

CANADA

PROVINCE OF QUÉBEC  
DISTRICT OF MONTRÉAL

No: 500-11-042345-120

SUPERIOR COURT  
(Commercial Division)  
(Sitting as a court designated pursuant to the  
*Companies' Creditors Arrangement Act*,  
R.S.C. 1985, c. C-36)

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IN THE MATTER OF THE PROPOSED PLAN OF  
COMPROMISE AND ARRANGEMENT OF:

AVEOS FLEET PERFORMANCE INC./  
AVEOS PERFORMANCE AÉRONAUTIQUE INC.

And

AERO TECHNICAL US, INC.

Insolvent Debtors/Petitioners

and

FTI CONSULTING CANADA INC.

Monitor

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FIRST REPORT OF THE CHIEF RESTRUCTURING OFFICER TO THE COURT

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I. INTRODUCTION

1. On March 19, 2012, Aveos Fleet Performance Inc. ("Aveos") and Aero Technical US, Inc. ("Aero US" and, together with Aveos, the "Company" or the "Petitioners") filed a petition under the Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36, as amended (the "CCAA"). An initial order (the "Initial Order") was made by the Honourable Mr. Justice Schragger of the Superior Court of Quebec (Commercial Division) (the "Court"), granting, inter alia, a stay of proceedings against the Petitioners until April 5, 2012, (the "Stay Period"), and appointing FTI Consulting Canada Inc. as monitor of the Petitioners (the "Monitor"). The proceedings commenced by the Petitioners under the CCAA will be referred to herein as the "CCAA Proceedings".
2. On March 20, 2012, an Order For The Appointment Of a Chief Restructuring Officer (the "CRO Order") was made by the Court, appointing Mr. Jonathan Solursh as chief restructuring officer of the Petitioners. (collectively, with R.e.I. Group Inc. ("REL") the "CRO").
3. The purpose of this report is to inform the Court of the following:
  - a) The activities of the CRO since the date of appointment on March 20, 2012;

- b) The Company's cash flow forecast prepared in support of the request for an extension of the Stay Period; and
  - c) Address other matters relevant to this proceeding.
4. In preparing this report, the CRO has relied upon unaudited financial information of the Petitioners, the Petitioners' books and records, certain financial information prepared by the Petitioners and discussions with the Applicants' management and employees. The CRO has not audited, reviewed or otherwise attempted to verify the accuracy or completeness of the information. Future oriented financial information reported or relied on in preparing this report is based on management's assumptions regarding future events; actual results may vary from forecast and such variations may be material.
5. Unless otherwise stated, all monetary amounts contained herein are expressed in Canadian Dollars.

## II. ACTIVITIES OF THE CRO FOLLOWING HIS APPOINTMENT

### 6. Engagement Letter

The CRO's engagement letter was executed by the Company, effective as of March 20, 2012, as required pursuant to paragraph 7 of the CRO Order.

### 7. Establish control

- a) On March 21, 2012, the CRO and members of the REL team met with the Company's Chief Financial Officer and VP Human Resources to gain a preliminary understanding of events to date and the current situation and status of the Company.
- b) Immediately following this meeting the CRO and members of his team attended at the Aveos head office on Boul. Alfred-Nobel. The offices were found to be unpopulated, with the exception of security guards on site.
- c) Steps were immediately taken by the CRO to begin:
  - (i) Contacting remaining employees and establishing a management hierarchy;
  - (ii) performing a preliminary assessment of the state of the Company, including finance, operations and the status of employees;
  - (iii) initiating protocols to manage cash and related controls;
  - (iv) initiating protocols to managing physical plant security;
  - (v) Identifying unnecessary expenditures in an attempt to minimize cash expenditures to the extent possible;
  - (vi) defining specific work packages and assessing necessary staffing; and

