

CANADA

**PROVINCE OF QUEBEC
DISTRICT OF MONTREAL**

No.: 500-11-035903-091

**SUPERIOR COURT
Commercial Division
(In Bankruptcy and Insolvency)**

**IN THE MATTER OF THE COMPANIES' CREDITORS
ARRANGEMENT ACT, R.S.C. (1985), c. C-36 WITH
RESPECT TO:**

BLUE MOUNTAIN WALLCOVERINGS GROUP INC., a legal person duly incorporated under the laws of Canada, having its chief place of business at 1010 Sherbrooke Street West, office 410, in the city and district of Montréal, Province of Québec, H3A 2R7;

- and -

BLUE MOUNTAIN WALLCOVERINGS INC., a legal person duly incorporated under the laws of Canada, having its head office at 15 Akron Road, Toronto, Ontario, M8W 1T3;

- and -

BLUE MOUNTAIN WALLCOVERINGS CANADA INC., a legal person duly incorporated under the laws of Canada, having its chief place of business at 1010 Sherbrooke Street West, office 410, in the city and district of Montréal, Province of Québec, H3A 2R7;

- and -

BLUE MOUNTAIN WALLCOVERINGS USA INC., a corporation incorporated under the laws of the State of Delaware, having its registered office at Corporation Trust Center, 1209 Orange Street, Wilmington, Delaware, 19801;

Debtors/Petitioners

- and -

RSM RICHTER INC., a duly incorporated legal person having its principal place of business at 2 Place Alexis-Nihon, in the city and district of Montreal, H3Z 3C2

Monitor

**REPORT OF THE MONITOR
ON THE STATE OF THE PETITIONERS' FINANCIAL AFFAIRS
AND THE PLAN OF ARRANGEMENT**

EXECUTIVE SUMMARY

1. On March 19, 2009, Blue Mountain Wallcoverings Group Inc., Blue Mountain Wallcoverings Inc., Blue Mountain Wallcoverings Canada Inc. and Blue Mountain Wallcoverings USA Inc. (collectively, the "**Petitioners**" or "**BMWG**") filed with the Quebec Superior Court (the "Court"), a Petition for the Issuance of an Initial Order pursuant to the *Companies' Creditors Arrangement Act* (the "CCAA"). On March 20, 2009, the Honourable Justice Jean-François Buffoni, J.S.C issued an initial order (the "Initial Order"), granting, *inter alia*, the Petitioners the protection it was seeking pursuant to the aforementioned Petition and appointing RSM Richter Inc. as monitor (the "Monitor").

2. This Report of the Monitor on the State of the Petitioners' Financial Affairs and the Plan of Arrangement (the "Monitor's Report"), is being presented to provide information on the Petitioners and to assist the creditors in their review and assessment of the Plan of Arrangement (the "Plan") pursuant to the CCAA. The Plan is being submitted to the creditors of BMWG for their consideration and approval at a meeting of creditors to be held on December 10, 2009, at 10:00 a.m., at the **Marriott Chateau Champlain (Salle Viger AB), located at 1050 de la Gauchetière West, Montréal, Québec.**

As set out in greater detail in this Monitor's Report, the Plan has been developed by BMWG in a continuing effort to provide greater value to the creditors of BMWG than would be achieved in a bankruptcy.

Pursuant to the Plan, Unsecured Creditors (as defined in the Plan) have the option to receive payment in the amount of the lesser of their Unsecured Claim and CDN \$1,500, in full and final settlement of all of their Claims ("Option 1 Distribution"), provided they complete and return the Election and Voting Form (with the Proxy form) by the deadline of December 9, 2009. Alternatively, Unsecured Creditors who do not elect for the Option 1 Distribution on the Election and Voting Form will receive their pro rata share of the balance of the \$3.0 million basket after payment of Crown Claims and distributions to the Unsecured Creditors who elected for the Option 1 Distribution.

BMWG and the Monitor believe that the Plan is in the best interests of all BMWG creditors and recommend that all Unsecured Creditors vote IN FAVOUR of the Plan. The only realistic alternative to the Plan is bankruptcy, which would result in a significant shortfall to the Secured Creditors and further result in no recovery to the Unsecured Creditors.

To become effective, the Plan must be voted upon and approved by the required majorities (as defined in the Plan) of BMWG's Unsecured Creditors voting on the Plan and approved by the Court. Each Creditor's vote is important and the Monitor strongly encourages all creditors entitled to vote on the Plan to complete, sign, date, and return the Election and Voting Form and the Proxy sent with this Report for receipt by the Monitor by no later than December 9, 2009 at 5:00 p.m. preferably by fax or email, or alternatively, by mail or courier, in accordance with the instructions included with the forms.

The Election and Voting Form, the Proxy and the Plan (as well as the French translation) can be obtained from the Monitor's website at: www.rsmrichter.com/restructuring/bluemountain.aspx or by calling the Monitor's office at 514.934.3497.

OUTLINE AND RESERVES

3. As previously stated, the purpose of the Monitor's Report is to provide useful information on the state of the Petitioners' financial affairs and the Plan as well as assist the creditors in their review and assessment of the Plan and provide information with respect to the following:
 - Background information;
 - Events leading to seeking protection under the CCAA;
 - Post CCAA filing operational and restructuring measures;
 - Current financial position of the Petitioners;
 - Claims Process;
 - Summary of the Plan;
 - Monitor's assessment of the Plan and recommendation.

