

**ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST**

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

**AND IN THE MATTER OF A PLAN OF COMPROMISE OR
ARRANGEMENT OF TARGET CANADA CO., TARGET
CANADA HEALTH CO., TARGET CANADA MOBILE GP
CO., TARGET CANADA PHARMACY (BC) CORP., TARGET
CANADA PHARMACY (ONTARIO) CORP. TARGET
CANADA PHARMACY CORP., TARGET CANADA
PHARMACY (SK) CORP., AND TARGET CANADA PROPERTY LLC.**

**SIXTEENTH REPORT OF THE MONITOR
ALVAREZ & MARSAL CANADA INC.**

JUNE 24, 2015

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Appendix “A” – List of the Applicants and Partnerships

1.0 INTRODUCTION

- 1.1 On January 15, 2015, Target Canada Co. (“**TCC**”) and those companies listed in **Appendix “A”** (collectively, the “**Applicants**”), together with the Partnerships also listed in **Appendix “A”** (the “**Partnerships**”, and collectively with the Applicants, the “**Target Canada Entities**”), applied for and were granted protection by the Ontario Superior Court of Justice (Commercial List) (the “**Court**”) under the *Companies’ Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended (the “**CCAA**”). Pursuant to an Order of this Court dated January 15, 2015, Alvarez & Marsal Canada Inc. (“**A&M**”) was appointed Monitor of the Target Canada Entities in the CCAA proceedings (the “**Monitor**”). The proceedings commenced by the Applicants under the CCAA are referred to herein as the “**CCAA Proceedings**”.
- 1.2 On February 11, 2015, this Court issued the “Amended and Restated Initial Order” (hereinafter, unless the context otherwise requires, the “**Initial Order**”) which incorporates certain changes to the Initial Order granted January 15, 2015 that are described in the Second Report of the Monitor (the “**Second Report**”) dated February 9, 2015.
- 1.3 In connection with the CCAA Proceedings, the Monitor has previously provided to this Court fifteen reports and one supplementary report (the “**Supplementary Report**”, and collectively, the “**Monitor’s Reports**”). A&M has also provided to this Court the Pre-Filing Report of the Proposed Monitor (the “**Pre-Filing Report**”) dated January 14, 2015 (together with the Monitor’s Reports, the “**Prior Reports**”). The Prior Reports, the Initial Order and other Court-filed documents and notices in these CCAA Proceedings are available on the Monitor’s website at www.alvarezandmarsal.com/targetcanada.

1.4 The purpose of this Sixteenth Report of the Monitor (the “**Sixteenth Report**”) is to provide this Court with:

- (1) information regarding the following:
 - (a) the Applicants’ motion for an order substantially in the form attached to the Applicants’ Motion Record dated June 24, 2015:
 - (i) approving the Asset Purchase Agreement entered into as of June 24, 2015 between TCC and Ocean State Jobbers, Inc. (“**Ocean State**” and the Agreement the “**Ocean State APA**”), a copy of which is attached as Exhibit “F” to the affidavit of Mark J. Wong, General Counsel and Assistant Secretary of TCC sworn June 24, 2015 (the “**Wong Affidavit**”); and
 - (ii) vesting in Ocean State all of TCC’s right, title and interest in and to the Purchased Assets (defined below) free and clear of all encumbrances; and
 - (b) the Access Agreement entered into between TCC and Sobeyes Capital Incorporated (“**Sobeyes**”) in order to facilitate the activities contemplated under the Ocean State APA; and
- (2) the Monitor’s conclusions and recommendations in connection with the foregoing.

2.0 TERMS OF REFERENCE AND DISCLAIMER

2.1 In preparing this Sixteenth Report, the Monitor has been provided with, and has relied upon, unaudited financial information, books and records and financial information prepared by the

Target Canada Entities and Target Corporation, and discussions with management of the Target Canada Entities and Target Corporation (collectively, the “**Information**”).

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

2.3 Capitalized terms not otherwise defined in this Sixteenth Report are as defined in the Prior Reports, the Wong Affidavit, or the Ocean State APA, as applicable.

2.4 Unless otherwise stated, all monetary amounts contained in this Sixteenth Report are expressed in Canadian dollars.

3.0 ASSET PURCHASE AGREEMENT

3.1 Subject to the approval of the Court and with the consent of the Monitor, TCC has entered into the Ocean State APA with Ocean State in respect of certain assets owned by TCC located within the Calgary distribution centre and set out in the Ocean State APA (the “**Purchased Assets**”). At a high level, the Ocean State APA provides for a purchase price of \$1,286,000.00 for the Purchased Assets, subject to transaction fees of 7.95% or \$102,237.00 plus GST as described below, which represents a net realization to the estate of \$1,183,763.00 on a class of highly specialized assets that pose significant resale challenges, and for which TCC would, absent a sale, be forced to abandon outright, or to remove and destroy at a loss to the estate.