- (vii) initiating contacts with key stakeholders.
8. The Company operates three divisions performing services for customers: Airframes, Engines and Components. The Company's primary locations are in Montreal, Winnipeg, Toronto and Vancouver, with secondary locations in Edmonton and Trenton. The Company has a warehouse location in Memphis, TN. In addition, there is inventory at customer locations in Mexico and El Salvador.
  9. At the time of writing this report, there were approximately 64,130 SKUs for parts in component inventory, located in 71,000 bins in 19 locations. Much of this inventory is commingled with parts owned by Air Canada and others. There were three aircraft in the Company's possession – two in Montreal (A320 and A330) and one in Vancouver (B767). In addition, there were 54 engines in the Company's possession – 14 awaiting induction, 4 completed, and 36 in various stages of work in process ("WIP") (8 of which are subject to litigation). There were approximately 5,100 components orders in various states of repair (WIP). There are 80,802 tools in the airframe facility, and there are also thousands of specialized tools associated with engines and components. The square footage for the primary plants is approximately 2 million square feet. Aveos owns the 515,000 square foot building which houses the engine shop, while the remainder of the 2 million square feet is leased space.
  10. Immediately after the CCAA filing on March 19, 2012, the Company expanded its security detail at each of the main locations to ensure that assets were protected. The cost of the enhanced security services was estimated to be approximately \$400,000 per week. The CRO has maintained security but at a greatly reduced rate of approximately \$75,000 per week.
  11. In order to establish control over cash receipts and disbursements, the CRO immediately initiated the following processes:
    - a) Replacing existing cheque signing authorities with the CRO and certain appointees, and putting processes in place for cheque signing, including establishing limits for signing authority;
    - b) Reviewing existing bank accounts, closing those that were unnecessary, and consolidating accounts at Bank of Montreal ("BMO");
    - c) Reviewing cheques and other payment items in circulation and issuing instructions to stop payment or return items as necessary;
    - d) Working with BMO to ensure that certain accounts remained frozen, while unfreezing the General and Payroll accounts to allow approved disbursements, including payroll, to be made;
    - e) Putting in place processes for the collection of accounts receivable; and
    - f) Establishing a protocol wherein the Monitor approves disbursements in accordance with the Initial Order and the CRO Order.
  12. The CRO has also undertaken other initial cost cutting measures, including reviewing the level of services received and initiating plans to scale back, where appropriate, other non-essential

services such as IT infrastructure, hardware and peripherals, telephone, data and other scalable operating costs.

13. The CRO, with the assistance of Aveos management, immediately began working to determine the ongoing staffing and personnel needs of the Company. It was determined that 83 employees would be retained, with certain employees on an incentive plan in order to motivate those with key knowledge to remain during the restructuring period.
14. The repair and maintenance of aircraft, aircraft engines and components is a complex and highly regulated undertaking due to the requirement to maintain strict adherence to safety systems. As a result of the complexities and regulatory requirements, and recognizing the fact that the majority of Aveos employees were terminated prior to its appointment, the CRO has directed the Company not to engage in any direct, ongoing repair or overhaul work. As a result Aveos is not in a position to complete WIP or perform work for customers. The Company is investigating alternate options for having the WIP completed, which could include use of IAM (as defined below) labour, third party oversight or customer-initiated and managed work packages. The CRO is in ongoing discussions with customers on finding ways to have WIP completed while attempting to balance the interests of the stakeholders.
15. The CRO has been in contact with certain of the Company's key stakeholders, as follows:
  - a) Air Canada - The CRO and Aveos' legal counsel, Fraser Milner Casgrain, met with Air Canada ("AC") on March 21, 2012 at the offices of AC's legal counsel. Also present at this meeting were the Monitor and its legal counsel. During this meeting an Interim Agreement was negotiated, the terms of which contemplate:
    - (i) AC obtaining access for the purpose of viewing its assets;
    - (ii) Aveos agreement in principle that it will work towards the return of AC's assets under the following conditions:
      - I. AC would waive the rent that Aveos would otherwise be obliged to pay during the working period of the interim agreement (approximately \$1.5 million per month, calculated on a per diem basis);
      - II. AC would waive the fee for the Company's IT access (approximately \$500,000 per month); and
      - III. AC would agree that, in the case of amounts owing for disputed items, AC would pay amounts which might be subject to Aveos' lien rights into court or post security for the release of the items;
    - (iii) iii. Aveos and AC will work together to validate the title to assets which AC is seeking to have returned.
  - b) The CRO has had further operational and strategic discussions with Air Canada at various levels, including Air Canada's executive. The CRO will continue to work with Air Canada in an effort to gain its support in attracting a buyer who will operate one or

more of the lines of business. It is apparent that whoever purchases the business will need to be acceptable to Air Canada from a quality and compliance perspective;

