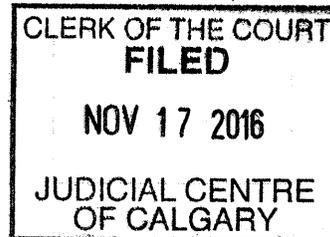


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COURT FILE NUMBER 1601-11708

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 **THIRD REPORT OF MONITOR  
HARDIE & KELLY INC. IN ITS CAPACITY AS MONITOR OF  
QUATTRO EXPLORATION AND PRODUCTION LTD.**

**NOVEMBER 17, 2016**

ADDRESS FOR SERVICE AND CONTACT  
INFORMATION OF PARTY FILING THIS DOCUMENT

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**THIRD REPORT OF THE MONITOR  
HARDIE & KELLY INC.  
NOVEMBER 17, 2016**

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## **INTRODUCTION**

1. On August 10, 2016, (the “Filing Date”), Quattro Exploration and Production Ltd. (“Quattro” or the “Company”) commenced restructuring proceedings (the “BIA Proceedings”) by filing a Notice of Intention to Make a Proposal (the “NOI”) pursuant to the *Bankruptcy & Insolvency Act*, R.S.C. 1985, c. B-3, as amended (the “BIA”). Hardie & Kelly Inc. (“HKI”) consented to act as proposal trustee.
2. Pursuant to the BIA, the filing of the NOI provided the Company with an automatic 30-day stay of proceedings through to September 9, 2016.
3. On September 6, 2016, HKI filed a report (the “Pre-Filing Report”) with the Court of Queen’s Bench of Alberta (the “Court”) in contemplation of the Company’s September 8, 2016 application pursuant to Section 11.6(a) of the *Companies’ Creditors Arrangement Act*, R.S.C. 1985 c. C-36, as amended (the “CCAA”) seeking to, *inter alia*, continue its restructuring proceedings from the BIA to the CCAA.
4. On September 8, 2016, the Court granted the Company’s application and issued an Order (the “Initial Order”) providing certain relief to the Company, including continuing its BIA Proceedings under the CCAA, extending the stay of proceedings originally established under the BIA Proceedings through to October 8, 2016 and appointing HKI as monitor (the “Monitor”).
5. On September 30, 2016, the Monitor prepared a report for this Honourable Court (the “First Report”) in advance of the Company’s application for an extension of the stay of proceedings provided for in the Initial Order
6. On October 7, 2016, Quattro made an application to the Court for an extension of the stay of proceedings through to November 30, 2016.
7. On October 7, 2016, this Honourable Court granted an order extending the stay of proceedings through to November 30, 2016 and directing the Monitor to provide an interim report to the Court on the status of the restructuring proceedings by November 4, 2016.

8. On November 4, 2016, the Monitor filed a report for this Honourable Court (the “Second Report”) updating the Court on Quattro’s cash flow and restructuring efforts.

### **PURPOSE**

9. The purpose of this report (the “Third Report”) is to provide information to this Honourable Court with respect to:
  - a) An update on the status of Quattro’s operations;
  - b) An update on the financial performance of the Company since it last updated its cash flow projections;
  - c) The Company’s revised cash flow forecast for the period November 14, 2016 to February 5, 2017;
  - d) The status of the interim financing;
  - e) The Company’s restructuring activities;
  - f) The Company’s application for the establishment of a claims process and the Monitor’s recommendation thereto; and
  - g) The Company’s request for an extension of the stay of proceedings through to December 16, 2016 (the “Second Extension Application”) and the Monitor’s recommendation thereto.

### **TERMS OF REFERENCE**

10. In preparing this Third 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”) and the Company’s two financial advisors. Except as described in this Third Report, the Monitor has not audited, reviewed or otherwise attempted to verify the accuracy or completeness of such financial information in a manner that would wholly or partially comply with Generally Accepted Assurance Standards (“GAAS”) pursuant to the Chartered Professional Accountants Canada Handbook and, accordingly, the Monitor expresses no opinion or other form of assurance

contemplated under GAAS in respect of such information.

11. Some of the information referred to in this Third Report consists of forecasts and projections or references thereto. An examination or review of any financial forecast and projections, as outlined in the Chartered Professional Accountants Canada Handbook, has not been performed.
12. Unless otherwise stated, all monetary amounts noted herein are expressed in Canadian dollars.
13. Capitalized terms which are not defined within this Third Report shall have the meaning ascribed to them in the First Report or the Second Report.

