

Court File No. _____

**PAYLESS SHOESOURCE CANADA INC. and PAYLESS SHOESOURCE CANADA GP
INC.**

**PRE-FILING REPORT OF FTI CONSULTING CANADA INC., AS PROPOSED
MONITOR**

February 19, 2019

**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
PAYLESS SHOESOURCE CANADA INC. AND PAYLESS SHOESOURCE CANADA
GP INC.**

(the "**Applicants**")

**PRE-FILING REPORT TO THE COURT SUBMITTED BY
FTI CONSULTING CANADA INC.,
IN ITS CAPACITY AS PROPOSED MONITOR**

A. INTRODUCTION

1. On February 18, 2019, Payless Holdings LLC and certain of its subsidiaries and affiliates (collectively, the "**U.S. Debtors**") commenced cases (collectively, the "**U.S. Proceedings**") under Chapter 11 of Title 11 of the United States Code (the "**Bankruptcy Code**") in the United States Bankruptcy Court for the Eastern District of Missouri (the "**U.S. Bankruptcy Court**").
2. FTI Consulting Canada Inc. ("**FTI**" or the "**Proposed Monitor**") understands that Payless ShoeSource Canada Inc. and Payless ShoeSource Canada GP Inc. (the "**Applicants**"), which are debtors in the U.S. Proceedings, also intend to make an application (the "**Initial Application**") under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended (the "**CCAA**") for an initial order (the "**Proposed Initial Order**") granting certain relief, including, *inter alia*, a stay of proceedings against the Applicants and Payless ShoeSource Canada LP ("**Payless Canada LP**"), and together with the Applicants, the "**Payless Canada Entities**") and their officers and directors until March 21, 2019, and appointing FTI as the monitor (the "**Monitor**"). The proceedings to be commenced by the Applicants in respect of the Payless Canada Entities are referred to herein as the "**CCAA Proceedings**".

3. While each of the Payless Canada Entities is also a U.S. Debtor, the Proposed Monitor understands that the U.S. Debtors intend to seek Orders in the U.S. Bankruptcy Court providing that the CCAA Court Orders will take precedence to the extent of any inconsistency with respect to the Payless Canada Entities. First day hearings in respect of the Orders in the U.S. Proceedings are scheduled for the afternoon of February 19, 2019. The Proposed Monitor understands that similar provisions were incorporated in Orders in the Toys "R" Us restructuring proceedings in respect of the Toys "R" Us Canadian entity. The proposed CCAA proceedings deal only with the Payless Canada Entities.
4. The purpose of this pre-filing report (the "**Pre-Filing Report**") is to provide the Court with the following:
 - (a) FTI's qualifications to act as Monitor, if appointed;
 - (b) a description of the activities of FTI and its independent counsel, Bennett Jones LLP ("**Bennett Jones**"), to date;
 - (c) an overview of the Payless Canada Entities, including their business and affairs, the events leading up to the CCAA Proceedings and their restructuring efforts to date;
 - (d) FTI's comments regarding the proposed extension of the CCAA benefits, protections, authorizations and restrictions to Payless Canada LP;
 - (e) FTI's comments regarding the Payless Canada Entities' consolidated cash flow projections of its receipts and disbursements for the 13-week period ending May 17, 2019 (the "**Cash Flow Forecast**") and the reasonableness thereof, in accordance with section 23(1)(b) of the CCAA;
 - (f) FTI's comments regarding the customary protocol to ensure effective and efficient coordination and administration of the CCAA Proceedings and the U.S. Proceedings (the "**Cross Border Protocol**");
 - (g) FTI's comments regarding the Payless Canada Entities' request for the approval of the engagement letter of Ankura Consulting Group, LLC ("**Ankura**") as

Chief Restructuring Organization to the Payless Canada Entities;

- (h) FTT's comments regarding the Payless Canada Entities' proposed administration charge (the "**Administration Charge**") and proposed directors' and officers' charge (the "**Directors' Charge**");
- (i) a discussion of the Payless Canada Entities' intended next steps in the CCAA Proceedings and FTT's comments regarding:
 - (i) the Liquidation Approval Order (which includes the Sale Guidelines) and the Liquidation Consulting Agreement (each as defined below); and
 - (ii) the Payless Canada Entities' proposed extension of the stay of proceedings until May 10, 2019 at the Comeback Hearing (as defined below).
- (j) FTT's conclusions and recommendation with respect to the proposed CCAA Proceedings and certain of the relief sought in the Proposed Initial Order and at the Comeback Hearing.

B. TERMS OF REFERENCE

- 5. In preparing the Pre-Filing Report, the Proposed Monitor has relied upon audited and unaudited financial information provided by the Payless Canada Entities and the other U.S. Debtors, including their books and records, financial information, forecasts and analysis, in addition to discussions with various parties, including senior management ("**Management**") of, and advisors to, the Payless Canada Entities, the other U.S. Debtors, and Ankura (collectively, the "**Information**").
- 6. Except as otherwise described in the Pre-Filing Report:
 - a. the Proposed Monitor has not audited, reviewed or otherwise attempted to verify the accuracy or completeness of the Information in a manner that would comply with Generally Accepted Assurance Standards pursuant to the Chartered Professional Accountants of Canada Handbook; and
 - b. the Proposed Monitor has not examined or reviewed the financial forecasts or

projections referred to in the Pre-Filing Report in a manner that would comply with the procedures described in the Chartered Professional Accountants of Canada Handbook.

7. Future-oriented financial information reported in or relied on in preparing the Pre-Filing Report is based on Management's and Ankura's assumptions regarding future events. Actual results will vary from these forecasts and such variations may be material.
8. The Proposed Monitor has prepared the Pre-Filing Report in connection with the Initial Application and the Comeback Hearing. The Pre-Filing Report should not be relied on for any other purpose.
9. Unless otherwise stated, all monetary amounts contained herein are expressed in Canadian Dollars.
10. Capitalized terms not otherwise defined herein have the meanings ascribed to them in the affidavit of Stephen Marotta, Senior Managing Director at Ankura, the Chief Restructuring Organization of the Payless Canada Entities filed in support of the Initial Application (the "**Marotta Affidavit**").

C. FTI'S QUALIFICATIONS TO ACT AS MONITOR

11. Pursuant to an engagement letter dated January 10, 2019, the Payless Canada Entities engaged FTI to prepare, on a contingency basis, for the possibility of insolvency proceedings in which FTI would act as Monitor (subject to Court approval). Greg Watson and Paul Bishop, each a trustee within the meaning of subsection 2(1) of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, as amended, lead the FTI team with carriage of this matter.
12. Since becoming engaged by the Payless Canada Entities, FTI has acquired knowledge of the business and operations of the Payless Canada Entities, including its personnel, stakeholders, integration with and reliance on the U.S. Debtors in order to operate and the key issues in the proposed CCAA Proceedings. As a result, FTI is in a position to

immediately act as Monitor in the CCAA Proceedings if appointed by this Court.

13. Neither FTI nor any of its representatives or affiliates has been, at any time in the past two years:
 - a. a director, officer or employee of any member of the Payless Canada Entities;
 - b. related to any member of the Payless Canada Entities, or to any director or officer of any member of the Payless Canada Entities; or
 - c. the auditor, accountant or legal counsel, or a partner or an employee of the auditor, accountant or legal counsel, of any member of the Payless Canada Entities.
14. At no time has FTI had any involvement with any member of the Payless Canada Entities other than in its current role as Proposed Monitor.
15. FTI has consented to act as Monitor should this Court grant the Payless Canada Entities' request for the Proposed Initial Order. A copy of FTI's consent to act as Monitor is attached as Exhibit "J" to the Marotta Affidavit.

D. FTI'S INVOLVEMENT TO DATE

Proposed Monitor's Activities

16. The Proposed Monitor has been extensively involved in a number of activities leading up to the filing date, including:
 - a. participating in discussions with Management, counsel to the Payless Canada Entities, and Ankura. These discussions have related to the business and affairs of the Payless Canada Entities generally, as well as the Initial Application and the Comeback Hearing;
 - b. generating, reviewing and commenting on the Payless Canada Entities' Cash Flow Forecast;
 - c. revising and considering various documentation and information in connection with the Payless Canada Entities' business, operations, the CCAA Proceeding and

the U.S. Proceedings;

- d. engaging with Bennett Jones as its legal counsel to consider issues with respect to the foregoing, and instructing Bennett Jones to perform or cause to be performed security reviews in order to deliver one or more opinions (the "**Security Opinions**") in respect of the validity and enforceability of security held by Wells Fargo Bank, National Association ("**Wells Fargo**") and Cortland Products Corp. ("**Cortland**") pursuant to their respective facilities (respectively, the "**ABL Credit Facility**" and the "**Term Loan Credit Facility**"); and
- e. preparing the Pre-Filing Report.

Security Opinions

- 17. As counsel to the Proposed Monitor, Bennett Jones and local counsel in the Provinces where Bennett Jones does not practice reviewed the security granted by the Payless Canada Entities to Wells Fargo and Cortland.¹ Bennett Jones and such local counsel have delivered the security opinions to the Proposed Monitor which provide that, subject to the assumptions and qualifications typically contained in security opinions of this nature, the security granted by the Payless Canada Entities in respect of the ABL Credit Facility and the Term Loan Credit Facility (the "**Pre-Filing Security**") constitute good and valid security enforceable in accordance with their respective terms, and perfected by registration, in all jurisdictions where the Payless Canada Entities operate.

E. BACKGROUND INFORMATION WITH RESPECT TO THE PAYLESS CANADA ENTITIES

- 18. The Marotta Affidavit sets out detailed information with respect to the Payless Canada Entities' business and operations, as well as the causes of its ongoing financial distress. The information contained in the Pre-Filing Report is intended to provide context for, and to facilitate an understanding of, the issues addressed in the Pre-Filing Report and

¹ The Proposed Monitor will make the Security Opinions available to the Court upon request.

is not intended to be an exhaustive summary of all matters relating to the business or financial difficulties of the Payless Canada Entities.

19. A copy of the first day declaration (the "**U.S. Declaration**") filed in the U.S. Proceedings is attached hereto without exhibits as Appendix "A" for additional context.
20. The Proposed Monitor recommends that stakeholders carefully review all of the materials filed by the Payless Canada Entities in connection with the Initial Application, including the Marotta Affidavit, as well as the U.S. Declaration.

Background

21. As described above, on February 18, 2019, the U.S. Debtors commenced the U.S. Proceedings under the Bankruptcy Code in the U.S. Bankruptcy Court. The proposed CCAA proceedings deal only with the Payless Canada Entities, and the Monitor understands that the U.S. Debtors intend to seek Orders in the U.S. Bankruptcy Court providing that the CCAA Court Orders will take precedence to the extent of any inconsistency with respect to the Payless Canada Entities.
22. Payless Holdings LLC and certain of its other subsidiaries and affiliates (the "**Payless Group**"). are the largest specialty family footwear retailer in the Western Hemisphere and offers a wide range of products and accessory items at affordable prices. The Payless Group is headquartered in Topeka, Kansas, and has stores in more than 40 countries around the globe including, the United States, Canada, Latin America, Asia, the Middle East, and Europe. The Payless Group also operates a number of stores through a franchise model.
23. Both a simplified and a complete corporate organization chart for the Payless Group are included at Appendix "B" of this Report.
24. In April 2017, the Payless Group commenced cases under Chapter 11 of Title 11 of the Bankruptcy Code (the "**Prior U.S. Proceedings**"). Payless Holdings LLC then applied to the Ontario Superior Court of Justice (Commercial List) (the "**Canadian Court**") as

the foreign representative and the Prior U.S. Proceedings were recognized as a "foreign main proceeding" under section 46 of the CCAA. The Canadian Court and the U.S. Bankruptcy Court approved a plan of reorganization, which was effective as of August 10, 2017. Despite the Prior U.S. Proceedings, the Payless Group has been unable to sustain profitable operations in the current retail environment.

Payless Canada Entities

25. The Payless Canada Entities sell footwear and merchandise and operate 248 stores, as detailed in the chart below, across Canada:

Province	Number of Stores
Alberta	38
British Columbia	31
Manitoba	4
New Brunswick	4
Newfoundland	3
Nova Scotia	10
Ontario	119
Prince Edward Island	2
Quebec	24
Saskatchewan	8
TOTAL	248

As of January 10, 2019, the Payless Canada Entities employed approximately 2,400 employees, of which approximately 560 were full-time and approximately 1,840 were part-time. 12 of the total employees were employed at the Corporate Office while the remaining were employed at the various stores.

