District of ONTARIO
Division 09-Toronto
Estate #: 31-2237153
Court # 31-2237153

SUPERIOR COURT OF JUSTICE (IN BANKRUPTCY)

IN THE MATTER OF THE PROPOSAL OF

**MASTERFILE CORPORATION
OF THE CITY OF TORONTO,
IN THE PROVINCE OF ONTARIO**

REPORT OF TRUSTEE TO THE CREDITORS

(Section 50(5) of the Bankruptcy and Insolvency Act)

Enclosed are the following documents:

- Notice of Proposal to Creditors;
- Proposal under Part III, Division I, of the *Bankruptcy and Insolvency Act* (the "**BIA**"), dated April 5, 2017 (the "**Proposal**") lodged with MNP Ltd. (the "**Trustee**") by Masterfile Corporation ("**MFC**" or the "**Company**") and filed with the Official Receiver on April 5, 2017;
- a statement of the Company's assets and liabilities as at April 5, 2017 ("**SOA**");
- a proof of claim form;
- voting letter if you wish to vote in advance of the meeting; and
- general proxy.

The following is an outline of the background and financial position of the Company, including relevant information that should be of assistance to the creditors in considering their position with respect to the Proposal.

In preparing this Report and making the comments herein, the Trustee has been provided with, and has relied upon, certain unaudited, draft and/or internal financial information, the Company's books and records, discussions with employees and management and information from other third-party sources (collectively, the "**Information**"). Except as described in this Report, the 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 Assurance Standards pursuant to the CPA Canada Handbook.

Capitalized terms used in this Report are the same as those referenced in the Proposal.

SECTION A - Background

MFC, a stock-image company with a history dating back to 1973, engages in the acquisition, organization, distribution, and licensing of photos, vectors, and illustrations for commercial use in editorial publications, printed advertising and marketing, display, websites and mobile media. Its collection features various premium rights-managed and royalty-free photos and illustrations by artists covering a wide range of subjects.

On April 5, 2017, the Company filed a Proposal pursuant to the BIA, as a means of offering its creditors a dividend that would be higher than its creditors would receive in the event of a bankruptcy.

The Trustee is maintaining a website at http://mnpdebt.ca/masterfile with publicly available information on MFC's proposal proceedings.

SECTION B - Summary of the Proposal

This section contains a summary of the Proposal, the terms of which would be effective only if the Proposal is accepted by the creditors and approved by the Court, in accordance with the provisions of the BIA.

As set out in the Proposal, the Proposal provides for the following:

(i) Conditional on the approval of the Proposal by the Unsecured Creditors of MFC and the making of the Approval Order, MFC will pay to the Trustee the following:
(a) $800,000 (the "**Article 6.3 Funds**") in minimum quarterly installments of $40,000 commencing within 90 days of the Implementation Date;
(b) Immediately after the making of the Approval Order, the funds required to satisfy payment of the Employee Creditors claims; and
(c) Unless Her Majesty agrees otherwise, within six months after the making of the Approval Order, the funds required to satisfy payment of the Source Deduction Creditors,

(collectively, the "**Proposal Proceeds**").

The Debtor shall be at liberty to accelerate any payments required to be made herein;

(ii) Secured Creditors will be paid in accordance with existing arrangements, or as may be arranged with them and are not affected by this Proposal;

(iii) The Related Creditors, namely Masterfile USA Corporation and Crestock Corporation, shall receive no dividend under the Proposal;

(iv) Payment of the proper fees and expenses of the Trustee, including legal fees, in connection with the Proposal (the "**Administrative Fees and Expenses**") shall be paid by the Company from the Proposal Proceeds;

(v) The claims of the Employee Creditors shall be paid by the Trustee from the Proposal Proceeds immediately after the making of the Approval Order;

(vi) Unless Her Majesty agrees otherwise, the Proven Claims, if any, of the Source Deduction Creditors shall be paid by the Trustee from the Proposal Proceeds within six months after the making of the Approval Order.