#### **OPERATIONAL UPDATE**

14. In its First Report and Second Report, the Monitor advised that the Company's average daily production had reached approximately 1,400 BOE per day, including both operated and non-operated properties, then declined significantly due to weather issues which occurred in and around late September / early October, before increasing back to approximately 1,400 BOE per day as of October 23, 2016. As of the date of this Third Report, Management reports that Quattro's production is approximately 1,450 BOE per day. This is lower than the Company had expected, as it had planned to complete a work-over on a compressor in its Bashaw area to increase production in that area. The work-over was delayed pending receipt of a part which had to be ordered, and is now expected to be completed by the end of November.

#### **FINANCIAL PERFORMANCE**

15. Attached as Exhibit "A" to the Supplemental Affidavit of Mr. Leonard Van Betuw sworn on September 29, 2016 filed in these proceedings was a revised cash flow forecast (the "September 29<sup>th</sup> Forecast") encompassing the period September 26 to December 11, 2016.
16. In its Second Report, the Monitor provided a variance analysis of the Company's actual receipts and disbursements over the period September 26 to October 30,

2016 versus the corresponding period in the September 29<sup>th</sup> Forecast. The Monitor has updated this variance analysis to comprise the period September 26 to November 13 (the “First Extension Period”), as set out in the following table:

	<b>September 26 - November 13, 2016</b>			<b>Notes</b>
	<b>Actual</b>	<b>Forecast</b>	<b>Variance</b>	
<b>Receipts</b>				
Production revenues	974,107	1,251,232	(277,125)	a)
Miscellaneous	47,590	47,600	(10)	
	<b>1,021,697</b>	<b>1,298,832</b>	<b>(277,135)</b>	
<b>Disbursements</b>				
Royalties	(28,690)	(28,000)	(690)	
Production and operating	(849,811)	(996,991)	147,180	b)
Transportation	-	(143,160)	143,160	b)
General and administration	(382,991)	(460,000)	77,009	c)
Restructuring	(160,025)	(175,000)	14,975	d)
	<b>(1,421,518)</b>	<b>(1,803,151)</b>	<b>381,633</b>	
<b>Investing</b>				
Interim financing - Tranche 1	580,000	630,000	(50,000)	e)
Interim financing - Tranche 2	100,000	-	100,000	
Capital expenditures	(82,600)	(87,500)	4,900	
Sale of assets	-	-	-	
	<b>597,400</b>	<b>542,500</b>	<b>54,900</b>	
<b>Financing</b>				
Interest payments	(58,935)	(64,798)	5,863	
	<b>(58,935)</b>	<b>(64,798)</b>	<b>5,863</b>	
Increase in cash	<b>138,644</b>	<b>(26,617)</b>	<b>165,261</b>	
Cash - beginning	173,868	173,868	-	
Cash - closing	<b>312,512</b>	<b>147,251</b>	<b>165,261</b>	

17. The Company experienced overall positive cash flow of approximately \$139,000 over the First Extension Period, which represented a positive variance of approximately \$165,000 compared to the corresponding period of the September 29<sup>th</sup> Forecast. The Monitor offers the following comments with respect to certain individual variances:

- a) Oil and gas revenues received during the First Extension Period relate to August and September production. As the August revenues were known at

the date of the September 29<sup>th</sup> Forecast, the negative variance of approximately \$279,000 related to September revenues received in October. As discussed in the Second Report, Management has advised that a portion of this variance is a temporary timing difference caused by weather issues, whereas the remainder appears to relate to a permanent reduction of volumes due to well shut-ins caused by the inclement weather.

- b) The figure of \$849,811 representing actual production and operating costs paid also includes transportation expenses which had been forecasted as a separate line item. Combined payments for operating expenses and transportation expenses were approximately \$290,000 (or 29%) lower than forecast.

This positive variance has been significantly reduced since the date of the Second Report as a large number of cheques issued to the Company's suppliers and service providers have cleared Quattro's bank account since that time. The positive variance is further reduced by \$84,000 in cheques issued to suppliers and service providers that had not yet cleared the bank (the "Un-cleared Cheques") as at November 13, 2016, which are not accounted for in the above analysis. When taking into account the Un-cleared Cheques, the variance would otherwise be approximately \$206,000.