26. The Payless Canada Entities' employees are not unionized and are not the beneficiaries of any registered pensions plans. The Payless Canada Entities do offer a group registered retirement savings plan (the "**Group RRSP**") and a Deferred Profit Sharing Plan (the "**DPSP**") for their full-time and part-time employees who have completed one year of continuous employment with the Payless Canada Entities.
27. All of the Payless Canada Entities' 248 stores are leased. Under approximately 57 of the leases, Payless ShoeSource Inc., a non-Canadian U.S. Debtor, has guaranteed the obligations of the applicable Payless Canada Entity.
28. The Applicants are both indirect wholly owned subsidiaries of Payless Holdings LLC. Their directors are (i) Carol Perdic, (ii), Mario Zarazua, and (iii) Neil Hansen (the "**Directors**"). Payless Canada LP is a limited partnership organized under the laws of Ontario.
29. As outlined in the Marotta Affidavit, as of January 4, 2019, the Payless Canada Entities' primary asset is approximately USD\$21 million of inventory.

F. OVERVIEW OF CORPORATE ORGANIZATION AND INTERCOMPANY AGREEMENTS

30. The Payless Canada Entities and their operations are entirely reliant on the infrastructure and support of the Payless Group. There are a number of intercompany agreements (the "**Intercompany Agreements**") between the Payless Group and the Payless Canada Entities whereby certain essential services are provided to the Payless Canada Entities.
31. The services that the Payless Group provides to the Payless Canada Entities pursuant to the Intercompany Agreements include, *inter alia*, the following:

- i. Inventory procurement and management services (i.e.; the Payless Canada Entities do not have their own supply chain independent of the Payless Group, and in fact do not even have a warehouse in Canada)
- ii. Corporate services;
- iii. Licensing; and
- iv. Treasury Services.

32. In light of the significant operational and administrative services provided for by the Intercompany Agreements, the Proposed Monitor has reviewed the various Intercompany Agreements, as well as the processes, in order to assess what monitoring procedures would be necessary or desirable in the event that the Payless Canada Entities are granted the Proposed Initial Order to enable the Proposed Monitor to report to the Court on the continuation of such services.

G. CERTAIN INTERCOMPANY FUNDING TRANSACTIONS

33. The Proposed Monitor has been made aware that, from time to time and in the ordinary course, funds are transferred either upstream or downstream amongst the various related entities.

34. The Payless Group entities, including the Payless Canada Entities, have certain Intercompany Agreements for services such as vendor sourcing, sampling and quality standards review, review of inventory status, the creation of purchase orders, coordinating new store startup, purchasing of merchandise, telecommunications, corporate management, and internal audit. These Intercompany Agreements result in certain monies being owed as between the Payless Group entities from time to time.

35. In addition to ordinary course arrangements, the Proposed Monitor understands that certain non-ordinary course transactions have also resulted in amounts being owing between certain Payless Group entities, including the Payless Canada Entities.

36. The following chart details, in U.S. dollars, the intercompany balances involving the Payless Canada Entities as of December 31, 2018:

Intercompany amounts presented as at December 31, 2018					Unaudited
(all amounts stated in U.S. dollars)					
	Payless ShoeSource Canada GP, Inc	Payless ShoeSource Canada Inc	Payless ShoeSource Canada LP	Total	
Receivable from / (Payable to)					
US	Payless Finance, Inc	-	110,690,620	(53,859)	110,636,761
	Payless Purchasing Services, Inc	-	-	(93,536)	(93,536)
	Payless ShoeSource Distribution, Inc	-	-	(26,417,862)	(26,417,862)
	Payless ShoeSource Merchandising, Inc	-	-	(807,657)	(807,657)
	Payless ShoeSource Worldwide, Inc	-	-	(2,894,263)	(2,894,263)
	Intercompany - Canada and US	-	110,690,620	(30,267,178)	80,423,442
Netherlands	Collective Brands II Cooperatief UA	-	(61,681,508)	-	(61,681,508)
	Intercompany - Canada and Netherlands	-	(61,681,508)	-	(61,681,508)
Canada	Payless ShoeSource Canada GP, Inc		64	3,927	3,991
	Payless ShoeSource Canada Inc	(64)		11,619,833	11,619,769
	Payless ShoeSource Canada LP	(3,927)	(11,619,833)		(11,623,760)
	Intercompany - Canada	(3,991)	(11,619,769)	11,623,760	-
	Intercompany receivable/ (payable)	(3,991)	37,389,342	(18,643,417)	18,741,934

Red - amounts owing between the Payless Canada Entities and the U.S. Debtors.
Green - amounts owing between the Payless Canada Entities and the other entities within the Payless Holdings LLC group.
Blue - amounts owing between the Payless Canada Entities.

37. If appointed Monitor, FTI intends to review and track intercompany transfers and will report to the Court on such transfers as appropriate. The Proposed Monitor notes that only limited payments are intended to be made under the Intercompany Agreements, and only in respect of post-filing services.

H. THE DEBT STRUCTURE

38. The Payless Group's debt structure consists principally of the ABL Credit Facility and the Term Loan Credit Facility (collectively, the "**Secured Indebtedness**"). The Proposed Monitor understands that the Payless Group is in default of both the ABL Credit Facility and the Term Loan Facility.

Secured Indebtedness

39. The ABL Credit Facility, to which the Payless Canada Entities are guarantors, allows the borrowers under the ABL Credit Facility to obtain loan advances up to the maximum amount of approximately USD\$280,000,000 on a margined basis. Letters of credit are available under the ABL Credit Facility. The Proposed Monitor understands

that approximately an aggregate principal amount of USD\$156.7 million was outstanding as at February 18, 2019.

40. The Proposed Monitor understands that, with respect to the ABL Credit Facility, by way of a direction dated January 18, 2019, the ABL Credit Facility is currently being administered as if a "Cash Dominion Event" (as defined in the ABL Credit Facility credit agreement) has occurred and is continuing under the agreement.
41. The Term Loan Credit Facility, to which the Payless Canada Entities are guarantors, established a USD\$280,000,000 term loan facility. The Payless Canada Entities are each guarantors under the Term Loan Credit Facility. The Proposed Monitor understands that approximately an aggregate principal amount of USD\$277.2 million was outstanding as at February 18, 2019.
42. The rights and priorities of Wells Fargo and Cortland, as agents on behalf of the lenders they represent, are governed by an intercreditor agreement dated August 10, 2017 (the "**Intercreditor Agreement**") between Wells Fargo and Cortland and acknowledged by the Payless Group.
43. The Intercreditor Agreement provides that:
 - a. the security of the lenders under the ABL Credit Facility on, among other things, all accounts (other than specified accounts), cash, money, cash equivalents, deposit accounts, security accounts, commodity accounts, inventory, fee owned real estate and fixtures (collectively, the "**ABL Priority Collateral**"), ranks in priority to any security of the lenders under the Term Loan Credit Facility; and
 - b. the security of the lenders under the Term Loan Credit Facility on, among other things, all collateral other than the ABL Priority Collateral, ranks in priority to any security of the lenders under the ABL Credit Facility,

in each case for all obligations up to prescribed maximum amounts.²

² The foregoing is only a description of selected terms of the Intercreditor Agreement. Neither FTI nor Bennett Jones have provided any opinion on the priority of any party's security interest over assets of any of the Payless Canada Entities.

Unsecured Indebtedness

44. In addition to their Secured Indebtedness, the Payless Canada Entities have unsecured indebtedness in respect of, *inter alia*, employee obligations, taxes, intercompany liabilities, leases, third party suppliers and customers.
45. With respect to their customers, the Payless Canada Entities intend to seek authorization from this Court to continue to honor customer gift cards and store credit, and to honour returns and exchanges for a period of 30 days following the granting of the Initial Order, each in accordance with the Payless Canada Entities' applicable policies and procedures as they existed as of the date of the Initial Order. It is proposed that all future sales will be final sales. The Payless Canada Entities and the U.S. Debtors intend to discontinue their rewards programs and any outstanding merchandise coupons effective immediately.

Payless' Financial Difficulties

46. As indicated in the Marotta Affidavit, the Payless Group, on April 4, 2017, commenced the Prior U.S. Proceedings. As a result of an application by Payless Holdings LLC as the foreign representative, the Prior U.S. Proceedings were recognized as a "foreign main proceeding" under section 46 of the CCAA.
47. The Canadian Court and the U.S. Bankruptcy Court approved the Joint Plan, which became effective as of August 10, 2017. Since the approval of the Joint Plan, the Payless Group has been unable to sustain profitable operations in the current retail environment due to a variety of factors.
48. After emergence from the Prior U.S. Proceedings, the Payless Group sought to deleverage their balance sheet and implement additional cost-reduction including by, *inter alia*, reviewing marketing expenses, downsizing their corporate office, terminating various employees, reevaluating the budget for every department and reducing their capital expenditures plan. Notwithstanding these efforts, Payless' North American brick and mortar business continued, and continues, to experience top-line sales decline.

49. In March 2018 and October 2019, respectively, in light of mounting operational issues and in an effort to build liquidity reserves, the Payless Group negotiated with their prepetition lenders for additional credit under their existing ABL Credit Facility and for the strategic infusion of capital through a debt offering to lenders under their Term Loan Facility. Despite these efforts, amongst others, the Payless Canada Entities have been unable to return to profitability and reported a net operating loss on a consolidated basis of more than USD\$12 million in 2018.
50. The Proposed Monitor understands that the Payless Canada Entities have failed to pay rent for February with respect to approximately 220 of the 248 Canadian stores.
51. As a result of the financial difficulties suffered, and as described in the Marotta Affidavit, the Payless Canada Entities are insolvent and are unable to meet their liabilities as they become due.

I. EXTENSION OF CCAA BENEFITS AND PROTECTIONS TO PAYLESS CANADA LP

52. Pursuant to the Proposed Initial Order, the Applicants are seeking a stay of all proceedings against the Applicants up to and including March 21, 2019 (the "**Stay of Proceedings**"). The Payless Canada Entities are also seeking to extend the Stay of Proceedings and other benefits, protections, authorizations and restrictions of the Proposed Initial Order to Payless Canada LP.
53. Payless Canada LP is a limited partnership organized under the laws of Ontario. Payless Canada GP is the general partner of Payless Canada LP and Payless Canada Inc. is the limited partner holding 0.1% ownership in Payless Canada LP. For the reasons stated in the Marotta Affidavit, including that Payless Canada LP is the primary operating company in Canada, the Proposed Monitor believes that it is appropriate to extend the Stay of Proceedings and other provisions of the Proposed Initial Order to Payless Canada LP.
54. Payless Canada LP is the operating Payless Canada Entity, is vital to the business of the Applicants, and is also a guarantor under the ABL Credit Facility and the Term Loan Credit Facility.

55. The Proposed Monitor believes that the proposed Stay of Proceedings is essential for the preservation of the Payless Canada Entities' enterprise value and to allow for the orderly conduct and operation of the business during the CCAA Proceedings.

J. CASH FLOW FORECAST

56. The Cash Flow Forecast, together with Management's report on the cash-flow statement as required by section 10(2)(b) of the CCAA, is attached as Appendix "C" to this Pre-Filing Report. The Cash Flow Forecast covers the 13-week period ending May 17, 2019.

57. Pursuant to section 23(1)(b) of the CCAA³ and in accordance with the Canadian Association of Insolvency and Restructuring Professionals Standard of Practice 09-1, the Proposed Monitor hereby reports to the Court as follows:

- a. the Proposed Monitor has reviewed the Cash Flow Forecast, which was prepared by Management and Ankura for the purpose described in notes to the Cash Flow Forecast (the "**Forecast Notes**") using the Probable Assumptions and Hypothetical Assumptions set out therein;
- b. the review consisted of inquiries, analytical procedures and discussion related to information provided by certain members of Management and employees of the Payless Canada Entities, and Ankura. Since Hypothetical Assumptions need not be supported, the Proposed Monitor's procedures with respect to the Hypothetical Assumptions were limited to evaluating whether the Hypothetical Assumptions were consistent with the purpose of the Cash Flow Forecast. The Proposed Monitor has also reviewed the support provided by Management and Ankura for the Probable Assumptions and the preparation and presentation of the Cash Flow Forecast;
- c. based on that review, and as at the date of the Pre-Filing Report, nothing has come to the attention of the Proposed Monitor that causes it to believe that:

³ Section 23(1)(b) of the CCAA requires the Monitor to review the Payless Canada Entities' cash-flow statements as to its reasonableness and file a report with the court on the Monitor's findings.

