

**CINRAM INTERNATIONAL  
INC., CINRAM  
INTERNATIONAL INCOME  
FUND AND THE COMPANIES  
LISTED ON SCHEDULE "A**

**FIRST REPORT  
OF FTI CONSULTING CANADA INC.,  
IN ITS CAPACITY AS MONITOR OF THE  
APPLICANTS  
July 9, 2011**

**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 CINRAM INTERNATIONAL INC.,  
CINRAM INTERNATIONAL INCOME FUND AND THE  
COMPANIES LISTED IN SCHEDULE "A"**

**FIRST REPORT OF FTI CONSULTING CANADA INC.,  
in its capacity as Monitor of the Applicants**

**July 9, 2012**

**INTRODUCTION**

1. By Order of this Court dated June 25, 2012 (the "**Initial Order**"), Cinram International Inc. ("**CII**"), CII Trust, Cinram International Income Fund ("**Cinram Fund**") and the companies listed in **Schedule "A"** attached to this report (together with CII and Cinram Fund, the "**Applicants**") obtained protection from their creditors under the *Companies' Creditors Arrangement Act*, R.S.C. 1985 c. C-36, as amended (the "**CCAA**"). The Initial Order also granted relief in respect of Cinram International Limited Partnership (together with the Applicants, the "**CCAA Parties**") and appointed FTI Consulting Canada Inc. ("**FTI**") as monitor (the "**Monitor**") of the CCAA Parties.

2. Cinram Fund, collectively with its direct and indirect subsidiaries, shall be referred to herein as “**Cinram**” or the “**Cinram Group**”. The proceedings to be commenced by the Applicants under the CCAA will be referred to herein as the “**CCAA Proceedings**”.
3. Cinram Group is one of the world’s largest producers of pre-recorded multimedia products and related logistics services. As described in greater detail in the Hootnick Affidavit, Cinram Group has been unable to find an out-of-court solution to its financial difficulties and sought protection from its creditors under the CCAA.
4. The Initial Order granted, *inter alia*, a stay of proceedings until July 25, 2012, or such later date as this Honourable Court may order.
5. On June 26, 2012, Cinram International ULC obtained an order from the United States Bankruptcy Court (District of Delaware) under Chapter 15 of the U.S. Bankruptcy Code recognizing and enforcing the Initial Order on an interim basis and granting an interim stay of any enforcement or actions against the CCAA Parties or their assets.
6. The Applicants’ stated principal objectives of the CCAA Proceedings were: (i) to ensure the ongoing operations of the Cinram Group; (ii) to ensure the Applicants have the necessary availability of working capital funds to maximize the ongoing business of the Cinram Group for the benefit of its stakeholders; and (iii) to

complete the sale and transfer of substantially all of Cinram's core business (the "**Sale Transaction**") to Cinram Acquisition, Inc. or one or more of its nominees.

7. Further background information regarding the CCAA Parties and these proceedings is provided in, *inter alia*, the affidavit of John Bell sworn June 23, 2012 (the "**Bell Affidavit**") and FTI's pre-filing report dated June 23, 2012, copies of which have been posted on the Monitor's website for the CCAA Proceedings at <http://cfcanada.fticonsulting.com/cinram>.

#### **PURPOSE OF THIS REPORT**

8. The purpose of this First Report is to inform the Court on the Applicants' request for an Order, *inter alia*:
  - (a) approving the sale of substantially all of the property and assets used in connection with the business carried on by Cinram in North America (except for certain excluded assets) (the "**Asset Sale Transaction**") pursuant to the Asset Purchase Agreement dated June 22, 2012 (the "**Asset Purchase Agreement**") between CII and Cinram Acquisition, Inc. (the "**Purchaser**");
  - (b) approving the sale of all of the issued and outstanding shares of Cooperatie Cinram Netherlands UA and thereby the business carried on by Cinram in Europe (the "**Share Sale Transaction**") pursuant to the binding purchase offer dated June 22, 2012 (the "**Share Purchase Offer**")

provided by the Purchaser to CII and 1362806 Ontario Limited (together with CII, the “**Share Sellers**”);

