



COURT FILE NUMBER 1601-11708

COURT COURT OF QUEEN'S BENCH OF ALBERTA

JUDICIAL CENTRE CALGARY

APPLICANTS 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 ARRANGEMENT OF
QUATTRO EXPLORATION AND PRODUCTION LTD.

DOCUMENT **SUPPLEMENT TO THE FIFTH REPORT OF MONITOR
HARDIE & KELLY INC. IN ITS CAPACITY AS MONITOR OF
QUATTRO EXPLORATION AND PRODUCTION LTD.**

JANUARY 4, 2017

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**SUPPLEMENT TO THE FIFTH REPORT OF THE MONITOR
HARDIE & KELLY INC.
JANUARY 4, 2017**

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INTRODUCTION AND PURPOSE

1. On December 30, 2016, the Monitor prepared a report (the “Fifth Report”) in advance of the Company’s application scheduled for January 3, 2017, to seek an extension of the stay of proceedings through to February 4, 2017. On January 3, 2017, the Company, the Monitor and the Company’s principal lender, the Business Development Bank of Canada (“BDC”), attended before the Court with respect to the Company’s stay extension application. This application was opposed by BDC, who has brought an application to appoint a receiver over the Company. On January 3, 2017, the Court adjourned BDC’s receivership application to January 5, 2017 and extended the Company’s stay of proceedings through to and including January 5, 2017.
2. Subsequent to the preparation of the Fifth Report, Mr. Leonard Van Betuw swore a Supplemental Confidential Affidavit dated January 2, 2017 (the “Van Betuw Supplemental Affidavit”) with respect to the Company’s stay extension application and the competing receivership application brought by BDC. Further, Mr. Derek Church, of BDC, swore a Supplemental Confidential Affidavit dated January 4, 2017 (the “Church Supplemental Affidavit”) in response to the Van Betuw Supplemental Affidavit.
3. This report (the “Supplemental Report”) is to provide the Court with the Monitor’s comments with respect to certain of the statements in the Van Betuw Supplemental Affidavit, the Church Supplemental Affidavit, and the developments between the parties’ attendance before the Court on January 3, 2017 and the date of this Supplemental Report.

TERMS OF REFERENCE

4. In preparing this Supplemental Report, the Monitor has been provided with, and has relied upon unaudited financial information, books and records of the Company, and discussions with the Company’s management (“Management”).
5. Unless otherwise stated, all monetary amounts noted herein are expressed in Canadian dollars.

6. Capitalized terms which are not defined within this Supplemental Report shall have the meaning ascribed to them in the First Report, the Second Report, Third Report, the Fourth Report and the Fifth Report.

FINANCIAL PERFORMANCE

7. In respect of Paragraphs 11, 14 and 16 of the Van Betuw Supplemental Affidavit, the Monitor advises that over the approximately five month course of the restructuring proceedings, the Company has experienced lower than forecasted monthly revenue receipts on the following occasions:
 - a) Revenues received in September totalled approximately \$570,000, which was approximately 17% lower than previously forecast. According to the Company, this negative variance related mainly to lower than forecast pricing for its oil and natural gas;
 - b) Revenues received in October totalled approximately \$400,000, which was approximately 48% lower than originally forecast and 23% lower than the Company's revised forecast. According to the Monitor's review, it appears that approximately \$130,000 of the variance was caused by a temporary timing difference related to weather-related transportation issues and the remainder was likely a permanent reduction in production volumes caused at least in part by weather-related access issues;
 - c) Revenues received in November totalled approximately \$700,000. Although this was higher than its most recent updated forecast, which took into account the approximately \$130,000 in additional revenue related to the reversal of the temporary timing differences from the prior month, it was approximately 15% lower than the Company's forecast at the outset of the CCAA proceedings despite the fact that it did not at that time take into account the additional timing-related revenue; and
 - d) Revenues received in December totalled approximately \$590,000, which was approximately 18% lower than the Company's most recent forecast despite the fact that commodity prices had been increasing and the Company had completed workover activities at its Bashaw field to increase production.