According to the Monitor's review, this positive variance relates to the fact that the Company has not yet paid all of its expenses, as its suppliers and service providers have extended payment terms. In fact, according to a list supplied by Management on November 16, 2016, Quattro's accounts payable balance currently totals approximately \$965,000. However, the Monitor notes that upon further review Management has indicated that the listing is overstated by at least \$219,000 as a result of a) invoices that were paid in the prior week but have not yet been removed from the listing; and b) post-dated invoices not currently due.

- c) Actual general and administrative expenses during the First Extension Period were approximately \$77,000 (or 17%) lower than forecast. Management advises this variance is a result of the reduction of its staff by three individuals.
- d) The positive variance of approximately \$15,000 in respect of restructuring expenses is offset by an Un-Cleared cheque for over \$27,000. The Company has brought its accounts payable in relation to restructuring invoices largely up to date after issuing payments totalling approximately \$123,000 in the past week.
- e) The Company borrowed \$400,000 in interim funding from Tranche 1, and \$100,000 in interim funding from Tranche 2 in the period since the Second Report, bringing its interim funding to a level which is slightly higher in the aggregate than provided for in the September 29<sup>th</sup> Forecast.

#### **REVISED CASH FLOW FORECAST**

18. Management prepared an updated cash flow forecast for the period from November 14, 2016 to February 5, 2017 (the “November 15<sup>th</sup> Forecast”) which was attached as Exhibit “A” to the Affidavit of Leonard B. Van Betuw sworn on November 15, 2016 in connection with Quattro’s Second Extension Application. However, after further review of the November 15<sup>th</sup> Forecast, it was determined that the document contained a formula error. Therefore, the Company issued a revised forecast for the same period (the “Revised Forecast”), which was attached as Exhibit “A” to the Supplemental Affidavit of Leonard B. Van Betuw sworn on November 16, 2016.

The Revised Forecast can be summarized as follows:

	<b>November 14, 2016 - February 5, 2017</b>	<b>Notes</b>
<b>Receipts</b>		
Production revenues	1,778,264	a)
Miscellaneous	-	
	<b>1,778,264</b>	
<b>Disbursements</b>		
Royalties	(86,400)	
Production and operating	(1,466,330)	b)
Transportation	(305,421)	b)
General and administration	(690,000)	b)
Restructuring	(300,000)	b)
	<b>(2,848,151)</b>	
<b>Investing</b>		
Interim financing - Tranche 1	250,000	c)
Interim financing - Tranche 2	-	
Capital expenditures	(40,000)	d)
Sale of assets	-	
	<b>210,000</b>	
<b>Financing</b>		
Interest payments	(194,393)	
	<b>(194,393)</b>	
Increase in cash	<b>(1,054,280)</b>	
Cash - beginning of period	312,513	e)
Cash - end of period	<b>(741,767)</b>	f)

19. The Monitor provides the following comments on the Revised Forecast:

- a) Revenues to be received the week of November 21, 2016 have been reduced as compared to the September 29<sup>th</sup> Forecast despite the fact that the revenues received will include the Delayed Inventory (discussed in the Second Report) from September which the Monitor estimates is valued at approximately \$130,000. Therefore, the Company appears to have reduced its revenue forecast for October production (which is received November 25<sup>th</sup>) to approximately \$470,000, a 43% reduction from the September 29<sup>th</sup> Forecast which estimated it at approximately \$820,000. According to Management, the reduction is mainly due to a delay in performing a work-over on a compressor located in its Bashaw area,

which would otherwise have resulted in a significant increase in production in October if the work-over had been completed prior to October. Management has indicated that it now expects the work-over to be completed by the end of November

The Monitor also notes that the Company's November revenue, forecast to be received the week of December 19, 2016, may be received in the following week due to the fact that December 25<sup>th</sup> is a holiday and falls on a weekend.

- b) Forecast payments of operating expenses (including transportation expenses), G&A expenses and restructuring expenses appear to be generally consistent with the September 29<sup>th</sup> Forecast. The Monitor notes that achieving these values would require that payment terms with suppliers remain consistent over the balance of the forecast period.

As previously mentioned, the Company's current accounts payable balance, while potentially overstated at \$965,000, is roughly equal to 45 days of the Company's budgeted operating expenses. Although neither the Monitor, nor Management, are aware of any outstanding issues related to the extension of payments to post-filing suppliers, in the event a significant number of post-filing suppliers demand payment at the same time or begin requiring significant upfront payments, the Company may find itself unable to effectively source required services and supplies during the proposed stay extension period absent additional funding.

