

CANADA  
DISTRICT OF MONTREAL  
No.: 500-11-035903-091

**SUPERIOR COURT**  
**Commercial Division**  
*(The Companies' Creditors Arrangement Act)*

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**IN THE MATTER OF THE RE-AMENDED PLAN OF  
ARRANGEMENT WITH RESPECT TO:**

**BLUE MOUNTAIN WALLCOVERINGS GROUP INC.**  
- and -  
**BLUE MOUNTAIN WALLCOVERINGS INC.**  
- and -  
**BLUE MOUNTAIN WALLCOVERINGS CANADA INC.**  
- and -  
**BLUE MOUNTAIN WALLCOVERINGS USA INC.**

**Debtors/Debtors**

- and -

**RSM RICHTER INC.**

**Monitor**

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**MONITOR'S REPORT TO THE OPTION 2 CREDITORS  
ON THE STATE OF THE DEBTORS FINANCIAL AFFAIRS AND  
THE RE- AMENDED PLAN OF ARRANGEMENT**

**INTRODUCTION AND CHRONOLOGY OF EVENTS**

1. On March 20, 2009, the Honourable Justice Jean-François Buffoni, J.S.C, rendered an order (the "**Initial Order**") under the CCAA declaring and/or ordering, *inter alia*:
  - a) that Blue Mountain Wallcoverings Group Inc., Blue Mountain Wallcoverings Inc., Blue Mountain Wallcoverings Canada Inc. and Blue Mountain Wallcoverings USA Inc. (collectively, the "**Debtors**" or "**BMWG**") were companies to which the CCAA applies;
  - b) a stay of proceedings in respect of the Debtors up to and including April 20, 2009; and
  - c) that RSM Richter Inc. is appointed to act as monitor (the "**Monitor**").

2. Since the Initial Order, the Stay Period and the Stay Termination Date (these terms are defined in the Initial Order) were extended. The extensions were required in order to allow for the following:
  - a) Successfully implement the planned restructuring and reorganization measures;
  - b) Finalize negotiations with HSBC Bank with regard to the assignment of its debt;
  - c) Finalize negotiations with FSTQ with regard to its convertible debenture;
  - d) Initiate a Claims Process;
  - e) File a Plan of Arrangement ("Plan");
  - f) Proceed with the vote on the Plan;
  - g) Proceed to the Sanctioning of the Plan.
3. On December 10, 2009, a Plan was presented to the creditors and was accepted by the statutory majority. As such, on January 11, 2010 the Plan was sanctioned by the Court.
4. On March 2, 2010, as provided for in the Plan, the Trustee proceeded in making a dividend distribution to the creditors having chosen Option 1 of the Plan. The distribution in question, which was financed through cash flow, amounted to approximately \$120,000.
5. The first payment under Option 2 of the Plan, which amounts to approximately \$1,400,000, was scheduled to be made on May 3, 2010. However, the Debtors were unable to secure financing for their operations by that date and were therefore unable to pay the dividend.
6. Accordingly, on May 7, 2010 the Monitor mailed to all Unsecured Creditors entitled to the Option 2 Distributions under the Plan, its Report dealing with an Application for Postponement of the Delay to Make the Distributions under the Sanctioned Plan of Arrangement. In addition, the creditors in question were informed in a letter accompanying the Report, that BMWG was unable to secure a financing in time to make the initial 50% Option 2 distribution under the Plan and that the Debtors will be presenting to the Court, on May 25, 2010 at 9:00 a.m., a Petition to Amend the Plan, requesting a postponement of 90 days for the delay to make the distributions under the Plan. Although creditors were provided with sufficient time to make representations to the Court, no one opposed the Application.
7. On May 25, 2010 the Court granted the Order to Amend the Plan by modifying the distribution dates for Option 2 Distributions to August 3, 2010 (first 50%) and October 29, 2010 (second 50%) respectively.
8. As of August 3, 2010 and October 8, 2010, the Debtors informed the Monitor that they still had not secured a sufficient financing for their operations and therefore were still unable to make the first required Option 2 Distribution. Accordingly, on October 8, 2010 the Monitor mailed to all Unsecured Creditors entitled to the

