

Court File No. _____

**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 PAYLESS HOLDINGS LLC, PAYLESS SHOESOURCE
CANADA INC., PAYLESS SHOESOURCE CANADA GP INC. AND THOSE OTHER
ENTITIES LISTED ON SCHEDULE "A" HERETO**

**APPLICATION OF PAYLESS HOLDINGS LLC UNDER SECTION 46 OF THE
COMPANIES' CREDITORS ARRANGEMENT ACT, R.S.C. 1985, c. C-36, AS AMENDED**

**REPORT OF THE PROPOSED INFORMATION OFFICER
ALVAREZ & MARSAL CANADA INC.**

APRIL 7, 2017

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1.0 INTRODUCTION

- 1.1 On April 4, 2017 (the “**Filing Date**”), Payless Holdings LLC (“**Payless Holdings**”), Payless ShoeSource Canada Inc. (“**PSS Canada**”), Payless ShoeSource GP Inc. (“**PSS GP Inc.**”) and Payless ShoeSource Canada LP (“**Payless LP**”) together with the other entities listed on **Appendix “A”** (collectively, “**Payless**”, or the “**Chapter 11 Debtors**”) commenced voluntary reorganization proceedings (the “**Chapter 11 Proceedings**”) in the United States Bankruptcy Court for the Eastern District of Missouri (the “**US Court**”) by filing voluntary petitions for relief under Chapter 11 of Title 11 of the United States Code, 11 U.S.C. 101-1532 (the “**US Code**”).
- 1.2 On the Filing Date, the Chapter 11 Debtors filed a number of motions for interim and/or final orders (the “**First Day Motions**”) in the Chapter 11 Proceedings to permit the Chapter 11 Debtors to continue to operate their business in the ordinary course and to advance their reorganization. The First Day Motions, which were heard by the US Court on April 5, 2017, included a motion for entry of an order (the “**Foreign Representative Order**”) authorizing Payless Holdings to act as foreign representative on behalf of the Chapter 11 Debtors’ estates.
- 1.3 On April 5, 2017, the US Court granted the Foreign Representative Order and a series of other orders in respect of the First Day Motions (the “**First Day Orders**”), as described below.

1.4 On April 7, 2017, Payless Holdings commenced, by notice of application, an application before this Court (the “**Court**”) pursuant to Part IV of the *Companies’ Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended (the “**CCAA**”) (the “**CCAA Recognition Proceedings**”, together with the Chapter 11 Proceedings, the “**Restructuring Proceedings**”) for:

- (a) An initial recognition order (the “**Initial Recognition Order**”), pursuant to sections 46, 47 and 48 of the CCAA, among other things: (i) declaring that Payless Holdings is a “foreign representative” (the “**Foreign Representative**”); (ii) declaring that the Chapter 11 Proceedings are recognized as a “foreign main proceeding” under the CCAA; (iii) granting a stay of proceedings in respect of the Chapter 11 Debtors until otherwise ordered by this Court; (iv) prohibiting the sale or disposition outside of the ordinary course of business by the Chapter 11 Debtors of any of their property in Canada; and (v) requiring the Foreign Representative to publish notice of these CCAA Recognition Proceedings as required by section 53(b) of the CCAA; and
- (b) A supplemental order (the “**Supplemental Order**”) pursuant to section 49 of the CCAA, among other things: (i) recognizing in Canada and enforcing certain orders of the US Court made in the Chapter 11 Proceedings (the “**First Day Orders**”), including the Interim DIP Order (as defined and described below); (ii) appointing Alvarez & Marsal Canada Inc. (“**A&M Canada**”, or the “**Proposed Information Officer**”) as the information officer in respect of the CCAA Recognition Proceedings; (iii) staying any claims, rights, liens or proceedings against or in respect of the Chapter 11 Debtors; (iv) restraining the right of any

person or entity to, among other things, discontinue or terminate any supply of products or services to the Chapter 11 Debtors; (v) granting super-priority charges on the property of Chapter 11 Debtors located in Canada (A) in favour of the Proposed Information Officer and its legal counsel as security for their professional fees and disbursements incurred in respect of these proceedings up to the maximum amount of \$500,000 (the “**Administration Charge**”); (B) in favour of arm’s length unsecured trade creditors of the Payless Canada Group up to the maximum amount of \$1.4 million to secure the repayment of the claims of such creditors (the “**Canadian Unsecured Creditors’ Charge**”); and (C) in favour of the DIP ABL Lenders (defined below) to secure obligations of the Chapter 11 Debtors, including the Payless Canada Group, under the DIP ABL Credit Facility (defined below) (the “**DIP ABL Lenders’ Charge**”).

1.5 Other than these Restructuring Proceedings, there are currently no other foreign proceedings in respect of the Chapter 11 Debtors of which the Proposed Information Officer is aware.

1.6 The primary objectives of the Chapter 11 Proceedings are for Payless to: (a) obtain immediate liquidity to address and normalize its distressed supply chain; (b) implement a pre-arranged restructuring that will reduce outstanding debt from approximately \$838 million to \$469 million (including assumed revolving loans), with corresponding reductions in debt service costs, by converting the pre-filing term debt into new equity of the Chapter 11 Debtors (with approximately 91% and 9% of the new equity being distributed to the existing First Lien Term Lenders (defined below) and Second Lien Term Lenders (defined below), respectively); and (c) reduce its store footprint to

eliminate unprofitable stores and renegotiate above market leases to improve profitability. In order to advance those objectives, the Chapter 11 Debtors have obtained DIP ABL financing of up to \$305 million and new money DIP term financing of up to \$80 million, and have entered into a Restructuring Support Agreement (the “**RSA**”) that has the support of parties who hold or control approximately two-thirds in amount of each of the Chapter 11 Debtors’ first and second lien term loans. The RSA and DIP ABL Credit Agreement (defined below) include a series of milestones in the Chapter 11 Proceedings designed to ensure that the Chapter 11 Debtors move expeditiously towards confirmation of a plan, including the filing of a plan of reorganization with the US Court on or before April 25, 2017.

1.7 The primary reasons for the Payless Canada Group being included in the Restructuring Proceedings are:

- (c) Approximately 56 store leases in Canada (out of 258) are indemnified by a US Chapter 11 Debtor, Payless ShoeSource, Inc. The Chapter 11 filing of that debtor caused a breach of the lease indemnities, which in turn caused a cross-default in the 56 store leases. The Payless Canada Group requires a stay of proceedings to prevent landlords from exercising rights that they may have pursuant to such cross-default provisions; and
- (d) The DIP ABL Lenders have required that the Payless Canada Group guarantee the DIP ABL Credit Facility, and that the guarantee be secured by the Payless Canada Group’s assets – assets that are currently unencumbered.

- 1.8 Payless had net sales of approximately \$2.3 billion in fiscal 2016, of which approximately \$160 million or 7% was attributable to the Payless Canada Group. The operations of the Payless Canada Group are wholly dependent on shared services provided by other Chapter 11 Debtors primarily from Payless's headquarters in Topeka, Kansas. Virtually all of the Payless Canada Group's buying, logistics, accounting and finance, information technology, marketing and payroll functions are provided by the Chapter 11 Debtors formed under the laws of the United States (the "**US Chapter 11 Debtors**"). It is extremely unlikely that the Payless Canada Group would be able to continue to operate if the US Chapter 11 Debtors ceased to operate.
- 1.9 The Payless Canada Group has approximately 2,100 employees (relative to Payless's approximately 22,000 employees globally). Only 20 of these Canadian employees are non-store level employees - all others are employed in the Payless Canada Group's 258 stores. Further, only five of the 20 non-store level employees work in management or administrative roles at a regional office in Etobicoke, Ontario. The other 15 employees work in field management roles. As noted above, virtually all of the corporate functions required to manage and support the Payless Canada Group are provided by the Chapter 11 Debtors, primarily from Payless's headquarters in Kansas, which houses over 750 employees.
- 1.10 As a relevant example of the above dependence, the Payless Canada Group acquires its inventory from a US affiliate, such that the Payless Canada Group does not have any third-party merchandise accounts payable, and its third-party trade/vendor liabilities are relatively small (approximately \$2.6 million). It is intended that these creditors will be unaffected in the Restructuring Proceedings as if they are captured by the Interim Critical

Vendors Order (defined below) (primarily freight transportation and logistics service providers) they will be paid in the ordinary course, and if they are not captured by that order, they are to receive the benefit of the Canadian Unsecured Creditors' Charge.

1.11 Pursuant to the requirements in the DIP ABL Credit Agreement, approximately 400 of Payless's 3500 stores in the US are anticipated to be liquidated and closed shortly after the Restructuring Proceedings commence. The Chapter 11 Debtors are also in the process of reviewing an additional 3000 stores for potential additional closures. The DIP ABL Credit Agreement contemplates the closure of 600 stores to the extent included in the approved budget. The Proposed Information Officer understands that there are currently no plans to liquidate and close any Canadian stores. Further, the DIP ABL Credit Agreement specifies that the stores of the Payless Canada Group are not required to be closed.

1.12 As described in more detail below, it is the Proposed Information Officer's view that, on balance, the Payless Canada Group's landlords, employees and other creditors are more likely to benefit from these Restructuring Proceedings, than be prejudiced by the approval of the DIP ABL Credit Facility and related DIP ABL Lenders' Charge.

2.0 TERMS OF REFERENCE

2.1 In preparing this Report of the Proposed Information Officer (the "**Pre-Filing Report**"), A&M Canada has relied solely on information and documents provided by the Foreign Representative, the other Chapter 11 Debtors and their Canadian legal counsel (collectively the "**Information**"). Except as otherwise described in this Pre-Filing Report in respect of the Payless cash flow forecast:

- (a) The Proposed Information Officer has reviewed the Information for reasonableness, internal consistency and use in the context in which it was provided. However, the Proposed Information Officer has not audited or otherwise attempted to verify the accuracy or completeness of the Information in a manner that would wholly or partially comply with Canadian Auditing Standards (“CASs”) pursuant to the *Chartered Professional Accountants of Canada Handbook* (the “**Handbook**”) and accordingly, the Proposed Information Officer expresses no opinion or other form of assurance contemplated under CASs in respect of the Information; and
- (b) Some of the information referred to in this Pre-Filing Report consists of forecasts and projections. An examination or review of the financial forecasts and projections, as outlined in the Handbook, has not been performed.