- (c) authorizing CII to enter into the Asset Purchase Agreement and the Share Sellers to enter into the Share Purchase Offer;
- (d) authorizing CII, Cinram, Inc., Cinram Retail Services LLC, One K Studios, LLC, Cinram Distribution LLC and Cinram Manufacturing LLC (collectively, the “**Asset Sellers**”) to complete the Asset Sale Transaction;
- (e) authorizing the Share Sellers to complete the Share Sale Transaction;
- (f) vesting all of the Asset Sellers’ right, title and interest in and to the Purchased Assets (as defined in the Asset Purchase Agreement) and the Share Sellers’ right, title and interest in and to the Purchased Shares in the Purchaser, or one or more of its nominees, free and clear of all interests, liens, charges and encumbrances, other than permitted encumbrances;
- (g) sealing the Confidential Supplement (defined below) until further Order of this Court; and
- (h) extending the Stay Period to September 14, 2012.

9. This report should be read in conjunction with the affidavit of Mark Hootnick sworn June 23, 2012 (the “**Hootnick Affidavit**”) as certain information contained in the Hootnick Affidavit has not been included herein in order to avoid unnecessary duplication. A copy of the Hootnick Affidavit is available on the Monitor’s website for the CCAA Proceedings.
10. Capitalized terms not otherwise defined herein have the meaning given to them in the Hootnick Affidavit.

#### **TERMS OF REFERENCE**

11. In preparing this report, FTI has relied upon unaudited financial information of the Applicants, the Applicants’ books and records, certain financial information prepared by, and discussions with, the Applicants’ management. FTI has not audited, reviewed or otherwise attempted to verify the accuracy or completeness of the information and accordingly expresses no opinion or other form of assurance on the information contained in this report.
12. Unless otherwise stated, all monetary amounts contained in this report are expressed in United States dollars.

#### **PROCESS LEADING TO THE PROPOSED SALE TRANSACTION**

13. Pursuant to certain amendments and waivers with respect to Cinram’s Credit Agreements, in September 2011, Cinram engaged Moelis as investment banker to

assist it in a comprehensive and thorough review of Cinram's strategic alternatives with the goal of maximizing value for Cinram's stakeholders.

14. As described in greater detail in the Hootnick Affidavit, Moelis is a global investment bank with expertise in mergers and acquisitions, recapitalization and restructuring, capital market risk advisory and asset management and is recognized for its leading global media practice having completed over \$50 billion in transaction volume across over 60 transactions.
  
15. As part of Cinram's strategic review process, Moelis, among other things:
  - a) sought to identify a potential transaction, such as a sale of the company, strategic combination or new money investment from a strategic or financial investor, while concurrently evaluating a possible stand-alone transaction with Cinram's lenders;
  
  - b) commencing in the fall of 2011, conducted preliminary discussions with certain key parties-in-interest, including the Lenders' financial advisors, key customers and certain strategic parties.
  
  - c) prepared and disseminated a Confidential Information Memorandum (the "**CIM**") to prospective purchasers to review upon execution of a confidentiality agreement and contacted prospective investors,

communicating the Cinram investment opportunity and providing interested parties with a brief overview of the Cinram Business;

- d) undertook a comprehensive assessment of the market for the Cinram Business to identify potential parties that might be interested in considering an acquisition or investment transaction; and
  - e) contacted approximately 59 parties, including 54 financial investors and 5 strategic parties.
16. A number of parties executed confidentiality agreements and were provided with the CIM and access to Cinram's data room. Non-binding proposals were requested from interested parties by January 20, 2012.
17. A number of potential bidders submitted non-binding expressions of interest in January 2012.
18. Cinram, its advisors and Moelis worked diligently with all of the potential bidders that submitted non-binding expressions of interest and provided the prospective bidders with information necessary to formulate an offer for the Cinram Business.
19. Following a request for detailed proposals made on February 28, 2012, several second round bids were received on or about March 12, 2012, and were reviewed by Moelis, Cinram management and its advisors.