8. These variances in the Company's monthly revenue receipts have contributed to reduced cash balances which have resulted in an accumulation of over \$1 Million of post-filing accounts payable.
9. In respect of Paragraphs 11, 14 and 16 of the Van Betuw Supplemental Affidavit, the Monitor also advises that, based on operational reports provided by Quattro to the Monitor, the Company's oil and gas production levels do not appear to have significantly increased to a consistently sustainable level during the course of the restructuring. In the First Report, the Monitor advised that the Company had reported total average daily production of approximately 1,400 BOE per day. As of the last operational report provided by Quattro as at December 18, 2016, it appears its total average daily production was approximately 1,460 BOE per day. In the interim, production fluctuated, reaching approximately 1,700 BOE per day at its highest and approximately 1,050 BOE per day at its lowest, according to operational reports provided by Quattro. Likewise, monthly revenues have not steadily increased over the period of the restructuring, as set out above.
10. The Monitor has been advised by Management that the payments to creditors referred to in Paragraph 62 of the Van Betuw Supplemental Affidavit have already been recorded as being made and therefore removed from the most recent post-filing accounts payable listing provided to the Monitor by the Company. Funds from November production revenues are therefore not being used to reduce the already accrued post-filing accounts payable balance, but to pay further post-filing accounts accrued for the month of December. As a result, the post-filing accounts payable balance is still in excess of \$1 Million.
11. The Monitor reiterates that the cash flow forecast included as Exhibit "C" of the December 23, 2016 sworn Affidavit of Mr. Van Betuw (the "Dec. 23rd Revised Forecast") contemplates no payments being made to post-filing suppliers in 2017 until the last week of January; however, the Monitor is aware that the Company is preparing a further revised forecast that has yet to be filed.

ALBERTA CORPORATE PROGRAM

12. At paragraph 35 of the Van Betuw Supplemental Affidavit, it states that:

...the Monitor and BDC are concerned with the ability of Quattro to close the transaction contemplated by the asset purchase agreement with Wellstar (the “Wellstar APA”) because Wellstar will not have the requisite 2.0 threshold Liability Management Rating (“LMR”) for the Alberta Energy Regulator (the “AER”) to transfer certain AER licenses contemplated by the Wellstar APA.
13. While Quattro and Wellstar’s respective LMRs are part of the Monitor’s concern with the Wellstar transaction, the Monitor’s concern relates primarily to the fact that the completion of the Wellstar APA is inextricably linked to the AER’s approval of not only the license transfers between Quattro and Wellstar, but also the AER’s approval of the proposed Alberta Corporate Program, the AER’s satisfaction that each of Quattro and Wellstar have the financial wherewithal to complete the proposed Alberta Corporate Program, and the AER’s approval of the Regulator Directed Transfer submitted by Quattro, transferring licenses from a bankrupt entity to Quattro.
14. With respect to the Alberta Corporate Program, the Monitor wishes to clarify its earlier comments, contained in paragraph 25 of the Fifth Report, regarding the necessary capital to complete the program. The Monitor wishes to clarify and confirm that it did not prepare an estimate of the investment required to complete the program. Rather, the Monitor quoted the figure of \$4 Million from the Alberta Corporate Program document. According to the Company, this figure does not represent the funds required to be invested to complete the program, but rather the LMR deficit the Company must overcome to be compliant with the AER’s requirements for a license transfer. Management advises that only \$200,000 of capital expenditures is required to initially bring the LMR to above 2.0. The Monitor notes that capital expenditures to that extent are not accounted for in the Dec. 23rd Revised Forecast.

15. The Monitor is not in a position to provide any advice or opinion as to the technical or financial accuracy, completeness, viability or achievability of the Alberta Corporate Program proposed by the Company or with respect to the quantum of investment contemplated by the program. We can advise that the Monitor has not received any feedback from the AER as to the AER's position in respect of the Alberta Corporate Program or the Regulator Directed Transfer and by extension its position as to the proposed sale to Wellstar.

SISP PROCESS

16. The Monitor wishes to highlight that the information presented by the Monitor in Paragraph 27 of the Fifth Report supersedes the e-mail correspondence referenced at paragraph 48 of the Van Betuw Supplemental Affidavit. In particular, subsequent to the December 23, 2016 e-mail correspondence from Bidder B advising the Monitor that Bidder B still intended to submit a binding bid, the Monitor and the Company participated in a conference call with a representative from Bidder B on December 27, 2016. During that call, the representative of Bidder B:
 - a) Confirmed that a binding offer had not been submitted by the agreed upon extension date of December 23, 2016;
 - b) Advised that certain due diligence requirements still had to be satisfied prior to Bidder B being in a position to submit a binding offer, including, but not limited to:
 - i. Finalizing various reconciliations between information initially provided to Bidder B by the Company and the results of Bidder's B engineering reports;
 - ii. An understanding of the quantum of priority claims against Quattro; and
 - iii. An understanding of BDC's position respecting the release of BDC's liens in the event BDC would not be paid out in full, given the cash to close under the Wellstar transaction has been substantially reduced;