2.2 Future-oriented financial information referred to in this Pre-Filing Report was prepared based on estimates and assumptions made by Payless’s management. Readers are cautioned that, since projections are based upon assumptions about future events and conditions that are not ascertainable, the actual results will vary from the projections, and the variations could be significant.

2.3 This Pre-Filing Report should be read in conjunction with the Affidavit of Michael Schwindle, the Chief Financial Officer and Senior Vice President of Payless Holdings, and Vice President, Treasurer and a Director of each of the Payless Canada Group entities, sworn on April 6, 2017 (the “**Schwindle Affidavit**”).

2.4 Unless otherwise stated, all monetary amounts contained in this Pre-Filing Report are expressed in United States dollars, which is the Chapter 11 Debtors' common reporting currency.

3.0 PURPOSE OF THIS REPORT

3.1 The purpose of this Pre-Filing Report is to assist the Court in considering the Foreign Representative's request for the Initial Recognition Order and the Supplemental Order, and to provide the Court with certain background information in respect of the Chapter 11 Debtors, including:

- (a) A&M Canada's qualifications to act as Information Officer;
- (b) The Chapter 11 Debtors' business and operations, including its organizational structure and financing facilities;
- (c) The Chapter 11 Debtors' centre of main interest;
- (d) The events leading up to the Restructuring Proceedings;
- (e) The First Day Orders of the US Court that the Chapter 11 Debtors are seeking to be recognized and enforced pursuant to section 46 of the CCAA, including the Interim DIP Order (as described and defined below); and
- (f) The proposed initial activities of the Information Officer.

4.0 A&M'S QUALIFICATIONS TO ACT AS INFORMATION OFFICER

4.1 Alvarez & Marsal North America, LLC (“**A&M US**”) was engaged to act as consultant to Payless, Inc. and its subsidiaries in December 2016. A&M US’s activities have included:

- (a) Assisting Payless with the development of a 13-week cash flow forecast;
- (b) Assisting in the evaluation of Payless’ business plan and of a revised operating plan; and
- (c) Assisting with the preparations for commencement of the Chapter 11 Proceedings.

4.2 The Chapter 11 Debtors appointed A&M US as Chief Restructuring Officer (the “**CRO**”) of the Chapter 11 Debtors at the commencement (i.e. at the time of filing) of the Chapter 11 Proceedings. Robert Campagna is assuming the role and leading the engagement on behalf of A&M US. The scope of the CRO's mandate and compensation have not been finalized but it is anticipated that the CRO will be mandated with advancing the restructuring of Payless in accordance with the milestones set out in the RSA and DIP ABL Credit Agreement. It is also contemplated that the CRO’s compensation will include a completion fee if Payless can achieve those milestones. The Proposed Information Officer has been informed that the Chapter 11 Debtors intend to bring a motion seeking approval of A&M US's appointment as CRO which will be heard on May 9, 2017.

- 4.3 A&M Canada and A&M US are related to Alvarez & Marsal Holdings, LLC. Alvarez & Marsal Holdings, LLC is an independent international professional services firm, providing, among other things, bankruptcy, insolvency and restructuring services. A&M Canada recently became involved with the Payless Canada Group as it became clearer that Part IV CCAA Recognition Proceedings would be pursued in Canada. Prior to this involvement, the professional personnel of A&M Canada had not previously been involved in the activities of A&M US in respect of its engagement by Payless. A&M Canada's engagement team operates separately from the A&M US engagement team.
- 4.4 Through its recent engagement, the Proposed Information Officer has become familiar with the business and operations of the Payless Canada Group, and the key issues and stakeholders in the proposed CCAA Recognition Proceedings. This familiarity will enhance the efficiency of the Canadian Recognition Proceedings.
- 4.5 A&M Canada is a trustee within the meaning of subsection 2(1) of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, as amended, and has significant experience in connection with proceedings under the CCAA, including acting as Information Officer in several cases, most recently in the proceedings of Modular Space Holdings Inc. which obtained CCAA protection on December 27, 2016.
- 4.6 A&M Canada and A&M US are related to Alvarez & Marsal Holdings, LLC. Alvarez & Marsal Holdings, LLC is an independent international professional services firm, providing, among other things, bankruptcy, insolvency and restructuring services. The senior A&M Canada professional personnel with carriage of this matter include experienced insolvency and restructuring practitioners who are Chartered Professional Accountants, Chartered Insolvency and Restructuring Professionals and Licensed

Insolvency Trustees, whom have acted in cross-border restructurings and CCAA matters of a similar nature in Canada.

4.7 A&M Canada and A&M US do not expect to be in a position of conflict despite holding the positions described above, as a result of the following:

- (a) A&M Canada and A&M US and their respective personnel operate independently in respect of their respective engagements;
- (b) The Payless Canada Group is wholly dependent on the Chapter 11 Debtors for virtually all of its buying, logistics, accounting and finance, information technology, marketing and payroll functions. It is extremely unlikely that the Payless Canada Group would be able to continue to operate if the other Chapter 11 Debtors ceased to operate;
- (c) Pursuant to the RSA, Payless has the support of parties who hold or control approximately two-thirds in amount of the Chapter 11 Debtors' first and second lien term loans, and there is a pre-arranged path to advance and ultimately emerge from the Restructuring Proceedings;
- (d) There are currently no plans to liquidate and close any of the 258 Canadian stores;
- (e) As a result of the Payless Canada Group's dependence on the Chapter 11 Debtors for corporate managerial and support functions, including the buying cycle for inventory, the Payless Canada Group acquires its inventory from a US affiliate, such that the Payless Canada Group does not have any third-party merchandise accounts payable, and its only third-party trade/vendor liabilities are relatively small (approximately \$2.6 million). It is intended that these creditors will be

unaffected in the Restructuring Proceedings as they will either be paid in the ordinary course or they will receive the benefit of the Canadian Unsecured Creditors' Charge;

- (f) Employees will continue to be paid all wages, salaries, bonuses, vacation pay, commissions and benefits;
- (g) The CCAA Recognition Proceedings were commenced for a limited purpose, as described herein; and
- (h) Subject to this Court granting the Supplemental Order, and in particular recognizing and giving effect to the Interim DIP Order (which, on balance, the Information Officer supports, as described below), no material contentious cross-border issues are anticipated between the Payless Canada Group and the other Chapter 11 Debtors.

4.8 The Proposed Information Officer has retained Stikeman Elliott LLP to act as its independent legal counsel.

4.9 A&M Canada has consented to act as Information Officer should this Court approve the requested Initial Recognition Order and the Supplemental Order.

5.0 BACKGROUND

Corporate Overview

5.1 Payless Holdings has 28 direct and indirect subsidiaries that are Chapter 11 Debtors. A copy of the Payless Organizational Chart is attached as **Appendix "B"**.

- 5.2 Payless is an American footwear retailer that sells quality shoes at affordable prices in a self-service environment through its store and e-commerce sites. Payless was founded in 1956 in Topeka, Kansas, where it remains headquartered today. There are nearly 4,400 Payless stores in more than 30 countries, with over 22,000 employees.
- 5.3 Payless had approximately \$2.3 billion in net sales and \$95 million in EBITDA in fiscal 2016, and is the second largest footwear retailer by unit sales in the United States.

Capital Structure

- 5.4 The Chapter 11 Debtors' pre-Filing Date capital structure as at March 30, 2017 is summarized in the table below:

Debt Obligation	Debt Facility Size	Approximate Amount Outstanding as of Filing Date	Maturity Date
ABL Credit Facility	\$300 million	\$187 million	March 14, 2019
First Lien Term Loan	\$520 million	\$506 million	March 11, 2021
Second Lien Term Loan	\$145 million	\$145 million	March 11, 2022

Asset-Based Lending Facility

- 5.5 On October 9, 2012, Payless, Inc. as the lead borrower, the US Chapter 11 Debtors party thereto as borrowers and, Wells Fargo Bank, National Association (“**Wells Fargo**”) as administrative agent, entered into a revolving credit facility documented by a Credit Agreement (as amended, restated, modified, and/or supplemented, and as in effect immediately prior to the Filing Date, the “**ABL Credit Agreement**”).
- 5.6 The ABL Credit Agreement provides for an ABL facility (the “**ABL Credit Facility**”), which has two tranches bearing interest at different rates, the US Chapter 11 Debtors may

draw up to \$300 million for general purposes subject to borrowing base constraints. As at March 30, 2017, an aggregate balance of approximately \$187 million was outstanding.

5.7 The ABL Credit Facility is secured by a priority lien over certain tangible and intangible assets of the US Chapter 11 Debtors including, among other things, and subject to certain limitations, accounts, cash, inventory, and real property (the “**ABL Priority Collateral**”). The ABL Credit Facility is also secured by a junior lien on the remaining assets of the US Chapter 11 Debtors, such as equipment, fixtures and stock pledges (the “**Term Loan Priority Collateral**”).

5.8 None of the Payless Canada Group entities is a borrower or guarantor under the ABL Credit Agreement.

5.9 As a result of the liquidity troubles and decreasing borrowing base and in preparation for the Chapter 11 Proceedings, the US Chapter 11 Debtors recently agreed to enter into “cash dominion” with Wells Fargo and to, among other things, cause all funds in certain of their deposit accounts, subject to any nominal minimum balances required, to be swept daily into a “concentration account” held at Wells Fargo.

5.10 The Payless Canada Group is not subject to cash dominion in respect of the ABL Credit Facility.

First Lien Term Loan

5.11 Payless Inc., Payless Finance, Inc., Payless ShoeSource Distribution, Inc. as borrowers, the other Chapter 11 Debtors party thereto as guarantors, Morgan Stanley Senior Funding, Inc. (“**Morgan Stanley**”) as administrative and collateral agent, and the lenders party thereto (the “**First Lien Term Lenders**”), are parties to a First Lien Term Loan and

Guarantee Agreement dated March 11, 2014 (as amended, restated, modified, and/or supplemented and as in effect immediately prior to the Filing Date, the “**First Lien Term Loan Agreement**”).

5.12 The First Lien Term Loan Agreement provides a \$520 million first lien term loan (the “**First Lien Term Loan**”) secured by a first priority lien on the Term Loan Priority Collateral and a second priority lien on the ABL Priority Collateral. As at March 22, 2017, approximately \$506 million was drawn under the First Lien Term Loan Agreement.