20. Following request for binding indications of interest from the second round bidders by April 6, 2012, indications of interest were received, none of which were binding or in a form acceptable to Cinram.
21. In early April 2012, Moelis received an inquiry from the Purchaser expressing interest in Cinram. The Purchaser executed a confidentiality agreement and was provided with access to the Cinram data room. Subsequently, in mid-April, 2012 the Purchaser submitted a formal indication of interest.
22. Moelis, Cinram and its advisors continued discussions and conducted meetings with the interested parties.
23. Cinram carefully reviewed and considered all of the proposals received in the strategic review process. After a detailed evaluation of the economic and other terms of the various proposals received, and after consultation with Moelis, Cinram's other advisors and the Lenders' advisors, Cinram determined that the offer submitted by the Purchaser was the best offer submitted in the circumstances taking into account such factors as: (a) purchase price; (b) conditions for closing; (c) required financing; (d) structuring of the transaction; (e) assets included in the transaction; (f) the timeframe within which the transaction could be closed; and (f) number of jobs that would be preserved.
24. Accordingly, Cinram, with the assistance of Moelis and Cinram's counsel, entered into negotiations with the Purchaser in respect of definitive agreements for the

- sale of the Purchased Assets and Purchased Shares which resulted in the execution on June 22, 2012 of the Asset Purchase Agreement by CII and the Purchaser and of the Share Purchase Offer by the Purchaser, CII and 1362806 Ontario Limited. The Lenders' counsel and advisors were kept fully apprised throughout the negotiations of the Asset Purchase Agreement and Share Purchase Offer and took part in a number of direct discussions with the Purchaser.
25. FTI has been retained by CII since February 2010 as Cinram's financial advisor, initially in North America and subsequently in Europe, to, among other things, assist with liquidity management and reporting (including assisting with the preparation of cash flow forecasts), the development and implementation of a multi-year financial plan and identification of cost reduction and other liquidity enhancement opportunities. Among other things, FTI participated in a number of calls and meetings with the Purchaser and other interested parties, was kept fully apprised of the steps taken by Cinram and Moelis in its strategic review process and assisted Cinram in reviewing and analyzing proposals received.
26. Throughout the strategic review process, Cinram also kept key stakeholders, including its major customers, apprised of its progress. Such parties have been supportive of Cinram's efforts in pursuing a successful restructuring of its business, including through the Sale Transaction.

## **PROPOSED SALE TRANSACTION**

27. The Sale Transaction involves the Asset Sale Transaction contemplated by the Asset Purchase Agreement and the Share Sale Transaction contemplated by the Share Purchase Offer and, upon exercise thereof, the Share Purchase Agreement.
28. Cinram's goal is to close the Asset Sale Transaction and the Share Sale Transaction simultaneously in August 2012; however, the closing of the Share Sale Transaction may be extended if necessary to complete certain regulatory consultation matters and subject to the Purchaser's right to extend the closing to not later than December 17, 2012 even if the conditions to closing have then been satisfied.

*Asset Purchase Agreement*

29. The key elements of the Asset Purchase Agreement are discussed in greater detail in the Hootnick Affidavit and include the following:
- a) an aggregate cash purchase price of \$82,500,000 (subject to certain adjustments as provided in the Asset Purchase Agreement) to be allocated as follows: \$50 million to the Purchased Assets ("**Asset Purchase Price**") and \$32.5 million to the Purchased Shares ("**Share Purchase Price**") pursuant to an agreement reached between the CCAA Entities and the Purchaser. \$40 million of the Asset Purchase Price will be payable on the closing of the Asset Sale Transaction and the remaining \$10 million of the Asset Purchase Price is payable upon the earlier of the Share Sale

Transaction closing and December 17, 2012. The Share Purchase Price is payable upon the Share Sale Transaction closing;

- b) the purchase from the Asset Sellers of substantially all of the property and assets used in connection with the business carried on by Cinram in North America (other than certain excluded assets described below) (the "**North America Purchased Business**"), including, without limitation, the assumption of the contracts, personal property leases, real property leases and third party licenses as set out in the Asset Purchase Agreement, pursuant to the terms and conditions of the Asset Purchase Agreement;
- c) the effective date of the Asset Sale Transaction is April 30, 2012 (the "**Asset Sale Effective Date**"), with the Purchaser assuming the liabilities of the North America Purchased Business as of that date (to the extent not paid by the Asset Sellers prior to Closing or not to be assumed by the Purchaser, in each case in accordance with the Asset Purchase Agreement) and with the Purchaser effectively entitled to the benefit of all revenues and profits and bearing the responsibility of all expenses and losses of the North America Purchased Business from and after the Asset Sale Effective Date;
- d) continued fulfillment by the Purchaser of obligations to customers and suppliers relating to the North America Purchased Business, as set out in the Asset Purchase Agreement; and

