

Court File No. CV-09-8221-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

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

AND IN THE MATTER OF A PLAN OF COMPROMISE OR
ARRANGEMENT OF COPPLEY APPAREL GROUP LIMITED

SECOND REPORT OF
BDO DUNWOODY LIMITED
IN ITS CAPACITY MONITOR OF
COPPLEY APPAREL GROUP LIMITED

DATED JULY 10, 2009

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1. Introduction and Background

1.1 On June 10, 2009 pursuant to an application made by Coppley Apparel Group Limited (“**Coppley**” or the “**Company**”), the Court made an Order (the “**Initial Order**”) declaring that Coppley is a company to which the *Companies’ Creditors Arrangement Act* (“**CCAA**”) applies, and granting the customary intital relief, including a Stay of Proceedings against Coppley until and including July 8, 2009. On July 8, 2009 Madam Justice Pepall granted an Order extending the CCAA stay of proceedings until and including July 14, 2009 (the “**Stay Period**”).

1.2 BDO Dunwoody Limited was appointed Monitor under the Initial Order under the CCAA (the “**Monitor**”) and was authorized to take a number of actions including, but not limited to, monitoring receipts and disbursements, assisting Coppley with its required cash flow reporting requirements to the Debtor-in-Possession Lender, Wachovia Capital Finance Corporation (Central) (“**Wachovia**” or the “**DIP Lender**”), in accordance with the Forbearance Agreement dated June 8, 2009 (the “**Forbearance Agreement**”), assisting with the dissemination of financial information, consulting and assisting Coppley to conduct a sales process in accordance with the Canadian Bid Procedures (the “**Sales Process**”) and advising Coppley on the development of a Plan of Arrangement.

1.3 As a result of the timelines agreed to by Coppley in the Canadian Bid Procedures, the Sales Process required that offers for the assets of Coppley be received by the Monitor no later than 5:00pm on Sunday June 21, 2008 in order that, if necessary an auction could take place among any

parties having submitted “Qualified Bids” (as hereinafter defined) and the stalking horse bidder in the Canadian Bid Procedures, Emerisque Brands UK Limited and SKNL North America B.V. and its assignee HMX Canada Acquisition Corp. (collectively “**Emerisque**”) on June 23, 2009, and the transaction with Emerisque, if the successful bidder, could close on or before July 3, 2009.

1.4 On June 19, 2009, Emerisque requested an extension of the closing date for the Canadian Agreement of Purchase and Sale (the “**Canadian APA**”) to July 20, 2009. The Company was authorized to extend the bid deadline in the Canadian Bid Procedure by one day, which it did while it prepared materials to apply to Court on June 23, 2009 for an Order amending the terms of the Canadian Bid Procedure and extending the milestone dates effectively extending the sale process for an additional two week period as discussed in greater detail below.

1.7 The “Proposed” Monitor’s First Report dated June 9, 2009 (the “**First Report**”) was filed in support of the Company’s initial application under the CCAA and briefly reported and commented on the following:

- a) the projected statement of Anticipated Receipts and Disbursements for the seven weeks ending July 17, 2009 (the “**DIP Budget**”) provided by Coppley to the Court;
- b) the Debtor-In-Possession Financing as described in the Forbearance Agreement; and

- c) the proposed sale process as outlined in the affidavit of Richard Sexton, Chief Financial Officer of Copley, sworn on June 8, 2009 and described as the Canadian Bid Procedure.

Purpose of this Report

1.8 The purpose of this Second Report to the Court is as follows:

- a) to update this Court on the events and the activities of the Company and of the Monitor since June 10, 2009, the date of the First Report;
- b) to report to Court on the cash flow results of the Company since June 10, 2009;
- c) to report on the actions undertaken by the Company and the Monitor to carry out the Sales Process;
- d) to report on the results of the Sale Process;
- e) to recommend to the Court that it approve the sale of the assets of Copley, excluding the inventory and equipment of the former Royal Shirt manufacturing facility in Concord, Ontario (the "**Concord Assets**"), to Emerisque in accordance with the terms and conditions set out in the Canadian APA;
- f) to seek approval of the Monitor's conduct and activities to date as set out in this report; and

g) to seek approval of the professional fees of the Monitor and its legal counsel to July 3, 2009.