- i. the Hypothetical Assumptions are inconsistent with the purpose of the Cash Flow Forecast;
 - ii. the Probable Assumptions are not suitably supported or consistent with the plans of the Payless Canada Entities or do not provide a reasonable basis for the Cash Flow Forecast, given the Hypothetical Assumptions; or
 - iii. the Cash Flow Forecast does not reflect the Probable and Hypothetical Assumptions;
 - d. since the Cash Flow Forecast is based on assumptions regarding future events, actual results will vary from the forecast even if the Hypothetical Assumptions occur. Those variations may be material. Accordingly, the Proposed Monitor expresses no assurance as to whether the Cash Flow Forecast will be achieved. The Proposed Monitor also expresses no opinion or other form of assurance with respect to the accuracy of any financial information presented in the Pre-Filing Report, or relied upon by the Proposed Monitor in preparing the Pre-Filing Report; and
 - e. the Cash Flow Forecast has been prepared solely for the purpose described in the Forecast Notes. The Cash Flow Forecast should not be relied upon for any other purpose.
58. The Proposed Initial Order seeks to restrict the payment of principal, interest thereon or otherwise on account of amounts owing by any of the Payless Canada Entities to any of their creditors (which is consistent with the Model Order), with the exception of repayments of obligations owing under the ABL Credit Facility in the amounts noted as Canadian Excess Proceeds in the Cash Flow Forecast. Of additional note, the Proposed Initial Order provides for the establishment and funding of the Reserve (as detailed in the Cash Flow Forecast) in a separate Payless Canada Entity bank account from which payments, with the consent of the Monitor (if appointed), will be made to satisfy those items for which the Reserve was established, and which no repayments will be made from without the consent of the Monitor (if appointed) or further Order of the Canadian Court.

K. THE PAYLESS CANADA ENTITIES' CASH MANAGEMENT SYSTEM

59. The Proposed Monitor has reviewed the description of the cash management system for the Payless Canada Entities set out in the Marotta Affidavit and believes those descriptions to be accurate.

60. This cash management system is critical to the ongoing management of the Payless Canada Entities' business and affairs. Replacement of the cash management system would be costly and time consuming. Accordingly, the Proposed Monitor supports the Payless Canada Entities' request to continue to operate its existing cash management system throughout the CCAA Proceedings.

L. CROSS-BORDER PROTOCOL

61. The Payless Canada Entities and the other U.S. Debtors have developed a Cross-Border Protocol with the intention to facilitate a coordinated and efficient administration of the CCAA Proceedings and the U.S. Proceedings (collectively, the "**Insolvency Proceedings**") without divesting or diminishing the Canadian Court's or U.S. Bankruptcy Court's respective jurisdiction over the subject matter of the CCAA Proceedings and the U.S. Proceedings, respectively.

62. The Cross-Border Protocol provides that, *inter alia*:

- i. the Cross-Border Protocol is to become effective only upon its approval by both the Canadian Court and the U.S. Bankruptcy Court;
- ii. the Canadian Court and the U.S. Bankruptcy Court may harmonize and coordinate the administration of the Insolvency Proceedings and may coordinate activities with, and defer to the judgement of, the other Court where appropriate and feasible;
- iii. the Canadian Court and the U.S. Bankruptcy Court may conduct joint hearings with respect to any matter relating to the conduct, administration, or determination of any aspect of the CCAA Proceedings and the U.S. Proceedings, including the interpretation or implementation of this Cross Border Protocol where both Courts consider such a joint

hearing necessary or advisable;

- iv. the Canadian Court and the U.S. Bankruptcy Court remain independent courts;
- v. the Monitor (if appointed), its officers, directors, employees, counsel, agents and any other professionals related thereof, wherever located (collectively, the "**Monitor Parties**") and any other estate representative in the CCAA Proceedings (collectively with the Monitor Parties, the "**Canadian Representatives**") shall be subject to the sole and exclusive jurisdiction of the Canadian Court with respect to all matters. The Monitor Parties shall be entitled to the protections of the Bankruptcy Code, section 306 and to the same protections and immunities in the U.S. as well as those granted to them under the CCAA or the Proposed Initial Order. Likewise, any estate representative appointed in the U.S. Proceedings (the "**U.S. Representatives**") shall be subject to the sole and exclusive jurisdiction of the U.S. Bankruptcy Court with respect to all matters. Any professional retained by the Payless Canada Entities for Canadian related advice and activities performed in Canada, or in connection with the CCAA Proceedings, shall be subject to the sole and exclusive jurisdiction of the Canadian Court. Any professionals retained by the U.S. Debtors (other than the Payless Canada Entities), or the for activities performed in the U.S. or in connection with the U.S. Proceedings, shall be subject to the sole and exclusive jurisdiction of the U.S. Bankruptcy Court. Likewise, any professionals retained by the official committee of unsecured creditors (if appointed, the "**U.S. Creditors Committee**") shall be subject to the sole and exclusive jurisdiction of the U.S. Bankruptcy Court, provided that each of the foregoing may be subject to the jurisdiction of the other Court in connection with a request for relief as described in the Cross-Border Protocol; and
- vi. the Canadian Court recognizes the validity of the stay of proceedings and

actions against or respecting the U.S. Debtors and their property under the Bankruptcy Code and, likewise, the U.S. Bankruptcy Court recognizes the validity of the stay of proceedings and actions against or respecting the Payless Canada Entities under the CCAA and the Proposed Initial Order.

63. The Cross-Border Protocol is consistent with protocols approved by this Court in other cross-border cases. An application for the approval of the Cross-Border Protocol has been filed in the U.S. Bankruptcy Court by the U.S. Debtors.
64. The Proposed Monitor is of the view that the Cross-Border Protocol will, among other things, create better coordination between the Canadian Court and the U.S. Bankruptcy Court, and that it should be granted.

M. APPROVAL OF THE ENGAGEMENT OF ANKURA AS CRO

65. Since January 2019, Ankura has been actively involved in providing restructuring advisory services to the U.S. Debtors, including the Payless Canada Entities.
66. In early January 2019, Ankura was engaged to provide advice to the Payless Group and on January 29, 2019, Stephen Marotta, a managing partner at Ankura, was appointed to serve as Chief Restructuring Officer of Payless Holdings LLC and certain subsidiaries thereof (excluding the Payless Canada Entities) to oversee the management and operation of the Payless Group's business and to perform certain professional services.
67. Pursuant to an engagement letter dated as of January 24, 2019 (the "**Ankura Engagement Letter**"), the Payless Canada Entities separately engaged Ankura to act as Chief Restructuring Organization for the Payless Canada Entities (in such capacity, the "**CRO**"), subject to the Court's approval.
68. Ankura has played, and will continue to play, a significant role in driving deal negotiations with various stakeholders, and in any restructuring transactions. Ankura has and will continue to, work closely with the board of Directors through this restructuring process and will provide the support required to fill the gaps in the current

management structure.

69. The Ankura Engagement Letter provides that the CRO is to be compensated as part of the ongoing corporate services supplied under the Intercompany Agreements. These amounts are contemplated in the Cash Flow Forecast, but in the event that payments under the Intercompany Agreements are not made, the CRO has reserved its right to charge the Payless Canada Entities directly for services performed on an hourly basis.
70. As outlined in the Marotta Affidavit, pursuant to the Ankura Engagement Letter, the CRO's proposed powers include, *inter alia*:
- a. the power to make decisions with respect to the day to day aspects of the management and operations of the Payless Canada Entities and their business;
 - b. the power to realize and dispose of the property of each of the Payless Canada Entities on behalf of such Payless Canada Entity(ies);
 - c. the power to represent each of the Payless Canada Entities in any negotiations with any other stakeholders and their professional constituencies;
 - d. the power to assist the Payless Canada Entities with store closures and liquidations;
 - e. the power to evaluate the short-term company prepared cash flows and financing requirements of the Payless Canada Entities as they relate to the CCAA Proceedings;
 - f. the power to assist the Payless Canada Entities in the preparation and oversight of the financial statements and schedules, monthly operating reports, and other information required in these proceedings;
 - g. the power to communicate with and provide information to the Monitor (if appointed) and its advisors regarding the Payless Canada Entities and their business;
 - h. the power to assist the Monitor (if appointed), as requested by the Monitor (if appointed), in connection with powers given to the Monitor (if appointed); and

- i. the power to work with the Payless Canada Entities' professional advisors, and in respect of the CCAA proceedings, execute all documents permitted or required by the CCAA and work with the Monitor (if appointed) in respect of the CRO's duties above.
71. Ankura is a well-known consulting and financial advisory firm and has significant expertise in providing the services contemplated by the Ankura Engagement Letter in the context of Court-supervised restructuring proceedings.
72. The Proposed Monitor is of the view that the engagement of Ankura is beneficial to the Payless Canada Entities and its stakeholders generally. Ankura has already been providing assistance and advice to the U.S. Debtors, including the Payless Canada Entities, and is familiar with the Payless Canada Entities' business and assets.
73. In addition, given the recent attrition of the Payless Group's Management and employees, the Proposed Monitor understands that third-party assistance is required.
74. The Proposed Monitor supports the engagement of Ankura as CRO. To the extent any conflict arises as a result of Ankura's involvement with the Payless Canada Entities and also the other U.S. Debtors, FTI, if appointed as Monitor, intends to report to this Court with respect to such issues.

N. ADMINISTRATION CHARGE

75. The Proposed Initial Order provides for a first-ranking Administration Charge in an amount up to USD\$2 million on the Payless Canada Entities' assets to secure the fees and disbursements incurred in connection with services provided to the Payless Canada Entities both before and after the commencement of the CCAA Proceedings. The Administration Charge is proposed to secure the services provided to the Payless Canada Entities by:
 - i. counsel to the Payless Canada Entities;
 - ii. the Monitor and its counsel; and
 - iii. the CRO.

76. The Proposed Monitor has worked with these groups to estimate their fees and costs, and the quantum of the proposed Administration Charge.
77. Given the anticipated amount of time it will take to complete the CCAA Proceedings, the size and complexity of the CCAA Proceedings, the potential work involved at peak times, and the size of charges approved in similar proceedings, the Proposed Monitor is of the view that the size and scope of the Administration Charge is fair and reasonable in the circumstances. The Proposed Monitor also believes that there will not be any unwarranted duplication of roles between the beneficiaries of the Administration Charge, and the participation of the persons benefiting are necessary to the CCAA Proceedings. The Proposed Monitor therefore supports the Payless Canada Entities' request that the Court approve the Administration Charge.
78. The Payless Canada Entities or related entities have previously provided retainers to their counsel, the Monitor (if appointed) and the Monitor's counsel in the aggregate amount of \$1 million.

O. DIRECTORS' AND OFFICERS' CHARGE

79. The Payless Canada Entities, along with the other members of the Payless Group, maintain director's and officer's liability insurance (the "**D&O Insurance**"). The current D&O Insurance policy, with respect to the Payless Canada Entities, provides for an aggregate amount of coverage of \$80 million (the "**D&O Canadian Insurance Policy**").
80. The Proposed Monitor has worked with the Payless Canada Entities to estimate the potential liabilities that the Directors and officers of the Payless Canada Entities (the "**Officers**") may be exposed to in their capacities as directors and officers during the CCAA Proceedings.
81. The Proposed Initial Order proposes to bifurcate the Directors' Charge as follows: (i) the first portion would be a charge specifically over the Reserve and in the amount of the Reserve at any given point in time, and (ii) the second portion would be a general charge in the initial maximum amount of USD\$4 million that would be reduced to

USD\$2 million on March 21, 2019 without further Order of the Canadian Court. The Directors' Charge would constitute a second-ranking charge over the assets of the Payless Canada Entities to secure the indemnity provided to the Directors and Officers in respect of liabilities they may incur after the filing date and will apply only to the extent that the Directors and Officers do not have coverage under the D&O Insurance.

