

Court File No. _____

**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 PRODUCT EXCELLENCE
INC.**

APPLICANT

REPORT OF DELOITTE & TOUCHE INC.

In its capacity as the Proposed Monitor of the Applicant

JULY 31, 2009

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INTRODUCTION

1. Deloitte & Touche Inc. (“**Deloitte**” or the “**Proposed Monitor**”) understands that Product Excellence Inc. (“**PEI**” or the “**Applicant**”) has brought an application before this Honourable Court seeking certain relief under the *Companies’ Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended (the “**CCAA**”).
2. Deloitte has consented to act as Monitor in these CCAA proceedings.
3. This report (“**Report**”) is prepared by Deloitte as the Proposed Monitor in the Applicant’s CCAA proceedings to assist this Honourable Court in considering the Applicant’s requests for relief.
4. The purpose of this Report is to provide this Honourable Court with information concerning:
 - (a) Background information about PEI;
 - (b) The reasons for the CCAA proceedings;
 - (c) PEI’s Debt Structure;
 - (d) Secured Credit Facility;
 - (e) The Promissory Notes;
 - (f) Financial Position of the Applicant;
 - (g) Critical Suppliers;
 - (h) Creditor notification;
 - (i) Directors’ and officers’ charge;
 - (j) The Proposed Transaction; and
 - (k) The Proposed Monitor’s conclusions.

5. In preparing this Report, Deloitte has relied upon audited and unaudited financial information, the Applicant's books and records, financial information prepared by the Applicant, and discussions with management of the Applicant. Deloitte has not audited, reviewed, or otherwise attempted to verify the accuracy or completeness of the information and, accordingly, Deloitte expresses no opinion or other form of assurance on the information contained in this Report. Future oriented financial information included in this Report is based on the Applicant's assumptions regarding future events. Actual results achieved will vary from this information, and the variations may be material.
6. Unless otherwise stated, all dollar amounts contained in this Report are expressed in Canadian dollars.
7. The Proposed Monitor's affiliated accounting firm, Deloitte & Touche LLP is not the auditor of PEI.
8. Deloitte was retained by the Applicant on July 13, 2009, as the Proposed Monitor. Since that date, Deloitte has been reviewing the Applicant's available financial information to gain knowledge of the business and financial affairs of the Applicant and has been assisting in the preparation of the Applicants' anticipated CCAA application.
9. If appointed, the Proposed Monitor will make all relevant documents pertaining to these CCAA proceedings available on its website at www.deloitte.ca

BACKGROUND

10. Based in Concord, Ontario, PEI is a privately owned corporation engaged in the sales, marketing and retail distribution of cosmetics, over the counter products, and health and beauty aids for various brand owners in the United States and Canada. The Applicant currently holds distribution rights to 17 brand manufacturers, as well as two brands owned by PEI.
11. PEI was incorporated in February 2003 under the Ontario Business Corporations Act and commenced the above-noted operations in the same year. For the fiscal year ended December 31, 2008, the Applicant had revenues of approximately \$14 million, down

approximately 31% from the previous year, and suffered a net loss from operations of approximately \$2.6 million. Attached hereto as Appendix "A" is a copy of the review engagement financial statements for the year ended December 31, 2008.

12. For the five months ended May 31, 2009, PEI recorded a net loss from operations of approximately \$963,000 on net sales of approximately \$4.7 million, which were below budget and down from sales for the same period in fiscal 2008. Attached hereto as Appendix "B" is a copy of PEI's internally prepared financial statements for the five months ended May 31, 2009.
13. PEI employs approximately 26 non-unionized employees at its Concord head office and warehouse facility. The Applicant also engages the services of various independent sales representatives located in designated sales territories across Canada, who are paid, on average, 5% of sales generated by them. PEI has entered into a services agreement with a third party warehouse, which provides all inventory control, order picking, brokerage and transportation logistic services to PEI.
14. Deloitte understands that PEI is the wholly-owned subsidiary of PEI Holdings Inc. ("**Holdings**"), which is in turn 80% owned by PEI Investments Inc. ("**Investments**") and 20% owned by Next Paradigm Inc. ("**Next**"), collectively, (the "**Shareholder Group**"). Attached hereto as Appendix "C" is an organization chart of the Applicant's ownership structure.

REASONS FOR CCAA PROCEEDINGS

15. The Proposed Monitor has been advised by PEI that its operations have been negatively impacted by, among other things:
 - (a) Insufficient sales to generate positive cash flow relative to overhead expenses;
 - (b) Large amount of product returns from retailers as a result of PEI being required to guarantee sales to its customers, and PEI's inability to pass these returns on to its suppliers;

- (c) Decline in sales as a result of distribution rights being terminated by brand owners;
 - (d) The cost of developing and holding private label brands owned by PEI, that were either rejected by retailers or ultimately did not sell through and were eventually returned to PEI; and
 - (e) Reduced gross profit as a result of the declining Canadian dollar vis-a-vis the U.S. dollar, as a significant amount of purchases are from suppliers in the United States, which cost increases cannot be passed through to customers.
16. As noted in more detail below, Royal Bank of Canada (“RBC”) informed the Applicant of its intention to terminate the existing credit facility by July 1, 2009, but is currently working with PEI while it arranges alternate financing.
17. As a result of RBC’s intention to terminate its credit facility, PEI unsuccessfully sought additional funding from asset based lenders.
18. The Applicant has indicated to the Proposed Monitor that the Shareholder Group has advised PEI that they are no longer willing to fund PEI’s operations and no longer prepared to provide additional funding necessary for PEI to continue operating, and intend to demand repayment of their secured loans.
19. Despite the recent efforts of PEI to obtain new or additional financing, the Applicant has advised the Proposed Monitor that it is unable to restructure its business and address the claims of its creditors without the benefit of creditor protection.

PEI’s DEBT STRUCTURE

20. According to management’s internally prepared financial statements for the five months ended May 31, 2009, PEI’s approximate outstanding debt obligations are as follows:

Type of Debt	Amount
Secured Credit Facility	\$1.4 million
Promissory Notes (as defined below)	\$11.1 million
Unsecured trade creditors	\$0.90 million

SECURED CREDIT FACILITY

21. PEI's senior secured credit facility (the "**Credit Facility**") was established in 2003 between PEI and RBC, and was most recently renewed by an agreement dated June 16, 2008. The Credit Facility provides a revolving demand loan of \$2.5 million, with maximum borrowings determined by a standard margin calculation based on accounts receivable and inventory levels. The Credit Facility is secured by, among other things, a general security agreement over the Applicant's accounts receivable, inventory and fixed assets.
22. The Credit Facility includes the standard positive and negative covenants typically found in such agreements. The Applicant's books and records indicate that, as at May 31, 2009, the Applicant's owed RBC approximately \$1.4 million in respect of the Credit Facility, however, based the affidavit of Norman Paul, PEI's Chief Executive Officer, dated July 30, 2009 to be filed in support of the Applicant's CCAA filing (the "**Paul Affidavit**") this amount has recently increased to \$1.8 million.
23. Deloitte understands that the Applicant's account has been in RBC Special Loans since 2006. In addition, PEI advises that although no event of default has occurred in connection with the Credit Facility, RBC informed the Applicant in March of 2009 of its intention to terminate the Credit Facility by July 1, 2009, and that PEI should seek an alternative source of financing.
24. The Applicant has advised Deloitte that RBC has agreed to refrain from enforcing its security pending the completion of a proposed sale of certain of PEI's assets, which proposed sale is addressed in greater detail below.

THE PROMISSORY NOTES

25. From 2003 through 2009, the Shareholder Group advanced loans in various amounts to PEI in order to fund brand acquisitions as well as working capital requirements. These loans totalled approximately \$11.1 million as at May 31, 2009.
26. The Applicant provided secured demand promissory notes to the Shareholder Group as evidence of the indebtedness (the "**Promissory Notes**").
27. The Promissory Notes are interest bearing, however, are currently non-interest bearing at by agreement of the Shareholder Group, as PEI does not have sufficient cash to service this debt.
28. The Proposed Monitor understands that the Promissory Notes are subordinated to the Credit Facility, and are secured by general security agreements over all of the assets of the Applicant.
29. In connection with the debt obligations described above, Deloitte understands that PEI has executed additional security documents in favour of RBC and the Shareholder Group (collectively, the "**Security Documents**"). If this Honourable Court chooses to grant the Applicant the relief it is seeking, and chooses to appoint Deloitte as the Monitor, then Deloitte will retain independent legal counsel in order to opine on the validity and enforceability of the Security Documents.

FINANCIAL POSITION OF THE APPLICANT

30. PEI has prepared a 13 week cash flow forecast to the week ended October 23, 2009 (the "**Cash Flow Forecast**") which is appended to the Paul Affidavit and attached hereto as Appendix "D".
31. The Cash Flow Forecast indicates that the Applicant has sufficient funds in order to operate during the proposed CCAA proceedings provided it receives approximately \$569,000 in additional financing from the Shareholder Group.

32. Management has advised Deloitte that the Shareholder Group has agreed to provide the required bridge financing in order to enable PEI to meet its financial obligations, while completing the proposed CCAA process.