(vii) The Article 6.3 Funds will be distributed by the Trustee as follows:

(a) First, to pay the Administrative Fees and Expenses in full;
(b) Second, to pay the Preferred Claims; and
(c) Third, after making the distributions contemplated by paragraphs (a) and (b) pay to each Unsecured Creditor *pro rata* based on the proportion that the Proven Claim of such Unsecured Creditor bears to the total Proven Claims of all Unsecured Creditors, exclusive of Preferred Claims, claims of Employee Creditors (as such term is defined in the Proposal) and claims of Source Deduction Creditors;

(viii) Any Claims against MFC by any Creditor that are also Claims against the directors and/or officers of MFC that relate to obligations of MFC where directors and/or officers are under any law liable in their capacity as directors and/or officers for the payment of such obligations shall be, and upon Court approval of the Proposal, are to the extent permitted by the BIA, released and forever discharged as against the directors and/or officers of MFC; and

(ix) Sections 95-101 of the BIA will not apply in respect of the MFC, or this Proposal.

The description of the Proposal is a summary only, and readers are cautioned that if there is inconsistency between this report and the Proposal, the terms of the Proposal shall govern.

SECTION C - Financial Position and Causes of Difficulties

A summary of the Company's historical financial results is set out below:

Year Ended February 28 (CAD '000s)	F2014 Internal	F2015 Internal	F2016 Internal	F2017 Internal
Revenue	**$ 9,920**	**$ 7,982**	**$ 7,015**	**$ 5,140**
% Growth	*N/A*	*-20%*	*-12%*	*-27%*
Royalties	4,416	3,552	2,993	2,150
Gross Margin	**5,504**	**4,430**	**4,022**	**2,990**
Gross Margin (%)	*55%*	*55%*	*57%*	*58%*
Operating Expenses	**5,536**	**4,801**	**6,918**	**4,007**
SG&A (%)	56%	60%	99%	78%
EBITDA	**- 32**	**- 371**	**- 2,896**	**- 1,017**
EBITDA (%)	*0%*	*-5%*	*-41%*	*-20%*

The above historical financial results are based on internally prepared financial statements. Externally prepared financial statements are only available at a consolidated level which incorporate the results of other related parties to MFC.

The management of the Company advises that the cause of its financial difficulties can mainly be attributed to the following:

1. The stock photo business has been "uberized". The advent of digital photography and the quantity of reproduction grade imagery that can be produced with a digital camera or even a smartphone, has allowed part-time amateurs and hobbyists to create reproduction grade images quickly and easily. As a result, the supply of images available for commercial use has exploded into the hundreds of millions thus commoditizing the product, dramatically depressing prices and pushing many professional photographers out of the market.

2. Likewise, technology has had a massive impact on MFC's clientele: advertisers, publishers, printed media of all descriptions and other users of premium-priced content.

3. After a 35-year growth period with revenues peaking at $31 million in 2008, MFC's revenues have declined year-over-year and are only now showing signs of levelling off.

4. MFC's current revenues were unable to support the scale of operations MFC has maintained to compete against huge competitors like Getty, Shutterstock and Adobe – and MFC has scaled back overhead tremendously in recent years by taking the following measures:

    a. closing all regional offices;
    b. reducing space in Toronto by 50%;
    c. reducing headcount by 80% (from 150 to 30 FTE staff); and
    d. reducing salaries for the remaining employees, with larger salary reductions for senior managers.

5. Notwithstanding the measures referenced in 4 above, MFC suffered significant financial losses and a severe cash deficit in 2014/2015. MFC got progressively later paying royalties throughout 2014 and into 2015 resulting in a 6-month payment backlog for statements dated November 2014 – April 2015.

6. In April 2015, MFC sold its European operations to Mediapro Mediamarketing GmbH ("**Mediapro**") as a means of acquiring much-needed working capital to stabilize MFC's business, but the sale did not provide sufficient cash to pay out the royalties backlog. MFC therefore made the decision to pay only current royalties and froze the backlog, which would be paid from funds generated through increasing sales and cash going forward. But sales and cash continued to decline despite MFC's best efforts and MFC soon used up the capital provided by the sale of the European operations.

7. MFC managed to keep royalty payments current from May 2015 through June 2016 but the cash drain on MFC continued to grow and it has been unable to pay most royalties owed to its contributors since September 2016.

8. Additionally, there are large amounts owed to MFC from some international distributors who are having identical problems in their own countries – and that has made a bad situation worse for MFC. Most notably, Mediapro began defaulting on royalties in 2016 (see Section L for more information on Mediapro).