82. The Directors and Officers have been involved with the Payless Canada Entities' business and its efforts to restructure to date, and the continued support and service of the Directors and Officers, including using their valuable historical knowledge of the Payless Canada Entities to direct and assist the CRO, will be valuable during the CCAA Proceedings and will enable the Payless Canada Entities to preserve value and maximize recoveries for stakeholders.
83. In arriving at the quantum of the Directors' Charge, the Proposed Monitor and the Payless Canada Entities have taken into account the Directors' and Officers' potential statutory liabilities for wages, vacation pay, severance and termination, unremitted source deductions, sales and services taxes.
84. The Proposed Monitor is of the view that the granting of the Directors' Charge is appropriate in the circumstances and that the quantum and scope of the charge is both fair and reasonable, and is solely intended to cover obligations and liabilities the Directors and Officers may incur after the filing date. The Proposed Monitor is also of the view that the Directors' Charge is consistent with this Court's practice and the potential foreseeable scope of director and officer liabilities for unremitted or unpaid employee and tax amounts in this case.

P. ANTICIPATED NEXT STEPS IN THE CCAA PROCEEDINGS

Liquidation Approval Order

85. The Proposed Monitor understands that, if the Proposed Initial Order is granted, the Payless Canada Entities intend to bring a motion on February 21, 2019 (the "**Comeback Hearing**") to seek this Court's approval of the Liquidation Consulting Agreement and the Sale Guidelines (the "**Liquidation Approval Order**") which will

allow the Payless Canada Entities to conduct an orderly liquidation under the supervision of the Monitor (if appointed).

86. The Proposed Monitor understands that the Payless Group, with the assistance of Ankura and PJ Solomon, L.P. ("**PJ Solomon**"), conducted an analysis of the retail locations in both the U.S. and Canada and determined that it is in the best interests of all the Payless Group's stakeholders to cease operation in the U.S. and to liquidate the U.S. stores (the "**U.S. Liquidation**") and pursue a reorganization of the Latin American and franchise business.
87. The Proposed Monitor understands that the decision to liquidate the North American business stemmed from, among other things, the need to preserve enterprise value, address liquidity issues and restructure the business to preserve the going-concern value of the Latin America operations. PJ Solomon's view was that achieving a profitable U.S. store base would have required substantial improvements in merchandising margin, stabilized comparable store sales and significant capital investment to lower overhead and IT costs – all efforts that could not be reasonably financed.
88. As mentioned earlier, the Payless Canada Entities are entirely reliant on the other U.S. Debtor entities and it would be cost prohibitive and logistically impossible to operate after the wind down of the U.S. operations. As a result, the Payless Canada Entities have determined that it is necessary to seek the Liquidation Approval Order to conduct their own liquidation process (the "**Canadian Liquidation**", and together with the U.S. Liquidation, the "**Payless Liquidation**").
89. The Payless Group and the Payless Canada Entities, along with Ankura, have negotiated and entered into an agreement (the "**Liquidation Consulting Agreement**") with a contractual joint venture comprised of Great American Group, LLC and Tiger Capital Group, LLC (the "**Liquidation Consultant**") dated February 12, 2019. The Canadian Liquidation is to be conducted in accordance with the sales guidelines (the "**Sale Guidelines**") as appended to the Liquidation Approval Order.
90. The Liquidation Consulting Agreement will not be effective in Canada until and unless

the Liquidation Approval Order is granted by this Court.

91. The Payless Group engaged Malfitano Advisors LLC ("**Malfitano Advisors**") to assist as asset disposition advisor. Together, they conducted a solicitation and bidding process for a liquidator.
92. The Payless Group and the Payless Canada Entities marketed the liquidation consulting opportunity to 4 firms and received 2 bids. Each bid was evaluated based on, *inter alia*, whether the firm:
 - a. had realistic views on overall recovery on the inventory;
 - b. had recent experience liquidating specialty footwear retail inventory;
 - c. would dedicate the best resources to accomplish the Payless Group's goals;
 - d. had familiarity with the Payless Group, its inventory systems and operational structure; and
 - e. had shown the ability to assist retailers in the execution of a large-scale liquidation on an expedited basis.
93. The Liquidation Consulting Agreement contemplates that
 - a. the Liquidation Consultant is retained as the Payless Canada Entities' independent consultant to conduct the liquidation sale at the Canadian stores;
 - b. the liquidation sale for the Canadian stores will not begin prior to the date on which the Liquidation Consulting Agreement is approved by the Canadian Court, and the sale will end by April 30, 2019;
 - c. all expenses incident to the conduct of the sale and the operation of the Canadian stores during the liquidation sale are to be borne by the Payless Canada Entities except solely for any of the specifically enumerated "Consultant Controlled Expenses" (as defined in the Liquidation Consulting Agreement) that exceed the aggregate budgeted amount as established by the Liquidation Consulting Agreement for such Consultant Controlled Expenses;
 - d. the Liquidation Consultant will be paid a fee ranging from 0.75% to 2.1% of the

Gross Proceeds (as defined in the Liquidation Consulting Agreement). The fee varies based on the total gross cost recovery received for the sold merchandise. The receipts from the Canadian Liquidation will be accounted for separately from the receipts from the U.S. Liquidation; and

- e. the sale at the Canadian stores is to be conducted in accordance with the Sale Guidelines appended as Schedule "A" to the Liquidation Approval Order.
94. The Proposed Monitor believes that the proposed liquidation in Canada is the most effective way to maximize value and is in the best interests of the Payless Canada Entities and their stakeholders.

Stay Extension

95. At the Comeback Hearing, the Applicants will be seeking an extension of the Stay of Proceedings up to and including May 10, 2019 (the "**Extension**"). If the Liquidation Agreement is approved, the Proposed Monitor is supportive of such an extension and believes that the Applicants will be acting in good faith and due diligence to maximize value for their stakeholders by conducting the Liquidation throughout this period.
96. The Extension is appropriate in the circumstances as the Canadian Liquidation is expected to take until April 30, 2019, and the Cash Flow Forecast demonstrates that the Payless Canadian Entities will be able to support their operations to May 10, 2019. In addition, the Monitor believes it is in the best interests of all stakeholders to minimize unnecessary court attendances and the resultant professional costs through the Extension.

Q. RECOMMENDATIONS

97. For the reasons stated in the Pre-Filing Report, the Proposed Monitor believes that it is appropriate for the Payless Canada Entities to be granted protection under the CCAA and respectfully recommends that the Court grant the Proposed Initial Order and, at the subsequent hearing, the Liquidation Approval Order and the requested Extension.

The Proposed Monitor respectfully submits to the Court this, its Pre-Filing Report.

Dated this 19th day of February, 2019.

FTI Consulting Canada Inc.,
solely in its capacity as Proposed Monitor of Payless ShoeSource Canada Inc.,
Payless ShoeSource Canada GP Inc. and Payless ShoeSource Canada LP,
and not in its personal capacity



Greg Watson
Senior Managing Director



Paul Bishop
Senior Managing Director

APPENDIX "A"

[ATTACHED]

**UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF MISSOURI
EASTERN DIVISION**

In re:) Case No. 19-40883-659
) Chapter 11
PAYLESS HOLDINGS LLC, *et al.*,)
) (Joint Administration Requested)
Debtors.¹)

**DECLARATION OF STEPHEN MAROTTA, CHIEF
RESTRUCTURING OFFICER OF PAYLESS HOLDINGS LLC, IN SUPPORT
OF DEBTORS' CHAPTER 11 PROCEEDINGS AND FIRST DAY PLEADINGS**

I, Stephen Marotta, hereby declare under penalty of perjury to the best of my knowledge, information, and belief:

1. I am a Senior Managing Director at Ankura Consulting Group, LLC ("Ankura") and concurrently serve as the Chief Restructuring Officer of Payless Holdings LLC and twenty-three of its affiliated debtors and debtors in possession (collectively, with the three Canadian debtors described below, the "Debtors," and, together with their non-debtor affiliates and subsidiaries, "Payless" or the "Company"). In this capacity, I am familiar with the Debtors' day-to-day operations, business, financial affairs, and books and records.

¹ The Debtors in these chapter 11 cases, along with the last four digits of each Debtor's federal tax identification number, are: Payless Holdings LLC [5704]; Payless Intermediate Holdings LLC [5190]; WBG-PSS Holdings LLC [0673]; Payless Inc. [3160]; Payless Finance, Inc. [2101]; Collective Brands Services, Inc. [7266]; PSS Delaware Company 4, Inc. [1466]; Shoe Sourcing, Inc. [4075]; Payless ShoeSource, Inc. [4097]; Eastborough, Inc. [2803]; Payless Purchasing Services, Inc. [3043]; Payless ShoeSource Merchandising, Inc. [0946]; Payless Gold Value CO, Inc. [3581]; Payless ShoeSource Distribution, Inc. [0944]; Payless ShoeSource Worldwide, Inc. [6884]; Payless NYC, Inc. [4126]; Payless ShoeSource of Puerto Rico, Inc. [9017]; Payless Collective GP, LLC [2940]; Collective Licensing, LP [1256]; Collective Licensing International LLC [5451]; Clinch, LLC [9836]; Collective Brands Franchising Services, LLC [3636]; Payless International Franchising, LLC [6448]; PSS Canada, Inc. [4969]; Payless ShoeSource Canada Inc. [4180]; Payless ShoeSource Canada GP Inc. [4182]; and Payless ShoeSource Canada LP [4179]. With respect to certain taxing authorities, the Debtors' address is 2001 Bryan Street, Suite 800, Dallas, Texas 75201. However, the location of Debtor Payless Holdings LLC's corporate headquarters and the Debtors' service address is: c/o Payless ShoeSource Inc., 3231 S.E. 6th Avenue, Topeka, Kansas 66607.

2. I have more than 35 years of experience providing professional accounting and consulting services to major corporations and businesses, including 29 years of consulting to financially-troubled companies. My experience includes business plan development, viability assessments, reengineering and overhead reduction programs, claims and preference analyses, crisis management, and forensic investigation and litigation support. My industry experiences include retail, healthcare, telecommunications, manufacturing, wholesale distribution, entertainment, and financial services. I have served in restructuring advisory roles in such chapter 11 cases as *In re Model Reorg Acquisition, LLC (aka Perfumania Inc.)*, Case No. 17-11794-CSS (Bankr. D. Del. 2017) (largest specialty retailer and distributor of fragrances and related beauty products in the United States); *In re SynCardia Systems, Inc.*, Case No. 16-11599-MFW (Bankr. D. Del. 2016) (Chief Restructuring Officer) (medical technology company); *In re C. Wonder LLC*, Case No. 15-11127-MBK (Bankr. D.N.J. 2015) (Chief Restructuring Officer) (specialty retailer that designs and markets women's clothing, jewelry, shoes, handbags and other accessories as well as select home goods); *In re Deb Stores Holding LLC*, Case No. 14-12676-KG (Bankr. D. Del. 2014) (mall-based retailer in the juniors "fast-fashion" specialty sector); *In re Daytop Village Foundation Incorporated*, Case No. 12-11436-SCC (Bankr. S.D.N.Y. 2012) (Chief Restructuring Officer) (a substance abuse prevention provider); *In re CoreComm N.Y., Inc.*, Case No. 04-10214-PCB (Bankr. S.D.N.Y. 2004) (Chief Restructuring Officer) (facilities-based integrated communications providers); *In re Andover Togs, Inc.*, Case No. 96-41437-ALG (Bankr. S.D.N.Y. 1996) (garment manufacturer); *In re Alexander's Inc.*, Case No. 92-42704 (Bankr. S.D.N.Y. 1992) (chain of New York area department stores); *In re Federated Department Stores, Inc.*, Case No. 90-00130 (Bankr. S.D. Ohio 1990) (retailing and real estate conglomerate with 258 department

stores operating nationwide under 10 names—including Bloomingdale’s, Abraham & Straus, Jordan Marsh and Burdines).²

3. In early January 2019, the Debtors selected Ankura as their restructuring advisor because of Ankura’s experience and reputation for providing advisory and crisis management services in large, complex chapter 11 cases. I have overseen the team of Ankura professionals that has been working with the Debtors in connection with this process. On January 29, 2019, the Board of Managers of Payless Holdings LLC appointed me as the Chief Restructuring Officer of Payless Holdings LLC, the parent company, to oversee the management and operation of the Debtors’ business and to perform certain professional services.³

4. On the date hereof (the “Petition Date”), the Debtors filed voluntary petitions for relief under chapter 11 of title 11 of the United States Code (the “Bankruptcy Code”). The Debtors continue to operate their business and manage their affairs as debtors in possession pursuant to Bankruptcy Code section 1107(a) and 1108.