CRITICAL SUPPLIERS

33. The Proposed Monitor has been advised by the Applicant that PEI's ongoing operations depend on an ongoing supply of products from third party suppliers. In addition, Deloitte has been advised that the Applicant's operations are reliant on a third party warehousing facility that also provides invoicing to end customers as well as warehousing and customer order fulfillment.
34. Accordingly, Deloitte understands that the draft Initial Order in these CCAA proceedings contemplates that PEI be permitted to pay pre-filing amounts owing to this third party warehouse. In addition, the draft Initial Order contemplates that the Applicant be permitted to pay pre-filing amounts to suppliers who are, in the Applicant's view, critical to the PEI's business to a maximum amount of \$800,000.
35. The Proposed Monitor has been advised by the Applicant that, in order to maintain the value of various product lines and to ensure the continued availability of key supplies and services in the near-term, PEI has made payments to critical suppliers totalling approximately \$183,000 in the week preceding the filing of these CCAA proceedings.

DIRECTORS' AND OFFICERS' CHARGE

36. The Applicant proposes to indemnify its directors and officers by way of the Directors' Charge, for liabilities incurred by the Applicant that may result in post filing claims against the directors and officers in their personal capacities.
37. The Directors' Charge shall be on the property of the Applicant, and shall not exceed \$500,000 in aggregate.

CREDITOR NOTIFICATION

38. The draft Initial Order provides for the notice of the CCAA proceedings to be sent only to known creditors, excluding employees, who are owed more than \$1,000.
39. The Applicant has advised the Proposed Monitor that all 26 employees have been made aware of the proposed CCAA proceedings, and that management will continue to provide updates regularly throughout the proceedings.

THE PROPOSED TRANSACTION

40. The Applicant has advised the Proposed Monitor that it has negotiated a Letter of Intent (“**LOI**”) dated June 11, 2009 with a third party (the “**Proposed Purchaser**”). The LOI contemplates the Proposed Purchaser purchasing from PEI all or substantially all of the assets of PEI’s business (the “**Proposed Transaction**”).
41. The Proposed Transaction anticipates a post closing transition period (the “**Transition**”), whereby PEI will continue to operate the business in order to facilitate the successful integration of PEI’s product line into the Proposed Purchaser’s business, and to provide for the interim processing of orders until such a time as the Proposed Purchaser can set up vendor numbers with current customers.
42. In order to carry on business during the Transition, PEI will require its premises and employees until PEI’s product lines have been fully integrated by the Proposed Purchaser.
43. The Proposed Monitor understands that negotiations are ongoing between PEI and the Proposed Purchaser. Should an agreement of purchase and sale be finalized after the filing of the CCAA application, the Applicant anticipates appearing before this Honourable Court in the near future in order to seek approval of the Proposed Transaction and vesting title to the assets with the Proposed Purchaser.

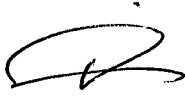
CONCLUSION

44. The Proposed Monitor is of the view that CCAA proceedings will benefit all stakeholders for a variety of reasons, including, *inter alia*:
- (a) the operations of the Applicant will continue in the short term, providing employment to all current employees;
 - (b) ongoing operations will preserve the value of the current branded product line in anticipation of a potential asset sale to a third party;
 - (c) the Applicant will continue to pay landlords and suppliers;
 - (d) the Applicant will have additional time in order to prepare its strategy, which will increase the likelihood of a greater recovery for creditors;
 - (e) the Applicant will have additional time to continue negotiations with the Proposed Purchaser, which may lead to greater recovery for the Applicant's creditors; and
 - (f) without the CCAA proceedings, RBC and the Shareholder Group will enforce their security against the Applicant's assets, forcing a liquidation and the likelihood of a lower recovery for creditors.
45. Attached hereto as Appendix "E" is a copy of the proposed initial CCAA Order.
46. The Proposed Monitor supports the Applicant's motion for CCAA protection.

All of which is respectfully submitted at Toronto, Ontario this 31st day of July, 2009.

DELOITTE & TOUCHE INC.
in its capacity as the Proposed Monitor
of Product Excellence Inc.

Per: _____



f/ Bryan A. Tannenbaum FCA, CA●CIRP, FCIRP

APPENDIX "A"

PEI YEAR END FINANCIAL STATEMENTS

AS AT DECEMBER 31, 2008

PRODUCT EXCELLENCE INC.

FINANCIAL STATEMENTS
(Unaudited)

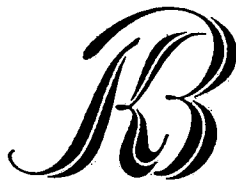
DECEMBER 31, 2008

PRODUCT EXCELLENCE INC.

DECEMBER 31, 2008

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REVIEW ENGAGEMENT REPORT

To the Shareholder of
PRODUCT EXCELLENCE INC.

We have reviewed the balance sheet of **PRODUCT EXCELLENCE INC.** as at December 31, 2008 and the statements of loss and deficit and cash flows for the year then ended. These financial statements have been prepared in accordance with Canadian generally accepted accounting principles, using differential reporting options available to non-publicly accountable enterprises, as described in Note 2(a) to the financial statements. Our review was made in accordance with Canadian generally accepted standards for review engagements and accordingly consisted primarily of enquiry, analytical procedures and discussion related to information supplied to us by the company.

A review does not constitute an audit and consequently we do not express an audit opinion on these financial statements.

Based on our review, nothing has come to our attention that causes us to believe that these financial statements are not, in all material respects, in accordance with Canadian generally accepted accounting principles.

Kraft Berger LLP

KRAFT BERGER LLP
Chartered Accountants
Licensed Public Accountants

Toronto, Ontario
February 27, 2009

PRODUCT EXCELLENCE INC.

BALANCE SHEET
(Unaudited)
DECEMBER 31, 2008

	<u>2008</u>	<u>2007</u>
ASSETS		
CURRENT		
Accounts receivable	\$ 849,447	\$ 2,277,442
Inventory (Note 3)	5,070,432	5,467,125
Sundry receivables	44,855	20,938
Prepaid expenses	<u>244,325</u>	<u>494,639</u>
	6,209,059	8,260,144
PROPERTY AND EQUIPMENT (Note 4)	154,618	156,838
GOODWILL (Note 5)	<u>515,966</u>	<u>515,966</u>
	<u>\$ 6,879,643</u>	<u>\$ 8,932,948</u>
LIABILITIES		
CURRENT		
Bank indebtedness (Note 6)	\$ 1,671,161	\$ 912,694
Accounts payable and accrued liabilities	2,317,314	4,536,672
Obligation under capital lease (Note 7)	<u>13,349</u>	<u>12,205</u>
	4,001,824	5,461,571
OBLIGATION UNDER CAPITAL LEASE (Note 7)	3,529	16,878
ADVANCES FROM PARENT COMPANY AND AFFILIATED COMPANIES (Note 8)	<u>10,104,918</u>	<u>8,105,418</u>
	<u>14,110,271</u>	<u>13,583,867</u>
SHAREHOLDER'S DEFICIENCY		
CAPITAL STOCK (Note 9)	100	100
DEFICIT	<u>(7,230,728)</u>	<u>(4,651,019)</u>
	<u>(7,230,628)</u>	<u>(4,650,919)</u>
	<u>\$ 6,879,643</u>	<u>\$ 8,932,948</u>

See accompanying notes to financial statements.

APPROVED ON BEHALF OF THE BOARD:

_____ Director

_____ Director

PRODUCT EXCELLENCE INC.
STATEMENT OF LOSS AND DEFICIT
(Unaudited)
FOR THE YEAR ENDED DECEMBER 31, 2008

	<u>2008</u>	<u>2007</u>
SALES	\$ 13,957,415	\$ 20,417,911
COST OF SALES	<u>8,260,666</u>	<u>10,467,963</u>
GROSS PROFIT	5,696,749	9,949,948
DIRECT EXPENSES	<u>5,096,834</u>	<u>7,020,302</u>
INDIRECT EXPENSES	<u>599,915</u>	<u>2,929,646</u>
Sales and marketing	927,474	1,105,426
General and administrative	1,721,684	1,745,373
Warehouse	<u>414,937</u>	<u>449,160</u>
	<u>3,064,095</u>	<u>3,299,959</u>
LOSS BEFORE THE FOLLOWING	<u>(2,464,180)</u>	<u>(370,313)</u>
Interest expense	72,011	103,968
Amortization	43,518	51,578
Loss on disposal of property and equipment	-	16,694
Impairment of goodwill	<u>-</u>	<u>1,300,000</u>
	<u>115,529</u>	<u>1,472,240</u>
NET LOSS FOR THE YEAR	(2,579,709)	(1,842,553)
DEFICIT, beginning of year	<u>(4,651,019)</u>	<u>(2,808,466)</u>
DEFICIT, end of year	<u>\$ (7,230,728)</u>	<u>\$ (4,651,019)</u>

See accompanying notes to financial statements.

PRODUCT EXCELLENCE INC.
STATEMENT OF CASH FLOWS
(Unaudited)
FOR THE YEAR ENDED DECEMBER 31, 2008

	<u>2008</u>	<u>2007</u>
OPERATING ACTIVITIES		
Net loss for the year	\$ (2,579,709)	\$ (1,842,553)
Amortization	43,518	51,578
Loss on disposal of property and equipment	-	16,694
Impairment of goodwill	-	<u>1,300,000</u>
	<u>(2,536,191)</u>	<u>(474,281)</u>
Change in non-cash components of working capital		
Accounts receivable	1,427,995	(1,041,854)
Inventory	396,693	(1,644,104)
Sundry receivables	(23,917)	25,404
Prepaid expenses	250,314	(79,876)
Accounts payable and accrued liabilities	<u>(2,219,358)</u>	<u>1,334,824</u>
	<u>(168,273)</u>	<u>(1,405,606)</u>
	<u>(2,704,464)</u>	<u>(1,879,887)</u>
INVESTING ACTIVITIES		
Purchase of property and equipment	(41,298)	(48,472)
Business acquisition	-	<u>(843,720)</u>
	<u>(41,298)</u>	<u>(892,192)</u>
FINANCING ACTIVITIES		
Increase in bank indebtedness	758,467	733,452
Increase in (repayment of) obligation under capital lease	(12,205)	29,083
Increase in advances from parent company and affiliated companies	<u>1,999,500</u>	<u>2,009,544</u>
	<u>2,745,762</u>	<u>2,772,079</u>
CHANGE IN CASH, BEING CASH, end of year	\$ <u>-</u>	\$ <u>-</u>
SUPPLEMENTARY CASH FLOW INFORMATION:		
Interest paid	\$ 72,097	\$ 325,692

See accompanying notes to financial statements.