Background

- 3.2 As detailed in the Prior Reports, TCC entered into asset purchase agreements with Sobeys in respect of the Calgary distribution centre (the “**Calgary DC**”), Wal-Mart Canada Corp. (“**Wal-Mart**”) in respect of the Cornwall distribution centre (the “**Cornwall DC**”), and with Lowe’s Companies Canada, ULC (“**Lowe’s**”) in respect of the Milton distribution centre (the “**Milton DC**”). The Court issued approval and vesting orders in respect of all three distribution centre transactions on May 20, 2015, copies of which are available on the Monitor’s website. During the negotiations of the distribution centre transactions, TCC offered to sell to each of Sobeys, Wal-Mart, and Lowe’s the TCC-owned FF&E remaining in the respective distribution centres. After discussions, all of the TCC-owned FF&E at the Cornwall DC and the Milton DC were conveyed or transferred to Wal-Mart and Lowe’s, respectively.
- 3.3 In discussions with the Monitor during the negotiation of the Calgary DC APA, Sobeys indicated at that time that it was not interested in acquiring certain assets located in the Calgary DC, as it intends to install its own operational equipment. Information regarding the Asset Purchase Agreement among TCC and Sobeys in connection with the Calgary DC (the “**Calgary DC APA**”) was provided in the Applicants’ Motion Record dated May 13, 2015 and the Twelfth Report of the Monitor dated May 15, 2015 at section 6.0.¹ Schedule “B” to the Calgary DC APA lists Excluded Assets, for which legal ownership and title will remain with either TCC or Eleven Points Logistics and will not transfer to Sobeys upon closing of the Calgary DC APA. The Excluded Assets for which title remained with TCC, include “all FF&E which have been removed from the Property by or on behalf of the Vendor prior to closing.” Although the list of Excluded Assets under the Calgary DC APA is not itemized, these assets generally include the conveyor belt systems, storage racking, some office furniture, and other miscellaneous fixtures and equipment related to the operation of the distribution centre.

¹ A copy of the Calgary DC APA is included as Exhibit “A” to the Wong Affidavit.

3.4 Under sections 2.2(f) and 5.1(a) of the Calgary DC APA, TCC is entitled but not obligated to remove and sell any and all chattels, personal property, or Excluded Assets from the Property during the Interim Period, which expires upon closing.²

Nature of the Purchased Assets

3.5 As set out in paragraph 6 of the Wong Affidavit, the Purchased Assets include an industrial conveyor system and certain related items necessary for the operation of the conveyor, including a “Pick to Light” system for large-scale inventory management, all of which were Excluded Assets under the Calgary DC APA. As set out at Schedule “A” to the Ocean State APA, which provides a full list of the Purchased Assets, the Purchased Assets include over three miles of conveyor belts of various lengths and ranging between 28 and 52 inches in width. The Monitor is advised that these are highly specialized assets that could only be used in large-scale commercial distribution operations.

3.6 As described hereafter, in connection with the Access Agreement and the Ocean State APA, the storage racking and other miscellaneous furniture and equipment, which were also Excluded Assets under the Calgary DC APA, were excluded from the Purchased Assets provided under the Ocean State APA as consideration to Sobeys for the disruption to its construction schedule arising from the removal of the Purchased Assets.

Process Overview

Initial Discussions with Potential Purchasers

3.7 Following the completion of the Calgary DC APA, TCC and the Monitor considered options for realizing on the Excluded Assets, which included the conveyor and “Pick to Light” systems, a significant amount of storage racking, and various miscellaneous office furniture and equipment.

² It is currently anticipated that the transaction with Sobeys in respect of the Calgary DC will close by June 30, 2015.

In discussions with the Agent, the Monitor was advised that the racking and the conveyor system were the most valuable of the Excluded Assets.