- c) On March 27, 2012, the CRO and the Monitor met with legal counsel for the International Association of Machinists and Aerospace Workers ("IAM"). The purpose of the meeting was to open the lines of communication with IAM, listen to their perspectives and answer questions, where possible. IAM has been clear that it would like to see a restart of Aveos as soon as possible. In this regard, they indicated a willingness to work with potential purchasers and are planning on bringing a potential investor to the table. The CRO is encouraged by this enthusiasm but is mindful that a purchaser will also need to enter into an appropriate commercial arrangement acceptable to both parties;
  - d) The CRO met with representatives of the government of the Province of Quebec who have offered assistance in helping potential purchasers with various support options; and
  - e) The CRO continues to work with and keep the Lenders apprised of material developments, and is actively consulting on cash flow issues, disbursements and other matters that come up from time to time.
16. To date the Company has received approximately 21 requests from third parties for the return of their property.
17. The Company is working with the Monitor to resolve third party property claims and develop a protocol for the return of property. This process is time consuming and requires significant time and attention of the CRO, the Monitor and Aveos employees.
18. A process has been established within Aveos for the identification, adjudication and ultimate release of third party property. The process includes:
- a) Locating the property and assessing the state of the goods (finished, in WIP or not yet inducted);
  - b) Validation of ownership of the goods;
  - c) Review of records to ensure no monies are owing with respect to work performed on the item and, if monies are owing, establish the balance due on release; and
  - d) When goods are to be released a release document in a form agreed by the Company and the Monitor is obtained.
19. Given the extent of the property, the number of locations and significant commingling of assets, this process will take some time. Motions for the return of property have been made or threatened and these have proven to be a distraction that has slowed down the process. The CRO notes that it would be helpful if parties would endeavour to work co-operatively with the Monitor and the Company on the return of their property, recognizing that this is an exceptional situation and it will take time to satisfy all requests for property to be returned.

### III. FINANCIAL INFORMATION AND CASH FLOW

20. The Company's cash flow forecast for the five-week period commencing March 31, 2012 indicates it can fund its ongoing costs during that period.
21. On the date of the appointment of the CRO there was approximately \$12.0 million of cash on hand. The company had pre-petition unpaid wages of approximately \$6.2 million (including approximately \$450,000 of employer payroll contributions). There were also post petition wages payable of approximately \$1.0 million, as well as significant professional fees related to the CCAA filing.
22. The Company has paid approximately half of the post-filing wages and source deductions of the employees who remain on staff as well as employees who were terminated after the making of the Initial Order but on or prior to the CRO's appointment. The balance of the wages for both these groups totals approximately \$450,000 and will be paid the week ending April 13, 2012.
23. The CRO has been working with the interested parties in facilitating the payment of the pre-petition wages. A motion to have the pre-petition wages paid upon certain terms was served on April 2, 2012. It is the CRO's view that the approach set out in the motion will allow for the wages to be paid as quickly as possible, on terms that would be acceptable to the Secured Lenders.
24. An assessment of WIP and preliminary investigations into ways to complete the WIP so that it can be monetized are underway. Given the complexity of the operations and the nature of the regulated aviation business this is a complex task.
25. It is the view of the CRO that implementing a sale process as quickly as possible is critical to maximizing value in this matter. Among other reasons, the costs of maintaining the infrastructure associated with Aveos' facilities in the wake of the abrupt cessation of operations are significant.