- e) the exclusion of certain assets (as more particularly described in Section 2.2 of the Asset Purchase Agreement) from the Asset Sale Transaction including, among other things, the following:
    - i. the assets and business of IHC Corporation and Cinram Wireless LLC;
    - ii. the shares of capital stock or other equity interest in Cinram (U.S.) Holding's Inc., Synbar Equities Inc., Cinram International (Hungary) PrLtd, Cooperatie Cinram Netherlands UA and 1362806 Ontario Limited, intercompany receivables or payables, and any intercompany investments;
    - iii. subject to Section 8.16 of the Asset Purchase Agreement, the cash collateral securing Letters of Credit;
    - iv. all real property interests of Cinram Manufacturing LLC in the Olyphant Facility; and
    - v. those assets of the Asset Sellers set forth on Schedule 2.2(p) of the Asset Purchase Agreement.
30. The completion of the Asset Sale Transaction is conditional on, among other things,

- a) the granting of the Approval and Vesting Order, together with the Sale Recognition Order, the form and substance of which have been agreed to by the Purchaser;
  - b) obtaining the regulatory approval under the *Investment Canada Act* (Canada);
  - c) assignment of the Material Contracts (as defined in the Asset Purchase Agreement) to the Purchaser or its nominees, or a replacement thereof with new contracts in a manner acceptable to the Purchaser;
  - d) obtaining the consents of the Material Customers and the European Material Customers (each as defined in the Asset Purchase Agreement);  
and
  - e) executing the Transition Services Agreement (as defined in the Asset Purchase Agreement).
31. The Company and its counsel, with the assistance of the Monitor where appropriate, are working with the Purchaser to satisfy these conditions.
32. The Purchaser has paid a deposit of \$5,000,000 to JPMorgan Chase Bank to be held in escrow in accordance with the Asset Purchase Agreement.

33. If Closing (under the Asset Purchase Agreement) does not occur on or before September 15, 2012, or such later date agreed to by both parties (the "**Sunset Date**"), the Asset Purchase Agreement may be terminated by the Purchaser or CII.
34. CII shall not, and shall cause its affiliates not, to pursue an Acquisition Proposal (as defined in the Asset Purchase Agreement). CII may consider an Acquisition Proposal that could reasonably be expected to lead to a Superior Proposal (as defined in the Asset Purchase Agreement) subject to the terms and conditions set forth in the Asset Purchase Agreement.
35. CII must pay to the Purchaser a break fee in the amount of \$2,250,000 if CII terminates the Asset Purchase Agreement for the purpose of entering into a binding written agreement with respect to a Superior Proposal, or the Purchaser terminates the Asset Purchase Agreement as a result of:
- a) CII withdrawing or seeking authority to withdraw the Approval and Vesting Order or the Sale Recognition Order;
  - b) CII selling, transferring or otherwise disposing of any material portion of the Purchased Assets, except in connection with the CCAA Proceedings and/or the Chapter 15 Proceedings, and except with the consent of the Purchaser; or

- c) a condition to closing not being satisfied by the Sunset Date due to a material breach by CII that cannot be timely cured.
36. The Monitor is advised that Moelis is of the view the proposed break fee is within the range for break fees in comparable circumstances.