Option 2 Distributions under the Plan, its Report dealing with the Second Application for Postponement of the Delay to Make the Distributions under the Sanctioned Plan of Arrangement. In addition, the creditors in question were informed in a letter accompanying the Report, that BMWG was unable to secure a financing in time to make the initial 50% Option 2 distribution under the Plan and that the Debtors will be presenting to the Court, on October 28, 2010 at 9:00 a.m., a Petition for the Approval of a Re-Amended Plan, requesting a further postponement of 6 months for the delay to make the distributions under the Plan. Although creditors were provided with sufficient time to make representations to the Court, no one opposed the Application.

9. On October 28, 2010 the Court granted the Order for the approval of the Re-Amended the Plan by modifying the distribution dates for Option 2 Distributions to February 3, 2011 (first 50%) and May 3, 2011 (second 50%) respectively.
10. As of January 20, 2011, the Debtors informed the Monitor that they still had not secured the financing that would have allowed the payment of first required Option 2 Distribution on February 3, 2011.
11. In addition, the wallpaper market is still very affected by the current world economic conditions, especially with respect to the housing market and the return to prosperity will be slower than originally anticipated.
12. Given the foregoing, the Debtors' believe that they will not be able to pay the anticipated Option 2 dividend as it is too onerous for the Debtors current financial position.
13. The Debtors therefore informed us that they are planning on re-amending the Plan with respect to the dividend available for distribution and the timing of the distribution to be made to the Creditors eligible for Option 2 Distributions under the Plan ("Option 2 Creditors").
14. This Monitor's Report deals with the State of the Debtors' Financial Affairs and the Re-Amended Plan of Arrangement (the "Monitor's Report"), that is being presented to the Option 2 Creditors in order to assist them in their review and assessment of the Re-Amended Plan of Arrangement (the "Re-Amended Plan") pursuant to the CCAA and the *Canada Business Corporations Act*. The Plan is being submitted to the Option 2 Creditors for their consideration and approval at a meeting of creditors to be held on **March 7, 2011, at 10:00 a.m., on the 19<sup>th</sup> floor of RSM Richter Inc.'s offices, located at 2 Place Alexis Nihon, Montréal, Québec.**
15. As set out in greater detail in this Monitor's Report, the current Plan has been developed by BMWG in an effort to protect their operations from Bankruptcy, alternative that would be detrimental to all stakeholders, including new creditors, employees and other stakeholders.

16. The Option 2 alternative of the initial Plan provided for the payment of a \$3M basket after payment of Crown Claims and distributions to the Unsecured Creditors who had elected for Option 1.
17. Pursuant to the Re-Amended Plan, the Option 2 Creditors will receive an amount equal to 1% of their Proven Claims (in aggregate approximately \$310,000) and the distribution will take effect immediately following the sanctioning of the Re-Amended Plan by the Court.
18. BMWG and the Monitor believe that the Plan is in the best interests of all BMWG Option 2 Creditors and recommend that all Option 2 Creditors vote IN FAVOUR of the Re-Amended Plan. The only realistic alternative to the Re-Amended Plan is Bankruptcy, which would result in a significant shortfall to the Secured Creditors and in no recovery to the Option 2 Creditors.
19. **To become effective, the Re-Amended Plan must be voted upon and approved by the required majorities (as defined in the Plan) of BMWG's Option 2 Creditors voting on the Re-Amended Plan and approved by the Court. Each Creditor's vote is important and the Monitor strongly encourages all creditors entitled to vote on the Re-Amended Plan to complete, sign, date, and return the Voting Form and the Proxy sent with this Report for receipt by the Monitor by no later than March 4, 2011 at 3:00 p.m. preferably by fax or email, or alternatively, by mail or courier, in accordance with the instructions included with the forms.** The Voting Form, the Proxy and the Re-Amended Plan can be obtained from the Monitor's website at: [www.rsmrichter.com/restructuring/bluemountain.aspx](http://www.rsmrichter.com/restructuring/bluemountain.aspx) or by calling the Monitor's office at 514.934.3497.
20. **The Creditors do not need to file a new Proof of Claim. Only voting ballots are required in the present circumstances.**