9. Given the foregoing, MFC decided to file the Proposal as part of a further financial and operational restructuring of the business to address the following issues and opportunities:

    a. MFC still has market recognition and client goodwill, but the cost structure of its licensing business is too high and must be scaled back further to reflect current revenues.
    b. Staff costs have been reduced significantly, with the related termination costs being included as a claim in the Proposal.
    c. Pressure from suppliers to pay their royalties was reaching the breaking point.
    d. ArtistDefense Inc. ("**ADI**"), a recently created 100% owned subsidiary of MFC, provides a growth opportunity and a pivot for the business if MFC can survive. As revenues grow, ADI would absorb staff and overhead from MFC thus reducing the expenses significantly on the licensing side of the business.

SECTION D - Interim Receiver

Not Applicable.

SECTION E - Identification and Evaluation of Assets

According to the SOA, the Company's assets and their estimated realizable value are as listed below. Further details can be found in Section L of this Report.

Description	Estimated Realizable Value
Inventory (wholly owned stock images)	$ 75,000
Accounts receivable (net of allowance for doubtful accounts)	318,000
Cash	16,862
Equipment	15,000
Shares in subsidiary companies	1
Vehicles (leased 2015 Toyota Sienna)	1
TOTAL	$ 424,864

The Trustee performed a *Personal Property Security Act* (Ontario) registration search on March 8, 2017. The search revealed only registrations by HSBC Bank Canada ("**HSBC**") (in respect of a credit card with a current balance of approximately $35,000) and Toyota Credit Canada Inc. (in respect of the leased vehicle).

SECTION F - Conduct of the Company

The conduct of the Company does not appear to be subject to censure.

SECTION G - Creditors' Claims

Per the SOA, the Company's creditors consist of:

Creditor Classifications	SOA Amount
Secured	$ 35,001
Preferred	53,350
Unsecured	3,883,504
TOTAL	$ 3,971,855

Included in the Unsecured Creditor pool is an amount due to Masterfile USA Corporation, a related creditor claim, in the amount of $417,022. Under the terms of the Proposal, Related Creditors are not sharing in the distribution from the Proposal Proceeds.

SECTION H - Previous Business Dealings with the Company

The Trustee previously had discussions with MFC concerning restructuring, but was not formally retained until March 17, 2017.

SECTION I - Informal Meeting with Major Creditors

Not Applicable.

SECTION J - Remuneration of Trustee

The Trustee's fees and expenses related to the administration of the Proposal, including those of its and MFC's legal counsel, will be paid in full from the Proposal Proceeds as detailed in Paragraph (iv) of Section B above. To date, MFC has provided a retainer of $20,000 to the Trustee.

SECTION K - Other

Not applicable.

SECTION L - Statement of Estimated Realizations

Set out below is the Trustee's estimate of the distribution to ordinary unsecured creditors if the Proposal is accepted by the creditors and approved by the Court:

Proposal funds available to satisfy Unsecured Creditors	$ 800,000
Less:	
Estimated Administrative Fees and Expenses	($50,000)
Estimated Funds Available for Distribution	$750,000
Estimated claims of Unsecured Creditors per SOA (net of Related Creditors claims)	3,466,482
Estimated distribution to Unsecured Creditors (%)	**21.6%**

If the Proposal is rejected by the Creditors, the Company will be deemed bankrupt. The anticipated realizations from a bankruptcy are summarized below.

	Notes	**Book Value (as at Feb 28, 2017)**	**Estimated Realization**
Inventory (wholly owned stock images)	*(1)*	Nil	$ 75,000
Accounts receivable (book value is net of allowance for doubtful accounts)	*(2)*	424,000	318,000
Cash (values as at April 5, 2017)		16,862	16,862
Equipment	*(3)*	70,634	15,000
Shares in subsidiary companies	*(4)*	1,001	1
Vehicles (leased)		Nil	1
Total:		**$ 512,497**	**424,864**
Less:			
Claims of Employee Creditors	*(5)*		(55,350)
Claims of Secured Creditors	*(5)*		(35,001)
Estimated Professional Fees			(40,000)
Available for distribution to Ordinary Unsecured Creditors *(5)*			**$ 294,513**
Estimated Claims of Unsecured Creditors per SOA (6)			$ 3,883,504
Estimated Distribution to Ordinary Unsecured Creditors per dollar of Proven claim			**7.6%**

Notes:

1. Inventory consists of the Company's wholly owned stock images. The Company has valued the images based on revenue the images have generated in the trailing twelve months. The Company and Trustee have not obtained a liquidation appraisal of this inventory.
2. Accounts receivable of $424,000 is composed 54% of amounts due from international distributors and 46% from North American customers. The amounts due from North American customers are comprised of many customers with small balances. Collection of accounts receivable from international distributors in a bankruptcy situation would likely be lower than the amount estimated by management to be realizable due to the difficulties in initiating enforcement action in foreign jurisdictions. Not included in the accounts receivable balance is any amount owing from Mediapro prior to Dec 31/2016, which as noted below was written off as part of a restructuring agreement between MFC and Mediapro.
3. Equipment consists of office furniture and fixtures, computer hardware and software. The Trustee has not obtained an appraisal in respect of the liquidation value of these assets.
4. MFC owns 100% of the shares of Masterfile USA Corporation, ADI and Crestock Corporation. An independent valuation of these companies has not been performed, but these entities are economically dependent on MFC and have liabilities exceeding their assets.
5. In the event of a bankruptcy, claims of Employee Creditors and Secured Creditors would rank ahead of unsecured creditors. As noted above, the Secured Creditor claim is limited to the approximately $35,000 MFC is indebted to HSBC. Accordingly, the Trustee has not incurred the expense associated with obtaining an independent legal opinion on the validity or enforceability of the security granted by MFC to HSBC.
6. In the event of MFC's bankruptcy, the claim of Related Creditors would participate in the distribution to unsecured creditors.

Mediapro

In April, 2015, Mediapro purchased the shares of MFC's wholly-owned subsidiaries in Germany, France and the UK. The acquired subsidiaries were losing considerable money for MFC. The Purchaser paid an amount on account of the shares of the acquired subsidiaries, together with payment of a portion of the intercompany receivables due from Masterfile UK Limited and Masterfile Deutschland GmbH (concurrent with the transaction MFC wrote-off about $2.2 million in unrecoverable intercompany receivables for which MFC had already paid royalties to its contributors on all but $501,000[1]). The total consideration received by MFC approximated $1 million cash.

As noted above, MFC largely applied the proceeds from the Mediapro transaction to pay a portion of past due royalties and to continue paying current royalties until approximately July, 2016.

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[1] Royalties are generally not due to contributors until MFC has been paid by its clients or distribution partners but MFC made the decision to continue to pay royalties on the sales made by the European subsidiaries as if MFC had received royalty payments from the subsidiaries on schedule for all transactions up to the date ownership transferred to Mediapro.

In parallel with the transaction, Mediapro was granted exclusive rights for rights-managed images and copyright enforcement for all European, Asian and most African countries in the time zone GMT -1 to +4 (the "**Territory**"). Exceptions were made for territories where Masterfile had pre-existing non-exclusive or exclusive distributors. Mediapro had the option to take over the territory of pre-existing distributors as contracts came up for renewal.

Mediapro was permitted to negotiate sublicense rights to Sub licensees in the Territory for rights-managed content provided that each Sub licensee entered into a written agreement with Mediapro and MFC. MFC was not permitted to enter into any new distribution agreement in the Territory.

Under the share purchase agreement, Mediapro would retain a 15% discount on all royalty payments made to MFC until a Cumulative Discount reached €600,000 in aggregate.
The Cumulative Discount, together with MFC's other obligations under the Share Purchase Agreement, was secured by a General Security Agreement ("**GSA**") granted by MFC in favour of Mediapro. Mediapro's CEO, Alfred Höfinger was nominated for, and subsequently granted, a seat on the Board of Directors of Masterfile.

Mediapro invested heavily in restructuring the European companies but by May 2016 it had accumulated significant cash losses. It began delaying royalty payments to MFC and was unable to make any further payments after July 2016. This put additional pressure on MFC's cash flow which was already suffering because of generally declining sales globally.

As of December 31, 2016, Mediapro owed MFC approximately €460,000 in unpaid royalties with no ability to pay the backlog.