#### **IV. FUTURE DIRECTION**

26. In order to maximize the value of the Aveos assets the Company must begin a sale process. It is the CRO's view that this process must include two of Aveos' key stakeholders, Air Canada and IAM, both working independently with potential purchasers.
27. An ideal outcome would be the sale of one or more of the business units (airframes, engines and components) on an en bloc basis. However, the Company had concluded that the airframe business was not viable prior to the filing of the CCAA. Accordingly, the CRO will need to further investigate the options for the airframe division.
28. As of April 2, 2012, approximately 23 interested parties have contacted the Company, the CRO or the Monitor to express an interest in the Aveos business or assets. Interest has been shown by both strategic and financial investors, parties looking for specific assets, and a number of asset liquidation firms.
29. The highest probability for an en bloc sale of one or more of the divisions with a re-start or partial re-start of the operations likely lies with either a large financial or strategic player. The CRO believes that there are parties in both camps who are interested and likely have the capability to enter into and complete a transaction.
30. However, given the revenue concentration with Air Canada, a successful en bloc sale and the ongoing viability of a restarted business likely requires that the buyer work with (and be



acceptable to) Air Canada. Aveos has an economic dependence on Air Canada as its largest customer. The MRO business is complex, with long planning cycles. Even if Aveos restarts and can bring new customers through organic growth or being acquired through a strategic acquisition, it will take time for new customers to come on board. Accordingly, Air Canada's involvement is critical.

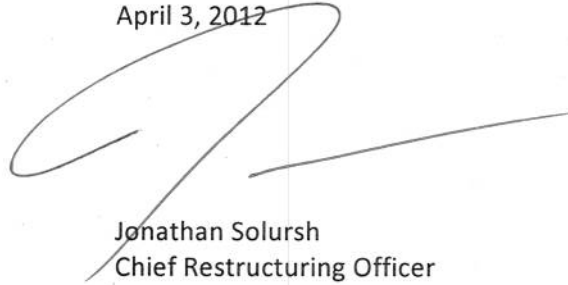
31. The Company has had preliminary discussions with a number of interested parties and has initiated site visits where appropriate. The CRO intends to report back to the Court as soon as possible on a sale process.

#### **V. OTHER MATTERS**

32. Aveos supplies services to the Department of National Defense ("DND") in respect of a contract to service its CC-150 Polaris aircraft. The DND contacted the CRO and advised that it was critical that support for the aircraft be continued. The work is performed at the Trenton, Ontario location primarily by Air Canada employees who are seconded to Aveos. A short-term solution was provided by transferring oversight of the maintenance work from Aveos to the Canadian Forces. The CRO is working with the interested parties in finding a long-term solution to the problem, taking Aveos' current circumstances into account.
33. It has come to the CRO's attention that certain source deductions from pre-filing payroll, namely CPP, EI and income taxes withheld, had not been remitted. The Company estimates the combined employer and employee portion of these unpaid amounts to be approximately \$2.63 million. In addition, there are unpaid pension payments, which relate to the pre-filing period, but were not yet due at the time of filing. The Company is working on quantifying these amounts.
34. The Air Canada account receivable balance owing according to Aveos' records remains unpaid at the time of writing this report. The Company is working through a reconciliation of these accounts; the agreements are complex, so it is expected to take a few weeks to come to a position on this matter.
35. The CRO is of the view that the CCAA process should be continued to allow the Company an opportunity to attempt to find a buyer for one or more of its divisions on an expedited basis. Working with all of the parties, the CRO is hopeful that it can attempt to facilitate a transaction that could lead to a restart of one or more divisions. This would likely require a purchaser to reach agreements with the IAM and, additionally, it would require commitments from Air Canada as the key customer.

36. The Company suffered a sudden, unplanned, catastrophic interruption of operations that has left it in a severely handicapped state. We believe there is substantial value in the business, if its customers and other stakeholders work with it; however, to access this value, order and stability must be restored, and one or more sale transactions implemented on an accelerated timeframe.

April 3, 2012

A handwritten signature in black ink, consisting of a large, stylized loop followed by a horizontal line extending to the right.

Jonathan Solursh  
Chief Restructuring Officer

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