

Court File No. CV-11-9159-00CL

**PRISZM INCOME FUND,
PRISZM CANADIAN OPERATING TRUST,
PRISZM INC. AND KIT FINANCE INC.**

FIRST REPORT OF THE MONITOR
April 26, 2011

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

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

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT
OF PRISZM INCOME FUND, PRISZM CANADIAN OPERATING TRUST,
PRISZM INC. AND KIT FINANCE INC.

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

INTRODUCTION

1. On March 31, 2011, Prizm Income Fund, Prizm Canadian Operating Trust, Prizm Inc. and Kit Finance Inc. (collectively, the “**Applicants**”) made an application under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended (the “**CCAA**”), and an initial order (the “**Initial Order**”) was made by the Honourable Mr. Justice Morawetz of the Ontario Superior Court of Justice (Commercial List) (the “**Court**”) granting, *inter alia*, a stay of proceedings against the Applicants until April 29, 2011, (the “**Stay Period**”) and appointing FTI Consulting as monitor (the “**Monitor**”). The Initial Order also extended the benefits of the protections and authorizations provided by the Initial Order to Prizm Limited Partnership (“**Prizm LP**” and together with the Applicants, the “**Prizm Entities**”). The proceedings commenced by the Applicants under the CCAA will be referred to herein as the “**CCAA Proceedings**”.
2. The purpose of this, the Monitor’s First Report, is to inform the Court on the following:

- (a) The activities of the Prizm Entities and the Monitor since the commencement of the CCAA Proceedings;
- (b) The status of the proposed sale of 231 store locations to Soul Restaurants Canada Inc., an affiliate of Soul Foods Group (“**Soul**”), a U.K. based franchisee of YUM! Restaurants International (the “**Soul Transaction**”) and of the marketing process being undertaken for the business and assets not subject to the Soul Transaction (the “**Marketing Process**”);
- (c) The receipts and disbursements of the Prizm Entities for the period from the start of the CCAA Proceedings to April 17, 2011;
- (d) The Prizm Entities’ revised cash flow forecast for the period April 18 to July 3, 2011 (the “**April 20 Forecast**”);
- (e) Revision of the estimated maximum amount outstanding from time to time that would be subject to the Critical Supplier Charge as stated in paragraph 35 of the Proposed Monitor’s Pre-Filing Report;
- (f) The Prizm Entities’ request for approval of some minor amendments to the existing key employee retention plan (the “**KERP Amendments**”) and the Monitor’s recommendation thereon;
- (g) The Prizm Entities’ request for the granting of a charge in favour of Yum! Restaurants International (Canada) LP (the “**Franchisor**”) securing Continuing Fees accruing and payable subsequent to the commencement of the CCAA Proceedings under the Franchise Agreement, as defined in the Papernick Affidavit (the “**Franchisor Charge**”) and the Monitor’s recommendation thereon; and
- (h) The Prizm Entities’ request for an extension of the Stay Period to June 30, 2011, and the Monitor’s recommendation thereon.

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

4. Unless otherwise stated, all monetary amounts contained herein are expressed in Canadian Dollars. Capitalized terms not otherwise defined herein have the meanings defined in the affidavit of Deborah Papernick, Chief Financial Officer of the Prizm Entities, sworn March 30, 2011, and filed in support of the CCAA application (the "**Papernick Affidavit**"), the Proposed Monitor's Pre-Filing Report, the Initial Order or in the affidavit of Ms. Deborah Papernick sworn April 21, 2011 and filed in support of the Prizm Entities' motion (the "**April 21 Affidavit**"). Copies of Court orders and other materials in respect of the CCAA Proceedings are available on the Monitor's Website at <http://cfcanada.fticonsulting.com/prizm>.

THE ACTIVITIES OF THE PRIZM ENTITIES AND THE MONITOR

5. To date, the Prizm Entities and their management and staff have provided the Monitor with their full co-operation and unrestricted access to the Prizm Entities' premises, books and records. The Monitor has implemented procedures for the monitoring of operations, receipts and disbursements and is assisting the Prizm Entities in their dealings with employees, suppliers, creditors and other interested parties.