3.8 During May 2015, TCC and the Monitor engaged with several potential third party purchasers to assess the possibility of selling substantially all of the Excluded Assets in an *en bloc* transaction. As set out in paragraph 11 of the Wong Affidavit, proposals for the full list of Excluded Assets ranged between \$1.0 and \$1.9 million. The potential purchasers and the general terms of initial offers are as follows:

- (1) The Agent – proposed to sell the Excluded Assets in consideration for a 20% commission and related expenses. The Agent indicated that it was not prepared to purchase the assets on its own account, but would provide a guaranteed amount of \$1.2 million based on specific conditions, and an estimated liquidation value of \$1.6 million (net of commissions and expenses) for the Excluded Assets;
- (2) A Racking Supplier (“**Party A**”) – Target Corporation contacted the original supplier of the racking on behalf of TCC to assess whether it was interested in purchasing the racking. Although Party A was not interested in pursuing such a transaction, it recommended another racking-related company that deals in both new and used equipment (“**Party B**”) for TCC to contact;
- (3) Party B – Party B expressed an interest in purchasing all of the Excluded Assets, although it indicated that it was most interested in the storage racking. Party B did not provide an offer for the Excluded Assets in the discussions with TCC and the Monitor;
- (4) A manufacturer and installer of conveyor systems (“**Party C**”) – Party C advised that it was not interested in purchasing or re-selling the Excluded Assets, however estimated that removal costs related to the conveyor systems would be approximately \$1 million;

- (5) Ocean State – 2084381 Ontario Inc. (“**Warehouse 66**”), a liquidation company, approached the Monitor as representative of potential buyers, including Ocean State (a U.S.-based liquidation firm), to express an interest in purchasing all of the Excluded Assets for approximately \$1.9 million. The Monitor is advised by the Agent that Warehouse 66 learned of this opportunity through discussions with the Agent;
- (6) A discount retailer (“**Party D**”) – representatives of Party D also approached TCC and the Monitor and expressed an interest in bringing a buyer who would purchase all of the Excluded Assets, although it declined to make an offer at this stage. Party D, who also has experience in asset liquidations, has been employed by Eleven Points to facilitate the removal of Eleven Points’ assets from the distribution centres; and
- (7) An industrial machinery and equipment disposal specialist (“**Party E**”) – the Monitor attempted to contact Party E, who had previously contacted the Monitor to express an interest in the Excluded Assets, however Party E did not respond.

3.9 As part of its discussions with these potential third party purchasers, the Monitor was originally advised that removal of all of the Excluded Assets is likely to take between 15 to 18 weeks, due in large part to the removal of the extensive conveyor system, which caused concern as to whether a sale of the Excluded Assets was viable in the circumstances.

Subsequent Discussions with Sobeys and Access Agreement

3.10 Given the prolonged estimated removal time for the Excluded Assets, TCC and the Monitor engaged in further discussions with Sobeys regarding the possibility of an access arrangement to allow for the removal of the assets following the closing of the Calgary DC APA (i.e., after the Interim Period). A similar access arrangement exists under the Calgary DC APA, where Eleven Points Logistics is permitted 30 days access post-closing in order to remove its assets from the premises.

3.11 The Monitor met with Sobeys on June 1, 2015 to discuss the terms of an access arrangement in respect of the Excluded Assets. Sobeys expressed concern with the 15 to 18 week timeframe proposed by the Monitor for the removal of the Excluded Assets, as it is Sobeys' intention to install its own conveyor and other operational systems expeditiously following the closing of the Calgary DC APA. Sobeys' proposed terms were as follows:

- (1) Sobeys would grant access to the distribution centre for a period of 16 weeks post-closing to allow for the removal of the Excluded Assets; and
- (2) in consideration for the 16-week access period (the "**Access Period**"), TCC would abandon certain of the Excluded Assets, including the racking, and would not market these assets to potential purchasers of the Excluded Assets.

3.12 With an understanding of the general terms of an access arrangement in hand, TCC and the Monitor approached the interested potential third party purchasers to reassess interest and move towards consummating a transaction.

Subsequent Discussions with Potential Purchasers

3.13 Subsequent discussions with potential purchasers regarding interest in the assets, other than the racking and other miscellaneous furniture and equipment, yielded the following:

- (1) The Agent maintained that it was not interested in purchasing the assets on its own account, but reaffirmed its interest in selling the assets on a commission basis, and estimated a liquidation value of approximately \$1 million for the revised group of assets;
- (2) Party B, whose primary interest had been the racking, indicated it was no longer interested in the offered assets;

- (3) Ocean State, through Warehouse 66, proposed a reduced offer of \$900,000 for the offered assets; and
- (4) Party D proposed a reduced offer of \$750,000 for certain of the offered assets.