5.13 None of the Payless Canada Group entities is a borrower or a guarantor under the First Lien Term Loan Agreement.

Second Lien Term Loan

5.14 Payless, Inc., Payless Finance Inc., Payless ShoeSource Inc., and Payless ShoeSource Distribution, Inc. as borrowers, the US Chapter 11 Debtors thereto as guarantors, Morgan Stanley as administrative and collateral agent, and the lenders party thereto, are parties to a Second Lien Term Loan and Guarantee Agreement dated March 11, 2014 (as amended, restated, modified, and/or supplemented and as in effect immediately prior to the Filing Date, the “**Second Lien Term Loan Agreement**”, together with the “First Lien Term Loan Agreement, the “**Term Loan Agreements**”).

5.15 The Second Lien Term Loan Agreement provides a \$145 million second lien term loan (the “**Second Lien Term Loan**”) secured by a second priority lien on the Term Loan Priority Collateral and a third priority lien on the ABL Priority Collateral. As at March 22, 2017, the Second Lien Term Loan Agreement was fully drawn.

5.16 None of the Payless Canada Group entities is a borrower or guarantor under the Second Lien Term Loan Agreement.

The Payless Canada Group

Canadian Corporate Structure

5.17 Three Canadian entities, PSS Canada and PSS GP Inc. (each federally incorporated), and Payless LP (an Ontario limited partnership) (collectively, the “**Payless Canada Group**”), are Chapter 11 Debtors.

5.18 Payless Holdings (the Foreign Representative) is seeking to have a stay of proceedings and other benefits of the relief sought in its application extended to Payless LP, which is related to and carries on operations that are integral to the business of the Payless Canada Group and is the principal entity through which the Payless Canada Group’s business is conducted. Payless LP is also a guarantor under the DIP ABL Credit Agreement.

5.19 PSS Canada is a holding company and PSS GP Inc. is the general partner of Payless LP. As noted above, Payless LP is the principal entity through which the Payless Canada Group’s business is conducted.

Stores and Leases

5.20 The Payless Canada Group currently operates 258 stores from leased locations across all ten Canadian provinces, with almost half of them (121) in Ontario. There is also one leased regional office located in Etobicoke, Ontario (the “**Regional Office**”).

5.21 Approximately 56 of the Canadian store leases are subject to an indemnity with cross-default provisions such that an Event of Default under the respective lease will occur if the “Indemnifier” becomes bankrupt or insolvent, or takes the benefit of any statute for

bankrupt or insolvent debtors. The “Indemnifier” in the applicable leases is Payless ShoeSource Inc., a Chapter 11 Debtor.

5.22 The Proposed Information Officer understands that due to an oversight, the Canadian landlords of the Payless Canada Group’s stores did not receive April rent payments which were due on March 31, 2017. The Chapter 11 Debtors made a decision to stop April rent payments for US operations due to uncertainty of the timing of the commencement of the Chapter 11 Proceedings. The rent payments for Canadian landlords were not segregated from rent owing in respect of US Chapter 11 Debtors’ operations and were also caught by the payment stoppage. Due to the automatic stay under the US Code, the Chapter 11 Debtors are now not permitted to make payments on account of pre-Filing Date rent without authorization from the US Court. The Proposed Information Officer has been informed by the Chapter 11 Debtors that they intend to the seek an order authorizing the payment of April rent of the Payless Canada Group when the final orders in respect of the first day matters are sought on May 9, 2017. If such an order is granted by the US Court, the Payless Canada Group intends to make the payments.

Employees

- 5.23 As at March 1, 2017, the Payless Canada Group employed approximately 600 full-time employees and 1,500 part-time employees. Five of the full-time employees work at the Regional Office, and another 15 work in field management functions throughout Canada. All other employees work in the stores.
- 5.24 Employees are paid wages or salary, and full-time employees also receive benefits which vary depending on the employee's role. Payroll for employees of the Payless Canada Group is processed at the Chapter 11 Debtors' head office in Kansas through Payless's consolidated cash management system.
- 5.25 The Payless Canada Group offers a Registered Retirement Savings Plan matching program and a Deferred Profit Sharing Plan to full-time employees.
- 5.26 None of the Canadian employees are represented by a union.
- 5.27 The Payless Canada Group currently has an accrued vacation pay liability of approximately \$850,000 and approximately \$260,000 in accrued but unpaid payroll taxes and related amounts.
- 5.28 The Proposed Information Officer understands that the Chapter 11 Debtors intend to honour vacation entitlements and continue to remit payroll taxes and related amounts to the appropriate authorities in the ordinary course and that the First Day Orders, including the Wages Order, contemplates that all priority amounts payable including wages, vacation pay, source deductions and federal and provincial sales tax will continue to be paid in the ordinary course.

Cash Management System

- 5.29 Payless uses an integrated, centralized cash management system operated by the treasury team in the United States to collect, transfer and disburse funds generated by the operations of Payless (the “**Cash Management System**”).
- 5.30 The Payless Canada Group entities maintain 13 CAD and USD bank accounts in Canada (the “**Canadian Operations Accounts**”) at five of the major Canadian banks.
- 5.31 The Canadian Operations Accounts include five accounts into which store receipts are deposited and an account into which credit and debit card receipts are deposited. These accounts are swept on a regular basis into a master account. The other Canadian Operations Accounts include an account used for Canadian accounts payable, three US dollar accounts, an account for PSS GP Inc. and an account for PSS Canada.
- 5.32 Notwithstanding that the Canadian Operations Accounts largely operate as a self-contained cash management system within the broader Cash Management System of Payless, the cash management system of the Payless Canada Group is dependent upon the other Chapter 11 Debtors for certain treasury, banking and related services that are provided by Payless Finance Inc. (formerly, Collective Brands Finance Inc.) pursuant to a Treasury Services Agreement with the Payless Canada Group entities (the “**Treasury Services Agreement**”).
- 5.33 Additional information in respect of the Cash Management System is provided in the Schwindle Affidavit and the US cash management motion attached as Exhibit “J” to the Affidavit of Francesca Del Rizzo sworn April 6, 2017.

Customer Programs

5.34 The Chapter 11 Debtors, including the Payless Canada Group, offer and engage in certain customer programs, including customer gift card programs, returns, exchanges and refunds, promotional programs such as the “Payless Rewards” program, warranty-related programs in respect of the products sold by the Chapter 11 Debtors, merchant credit card agreements, and other similar programs. The Payless Canada Group is dependent on the Chapter 11 Debtors for the administration of these customer programs.

Supply Chain and Trade Creditors

5.35 The Payless Canada Group does not independently design or source its own merchandise, nor does it maintain the licensing partnerships that allow the Chapter 11 Debtors to offer their partners’ designs under the Payless brand. The Payless Canada Group relies entirely on the purchasing power and sourcing relationships of the US Chapter 11 Debtors from whom it sources and purchases substantially all of its inventory which is then accounted for through intercompany transactions.

5.36 As a result of the manner in which the inventory for the Payless Canada Group is procured, the Payless Canada Group entities do not have any trade accounts payable to arms’ length parties in respect of inventory. Substantially all of the Payless Canada Group’s merchandise related accounts payable are due to Payless ShoeSource Distribution Inc., a US Chapter 11 Debtor.

5.37 As at March 27, 2017, the Payless Canada Group had arms' length non-merchandise trade accounts payable of approximately \$2.6 million. The largest of these creditors, Kuehne & Nagel Ltd. ("K&N"), which provides logistics and freight services, is owed approximately \$1.3 million. The Proposed Information Officer understands that at this time, the Chapter 11 Debtors anticipate that K&N will be paid in the ordinary course in accordance with the Interim Critical Vendors Order.

5.38 It is intended that the unsecured trade creditors of the Payless Canada Group will be unaffected in the Restructuring Proceedings. Freight transportation and logistics service providers are captured by the Interim Critical Vendors Order and will be paid in the ordinary course. The other unsecured trade creditors receive the benefit of the Canadian Unsecured Creditors' Charge. It is anticipated that the Canadian Unsecured Creditors' Charge will be discharged following the payment of the approximately \$1.4 million that was owing to Canadian trade creditors as of the date of the filing of the US bankruptcy petitions.

Financial Information

5.39 For the year ended January 28, 2017, Payless generated approximately \$2.28 billion in net revenues, of which, Canadian sales accounted for approximately 7%.

5.40 As at the month ended February 25, 2017, the Payless Canada Group had total assets with a book value of approximately \$133.0 million.

5.41 The Payless Canada Group's assets include, among others:

- (a) An unsecured, amended and restated promissory note from Payless Finance Inc., a US Chapter 11 Debtor, in the approximate amount of \$101.3 million, including

accrued interest owing to PSS Canada, due October 9, 2022. PSS Canada has agreed to subordinate repayment of this debt to the payment by Payless Finance Inc. of senior indebtedness as evidenced by an Intercompany Promissory Note dated March 11, 2014; and

- (b) Approximately \$25.7 million of inventory acquired from Payless ShoeSource Distribution Inc., a US Chapter 11 Debtor.

5.42 As at February 25, 2017, the Payless Canada Group had total liabilities with a book value of approximately \$80.4 million. These liabilities include, among others:

- (a) Approximately \$61.1 million, including interest, due to Collective Brands II Cooperatief UA, a Netherlands Payless entity that is not a Chapter 11 Debtor, pursuant to an amended and restated promissory note for approximately CDN\$59.0 million due April 28, 2016 and an amended and restated promissory note for approximately CDN\$22.9 million due July 14, 2016; and
- (b) Approximately \$9.2 million owed to certain other US Chapter 11 Debtors, including: (i) approximately \$6.2 million in connection with merchandise purchases; (ii) approximately \$2.3 million in connection with non-merchandise goods and services such as royalties, service fees and expense reimbursements; and (iii) approximately \$535,000 in connection with, among other things, merchandise planning and buying fees.

Liquidity Position

5.43 Included in total assets of the Payless Canada Group as at February 25, 2017 is approximately \$4.5 million of cash.