6. The Monitor has established a website at <http://cfcanada.fticonsulting.com/priszm> (the “**Monitor’s Website**”) on which regular updates on the CCAA Proceedings are being posted, together with all Court materials filed in the CCAA Proceedings. In addition, the Monitor has established contact numbers (416-739-2920 and 1-855-492-6215) and an email address (priszm@fticonsulting.com) to allow stakeholders to communicate directly with the Monitor in order to address any questions or concerns in respect of the CCAA Proceedings.
7. Pursuant to paragraph 52 of the Initial Order the Monitor:
 - (a) On April 5, 2011, published the initial notice containing the information prescribed under the CCAA in the Globe and Mail (National Edition) and La Presse;
 - (b) On April 1, 2011, made the Initial Order publicly available by posting it on the Monitor’s Website;
 - (c) On April 5, 2011, with the assistance of the Priszm Entities, sent a notice in the prescribed manner to every known creditor with a claim against the Priszm Entities of more than \$1,000.00; and
 - (d) On April 5, 2011, posted a list of creditors, other than the names or addresses of individuals, on the Monitor’s Website.
8. As described in more detail below, since the start of the CCAA Proceedings the Priszm Entities and the Monitor have had numerous meetings and discussions with suppliers and other creditors. The Priszm Entities have received a high degree of support from their suppliers and there has been little disruption to operations, which are continuing on a “normal course” basis. It is the Monitor’s view that the designation of Critical Suppliers and the granting of the Critical Supplier Charge in the Initial Order have been extremely valuable in minimizing disruption of supply.

9. Immediately after the granting of the Initial Order the Monitor and the Prizm Entities began contacting the Critical Suppliers to inform them of the granting of the Initial Order, their designation as Critical Suppliers and the effect of the relevant provisions of the Initial Order. All Critical Suppliers that were not Utility Service Providers were contacted by telephone; Utility Service Provider Critical Suppliers were contacted by telephone in the first week of the CCAA Proceedings or received a letter.
10. For the most part, supply by Critical Suppliers continued without interruption. While there were a few instances where there was a temporary interruption of supply, these were typically as a result of the information not having reached regional divisions of suppliers and were quickly resolved.
11. In addition to its discussions with Critical Suppliers, the Monitor has received more than 350 calls and emails to the Monitor's hotline and mailbox. These enquiries have been primarily from suppliers requesting additional information with respect to the impact of the CCAA Proceedings on their account or to discuss the terms of ongoing supply, with other calls being from other creditors, unitholders and parties expressing interest in potentially acquiring assets.
12. The Monitor, with the assistance of the Prizm Entities, responds to all calls and emails, typically within one business-day. There has been little disruption to supply by suppliers that are not designated Critical Suppliers and no impact on operations from the few minor disruptions that did occur. Many suppliers have continued to provide goods and services on credit terms.

13. In addition to communications with suppliers, the Prizm Entities and the Monitor have endeavoured to ensure that there is open and ongoing communication with employees. Immediately following the granting of the Initial Order, “town hall” meetings were held for both the regional and area management staff of the restaurants and head office staff. A “Frequently Asked Questions” document addressing common questions arising in respect of a CCAA proceeding was posted in each restaurant, at head office and on the Monitor’s Website. Employees were also informed of the Monitor’s Website, hotline and mailbox in order that they could obtain additional information on the CCAA Proceedings and contact the Monitor directly with any questions or concerns.
14. Three head office employees that were participants of the KERPs have resigned since the commencement of the CCAA Proceedings and the Prizm Entities have taken and are taking steps to address the impact of these resignations. Restaurant staff turnover has not been significant and the Prizm Entities have informed the Monitor that it is within seasonal norms.

