

District of British Columbia
Division No.: 03 - Vancouver
Court No.: B240300
Estate No.: 11-3089419
Vancouver Registry



**IN THE SUPREME COURT OF BRITISH COLUMBIA
IN BANKRUPTCY AND INSOLVENCY**

**IN THE MATTER OF THE NOTICE OF INTENTION TO MAKE A PROPOSAL OF
CLOUD DIAGNOSTICS CANADA ULC**

CROWE MACKAY & COMPANY LTD., PROPOSAL TRUSTEE

SECOND REPORT TO COURT

November 13, 2024

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I. INTRODUCTION

1. On June 5, 2024 (the "**Filing Date**"), Cloud Diagnostics Canada ULC (the "**Company**") filed a Notice of Intention to Make a Proposal (the "**NOI**") pursuant to subsection 50.4(1) of the *Bankruptcy and the Insolvency Act* R.S.C.1985, c. B-3 (the "**BIA**") and Crowe MacKay and Company Ltd. consented to act as Trustee under the Proposal (the "**Proposal Trustee**").
2. Pursuant to section 50.4(8) of the BIA, the initial stay period in the proposal proceedings was from June 5, 2024 to July 5, 2024 (the "**Stay Period**"). The Court granted an extension (the "**First Extension**") of the stay of proceedings and deadline to file a proposal to August 19, 2024. On this same date, the Court also granted an administration charge and an interim financing charge. On June 14, 2024, the Court granted further interim financing.
3. On June 21, 2024, the Court granted an Order that the Company would carry out a sale and investment solicitation process (the "**SISP**"), which would allow the Proposal Trustee, in consultation with the Company and its management to sell the Company and/or its business assets. The deadline to submit a bid was July 26, 2024 (the "**Bid Deadline**"). Particulars of the SISP and the bids received at the Bid Deadline are discussed in greater detail below.
4. On August 15, 2024, the Court granted an extension (the "**Second Extension**") to the stay of proceedings and deadline to file a proposal to October 3, 2024.
5. On September 13, 2024, the Court granted an extension (the "**Third Extension**") to the stay of proceedings and deadline to file a proposal to November 5, 2024.
6. On November 5, 2024, the Court granted an extension (the "**Fourth Extension**") to the stay of proceedings and deadline to file a proposal to December 20, 2024.

7. This report (the "**Second Report**") should be read in conjunction with the Proposal Trustee's First Report to Court dated June 10, 2024 (the "**First Report**"), along with the Company's Notice of Motion dated November 1, 2024 to, among other things, approve the Superior Bid and the RVO (both terms defined below).
8. The Proposal Trustee has made the materials related to these proceedings available on its website at: <https://crowemackayco.ca/project/cloud-diagnostics-canada-ulc/>

II. PURPOSE OF REPORT

9. The purpose of the Second Report is to provide this Honourable Court and the Company's stakeholders with the following:
 - a. a summary of the activities of the Proposal Trustee since the date of the First Report;
 - b. an update on the Company's activities since the date of the First Report;
 - c. an update on the Proposal Trustee's monitoring of the Company's weekly cash flows;
 - d. information pertaining to the SISP undertaken, as well as the Proposal Trustee's recommendation on the acceptance of the Superior Bid (defined below); and,
 - e. the Proposal Trustee's conclusions and recommendations on the relief sought.

III. TERMS OF REFERENCE

10. In preparing this Second Report, the Proposal Trustee has necessarily relied upon unaudited financial and other information provided by the Company, the Company's books

and records, and discussions with management of the Company, namely Mr. Robert Kaul and Mr. Anthony Kaul ("**Management**") (collectively, the "**Information**").

11. The Proposal Trustee has not audited, reviewed or otherwise attempted to verify the accuracy or completeness of the Information in a manner that would wholly or partially comply with Generally Accepted Auditing Standards pursuant to the Chartered Professional Accountants Handbook. Accordingly, the Proposal Trustee expresses no opinion and does not provide any other form of assurance on the accuracy and/or completeness of any information used to prepare this Second Report.
12. Certain of the information referred to in this Second Report consists of financial forecasts and/or projections prepared by the Company. An examination or review of the financial forecasts/projections and procedures as outlined by the Chartered Professional Accountants of Canada has not been performed by the Proposal Trustee. Readers are cautioned that since financial forecasts and/or projections are based upon assumptions of future events and conditions that are not ascertainable, actual results may vary and the variations could be material.