6.0 CENTRE OF MAIN INTEREST

6.1 The Chapter 11 Debtors, including the Payless Canada Group, are managed in the United States as an integrated group from a corporate, strategic and management perspective. In particular:

- (a) All corporate, strategic, financial, inventory sourcing and other major decision-making occurs from the head office in Topeka, Kansas;
- (b) Only one of the directors of the Payless Canada Group entities resides in Canada. All other directors reside in the United States;
- (c) Only one of the senior executives of the Payless Canada Group resides in Canada, the President of PSS Canada and PSS GP Inc. All of the other senior executives of the Payless Canada Group reside in the United States;
- (d) The net sales of the Payless Canada Group comprise only approximately 7% of the net sales of Payless;
- (e) The Payless Canada Group is entirely reliant on managerial functions provided by the US Chapter 11 Debtors for all overhead services, including the buying, logistics, accounting and finance, marketing, strategic direction, IT and other functions;

- (f) The Payless Canada Group entities are all a party to Treasury Services Agreement with Payless Finance Inc., one of the Chapter 11 Debtors, wherein Payless Finance Inc. provides certain treasury and banking related services, and makes certain financial accommodations to the borrowers under that agreement;
- (g) The Payless Canada Group is entirely dependent on the US Chapter 11 Debtors for all of the licensing agreements, design partnerships and company-owned brands. All trademarks and intellectual property are owned by US entities outside of the Payless Canada Group;
- (h) Senior management located in the United States is responsible for final decisions regarding pricing, business development, treasury, asset management, capital expenditures and accounts receivable for all of the Chapter 11 Debtors;
- (i) The majority of the data for the Canadian operations is housed within the same IT systems (located and operated out of the United States) that support both the Canadian and US operations;
- (j) The Cash Management System of the Payless Canada Group entities, while largely self-contained, functions as a subset of the Cash Management System operated by the treasury team in the United States, as reflected in the Treasury Services Agreement; and
- (k) The Payless Canada Group is dependent on the Chapter 11 Debtors for the administration of the customer programs offered by Payless.

- 6.2 Payless Holdings has asserted that the preceding factors collectively rebut the presumption under the CCAA that the Payless Canada Group entities' centre of main interest (“COMI”) is the location of its registered office. Furthermore, Payless Holdings asserts that these factors indicate that the “mind and management”, head office functions and senior management of the Chapter 11 Debtors, including the Payless Canada Group, are located in the United States.
- 6.3 Based on the foregoing, the Proposed Information Officer concurs with Payless Holdings' assertion that the Chapter 11 Debtors' COMI is in the United States – including the Payless Canada Group entities - and that the Chapter 11 Proceedings are the “foreign main proceeding” as defined in section 45 of the CCAA.

7.0 EVENTS LEADING UP TO THE RESTRUCTURING PROCEEDINGS

- 7.1 Since early 2015, the Chapter 11 Debtors have experienced a decline in sales resulting from a set of significant and detrimental non-recurring events, foreign exchange rate volatility, and challenging retail market conditions which, together with a highly levered capital structure, led to the inability of the Chapter 11 Debtors to service both their pre-Filing Date secured indebtedness and remain current with their trade obligations. These events resulted in a 33% decrease in EBITDA in 2015 from which Payless has not fully recovered.
- 7.2 For the past several months, Payless has explored alternatives for reorganizing its business and improving its overall financial condition, including implementing cost-saving initiatives and adjusting the vendor base and supply chain.

- 7.3 In February, 2017, the Chapter 11 Debtors commenced discussions with a steering committee of their senior lenders to build consensus around a long-term business plan which culminated in the execution of the RSA, supported by holders of approximately two-thirds of Payless' secured term lenders, for a comprehensive restructuring and recapitalization transaction which contemplates a consensual restructuring implemented by way of plan of reorganization through these Restructuring Proceedings.
- 7.4 In addition, and as further described below, the Chapter 11 Debtors also negotiated the DIP Facilities (described below) to ensure that they have the liquidity necessary to implement the RSA. The DIP Facilities were the result of a competitive marketing process conducted by the Chapter 11 Debtors with the assistance of their investment banker, Guggenheim Securities LLC.
- 7.5 The Proposed Information Officer understands that after the Chapter 11 Debtors determined that proceedings under the US Code would be required to complete a restructuring, the Chapter 11 Debtors solicited interest from twelve parties on the provision of DIP financing. The parties included the ABL Lenders, an ad hoc group of First Lien Lenders and ten potential third-party lenders. Of the twelve parties, five submitted preliminary proposals. The Proposed Information Officer understands that upon evaluation of these proposals based on the Chapter 11 Debtors' immediate liquidity needs, the constraints imposed by the existing capital structure and existing time constraints, the Chapter 11 Debtors determined that the DIP Facilities presented the best viable option to allow for a comprehensive restructuring of their business.

8.0 THE RESTRUCTURING PLAN

The Restructuring Support Agreement

- 8.1 A copy of the RSA is attached as Exhibit “H” of the Schwindle Affidavit. The RSA contemplates a comprehensive “pre-pack” reorganization of the Chapter 11 Debtors, which already has the support of approximately two-thirds of the Chapter 11 Debtor’ secured term lenders. The RSA, together with the DIP Facilities, will allow the Chapter 11 Debtors to: (a) obtain access to sufficient DIP financing that is intended to provide immediate and near-term financial support to execute the restructuring plan; (b) right-size the balance sheet by significantly reducing annual debt service and total outstanding funded debt from approximately \$838 million to \$469 million by converting the pre-filing term debt into new equity of the Chapter 11 Debtors; and (c) reduce the store footprint to eliminate unprofitable stores and renegotiate above market leases to improve profitability.
- 8.2 The following provides a brief summary of the material terms of the RSA, on which the Chapter 11 Debtors intend to pursue a plan of reorganization:
- (a) The DIP ABL Credit Facility (defined below) shall be paid in full in cash with proceeds of a new ABL facility upon the Chapter 11 Debtors exit from the Chapter 11 Proceedings;
 - (b) The DIP Term Loan Facility (defined below) shall convert to the tranche A-1 portion of a \$280 million exit term loan facility on a dollar-for-dollar basis upon the Chapter 11 Debtors exit from the Chapter 11 Proceedings;

- (c) Each holder of a claim in respect of the First Lien Term Loan shall receive its pro-rata share of (i) the tranche A-2 portion of the \$280 million exit term loan facility; and (ii) 91% of the new equity of the reorganized Chapter 11 Debtors; and
- (d) Each holder of a claim in respect of the Second Lien Term Loan shall receive its pro rata share of 9% of the new equity of the reorganized Chapter 11 Debtors.

8.3 The RSA also contains certain conditions and covenants that include achieving certain forecast rent concessions, EBITDA targets and inventory receipts, as well as renegotiating the terms of existing joint venture agreements such that they are on market terms within 100 days of the Filing Date.

8.4 To accomplish these objectives the Chapter 11 Debtors intend to bring a motion for approval of the liquidation and closure of 389 US stores (the “**Initial Store Closure Sale**”). The Chapter 11 Debtors are also evaluating an additional 3000 stores for potential closures. The DIP ABL Credit Agreement and DIP Term Loan Agreement contemplate the closure of additional stores but at this time it is not anticipated that any Canadian stores will be closed and the DIP ABL Credit Agreement specifies that no stores of the Payless Canada Group are required to be closed in the Initial Store Closure Sale.

8.5 The RSA, along with the DIP Facilities, include certain milestones in the Chapter 11 Proceedings designed to ensure the Chapter 11 Debtors move expeditiously towards confirmation of a plan. These milestones are discussed later in this report.

DIP Facilities

- 8.6 The Proposed Information Officer understands, based on the DIP Budget, that the Chapter 11 Debtors do not have sufficient liquidity to maintain normal course operations without additional financing. The Proposed Information Officer also understands that, although the Payless Canada Group does not specifically require additional funds to continue operating, it is extremely unlikely that the Payless Canada Group would be able to continue to operate if the US Chapter 11 Debtors ceased to operate. As such, it was critical to the Payless Canada Group that the other Chapter 11 Debtors access additional financing.
- 8.7 The Chapter 11 Debtors' DIP financing, which provides the liquidity to allow Payless to pursue a comprehensive restructuring pursuant to the RSA, includes:
- (a) Access up to \$305 million under a DIP ABL facility (the “**DIP ABL Credit Facility**”) pursuant to a debtor-in-possession credit agreement dated April 5, 2017 (the “**DIP ABL Credit Agreement**”) between the Chapter 11 Debtors, Wells Fargo as collateral agent, administrative agent and swing line lender, and certain other lenders party thereto (together with Wells Fargo in its capacity as a lender, the “**DIP ABL Lenders**”); and
 - (b) Access up to \$80 million in new money DIP term financing (the “**DIP Term Loan Facility**”, together with the DIP ABL Credit Facility, the “**DIP Facilities**”) pursuant to a superpriority debtor-in-possession term loan and guarantee agreement dated April 5, 2017 (the “**DIP Term Loan Agreement**”) between certain of the Chapter 11 Debtors, Cortland Products Corp., as administrative

agent and collateral agent, and certain First Lien Term Lenders party thereto (the “**DIP Term Loan Lenders**”).

8.8 The DIP Facilities are described further in paragraphs 9.8 – 9.19 of this Pre-Filing Report.

9.0 FIRST DAY ORDERS OF THE US COURT

9.1 Payless Holdings is seeking recognition of certain First Day Orders that have been entered by the US Court in the Chapter 11 Proceedings, including:

- (a) The Foreign Representative Order recognizing Payless Holdings as the foreign representative of the Chapter 11 Debtors;
- (b) An order permitting the joint administration of the Chapter 11 cases of the Payless Group in the Chapter 11 Proceedings (the “**Joint Administration Order**”);
- (c) An order permitting the Chapter 11 Debtors to pay pre-Filing Date wages, compensation and employee benefits (the “**Employee Wages Order**”);
- (d) An interim order authorizing, but not directing, the Chapter 11 Debtors to maintain their existing bank accounts, cash management system and authorizing the continuation of (and administrative expense priority status of) intercompany transactions (the “**Cash Management Order**”);
- (e) An interim order: (i) authorizing the Chapter 11 Debtors to obtain the DIP Facilities; (ii) granting liens and super-priority administrative expense claim status to the DIP ABL Lenders and DIP Term Loan Lenders; (iii) modifying the automatic stay under the US Code; and (iv) scheduling a final hearing in respect of DIP Facilities (the “**Interim DIP Order**”);

- (f) An order authorizing the payment of pre-Filing Date taxes and fees (the “**Taxes Order**”);
- (g) An interim order: (i) authorizing the continuation of insurance coverage entered into prior to the Filing Date and the payment of associated pre-Filing Date obligations; and (ii) authorizing the renewal, supplement or purchase of insurance policies (the “**Insurance Order**”);
- (h) An interim order: (i) authorizing the Chapter 11 Debtors to honour pre-Filing Date obligations to customers and partners; and (ii) authorizing the continuation of certain customer and partner programs in the ordinary course (the “**Customer Programs Order**”);
- (i) An interim order: (i) authorizing the continuation and renewal of the Chapter 11 Debtors’ Surety Bond Program on an uninterrupted basis (the “**Surety Bond Order**”); and
- (j) An interim order: (i) authorizing the Chapter 11 Debtors to pay certain pre-Filing Date claims of critical vendors, carriers and warehousemen (the “**Interim Critical Vendors Order**”).