THE SOUL TRANSACTION AND THE MARKETING PROCESS

15. As described in the Papernick Affidavit, the targeted closing date for the Soul Transaction was April 18, 2011 and the Prizm Entities intended to seek Court approval of the Soul Transaction prior to closing. Since the commencement of the CCAA Proceedings negotiations have continued with Soul, and the Prizm Entities are hopeful that these negotiations will result in the execution of an amended and restated agreement of purchase and sale between Soul, Prizm LP and Prizm Inc. (the “**Soul Agreement**”) in the near future.
16. The Monitor understands that if the Soul Agreement is executed, the Prizm Entities will file a motion seeking approval of the Soul Agreement. The Monitor will provide a report on the Soul Transaction in conjunction with that motion.

17. As described in the Papernick Affidavit, the Prizm Entities are in the process of seeking offers for the acquisition of the locations that are not part of the Soul Transaction with the assistance of Canaccord Genuity, and expressions of interest covering all operating locations have been received. The Monitor understands that the Prizm Entities will be filing a motion seeking approval of the Marketing Process and the engagement of Canaccord Genuity. The Monitor will provide a report with respect thereto in conjunction with that motion.

RECEIPTS & DISBURSEMENTS FOR THE PERIOD TO APRIL 17, 2011

18. The Prizm Entities' actual cash flow on a consolidated basis for the period from the start of the CCAA Proceedings to April 17, 2011, was approximately \$7.9 million better than the March 30 Forecast filed as Appendix A to the Proposed Monitor's Pre-Filing Report, as summarized below:

	Forecast	Actual	Variance
	\$M	\$M	\$M
Receipts:			
Sales	23.3	24.2	0.9
Other	0.3	0.3	0.0
Total Receipts	23.6	24.5	0.9
Disbursements:			
Store costs	8.1	5.1	3.0
Occupancy costs	3.2	2.8	0.4
IT	0.3	0.0	0.3
Fixed asset vendors	0.2	0.0	0.2
Repairs & maintenance	0.6	0.0	0.6
Marketing	0.6	0.3	0.3
Other vendors	1.6	0.2	1.4
Royalties	0.0	0.0	0.0
Co-op marketing	1.3	1.3	0.0
Legal fees	0.1	0.0	0.1
Bank fees	0.2	0.1	0.1
Interest	0.0	0.0	0.0
Sales taxes	2.2	2.2	0.0
Legal & professional fees	1.6	1.5	0.1
Other	0.0	(0.5)	0.5
Total Disbursements	20.0	13.0	7.0
Excess of Receipts over Disbursements	3.6	11.5	7.9
Pre-filing payment of Notes	(2.4)	(2.4)	0.0
Net Cash Flow	1.2	9.1	7.9
Opening Cash	4.9	4.9	0.0
Closing Cash	6.1	14.0	7.9

19. Explanations for the key variances in actual receipts and disbursements as compared to the March 30 Forecast are as follows:

- (a) The variance in store costs arises as a result of the reversal of uncleared cheques following the commencement of the CCAA Proceedings together with lower than forecast payroll related costs;
- (b) The variances in Occupancy costs and in Other disbursements arise primarily as a result of the reversal of uncleared cheques following the commencement of the CCAA Proceedings; and

- (c) The variances in the other disbursement categories are believed to be primarily timing variances that are expected to reverse in future periods.

REVISED CASH FLOW FORECAST TO JULY 3, 2011

20. The April 20 Forecast is attached hereto as Appendix A and shows cash flow is break-even in the period April 18 to July 3, 2011, with a minimum cash balance of approximately \$13.5 million in that period. The April 20 Forecast is summarized below:

	\$M
Receipts:	
Sales	95.0
Other	1.0
Total Receipts	96.0
Disbursements:	
Store costs	60.3
Occupancy costs	10.8
IT	0.7
Fixed asset vendors	0.8
Repairs & maintenance	1.3
Marketing	1.2
Other vendors	5.4
Royalties	0.0
Co-op marketing	3.9
Legal fees	0.4
Bank fees	0.4
Interest	0.0
Sales taxes	7.3
Legal & professional fees	3.1
Other	0.4
Total Disbursements	96.0
Excess of Receipts over Disbursements	0.0
Opening Cash	14.0
Closing Cash	14.0

21. The only significant change in the underlying assumptions in the April 20 Forecast as compared to the March 30 Forecast is a reduction of approximately 2% in forecast sales in the forecast period to reflect management's current expectations.