IV. **ACTIVITIES OF THE COMPANY**

13. Since the First Report, the Company's Management have engaged in, among other things, the following activities:
 - a. attended numerous meetings and telephone calls with the Proposal Trustee to discuss the affairs of the Company, as well as the ongoing SISP;
 - b. prepared and filed four (4) projected cash flow statements for the period covering June 4, 2024 to December 20, 2024, along with the accompanying assumptions on June 7, 2024, August 13, 2024, September 13, 2024, and November 1, 2024 respectively;
 - c. assisted the Proposal Trustee with the SISP, including the following:

- b. assisted the Company with the planning and execution of the SISP including, but not limited to, the following:
 - i. prepared a list of approximately 115 prospective parties which includes companies in a same or similar industry;
 - ii. coordinated distribution of teaser letter outlining the opportunity to prospective purchasers;
 - iii. created a data room with various documents to assist interested parties in assessing the opportunity;
 - iv. numerous discussions and correspondence with prospective parties with respect of the opportunity, SISP process, and other matters;
 - v. prepared and coordinated the execution of non-disclosure agreements to parties wishing to access the data room;
 - vi. provided interested parties access to the data room, and assisted with any questions thereafter;
 - vii. conducted follow-up telephone calls and emails to interested parties reminding them of the opportunity and deadline to submit a bid;
 - viii. assessed the various bids received, and prepared an analysis of same;
and,
 - ix. other matters.
- c. monitored the Company's financial affairs and activities on a weekly basis and investigated any material variances;
- d. prepared three (3) letters dated August 13, 2024, September 12, 2024, and November 1, 2024 to Mr. Jonathan Williams, in his capacity as counsel for the Company, with respect to the Proposal Trustee's support of the Second Extension, Third Extension, and Fourth Extension respectively;

- e. mailed a notice to unsecured creditors to advise them of the Company's Notice of Motion to, among other things, approve the Superior Bid and the RVO.
- f. prepared this Second Report; and,
- g. other matters of a general and specific nature not otherwise referred to above.

VI. CASH FLOW VARIANCE ANALYSIS

- 15. The Company, with assistance of the Proposal Trustee, has four (4) separate cash flow statements for the periods covering June 4, 2024 to December 20, 2024 (collectively, the "**Cash Flow Statements**")
- 16. The Proposal Trustee's monitoring of the Cash Flow Statements consisted of inquiries, analytical procedures and discussions related to information supplied to the Proposal Trustee by Management. During its weekly monitoring of the Cash Flow Statements, the Proposal Trustee did not identify any variances which may constitute as material adverse changes.

VII. SALES AND INVESTMENT SOLICIATION PROCESS

- 17. Pursuant to an Order entered on June 21, 2024, the Company was authorized to, with the assistance of the Proposal Trustee, market any and all of the Company's assets, undertakings and properties (the "**Assets**") which included, among other things, advertising and soliciting offers in respect of the Assets or any part or parts thereof and negotiating such terms and conditions of sale as the Proposal Trustee considers appropriate.
- 18. The Proposal Trustee worked alongside with the Company to plan and execute a comprehensive SISP. Below is a summary of the efforts made by the Proposal Trustee and the Company:

- a. prepared an extensive list including approximately 115 prospective parties which included companies in a same or similar industry;
 - b. advertised on a weekly basis, for a number of weeks, in the insolvency industry newsletter: Insolvency Insider;
 - c. gathered and compiled documents relevant to the SISP and prepared a data room for prospective parties to gain access;
 - d. prepared a non-disclosure agreement for prospective parties to execute in order to gain access into the data room;
 - e. emailed a teaser letter with information regarding the SISP and the bidding process to at least 115 parties;
 - f. followed up with emails to the various aforesaid parties reminding them of the opportunity and deadline to submit a bid/proposal;
 - g. received at least 17 responses to the teaser and advertisement from various parties expressing an interest in the opportunity;
 - h. coordinated the execution of non-disclosure agreements with at least 15 parties and provided them with access to the data room;
 - i. attended to numerous emails and telephone calls from prospective purchasers; and,
 - j. received 2 offers before the Bid Deadline.
19. As mentioned above, the Proposal Trustee received two (2) bids. The first bid it received was a cash offer in the amount of \$50,000 for the purchase of the Assets. This offer was received well in advance of the Bid Deadline.
20. The second bid received was from 1493907 B.C. Ltd. ("**907Co**") on the date of the Bid Deadline. The bid included the following major terms, among others:
- a. 907Co would acquire 100% of the shares of the Company through a transaction enabled, among other things, by a reverse vesting order ("**RVO**") issued by the Court;