9.2 These First Day Orders are, for the most part, common in Chapter 11 proceedings and are based on model orders. Copies of the First Day Orders and other documents related to the Chapter 11 Proceedings are available at the web-site maintained by the US Noticing Agent, Prime Clerk LLC, at <https://cases.primeclerk.com/payless/>. Certain of the First Day Orders that may be of particular relevance to Canadian stakeholders are discussed below.

Foreign Representative Order

- 9.3 The Foreign Representative Order authorizes Payless Holdings to act as the Foreign Representative on behalf of the Chapter 11 Debtors' estates in any judicial proceeding in a foreign country, including in these CCAA Recognition Proceedings, and grants Payless Holdings, in its capacity as the Foreign Representative, the power to act in any way permitted by applicable foreign law. In the Foreign Representative Order, the US Court requests the aid and assistance of this Court to recognize the Chapter 11 Proceedings as a "foreign main proceeding" and Payless Holdings as a "foreign representative" under the CCAA.

Wages Order

- 9.4 The Wages Order, among other things, authorizes the Chapter 11 Debtors, including the Payless Canada Group, to: (a) pay pre-Filing Date wages, salaries, bonuses, vacation pay, commissions and employee benefits and other amounts owed to their employees; (b) continue all benefit plans; and (c) pay all employee withholdings as such obligations are due. It also authorizes and directs financial institutions to receive, process, honour, and pay all cheques and electronic requests made relating to the foregoing; and schedules a final hearing in the US to consider entry of a final order on May 9, 2017.

Cash Management Order

- 9.5 The Cash Management Order, among other things, authorizes the Chapter 11 Debtors to continue to operate their existing cash management system (including maintaining existing bank accounts), to maintain existing forms (such as cheques), and to continue to

perform intercompany transactions consistent with past practice. It also schedules a final hearing to consider entry of a final order on May 9, 2017.

Interim DIP Order

9.6 On April 5, 2017, the US Court entered the Interim DIP Order. A motion seeking a final order in respect of the DIP Facilities (the “**Final DIP Order**”, and together with the Interim DIP Order, the “**DIP Orders**”) has been scheduled for May 9, 2017. The Proposed Information Officer understands that the Foreign Representative will seek recognition of the Final DIP Order if the order is granted by the US Court.

9.7 The Interim DIP Order, among other things:

- (a) Authorized the Chapter 11 Debtors to enter into and perform their obligations under the DIP ABL Credit Agreement, DIP Term Loan Agreement and their respective related credit and loan documents, subject to the terms of the Interim DIP Order;
- (b) Authorized the Chapter 11 Debtors to borrow up to \$245 million under the DIP ABL Credit Agreement pending the hearing on the Final DIP Order;
- (c) Granted the DIP ABL Lenders and DIP Term Loan Lenders security interests in and liens on the collateral provided by the Chapter 11 Debtors under the DIP ABL Credit Agreement and DIP Term Loan Agreement and allowed superpriority administrative expense claims for the obligations owing under the DIP ABL Credit Agreement and DIP Term Loan Agreement;

- (d) Authorized the Chapter 11 Debtors to use the collateral under the ABL Credit Facility and First Lien Term Loan, including the cash collateral, and granted the ABL Lenders and First Lien Lenders adequate protection to protect against the diminution in value of their pre-Filing Date collateral; and
- (e) Scheduled a final hearing to consider the Final DIP Order for May 9, 2017.

DIP ABL Credit Facility

9.8 The DIP ABL Credit Facility has a maximum principal amount of \$305 million, consisting of \$245 million Tranche A financing that was made available following the granting of the Interim DIP Order, subject to borrowing base constraints, and an additional \$60 million Tranche A-1 financing to be made available following the issuance of a Final DIP Order, subject to borrowing base constraints. Approximately \$177 million of the DIP ABL Credit Facility will be used to repay outstanding obligations under the ABL Credit Facility. Therefore, the DIP ABL Credit Facility provides approximately \$128 million of incremental liquidity to the Chapter 11 Debtors. The additional liquidity is intended to: (a) fund the Chapter 11 Proceedings; (b) make certain payments approved by the DIP Orders; and (c) provide working capital to the Chapter 11 Debtors during the Chapter 11 Proceedings in accordance with an approved budget agreed to with the DIP ABL Lenders.

9.9 Below is a summary of the material terms of the DIP ABL Credit Agreement:

- (a) Borrowers: Payless Inc., Payless ShoeSource, Inc., Payless ShoeSource Distribution, Inc., and Payless Finance, Inc.;

- (b) Guarantors: Certain of the Chapter 11 Debtors, including all of the entities in the Payless Canada Group;
- (c) Maturity: The earliest of:
- (i) 210 days following the closing date under the DIP ABL Credit Agreement;
 - (ii) if the Final DIP Order is not entered, within thirty-five (35) calendar days after the commencement date of the Chapter 11 Proceedings;
 - (iii) upon entry of an order confirming any plan of reorganization; and
 - (iv) the closing of a sale of all or substantially all of the working capital assets of the Chapter 11 Debtors;
- (d) Security: All of the present and after acquired real and personal property of the Chapter 11 Debtors, including all of the entities in the Payless Canada Group;
- (e) Interest Rate:
- (i) Tranche A Loans: LIBOR + 4%;
 - (ii) Swing Line Loans: Base Rate¹ + 3%; and
 - (iii) Tranche A-1 Loans: LIBOR + 8.50%;
- (f) Fees: The following fees are payable under the DIP ABL Credit Agreement:
- (i) Commitment Fee: a fee of 0.375% of the average aggregate Tranche A and Tranche A-1 commitments that exceed the Tranche A and Tranche A-1 obligations outstanding under the pre-Filing Date ABL Credit Facility.

¹ The “Base Rate” is equal to the highest of (a) the Federal Funds Rate, in effect from time to time, plus one-half of one percent (0.50%); (b) the Adjusted LIBO Rate plus one percent (1.00%); or (c) the rate of interest in effect for such day as publicly announced from time to time by Wells Fargo as its “prime rates.”

- (ii) Closing Fee: 1.25% on \$300 million of existing commitments; 3.00% fee on \$5 million incremental commitments, totaling approximately \$3.9 million.
 - (iii) Letter of Credit Fees: 4.00% for standby letters of credit and 3.50% for commercial letters of credit; and
 - (iv) Fronting Fee: 0.125%;
- (g) Store Closures: The Chapter 11 Debtors are required to obtain an order from the US Court authorizing the Chapter 11 Debtors to enter into an agency agreement with a liquidator and commence the closure of, and liquidation of inventory and equipment at, 389 US stores that have previously been identified, plus up to an additional 600 stores to the extent contemplated by the approved budget. The DIP ABL Credit Agreement specifies that the stores of the Payless Canada Group are not required to be closed;
- (h) Recognition Order: The Chapter 11 Debtors are required to obtain a recognition order from this Court under Part IV of the CCAA no later than five (5) business days following the entry of the Interim DIP Order. The Recognition Order must:
 - (i) determine that the COMI of the Chapter 11 Debtors is in the United States;
 - (ii) recognize the Chapter 11 Proceedings under Part IV of the CCAA;
 - (iii) grant a stay of proceedings to the Chapter 11 Debtors;
 - (iv) recognize certain of the First Day Orders; and
 - (v) appoint A&M Canada as the Information Officer in the CCAA Recognition Proceedings.

The assets of the Payless Canada Group, including inventory and credit card receivables, are not included in the borrowing base under the DIP ABL Credit Agreement pending entry of the Recognition Order;

(i) Milestones: The DIP ABL Credit Agreement requires the Chapter 11 Debtors to comply with the following milestones, among others:

- (i) no later than April 7, 2017, the US Court shall have entered the Interim DIP Order;
- (ii) no later than May 9, 2017, the US Court shall have entered the Final DIP Order;
- (iii) on or before April 25, 2017, the Chapter 11 Debtors shall file a plan of reorganization, disclosure statement, and plan solicitation process, upon terms and conditions acceptable to the DIP ABL Lenders;
- (iv) on or before June 5, 2017, the US Court shall have entered an order approving the disclosure statement;
- (v) on or before June 8, 2017, the Chapter 11 Debtors shall have commenced solicitation with respect to a plan acceptable to the DIP ABL Lenders (an “**Acceptable Plan**”);
- (vi) on or before July 23, 2017, the US Court shall have held a hearing on the approval of the Acceptable Plan;
- (vii) on or before July 27, 2017, the US Court shall have entered an order confirming the Acceptable Plan, which order shall be recognized and enforced by this Court in the CCAA Recognition Proceedings within five (5) business days thereafter;
- (viii) on or before July 28, 2017, the Chapter 11 Debtors shall enter into an agreement with a liquidator with respect to closing and liquidating their remaining stores, and such liquidation shall commence on August 11, 2017 if an Acceptable Plan has not been consummated; and
- (ix) on or before August 10, 2017, the Acceptable Plan shall be consummated which shall include payment in full in cash of all pre-Filing Date obligations under the ABL Credit Facility.