THE CRITICAL SUPPLIER CHARGE

22. Paragraph 35 of the Proposed Monitor's Pre-Filing Report stated:

“Based on information provided by the Prizm Entities, the Monitor estimates that the maximum amount outstanding from time to time that would be subject to the Critical Supplier Charge would be approximately \$6.2 million. Given the purchase price of the Soul Transaction and the expressions of interest received for the remaining stores, the Monitor is of the view that the Critical Supplier Charge provides adequate security for the credit that would be advanced by the Critical Suppliers.”

23. The Monitor has since determined that in preparing the Pre-Filing Report, a calculation based on the cash flow forecast for the scenario wherein the Soul Transaction was assumed to close on April 17, 2011, as described at paragraph 17 of the Pre-Filing Report, was inadvertently used as the basis for the estimate of the maximum outstanding that would be subject to the Critical Supplier Charge, rather than the March 30 Forecast. Based on the April 20 Forecast, the most current forecast available, the Monitor's current estimate of the approximate maximum amount outstanding from time to time that would be subject to the Critical Supplier Charge is \$9.8 million.
24. Notwithstanding this increased estimate, the Monitor remains of the view that given the purchase price of the Soul Transaction and the expressions of interest received for the remaining stores, the Critical Supplier Charge provides adequate security for the credit that would be advanced by the Critical Suppliers.

THE KERP AMENDMENTS

25. As described at paragraphs 102 to 106 of the Papernick Affidavit, prior to the commencement of the CCAA Proceedings, the Prizm Entities offered 41 key personnel retention bonuses (the “**KERPs**”) and created trusts in favour of the KERP participants to secure the obligations under the KERPs.
26. As noted earlier in this report, three KERP participants have resigned since the commencement of the CCAA Proceedings and have therefore forfeited their entitlement under the KERPs. The Prizm Entities continue to have concerns regarding the retention of key employees and propose to redistribute the amount forfeited amongst certain other KERP participants. As this would be a redistribution of amounts already subject to a trust agreement and the quantum is not significant to the estate as a whole, the Monitor is of the view that there would be no adverse impact on creditors of the Prizm Entities.
27. The Monitor respectfully recommends that this Honourable Court grant the Prizm Entities’ request.

THE PRISZM ENTITIES’ REQUEST FOR THE FRANCHISOR CHARGE

28. Pursuant to the Franchise Agreement, Continuing Fees are payable monthly in arrears at the rate of 6% of sales. Interest accrues on unpaid Continuing Fees at the rate of 18%.
29. Paragraph 81 of the Papernick Affidavit stated:

“In its continuing efforts to conserve cash, particularly in light of the traditional sales declines during the winter, Prizm LP withheld payment of the continuing fee payable pursuant to the Franchise Agreement on December 7, 2010 and has failed to pay the continuing fees to the Franchisor since December 2010. On December 10, 2010, the Franchisor provided Prizm LP an

extension on the unpaid continuing fee until January 15, 2011. Interest is accruing on the unpaid continuing fees. The Prizm Entities do not intend to pay the outstanding or accruing continuing fees to the Franchisor during the term of their proceedings under the CCAA.”