The Monitor also notes that the Company has forecasted that no payments on account of operating expenses, G&A expenses, and restructuring expenses will be made the week of December 12, 2016 due to forecasted cash constraints. Instead, Management has anticipated that expenses not paid that week will be paid in the following week, after November revenues are received. The Monitor notes that if November revenues are not received until a week later than forecast due to the intervening Christmas holiday, as mentioned above, the delay in payment of expenses

could be further extended by a week.

- c) The amount of interim financing included in the Revised Forecast represents the balance of the funds available pursuant to the existing Interim Facility.
  - d) The forecast capital expenditures represent the remaining costs expected to complete the work-over of a compressor in the Company's Bashaw area which has already been commenced.
  - e) The opening cash reflects the amount existing in the Company's bank accounts as at November 13, 2016. It has not been reduced to reflect the Un-cleared Cheques, as Management has advised it anticipates the average amount of Un-cleared Cheques will remain relatively stable over the forecast period.
  - f) The Revised Forecast anticipates that the Company will experience a cash shortage commencing the week of December 26<sup>th</sup>, which is after the extended stay period contemplated in the Second Extension Application. According to Management, it anticipates that its cash requirements will nonetheless be met through either the receipt of sale proceeds from the closing of one or more asset sales from the SISP or by obtaining additional interim financing to allow it to complete its restructuring efforts.
20. As discussed in the following section, the Monitor understands the Company has entered into discussions with BDC to secure additional interim financing.

### **INTERIM FINANCING**

21. As set out in the First Report, the Initial Order authorized Quattro to enter into an Interim Facility with its principal lender, BDC.
22. The Interim Facility of \$1,250,000 is comprised of:
- ) Tranche 1 - \$1,000,000 – towards operations. To date, the Company has borrowed \$750,000; and

- J) Tranche 2 - \$250,000 – towards a SISP, which the Company has fully drawn as of the date of this Third Report.
23. As set out in the Second Report, BDC has formally notified Quattro that it has identified certain events of default or potential events of default in respect of the Interim Facility. Although BDC has advanced further funds under the Interim Facility, BDC has not waived any of the defaults and is reserving its rights in that regard.
24. Since the Second Report, the Company has advised BDC that it anticipates a further event of default will occur upon the receipt of October revenues which, as previously discussed, are forecast to be significantly lower than previously forecast.
25. The Monitor understands that the Company and BDC are in discussions regarding potential amendments to the interim financing facility. The Monitor anticipates that the Company will seek this Court’s approval with respect to certain amendments to the interim financing.

### **RESTRUCTURING ACTIVITIES**

26. The Initial Order directed the establishment of the SISP, which Management anticipates will form the basis for the Company’s restructuring plan. In the First Report, we advised that the Company engaged two Financial Advisors, NRG and Durham, to assist with the SISP.
27. The first phase of the SISP has already occurred, with non-binding indications of interest received by October 31, 2016. On November 1, 2016, the Monitor and BDC attended a presentation made by NRG and Durham to review the preliminary results as of the Phase I Bid Deadline. Quattro, in consultation with BDC and the Monitor, then qualified multiple parties to carry on as Phase II participants (the “Qualified Phase II Participants”). A summary of the non-binding indications of interest received and copies of the non-binding indications of interest submitted by the Qualified Phase II Participants are included in the Confidential Supplemental Affidavit of Mr. Leonard Van Betuw sworn November

15, 2016.

28. With the assistance of the Financial Advisors, Quattro has now entered into Phase II of the SISP with a view to entering into binding agreements for the sale of certain of its assets and to attract additional investment in the business and operations of Quattro. The deadline for Qualified Phase II Participants to deliver a Qualified Bid is November 28, 2016.
29. Based on the non-binding indications of interest received at the Phase I Bid Deadline, at this time it appears that the Company would be able to formulate a restructuring plan, provided the Company ultimately receives final Qualified Bids by the Phase II Bid Deadline that do not vary significantly from the terms of the non-binding indications of interest that have been received.