Management concluded that resuming an ongoing royalty income for new sales by Mediapro, reducing the Territory to allow MFC to have the ability to generate new revenues by adding distributors in the now non-exclusive territories and having the GSA discharged was in the best interest of MFC and its contributing artists. Additionally, management sought to protect future revenues available by continuing to leverage the long-standing relationships with the European client base which the MFC and now Mediapro European sales team had developed over the years. Accordingly, MFC negotiated the following agreement:

- MFC would write off the unpaid royalties;
- The amount of these uncollected unpaid royalties would be applied against the Cumulative Discount, which had the effect of eliminating the Cumulative Discount;
- The parties would terminate the GSA and Mediapro would discharge the security granted in its favour;
- Mediapro waived all its rights to any remaining warranties and representations in the Share Purchase Agreement;
- The exclusive territory would be limited to Austria, France, Germany, Netherlands, Switzerland and the UK. The rest of the original territory would be non-exclusive;
- The royalty rate would be increased from 30% to 50% on all copyright compliance revenues;

- New Payment Terms: Effective January 1, 2017, royalties to be paid to MFC by Mediapro within 90 days following the last day of the month of invoice (i.e. royalties for all amounts invoiced in January, 2017 to be paid to MFC on or before April 30, 2017);

- Mediapro would no longer have sublicensing rights unless agreed by MFC; and

- The provision to replace MFC's existing distributor in Italy would be removed.

Preferences and Transactions at Under Value

The Proposal provides that sections 95-101 are not applicable. Accordingly, and to assess the appropriateness of the inclusion of this clause, the Trustee has undertaken a review of the Company's books and records in order to enable it to be in a position to report to the creditors on any potential preferences or transfers at undervalue identified. To date, the scope of the Trustee's review has been limited to:

- examining cheques and transfers greater than $20,000 in the twelve (12) month period preceding the Proposal filing;
- reviewing the accounts payable sub ledger for the 3 months preceding the Proposal filing; and
- inquiring with management whether any assets were transferred or disposed for no consideration or conspicuously less than fair market value.

To date, the Trustee has not identified any transactions in the last 12 months that could be considered preferences or transactions at under value. The Trustee will advise creditors at the meeting of creditors on April 25, 2017 should any preferences or transactions at under value be identified as part of the Trustee's review.

SECTION M - Recommendations

Based on the above, the Trustee recommends the acceptance of the Proposal as the Proposal contemplates a higher distribution to the Unsecured Creditors than a bankruptcy. The Proposal would also provide for the continued employment of MFC's current employees and the preservation of business relationships with MFC's existing suppliers and customers.

SECTION N - Technical Requirements for a Successful Proposal

This Proposal will become effective only if it is accepted by a resolution of the Unsecured Creditors and approved by the Court. To obtain Creditor approval, a simple majority in the number of Unsecured Creditors voting, with this majority representing at least 2/3 of the dollar value of the Unsecured Creditors voting, must vote in favour of the Proposal. If the Unsecured Creditors do not accept the Proposal, then the Company will be deemed to have made an assignment in bankruptcy and a meeting of creditors in the matter of the bankruptcy will immediately take place.

If the Unsecured Creditors vote to accept the Proposal, Court approval of the Proposal must then be sought. If the Court does not approve the Proposal, the Company would be deemed to have made an assignment in bankruptcy and the Trustee will then call a meeting of creditors in the matter of the bankruptcy.

When completing the Proof of Claim form submitted herewith, Creditors should include all outstanding amounts as at April 5, 2017, the date of the filing of the Proposal. It is expressly noted and should be clearly understood that the Trustee, in its capacity as Trustee, assumes no personal liability for any claims that Creditors may have against MFC either before or after the filing of the Proposal.

Creditors may attend, in person or by proxy, the meeting to consider the Proposal, which will be held in the Office of the Trustee, MNP Ltd., located at 300-111 Richmond Street West, Toronto, Ontario on April 25, 2017 at 10:00 am (Toronto Time).

Creditors who do not wish to attend or be represented at the meeting but who wish to vote, may forward their Proofs of Claim and voting letters by either email to masterfile@mnp.ca or fax to (416) 323-5242, to the Trustee so as to be received prior to 10:00 am (Toronto Time) on April 25, 2017.

If you should have any questions or comments on the Proposal or this report, please do not hesitate to contact the undersigned.

Dated at Toronto, Ontario, the 11th day of April, 2017.

MNP LTD.
Trustee acting in *re the Proposal of*
Masterfile Corporation
Per:

Sheldon Title, CPA, CA, CIRP, LIT

Encl.