PRODUCT EXCELLENCE INC.
NOTES TO FINANCIAL STATEMENTS
(Unaudited)

DECEMBER 31, 2008

1. NATURE OF BUSINESS

Product Excellence Inc. ("PEI" or the "Company"), an Ontario corporation, is a distributor of cosmetic, health and beauty products to Canadian retailers.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Differential Reporting Options

The Company, with the consent of its shareholder, has elected to prepare its financial statements in accordance with Canadian generally accepted accounting principles, using the differential reporting options available to non-publicly accountable enterprises described below.

Goodwill

The Company has elected to apply the differential reporting measurement option allowed for goodwill, and, accordingly goodwill will be tested for impairment only when an event or circumstance occurs that indicates that the fair value may be less than its carrying amount.

(b) Inventory

Inventory is valued at the lower of cost and net realizable value, being the estimated selling price of inventory. Cost is determined on a first in, first out basis. Cost represents the direct invoice amount from the supplier plus freight and duty charges.

(c) Property and Equipment

Property and equipment are stated at cost. Amortization is being provided for annually as follows:

Furniture and fixtures	- 20%, declining balance basis
Warehouse equipment	- 20%, declining balance basis
Computer equipment	- 20%, declining balance basis
Computer software	- 100%, declining balance basis
Leasehold improvements	- 10%, straight-line basis
Equipment under capital lease	- 20%, declining balance basis

(d) Revenue Recognition

Sales are recognized upon shipment of products to customers and when collectibility of proceeds is reasonably assured. The Company deducts, from gross sales, payments to customers relating to early payment discounts and returns. Cooperative advertising paid to customers, certain sales and marketing discounts, promotion funds and product listing fees are not deducted from sales but are classified as selling and marketing expenses.

PRODUCT EXCELLENCE INC.
NOTES TO FINANCIAL STATEMENTS
(Unaudited)

DECEMBER 31, 2008

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(e) Foreign Currency Translation

Monetary assets and liabilities denominated in foreign currencies are translated to Canadian dollars at the exchange rate in effect at the balance sheet date. Non-monetary assets and liabilities denominated in foreign currencies are translated at the rates in effect on the transaction date. Revenue and expenses denominated in foreign currencies are translated at the average exchange rate during the year. Foreign currency gains or losses are included in the determination of net income for the year.

(f) Estimates and Measurement Uncertainty

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Items requiring significant estimates and subject to measurement uncertainty include the determination of allowance for doubtful accounts receivable, provision for inventory obsolescence and useful lives of property and equipment and assessment of any impairment in goodwill. By their nature, these estimates are subject to measurement uncertainty. Actual results could differ from those estimates. These estimates are reviewed periodically, and, as adjustments become necessary, they are reported in earnings in the period in which they become known.

(g) Impairment of Long-Lived Assets

The Company reviews, when circumstances indicate it to be necessary, the carrying values of its long-lived assets by comparing the carrying amount of the asset or group of assets to the expected future undiscounted cash flows to be generated by the asset or group of assets. An impairment loss is recognized when the carrying amount of an asset or group of assets held for use exceeds the sum of the undiscounted cash flows expected from its use and eventual disposition. The impairment loss is measured as the amount by which the asset carrying amount exceeds its fair value, based on quoted marked prices, when available, or on the estimated current value of future cash flows.

(h) Income Taxes

The Company uses the asset and liability method to account for income taxes. The asset and liability method requires that income taxes reflect the expected future tax consequences of temporary differences between the carrying amounts of assets or liabilities and their tax bases. Future income tax assets and liabilities are determined for each temporary difference based on the tax rates which are expected to be in effect when the underlying items of income and expense are expected to be realized. The effect on future income tax assets and liabilities of a change in the tax rates is included in income in the period that the rate changes. The amount of future income tax assets recognized is limited to the amount that is more likely than not to be realized.

PRODUCT EXCELLENCE INC.
NOTES TO FINANCIAL STATEMENTS
(Unaudited)

DECEMBER 31, 2008

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

(i) Adoption of Accounting Standards

Effective, January 1, 2008, the Company implemented the new CICA Handbook Section 3031, Inventories, which is effective for fiscal years beginning on or after January 1, 2008. This new standard provides guidance on the determination of cost and requires inventories to be measured at the lower of cost and net realizable value. It provides further guidance on the determination of cost and its subsequent recognition as an expense, including any write-downs to net realizable value and circumstances for their subsequent reversal.

It also provides more restrictive guidance on the cost methodologies that are used to assign costs to inventories and describes additional disclosure requirements. The adoption of this standard has had no impact on the Company's financial statements.

(j) Future Accounting Changes

The following accounting policies will be effective for fiscal 2009.

The Company will be required to adopt the CICA Handbook Section 1535 – Capital Disclosures. This Section specifies the disclosure of (i) an entity's objectives, policies and processes for managing capital; (ii) quantitative data about what the entity regards as capital; (iii) whether the entity has complied with any capital requirements; and (iv) if it has not complied, the consequences of such non-compliance.

The Company will be required to adopt the CICA Handbook Section 3064 – Goodwill and Intangible Assets. This Section establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises.

The Company will be required to adopt the CICA Handbook Section 1400 – General Standards of Financial Statement Presentation. This Section was amended to include guidance on an entity's ability to continue as a going concern. The revised standard explicitly requires management to assess the Company's ability to continue as a going concern.

The Company is assessing the impact of the adoption of the above standards on the financial statements of the Company.

3. INVENTORY

During the year, the Company recognized an impairment charge on inventory of \$1,061,836 (2007 - \$77,003).

	<u>2008</u>	<u>2007</u>
Finished goods	\$ 6,434,466	\$ 5,769,323
Less: Provision for obsolescence and slow-moving inventory	<u>(1,364,034)</u>	<u>(302,198)</u>
	<u>\$ 5,070,432</u>	<u>\$ 5,467,125</u>

PRODUCT EXCELLENCE INC.
NOTES TO FINANCIAL STATEMENTS
(Unaudited)

DECEMBER 31, 2008

4. PROPERTY AND EQUIPMENT

	2008			2007
	Cost	Accumulated Amortization	Net	Net
Furniture and fixtures	\$ 67,374	\$ 46,044	\$ 21,330	\$ 26,662
Warehouse equipment	101,306	69,829	31,477	42,135
Computer equipment	125,054	66,354	58,700	41,232
Computer software	49,920	44,048	5,872	1,352
Leasehold improvements	40,742	24,916	15,826	16,906
	384,396	251,191	133,205	128,287
Equipment under capital lease	37,546	16,133	21,413	28,551
	\$ 421,942	\$ 267,324	\$ 154,618	\$ 156,838

5. GOODWILL

Goodwill represents the excess purchase price of acquired businesses over the fair value of the net assets acquired in the gross amount of \$2,920,569. The cumulative impairment since acquisition is \$2,404,603.

6. BANK INDEBTEDNESS

The Company has a bank credit facility agreement ("the facility") with an authorized maximum amount of \$2,535,000. As at December 31, 2008, \$1,375,000 (2007 - \$747,300) of the facility was utilized. The facility provides for two separate facilities: (i) a \$2,500,000 secured revolving credit facility to finance operations, and (ii) a \$35,000 secured credit card facility. The facility requires, among other things, that the Company satisfy certain financial covenants, including the maintenance of certain financial ratios. As at December 31, 2008, the Company was in compliance with these financial covenants. The interest rate charged on the facility is bank prime rate plus 3% per annum. Security for the facility is provided by a general security agreement covering substantially all of the assets of the Company and a postponement and assignment of advances from the parent company (Note 8).

7. OBLIGATION UNDER CAPITAL LEASE

The capital lease bears interest at 9.1% per annum, is repayable in quarterly installments of \$3,608, matures April 2010 and is secured by certain equipment. Future minimum lease payments are as follows:

2009	\$ 14,434
2010	<u>3,608</u>
	18,042
Less: amount representing interest	<u>(1,164)</u>
	16,878
Less: Current portion	<u>13,349</u>
	<u>\$ 3,529</u>

PRODUCT EXCELLENCE INC.
NOTES TO FINANCIAL STATEMENTS
(Unaudited)

DECEMBER 31, 2008

8. ADVANCES FROM PARENT COMPANY AND AFFILIATED COMPANIES

	2008	2007
Advances from parent company	\$ 9,600,000	\$ 7,981,193
Advances to parent company	<u>(626,850)</u>	<u>(626,350)</u>
	<u>8,973,150</u>	<u>7,354,843</u>
Advances from affiliated companies		
Next Paradigm Inc.	175,000	175,000
PEI Investments Inc.	<u>956,768</u>	<u>575,575</u>
	<u>1,131,768</u>	<u>750,575</u>
	<u>\$ 10,104,918</u>	<u>\$ 8,105,418</u>

- (a) The advances from parent company, PEI Holdings Inc., bear interest at approximately 3.7% per annum effective January 1, 2006 until February 23, 2007 at which time the advances became non-interest bearing and accrued and unpaid interest was paid in full. The advances are due on demand with security provided by a general security agreement over all of the assets of the Company which is subordinated in favour of the bank (Note 6).
- (b) The advances to parent company are non-interest bearing, unsecured and due on demand.
- (c) The advances from affiliated companies are non-interest bearing, unsecured and due on demand. Security for the advances is provided by a general security agreement over all of the assets of the Company, which is subordinated in favour of the bank (Note 6).