2. Monitor's Activities

2.1 The key activities of the Monitor since June 10, 2009, the date of the Initial Order, include the following:

- a) reviewing Copley's cash flow and providing a weekly variance analysis to the Company and the DIP Lender comparing actual results to forecasted amounts for the four week period ending July 3, 2009 as discussed below;
- b) reviewing availability under the borrowing base with Copley and reporting the results to the DIP Lender;
- c) assisting the Company to carrying out the Sale Process as more fully described below;
- d) notifying potential bidders of the one day extension of the initial bid deadline as authorized under the Canadian Bid Procedure from June 21, 2009 to June 22, 2009; and
- e) notifying all interested parties of the Court approved amendments extending the Canadian Bid Procedure milestone dates (the "**Amended Bid Procedures**") as follows:

- i) Bid Deadline from June 21, 2009 to July 7, 2009;
 - ii) Auction on June 23, 2009 to July 9, 2009; and
 - iii) Sale Hearing on June 25, 2009 to July 13, 2009.

- f) Reviewing offers received with the Company and in consultation with Wachovia to determine if any bids received by the Monitor qualified as "Qualified Bids" as defined in the Amended Bidding Procedures to determine whether an auction was necessary under the terms of the Amended Bid Procedure; and

- g) analyzing the collectability of Copley's accounts receivable in order to determine whether any of the offers received in the Sales Process would qualify as a Qualified Bid, and to generally determine Copley's forced liquidation value so as to be able to report to the Court on
 - i) whether the existing stalking horse bid of Emerisque is greater than the forced liquidation value of the Company's assets; and
 - ii) whether the forced liquidation value of the Copley assets, excluding the Concord Assets, exceeds the amount owing to Wachovia as secured creditor, thereby resulting in a recovery for unsecured creditors, since the recoveries anticipated from the Emerisque transaction will result in a shortfall to Wachovia and no recovery to the Company's unsecured creditors.

3. Cash Flow Reporting

A. Results to July 3, 2009

- 3.1 The Company filed with the Court a DIP Budget in support of its initial CCAA application. The DIP Budget covered the short period of time required to carry out the abbreviated sale process dictated by the Canadian Bid Procedures. On June 23, 2009 the Company applied for and was granted an Order amending the terms of the Canadian Bid Procedure and extending the Bid Procedure dates.
- 3.2 The Company filed with the Court a revised Anticipated Receipts and Disbursements Schedule Version 2 (the “**Revised Cash Flow Forecast**”) and entered into an Amending Agreement to the original Forbearance Agreement (the “**Amended Forbearance Agreement**”) in support of the extended Sale Process.
- 3.3 As part of the terms of the Amended Forbearance Agreement, the DIP Lender agreed to provide up to \$803,000 in additional funding during the CCAA proceedings to fund the projected Company’s cumulative shortfall from operations as contemplated in the Revised Cash Flow Forecast.
- 3.4 The Monitor has now had the opportunity to conduct a fulsome review of the Revised Cash Flow Forecast for the eight week period ending July 31, 2009.