- c) Advised that as a result of the due diligence undertaken to date, in the event a binding offer is ultimately presented, it would be less than the non-binding indication of interest previously submitted by Bidder B by the October 31, 2016 Phase I Bid Deadline; and
- d) Advised that a binding offer could not be presented until the middle of the first week of January at the earliest, assuming all due diligence requirements were satisfied in the interim on a timely basis.

17. The Monitor had a further conversation with the representative of Bidder B on the afternoon of January 4, 2017, at which time the Monitor was advised that Bidder B was still not in a position to submit a binding offer as due diligence information requests remained outstanding.

RE-PAYMENT PLAN

18. In respect of Paragraph 33 and Exhibit "C" of the Van Betuw Supplemental Affidavit regarding Quattro's plans to re-pay BDC, the Monitor has the following comments:
- a) The proceeds of the sale of assets to ARC have already been used to re-pay a portion of the Interim Facility and are therefore no longer available to re-pay the current balance owed to BDC;
 - b) The Monitor has previously set out its concerns with respect to the Company's ability to close the contemplated transaction with Wellstar;
 - c) The Company expects the receivable referred to in Paragraphs 15 and 56 of the Van Betuw Supplemental Affidavit to be received within the early weeks of 2017. The Monitor notes that the share transaction underlying the collection of this receivable advises of several conditions prior to closing, including the completion of a private placement by the purchaser on or before March 30, 2017. The Monitor asked the Company to provide some form of third party confirmation of the indebtedness underlying the receivable and an indication that payment of the receivable will be forthcoming. On January 4, 2017, the Company provided the Monitor with the document attached as Confidential Appendix "A" to this Supplemental Report, which the Monitor understands is intended to represent such third party confirmation that

payment of this receivable will be forthcoming; and

- d) In reference to the term sheet referred to beginning at paragraph 51 of the Van Betuw Supplemental Affidavit, the Monitor is aware of a term sheet provided by the proposed financier which expired early in 2016, and has not been provided an unexpired term sheet as of the date of this Supplemental Report.

INTERIM FINANCING

- 19. Although it is indicated at Paragraph 60 of the Van Betuw Supplemental Affidavit that the Company has secured replacement interim financing (the “Replacement Interim Facility”), the Monitor is concerned with the certainty of availability and access to the Replacement Interim Facility over and above the amount that would be necessary to retire the existing interim financing in place with BDC (the “Existing Interim Facility”).
- 20. Only \$1.25 million is immediately available under the Replacement Interim Facility. The balance of the \$750,000 is to be available to the Company as required by the Company’s cash flow forecast and upon request by the Company. In light of the Monitor’s previously expressed concerns with respect to the quantum of Quattro’s post-filing accounts payable, the Monitor would be apprehensive of a scenario that would see the Replacement Interim Facility approved and the Existing Interim Facility retired without some form of confirmation or safeguards put in place that would guarantee the Company access to the balance of the Replacement Interim Facility to make payments to suppliers of post-filing goods and services.
- 21. Absent any form of funding guarantee arrangement being in place, the Monitor would be concerned of a potential situation where an extension of the stay of proceedings is granted over which time the Company incurs further post-filing obligations but is not able to then access any funds from the Replacement Financing Facility resulting in post-filing trade suppliers being potentially further exposed.
- 22. The Monitor does not have any previous knowledge of or experience with the party proposing to provide the Replacement Financing Facility. Based on its review of the Church Supplemental Affidavit, the Monitor understands that BDC is opposed to the proposed replacement interim lender.

23. We also understand that the Company and BDC are in discussions with respect to the potential reinstatement of the Existing Interim Facility and an increase in the availability under the Existing Interim Facility. As of the date of this Supplemental Report, the Monitor is not aware of any definitive agreement having been reached in this regard.

All of which is respectfully submitted this 4th day of January 2017.

Per: 

Marc Kelly, CA, CIRP, LIT
Senior Vice President



Charla Smith, CGA, CIRP, LIT
Vice President

CONFIDENTIAL
APPENDIX “A”