The parent company, the Company and the affiliated companies have no intention of demanding repayment of any of the advances within the next twelve months. Therefore, these amounts have been classified as long-term.

9. CAPITAL STOCK

Authorized

Unlimited Class "A" common shares
 Unlimited Non-voting, non-redeemable Class "B" common shares
 Unlimited Redeemable at their paid-up amount, non-voting special shares

Issued

	2008	2007
90 Class "A" common shares	\$ 90	\$ 90
10 Class "B" non-voting common shares	<u>10</u>	<u>10</u>
	<u>\$ 100</u>	<u>\$ 100</u>

PRODUCT EXCELLENCE INC.
NOTES TO FINANCIAL STATEMENTS
(Unaudited)

DECEMBER 31, 2008

10. COMMITMENTS

- (a) The Company has guaranteed certain obligations of the parent company, PEI Holdings Inc., to an affiliated company in the principal amount of \$1,100,000 plus any interest that may be accrued.
- (b) The Company leases its office and warehouse premises under an agreement for a seven year, three month term ending October 31, 2010. The agreement requires the following minimum annual rental payments for the next two years and in aggregate until maturity, inclusive of taxes, maintenance, and incremental occupancy costs:

2009		\$ 220,631
2010		<u>187,487</u>
		<u>\$ 408,118</u>

- (c) The Company has entered into a number of distribution agreements with manufacturers that include minimum commitments for annual purchases of products. The agreements provide the manufacturers the right to terminate the agreements if the purchased commitments are not achieved. As at December 31, 2008 the Company has not achieved the minimum purchase requirements for these agreements. The manufacturers have given no indication of their intention to terminate the agreements.
- (d) In 2004, the Company entered into a five year distribution agreement with a manufacturer that requires the Company to pay the manufacturer a guarantee of US\$100,000 during each year of the agreement. During the year, the Company paid US \$25,000 of the guaranteed amount. Subsequent to December 31, 2008 the manufacturer terminated the distribution agreement with the Company for non-payment of the US \$100,000 guarantee. It is the opinion of management that the loss of the distribution rights from this manufacturer will not have a material effect on the Company's financial position or statement of earnings.

11. CONTINGENCIES

In the normal course of operations, the Company is involved in two legal claims and legal proceedings. While the final outcome with respect of claims and legal proceedings pending as at February 27, 2009 cannot be predicted with certainty, it is the opinion of management that their resolution will not have a material adverse effect on the Company's financial position or statement of earnings.

12. FINANCIAL INSTRUMENTS

(a) Fair Values of Financial Instruments

The carrying amounts of accounts receivable, sundry receivables, bank indebtedness, accounts payable and accrued liabilities and obligation under capital lease approximate fair value due to the short-term maturities of these financial instruments.

The carrying amount of advances from parent company and affiliated companies is not determinable because the terms of these financial instruments are not comparable to similar advances from non-related parties.

PRODUCT EXCELLENCE INC.
NOTES TO FINANCIAL STATEMENTS
(Unaudited)

DECEMBER 31, 2008

12. FINANCIAL INSTRUMENTS (Continued)

(b) Interest Rate Risk

The Company is exposed to interest rate risk as a result of its issuance of variable rate debt. There are no interest rate hedging transactions outstanding as at December 31, 2008.

(c) Credit Risk

The Company grants credit to its customers in the normal course of business. Credit valuations are performed on a regular basis and the financial statements take into account an allowance for bad debts. The Company does not have any credit risk concentration.

(d) Foreign Exchange Rate Risk

The Company earns certain revenue from sales of goods in U.S. dollars and purchases these goods in Canadian dollars. The Company also purchases goods for resale that are denominated in U.S. dollars and Euros and it earns its revenues in Canadian dollars. As such, it is subject to foreign exchange risk due to fluctuations in the U.S./Canadian exchange rate. There are no foreign exchange hedging transactions outstanding as at December 31, 2008. The foreign exchange loss during the year amounted to \$206,256 (2007 - \$8,376). The following amounts denominated in U.S. funds and Euros are translated at 1.2246 and 1.7046 respectively (2007 - U.S. funds 0.9820; Euros 1.4464) and are included in the following financial statement items:

	<u>2008</u>	<u>2007</u>
<u>U.S. Funds</u>		
Accounts receivable	US \$ 24,062	US \$ 171,158
Bank indebtedness	US \$ 184,382	US \$ 150,000
Accounts payable and accrued liabilities	US \$ 287,931	US \$ 531,951
<u>Euros</u>		
Accounts payable and accrued liabilities	Euros 66,055	Euros 304,522

13. SIGNIFICANT CUSTOMERS

During 2008, the Company had three customers that represent 24%, 15% and 10% respectively of total sales (2007 - 18%, 16% and 9%).

14. RELATED PARTY TRANSACTIONS

Included in general and administrative expenses is \$211,479 (2007 - nil) representing consulting fees from a company under common management. Included in accounts receivable is \$88,200 (2007 - nil) from a company under common management. All related party transactions are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

PRODUCT EXCELLENCE INC.
NOTES TO FINANCIAL STATEMENTS
(Unaudited)

DECEMBER 31, 2008

15. INCOME TAX INFORMATION

The company has operating losses for income tax purposes in the amount of approximately \$5,517,000 which may be carried forward to reduce taxable income of future years. No provision has been made in these financial statements for the potential tax benefits on the application of these losses. The losses expire as follows:

2010	\$ 806,000
2014	666,000
2016	457,000
2026	331,000
2027	584,000
2028	<u>2,673,000</u>
	<u>\$ 5,517,000</u>

16. BUSINESS ACQUISITION

On June 1, 2007 the Company acquired substantially all of the operating assets of the Salon Selectives styling business in Canada for cash consideration of \$843,720, including acquisition costs of \$15,966. The terms of the acquisition provide for an amount of three percent of gross sales to be paid to the vendor for each of the three years following the closing date. The amount is paid on an annual basis. The acquisition was accounted for by the purchase method. Details of the net assets acquired, at fair value, and the consideration given, are as follows:

Inventory	\$ 327,754
Goodwill	<u>515,966</u>
	<u>\$ 843,720</u>

APPENDIX "B"

PEI INTERNAL INTERIM FINANCIAL STATEMENTS

FIVE MONTHS ENDED MAY 31, 2009

Product Excellence Inc.
Balance Sheet
May 31, 2009
(CDN\$)

	Actual	Budget	Variance
ASSETS			
Current			
Cash and cash equivalents	-	-	-
Accounts receivable	1,201,380	1,566,270	(364,890)
Inventory	4,706,781	4,765,620	(58,839)
Sundry receivables	4,000	4,000	-
Prepaid expenses	213,184	157,730	55,454
Total current assets	<u>6,125,345</u>	<u>6,493,620</u>	<u>(368,275)</u>
Capital assets, net of accumulated depreciation	140,440	149,540	(9,100)
Goodwill	515,966	516,000	(34)
Total assets	<u>6,781,751</u>	<u>7,159,160</u>	<u>(377,409)</u>
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current			
Bank indebtedness	1,407,754	1,572,100	(164,346)
Accounts payable	879,135	1,147,270	(268,135)
Accrued liabilities	1,571,840	1,312,200	259,640
Current portion of capital lease obligation	9,741	10,560	(819)
Total current liabilities	<u>3,868,470</u>	<u>4,042,130</u>	<u>(173,660)</u>
Capital lease obligation	372	-	372
Loan from associated companies	11,106,422	11,104,900	1,522
Shareholders' equity			
Share capital	100	100	-
Retained earnings	(8,193,613)	(7,987,970)	(205,643)
Total shareholders' equity	<u>(8,193,513)</u>	<u>(7,987,870)</u>	<u>(205,643)</u>
Total liabilities and shareholders' equity	<u>6,781,751</u>	<u>7,159,160</u>	<u>(377,409)</u>

Product Excellence Inc.
Income Statement - Current Year Actual vs. Budget
May 31, 2009

Current Month				
Actual		Budget		Variance
\$\$	% Rev	\$\$	% Rev	\$\$
754,418	100.0%	1,333,860	100.0%	(579,442)
754,418	100.0%	1,333,860	100.0%	(579,442)

376,341	49.9%	760,650	57.0%	384,309
376,341	49.9%	760,650	57.0%	384,309

378,077	50.1%	573,210	43.0%	(195,133)
378,077	50.1%	573,210	43.0%	(195,133)

395,396	52.4%	464,230	34.8%	68,834
395,396	52.4%	464,230	34.8%	68,834

(17,319)	-2.3%	108,980	8.2%	(126,299)
(17,319)	-2.3%	108,980	8.2%	(126,299)

42,435	5.6%	38,400	2.9%	(4,035)
41,758	5.5%	46,260	3.5%	4,502
44,749	5.9%	46,350	3.5%	1,602
81,919	10.9%	102,090	7.7%	20,171
26,765	3.5%	28,510	2.1%	1,745
237,626	31.5%	261,610	19.6%	23,985