5. I submit this declaration (the “Declaration”) to assist this court (the “Court”) and parties in interest in: (a) understanding the Debtors, their operations, and their capital structure; (b) understanding the circumstances related to the commencement of the chapter 11 cases; and (c) in support of: (i) the Debtors’ petitions for relief under chapter 11 of the Bankruptcy Code; and (ii) the relief requested by the Debtors pursuant to the pleadings described herein.

6. Except as otherwise indicated, all facts set forth in this Declaration are based upon my personal knowledge of the Company’s operations and finances, information learned from my

² The foregoing list is a list of cases handled by Marotta Gund Budd & Dzera, LLC, a predecessor in interest of Ankura, except for (i) *In re Model Reorg Acquisition, LLC*, which was handled by Ankura and (ii) *In re Andover Togs, Inc.*, *In re Alexander’s Inc.* and *In re Federated Department Stores, Inc.*, which were handled by Zolfo Cooper, a predecessor in interest to AlixPartners, LLP.

³ On January 29, 2019, the Board of Managers of Payless Holdings LLC also appointed Adrian Frankum, a senior Managing Director at Ankura, as Restructuring Officer of Payless Holdings LLC.

review of relevant documents, information supplied to me by members of the Company's management, other Ankura professionals and the Company's other professional advisors, or my opinion based upon my experience and knowledge. If called as a witness, I could and would testify competently to the facts set forth in this Declaration on that basis. I am authorized to submit this Declaration on behalf of the Debtors.

Preliminary Statement

7. The Debtors have commenced these cases approximately 18 months after completing a restructuring and emerging from chapter 11 cases in this Court with a reduced debt burden.⁴ Notwithstanding the decline in the Debtors' overall financial performance, Payless Latin America continues to demonstrate stable growth and is the Company's most profitable business segment. Moreover, Payless' franchise business segment continues to provide the Debtors with favorable royalty fees. Accordingly, the Company has determined that the best way to maximize value for all stakeholders is to commence an orderly wind-down of the North America brick and mortar business and pursue a reorganization of the Latin America and franchise business segments. This overall strategy is to be implemented through an organized suite of international initiatives including (i) the commencement of these chapter 11 cases; (ii) the commencement of a CCAA proceeding in Canada and (iii) a reorganization around the Latin America and franchise business. The Company believes that this approach is in the best interests of the Debtors and their estates, and will preserve the most profitable segments of the Payless enterprise for the benefit of their stakeholders.

⁴ On April 4, 2017, the Debtors' predecessors in interest (the "Prior Debtors") commenced chapter 11 cases (the "Prior Cases") in this Court, which were jointly administered under the caption *In re Payless Holdings LLC*, No. 17-42267. All of the Prior Cases have been closed except for the Prior Cases of Payless Holdings LLC (Case No. 17-42267) and Payless ShoeSource Worldwide Inc. (Case No. 17-42288). The Debtors believe that the Prior Cases, which are limited to final claim reconciliation and the administration of distributions to unsecured creditors, can continue to conclusion without interruption as a result of these chapter 11 cases.

8. In furtherance of this objective, the Debtors have entered into a Consulting Agreement (as defined below) with the contractual joint venture comprised of Great American Group, LLC and Tiger Capital Group, LLC to effectuate the closure of the North America stores through going-out-of-business sales (the “Store Closing Sales”).

9. This Declaration is submitted to assist this Court in becoming familiar with the Debtors, the Debtors’ strategy for these chapter 11 cases, and the initial relief sought by the Debtors to stabilize operations. This Declaration is organized as follows: (a) **Part I** provides an overview of the Company and its operations; (b) **Part II** summarizes the Company’s prepetition organizational structure, capitalization and indebtedness; (c) **Part III** describes the circumstances leading to the commencement of these chapter 11 cases and the Company’s restructuring initiatives; (d) **Part IV** describes key components of and strategies for these chapter 11 cases; and (d) **Part V** provides an overview of the relief the Debtors seek at the outset of these chapter 11 cases, and, through the attached **Exhibit A**, provides the evidentiary basis for the relief requested in the first day pleadings.

I. Company Background

A. Overview

10. Founded in 1956 in Topeka, Kansas, Payless is an iconic American footwear retailer selling quality shoes at affordable prices in a self-select environment. With approximately 3,400 stores in more than 40 countries across the world, Payless is globally recognized and is the largest specialty footwear retailer in the Western hemisphere. Payless operates through its three business segments (North America, Latin America, and franchise stores), producing approximately 110

million pairs of shoes per year across the world. Payless also operates an e-commerce business through which it sells goods online at www.payless.com and Amazon.

11. Payless has offered its budget-conscious customers outstanding value on basics, on-trend and special occasion footwear through a national assisted-service store footprint, localized assortment, and a low-cost integrated-sourcing business model, including a significant online presence. This business model depends upon (a) identifying and developing on-trend merchandise, (b) developing strong relationships with branding partners, and (c) maintaining an overseas sourcing network that can develop and produce products at a scale and cost necessary to serve Payless' customers.

12. Payless has a strong seasonal cadence, as evidenced by its four key selling periods: Easter, summer sandals, back-to-school, and Holiday. Because these periods fall relatively evenly throughout the course of the year, Payless' selling periods create a broad, even flow of business throughout the year, even though the composition of the business varies widely depending on the time of year. This has served over many years to create a largely continuous overall flow of product from overseas suppliers through Payless' supply chain to customers in North America and abroad. An interruption in this product flow typically causes significant harm to the Company's (and thus the Debtors') business.

B. North America

13. Payless' North America business represents a majority of its store base, with approximately 2,500 wholly-owned stores in the United States, Puerto Rico, the U.S. Virgin Islands, Guam, Saipan, and Canada. Due to the industry-wide shift away from brick-and-mortar stores, the North America business (brick and mortar and e-commerce businesses) has experienced a precipitous decline in EBITDA, with 2018 EBITDA totaling negative \$63 million and 2017 EBITDA totaling negative \$4 million. Payless North America also provides an extensive range of

operational and corporate services to the Latin America and franchise business segments, including product development and sourcing, retail operations, marketing, IT, finance, tax, and legal assistance. In connection with the Store Closing Sales for the North America business, the Debtors are in the process of strategically transitioning certain of the operational and corporate services that Payless North America provides to the Latin America and franchise segments.

C. Latin America

14. Nineteen years after opening its first store in Latin America, Payless has become the largest specialty footwear retailer in the region. Payless Latin America has experienced stable growth since its inception, opening 15-20 new stores per year and averaging 6% annual revenue growth since 2013. It is also highly profitable, contributing approximately \$23 million to Payless' overall EBITDA despite accounting for less than 12% of Payless' store footprint. Payless currently operates approximately 420 stores in Latin America and enjoys leadership positions in each relevant market.

15. Many of Payless' Latin America operations are governed by joint venture agreements and related ancillary agreements, pursuant to which Payless receives certain sourcing and other corporate fees, as well as dividends, on a periodic basis, in exchange for use of the Debtors' intellectual property, sourcing, operational management and information technology. In exchange, the joint venture agreements have allowed Payless to utilize its partners' significant local market knowledge to buy, plan, and distribute their products. The Latin America business continues to perform well notwithstanding the challenges facing the North America brick and mortar business.

D. Franchise Store Segment

16. Payless' franchise segment consists of stores operated by franchisees in several countries in Africa, Asia, and the Middle East. Since opening their first franchise stores in 2009,

the Debtors' franchise business has grown to approximately 371 stores. The franchise stores are held to the same high standards as the Company's wholly-owned and joint venture stores and provide a similar customer experience. The Company receives royalty fees, which typically range from 6 to 8 percent of the franchisee's net revenue, pursuant to applicable franchise agreements. The franchise business requires minimal upfront risk, capital requirements, and overhead expenses, as it has historically leveraged the existing North America operations and sourcing capabilities to support the business segment. Payless intends to explore opportunities in connection with a reorganization around the franchise business.

E. Merchandising Strategy and Licensing

17. Payless maintains a number of branding relationships to assist it in bringing to market popular brands and designs to follow the trends of its core customer groups. The Company is also party to certain license agreements that grant it rights to use a number of popular, broadly-recognized brands, including Champion, Christian Siriano, Disney, Star Wars, and Marvel, each of which helps the Company maintain its strength in various niche target markets. The Company also utilizes design partnerships, through which popular labels provide the Company with existing product designs in exchange for a fee. These partnerships allow the Company to offer its partners' designs under the Payless name at much cheaper prices for the consumer. Finally, the Company markets certain high-volume proprietary brands, such as American Eagle, among others, which it owns outright.

F. Procurement and Global Supply Chain

18. Payless depends heavily on its supply chain and has unique relationships with its vendors, primarily based out of China and Vietnam. The Company has developed long-standing relationships (in some cases extending over 15 years) and highly streamlined processes with key supplier factories. The Company's ability to deliver its products in a timely manner also depends

on seamless interaction with various third-party service providers who ship and store the Company's products. This coordination across factories, distributors, shippers, carriers, warehousemen, and customer-facing stores is vital to ensuring Payless' shoes reach customers at the right season and at the right price.

II.

Prepetition Organizational Structure, Capitalization and Indebtedness

A. Prepetition Organizational Structure

19. Payless first traded publicly in 1962, and was taken private in May 2012. As set forth on the structure chart attached hereto as **Exhibit B**, Payless Holdings LLC currently owns, directly or indirectly, each of Payless' subsidiaries. One of the Debtors, Payless ShoeSource, Inc., is incorporated in the state of Missouri. In addition, the Debtors operate several Payless stores throughout the state. The Prior Cases that are still open are pending in the United States Bankruptcy Court for the Eastern District of Missouri under the caption *In re Payless Holdings LLC*, No. 17-42267.

B. Prepetition Capital Structure and Indebtedness

20. The Debtors' prepetition capital structure includes approximately \$470 million in aggregate principal amount of outstanding debt as of the Petition Date, primarily consisting of: (a) approximately \$156.7 million in aggregate principal amount revolving loans and FILO loans under the ABL Credit Facility (as defined below) as well as approximately \$36 million of undrawn letters of credit outstanding under the ABL Credit Facility (the "Standby Letters of Credit"); and (b) approximately \$277.2 million in secured debt under a term loan credit agreement (the "Term Loan Facility"). Certain non-debtor affiliates or subsidiaries included in the capital structure have outstanding indebtedness, including: (x) Payless CA Management Limited, which owes approximately \$45.4 million in aggregate principal amount of secured debt outstanding under a

first lien term loan (the “Payless CA Management Term Loan”); (y) Payless ShoeSource of Trinidad Unlimited, which owes approximately \$900,000 in aggregate principal amount pursuant to a demand loan (the “Trinidad Demand Loan”); and (z) Payless ShoeSource Ecuador Cia. Ltda., which owes approximately \$5.7 million in aggregate principal amount pursuant to a credit agreement (the “Ecuador Loan”).

i. The ABL Credit Facility

21. Payless, Inc., Payless Finance, Inc., Payless ShoeSource, Inc. and Payless ShoeSource Distribution, Inc., as borrowers, the other Debtors party thereto as guarantors, Wells Fargo Bank, National Association (“Wells Fargo”), as collateral agent and administrative agent, Wells Fargo as FILO agent, and the lenders party thereto from time to time are parties to that certain Credit Agreement, dated as of August 10, 2017 (as amended, restated, modified, and/or supplemented and as in effect immediately prior to the Petition Date, the “ABL Credit Facility”). The ABL Credit Facility provides for (x) a senior secured revolving credit facility, with a maximum availability of \$250 million, subject to borrowing base limitations and (y) a \$35 million FILO loan. The ABL Credit Facility is secured by a first priority lien over certain of the Debtors’ assets including, among other things and subject to certain limitations, accounts, cash, inventory, and real property (such collateral package, the “ABL Priority Collateral”). The ABL Credit Facility is also secured by a junior lien on the remaining assets of the Debtors including, among other things and subject to certain limitations, equipment and intellectual property (such collateral package, the “Term Priority Collateral”). As of the Petition Date, an aggregate balance of approximately \$156.7 million remains outstanding under the ABL Credit Facility as well as approximately \$36 million in Standby Letters of Credit.

