

**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
NFC ACQUISITION GP INC., NFC ACQUISITION CORP. AND
NFC LAND HOLDINGS CORP.**

**THIRD REPORT TO THE COURT
SUBMITTED BY FTI CONSULTING CANADA INC.,
IN ITS CAPACITY AS MONITOR**

February 21, 2012

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1. On January 17, 2012, pursuant to an application brought before the Ontario Superior Court of Justice (Commercial List) (the “**Court**”) by NFC Acquisition GP Inc., NFC Acquisition Corp. and NFC Land Holdings Corp. (collectively, the “**Applicants**” and together with NFC Acquisition L.P., and New Food Classics, “**NFC**”) under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended (the “**CCAA**”), the Honourable Mr. Justice Morawetz made an initial order (the “**Initial Order**”) in respect of NFC, which, *inter alia*, appointed FTI Consulting Canada Inc. as monitor (the “**Monitor**”), with the powers and obligations set out in the Initial Order and as set forth in the CCAA. A copy of the Initial Order is contained in Tab 1 of the NFC Compendium of Orders filed with the Court.

2. On February 16, 2012, upon motion made by the Applicants, the Court, *inter alia*, extended the stay of proceedings contained in the Initial Order to March 30, 2012, and granted a

charge in favour of Westco Multi Temp Distribution Centres Inc. (“**Westco**”), NFC’s Saskatoon cold storage provider, as security for pre-filing statutory lien amounts relating to NFC products released by Westco after the making of the Initial Order. A copy of the February 16, 2012, Order is contained at Tab 4 of the NFC Compendium of Orders. In connection with the February 16, 2012 motion, the Monitor filed its Second Report dated February 13, 2012 (the “**Second Report**”) describing the Monitor’s and the Applicants’ actions with respect to the Transaction Process leading up to February 13, 2012, the date by which final binding proposals for the purchase of NFC’s assets were to be received by the Monitor under the Transaction Process described in paragraphs 36 to 37 of the proposed Monitor’s Pre-Filing Report dated January 16, 2012, (the “**Pre-Filing Report**”) a copy of which can be found at Tab 1 of the NFC Compendium of Monitor’s Reports, and approved in the Initial Order.

PURPOSE OF THIS REPORT

3. The purpose of this Third Report is to inform and update the Court on the following matters:

- (a) Summarizing the Expressions of Interest received by the Monitor as of the January 30, 2012, Transaction Process deadline, as well as the parties (the “**Selected Parties**”) that were invited to participate in Phase 2 of the Transaction Process;
- (b) The course of dealings of the Monitor and NFC with respect to the Selected Parties (as defined herein) during Phase 2 of the Transaction Process; and
- (c) Summarizing the final proposals submitted as of the close of business on February 13, 2012, the final proposal deadline;

- (d) Summarizing certain material events relating to NFC's products and dealings with certain major NFC customers since February 13, 2012;
- (e) Describing the terms of the DIP Facility approved in the Initial Order, the communications sent by Bank of Montreal ("BMO"), as DIP Lender, to the Applicants on February 20, 2012, and the effect upon the Applicants' ability to carry on business after that date;
- (f) The Monitor's recommendations regarding a realization strategy for the NFC assets.

TERMS OF REFERENCE

4. In preparing this report, the Monitor has relied upon unaudited financial information of NFC, NFC's books and records, certain financial information prepared by NFC and discussions with NFC's management. The Monitor has not audited, reviewed or otherwise attempted to verify the accuracy or completeness of the information. Accordingly, the Monitor expresses no opinion or other form of assurance on the information contained in this report or relied on in its preparation. Future oriented financial information reported or relied on in preparing this report is based on management's assumptions regarding future events; actual results may vary from forecast and such variations may be material.

5. Capitalized terms not otherwise defined herein have the meanings set out in the Pre-Filing Report, the first report of the Monitor dated January 20, 2012 (the "**First Report**") a copy of which is at Tab 2 of the NFC Compendium of Monitor's Reports and the Second Report.

EXPRESSIONS OF INTEREST RECEIVED BY THE MONITOR

6. On January 30, 2012, the Transaction Process deadline, eleven parties submitted Expressions of Interest (“EOIs”) to the Monitor. Of the eleven EOIs, four were proposals from liquidators, five were from strategic industry parties, and two were submitted by financial buyers. A list of the parties that submitted EOIs, the Selected Bidders, and the parties that submitted Final Offers is filed, but not attached hereto, as Confidential **Appendix “A”**.

7. On January 31, 2012, the Monitor, NFC and BMO met to evaluate and determine which parties that submitted EOIs would be invited to continue to Phase 2 of the Transaction Process. All submitted EOIs were evaluated and compared on the basis of factors including *inter alia* whether the offer would maximize value for NFC assets, the treatment of NFC’s employees and the closing conditions and other risks associated with a closing of the acquisition. Based on the foregoing evaluation criteria, of the eleven parties who submitted Expressions of Interest, seven Selected Parties were invited to proceed to Phase 2 of the Transaction Process.