(254,944)	-33.8%	(152,630)	-11.4%	(102,314)
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3,163	0.4%	2,900	0.2%	(263)
5,142	0.7%	7,100	0.5%	1,958
1	0.0%	-	0.0%	(1)
(263,250)	-34.9%	(162,630)	-12.2%	(100,620)

-	0.0%	-	0.0%	-
(263,250)	-34.9%	(162,630)	-12.2%	(100,620)

(7,930,363)	(7,825,340)	(105,023)
(263,250)	(162,630)	(100,620)
(8,193,613)	(7,987,970)	(205,643)

Year to Date				
Actual		Budget		Variance
\$\$	% Rev	\$\$	% Rev	\$\$
4,741,053	100.0%	5,825,810	100.0%	(1,084,757)
4,741,053	100.0%	5,825,810	100.0%	(1,084,757)

2,673,862	56.4%	3,257,640	55.9%	583,778
2,673,862	56.4%	3,257,640	55.9%	583,778

2,067,191	43.6%	2,568,170	44.1%	(500,979)
2,067,191	43.6%	2,568,170	44.1%	(500,979)

1,784,903	37.6%	1,961,350	33.7%	176,447
1,784,903	37.6%	1,961,350	33.7%	176,447

282,288	6.0%	606,820	10.4%	(324,532)
282,288	6.0%	606,820	10.4%	(324,532)

196,110	4.1%	194,350	3.3%	(1,760)
179,128	3.8%	198,260	3.4%	19,132
218,336	4.6%	255,240	4.4%	36,905
470,236	9.9%	521,270	8.9%	51,034
137,962	2.9%	142,566	2.4%	4,604
1,201,772	25.3%	1,311,686	22.5%	109,915

(919,483)	-19.4%	(704,866)	-12.1%	(214,617)
-----------	--------	-----------	--------	-----------

15,793	0.3%	14,500	0.2%	(1,293)
27,638	0.6%	38,304	0.7%	10,666
(28)	0.0%	-	0.0%	28
(962,886)	-20.3%	(757,670)	-13.0%	(205,216)

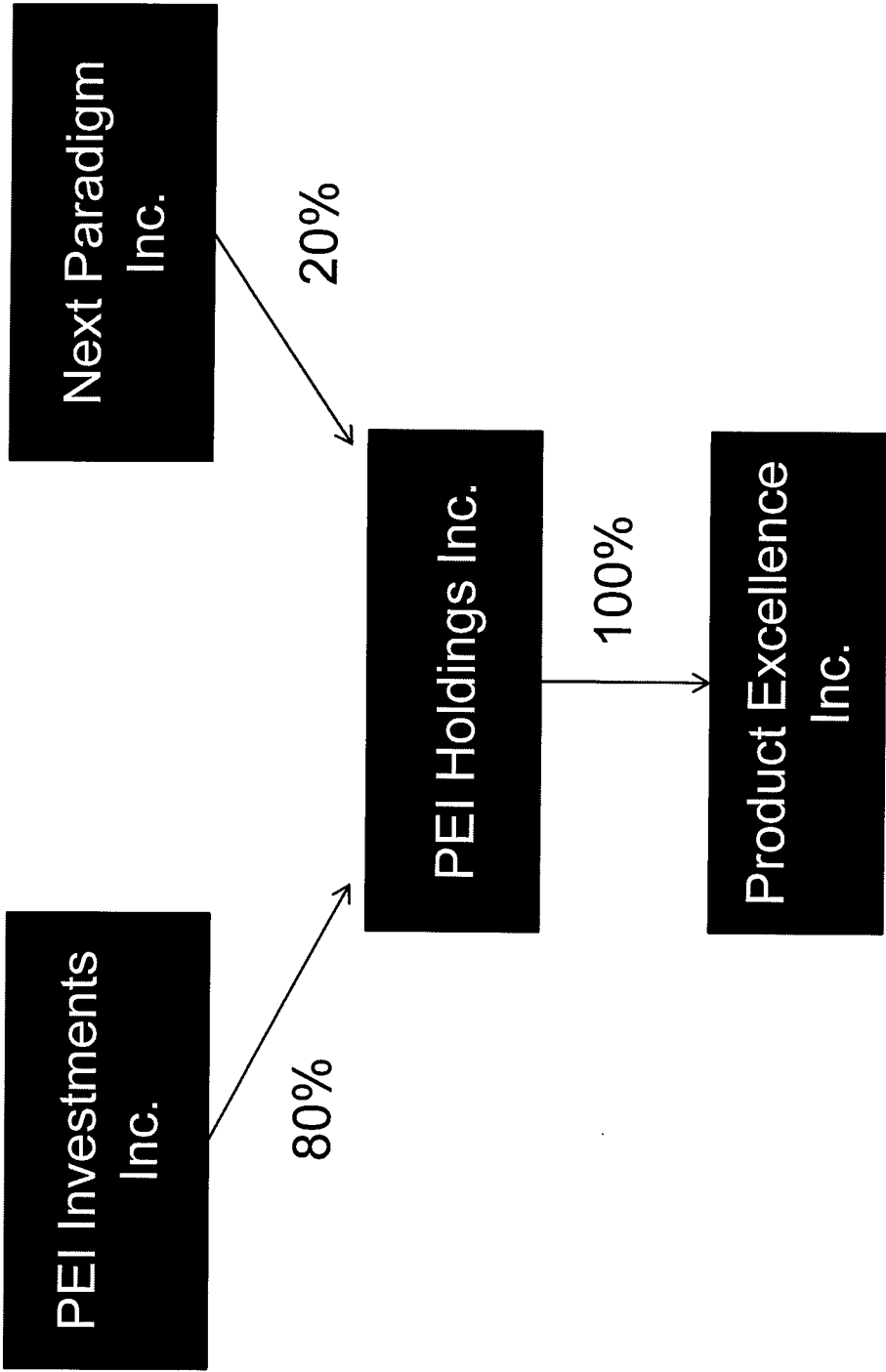
-	0.0%	-	0.0%	-
(962,886)	-20.3%	(757,670)	-13.0%	(205,216)

(7,230,727)	(7,230,300)	(427)
(962,886)	(757,670)	(205,216)
(8,193,613)	(7,987,970)	(205,643)

5

APPENDIX "C"
ORGANIZATION CHART

Product Excellence Inc. Ownership Structure



APPENDIX "D"

13 WEEK CASH FLOW FORECAST

**Product Excellence Inc.
13 Week Cash Flow Forecast
CAD (in 000's)**

Week Ended	1	2	3	4	5	6	7	8	9	10	11	12	13	Total
Receipts	31-Jul	7-Aug	14-Aug	21-Aug	28-Aug	4-Sep	11-Sep	18-Sep	25-Sep	2-Oct	9-Oct	16-Oct	23-Oct	
Collection of opening A/R	120	120	120	120	120	120	-	-	-	-	-	-	-	719
Collection of post filing A/R	7	15	33	52	72	93	117	144	170	186	199	211	225	1,523
Shareholder loan	200	-	-	100	169	-	-	100	-	-	-	-	-	559
Total Receipts	327	134	153	272	361	213	117	244	170	186	199	211	225	2,812
Cash Disbursements	183	103	102	86	280	71	36	-	-	16	-	68	-	945
Dsbrmnt of opening A/P & Accr														Note 4
Ongoing purchases														
Inventory purchases	-	15	-	-	-	-	98	137	50	54	66	42	42	517
W/H services	-	-	-	-	-	-	32	-	-	-	-	35	-	Note 6
Freightout	-	-	-	-	-	-	11	-	18	-	18	-	-	Note 7
Remuneration	4	78	4	61	4	78	4	87	4	56	26	99	9	Note 8
Travel	1	1	1	1	1	1	1	1	1	1	1	1	1	Note 9
Facilities	4	21	-	2	3	23	-	2	3	23	-	-	2	Note 10
Advrtg, Promo, Pckg	6	5	5	5	5	5	5	5	5	5	5	5	5	Note 11
Professional fees	-	-	2	-	-	-	-	14	-	-	-	14	-	Note 12
Office & general	9	12	1	-	9	-	-	-	-	9	-	-	-	Note 13
Administration	5	7	-	-	12	13	13	-	-	-	13	-	-	Note 14
Interest	7	-	-	-	7	7	-	-	-	-	-	-	-	Note 15
CAPEX (per budget)	-	-	-	3	-	-	-	-	-	4	-	-	-	Note 16
Total Disbursements	219	235	115	172	301	196	199	245	80	167	129	263	57	2,378
Net Cash Flow	108	(100)	38	99	60	17	(83)	(1)	90	19	70	(52)	167	434
Opening Cash Balance	-	108	8	46	146	206	223	140	139	229	248	319	267	-
Closing Cash Balance	108	8	46	146	206	223	140	139	229	248	319	267	434	434

Product Excellence Inc.
Unaudited 13 Week Cash Flow Projection
Notes and Assumptions