22. Due to the Debtors’ diminishing liquidity the Debtors were required to enter into “cash dominion” with Wells Fargo, pursuant to which the Debtors agreed to cause all funds held

in certain of their deposit accounts, subject to any nominal minimum balances required, to be swept daily into an account under the dominion and control of Wells Fargo (the “Concentration Account”), and cause the proceeds of all collections and balances of all other deposit accounts, subject to any nominal minimum balances required, to also be swept daily into the Concentration Account.

ii. The Term Loan

23. Payless, Inc., Payless Finance, Inc., Payless ShoeSource, Inc., and Payless ShoeSource Distribution, Inc., as borrowers, the other Debtors party thereto as guarantors, Cortland Products Corp., as administrative and collateral agent, and the lenders party thereto from time to time are parties to that certain Term Loan and Guarantee Agreement, dated as of August 10, 2017 (as amended, restated, modified, and/or supplemented and as in effect immediately prior to the Petition Date, the “Term Loan Agreement”). The Term Loan Agreement originally provided for \$280 million of term loans secured by a first priority lien on the Term Priority Collateral and a second priority lien on the ABL Priority Collateral. The Term Loan Agreement is comprised of two tranches: Tranche A-1 in an original principal amount of \$80 million and Tranche A-2 in an original principal amount of \$200 million, which bear interest at different rates and mature on different dates. Tranche A-1 bears interest at LIBOR (as defined in the Term Loan Agreement) plus 8.00% per annum and matures on February 10, 2022 and Tranche A-2 bears interest at LIBOR (as defined in the Term Loan Agreement) plus 9.00% per annum and matures on August 10, 2022. An aggregate principal amount of \$277.2 million was outstanding as of the Petition Date under the Term Loan Facility.

iii. The Intercreditor Agreement

24. The Debtors’ prepetition indebtedness under the ABL Credit Facility and the Term Loan Agreement is also subject to an intercreditor agreement, generally referred to as the

ABL/Term Loan Intercreditor Agreement.⁵ The ABL/Term Loan Intercreditor Agreement governs the relative contractual rights of lenders under the ABL Credit Facility and the Term Loan Facility.

iv. Unsecured Claims

25. As of the Petition Date, the Debtors estimate that they owe approximately \$225 million to unsecured creditors, consisting primarily of amounts owed to vendors and suppliers.

C. Indebtedness of Non-Debtor Affiliates

i. The Payless CA Management Term Loan

26. As described in additional detail below, Payless raised capital required to fund ordinary-course business operations in October 2018 through the incurrence of indebtedness at a non-debtor affiliate that owns the Company's 60% interest in two Latin America business joint venture entities. Non-debtor Payless CA Management Limited, as the borrower, certain subsidiaries of Payless CA Management Limited party thereto from time to time as guarantors, Alden Global Opportunities Master Fund, L.P., as administrative agent, and the lenders party thereto from time to time are parties to that certain Term Loan and Guarantee Agreement, dated as of October 2, 2018 (as amended, restated, amended and restated, supplemented or otherwise modified from time to time, the "Payless CA Management Term Loan Agreement"). The Payless CA Management Term Loan Agreement, which matures on October 2, 2023 and accrues paid in kind interest at 10% per annum, provided for an approximately \$45.5 million delayed draw term loan secured by a first priority lien in substantially all tangible and intangible assets of non-debtor Payless CA Management Limited and the other guarantor thereunder, but specifically excluding

⁵ The "ABL/Term Loan Intercreditor Agreement" means that certain Intercreditor Agreement dated as of August 10, 2017 (as amended, supplemented, restated, amended and restated or otherwise modified from time to time) by and among Wells Fargo Bank, National Association, as administrative agent for the lenders under the ABL Credit Agreement and Cortland Products Corp., the administrative agent and collateral agent under the Term Loan, and acknowledged by the Debtors.

the Company's 60% interest in two Latin America business joint venture entities. The obligations under the Payless CA Management Term Loan Agreement are also secured by a non-recourse pledge of the equity in non-debtor Payless CA Management Limited held by its direct parent. An aggregate principal amount of \$45.4 million was outstanding as of the Petition Date under the Payless CA Management Term Loan.

ii. The Trinidad Demand Loan

27. Non-debtor Payless ShoeSource of Trinidad Unlimited, as the borrower, and First Citizens Bank Limited, as the lender, are parties to that certain demand loan credit facility dated as of December 5, 2017. The Trinidad Demand Loan, which matures on June 5, 2019, provides a €3,000,000 demand loan secured by a cash deposit held with First Citizens Bank Limited. The proceeds of Trinidad Demand Loan were used to pay a prior loan and dividends. An aggregate amount of \$900,000 was outstanding as of the Petition Date under the Trinidad Demand Loan.

iii. The Ecuador Loan

28. Non-debtor Payless ShoeSource Ecuador Cia. Ltda., as the borrower, and Banco de la Produccion S.A., as the lender, are parties to that certain credit agreement comprised of two tranches: Tranche 1 dated as of September 29, 2017 and Tranche 2 dated as of December 14, 2017 (the "Ecuador Loan Agreement"). PSS Latin America Holdings is the ultimate owner of the Payless ShoeSource Ecuador Cia. Ltda. The Ecuador Loan is comprise of two tranches: Tranche 1 in the amount of \$6 million and Tranche 2 in the amount of \$2 million, which bear interest at

difference rates.⁶ The proceeds of the Ecuador Loan were used to pay dividends. An aggregate amount of \$5.7 million was outstanding as of the Petition Date under the Ecuador Loan.

III. **Events Leading to Chapter 11 and Restructuring Initiatives**

A. The Prior Cases

29. I understand that beginning in early 2015, the Prior Debtors experienced a top-line sales decline driven primarily by: (a) a set of significant and detrimental non-recurring events, (b) foreign exchange rate volatility, and (c) challenging retail market conditions. Those pressures led to the Prior Debtors' inability to both service their prepetition secured indebtedness and remain current with their trade obligations. Industry-wide declines in sales and traffic during 2015 and 2016 compounded these challenges. The Prior Debtors' weaker-than-anticipated financial performance forced management to curtail certain capital and marketing investments required to combat the broader challenges facing the retail industry. To address these challenges, the Prior Debtors took steps to evaluate and implement cost-reduction initiatives.

30. In early 2017, the Prior Debtors negotiated a restructuring support agreement with the support of a majority of their prepetition secured lenders and, on April 4, 2017, commenced the Prior Cases in this Court. On July 27, 2017, the Court confirmed the *Debtors' Fifth Amended Plan of Reorganization*, No. 17-42267 [Docket No. 1507] (Bankr. E.D. Mo. 2017) (as supplemented, the "Plan"). The Plan effective date occurred on August 10, 2017 (the "Effective Date"). Two of the Prior Debtors' chapter 11 cases, Payless Holdings LLC and Payless ShoeSource Worldwide, Inc., remain open in this Court while the claims reconciliation process and creditor distributions are completed.

⁶ Tranche 1 bears interest at 7.29% interest per annum. Tranche 2 bears interest at 7.45% per annum.

31. The Prior Cases accomplished three main objectives: (a) approximately \$435 million in funded debt was eliminated; (b) approximately 675 underperforming brick and mortar stores were closed and liquidated; and (c) approximately \$50 million in annual expenditure savings was realized through landlord concessions and modification of existing leases.

B. Challenges Subsequent to the 2017 Plan Effective Date

32. Upon emergence from the Prior Cases, the Debtors sought to capitalize on the deleveraging of their balance sheet with additional cost-reduction measures, including reviewing marketing expenses, downsizing their corporate office, reevaluating the budget for every department, and reducing their capital expenditures plan. Notwithstanding these measures, the Debtors have continued to experience a top-line sales decline driven primarily by inventory flow disruption during the 2017 holiday season, same store sales declines resulting in excess inventory, and challenging retail market conditions. These conditions are described in more detail below.

33. In the year following the Prior Debtors' emergence from chapter 11, the Debtors faced unanticipated delays from key supplier factories. Given the significant volume of made-to-order shoes, the Debtors depended heavily on receiving regular shipments of product from their existing vendors. Due to interruptions in production during the Prior Cases, the Debtors' key supplier factories took longer than expected to procure the raw materials and workers required for the Debtors to deliver their products in a timely manner. The delayed production caused a major inventory flow disruption during the 2017 Holiday season and a computer systems breakdown in the summer of 2018 significantly affected the back to school season, leading to diminished sales and same store sales declines.

34. The Debtors also faced an oversupply of inventory in the fall of 2018 leading into the winter of 2019. As a result, the Debtors were forced to sell merchandise at steep markdowns, which depressed margins and drained liquidity. Customers filled their closets with these deeply

discounted products, which served to reduce customer demand for new product. In total, millions of pairs of shoes were sold at below market prices in order to realign inventory and product mix. These challenges and the general trend toward online shopping, contributed to a decline in EBITDA for Payless' North America brick and mortar stores for 2018 at negative \$66 million compared to negative \$11 million in 2017 and \$51 million in 2016.

35. Moreover, Payless was unable to fulfill its plan for omni-channel development and implementation, *i.e.*, the integration of physical store presence with online digital presence to create a seamless, fully integrated shopping experience for customers. As of the Petition Date, the completion of this unified customer experience has been limited to approximately two hundred stores. Without a robust omni-channel offering, Payless has been unable to keep up with the shift in customer demand and preference for online shopping versus the traditional brick-and-mortar environment. In addition, the Debtors' liquidity constraints prevented the Debtors from investing in their store portfolio to open, relocate, or remodel targeted stores to keep up with competitors. All of the foregoing pressures prevented the Payless' North America business from achieving profitability in the last eighteen months.

C. Efforts to Address Liquidity Challenges

36. The Debtors negotiated with their prepetition lenders for additional credit under their existing ABL Credit Facility and the strategic infusion of capital through a debt offering to lenders under their Term Loan Facility to build liquidity reserves in light of mounting operational issues. In March 2018, the Debtors executed that certain First Amendment and Joinder to Credit Agreement dated as of March 1, 2018, which among other things increased the aggregate FILO commitment under the ABL Credit Facility from \$10 million to \$35 million (the "ABL Amendment").

37. Subsequently, in August 2018, the Debtors entered into discussions with their existing Term Loan lenders regarding, among other things, a potential transaction structure that would enable the Debtors to obtain capital, manage their vendor issues, and right size their balance sheet. Initially the Debtors engaged with the Term Loan lenders regarding a potential equity offering. Due to the Company's declining financial performance, none of the Term Loan lenders expressed interest in an equity offering. As such, the Debtors sought to develop an alternative transaction structure including a combined equity-debt offering. After attempts to negotiate an equity or debt offering on terms acceptable to the Term Loan Lenders proved unsuccessful, Alden Global Opportunities Master Fund, L.P. ("Alden"), which holds approximately 66.5% of the total outstanding equity of Payless, agreed to explore alternative financing options with the Company. Payless offered a debt financing opportunity to all of the Term Loan lenders and all lenders declined participation except for Alden. On October 2, 2018, Alden provided an approximately \$45.5 million delayed draw term loan to non-debtor affiliate, Payless CA Management Limited, which was offered to all Term Loan lenders pursuant to the terms of the Term Loan Facility. The funds from this loan, which were ultimately upstreamed to fund ordinary-course business operations of the Debtors and their subsidiaries, provided a much-needed injection of capital.

38. After emerging from the Prior Cases, the Debtors also engaged in employee reduction measures in light of their financial performance and operational needs. In the fall of 2017, the Debtors reduced their headquarters staff by approximately 170 employees located at the Debtors' corporate headquarters in Topeka. In the winter of 2018, the Debtors terminated an additional 49 employees in field organization positions. Between August 2018 and the Petition Date, the Debtors eliminated approximately 37 employees in their finance department and almost

50 employees in their merchandising and design department. Finally, the Debtors eliminated 65 store leaders and 10 group leaders in certain of their retail locations.