DEALINGS AMONG THE MONITOR, NFC AND THE SELECTED PARTIES

8. During Phase 2 of the Transaction Process, the Selected Parties were given additional access to confidential information relating to NFC in the Data Room and were invited to schedule site visits and attend management presentations. During Phase 2 of the Transaction Process, the Monitor responded to over fifty phone calls a day from Selected Parties and their Advisors and followed up with various Selected Parties to offer additional management presentations and opportunities for site tours. In response to the Monitor’s offer, three of the seven Selected Parties attended presentations and conducted site visits of the Applicants’ facilities.

9. Because NFC's major customers were not committed to NFC pursuant to binding sales contracts, as part of their due diligence process, Selected Parties sought any and all information and comfort that they could obtain with respect to the intention of NFC's major customers to pursue a business relationship with a purchaser of NFC, and the details thereof including future pricing and sales volumes. Significant amounts of customer information were included in the Data Room on a real time basis and the Monitor held ongoing discussions with NFC's major customers to keep them updated on the Transaction Process. This enabled Selected Customers to seek all necessary information with respect to the level of commitment was available regarding future pricing and sales volumes.

10. In addition to the foregoing, the Monitor, with the assistance of senior management of NFC, responded to various requests for additional information by uploading requested supplementary information about the NFC's operations to the Data Room. Upon receipt of a request for additional information, the Monitor undertook to reorganize and catalogue the Data Room to correspond with the format and itemization of each Selected Parties' request to ensure ease and efficiency in the due diligence process. The reorganization and inclusion of any additional information was made available to all the Selected Parties to ensure fairness of the process.

11. On February 8, 2012, the Monitor received a letter from counsel to Selected Party #6 requesting that the Monitor provide additional information pursuant to an itemized list set forth therein, and demanded that the Phase 2 Due Diligence Review period be extended beyond the February 13, 2012, deadline on the basis that new information was progressively being made available in the Data Room since February 1, 2012.

12. Fasken Martineau, counsel to the Monitor, responded with a letter dated February 9, 2012, explaining that the majority of additional information requested is already contained in the Data Room, to which Selected Party #6 was given access to since February 1, 2012. Fasken Martineau also confirmed that the Monitor has no authority to alter the timelines of the Phase 2 of the Transaction Process.

13. On February 9, 2012, the Monitor received an email from Selected Party #1, stating that they no longer had an interest in proceeding with the bid process and as such would not be submitting a Final Offer.

RECEIPT OF FINAL OFFERS

14. As at 8pm on February 13, 2012, the deadline for submission of final binding offers (“**Final Offers**”) in the Transaction Process, the Monitor received three Final Offers from the Selected Parties indicated in Confidential Appendix “A”.

15. Following a comparative review of the three Final Offers with the Applicants’ Board of Directors, TD Capital Mezzanine Partners Management Ltd. and BMO, the Monitor worked with NFC management and two of the bidders (one industry party and one financial party) (the “**Final Two Bidders**”) to refine the terms of their bids in order that they be in a format that is capable of acceptance by NFC and presentation to BMO.

CUSTOMER COMMUNICATIONS

16. As set out in the Applicants’ materials filed in support of the application for the Initial Order, NFC’s financial condition was *inter alia* attributable to its losses from the refusal of certain of NFC’s major customers to authorize price increases for finished product after the

market prices of inputs such as beef and energy rose in 2010 and 2011. Following the making of the Initial Order, and after discussions and negotiations with NFC and the Monitor, one of NFCs major customers (the “**Major Customer**”) agreed to implement a price increase for products commencing February 1, 2012. This revised pricing information was included in the Data Room and available to Selected Parties.

17. In the early evening of February 13, 2012, NFC was contacted by the Major Customer advising that it had received a competitive bid for the manufacture of certain products currently made by NFC and that NFC had one business day to determine if it would agree to match the competitive bid price (or implicitly lose the customer’s business). The competitive bid was alleged by the Major Customer to represent a \$1.7 million annual saving to it, as compared to the current NFC pricing.

18. The Monitor advised the Final Two Bidders of the information given the materiality thereof. In the days between February 13 and February 20, 2012, numerous discussions took place among the Major Customer, NFC, the Monitor and each of the Final Two Bidders in the hope that a transaction could be structured that would result in a going concern sale of the NFC Saskatoon production facility, or possibly both NFC production facilities.

NFC PRODUCT RECALLS

19. On the afternoon of February 15, 2012, the Monitor learned that a consumer was alleged to have consumed and made ill by E. coli bacteria contained in a frozen hamburger manufactured by NFC’s Saskatoon Facility in October of 2011. NFC immediately worked with the Federal health authorities and its insurers to implement a product recall and consumer advisory programme (the “**Recall**”). NFC was able to determine that the batch of raw material

used to produce the allegedly contaminated brand of frozen hamburgers only made up a relatively small (3,800 out of approximately two million cases of frozen hamburger products manufactured by NFC annually) quantity of product, which is readily identifiable by NFC and consumers alike. Though the quantum of possibly contaminated finished goods remaining on hand with NFC was negligible, the Monitor immediately communicated the facts relating to the Recall to the Final Two Buyers forthwith.