- 1 Collection of Opening AVR consists of receipts from customer accounts receivable generated from pre-filing sales and shipments, and takes into consideration the Applicant's historical provisions for discounts, program spending and bad debts.
- 2 Collection of Post Filing AVR consists of receipts from collection of customer accounts receivable generated from sales and shipments that take place post filing. The timing of receipt of these collections are based upon the historical collection history, and have been adjusted to reflect provisions for discounts, trade spend and bad debts.
- 3 These receipts reflect additional bridge loans made to PEI by the Shareholder Group in order to fund operations.
- 4 Disbursements made to certain suppliers in respect of amounts owing prior to August 3, 2009, the filing date in order to ensure ongoing supply of goods or services.
- 5 Payments made in respect of inventory purchased and received during the period in order to meet post filing sales to customers. Assumes that suppliers offers standard payment terms from 30 to 45 days.
- 6 Warehouse payments represent disbursements to VDI Warehouse for customer order fulfillment, and is based upon PEI's standard terms with VDI of 4% of sales on customer orders fulfilled by VDI.
- 7 Freight out represents disbursements in respect of shipments to customers during the period, as facilitated by VDI.
- 8 Remuneration represents gross amounts in respect of bi-weekly salaried and hourly payroll, inclusive of group health benefits, plus an employee contractor. PEI has also included commissions payable in respect of independent sales representatives in the United States and Canada.
- 9 Travel expense represent minor personal weekly expenses of employees, which are occasionally required.
- 10 Facilities represent payments made in respect of rent, utilities and upkeep of the Applicant's two leased locations throughout period. There are no arrears.
- 11 Represents in store marketing and product packaging development costs, based on historic amounts.
- 12 Professional Fees represent payments made in respect of legal and advisory services rendered. PEI assumes that professional fees associated with the CCAA filing and monitoring will be invoiced and paid subsequent to the cash flow period.
- 13 Represents payments made to various suppliers in respect of courier, postage and general office supplies.
- 14 Administration encompasses payments for insurance, recycling and maintenance of the Applicant's EDI network, which facilitates the customer order process.
- 15 Interest charges are based on RBC's operating loan.
- 16 Capital Expenditures primarily represent minimum forecast expenditures required to maintain the Applicant's warehouse location.

APPENDIX "E"

PROPOSED INITIAL CCAA ORDER

SCHEDULE "A"

Court File No.

**ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST**

THE HONOURABLE) TUESDAY, THE 4th
JUSTICE)
)
) DAY OF AUGUST, 2009

**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 PRODUCT EXCELLENCE INC.**

INITIAL ORDER

THIS APPLICATION, made by the Applicant, PRODUCT EXCELLENCE INC. ("PEI") pursuant to the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended (the "CCAA") was heard this day at 330 University Avenue, Toronto, Ontario.

ON READING the affidavit of NORMAN PAUL sworn July , 2009 and the Exhibits thereto and on hearing the submissions of counsel for PEI, counsel for the Royal Bank of Canada, and counsel for **, such other counsel as were present, and upon being advised that the Notice of Application and the Application Record herein were duly served on the service list, as appears from the affidavit of service of Kelly Barrett sworn ** and on reading the report of DELOITTE & TOUCHE INC. ("Deloitte") in its capacity as proposed Monitor, including the consent of Deloitte to act as the Monitor, if so appointed,

SERVICE

1. THIS COURT ORDERS that the time for service of the Notice of Application and the Application Record is hereby abridged so that this Application is properly returnable today and hereby dispenses with further service thereof.

APPLICATION

2. THIS COURT ORDERS AND DECLARES that PEI is a company to which the CCAA applies.

PLAN OF ARRANGEMENT

3. THIS COURT ORDERS that PEI shall have the authority to file and may, subject to further order of this Court, file with this Court a plan of compromise or arrangement (hereinafter referred to as the "Plan") between, *inter alia*, PEI and one or more classes of its secured and/or unsecured creditors as it deems appropriate.

POSSESSION OF PROPERTY AND OPERATIONS

4. THIS COURT ORDERS that PEI shall remain in possession and control of its current and future assets, undertakings and properties of every nature and kind whatsoever, and wherever situate including all proceeds thereof (the "Property"). Subject to further Order of this Court, PEI shall continue to carry on business in a manner consistent with the preservation of its business (the "Business") and Property. PEI shall be authorized and empowered to continue to retain and employ the employees, consultants, agents, experts, accountants, counsel and such other persons (collectively "Assistants") currently retained or employed by it, with liberty to retain such further Assistants as it deems reasonably necessary or desirable in the ordinary course of business or for the carrying out of the terms of this Order.

5. THIS COURT ORDERS that PEI shall be entitled but not required to pay the following expenses whether incurred prior to or after this Order:

- (a) all outstanding and future wages, salaries, employee and pension benefits, vacation pay, bonuses and expenses payable on or after the date of this Order, in each case

incurred in the ordinary course of business and consistent with existing compensation policies and arrangements; and

- (b) the fees and disbursements of any Assistants retained or employed by the Applicant in respect of these proceedings, at their standard rates and charges.

6. THIS COURT ORDERS that, except as otherwise provided to the contrary herein, PEI shall be entitled but not required to pay all reasonable expenses incurred by PEI in carrying on the Business in the ordinary course after this Order, and in carrying out the provisions of this Order, which expenses shall include, without limitation:

- (a) all expenses and capital expenditures reasonably necessary for the preservation of the Property or the Business including, without limitation, payments on account of insurance (including directors and officers insurance), maintenance and security services; and
- (b) payment for goods or services actually supplied to PEI following the date of this Order.

7. THIS COURT ORDERS that PEI shall remit, in accordance with legal requirements, or pay:

- (a) any statutory deemed trust amounts in favour of the Crown in right of Canada or of any Province thereof or any other taxation authority which are required to be deducted from employees' wages, including, without limitation, amounts in respect of (i) employment insurance, (ii) Canada Pension Plan, (iii) Quebec Pension Plan, and (iv) income taxes;
- (b) all goods and services or other applicable sales taxes (collectively, "Sales Taxes") required to be remitted by PEI in connection with the sale of goods and services by PEI, but only where such Sales Taxes are accrued or collected after the date of this Order, or where such Sales Taxes were accrued or collected prior to the date of this Order but not required to be remitted until on or after the date of this Order, and

- (c) any amount payable to the Crown in right of Canada or of any Province thereof or any political subdivision thereof or any other taxation authority in respect of municipal realty, municipal business or other taxes, assessments or levies of any nature or kind which are entitled at law to be paid in priority to claims of secured creditors and which are attributable to or in respect of the carrying on of the Business by PEI.

8. THIS COURT ORDERS that until such time as PEI delivers a notice in writing to repudiate a real property lease in accordance with paragraph 11(c) of this Order (a "Notice of Repudiation"), PEI shall pay all amounts constituting rent or payable as rent under real property leases (including, for greater certainty, common area maintenance charges, utilities and realty taxes and any other amounts payable to the landlord under the lease) or as otherwise may be negotiated between PEI and the landlord from time to time ("Rent"), for the period commencing from and including the date of this Order, monthly in equal payments on the first day of each month, in advance (but not in arrears). On the date of the first of such payments, any arrears relating to the period commencing from and including the date of this Order shall also be paid. Upon delivery of a Notice of Repudiation, PEI shall pay all Rent due for the notice period stipulated in paragraph 11(c) of this Order, to the extent that Rent for such period has not already been paid.

9. THIS COURT ORDERS that, except as specifically permitted herein, PEI is hereby directed, until further Order of this Court: (a) to make no payments of principal, interest thereon or otherwise on account of amounts owing by PEI to any of its creditors as of this date; (b) to grant no security interests, trust, liens, charges or encumbrances upon or in respect of any of its Property; and (c) to not grant credit or incur liabilities except in the ordinary course of the Business.

CRITICAL SUPPLIERS

10. THIS COURT ORDERS that notwithstanding paragraph 9 above, PEI shall be permitted to pay any amounts currently owing to the following critical suppliers:

ABGI Corporation
Accurate Rotal Co. Limited
American International Industries

Blossom Packaging Inc.
Body Care Manufacturing
Chicago Aerosol
Dicon Display Inc.
Interpak Systems Inc.
Marketing Impact Limited
M.E.F. Inc.
The New Milani Group Inc.
Quantum Management Services Ltd.
Tri-Quality Packaging Inc.
VDI Healthcare Logistics
Experchem Laboratories Inc.
Sales representatives for PEI

RESTRUCTURING

11. THIS COURT ORDERS that PEI shall have the right to:
- (a) permanently or temporarily cease, downsize or shut down any of its business or operations and to dispose of redundant or non-material assets not exceeding \$500,000.00 in any one transaction or \$1,000,000.00 in the aggregate, subject to paragraph 11(c), if applicable;
 - (b) terminate the employment of such of its employees or temporarily lay off such of its employees as it deems appropriate on such terms as may be agreed upon between PEI and such employee, or failing such agreement, to deal with the consequences thereof in the Plan;
 - (c) in accordance with paragraphs 12 and 13, vacate, abandon or quit the whole but not part of any leased premises and/or repudiate any real property lease and any ancillary agreements relating to any leased premises, on not less than [seven (7) days notice in writing to the relevant landlord on such terms as may be agreed upon between PEI and such landlord, or failing such agreement, to deal with the consequences thereof in the Plan;

- (d) repudiate such of its arrangements or agreements of any nature whatsoever, whether oral or written, as PEI deems appropriate on such terms as may be agreed upon between PEI and such counter-parties, or failing such agreement, to deal with the consequences thereof in the Plan; and
- (e) pursue all avenues of refinancing and offers for material parts of its Business or Property, in whole or part, subject to prior approval of this Court being obtained before any material refinancing or any sale (except as permitted by subparagraph (a), above),

all of the foregoing to permit PEI to proceed with an orderly restructuring of the Business (the "Restructuring").