39. In October 2018, the Debtors also explored opportunities to sell their corporate headquarters located at 3231 S.E. 6th Avenue, Topeka, Kansas. Following an auction, the Debtors agreed on terms with a proposed buyer and, on December 27, 2018, entered into purchase and sale agreement to sell the headquarters for approximately \$2 million. The purchase and sale agreement also provides the Debtors with a leaseback on a portion of the building, including their data center, dock area, and limited office space, with extensions as needed as the Debtors wind down their North America business. The sale closed on February 14, 2019 after the requisite consents and releases from the Debtors' lenders were obtained.

D. Exploration of Strategic Alternatives and Restructuring Initiatives

40. Notwithstanding the measures taken above, Payless was unable to return to profitability under its current business model. While the Latin America and franchise businesses continued to perform well, the Debtors' North America brick and mortar business suffered from same store sales declines and declining store productivity. As a result, in December 2018, the Company engaged PJ Solomon, L.P. ("Solomon"), as investment banker to perform a review of the go forward business plan and explore strategic alternatives. The Company also engaged Ankura, as financial advisor. Both Solomon and Ankura worked alongside Akin Gump to develop a restructuring strategy for the Company's businesses.

41. The Company and its advisors analyzed the Company's capital structure and potential alternatives, including the impact of reducing the store footprint in North America to various levels depending on store profitability. The analysis showed that achieving any profitable North America store base would require meaningful improvements in merchandizing margin, stabilized comparable store sales, and significant capital investment. However, the Company and

its advisors believed that significant value could be achieved through a reorganization around the Latin America and franchise businesses. As a result, the Company's efforts shifted to preserving the Latin America and franchise businesses while preparing for an orderly wind down of the North America business.

42. At the same time, the Company has been managing liquidity by making only payments to the merchandise vendors and suppliers that are essential to the Company's operations. Given the significant product volume concentrated among Payless' small group of merchandise vendors abroad, the suppliers have withstood delayed payments for nearly 80 days, and some of them have continued to ship products to Payless in January and February of this year. The suppliers require immediate liquidity to procure the raw materials necessary to meet the Company's product needs for maintaining the Latin America and franchise businesses. To that end, the Company and its advisors have been diligently meeting with vendors and suppliers to work through supply chain issues while limiting disruption to the greatest extent possible.

43. Beginning in January 2019, the Company commenced discussions with an ad hoc group of Term Loan lenders regarding the possible strategic alternatives including a potential transaction structure that would allow the Company to wind down the North America brick and mortar business through the commencement of these chapter 11 cases while preserving the value of their Latin America and franchise business. Given the relative priorities of the collateral securing the Debtors' indebtedness, it is the Company's view that the Term Loan lenders would be the primary recipient of value as associated with the Latin America and franchise business. For that reason, the Company has been in active discussions with the Term Lender group regarding financing to fund the reorganization efforts around such businesses. As of the commencement of

these chapter 11 cases, the Debtors have not obtained a commitment for such financing, but the Debtors intend to continue such discussions and efforts.

E. Appointment of Independent Managers

44. In January 2019, to ensure a thorough and fair process with respect to the Debtors' review of their strategic alternatives, the board of managers of Payless Holdings LLC (the "Board") appointed Patrick Bartels and Scott Vogel to the Board as disinterested directors (the "Independent Managers"). Both of the Independent Managers have extensive experience serving on boards of managers and boards of directors in distressed situations. The Independent Managers will review and investigate matters regarding any transactions between the Debtors (including their subsidiaries and affiliates) and any related parties and/or insiders and any other matters delegated to the Independent Managers by the Board. The Independent Managers subsequently retained Seward & Kissel LLP as independent counsel to assist the Independent Managers in their review. The investigation is progressing, and the Independent Managers and their advisors continue their efforts to evaluate applicable matters and transactions.

IV.
The Current Chapter 11 Cases

A. Liquidity and Use of Cash Collateral

45. Prior to the Petition Date, the events herein caused the Debtors to continue to experience tightening liquidity, leading the ABL Lenders to impose additional reserves under the ABL Credit Facility that affected the Debtors' availability under that facility. In the weeks leading up to these chapter 11 cases, the Debtors focused their efforts on negotiating terms for the consensual use of cash collateral to fund the Store Closing Sales. After arms' length and good faith negotiations, the lenders under the ABL Credit Facility and Term Loan Facility agreed to the use of cash collateral while the Debtors wind down the North America business subject to the

terms and conditions set forth in the *Interim Order Pursuant to 11 U.S.C. §§ 105, 361, 362, 363, 364, 507 and 552 (1) Authorizing Use of Cash Collateral, (2) Granting Adequate Protection, (3) Modifying the Automatic Stay, and (4) Scheduling a Final Hearing* (the “Cash Collateral Order”).⁷

B. Store Closing Sales

46. As described above, the Debtors, after thoughtfully evaluating all suitable alternatives under the circumstances, made the difficult decision to liquidate and close all stores in North America. Accordingly, the Debtors and their advisors conducted an extensive evaluation process for selecting a consultant to serve as the Debtors’ exclusive consultant in connection with conducting the Store Closing Sales in the North America brick and mortar locations. The Debtors’ evaluation process included, among other things, a formal request for proposals from potential consultants, access to diligence information, and review of recovery assumptions, forecasts and analysis. The Debtors also engaged Malfitano Advisors LLC to assist the Debtors and their lenders with selecting a consultant and conducting the Store Closing Sales. The Debtors received proposals from two bidders, a joint venture comprised of Gordon Brothers Retail Partners, LLC and Hilco Merchant Resources, LLC, and a joint venture of Great American Group, LLC and Tiger Capital Group, LLC. Each of the bidders provided a fee-based proposal and an equity proposal and the Debtors worked with their advisors and creditor constituencies to evaluate the various alternatives. Under the circumstances, the Debtors, in consultation with their advisors, determined that the fee-based proposal offered by the joint venture composed of Great American Group, LLC

⁷ For a summary of the terms on which the Debtors have obtained the consensual use of cash collateral, please refer to the *Debtors’ Motion for Entry of Interim and Final Orders Pursuant to 11 U.S.C. §§ 105, 361, 362, 363, 364, 507 and 552 (1) Authorizing Use of Cash Collateral, (2) Granting Adequate Protection, (3) Modifying the Automatic Stay, and (4) Scheduling a Final Hearing*

and Tiger Capital Group, LLC (together, the “Consultant”) provided the best and most competitive proposal to conduct the Store Closing Sales and store closings.⁸

47. On February 12, 2019, the Debtors and the Consultant entered into the Consultant Agreement attached to the Store Closing Motion, which will govern the terms of the Consultant’s engagement (the “Consulting Agreement”). Andrian Frankum, a Senior Managing Director with Ankura, and I were personally involved in negotiations with the Consultant regarding the terms and conditions of the Consulting Agreement, and I believe they were conducted in good faith and at arm’s length. The Consulting Agreement will enable the Debtors to use the logistical capabilities, experience, skills, and resources of the Consultant to conduct the Store Closing Sales effectively and efficiently. Based on my experience with liquidation agents and liquidation consulting agreements approved in other retail chapter 11 cases, I believe the terms of the Consulting Agreement are reasonable and market based. I believe that implementing the store closing procedures and conducting the Store Closing Sales at the Debtors’ stores in the manner proposed in the Store Closing Motion will provide the best and most efficient means for the Debtors to maximize the value of the Debtors’ inventory and other store assets.

48. Further, I believe that it is in the best interests of the Debtors’ estates to assume the Consulting Agreement and formally implement the Store Closing Sales. Prior to the Petition Date, the Debtors commenced “soft sales” as the stores prepared for the launch of the Store Closing Sales. Any delay in consummating the Store Closing Sales would diminish the recovery tied to the monetization of such assets for a number of reasons. Among other things, many of the Debtors’ stores fail to generate sufficient positive cash flow to support the required costs of systems, design,

⁸ For further information regarding the store closure process, *see Debtors’ Motion for Entry of Interim and Final Orders (I) Authorizing the Debtors to Assume the Consulting Agreement, (II) Approving Procedures for Store Closing Sales, and (III) Granting Related Relief* (the “Store Closing Motion”), filed contemporaneously herewith.

sourcing, merchandising and other corporate costs. With the Store Closing Sales, however, these stores (and indeed all of the Debtors' stores) will experience increased sales and cash inflows, which will supplement the Debtors' liquidity. Moreover, the swift and orderly implementation of the Store Closing Sales will allow the Debtors to timely reject the applicable store leases and avoid the accrual of unnecessary administrative expenses for rent payments. It is also important that the Store Closing Sales coincide with the Easter season, one of the Debtors' key selling periods. In sum, any delay in running the Store Closing Sales could deteriorate the Debtors' asset value and thus creditor recoveries in these cases.

49. In addition, on February 18, 2019, the Debtors engaged A&G Realty Partners, LLC to serve as their real estate consultant and advisor in connection with these chapter 11 cases to assess potential sale transactions with respect to the Debtors' store leases.

C. Reorganization of Latin America and Franchise Businesses

50. In parallel with running the Store Closing Sales, the Company will continue to pursue a reorganization involving the Latin America and franchise businesses. Among other things, these efforts will include: (a) seeking appropriate financing or other capital investments for the operation efforts associated with the Latin America and franchise businesses; (b) transitioning support services that were previously provided by the North America business to the Latin America and franchise businesses; (c) evaluating the most efficient transaction structures to create a stand-alone Latin America and franchise business; and (d) working with the Company's vendors and suppliers to adjust the supply chain to support the Latin America and franchise efforts. The Debtors believe that a reorganization of these business segments will provide value to the

Debtors' stakeholders while maintaining the Payless brand and preserving the ability for further growth.

D. Canadian Proceedings

51. In connection with the relief sought in these proceeding, Debtors Payless ShoeSource Canada Inc., ("Payless Canada") and Payless ShoeSource Canada GP Inc., ("Payless Canada GP") will commence proceedings in Canada under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended ("CCAA") by filing an application with the Ontario Superior Court of Justice (Commercial List) (the "Canadian Court"). Payless ShoeSource Canada LP ("Payless ShoeSource LP" together with Payless Canada GP and Payless Canada, the "Canadian Debtors"), is a partnership and not an applicant in the CCAA proceedings, but the Canadian Debtors will seek to extend the protections of the CCAA proceedings to Payless ShoeSource LP.

52. The purpose of the proceedings is to request that the Canadian Court authorize the relief required to implement the wind down of the North America business with respect to the Debtors' Canadian operations under the applicable provisions of the CCAA. In addition, the Canadian Debtors will seek the appointment of a Monitor, as required under the CCAA, to report to the Canadian Court regarding, among other things, the CCAA proceedings, the reasonableness of proposed transactions post-filing, the status of payment of post-filing obligations, the Canadian Debtors' conduct of the wind down, and other events arising in the CCAA proceedings. The Monitor will also serve as resource for Canadian stakeholders in the CCAA proceedings. The Debtors will work closely with the Monitor to provide information as required under applicable law.

53. After the commencement of the CCAA proceedings, the Canadian Debtors will be subject to the laws governing insolvency proceedings in the US and Canada. I have been informed

by Canadian counsel that the CCAA proceedings to be commenced in Canada are not recognition proceedings under Part IV of the CCAA, but plenary proceedings which subject the Canadian Debtors to more fulsome supervision by the Court. Because the Canadian Debtors' operations and many of their stakeholders are located in Canada, the Debtors, on advice from Canadian counsel, propose that with respect to the Canadian Debtors, in the event of a conflict between an order of this Court and an order of the Canadian Court, the order of the Canadian Court will control. I am advised by Akin Gump that the language governing a potential conflict between an order of this Court and an order of the Canadian Court in respect only of Canadian debtors in the context of plenary proceedings in both Canada and the U.S., was recently accepted in the cross border case of *In Toy R Us, Inc.*, No. 17- 34665 (KLP) (Bankr. E.D. Va. Oct. 25, 2017) [Docket No. 725]. The Debtors expect to work closely with their Canadian counsel and the Monitor to avoid any discrepancy between the U.S. and Canadian orders wherever possible.

V.