- 9.10 The entities in the Payless Canada Group are not borrowers under the DIP ABL Credit Agreement but are obligated to guarantee the DIP ABL Credit Facility. The DIP ABL Lenders' Charge is proposed to encumber the assets of the Payless Canada Group to secure the obligations of the Payless Canada Group under their guarantee. The DIP ABL Lenders' Charge is proposed to rank in priority to all other security interests, trusts, liens, charges and encumbrances, except for the Administration Charge, the Canadian Unsecured Creditors' Charge, the Carve Out (as defined by the Interim DIP Order) and specific existing perfected security interests held by pre-Filing Date secured creditors.
- 9.11 The Payless Canada Group previously was not liable for any obligations under the ABL Credit Facility and their assets did not comprise part of the collateral provided as security in connection with the ABL Credit Facility. Due to the repayment of the ABL Credit Facility contemplated by the DIP ABL Credit Agreement, following recognition of the Interim DIP Order, the Payless Canada Group will effectively become jointly liable with the US Chapter 11 Debtors for obligations incurred by the US Chapter 11 Debtors under the ABL Credit Facility prior to the Filing Date. The Payless Canada Group will also be liable for the new obligations of the US Chapter 11 Debtors incurred in connection with the DIP ABL Credit Facility.
- 9.12 Based on discussions with the Chapter 11 Debtors and their Canadian counsel, the Proposed Information Officer understands that the DIP ABL Lenders would not agree to provide additional financing if the Payless Canada Group did not guarantee the DIP ABL Credit Facility and provide collateral to secure such guarantee. The Proposed Information Officer also understands that the Chapter 11 Debtors were unable to obtain an offer for DIP financing on similar terms to the DIP ABL Credit Facility that did not provide for

repayment of the ABL Credit Facility. Due to the dependence of the Payless Canada Group's operations on the US Chapter 11 Debtors, including inventory procurement and the provision of virtually all managerial and support functions, and the US Chapter 11 Debtors' need for additional financing, the Payless Canada Group believed that providing the guarantee and required security was in the best interests of their stakeholders. Without the DIP ABL Credit Facility, the US Chapter 11 Debtors do not have the ability to continue business in the ordinary course and advance their restructuring plan which would necessarily impact the Payless Canada Group's viability. As discussed earlier in this report, the Payless Canada Group relies on the US Chapter 11 Debtors for all critical business functions, including buying, logistics, accounting and finance, information technology, marketing and payroll functions.

9.13 To minimize the impact of the guarantee and DIP ABL Lenders' Charge on existing unsecured creditors of Payless Canada Group, the proposed Supplemental Order creates a Canadian Unsecured Creditors' Charge to protect the Canadian unsecured trade creditors whose pre-Filing Date claims will not otherwise be paid through the provisions of the First Day Orders. The Canadian Unsecured Creditors' Charge creates a charge on the property of the Payless Canada Group that ranks ahead of the DIP ABL Lenders' Charge up to the maximum amount of \$1.4 million for claims of arm's length unsecured trade creditors of the Payless Canada Group. Under the Supplemental Order, the Canadian Unsecured Creditors' Charge ranks *pari passu* with the Carve Out which secures the payment of professional fees paid by the Chapter 11 Debtors in the Chapter 11 Proceedings. The Proposed Information Officer understands that the proposed ranking in the Supplemental Order is intended to be consistent with the Interim DIP Order.

- 9.14 Provision for the Canadian Unsecured Creditors' Charge was the result of negotiations between the Chapter 11 Debtors and the DIP ABL Lenders. It is anticipated that the Canadian Unsecured Creditors' Charge will be discharged following the payment of the approximately \$1.4 million that was owing to Canadian trade creditors as of the date of the filing of the US bankruptcy petitions.
- 9.15 The Proposed Information Officer also understands that the Chapter 11 Debtors intend to seek an order permitting the payment of rent for April, and that the Chapter 11 Debtors currently do not plan on closing any Canadian stores, which could otherwise give rise to claims from the Payless Canada Group's landlords.
- 9.16 The Proposed Information Officer has prepared a preliminary illustrative liquidation analysis in order to provide the Court, the landlords and other creditors of the Payless Canada Group with information regarding the estimated potential recoveries to creditors of the Payless Canada Group in an immediate bankruptcy and liquidation scenario in Canada. Based on the assumptions included in that analysis, it is estimated that net realizations from a liquidation and closure of the Payless Canada Group's stores over a three-month liquidation and closure period, could be up to approximately \$13 million (the "**NRV Amount**"). During the liquidation/closure period it is estimated that landlords would receive three-months' occupation rent of approximately \$6.9 million (approximately \$2.3 million per month). The NRV Amount would then be available for distribution to creditors based on filed and proven claims. After taking into consideration employee claims, third party trade claims and intercompany claims, the estimated distribution on unsecured claims could be in the range of approximately 35% (using one year of aggregate rents as a proxy for landlord claims, for purposes of this illustration

only). The Proposed Information Officer cautions that its illustrative liquidation analysis is preliminary and subject to change.

9.17 Taking in account:

- (a) That the Payless Canada Group is wholly dependent on other Chapter 11 Debtors for all corporate and managerial functions;
- (b) That the RSA sets out the framework of a reorganization plan;
- (c) The RSA, DIP ABL Credit Agreement, and DIP Term Loan Agreement include a series of milestones in the Chapter 11 Proceedings designed to ensure that the Chapter 11 Debtors move expeditiously towards confirmation of a plan, including the filing of a plan of reorganization with the US Court on or before April 25, 2017;
- (d) The proposed Canadian Unsecured Creditors' Charge; and
- (e) There are currently no plans to liquidate and close any Canadian stores;

in the circumstances, the creditors of the Payless Canada Group do not appear to be materially prejudiced by the terms of the DIP ABL Credit Agreement and the DIP ABL Lenders' Charge. Unsecured trade creditors' pre-filing claims will be secured by a Court-ordered super-priority charge and they will continue to be paid in the ordinary course for future supply. Employees will be paid all of their pre- and post-filing wages in the ordinary course and will continue to be employed. The Payless Canada Group's landlords will continue to be paid rent during the restructuring and if there is a liquidation in the future the landlords will still be entitled to the same occupation rent they would realize now during an immediate liquidation. If particular stores are closed, that landlord will

have received a number of months rent in the meantime and will be entitled to file a claim for any damages. In addition, if the restructuring is successful, the suppliers, employees and landlords will benefit from the ongoing relationship. Under the DIP ABL Credit Agreement, in event the Chapter 11 Debtors are not able to consummate a plan of reorganization, Payless is only required to commence a liquidation of their remaining stores on August 11, 2017. In view of this milestone, the Proposed Information Officer believes that it is likely that the Restructuring Proceedings would continue for at least three to four months if a plan of reorganization is not consummated.

- 9.18 Though the guarantee and security provided by the Payless Canada Group is not optimal from a Canadian creditor's perspective, the DIP ABL Credit Facility appears to be the best alternative in the circumstances to maintain the operations of the Payless Canada Group as a going concern to the benefit of all Canadian stakeholders and is a necessary precondition to advance towards a successful restructuring as contemplated by the RSA and the milestones included in the DIP ABL Credit Agreement.

DIP Term Loan Facility

- 9.19 The DIP Term Loan Facility has an aggregate principal amount of \$80 million, with an initial draw of \$30 million upon entering of the Final DIP Order and a final draw of up to \$50 million following entry of an order approving the disclosure statement filed in connection with a plan of reorganization. The proceeds from the DIP Term Loan Facility are intended to fund working capital and other general corporate purposes of the Chapter 11 Debtors through the Chapter 11 Proceedings, in accordance with an approved budget.

- 9.20 The interest rate on the DIP Term Loan Facility is LIBOR + 9%.
- 9.21 None of the entities in the Payless Canada Group are borrowers or guarantors under the DIP Term Loan Agreement and the Applicants are not seeking any relief in respect of the DIP Term Loan Facility in the proposed Supplemental Order.

Interim Critical Vendors Order

- 9.22 The Interim Critical Vendors Order describes critical brokers that provide specific merchandise and critical carriers and warehousemen that transport and store that merchandise, and authorizes the Chapter 11 Debtors to pay certain pre-Filing Date liabilities to such critical third parties up to \$52 million on an interim basis. It also schedules a final hearing to consider entry of a final order on May 9, 2017.

Customer Programs Order

- 9.23 The Customer Programs Order describes and seeks the continuation of various customer programs that the Payless Group offers, including but not limited to: “The Payless Rewards Program”, customer gift card programs, returns, exchanges, and refunds, as well as warranty programs in respect of Payless Group products, and merchant credit card agreements, and other similar policies, programs and practices. It also authorizes the Chapter 11 Debtors to honour associated pre-Filing Date obligations to customers and partners. This order provides that for a hearing to consider entry of a final order on May 9, 2017.

Taxes Order

9.24 The Taxes Order provides the Chapter 11 Debtors with the discretion to pay pre-Filing Date taxes and fees. Canadian taxation authorities and United States taxation authorities are treated consistently. A number of Canadian taxation authorities are listed in Appendix A to the Taxes Order, including the Minister of Finance (Canada) and various provincial and municipal taxing authorities.

10.0 PROPOSED INITIAL ACTIVITIES OF THE INFORMATION OFFICER

10.1 The Supplemental Order proposes that following its appointment, the initial activities of the Information Officer will include:

- (a) Establishing a website at to make available copies of the Orders granted in the CCAA Proceedings as well as other relevant motion materials and reports;
- (b) Coordinating publication of a notice of the Chapter 11 Proceedings and CCAA Proceedings in *The Globe & Mail* and *La Presse* newspapers commencing within seven days from the date of the Initial Recognition Order, once a week for two consecutive weeks, as required of the Foreign Representative by section 53(b) of the CCAA;
- (c) Responding to creditor inquiries regarding the Restructuring Proceedings;
- (d) Providing such assistance to the Foreign Representative in the performance of its duties as the Foreign Representative may reasonably request; and

- (e) Providing the Court with periodic reports, at least once every three months, on the status of the Restructuring Proceedings, which reports may include information relating to the property and the business of the Chapter 11 Debtors or such other matters as may be relevant to these proceedings.

11.0 RECOMMENDATIONS

- 11.1 A&M Canada and its legal counsel have reviewed the terms of the Initial Recognition Order and the Supplemental Order, and believes that the relief sought by Payless Holdings, as set out in the form of orders submitted to the Court for approval, are, on balance, reasonable in the circumstances, having regard to the current status of the Payless Canada Group entities and the other Chapter 11 Debtors. A&M Canada believes that the terms of the Supplemental Order relating to its role as information officer are reasonable, and consistent with the terms of appointments of information officers in other recognition proceedings under the CCAA.
- 11.2 Based on the foregoing, the Proposed Information Officer respectfully recommends that this Court grant the relief requested by Payless Holdings in the Initial Recognition Order and the Supplemental Order.

ALL OF WHICH IS RESPECTFULLY SUBMITTED at Toronto, Ontario this 7th
day of April, 2017.