12. THIS COURT ORDERS that PEI shall provide each of the relevant landlords with notice of PEI's intention to remove any fixtures from any leased premises at least seven (7) days prior to the date of the intended removal. The relevant landlord shall be entitled to have a representative present in the leased premises to observe such removal and, if the landlord disputes PEI's entitlement to remove any such fixture under the provisions of the lease, such fixture shall remain on the premises and shall be dealt with as agreed between any applicable secured creditors, such landlord and PEI, or by further Order of this Court upon application by PEI on at least two (2) days notice to such landlord and any such secured creditors. If PEI repudiates the lease governing such leased premises in accordance with paragraph 11(c) of this Order, it shall not be required to pay Rent under such lease pending resolution of any such dispute (other than Rent payable for the notice period provided for in paragraph 11(c) of this Order), and the repudiation of the lease shall be without prejudice to the Applicant's claim to the fixtures in dispute.

13. THIS COURT ORDERS that if a Notice of Repudiation is delivered, then (a) during the notice period prior to the effective time of the repudiation, the landlord may show the affected leased premises to prospective tenants during normal business hours, on giving PEI and the Monitor 24 hours' prior written notice, and (b) at the effective time of the repudiation, the relevant landlord shall be entitled to take possession of any such leased premises without waiver of or prejudice to any claims or rights such landlord may have against PEI in respect of such

lease or leased premises and such landlord shall be entitled to notify PEI of the basis on which it is taking possession and to gain possession of and re-lease such leased premises to any third party or parties on such terms as such landlord considers advisable, provided that nothing herein shall relieve such landlord of its obligation to mitigate any damages claimed in connection therewith.

14. THIS COURT ORDERS that, subject to the other provisions of this Order (including the payment of Rent as herein provided) and any further Order of this Court, PEI shall be permitted to dispose of any and all of the Property located (or formerly located) at such leased premises without any interference of any kind from landlords, warehousemen, storers or bailees wherever situate, and, for greater certainty, PEI shall have the right to realize upon the Property and other assets in such manner and at such locations, including leased premises, as it deems suitable or desirable for the purpose of maximizing the proceeds and recovery therefrom.

15. THIS COURT ORDERS that notwithstanding anything to the contrary in any agreement providing for the liquidation of assets from any leased premises but subject to: (a) any written agreement between PEI, a liquidator and the landlord; or (b) further Order of this Court:

- (a) PEI shall at all times abide by and be subject to the terms of all real property leases (collectively the "Leases") and shall cause any liquidator to abide by the terms of the Leases, and PEI and the liquidator shall obtain the applicable landlord's approval for all signage and promotional advertising for sales to be conducted by the liquidator pursuant to the agreement with PEI in any of the leased premises to the extent otherwise not permitted by the applicable Lease; and,
- (b) neither PEI nor any liquidator shall augment the merchandise in any leased premises unless otherwise permitted by the applicable Lease or approved by the applicable Landlord.

16. THIS COURT ORDERS that notwithstanding anything herein but subject to the rights of a trustee in bankruptcy with respect to the assignment of leases: (a) except as expressly permitted by the terms of the Leases, none of the Leases shall be amended or varied, or deemed to be amended or varied, in any way without obtaining the prior written consent of the applicable Landlords; and (b) where any Leases are not, in accordance with their terms, transferrable or

assignable to a purchaser without first obtaining the consent of the applicable Landlord, none of the Leases shall, absent further Order of the Court be transferred, conveyed, assigned or vested in a purchaser, save and except to the extent that respective consents have been, or are in the future, obtained from the respective Landlords.

NO PROCEEDINGS AGAINST THE APPLICANT OR THE PROPERTY

17. THIS COURT ORDERS that until and including SEPTEMBER 3, 2009, or such later date as this Court may order (the "Stay Period"), no proceeding or enforcement process in any court or tribunal (each, a "Proceeding") shall be commenced or continued against or in respect of PEI or the Monitor, or affecting the Business or the Property, except with the written consent of PEI and the Monitor, or with leave of this Court, and any and all Proceedings currently under way against or in respect of PEI or affecting the Business or the Property are hereby stayed and suspended pending further Order of this Court.

NO EXERCISE OF RIGHTS OR REMEDIES

18. THIS COURT ORDERS that during the Stay Period, all rights and remedies of any individual, firm, corporation, governmental body or agency, or any other entities (all of the foregoing, collectively being "Persons" and each being a "Person") against or in respect of PEI or the Monitor, or affecting the Business or the Property, are hereby stayed and suspended except with the written consent of PEI and the Monitor, or leave of this Court, provided that nothing in this Order shall (i) empower PEI to carry on any business which PEI is not lawfully entitled to carry on, (ii) exempt PEI from compliance with statutory or regulatory provisions relating to health, safety or the environment, (iii) prevent the filing of any registration to preserve or perfect a security interest, or (iv) prevent the registration of a claim for lien.

NO INTERFERENCE WITH RIGHTS

19. THIS COURT ORDERS that during the Stay Period, no Person shall discontinue, fail to honour, alter, interfere with, repudiate, terminate or cease to perform any right, renewal right, contract, agreement, licence or permit in favour of or held by PEI, except with the written consent of PEI and the Monitor, or leave of this Court.

CONTINUATION OF SERVICES

20. THIS COURT ORDERS that during the Stay Period, all Persons having oral or written agreements with PEI or statutory or regulatory mandates for the supply of goods and/or services, including without limitation all computer software, communication and other data services, centralized banking services, payroll services, insurance, transportation, services, utility or other services to the Business or PEI, are hereby restrained until further Order of this Court from discontinuing, altering, interfering with or terminating the supply of such goods or services as may be required by PEI, and that PEI shall be entitled to the continued use of its current premises, telephone numbers, facsimile numbers, internet addresses and domain names, provided in each case that the normal prices or charges for all such goods or services received after the date of this Order are paid by PEI in accordance with normal payment practices of PEI or such other practices as may be agreed upon by the supplier or service provider and each of PEI and the Monitor, or as may be ordered by this Court.

NON-DEROGATION OF RIGHTS

21. THIS COURT ORDERS that, notwithstanding anything else contained herein, no creditor of PEI shall be under any obligation after the making of this Order to advance or re-advance any monies or otherwise extend any credit to PEI. Nothing in this Order shall derogate from the rights conferred and obligations imposed by the CCAA.

PROCEEDINGS AGAINST DIRECTORS AND OFFICERS

22. THIS COURT ORDERS that during the Stay Period, and except as permitted by subsection 11.5(2) of the CCAA, no Proceeding may be commenced or continued against any of the former, current or future directors or officers of PEI with respect to any claim against the directors or officers that arose before the date hereof and that relates to any obligations of PEI whereby the directors or officers are alleged under any law to be liable in their capacity as directors or officers for the payment or performance of such obligations, until a compromise or arrangement in respect of PEI, if one is filed, is sanctioned by this Court or is refused by the creditors of PEI or this Court.

DIRECTORS' AND OFFICERS' INDEMNIFICATION AND CHARGE

23. THIS COURT ORDERS that PEI shall indemnify its directors and officers from all claims, costs, charges and expenses relating to the failure of PEI, after the date hereof, to make payments of the nature referred to in subparagraphs 5(a), 7(a), 7(b) and 7(c) of this Order which they sustain or incur by reason of or in relation to their respective capacities as directors and/or officers of PEI except to the extent that, with respect to any officer or director, such officer or director has actively participated in the breach of any related fiduciary duties or has been grossly negligent or guilty of wilful misconduct.

24. THIS COURT ORDERS that the directors and officers of PEI shall be entitled to the benefit of and are hereby granted a charge (the "Directors' Charge") on the Property, which charge shall not exceed an aggregate amount of \$500,000.00, as security for the indemnity provided in paragraph 23 of this Order. The Directors' Charge shall have the priority set out in paragraphs 35 and 37 herein.

25. THIS COURT ORDERS that, notwithstanding any language in any applicable insurance policy to the contrary, (a) no insurer shall be entitled to be subrogated to or claim the benefit of the Directors' Charge, and (b) PEI's directors and officers shall only be entitled to the benefit of the Directors' Charge to the extent that they do not have coverage under any directors' and officers' insurance policy, or to the extent that such coverage is insufficient to pay amounts indemnified in accordance with paragraph 23 of this Order.

APPOINTMENT OF MONITOR

26. THIS COURT ORDERS that DELOITTE & TOUCHE INC. is hereby appointed pursuant to the CCAA as the Monitor (the "Monitor"), an officer of this Court, to monitor the Property and PEI's conduct of the Business with the powers and obligations set out in the CCAA or set forth herein and that PEI and its shareholders, officers, directors, and Assistants shall advise the Monitor of all material steps taken by PEI pursuant to this Order, and shall co-operate fully with the Monitor in the exercise of its powers and discharge of its obligations.

27. THIS COURT ORDERS that the Monitor, in addition to its prescribed rights and obligations under the CCAA, is hereby directed and empowered to:

- (a) monitor PEI's receipts and disbursements;
- (b) report to this Court at such times and intervals as the Monitor may deem appropriate with respect to matters relating to the Property, the Business, and such other matters as may be relevant to the proceedings herein;
- (c) advise PEI in its development of the Plan and any amendments to the Plan;
- (d) assist PEI, to the extent required by PEI, with the holding and administering of creditors' or shareholders' meetings for voting on the Plan;
- (e) have full and complete access to the books, records and management, employees and advisors of PEI and to the Business and the Property to the extent required to perform its duties arising under this Order;
- (f) assist PEI as necessary with a transaction of sale or transfer of PEI's assets, or any part thereof;
- (g) be at liberty to engage independent legal counsel or such other persons as the Monitor deems necessary or advisable respecting the exercise of its powers and performance of its obligations under this Order;
- (h) consider, and if deemed advisable by the Monitor, prepare a report and assessment on the Plan; and
- (i) perform such other duties as are required by this Order or by this Court from time to time.