20. On February 20, 2012, after further testing, NFC expanded the Recall to include the frozen hamburger products which were manufactured by NFC after the Recalled Products on the same NFC line of equipment (the “**Additional Recalled Products**”) until that equipment was cleaned and sterilized by NFC’s contractors at the end of the manufacturing shift. The Additional Recalled Products total approximately 767 cases.

TRANSACTION PROCESS

21. Under the Transaction Process, NFC had until the close of business on February 17, 2012, to put forward a form of agreement of purchase and sale to BMO in its capacity as DIP Lender in order for BMO to determine, in its sole discretion, whether it will agree to advance an additional DIP amount of up to \$7 million to fund the working capital requirements of NFC leading up to a going concern sale closing in mid to late March, 2012.

22. The Monitor and NFC management continued to work diligently with the Final Two Buyers and other NFC stakeholders, including the landlord of the Saskatchewan Facility and major customers, in order to conclude a form of Asset Purchase Agreement that would result in a going concern sale transaction. Specifically, a going concern sale transaction that would produce a higher level of recovery to NFC’s creditors, including in particular BMO, relative to a

non-going concern sale scenario recognizing that a going-concern sale would require BMO to advance up to \$7million in additional working capital (the “**Additional DIP Advance**”) into the NFC business pending the closing of a transaction.

23. On Friday, February 17, 2012, after a further conference call with NFC, the Monitor and the Major Customer, one of the Final Two Bidders formally withdrew from the Transaction Process. A subsequent call was held with the one remaining bidder (the “**Final Bidder**”) and the Major Customer. Following that discussion the Bidder confirmed that it was willing to proceed with an amended form of going concern asset purchase agreement (the “**Amended Offer**”), that would require BMO to fund the full Additional DIP Advance.

24. The Monitor has conducted an analysis of the economic terms of the Amended Offer as compared to a liquidation scenario. Based upon the Monitor’s analysis, the Amended Offer would result in recoveries to BMO which are not materially different than the low end of the Monitors projected recoveries in a Liquidation scenario. However, the Amended Offer requires BMO to make the full Additional DIP Advance and thereby risk incurring material additional losses on the Additional DIP Advance if the Amended Offer fails to close. (In fact even if the proposed transaction closed, BMO would suffer losses on the Additional DIP Advance, given the discount being offered by the Final Bidder for NFC inventory and accounts receivable in the Amended Offer).

25. The Monitor reviewed the Amended Offer with the Board of Directors of the Applicants and presented the results of the Monitor’s comparison of the Amended Offer and the liquidation analysis. The NFC Board asked that the Monitor go back to the Final Bidder to ask for a further revision to the Amended Offer, and asked the Monitor to request BMO to allow for

certain limited additional funding of NFC's operations for one to two weeks, while a viable going concern transaction could be negotiated with the Final Bidder. The Monitor communicated both requests, and was rejected in both cases.

26. On the afternoon of Monday January 20, 2012, BMO delivered a notice that a "Sales Process Default" under the DIP Credit Agreement had occurred (the "**Default Notice**"), thereby terminating the Applicants' availability under the DIP Credit Facility.

27. At Meeting of the Board of Directors of NFC held on the evening of February 20, 2012, the Board of Directors of the Applicants resigned *en masse*, and accepted the resignations of the President and Chief Executive Officer of NFC.

MONITOR'S RECOMMENDATION

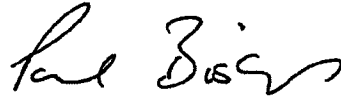
28. In light of the delivery of the Default Notice by BMO, the resignation of the NFC Board of Directors and management, the lack of funding for NFC's business and the perishable nature of NFC's inventory, the Monitor is of the view that it is vital to have an immediate and orderly shut-down of the NFC manufacturing operations and a swift transition to a court-appointed receivership of the assets of NFC. The Monitor is hopeful that a buyer for the closed NFC manufacturing facilities can be quickly identified among the parties that participated in the Transaction Process, and that the manufacturing facilities can be sold on a turn-key basis in a short period of time, rather than liquidated.

29. The Monitor has prepared a cash flow projection for the conduct of a shut-down receivership of the assets of NFC, which would be funded pursuant to Receiver's Certificates.

BMO has agreed to fund such Receiver Certificate amounts on a basis and priority consistent with the existing DIP Facility and DIP Charge.

30. FTI Consulting Canada Inc. consents to act as receiver of the assets of NFC.

FTI Consulting Canada Inc.
Monitor of the Applicants

A handwritten signature in cursive script, appearing to read "Paul Bishop", is written above a horizontal line.

Name: Paul Bishop
Title: Senior Managing Director,
FTI Consulting Canada Inc.

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