30. At the hearing of the initial application under the CCAA, counsel to the Franchisor raised a concern in respect of the intended non-payment of post-filing Continuing Fees. It was agreed amongst the parties that the issue would be addressed prior to the date on which the first payment of post-filing Continuing Fees would be due, being April 27, 2011. In that regard, the Monitor understands that the Prizm Entities and the Franchisor have agreed, subject to the granting of the Franchisor Charge, that payment of Continuing Fees accruing from March 31, 2011, to May 20, 2011, applicable to each restaurant will be made by the Prizm Entities on the sale of such restaurant and that the Franchisor will waive any claim to interest in respect of such post-filing Continuing Fees.
31. Although no draw under the DIP Amendment is forecast even if the post-filing Continuing Fees are paid in the normal course, the deferral of post-filing Continuing Fees preserves cash and reduces the possibility of the Prizm Entities needing to draw under the DIP Amendment in the event that the assumptions underlying the April 20 Forecast are not met. The waiver of a claim to interest by the Franchisor reduces the overall cost to the estate and is therefore a benefit to all other stakeholders. The granting of the Franchisor Charge would have no impact on other creditors as the post-filing Continuing Fees would otherwise have to be paid from cash flow in the same way as landlords and other suppliers are required to be paid post-filing. Consequently, if the payment of the Continuing Fees is deferred, cash on hand will be higher by the amount equal to the amount of the deferred post-filing Continuing Fees as compared to the scenario where such fees are paid by the Prizm Entities in the normal course.

32. The Monitor understands that Prudential has consented to the granting of the Franchisor Charge in priority to the DIP Lender's Charge and its pre-filing security.
33. Accordingly, the Monitor respectfully recommends that this Honourable Court grant the Prizm Entities' request for the granting of the Franchisor Charge.

THE PRIZM ENTITIES' REQUEST FOR AN EXTENSION OF THE STAY PERIOD

34. The Stay Period currently expires on April 29, 2011. Additional time is required for the Prizm Entities to complete the Marketing Process and distribute proceeds from the sale of their assets. The continuation of the stay of proceedings is necessary to provide the stability needed during that time. Accordingly, the Prizm Entities now seek an extension of the Stay Period to June 30, 2011.
35. While it is expected that the Prizm Entities would be appearing before the Court at various times before that date, a longer extension to the Stay Period is requested. The Prizm Entities and the Monitor believe a longer extension to the Stay Period is advantageous as it removes a degree of uncertainty amongst employees, suppliers and interested parties.
36. The April 20 Forecast demonstrates that the Prizm Entities have sufficient liquidity to fund operations to June 30, 2011.
37. Based on the information currently available, the Monitor believes that creditors would not be materially prejudiced by an extension of the Stay Period to June 30, 2011.
38. The Monitor also believes that the Prizm Entities have acted, and are acting, in good faith and with due diligence and that circumstances exist that make an extension of the Stay Period appropriate.

39. The Monitor therefore respectfully recommends that this Honourable Court grant the Prizm Entities' request for an extension of the Stay period to June 30, 2011.

The Monitor respectfully submits to the Court this, its First Report.

Dated this 26th day of April, 2011.

FTI Consulting Canada Inc.
In its capacity as Monitor of
Prizm Income Fund, Prizm Canadian Operating Trust,
Prizm Inc. and Kit Finance Inc.