3.5 Below is a table summarizing the budget versus actual cash flow analysis for the four week period ended July 3, 2009:

	Projected	Actual	Variance	
	(CDN \$ 000's)	(CDN \$ 000's)	\$	%
Collections				
A/R Collections	2,219	2,463	244	11%
	<u>2,219</u>	<u>2,463</u>	<u>244</u>	<u>11%</u>
Disbursements				
Employee Related Disbursements	1,517	1,425	(92)	-6%
Inventory Related Disbursements	658	664	6	1%
Overhead Related Disbursements	331	325	(6)	-2%
Financing Related Disbursements	57	64	7	12%
Professional Fees	792	493	(299)	-38%
	<u>3,354</u>	<u>2,971</u>	<u>(383)</u>	<u>-32%</u>
Net Change in Cash Position	(1,135)	(508)	(627)	55%
Opening Cash Balance	1,041	1,041	-	0%
Closing Cash Balance	<u>(94)</u>	<u>533</u>	<u>(627)</u>	<u>55%</u>

A detailed schedule of the budget versus actual cash flow analysis for the four week period ended July 3, 2009 is attached as **Schedule A**.

3.6 The Company was holding approximately \$533,000 in cash at July 3, 2009. The Company's net ending cash position as at July 3, 2009 was \$627,000 higher than projected and accordingly, approximately \$94,000 of anticipated borrowing from the DIP Lender was not required by the Company to fund operations.

3.7 Overall, collections of accounts receivable to July 3, 2009 were higher by \$244,000 or about 11% over projections while operating disbursements were approximately \$383,000 lower than projected. The

\$627,000 favourable cash variance is a result of an \$85,000 permanent reduction in payroll related disbursements with \$542,000 of the variance caused by temporary timing issues in the cash flow. Nearly all of the \$542,000 variance is considered temporary by the Company given the uncertainty surrounding future receivable collections and the unknown professional restructuring costs.

3.8 The Monitor, in consultation with the Company, has determined that there is an additional \$209,000 in cash disbursements (the “**Stub Period Disbursements**”) not currently reflected in the Revised Cash Flow Forecast, as a result of amounts which accrue prior to the Closing Date but would normally be payable after the Closing Date on a cash basis.

3.9 Based upon positive timing variances in its receivable collections to date, the Company may have sufficient cash on hand as at the Closing Date to fund these accruals, failing which, because substantially all of the accrued amounts constitute directors’ liabilities if not paid, the unpaid accruals can be funded out of the \$1,300,000 cash amount being held by the Monitor in trust on account of the Directors’ and Officers’ Indemnification Charge.

4. Borrowing Base Reporting

4.1 Copley has been operating outside of its existing margin covenants (availability) during the CCAA proceedings. The Company is currently in an over advance position of approximately \$750,000, however,

there is no provision in the Amended Forbearance Agreement to address this issue.

4.2 Copley engaged in discussions with Wachovia to address the margin covenant breach and the DIP Lender has advised the Company that it does not have to repay the over advance or operate within margin covenants during the CCAA proceedings provided Copley continues to operate within the Revised Cash Flow Forecast.

5. Sale Process

A. Monitor's Actions

5.1 In accordance with the Initial Order, the Monitor assisted Copley to conduct the Sale Process which included, among other things, the following:

- a) Setting up a website (the "Sale Site") and posting to it the Initial Order and the Endorsement of the Honourable Madam Justice Hoy.
- b) Setting up a dedicated page on the Sale Site advising of the Sale Process and outlining the Canadian Bid Procedure to invite offers for the assets and/or business of Copley.

- c) Posting financial and other information to a dedicated password protected virtual data room on the Sale Site for interested parties to be able to carry out due diligence.
- d) Interested parties were required to execute a Confidentiality Agreement prior to receiving access to the web-based virtual data room.
- e) The Monitor's Sale Site was set up and fully operational by Thursday, June 11, 2009 although additional due diligence material was posted to the dedicated virtual data room as it became available to the Monitor over the next few days.
- f) Advertisements were placed in the Hamilton Spectator and The Globe and Mail (National Edition) on Saturday, June 13, 2009 and Monday, June 15, 2009 respectively, advertising the sale. The advertisements are attached as **Schedule "B"** to this report.
- g) The Monitor contacted eight liquidators on June 11, 2009 to solicit liquidation offers for the Copley assets;
- h) The Monitor held discussions with Richard Sexton, Copley's Chief Financial Officer, to identify key strategic buyers in the apparel industry. Based on these discussions, the Monitor contacted representatives from Jack Victor, Peerless Clothing and Samuelsohn Suits through Grano Retail Investments to advise them of the Copley opportunity.