***Share Purchase Offer and the Share Purchase Agreement***

37. The key elements of the Share Purchase Offer and the Share Purchase Agreement are discussed in greater detail in the Hootnick Affidavit and include the following:
- a) a cash purchase price of \$82,500,000, less the purchase price paid for the Purchased Assets pursuant to the Asset Purchase Agreement; and
  - b) the purchase from the Share Sellers of all of the issued and outstanding shares in Cooperatie Cinram Netherlands UA, and indirectly, each of its direct and indirect subsidiaries (with the exception of Cinram Iberia SL).
38. The Share Purchase Offer is conditional upon, among other things:
- a) completion of the consultation process with the French works councils;
  - b) closing of the Asset Sale Transaction in accordance with the Asset Purchase Agreement; and



- c) the cancellation or termination of all debt obligations and guarantees of Cinram's European entities to the first and second lien lenders and the release of all security related thereto.
39. The Purchaser has the right to extend the closing of the Share Sale Transaction up to December 17, 2012. The Share Purchase Offer may be rescinded by either party if the Asset Purchase Agreement is terminated.
40. Pursuant to the Share Purchase Offer, the Share Sellers and their affiliates shall not solicit or encourage any inquiries or proposals for, or enter into any discussions with respect to, the acquisition by any other person or any shares of Cinram's European entities.
41. Cinram, the Lenders and the Monitor are aware of the need to institute appropriate transition agreements in respect of the Excluded Assets under the Asset Purchase Agreement and the European assets in the event the Share Purchase Transaction and Asset Purchase Transaction are not closed simultaneously. Preliminary discussions on these matters have commenced and will be continued in the week commencing July 9, 2012.
42. As at the date of this report, no stakeholder has advised the Monitor that it opposes or intends to oppose the Sale Transaction.

#### **REQUEST FOR AN EXTENSION OF THE STAY OF PROCEEDINGS**

43. Pursuant to the Initial Order, the Stay Period was granted until, and including, July 25, 2012, or such later date as this Court may order.
44. Additional time is required for the CCAA Parties to pursue their restructuring efforts, including implementation of the Sale Transaction and the restructuring or sale of the assets and business not being sold pursuant to the Sale Transaction. The continuation of the stay of proceedings to September 14, 2012 is necessary to provide the stability needed during that time.
45. It is the Monitor's view based on the CCAA Parties' cashflow forecast submitted with its application for Initial Order materials that the CCAA Parties have sufficient available cash resources during the requested Stay Period.
46. Based on the information presently available, the Monitor believes that creditors will not be materially prejudiced by an extension of the Stay Period to September 14, 2012.
47. The Monitor is not aware of any non-compliance by the CCAA Parties with requirements under the CCAA or pursuant to any Order issued by this Court in the CCAA Proceedings. The Monitor also believes that the CCAA Parties have acted, and are continuing to act, in good faith and with due diligence and that circumstances exist that make an extension of the Stay Period appropriate.

48. The Monitor is advised by the CCAA Parties that the Lenders support the requested extension of the Stay Period.

### **CONFIDENTIAL SUPPLEMENT**

49. The Monitor is advised that a confidential supplement will be provided by the Applicants to the Court in connection with the sale approval motion, which contains confidential information relating to the Sale Transaction, including the letter setting out the allocation of the Asset Purchase Price (as described above) and Schedules 2.1(i), 4.3, and 4.6 to the Asset Purchase Agreement and Schedule I.3 to Exhibit I to the Asset Purchase Agreement containing sensitive, competitive information of the CCAA Parties (the “**Confidential Supplement**”). The Applicants are requesting a sealing order in respect of the Confidential Supplement.

### **RECOMMENDATION AND CONCLUSIONS**

50. The Sale Transaction, if completed, will enable the Cinram Business to continue as a going concern.
51. According to the Hootnick Affidavit, Moelis undertook a comprehensive assessment of the market to identify parties potentially interested in purchasing the Cinram Business. The CCAA Parties believe that the Sale Transaction represents the best available alternative in the circumstances taking into account

such factors as (a) aggregate value to stakeholders, (b) the timeframe within which the transaction could be completed, and (c) the probability of closing.