#### **OUTLINE AND RESERVES**

21. This Report of the Monitor has been prepared in order to inform the Unsecured Option 2 Creditors and is presented under the following headings:
  - a) State of affairs of the Debtors;
  - b) Current Financial Position of the Debtors;
  - c) Summary of the Re-Amended Plan;
  - d) Monitor's Assessment of the Re- Amended Plan and Recommendation.
22. We hereby confirm that the information contained herein is based upon unaudited financial information provided to the Monitor by the Debtors' management. The Monitor has not conducted an audit or investigation

of the information it was provided by the Debtors and accordingly, no opinion is expressed regarding the accuracy, reliability or completeness of the information contained within this Report.

#### **STATE OF THE AFFAIRS OF THE DEBTORS**

23. The Plan, which was accepted by the creditors on December 10, 2009, was made in anticipation of the following:
  - a) Increase in post-filing sales;
  - b) Disposition of superfluous assets, including the Toronto factory;
  - c) New financing.
24. Unfortunately, none of the above hypothesis has materialized and it would appear that this situation will not be reversed in a perceivable future.
25. In order to finance the ongoing operations BMWG has been able to obtain limited additional funding from various stakeholders.
26. Notwithstanding the above, the Debtors have been able to maintain their streamlined operations without further deterioration and have been able to pay current accounts payable and accrued liabilities as they became due.
27. BMWG continues its efforts to negotiate new contracts with customers, which would ultimately result in increased sales, liquidity and profitability. The certainty, timing and cash flow impact of said contracts is unknown.
28. Accordingly the Debtors are submitting a Re-Amended Plan and are seeking approval from the Option 2 Creditors of this Re-Amended Plan.
29. Since the issuance of the Initial Order, BMWG has continued to act diligently and to carry on business in good faith while taking the appropriate actions to restore profitability.
30. BMWG has continued to pay for the services provided by its employees in the normal course of business and to pay suppliers of goods or services according to existing agreements.
31. According to the information provided to the Monitor, no expenses were incurred out of the ordinary course of business since the issuance of the Initial Order.

## CURRENT FINANCIAL POSITION OF THE DEBTORS

32. The Debtors' current balance sheet as at December 31, 2010 reflects the following:

<b>BLUE MOUNTAIN WALLCOVERINGS GROUP INC.</b>	
<b>Consolidated Balance Sheet</b>	
<b>As of December 31, 2010</b>	
<b>(\$'000)</b>	<b>2010</b>
<b>ASSETS</b>	
Current	\$ 11,175
Long Term	22,153
<b>TOTAL ASSETS</b>	<b>\$ 33,328</b>
<b>LIABILITIES</b>	
<b>Current</b>	
Bank Indebtedness	\$ -
Accounts Payables & Accruals	4,375
Amounts Payable to Option 2 Creditors, per the Plan	2,876
	<b>7,251</b>
<b>Long-Term</b>	
Secured Long Term Debt	36,379
Convertible Debenture	-
	<b>36,379</b>
<b>SHAREHOLDER EQUITY</b>	<b>(10,302)</b>
<b>TOTAL LIABILITIES AND SHAREHOLDER'S EQUITY</b>	<b>\$ 33,328</b>

33. As at December 31, 2010, the assets of the Debtors consisted of the following:

- a) Accounts Receivables of \$3.1 million consisting primarily of trade accounts receivable, net of allowances for doubtful accounts;
- b) Inventory of \$7.1 million consisting of inventory on hand net of reserves for slow moving and obsolete inventory;
- c) Prepaid expenses and deposits consisting of municipal taxes, insurance premiums and rent paid in advance as well as utility and service provider security deposits which will likely be expensed over time as the associated services are provided;