- i) The Monitor contacted Karabus Management Consultants (“Karabus”), a retail consulting firm, and sent to its Chief Operating Officer an interest solicitation email advising of the sale of the assets and business of Copley to ascertain whether Karabus had any existing clients that might be interested in the Copley opportunity.

- j) The Monitor met with its internal distressed corporate finance group to identify small private equity firms that might be interested in the Copley business opportunity. A search was conducted on the Capital IQ corporate finance database to identify private equity firms with existing investments in companies in the apparel industry with annual revenues below \$100 million. Additionally, the Monitor received private equity contacts from David Cohen from Gowlings Lafleur Henderson LLP. In total, fourteen private equity firms were made aware of the business opportunity and Sale Process through an interest solicitation email from the Monitor. The form of the interest solicitation letter is also attached hereto in **Schedule “C”**.

- k) The Monitor also sent a firm wide email inquiring whether any BDO Dunwoody Limited Partners had clients that would be interested in the Copley opportunity.

- l) Based on the aforementioned marketing efforts, forty-four parties were contacted directly by the Monitor and twenty six registered on the Monitor’s Sale Site. Twenty parties executed and returned Confidentiality Agreements and received access to the information

found in the Monitor's Sale Site virtual data room. Attached hereto as **Schedule "B.1"** is a copy of the Monitor's Sale Process Tracking Log.

m) The Monitor corresponded with prospective purchasers throughout the sale process and coordinated several site visits by interested parties.

5.2 The initial bid deadline under the Bid Procedure for submitting offers was 5:00 p.m. Eastern Standard Time on Sunday June 21, 2009.

5.3 On Friday June 19, 2009 the stalking horse bidder, Emerisque, had not yet secured its financing and as a result the bid deadline under the authorized Canadian Bid Procedure was extended to 5:00 p.m. Eastern Standard Time on Monday June 22, 2009 (the "**First Bid Extension Deadline Date**").

5.4 The Monitor immediately notified all parties that had signed Confidentiality Agreements by email on Friday June 19, 2009 of the extension of the bid deadline to 5:00 p.m. Eastern Standard Time on Monday June 22, 2009.

5.5 On Friday June 19, 2009, the Monitor also telephoned three strategic buyers that had executed Confidentiality Agreements to notify them of the extension of the bid deadline to Monday June 22, 2009.

B. Prospective Purchasers Comments

5.6 The Monitor received comments from several interested parties during the abbreviated sale process indicating that the timeframe was too short to be able to complete proper due diligence so as to be able to submit an unconditional offer for the Copley business and/or assets given the transaction size and complexity.

C. Offers Received

5.7 The Monitor received five separate bids for the Copley assets by the First Bid Extension Deadline Date. One of the liquidator offers was for all of the Copley assets and provided a separate price for the Concord Assets. The other four offers were for the Concord Assets; three of these offers came from liquidators and one offer from a strategic buyer.

5.8 The Monitor also received two letters from interested parties raising concerns about the brevity of the sale process and the requirement of additional time to be able to complete due diligence to submit offers. The letters received were from a liquidator and counsel acting for a strategic buyer, Grano Retail Investments, interested at the time in submitting an offer with the intention of acquiring the Copley business.

5.9 The five offers and two letters received by the Monitor by the First Bid Extension Deadline Date and are filed separately as **Confidential Schedule "D"** to this report. The Monitor requests that Confidential

Schedule "D" be sealed with the Court so as not to prejudice any of the parties and to protect the integrity of the Sale Process until sales of the Copley assets are completed.