3.14 With three offers in hand, TCC and the Monitor considered whether it would be necessary or advisable to market the assets more broadly, and it was ultimately decided not to undertake additional efforts. This decision was based primarily on the following factors:

- (1) Sobeys' timeline for an access arrangement, which, as described below, allows for 16 weeks from closing for the assets to be removed from the premises or face potential penalties of \$200,000 per week;³
- (2) the highly specialized nature of the assets, which are for use in large-scale commercial operations, and the fact that only very few companies would be able to carry out the timely removal of the assets;
- (3) the likely difficulty in identifying additional potential purchasers, and the contemplated timeframe involved in negotiating terms with such a purchaser;
- (4) consideration of the timeframe involved in conducting a more fulsome marketing or auction process, as a transaction had to be consummated no later than June 30, 2015 in order to allow the purchaser the benefit of the full 16 week access period permitted by Sobeys; and
- (5) the fact that the offers received were both within the range of guarantee or liquidation value estimate provided by the Agent.

³ Pursuant to the terms of the Access Agreement, the \$200,000 per week penalty commences as of the 18th week following closing.

- 3.15 TCC and the Monitor approached the Agent, Ocean State, and Party D on June 12, 2015 and requested final offers in respect of the offered assets. The Agent maintained its estimated liquidation value of \$1 million for the assets, but stated it was not prepared to purchase the assets on its own account. Party D maintained its offer at \$750,000. Ocean State increased its offer to approximately \$1.18 million, net of commissions. Ocean State also indicated that it would employ Intelligrated USA – the company that manufactured and installed the conveyor system – for the removal process.
- 3.16 On June 15, 2015, TCC and the Monitor asked each of the Agent, Ocean State, and Party D whether they would be prepared to post a performance bond in the amount of \$500,000 as part of their offers to protect the estate from potential claims arising from damage caused by the removal or delay in removal of the Purchased Assets, which both Ocean State and Party D agreed to do. The Agent was not prepared to commit to a performance bond, with the understanding that by doing so, they would be removed from the process.
- 3.17 TCC informed Party D that it had received a higher offer and asked whether it was prepared to increase its offer. Party D subsequently increased its offer to \$950,000.
- 3.18 TCC, in consultation with the Monitor, concluded that Ocean State’s offer was superior. Not only was Ocean State’s offer higher than that of Party D, but the use of Intelligrated USA (the original manufacturer and installer of the conveyor system) to carry out the removal could substantially reduce the risk of repair costs, as Intelligrated USA and its agents are familiar with both the conveyor system and the premises.

The Access Agreement

- 3.19 The Access Agreement between TCC and Sobeys is necessary to facilitate the removal of the Purchased Assets under the Ocean State APA. As detailed in paragraph 25 of the Wong

Affidavit, TCC and the Monitor engaged in discussions with Sobeys regarding the key terms of the Access Agreement in May and June, 2015.

- 3.20 The Access Agreement will provide access to Ocean State and its representatives for a period of 16 weeks, which may be extended on written request, in consideration for TCC's abandonment of certain of the Excluded Assets to Sobeys – most notably, the racking.
- 3.21 The Access Agreement contemplates that TCC may provide written notice to Sobeys prior to the end of the Access Period requesting access for additional two-week periods (each such period an “**Additional Access Period**”). Under the terms of the Access Agreement, there is a two-week grace period following the initial Access Period where no additional amounts will be charged to TCC. However, for Additional Access Periods after this two-week grace period (i.e. beginning at 18 weeks post-closing), TCC will be charged \$200,000 per week for the duration of any such Additional Access Periods. The Monitor is advised by Sobeys that this amount reflects Sobeys' estimated weekly rental rate for the Calgary DC.

The Ocean State APA and Fee Agreement

- 3.22 Pursuant to the terms of the Ocean State APA, Ocean State agrees to pay \$1,286,000.00 in cash for the Purchased Assets (the “**Purchase Price**”), which represents the highest amount offered to TCC. Pursuant to the terms of the Fee Agreement, \$102,237.00 plus GST of the Purchase Price will be paid over to Warehouse 66 in consideration for facilitating the transaction between TCC and Ocean State. As a result, the net benefit to the estate from the Ocean State APA is \$1,183,763.00. The Monitor is of the view that the Purchase Price, net of the payment to Warehouse 66 pursuant to the Fee Agreement, is a positive result for the estate, particularly given the constrained timeframe, and in light of the available alternatives, which were limited to: (i) acceptance of a lower offer from Party D, (ii) the costs of a 20% commission and expenses that

would be incurred if these items were marketed for sale by the Agent, or (iii) outright abandonment of the assets.

3.23 The Ocean State APA provides that Ocean State shall indemnify and save harmless TCC from and against all Claims which may be made or brought against TCC, or which it may suffer or incur, as a result of or in connection with or relating to:

- (1) any extension(s) of the Access Period beyond the initial 16-week period under the Access Agreement, including any and all fees relating thereto;
- (2) the Repairs; and
- (3) any Removal and Destruction Costs.

