015 up to, and including, June 19, 2015.

All of which is respectfully submitted this 6th day of May, 2015

ERNST & YOUNG INC.
in its capacity as Court Appointed Monitor
of Advance Engineered Products Ltd.

Per:

A handwritten signature in black ink, appearing to read "Kevin Brennan", written over a horizontal line.

Kevin Brennan, CA, CPA, FCIRP
Senior Vice President