- b. 907Co is funded by the of the secured debenture holders of the Company, by way of a secured facility assignment agreement and a private placement subscription agreement. The participating secured debenture holders represent 100% of the secured indebtedness of the Company;
 - c. The price offered is up to \$13,212,644.26, and is comprised of the following:
 - i. A credit bid of 90% of the Debenture Indebtedness, being \$10,445,868.79;
 - ii. A credit bid of the DIP Financing, as secured by the DIP Financing Charges, in the amount totalling \$1,645,000;
 - iii. Cash in the amount of \$921,775.47, relating to the payment of the Canada Revenue Agency's (the "**CRA**") for its priority claim; and,
 - iv. the Administration Charge in the amount of up to a maximum of \$200,000.
 - d. the bid is not subject to any conditions other than Court approval; and,
 - e. a wire representing the Deposit in the amount of \$149,980 was received by the Proposal Trustee on or around the Bid Deadline.
21. The Proposal Trustee is of the opinion that the bid from 907Co in the amount of up to \$13,212,644.26 is the superior bid (the "**Superior Bid**") for the following reasons:
- a. it offers the highest certainty for the highest gross recovery;
 - b. it offers to repay the CRA's priority claim in the amount of \$921,775.47;
 - c. it includes a credit bid by the majority of the secured creditors of the Company in the amount of \$12,090,868.79, which is comprised of \$10,445,868.79 being 90% of the total secured indebtedness, and \$1,645,000 being the DIP Financing secured by the DIP Financing Charges;
 - d. it allows for the continued operations through the existing entity whereas the other bid contemplated an immediate sale or liquidation of the Assets. This allows for the Company to preserve the value of the customer contracts, as discussed in greater detail below;
 - e. it potentially preserves the benefit of certain tax losses, tax credits and other tax attributes generated in the existing entity which is discussed in greater detail below; and,

- f. it benefits key stakeholders of the Company, as it allows for the Company to continue as a going concern. The key stakeholders include, among others, the following:
- i. approximately 1,700 active patients using the Company's products and services for their respective medical needs;
 - ii. health authorities and medical professionals who rely on the Company's products and services in order to monitor and evaluate their patients;
 - iii. the potential negative impacts of the ceasing of the Company's operations on patients currently benefitting from the Company's technology cannot be overstated
 - iv. employee who may continue their employment with the Company, and as a result have a positive impact on the local economy; and,
 - v. suppliers and vendors may continue a business relationship with the Company, and continue to supply goods and services.
22. In considering the Superior Bid, the Proposal Trustee notes that the majority of the value of the Company's Assets is held in its intangible assets including its intellectual property; primarily its ongoing customer contracts. The Proposal Trustee notes that the Company's tangible assets are quite limited in value (restricted to office furniture, computer equipment, etc.). Below is a table of the Company's tangible assets and their respective net book values as at June 30, 2024:

<u>Asset Class</u>	<u>Net Book Value</u>
Cash	\$ 446,179
Accounts Receivable	360,146
Inventory	477,126
Prepaid Expenses and Deposits	55,163
Property, Plant and Equipment	38,772
Right of Use Asset	199,744
	<u>\$ 1,577,130</u>

23. The Proposal Trustee notes the following with respect to the tangible assets:

- a. Cash: as at the date of this Second Report, the Company held a cash balance of approximately \$200,000 , much less than the balance in the above table. Further this cash balance is after the Company has received in or around \$150,000 in DIP Financing. Without the injection of cash by the DIP Lender, the Company's cash position is expected to deteriorate as the Company continues to operate;
- b. Accounts Receivable: as at the date of this Second Report, the Company had accounts receivable of in or around \$620,000. As discussed further below, the contracts are not transferable, and accordingly it is expected that in the event of an asset sale that much of the accounts receivable will not be collectible given potential claims of offset from damages from the cancellation of these customer contracts;
- c. Inventory: Management advised that as at the date of this report, it had inventory with a book cost of in or around \$50K. The Company has been ordering inventory on a just-in-time basis, and accordingly does not have much inventory in its possession;
- d. Prepaid Expenses and Deposits: Management has advised that it does not believe any of the prepaid expenses or deposits are refundable;
- e. Property, Plant and Equipment: the Company has very limited property and equipment consisting primarily of office furniture and computer equipment. It is understood that there is nominal value in the property and equipment;
- f. Right of Use Asset: the right of use asset is simply an accounting entry that arose as a result of IFRS 16 given that the Company has a leased premises. There is no realizable value anticipated to be realized from the right of use asset in the event that operations cease.