3.24 The Ocean State APA provides that, on or before closing, Ocean State will deliver to the Monitor a Security Deposit in favour of TCC in the amount of \$500,000 to secure Ocean State's indemnity obligations under the agreement. The Security Deposit was delivered to the Monitor on June 22, 2015. The Monitor will hold this amount in trust and will draw on the security deposit as directed by the parties and in accordance with the terms of the Ocean State APA. The Ocean State APA further provides that, after closing, Ocean State may elect to deliver a Letter of Credit issued by a Schedule I bank to TCC in the original face amount of the amount remaining under the Security Deposit. The Monitor views these provisions, which are aimed at ensuring that all repairs contemplated under the Ocean State APA are conducted in a timely manner, as reasonable in the circumstances.

3.25 The Monitor is of the view that the Ocean State APA provides a benefit to the Target Canada Entities and their stakeholders. As outlined above, a sale of the Purchased Assets allows the Target Canada Entities to realize value on a group of assets which would otherwise be abandoned

for no value. The Ocean State APA also shifts the costs of removing the Purchased Assets to Ocean State.

The Monitor Approves of the Process that Resulted in the APA

- 3.26 In assessing the Ocean State APA, the Monitor took into consideration the factors set out in sections 36(3) of the CCAA.⁴
- 3.27 The Monitor was actively involved with the identification of potential purchasers, worked with TCC and Ocean State to negotiate the Ocean State APA, and approves of the process.
- 3.28 The Monitor is of the opinion that the sale to Ocean State benefits the creditors of the Target Canada Entities. As set out herein, there were very few options to realize value for the Purchased Assets given the time constraints imposed by the Calgary DC APA and the Real Property Portfolio Sales Process. Failing such a sale, TCC would be forced to abandon the Purchased Assets.
- 3.29 In summary, given the timing constraints, TCC and the Monitor proceeded expeditiously to consummate a transaction to realize on the Purchased Assets and avoid their abandonment. The offers received in respect of the Purchased Assets are all consistent with the estimated liquidation value provided by the Agent, with the Ocean State APA representing the highest offer received. The Ocean State APA will provide value to the estate for the benefit of all of the estate's stakeholders, and the use of Intelligrated USA to perform the removal of assets will facilitate an efficient process within the timeframe set out in the Access Agreement. Ocean State has indicated in subsequent discussions with the Monitor that it expected the Purchased Assets to be removed within 14 weeks, in accordance with the Ocean State APA and the Access Agreement, and subject to any unforeseen delays.

⁴ Given that Ocean State is an unrelated third party purchaser, the factors set out in CCAA section 36(4) do not apply to this transaction.

3.30 The Monitor does not believe that a realization of the Purchased Assets under a bankruptcy would be more beneficial to the creditors of the Target Canada Entities. The issuance of the \$500,000 performance bond will also motivate Ocean State to carry out its obligations under the Ocean State APA in a timely manner, thus limiting execution risk under the agreement. For these reasons, the Monitor supports the requested approval of the Ocean State APA.

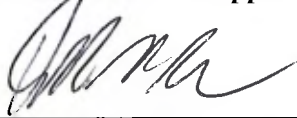
4.0 MONITOR'S RECOMMENDATION

4.1 For the reasons set out in this Sixteenth Report, the Monitor is of the view that the relief requested by the Applicants is reasonable.

All of which is respectfully submitted to this Court this 24th day of June, 2015.

**Alvarez & Marsal Canada Inc., in its capacity
as Monitor of Target Canada Co., and
the other Applicants listed on Appendix "A"**

Per:



Name: Douglas R. McIntosh
Title: President

Per:



Name: Alan J. Hutchens
Title: Senior Vice President

APPENDIX “A”

Applicants

Target Canada Co.

Target Canada Health Co.

Target Canada Mobile GP Co.

Target Canada Pharmacy (BC) Corp.

Target Canada Pharmacy (Ontario) Corp.

Target Canada Pharmacy (SK) Corp.

Target Canada Pharmacy Corp.

Target Canada Property LLC

Partnerships

Target Canada Pharmacy Franchising LP

Target Canada Mobile LP

Target Canada Property LP

**IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF TARGET CANADA CO.,
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PHARMACY (BC) CORP., TARGET CANADA PHARMACY (ONTARIO) CORP. TARGET CANADA
PHARMACY CORP., TARGET CANADA PHARMACY (SK) CORP., AND TARGET CANADA
PROPERTY LLC.**

Court File No.: CV-15-10832-00CL

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Proceeding commenced at Toronto

SIXTEENTH REPORT OF THE MONITOR

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