5.10 The day following the First Bid Extension Deadline Date, the Court granted an Order amending the terms of the Canadian Bid Procedure to extend the milestone dates including the bid deadline date to 5:00 p.m. Eastern Standard Time on Tuesday July 7, 2009 (the "**Second Bid Deadline Date**").

5.11 Following the granting of the Order approving the Amended Bid Procedures, the Monitor over the course of the next day sent out emails notifying all interested parties that had been in contact with the Monitor and the Company of the Second Bid Extension Deadline Date.

5.12 The Monitor also personally contacted each of the parties that had submitted bids by the First Bid Extension Deadline Date to advise them of the Amended Bid Procedures and of the Second Bid Extension Deadline Date.

5.13 Throughout the bid extension period both Copley and the Monitor continued to provide additional assistance and further due diligence information to several interested parties and accommodated, where possible, other requests for meetings and site tours so the interested parties could properly assess the Copley opportunity by the Second Bid Extension Deadline Date.

5.14 The strategic buyer, Grano Retail Investments, that had been interested in acquiring the Copley business and had written to the Monitor to request additional time to evaluate the Copley opportunity, eventually advised the Monitor that it would not submit an offer for the Copley assets citing economic uncertainty and business risk as the reasons for not submitting an offer.

5.15 The Monitor received only one offer for the Copley assets (excluding the Concord Assets) by the Second Bid Deadline Date.

D. Concord Asset Offers

5.16 The Monitor received one additional offer for the Concord assets by the Second Bid Extension Deadline Date while another liquidator resubmitted a lower bid.

5.17 Additionally, the one strategic buyer that had submitted a bid for the Concord Assets, Behar Cline Manufacturing Ltd., eventually withdrew its offer by the Second Bid Deadline Date advising that it was still interested in the assets, however, it had concerns with successor employer issues and required further information to make an informed decision as to the price to offer for the Concord Assets. A copy of the email correspondence received from counsel for Behar Cline Manufacturing Ltd. is included herein as **Schedule "E"**.

5.18 The Monitor received six offers for the Concord Assets by the Second Bid Deadline Date. Filed separately as **Confidential Schedule "F"** is a summary of the offers together with copies of the offers submitted, and requests that this **Confidential Schedule "F"** be sealed until a sale of the Concord Assets is completed.

5.19 The Company and the Monitor, in consultation with Wachovia, are considering the available options to maximize recoveries from the Concord Assets.

D. Qualified Bids

5.20 The Monitor received only one offer from a liquidator for the Copley Assets, (excluding the Concord Assets) and this offer did not meet the conditions of a "Qualified Bid" as defined in the Amended Bid Procedures (i.e. exceeded the Emerisque offer by \$250,000).

5.21 The Monitor has filed separately Confidential Schedule "G", an analysis of the liquidator's bid for the Copley Assets, which is significantly below the Monitor's estimated threshold amount of \$6,844,264 for a bid to be considered a "Qualified Bid" in accordance with the Amended Bid Procedures. The Monitor requests that Confidential Schedule "G" be sealed with Court until the Copley Assets are sold.

5.22 Given that the Monitor did not receive a “Qualified Bid” there was no necessity to call an auction on July 9, 2009 under the Amended Bid Procedures.

6. Forced Liquidation Value Estimate

6.1 The Monitor has analyzed the collectability of the Company’s accounts receivable and has combined its analysis with the only liquidation offer received for the Copley assets (excluding the Concord Assets) to determine a forced liquidation value of the Copley assets (excluding the Concord Assets) .

6.2 Based on the Monitor’s Liquidation Valuation included herein as **Confidential Schedule “H”**, the estimated stalking horse bid of Emerisque provides a greater net overall recovery compared with the liquidation offer received. In addition, the Emerisque stalking horse bid is significantly greater in value than the “High” recovery liquidation scenarios in a bankruptcy or liquidation under the CCAA. The Monitor requests that the Court seal **Confidential Schedule “H”** until a sale of the Copley assets is completed in order to maintain the integrity of the Sale Process.