Based on the above, there is nominal value in the Company's tangible assets. Accordingly, much of the Company's value is in its intangible assets, such as its ongoing customer contracts.

24. In addition to the assets outlined in the table above, Management advised that of the 35 ongoing customer contracts, 21 contracts were acquired through competitive bidding processes. Management has advised that the majority of its contracts are not transferable. Accordingly, in the event of a sale of the Assets, the customer contracts would not be transferable to a new entity. An RVO is required to provide for the continuation of these customer contracts.
25. The Proposal Trustee notes that the Superior Bid looks to preserve the ongoing customer contracts, while the only other bid in the amount of \$50,000 would not. Accordingly, the Company's value, in majority, is in its customer contracts which cannot be transferred. Further, the Company has accrued non-capital tax losses totalling \$34.8M. These tax losses would not be made available to a purchaser in an asset sale. Therefore, as a result of these considerations, the Proposal Trustee is of the view that an RVO, as set out in the Superior Bid, is necessary to optimize the value to stakeholders.
26. Based on the foregoing, the Proposal Trustee is of the opinion that the Superior Bid, including the RVO, provides a greater recovery to the Company's stakeholders than could be obtained by way of an assets sale, or in a bankruptcy. Accordingly, the Proposal Trustee recommends that this Honourable Court approve the Superior Bid, including the RVO.

VIII. CONSIDERATIONS OF SUPERIOR BID AND APPROPRIATENESS OF RVO

27. In considering the appropriateness of an RVO, the Proposal Trustee considered the factors as set out in subsection 65.13(4) and (5) of the BIA and as outlined in the *Harte Gold* decision. The factors considered are set out in detail below.

The Process Leading to the Sale was Reasonable

28. The Proposal Trustee is of the opinion that the SISP was conducted fairly, with integrity and in a reasonable manner. As detailed in paragraph 17 above, the Proposal Trustee, along with the assistance of the Company and its Management, provided sufficient exposure of the Company's business and Assets to the market, including:
- a. prepared and sent a teaser letter outlining the opportunity to at least 115 potentially interested parties;
 - b. established a virtual data room, which include information on the Company, its business, the Assets, and other financial information;
 - c. advertised the SISP on a weekly basis in the Insolvency Insider, a well-established and followed insolvency industry newsletter;
 - d. worked with interested parties in signing non-disclosure agreements with at least 15 parties in order to gain access to the virtual data room; and,
 - e. worked with interested parties and Management to address any inquiries about the SISP.
29. As mentioned above, as at the Bid Deadline, two (2) bids were received. The Proposal Trustee is of the opinion that the process leading to the proposed sale and RVO was reasonable in the circumstances, taking into account the interests of all stakeholders.

The Trustee Approved the Process Leading to the Proposed Sale

30. The Proposal Trustee does not have any concerns with respect to the SISP, the RVO, and the process leading to same. Accordingly, the Proposal Trustee approves the process leading to the Superior Bid.

The Sale is More Beneficial to the Creditors than a Sale under a Bankruptcy

31. The Proposal Trustee is of the opinion that the Superior Bid would provide a greater recovery to stakeholders than could be obtained in a bankruptcy. The Proposal Trustee considered the following in arriving at its conclusion:
- 32.
- a. as set out above in paragraph 22, the Proposal Trustee is of the opinion that the tangible assets have limited value in the event that they are liquidated, as would occur in a bankruptcy.
 - b. the majority of the Company's value is in its ongoing customer contracts, which would be terminated in the event of a bankruptcy. Further, the majority of the customer contracts are not transferable in the event of a bankruptcy.
 - c. in the event of a bankruptcy, it is unlikely that the CRA would be paid in full for its priority claim, while the proposed sale under the Superior Bid offers to pay the CRA in full for its priority claim.
 - d. The Proposal Trustee canvassed the market for the sale of either the business or the Assets. The only offer received for the Assets was in the amount of \$50,000. The Proposal Trustee is of the opinion that recoveries in bankruptcy would be similar to the \$50,000 offer received.