34. The Debtors cash position as of December 31, 2010 was \$440,000.

35. The Debtors anticipate that the cash balance will remain relatively constant and will ensure to maintain the funds available to fund the Re-Amended Plan, until the sanctioning of the Re-Amended Plan, as illustrated in the summary monthly projected monthly cash flow statement for the period January 1, 2011 to May 31, 2011:

Blue Mountain Wallcoverings Group Inc. Projected Combined Summary Monthly Cash Flow For the period January 1, 2011 to May 31, 2011 \$(,000)						
	Jan-11	Feb-11	Mar-11	Apr-11	May-11	Total
Cash Receipts	1,905	1,860	2,337	2,912	2,889	11,903
Cash Disbursements	2,020	1,877	2,325	2,905	2,904	12,031
Cash flow from operations	(115)	(17)	12	7	(15)	(128)
Opening Bank position	440	325	308	320	327	440
Closing Bank position	325	308	320	327	312	312

36. Projected cash receipts consist primarily of estimated collection of accounts receivables and sales tax refunds.
37. Projected cash disbursements consist of operating expenses.
38. BMWG's accounts payable and accrued liabilities as at December 31, 2010 relate primarily to amounts payable to suppliers who have provided payment terms to BMWG, municipal taxes, accrued interest on term debt, accrued promotion and royalty costs, accrued vacation pay and outstanding cheques.

#### THE RE-AMENDED PLAN

39. The initial Plan anticipated the payment of a \$3 million basket to the Petitioner's Unsecured Creditors. The Option 2 Creditors, which have claims amounting to \$31 million, were entitled to their pro-rata share of the balance of the basket.
40. The Debtors, after multiple applications to Court to defer the timing of the Option 2 Distributions, are unable to honour their commitment under the Plan.
41. The Debtors are therefore submitting a Re-Amended Plan to Option 2 Creditors, which provides for the immediate payment of a dividend equal to 1% of their proven claims.
42. The Re-Amended Plan provides for the remittance to the Monitor of a sum representing the aggregate value of the 1% dividends (approximately \$310,000) prior to proceeding with the Court Sanctioning of the Re-Amended Plan.
43. To become effective, the Re-Amended Plan must be voted upon and approved by the required majorities of the Debtors' Option 2 Creditors voting on the Re-Amended Plan and approved by the Court.

44. Should the Re-Amended Plan not be approved, the only realistic alternative to the Re- Amended Plan is Bankruptcy which would result in no recovery to the Option 2 Creditors.

#### **MONITOR'S ASSESSMENT OF THE PLAN AND RECOMMENDATION**

45. It is the Monitor's recommendation that all Option 2 Creditors vote in favour of the Re-Amended Plan, for the following reasons:

- a) Albeit, the amount offered is not substantial, it is the only amount that can be paid by the Debtors without jeopardizing its ongoing operations;
- b) It will enable continued business relationships with all stakeholders for the future;
- c) Ensures continued employment to 170 employees.

46. The Monitor believes that the Re-Amended Plan is advisable, considering the following factors:

- a) In a bankruptcy situation, the Option 2 Creditors would definitively receive nothing, as all of the Debtors' assets are pledged in favour of the Secured Creditors, who are owed significantly more than the estimated realizable liquidation value of the said assets;
- b) Approximately 170 employees still work for the Debtors;
- c) Some limited credit has been extended to the Debtors by suppliers of goods and services. A Bankruptcy would in all likelihood jeopardize the payment of these debts. As at December 31, 2010, these debts amounted to approximately \$1,400,000.
- d) The Debtors continue to act diligently, in good faith and in the interest of their creditors;

47. To become effective, the Re-Amended Plan must be voted upon and approved by the Required Majorities of the Option 2 Creditors voting on the Plan and sanctioned by the Court. Each creditor's vote is important and we strongly encourage you to complete, sign, date, and return the enclosed Voting Form and Proxy for receipt by the Monitor by no later than March 4, 2011 3:00 p.m. preferably by fax or email, or alternatively, by mail or courier.

Respectfully submitted,

DATED AT MONTREAL, this 3<sup>rd</sup> day of February 2011.

**RSM Richter Inc.**  
Court-appointed Monitor



Gilles Robillard, CA, CIRP