52. The Monitor considered the process leading to the proposed sale of, and the consideration to be received for, the Purchased Assets and the Purchased Shares (collectively, the “**Purchased Business**”) in light of the requirements of, *inter alia*, s. 36 of the CCAA. The Monitor is satisfied that the process was fair and reasonable in the circumstances and the consideration to be received for the Purchased Business represents the results of a thorough canvassing of the market.
53. The Monitor is of the view that the CCAA Parties have acted in good faith to maximize value for their stakeholders, made satisfactory efforts to obtain the best price for the Purchased Business and have not acted improvidently.
54. Prior to the commencement of these proceedings FTI provided an estimate of the realization value of the Company’s assets to the Lenders’ advisors and counsel. The purchase price to be paid under the Sale Transaction is insufficient to repay Cinram’s debt under the First Lien Credit Agreement and the Steering Committee representing approximately 40% of loans under the First Lien Credit Agreement (the “**First Lien Lenders**”) entered into support agreements supporting Cinram’s entering into the Asset Purchase Agreement and the Share Purchase Agreement.

55. The Monitor does not believe that realization on the assets of the Purchased Business under a bankruptcy would be more beneficial to the creditors of the CCAA Entities.
56. As at July 6, 2012 and since the signing of the Asset Purchase Agreement, First Lien Lenders representing an additional approximately 24% of the indebtedness under the First Lien Credit Agreement have agreed to support the Sale Transaction.
57. The Monitor's counsel has undertaken and will complete a review of the First Lien Lenders' security prior to any motion to distribute the proceeds of the Sale Transaction.
58. The Monitor is advised that all creditors with registered personal property security interests against the CCAA Parties have been served with notice of this motion.
59. The Monitor is advised that the CCAA Parties and the Purchaser are not related persons within the meaning of the CCAA.
60. The Monitor is also advised by the CCAA Parties that they can and will make the payments that would have been required under sections 6(5)(a) or 6(6)(a) of the

CCAA<sup>1</sup>. Therefore, the proposed sale is in compliance with section 36(7) of the CCAA.

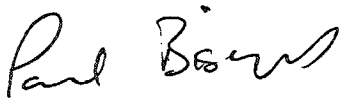
61. Accordingly, the Monitor recommends approval of the Asset Sale Transaction and the Share Sale Transaction by this Honourable Court. For the reasons set out herein and described in paragraph 42 of the Hootnick Affidavit, the Monitor also recommends that the Confidential Supplement be sealed by this Honourable Court pending further Order of this Court.

62. For the reasons outlined above, the Monitor also respectfully recommends that the Stay of Proceedings be extended until September 14, 2012.

All of which is respectfully submitted this 9<sup>th</sup> day of July, 2012.

FTI Consulting Canada Inc.,  
in its capacity as the Monitor of Cinram International Inc., Cinram International Income Fund and the other Applicants listed in Schedule "A"

Per



Paul Bishop  
Senior Managing Director

---

<sup>1</sup> Section 36(7) of the CCAA states that, "The court may grant the authorization only if the court is satisfied that the company can and will make the payments that would have been required under paragraphs 6(4)(a) and (5)(a) if the court had sanctioned the compromise or arrangement." As there is no section 6(4)(a) in the CCAA, it is the respectful submission of the Monitor that the current s. 36(7) of the CCAA contains a typographical error and the intended reference is to sections 6(5)(a) and 6(6)(a) of the CCAA.

**Schedule "A"**

**Additional Applicants**

Cinram International ULC

1362806 Ontario Limited

Cinram (U.S.) Holdings' Inc.

Cinram, Inc.

IHC Corporation

Cinram Manufacturing LLC

Cinram Distribution LLC

Cinram Wireless LLC

Cinram Retail Services, LLC

One K Studios, LLC

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 CINRAM  
INTERNATIONAL INC., CINRAM INTERNATIONAL INCOME FUND AND THE COMPANIES  
LISTED ON SCHEDULE "A"

Court File No. CV12-9767-00CL

**ONTARIO  
SUPERIOR COURT OF JUSTICE  
(COMMERCIAL LIST)**

**Proceeding commenced at Toronto**

**FIRST REPORT OF FTI CONSULTING CANADA  
INC., IN ITS CAPACITY AS MONITOR**

**STIKEMAN ELLIOTT LLP**  
Barristers & Solicitors  
5300 Commerce Court West  
199 Bay Street  
Toronto, Canada M5L 1B9

**David Byers LSUC#: 22992W**  
Tel: (416) 869-5697

**Maria Konyukhova LSUC#: 52880V**

Tel: (416) 869-5230

Fax: (416) 861-0445

Lawyers for the Monitor