The Extent to Which Creditors were Consulted

33. The secured creditors were consulted during the SISF, as they were included on the list of interested parties. Further, 907Co, in their capacity as the bidder for the Superior Bid, is made up of over 90% (in dollar value) of the Company's secured creditors.
34. While the unsecured creditors have not been formally consulted as it relates to the SISF and RVO, the unsecured creditors would not stand to benefit from either the second ranking bid in the amount of \$50,000, nor from a bankruptcy. Given the overwhelming buy-in from the secured creditors, the Proposal Trustee is of the opinion that the creditors were properly consulted given the circumstances.

The Effects of the Proposed Sale on the Creditors and Other Interested Parties

35. The Company's creditors as whole will benefit from the approval of the Superior Bid, and the RVO, namely the CRA for its priority claim, as well as the secured creditors participating as part of 907Co.
36. As set out above in paragraph 20(e) above, the Company's key stakeholders stand to benefit from the approval of the Superior Bid, including the RVO. This includes outpatients, health authorities, medical professionals, the Company's employees, suppliers and vendors, among other. The potential negative impacts associated with the ceasing of the Company's operations on patients currently benefitting from the Company's technology cannot be overstated.
37. The Proposal Trustee is of the opinion that the Superior Bid will positively impact the Company's creditors as a whole, as well as its stakeholders.

Whether the Consideration to be Received for the Assets is Reasonable and Fair

38. The Proposal Trustee is of the opinion that the consideration offered in the Superior Bid is reasonable and fair, taking into account their market value.
39. Further, the Proposal Trustee notes that a sales process, such as the SISP undertaken, is the best way to ascertain the market value of the business or the Assets.
40. The other bid received in the amount of \$50,000 was strictly for the Assets. This is much less than the Superior Bid, which contemplates an RVO, in the amount of \$13,212,644.26.
41. The Proposal Trustee notes that, while the Company has accrued non-capital tax losses ("NCL") in the amount of approximately \$34.8M, NCLs typically once applied only benefit the acquiring entity in the amount of between \$0.01 to \$0.10 per \$1.00. Accordingly, the value of the NCLs could range from \$348,000 to \$3,480,000. Further, the Proposal Trustee notes that there is much uncertainty when acquiring NCLs, including whether the

CRA will allow the application of the NCLs at all. Further again, the NCLs would be reduced by the debt forgiveness arising from these proceedings under section 80 of the Income Tax Act, and accordingly the value of the NCLs is expected to be ground down from the current accrued balance.

42. There is also potential value and benefit associated with substantial accrued Scientific Research and Experimental Development ("**SRED**") tax credits in the amount of \$679,257. Again, similar to the NCL, the ability to utilize these SRED credits is not at all certain and is conditional on the ability to earn income in the future. The application of the SRED credits is subject to review and oversight by CRA.
43. Given that a robust SISP was undertaken, and that two (2) bids were received, the Proposal Trustee is of the opinion that the \$13,212,644.26 offer is fair and reasonable given the circumstances.

IX. PROPOSAL TRUSTEE'S RECOMMENDATIONS

44. Based on the foregoing, the Proposal Trustee has the following comments in respect to the Company's application:
- a. the Company has been acting in good faith and with due diligence;
 - b. the Company has taken substantive steps, in consultation with the Proposal Trustee, to advance the SISP as well as the closing of the Superior Bid;
 - c. an RVO, as set out in the Superior Bid, is necessary in order to preserve the value of the customer contracts, tax losses and other tax attributes, and therefore the value of the Company;
 - d. an RVO avoids the potential negative impacts of the ceasing of the Company's operations on patients currently benefitting from the Company's technology;
 - e. the Superior Bid is appropriate in these circumstances when considering the factors set out in subsections 65.13(4) and (5) of the BIA; and,
 - f. the Superior Bid offers the greatest recovery to the Company's stakeholders.


45. For the above reasons, the Proposal Trustee respectfully recommends that this Honourable Court grant an Order for the relief sought by the Company.

DATED AT the City of Vancouver, in the Province of British Columbia, this 13th day of November 2024.

Crowe MacKay & Company Ltd.

in its capacity as Licensed Insolvency Trustee of the Proposal of
Cloud Diagnostics Canada ULC and not in its personal capacity

Per:


Mr. Jonathan McNair, CPA, CA, CIRP, LIT
(Chartered Insolvency & Restructuring Professional)