Relief Sought in the First Day Pleadings

54. Contemporaneously herewith, the Debtors have filed a number of first day pleadings seeking relief that the Debtors believe is necessary to enable them to administer efficiently their estates with minimal disruption and loss of value during the store closing and reorganization efforts described herein. The Debtors request that the relief requested in each of the first day pleadings be granted as critical elements in ensuring the maximization of value of the Debtors' estates.

55. I have reviewed each of the first day pleadings. The facts stated therein are true and correct to the best of my information and belief, and the relief sought in each of the first day pleadings is necessary to enable the Debtors to operate in chapter 11 with minimal disruption to their business operations and constitutes a critical element in successfully completing these chapter

11 cases. A description of the relief requested in and the facts supporting each of the first day pleadings is set forth in **Exhibit A** attached hereto and incorporated herein by reference.

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Pursuant to 28 U.S.C. § 1746, I declare under penalty of perjury that the foregoing is true and correct to the best of my knowledge and belief.

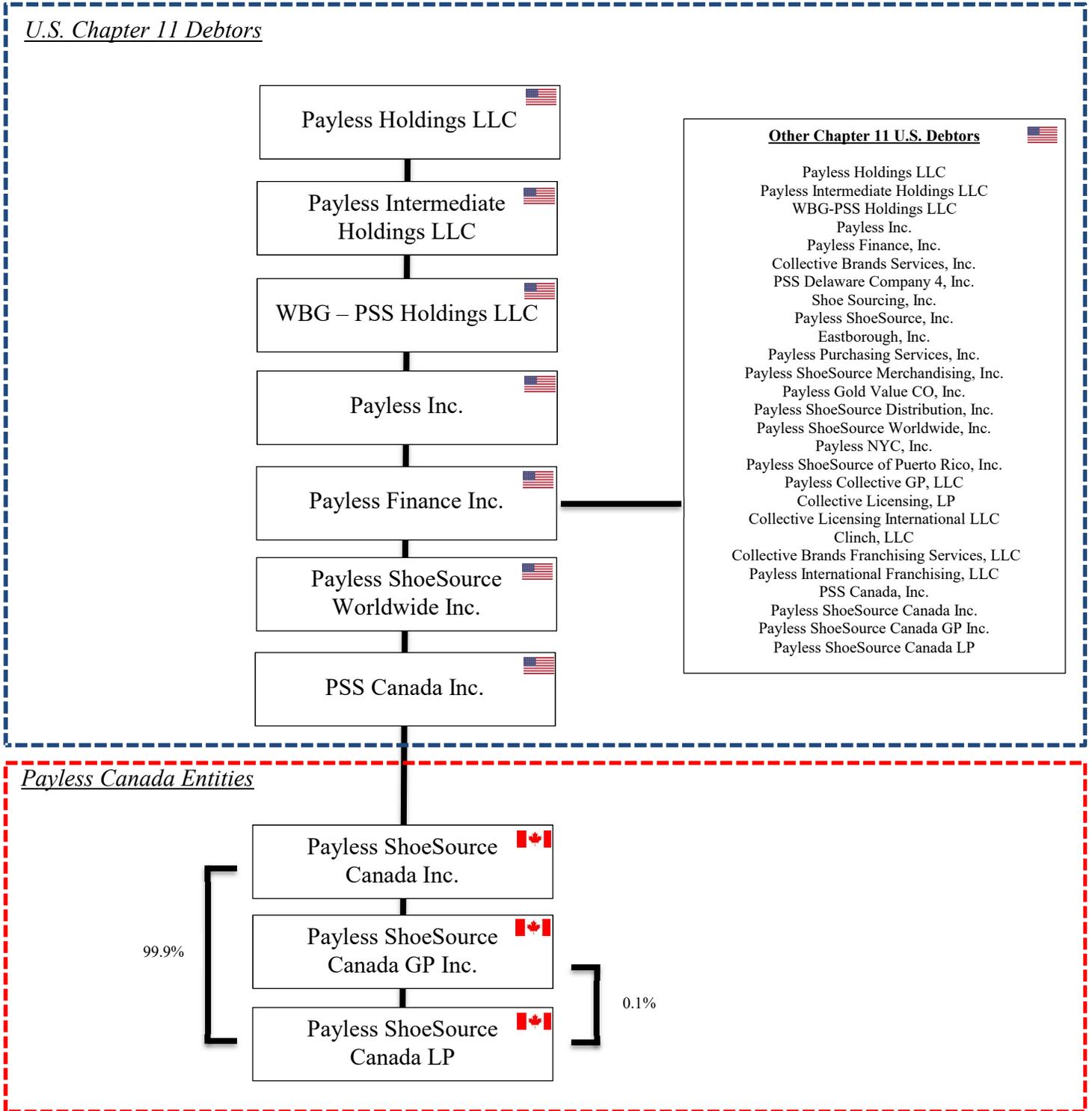
Executed on February 19, 2019

By: *Stephen Marotta*
Name: Stephen Marotta
Title: Chief Restructuring Officer, Payless
Holdings LLC

APPENDIX "B"

[ATTACHED]

Simplified Payless Organization Chart (United States Chapter 11 Debtors and Payless Canada Entities)



APPENDIX "C"

[ATTACHED]

Payless Canada Entities
 CCAA Cash Flow Forecast
 (\$CAD in 000's)

Week Ending:	22-Feb-19	1-Mar-19	8-Mar-19	15-Mar-19	22-Mar-19	29-Mar-19	5-Apr-19	12-Apr-19	19-Apr-19	26-Apr-19	3-May-19	10-May-19	17-May-19	13 - Week	
CCAA Filing Week #:	1	2	3	4	5	6	7	8	9	10	11	12	13	Total	
Receipts															
Trade Receipts	[2]	3,323	4,661	5,795	6,002	6,271	5,840	3,717	2,324	1,836	1,423	909	-	-	42,101
Other Receipts		-	-	-	-	-	-	-	-	-	-	-	-	-	-
Total Receipts		3,323	4,661	5,795	6,002	6,271	5,840	3,717	2,324	1,836	1,423	909	-	-	42,101
Operating Disbursements															
Payroll and Employee Related Costs	[3]	(1,832)	(105)	(1,733)	(6)	(1,638)	(5)	(1,654)	(1,879)	(599)	(2)	(576)	(1,085)	-	(11,113)
Occupancy Costs	[4]	(1,496)	(1,748)	(37)	(1,748)	(37)	(37)	(554)	(15)	(529)	(11)	(11)	-	-	(6,224)
Operating Expenses, Corporate, and Other Costs	[5]	(635)	(217)	(68)	(68)	(68)	(68)	(68)	(32)	(24)	(24)	(24)	(17)	-	(1,312)
Sales Taxes	[6]	-	(292)	-	-	-	-	(656)	-	-	-	(2,158)	-	-	(3,105)
Intercompany	[7]	(33)	(33)	(33)	(33)	(33)	(33)	(33)	(33)	(33)	(33)	(33)	(20)	(20)	(405)
Total Operating Disbursements		(3,996)	(2,396)	(1,871)	(1,855)	(1,776)	(144)	(2,965)	(1,959)	(1,185)	(70)	(2,802)	(1,121)	(20)	(22,160)
Net Operating Cash Inflows / (Outflows)		(673)	2,265	3,924	4,147	4,495	5,697	752	364	651	1,353	(1,893)	(1,121)	(20)	19,941
Professional Fees	[8]	(962)	(622)	(669)	(592)	(573)	(491)	(461)	(528)	(517)	(513)	(484)	(385)	(351)	(7,148)
Liquidation Costs	[9]	(36)	(193)	(273)	(287)	(246)	(226)	(198)	(970)	(86)	(78)	(42)	(360)	-	(2,994)
Net Cash Inflows / (Outflows)		(1,670)	1,450	2,983	3,268	3,676	4,979	93	(1,134)	49	762	(2,419)	(1,866)	(371)	9,799
Cash															
Beginning Balance		3,597	1,926	3,377	6,359	9,627	11,270	11,847	11,470	7,998	7,998	7,998	5,579	3,620	3,597
Net Cash Inflows / (Outflows)		(1,670)	1,450	2,983	3,268	3,676	4,979	93	(1,134)	49	762	(2,419)	(1,866)	(371)	9,799
Canadian Excess Proceeds		-	-	-	-	(2,033)	(4,402)	(470)	(2,338)	(49)	(762)	-	(93)	-	(10,147)
Ending Balance		1,926	3,377	6,359	9,627	11,270	11,847	11,470	7,998	7,998	7,998	5,579	3,620	3,249	3,249
Reserve	[10]	(6,650)	(6,572)	(7,252)	(7,891)	(8,612)	(9,189)	(8,812)	(5,340)	(5,340)	(5,340)	(3,182)	(628)	(591)	

Notes:

- [1] The purpose of this cash flow forecast is to estimate the liquidity requirements of the Payless Canada Entities during the forecast period.
- [2] Forecast Trade Receipts include collections from the normal sale of merchandise until February 21, 2019. Sales generated thereafter are via store closing sales conducted and operated by the Payless Canada Entities with the assistance of a third-party liquidator assisting solely in a consulting capacity to the Payless Canada Entities.
- [3] Forecast Payroll and Employee Related Costs are based on forecast payroll amounts and any bonuses owing, accrued vacation to be paid upon termination, benefits, and other employee-related amounts.
- [4] Forecast Occupancy Costs include payment to landlords, common-area maintenance costs, utility providers, property taxes, and other miscellaneous occupancy costs.
- [5] Forecast Operating Expenses include store level expenses, IT costs, directors' and officers' insurance, and other operating expenses.
- [6] Forecast Sales Taxes reflects net GST, HST, and PST amounts remitted to/from the Federal and Provincial governments. Remittances are generally made one month in arrears.
- [7] Forecast Intercompany Fees include on-going expenses for shared services between Payless entities.
- [8] Forecast Professional Fees include various legal, monitor, and real estate appraisal fees associated with the CCAA proceedings and are based on estimates provided by the various professionals.
- [9] Forecast Liquidation Costs include agency fees, liquidation expenses, store incentive programs, other liquidation-related costs, and estimated gift card redemptions.
- [10] Represents the estimated amount of sales tax, payroll, accrued vacation, severance, employer retirement savings plan, workers' compensation, and employee incentive plan reserves for the week noted in the cash flow.

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 PAYLESS
SHOESOURCE CANADA INC. AND PAYLESS SHOESOURCE CANADA GP INC.
(collectively, the "Applicants")

February 19, 2019

REPORT ON CASH FLOW STATEMENT
(paragraph 10(2)(b) of the CCAA)

The management of the Applicants has developed the assumptions and prepared the attached statement of projected cash flow dated February 19, 2019, consisting of a 13-week cash flow forecast for the weeks ending from February 22, 2019 to May 17, 2019 (the "Forecast").

The hypothetical assumptions are reasonable and consistent with the purpose of the projections as described in the notes to the Forecast (the "Notes"), and the probable assumptions are suitably supported and consistent with the plans of the Applicants and provide a reasonable basis for the Forecast. All such assumptions are disclosed in the Notes.

Since the Forecast is based on future events, actual results will vary from the information presented and the variations may be material.

The Forecast has been prepared solely for the purpose outlined in the Notes, using the probable and hypothetical assumptions as set out in the Notes. Consequently readers are cautioned that the Forecast may not be suitable for other purposes.

Dated at E. Shrewsbury, New Jersey, USA this 18th day of February, 2019.



Stephen Marotta
Chief Restructuring Organization Designated Representative

Payless ShoeSource Canada Inc.
Payless ShoeSource Canada GP Inc.
Payless ShoeSource Canada LP

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 PAYLESS
SHOESOURCE CANADA INC. AND PAYLESS SHOESOURCE CANADA GP INC. (the "Applicants")

Court File No:

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

Proceeding commenced at TORONTO

PRE-FILING REPORT TO THE COURT
SUBMITTED BY FTI CONSULTING CANADA INC.,
IN ITS CAPACITY AS PROPOSED MONITOR

BENNETT JONES LLP
3400 One First Canadian Place
Toronto, Ontario M5X 1A4 CANADA

Kevin J. Zych
Tel: 416-777-5738
Fax: 416-863-1716

Sean H. Zweig
Tel: 416-777-6254
Fax: 416-863-1716

Aiden Nelms
Tel: 416-777-4642
Fax: 416-863-1716

Lawyers for FTI Consulting Canada Inc., in its capacity as
Proposed Monitor