### **CLAIMS PROCESS**

30. Quattro is now seeking the establishment of a formal claims process to identify and determine the claims against the Company.
31. In the Pre-Filing Report, we advised the Court that we had been contacted by numerous creditors indicating that the respective amounts reflected on the Company's listing of creditors included as part of the prescribed NOI documentation (the "Initial Creditor Listing") were lower than the actual amounts claimed by these creditors. In some cases, the variances were significant. We have also since been contacted by several parties advising that they are creditors of Quattro but that they were not included on the Initial Creditor Listing.
32. The key terms of the claims process proposed by Quattro are as follows. All capitalized terms in this section not defined herein shall have the meaning ascribed to them in the application materials submitted by the Company:
  - ) The establishment of December 21, 2016 as a deadline for the filing of Pre-Filing claims with the Monitor (the "Claims Bar Date");
  - ) The relevant date for the establishment of Pre-Filing Claims is August 10, 2016 being the Filing Date;

- J The Monitor is to issue notice of the claims process and materials necessary to file a claim (the “Claims Package”) to known creditors by November 29, 2016, shall post the Claims Package on the Monitor's website by no later than November 28, 2016, and shall cause notice of the claims process to be published for at least two days in the in the Calgary Herald on or prior to November 30, 2016 and the Globe and Mail (National Edition) on or prior to December 7, 2016;
- J The establishment of a deadline (the “Subsequent Claims Bar Date”) for the filing of Subsequent Claims (any claim arising out of (A) the restructuring, disclaimer, resiliation, termination or breach by Quattro on or after the Filing Date of any contract, lease or other agreement, whether written or oral, and (B) any other action taken by the Company on or after the Filing Date) as the latter of 15 days after the date on which the Monitor issues a Claims Package to such claimants, and the Claims Bar Date;
- J Unless otherwise directed by the Court, creditors not filing a claim by the Claims Bar Date, or the Subsequent Claims Bar Date as the case may be, shall be forever barred from asserting or enforcing a claim against Quattro and all such claims shall be forever extinguished;
- J The Monitor, in consultation with the Company, shall review all claims received on or before the Claims Bar Date, or the Subsequent Claims Bar Date as the case may be, and shall accept, revise or disallow each claim. In the event the Monitor intends to revise or disallow a claim, the Monitor shall send a *Notice of Revision or Disallowance* in the format provided by no later than January 9, 2017, or such later date as may be reasonably required by the Monitor;
- J Any creditor who intends to dispute a Notice of Revision or Disallowance shall advise the Monitor and the Company of the dispute and provide its grounds for the dispute. If the dispute is not settled within 10 days of the receipt of the *Notice of Revision or Disallowance* in a manner satisfactory to the Monitor, in consultation with Quattro, then the disputing party must

file an application with this Court within 10 days of receiving the *Notice of Revision or Disallowance* and the creditor must serve the application on the Monitor and the Applicant;

- J) Where a creditor receives a *Notice of Revision or Disallowance* and does not file an application with the Court disputing the *Notice of Revision or Disallowance* within 10 days of receipt, the claim shall be deemed to be as set out in the *Notice of Revision or Disallowance* and the creditor will have no further right to dispute or pursue the claim; and
- J) BDC as the principal secured creditor shall not be required to file a claim.

33. Given the current stage of the SISP and the potential for the Company to be able to formulate a restructuring plan, the Monitor is of the view that the establishment of a claims process is appropriate in order to determine which claims may be the subject of a proposed plan of arrangement or compromise put forward by the Company. Additionally, the Monitor is of the view that the proposed claim procedures provide reasonable timelines for the claims of creditors to be submitted and considered.

### **RECOMMENDATIONS**

34. The Monitor is supportive of and recommends granting the Company's application for an extension of the Stay through to December 16, 2016 for the following reasons:

- a) The Monitor is satisfied that Management has been acting with due diligence and in good faith in working towards a successful restructuring;
- b) The stay extension is required in order for the Company to fully implement the SISP with a view to formulating a restructuring plan;
- c) The Company has commenced discussions with BDC regarding securing additional interim financing in the event it requires such additional financing in order to complete its restructuring activities; and

d) BDC has advised the Monitor that it is supportive of the Company's application in the circumstances.

35. The Monitor is also supportive of and recommends the Company's request for the establishment of a claims process and the proposed claims procedures for the reasons set out in this Third Report.

All of which is respectfully submitted this 17<sup>th</sup> day of November, 2016

Hardie & Kelly Inc.,  
in its capacity as the Monitor of Quattro Exploration and Production Ltd.  
and not in its personal or corporate capacity

Per:



Marc Kelly, CA, CIRP, LIT  
Senior Vice President



Charla Smith, CGA, CIRP, LIT  
Vice President