**ALVAREZ & MARSAL CANADA INC.,
in its capacity as the Proposed Information Officer of
Payless Holdings LLC and the other Applicants listed on Appendix "A",
and not in its personal or corporate capacity.**



Per: Alan J. Hutchens
Senior Vice-President

Appendix “A”

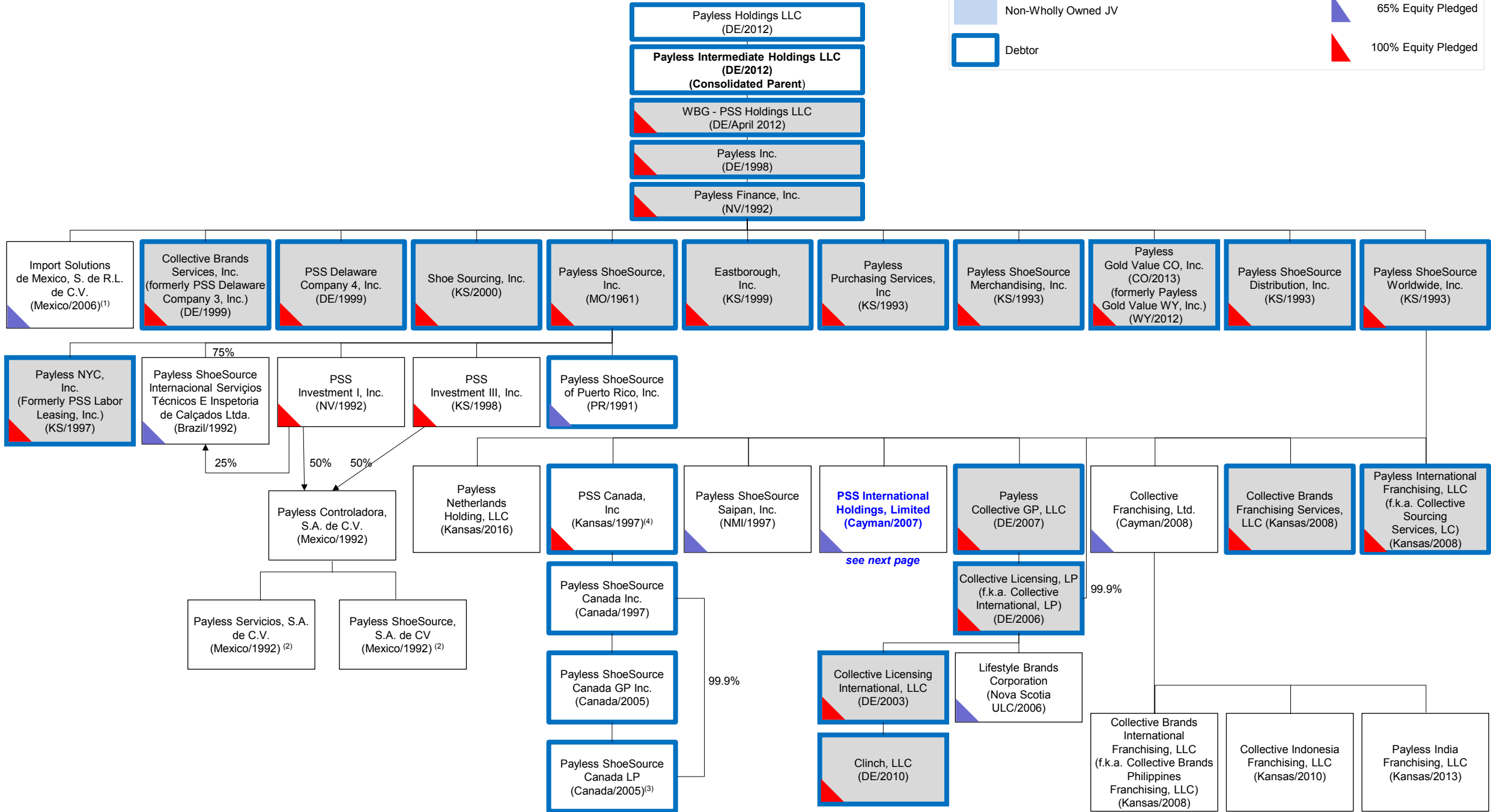
ADDITIONAL CHAPTER 11 DEBTORS

Payless Intermediate Holdings LLC
WBG PSS Holdings LLC
Payless Inc.
Payless Finance, Inc.
Collective Brands Services, Inc.
PSS Delaware Company 4, Inc.
Shoe Sourcing, Inc
Payless ShoeSource, Inc
Eastborough, Inc.
Payless Purchasing Services, Inc.
Payless ShoeSource Merchandising, Inc.
Payless Gold Value CO, Inc.
Payless ShoeSource Distribution, Inc.
Payless ShoeSource Worldwide, Inc.
Payless NYC, Inc.
Payless ShoeSource of Puerto Rico, Inc.
Payless Collective GP, LLC
Collective Licensing, LP
Collective Licensing International LLC
Clinch, LLC
Collective Brands Franchising Services, LLC
Payless International Franchising, LLC
Collective Brands Logistics, Limited
Dynamic Assets Limited
PSS Canada, Inc.

Appendix “B”

Payless Holdings LLC Corporate Structure

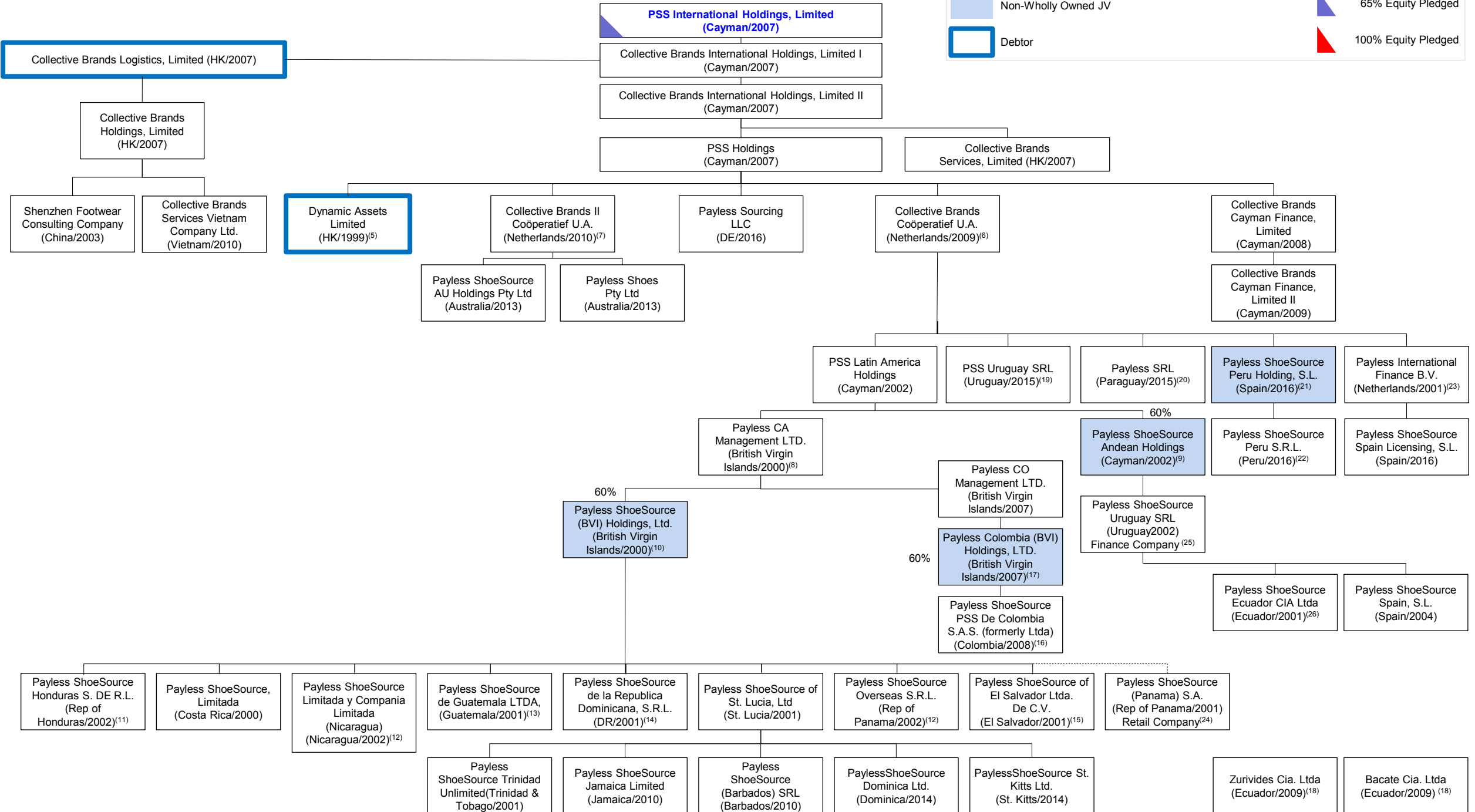
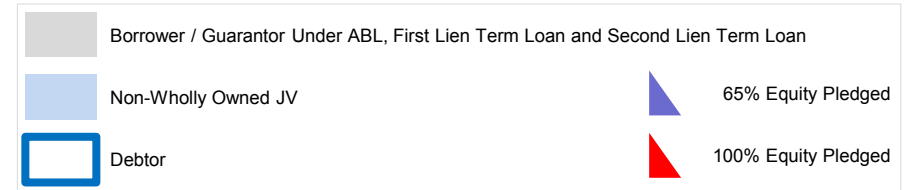
	Borrower / Guarantor Under ABL, First Lien Term Loan and Second Lien Term Loan		65% Equity Pledged
	Non-Wholly Owned JV		100% Equity Pledged
	Debtor		