28. THIS COURT ORDERS that the Monitor shall not take possession of the Property and shall take no part whatsoever in the management or supervision of the management of the Business and shall not, by fulfilling its obligations hereunder, be deemed to have taken or maintained possession or control of the Business or Property, or any part thereof.

29. THIS COURT ORDERS that nothing herein contained shall require the Monitor to occupy or to take control, care, charge, possession or management (separately and/or collectively, "Possession") of any of the Property that might be environmentally contaminated, might be a pollutant or a contaminant, or might cause or contribute to a spill, discharge, release or deposit of a substance contrary to any federal, provincial or other law respecting the protection, conservation, enhancement, remediation or rehabilitation of the environment or relating to the disposal of waste or other contamination including, without limitation, the *Canadian Environmental Protection Act*, the *Ontario Environmental Protection Act*, the *Ontario Water Resources Act*, or the *Ontario Occupational Health and Safety Act* and regulations thereunder (the "Environmental Legislation"), provided however that nothing herein shall exempt the Monitor from any duty to report or make disclosure imposed by applicable Environmental Legislation. The Monitor shall not, as a result of this Order or anything done in pursuance of the Monitor's duties and powers under this Order, be deemed to be in Possession of any of the Property within the meaning of any Environmental Legislation, unless it is actually in possession.

30. THIS COURT ORDERS that that the Monitor shall provide any creditor of PEI with information provided by PEI in response to reasonable requests for information made in writing by such creditor addressed to the Monitor. The Monitor shall not have any responsibility or liability with respect to the information disseminated by it pursuant to this paragraph. In the case of information that the Monitor has been advised by PEI is confidential, the Monitor shall not provide such information to creditors unless otherwise directed by this Court or on such terms as the Monitor and PEI may agree.

31. THIS COURT ORDERS that, in addition to the rights and protections afforded the Monitor under the CCAA or as an officer of this Court, the Monitor shall incur no liability or obligation as a result of its appointment or the carrying out of the provisions of this Order, save and except for any gross negligence or wilful misconduct on its part. Nothing in this Order shall derogate from the protections afforded the Monitor by the CCAA or any applicable legislation.

32. THIS COURT ORDERS that the Monitor, counsel to the Monitor and counsel to PEI shall be paid their reasonable fees and disbursements, in each case at their standard rates and charges, by PEI as part of the costs of these proceedings. PEI is hereby authorized and directed

to pay the accounts of the Monitor, counsel for the Monitor and counsel for PEI within seven days of the accounts being rendered, and, in addition, PEI is hereby authorized to pay to counsel to the Monitor, and counsel to PEI, retainers in the amount[s] of \$25,000.00 each to be held by them as security for payment of their respective fees and disbursements outstanding from time to time

33. THIS COURT ORDERS that the Monitor and its legal counsel shall pass their accounts from time to time, and for this purpose the accounts of the Monitor and its legal counsel are hereby referred to a judge of the Commercial List of the Ontario Superior Court of Justice.

34. THIS COURT ORDERS that the Monitor, counsel to the Monitor, if any, and PEI's counsel shall be entitled to the benefit of and are hereby granted a charge (the "Administration Charge") on the Property, which charge shall not exceed an aggregate amount of \$500,000.00, as security for their professional fees and disbursements incurred at the standard rates and charges of the Monitor and such counsel, both before and after the making of this Order in respect of these proceedings. The Administration Charge shall have the priority set out in paragraphs 35 and 37 hereof.

VALIDITY AND PRIORITY OF CHARGES CREATED BY THIS ORDER

35. THIS COURT ORDERS that the priorities of the Directors' Charge and the Administration Charge, as among them, shall be as follows:

First – Administration Charge (to the maximum amount of \$500,000.00);

and

Second – Directors' Charge (to the maximum amount of \$500,000.00).

36. THIS COURT ORDERS that the filing, registration or perfection of the Directors' Charge or the Administration Charge (collectively, the "Charges") shall not be required, and that the Charges shall be valid and enforceable for all purposes, including as against any right, title or interest filed, registered, recorded or perfected subsequent to the Charges coming into existence, notwithstanding any such failure to file, register, record or perfect.

37. THIS COURT ORDERS that each of the Directors' Charge and the Administration Charge (all as constituted and defined herein) shall constitute a charge on the Property and such Charges shall rank in priority to all other security interests, trusts, liens, charges and encumbrances, statutory or otherwise (collectively, "Encumbrances") in favour of any Person.

38. THIS COURT ORDERS that except as otherwise expressly provided for herein, or as may be approved by this Court, PEI shall not grant any Encumbrances over any Property that rank in priority to, or *pari passu* with, the Directors' Charge or the Administration Charge, unless PEI also obtains the prior written consent of the Monitor and the beneficiaries of the Directors' Charge and the Administration Charge, or further Order of this Court.

39. THIS COURT ORDERS that the Directors' Charge and the Administration Charge shall not be rendered invalid or unenforceable and the rights and remedies of the chargees entitled to the benefit of the Charges (collectively, the "Chargees") thereunder shall not otherwise be limited or impaired in any way by (a) the pendency of these proceedings and the declarations of insolvency made herein; (b) any application(s) for bankruptcy order(s) issued pursuant to BIA, or any bankruptcy order made pursuant to such applications; (c) the filing of any assignments for the general benefit of creditors made pursuant to the BIA; (d) the provisions of any federal or provincial statutes; or (e) any negative covenants, prohibitions or other similar provisions with respect to borrowings, incurring debt or the creation of Encumbrances, contained in any existing loan documents, lease, sublease, offer to lease or other agreement (collectively, an "Agreement") which binds PEI, and notwithstanding any provision to the contrary in any Agreement:

- (a) the creation of the Charges shall not create or be deemed to constitute a breach by PEI of any Agreement to which it is a party;
- (b) none of the Chargees shall have any liability to any Person whatsoever as a result of any breach of any Agreement caused by or resulting from or the creation of the Charges; and
- (c) the payments made by PEI pursuant to this Order and the granting of the Charges, do not and will not constitute fraudulent preferences, fraudulent conveyances, oppressive

conduct, settlements or other challengeable, voidable or reviewable transactions under any applicable law.

40. THIS COURT ORDERS that any Charge created by this Order over leases of real property in Canada shall only be a Charge in PEI's interest in such real property leases.

SERVICE AND NOTICE

41. THIS COURT ORDERS that PEI shall, within ten (10) business days of the date of entry of this Order, send a copy of this Order to its known creditors, other than employees and creditors to which PEI owes less than \$1,000.00, at their addresses as they appear on PEI's records, and shall promptly send a copy of this Order (a) to all parties filing a Notice of Appearance in respect of this Application, and (b) to any other interested Person requesting a copy of this Order, and the Monitor is relieved of its obligation under Section 11(5) of the CCAA to provide similar notice, other than to supervise this process.

42. THIS COURT ORDERS that PEI and the Monitor be at liberty to serve this Order, any other materials and orders in these proceedings, any notices or other correspondence, by forwarding true copies thereof by prepaid ordinary mail, courier, personal delivery or electronic transmission to PEI's creditors or other interested parties at their respective addresses as last shown on the records of PEI and that any such service or notice by courier, personal delivery or electronic transmission shall be deemed to be received on the next business day following the date of forwarding thereof, or if sent by ordinary mail, on the third business day after mailing.

43. THIS COURT ORDERS that PEI, the Monitor, and any party who has filed a Notice of Appearance may serve any court materials in these proceedings by e-mailing a PDF or other electronic copy of such materials to counsels' email addresses as recorded on the Service List from time to time, in accordance with the E-filing protocol of the Commercial List to the extent practicable, and the Monitor may post a copy of any or all such materials on its website at www.deloitte.com.

GENERAL

44. THIS COURT ORDERS that PEI or the Monitor may from time to time apply to this Court for advice and directions in the discharge of its powers and duties hereunder.
45. THIS COURT ORDERS that nothing in this Order shall prevent the Monitor from acting as an interim receiver, a receiver, a receiver and manager, or a trustee in bankruptcy of PEI, the Business or the Property.
46. THIS COURT HEREBY REQUESTS the aid and recognition of any court, tribunal, regulatory or administrative body having jurisdiction in Canada or in the United States, to give effect to this Order and to assist PEI, the Monitor and their respective agents in carrying out the terms of this Order. All courts, tribunals, regulatory and administrative bodies are hereby respectfully requested to make such orders and to provide such assistance to PEI and to the Monitor, as an officer of this Court, as may be necessary or desirable to give effect to this Order, to grant representative status to the Monitor in any foreign proceeding, or to assist PEI and the Monitor and their respective agents in carrying out the terms of this Order.
47. THIS COURT ORDERS that each of PEI and the Monitor be at liberty and is hereby authorized and empowered to apply to any court, tribunal, regulatory or administrative body, wherever located, for the recognition of this Order and for assistance in carrying out the terms of this Order.
48. THIS COURT ORDERS that any interested party (including PEI and the Monitor) may apply to this Court to vary or amend this Order on not less than seven (7) days notice to any other party or parties likely to be affected by the order sought or upon such other notice, if any, as this Court may order.

49. THIS COURT ORDERS that this Order and all of its provisions are effective as of 12:01 a.m. Eastern Daylight Time on the date of this Order.

Court File No.

**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 PRODUCT EXCELLENCE INC.**

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

PROCEEDINGS COMMENCED AT TORONTO

NOTICE OF APPLICATION

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