Nigel D. Meakin
Senior Managing Director



Toni Vanderlaan
Managing Director

Appendix A

The April 20 Forecast

Prizm Income Fund

CCAA Cash Flow Forecast

April 20, 2011

Amounts in CDN\$000's

Week Ended	4/24/11	5/1/11	5/8/11	5/15/11	5/22/11	5/29/11	6/5/11	6/12/11	6/19/11	6/26/11	7/3/11	Total
Prizm Accounting Week Number	17	18	19	20	21	22	23	24	25	26	27	
Receipts												
Sales	7,073	8,645	9,060	8,604	8,633	9,082	8,811	8,385	8,633	9,160	8,892	94,979
Other	88	88	88	88	88	88	88	88	88	88	88	963
Total Receipts	7,161	8,732	9,148	8,692	8,721	9,169	8,898	8,473	8,721	9,247	8,979	95,942
Disbursements												
Store Costs	5,304	2,588	9,003	3,110	7,368	3,195	8,046	3,615	7,630	3,106	7,335	60,299
Occupancy Costs	97	99	1,451	254	2,207	202	1,825	448	1,849	250	2,065	10,747
IT	159	-	-	32	154	31	-	189	155	-	-	718
Fixed Asset Vendors	59	56	25	37	51	48	46	278	56	52	58	765
Repairs and Maintenance	172	123	66	109	191	61	97	58	217	87	137	1,318
Marketing	322	-	186	-	10	86	430	1	-	-	159	1,194
Other Vendors	338	562	388	365	316	501	478	389	249	375	1,448	5,409
Royalties	-	-	-	-	-	-	-	-	-	-	-	-
Co-op Advertising	-	1,186	-	-	-	1,378	-	-	-	1,358	-	3,921
Legal Fees	-	2	5	13	1	135	62	25	81	63	40	426
Bank Fees	7	1	183	17	7	1	169	24	7	1	1	419
Interest	-	-	-	-	-	-	-	-	-	-	-	-
Taxes	-	2,213	-	-	-	2,580	-	-	-	2,539	-	7,332
Other Payments	-	-	-	-	-	-	-	-	-	-	-	-
Legal and Professional Fees - Restructuring	620	237	240	240	321	233	233	233	263	233	233	3,083
S'Cool Life / WHF	-	-	5	-	-	-	165	-	-	-	165	335
Total Disbursements	7,079	7,065	11,553	4,177	10,625	8,449	11,549	5,259	10,507	8,062	11,640	95,966
Net Cash Flow	82	1,667	(2,406)	4,515	(1,904)	720	(2,651)	3,213	(1,786)	1,185	(2,661)	(24)
Opening Cash Position	16,419	16,501	18,169	15,763	20,278	18,374	19,094	16,443	19,656	17,870	19,055	16,419
Net Cash Flow	82	1,667	(2,406)	4,515	(1,904)	720	(2,651)	3,213	(1,786)	1,185	(2,661)	(24)
Closing Cash Position	16,501	18,169	15,763	20,278	18,374	19,094	16,443	19,656	17,870	19,055	16,395	16,395
Funds NOT Available	(1,020)	726	(690)	(886)	(889)	(865)	(834)	(789)	(889)	(943)	(915)	(915)
Adjusted Cash Position	15,481	18,895	15,074	19,393	17,485	18,229	15,609	18,867	16,982	18,113	15,480	15,480

[A] Adjusted for DIP Financing and Costs

Opening Cash Position (not including "Funds not Available")	13,990	13,949	17,362	13,541	17,860	15,953	16,697	14,076	17,334	15,449	16,580	13,990
Reversal of previous week's "Funds NOT Available"	897	1,020	(726)	690	886	889	865	834	789	889	943	897
Net Cash Flow from Operations	82	1,667	(2,406)	4,515	(1,904)	720	(2,651)	3,213	(1,786)	1,185	(2,661)	(24)
Royalties	-	-	-	-	-	-	-	-	-	-	-	-
Commitment Fee (Note Amendment Agreement)	-	-	-	-	-	-	-	-	-	-	-	-
Issuance Fees (1% of principal amount as per Note Amendment Agreement)	-	-	-	-	-	-	-	-	-	-	-	-
Funds NOT Available for Outflow use - Non-RBC/ Cr & Dr Card Dep	(1,020)	726	(690)	(886)	(889)	(865)	(834)	(789)	(889)	(943)	(915)	(915)
Ending balance in cash before Funding and Interest	13,949	17,362	13,541	17,860	15,953	16,697	14,076	17,334	15,449	16,580	13,947	13,947
Issuance of Series 2011 Notes (includes minimum cash on hand assumption)	-	-	-	-	-	-	-	-	-	-	-	-
Interest on Series 2011 Notes	-	-	-	-	-	-	-	-	-	-	-	-
Issuance of Series 2011 DIP Notes	-	-	-	-	-	-	-	-	-	-	-	-
Adjusted Cash Position - Forbearance and Financing Costs	13,949	17,362	13,541	17,860	15,953	16,697	14,076	17,334	15,449	16,580	13,947	13,947