6.3 The forced liquidation value of Copley will not provide for any recovery for unsecured creditors given that even in the “High” recovery liquidation scenarios, Wachovia will suffer a significant loss on its secured loans to Copley.

7. Security Opinion and Payment to Wachovia

7.1 The Monitor asked its counsel, Fasken Martineau DuMoulin LLP (“Fasken”) to review the security held by Wachovia over the property assets and undertaking of Copley and to provide the Monitor with Fasken’s opinion on the Wachovia security. A copy of the Fasken security opinion is attached hereto as **Schedule K**. In summary, the Fasken security opinion finds the security interests of Wachovia to be valid and enforceable against the assets of Copley located in the Province of Ontario.

7.2 Because the method of payment of the purchase price by Emerisque for the purchased assets under the Canadian APA is to make payment directly to Wachovia, the Company’s within motion is effectively a distribution motion as well as a sale approval motion. Based upon the Fasken security opinion, and based upon the cash pre-funding of the Administration Charge and Directors and Officer’s Indemnification Charge by Wachovia, the Monitor is satisfied that it is appropriate for Wachovia to receive the proceeds of sale from Emerisque.

8. Professional Fees

8.1 Pursuant to the Initial Order, the Monitor has provided services and incurred disbursements which are more particularly described in the Affidavit of Gary Cerrato and detailed invoices attached hereto, as part of **Schedule “I”**.

8.2 The detailed time descriptions contained in the invoices provide a fair and accurate description of the services provided and the amounts charged by BDO Dunwoody Limited, in its capacity as Monitor. Included with each separate invoice is a summary of the time charges of Partners and Staff, whose services are reflected in the invoices, including the total fees and hours billed.

8.3 Additionally, the Monitor has incurred legal fees of its counsel to assist with carrying out its mandate up to June 30, 2009, as per the Affidavit of Edmond Lamek attached hereto as **Schedule "J"**, and the invoice exhibited thereto.

8.4 Additional time will be required to complete the Monitor's mandate under the Initial Order.

8.5 The Monitor requests that the Court approve its interim accounts for the period from June , 2009 to July 3, 2009 in the amount of \$82,447.50, plus disbursements of \$6,019.94, plus GST of \$4,423.37, for a total of \$92,890.81, and requests that the Court approve the accounts of its legal counsel, Fasken, in the amount of \$64,796.50 in fees, plus disbursements of \$ 207.75, plus GST of \$3,098.76, for a total of \$68,103.01, for services performed to the dates indicated on the invoices. The total of all these costs, including GST is \$160,993.82.

9. Summary and Recommendation

9.1 The Monitor is of the view that the Sale Process, following the bid deadline extensions, afforded interested parties sufficient time to submit offers and that the Copley opportunity was sufficiently exposed to the market.

9.2 Considering the following:

- a) that there were no qualified bids received under the Amended Bid Procedures;
- b) that the stalking horse offer of Emerisque, valued at 72% of the secured debt of Wachovia, will greatly exceed the forced liquidation value of the Copley assets (excluding the Concord Assets); and
- c) that there does not appear, after exposing the Copley opportunity to the market, to be any possible hope for a recovery for unsecured creditors given the offers received;

the Monitor recommends that this honorable Court approve the sale of the Copley assets (excluding the Concord Assets) to Emerisque in accordance with the Canadian APA.

9.3 The Monitor also seeks the approval of the Court of its actions to the date of this report and its fees and those of its legal counsel to July 3, 2009.

All of which is respectfully submitted this 10th day of July, 2009.

BDO DUNWOODY LIMITED
Monitor in the CCAA of
Copley Apparel Group Limited
Per:

A handwritten signature in black ink, appearing to read "BFD", with a long horizontal flourish extending to the right.

Blair F. Davidson, CA, CIRP, CBV
Senior Vice President