(1) One share owned by Payless ShoeSource Worldwide, Inc.
 (2) PSS Investment I, Inc. owns one share in Payless Servicios, S.A. de C.V. and in Payless ShoeSource, S.A. de C.V.
 (3) Payless ShoeSource Canada GP Inc. General Partner – 0.1% Payless ShoeSource Canada Inc. Limited Partner – 99.9%
 (4) 2 shares owned by Payless Finance, Inc.
 (5) One Share owned by Collective Brands Services Limited
 (6) 0.0001726892% owned by Collective Brands Logistics, Limited
 (7) 0.1% owned by Collective Brands Cayman Finance, Limited
 (8) One share owned by Payless ShoeSource Peru, Inc.
 (9) South America Local Partners S.A. – 40% PSS Latin America Holdings – 60%
 (10) PLP S.A. – 40% Payless CA Management Ltd. – 60%
 (11) Payless ShoeSource (BVI) Holdings, Ltd. – 98% Payless ShoeSource, Limitada – 2%
 (12) Payless ShoeSource (BVI) Holdings, Ltd. – 99% Payless ShoeSource, Limitada – 1%
 (13) Payless ShoeSource (BVI) Holdings, Ltd. – 99.98% Payless ShoeSource, Limitada – .02%

(14) Payless ShoeSource (BVI) Holdings, Ltd. – 999 shares Payless ShoeSource, Limitada – 1 share
 (15) Payless ShoeSource (BVI) Holdings, Ltd. – 99.99% Payless ShoeSource, Limitada – 0.1%
 (16) Payless Colombia (BVI) Holdings, Ltd. – 60,524,009 quotas Payless CA Management Limited – 1 quota
 (17) Payless CO Management Ltd. – 60% Patagonia Capital Limited – 30% Pataya Inc., – 10%
 (18) This entity is owned by Xavier Rosales of our law firm Corral & Rosales
 (19) Collective Brands Coöperatief U.A. – 99% and Collective Brands II Coöperatief U.A. – 1%
 (20) Collective Brands Coöperatief U.A. – 99% and is Oscar Brelles Mariño Dicen– 1%
 (21) Payless ShoeSource Peru Holding, S.L. is a JV entity which is owned 60% by Collective Brands Coöperatief U.A. and 40% by Bluestone Financial Inc
 (22) Payless ShoeSource Peru Holding, S.L. owns 9,999 quotas and Collective Brands II Coöperatief U.A. owns 1 quota
 (23) Payless international Finance B.V. and its subsidiary, Payless ShoeSource Spain Licensing, S.L. moved under Collective Brands II Coöperatief U.A.
 (24) 500 shares are owned (250 & 250) by our law firm in trust on behalf of Payless ShoeSource (BVI) Holdings, Ltd.
 (25) Payless ShoeSource Andean Holdings (99.93333%) and PSS Latin America Holdings (0.066670%)
 (26) One share owned by PSS Latin America Holdings

Payless Holdings LLC Corporate Structure (cont'd)



(1) One share owned by Payless ShoeSource Worldwide, Inc.
 (2) PSS Investment I, Inc. owns one share in Payless Servicios, S.A. de C.V. and in Payless ShoeSource, S.A. de C.V.
 (3) Payless ShoeSource Canada GP Inc. General Partner – 0.1% Payless ShoeSource Canada Inc. Limited Partner – 99.9%
 (4) 2 shares owned by Payless Finance, Inc.
 (5) One Share owned by Collective Brands Services Limited
 (6) 0.0001726892% owned by Collective Brands Logistics, Limited
 (7) 0.1% owned by Collective Brands Cayman Finance, Limited
 (8) One share owned by Payless ShoeSource, Inc.
 (9) South America Local Partners S.A. – 40% PSS Latin America Holdings – 60%
 (10) PLP S.A. – 40% Payless CA Management Ltd. – 60%
 (11) Payless ShoeSource (BVI) Holdings, Ltd. – 98% Payless ShoeSource, Limitada – 2%
 (12) Payless ShoeSource (BVI) Holdings, Ltd. – 99% Payless ShoeSource, Limitada – 1%
 (13) Payless ShoeSource (BVI) Holdings, Ltd. – 99.98% Payless ShoeSource, Limitada – .02%
 (14) Payless ShoeSource (BVI) Holdings, Ltd. – 999 shares Payless ShoeSource, Limitada – 1 share
 (15) Payless ShoeSource (BVI) Holdings, Ltd. – 99.99% Payless ShoeSource, Limitada – 0.1%
 (16) Payless Colombia (BVI) Holdings, Ltd. – 60,524,009 quotas Payless CA Management Limited – 1 quota
 (17) Payless CO Management Ltd. – 60% Patagonia Capital Limited – 30% Pataya Inc., – 10%
 (18) This entity is owned by Xavier Rosales of our law firm Corral & Rosales
 (19) Collective Brands Coöperatief U.A. – 99% and Collective Brands II Coöperatief U.A. – 1%
 (20) Collective Brands Coöperatief U.A. – 99% and is Oscar Brelles Mariño Dicen– 1%
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 (22) Payless ShoeSource Peru Holding, S.L. owns 9,999 quotas and Collective Brands II Coöperatief U.A. owns 1 quota
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 (24) 500 shares are owned (250 & 250) by our law firm in trust on behalf of Payless ShoeSource (BVI) Holdings, Ltd.
 (25) Payless ShoeSource Andean Holdings (99.93333%) and PSS Latin America Holdings (0.066670%)
 (26) One share owned by PSS Latin America Holdings

Appendix “C”

Retail Week:	1	2	3	4	5	6	7	8	9	10	11	12	13	Total 13-Week
Week Ending:	4/7/17	4/14/17	4/21/17	4/28/17	5/5/17	5/12/17	5/19/17	5/26/17	6/2/17	6/9/17	6/16/17	6/23/17	6/30/17	Forecast Period

Receipts	1	2	3	4	5	6	7	8	9	10	11	12	13	Total
Operating Receipts	42,509	40,739	44,829	34,607	35,302	37,000	35,547	35,544	33,159	33,055	30,939	29,351	27,249	459,851
Intracompany / Other Receipts	3,633	5,101	2,433	11,900	4,260	3,583	4,924	7,932	13,379	3,568	7,633	7,782	5,441	77,570
Total Receipts	46,143	45,840	47,262	46,507	39,562	40,584	40,471	43,476	46,538	36,623	33,592	37,133	33,690	537,421
Operating Disbursements														
Payroll & Benefits	(4,477)	(9,592)	(4,444)	(6,603)	(4,429)	(9,851)	(4,561)	(6,525)	(4,604)	(6,729)	(7,326)	(6,740)	(4,480)	(80,360)
Other Operating Expenses	(12,270)	(35,317)	(25,186)	(58,231)	(23,247)	(34,274)	(21,257)	(41,994)	(38,084)	(38,935)	(27,045)	(34,540)	(41,305)	(426,175)
Total Operating Disbursements	(17,247)	(44,909)	(29,630)	(65,333)	(27,676)	(44,625)	(26,318)	(48,519)	(42,688)	(37,654)	(34,371)	(41,280)	(46,286)	(506,535)
Total Operating Cash Flow	\$ 28,896	\$ 932	\$ 17,632	\$ (18,826)	\$ 11,886	\$ (4,042)	\$ 14,154	\$ (5,043)	\$ 3,850	\$ (1,031)	\$ (779)	\$ (4,147)	\$ (12,596)	\$ 30,886

Financing Activity	1	2	3	4	5	6	7	8	9	10	11	12	13	Total
Financing Activity	(4,200)	-	-	-	-	-	-	-	(777)	-	-	-	-	22,488
Total Financing Activity	(4,200)	-	-	-	-	-	-	-	(777)	-	-	-	-	22,488

Restructuring Activity	1	2	3	4	5	6	7	8	9	10	11	12	13	Total
Restructuring Activity	-	-	-	-	-	(1,730)	-	-	-	(1,730)	-	-	-	(7,608)
Professional Fees (1)	-	-	-	-	-	(1,730)	-	-	-	(1,730)	-	-	-	(7,608)
Total Restructuring Activity	-	-	-	-	-	(1,730)	-	-	-	(1,730)	-	-	-	(7,608)
Net Cash Flow	\$ 24,696	\$ 932	\$ 17,632	\$ (18,826)	\$ 11,109	\$ (5,772)	\$ 42,654	\$ (5,043)	\$ 2,815	\$ (5,179)	\$ (2,509)	\$ (4,147)	\$ (12,596)	\$ 45,756

Liquidity Schedule	1	2	3	4	5	6	7	8	9	10	11	12	13	Total
Cash Schedule														
Beginning Cash Balance	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000
Net Cash Flow	24,696	932	17,632	(18,826)	11,109	(5,772)	42,654	(5,043)	2,815	(5,179)	(2,509)	(4,147)	(12,596)	45,756
Revolving - Draw / (Paydown)	(24,696)	(932)	(17,632)	18,826	(11,109)	5,772	(42,654)	5,043	(2,815)	5,179	2,509	4,147	12,596	(45,756)
Ending Cash Balance	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000
ABL Schedule														
Capped Borrowing Base	299,381	287,663	275,945	263,774	260,735	259,098	250,873	242,948	241,644	244,770	243,749	242,727	241,705	241,705
Less: O/S Letters of Credit	(30,500)	(30,500)	(30,500)	(30,500)	(30,500)	(30,500)	(30,500)	(30,500)	(30,500)	(30,500)	(30,500)	(30,500)	(30,500)	(30,500)
Less: Line Reserve	(29,338)	(28,766)	(27,595)	(26,377)	(26,074)	(25,910)	(24,295)	(24,295)	(24,164)	(24,477)	(24,375)	(24,273)	(24,171)	(24,171)
Less: Outstanding Balance	(158,358)	(167,226)	(169,592)	(168,438)	(157,899)	(153,081)	(120,427)	(125,471)	(122,651)	(127,855)	(130,344)	(134,680)	(137,086)	(147,086)
Total ABL Availability	70,787	61,173	68,758	38,479	46,853	39,507	74,859	62,682	64,324	61,958	58,530	53,464	39,949	39,949
Total Liquidity	\$ 72,787	\$ 63,173	\$ 70,258	\$ 40,479	\$ 48,853	\$ 41,807	\$ 76,859	\$ 64,682	\$ 66,324	\$ 63,958	\$ 60,530	\$ 55,464	\$ 41,949	\$ 41,949

Memo:	1	2	3	4	5	6	7	8	9	10	11	12	13	Total
TLT Pro Fees Accruals (incl. Secured Creditors)	\$ 1,377	\$ 2,554	\$ 3,831	\$ 5,108	\$ 6,385	\$ 7,662	\$ 8,939	\$ 10,216	\$ 11,298	\$ 8,111	\$ 9,133	\$ 10,154	\$ 11,176	\$ 11,176

(1) The fees of the UCC professionals shall be limited to \$2,000M for the duration of these cases.