4. All amounts are stated in Canadian dollars unless otherwise noted. Capitalized terms used herein and not defined herein shall have the meaning ascribed to them in the Plan.

5. It should be noted that the Monitor has not conducted an audit or investigation of the books and records or the receipts and disbursements of the Petitioners and that accordingly, no opinion is expressed regarding the accuracy or completeness of the information contained herein. The present information emanates from the Petitioners' books and records that have been made available to the Monitor, as well as from discussions with its management.

6. The cash flow projections included to the Monitor's Report were prepared by BMWG's management and are based on underlying assumptions. The Monitor cannot provide an opinion as to the accuracy, completeness or reliability of these projections. As the cash flow projections relate to future events, which are indeterminable by nature, variances will occur, which may be material. Accordingly, the Monitor does not express an opinion regarding the likelihood of materialization of these cash flow projections.

BACKGROUND INFORMATION

7. Blue Mountain Wallcoverings Group Inc. was incorporated by articles of incorporation under the *Canada Business Corporations Act* (the "**Act**") on January 28, 2004 as 4170687 Canada Inc., which was subsequently changed to Blue Mountain Wallcoverings Group Inc. by articles of amendment dated February 19, 2004.
8. Blue Mountain Wallcoverings Canada Inc. ("**BMW Canada**") was incorporated by articles of incorporation under the Act on January 28, 2004 as 4170695 Canada Inc., which was subsequently changed to Blue Mountain Wallcoverings Canada Inc. by articles of amendment dated May 31, 2004.
9. Blue Mountain Wallcoverings Inc. ("**BMW**") was incorporated by articles of incorporation under the Act on December 4, 1986 as 153251 Canada Inc., which was subsequently changed to Blue Mountain Wallcoverings Inc. by articles of amendment dated July 9, 1990.
10. BMW and BMW Canada are both wholly-owned subsidiaries of Blue Mountain Wallcoverings Group Inc.
11. BMW is the parent company of two corporations incorporated in the United States, namely Blue Mountain Wallcoverings USA Inc. ("**BMW USA**") and Blue Mountain Wallcoverings Real Estate USA Inc. ("**BMW Real Estate**").
12. The Petitioners are North America's largest designers, manufacturers and distributors of residential wall covering products, including sidewalls, borders and other niche oriented product lines. The Petitioners' major customers are large home centers, mass market retailers, specialty chains, independent dealers and decorator/designers. Their customer base is diversified and includes the leading retailers in both the United States and Canada.
13. All of the Petitioners' products are distributed through BMW's Boucherville facility, which has the capability to fulfill bulk orders to large national chains as well as customized single customer orders for specialty wallpaper retailers.

14. BMW now maintains a vinyl manufacturing facilities in Sherbrooke (Léger Street), a wallcovering manufacturing facility in Sherbrooke (Woodward Street) which houses five print presses and integrated finishing lines and a distribution facility in Boucherville.
15. Since the CCAA filing, a manufacturing facility that was located in Toronto was permanently closed and certain equipments were relocated to the Sherbrooke (Woodward Street) facility, where the manufacturing activities were transferred.

EVENTS LEADING TO SEEKING PROTECTION UNDER THE CCAA

16. The Petitioners' assets were highly leveraged, their businesses were suffering serious liquidity crisis, their bank margin was in a deficit position and their suppliers were applying intense pressure to collect their accounts.
17. The Petitioners' financial and operational challenges were primarily attributable to the following factors:
 - a) The current housing crisis throughout the United States and certain parts of Canada;
 - b) A prolonged significant down cycle in the North American wallcoverings market;
 - c) The overall deteriorating economic conditions;
 - d) A steady decline in revenues since 2004, with a marked decline in the last years due to the loss of two major United States retail chains from traditional in-stock wall coverings programs, namely Home Depot and Lowe's;
 - e) The decline in the US currency, given that more than 80% of the Petitioners' sales are to the United States;
 - f) Significant overhead structure resulting from multi-plant operations (Sherbrooke and Toronto);
 - g) Liquidity constraints preventing investments which would enable the Petitioners to reduce their cost structure; and
 - h) The Petitioners were on near COD-terms with many of their vendors.
18. As a result of the above factors, the Petitioners incurred significant losses and their viability was in doubt.

19. The projected EBITDA (earnings before interest, taxes, depreciation and amortization) was not sufficient to service the Petitioners' debt and to fund required capital expenditures within the twelve months following the Initial Order.

POST CCAA FILING OPERATIONAL AND RESTRUCTURING MEASURES

20. Since the Initial Order, the Stay Period and the Stay Termination Date (these terms are defined in the Initial Order) were extended four times, the current extension being up to and including November 16, 2009 (a further extension to December 18, 2009 will be required), in order to allow for the following:

- a) Successfully implement the planned restructuring and reorganization measures;
- b) Finalize the negotiations with the HSBC Bank with regards to the assignment of its debt;
- c) Finalize negotiations with FSTQ with regards to its convertible debenture;
- d) The Petitioners to initiate their claims process; and
- e) The Petitioners to file the Plan.

21. Since the issuance of the Initial Order, the Petitioners have, amongst other things, implemented the following measures in order to restructure their operations:

- a) permanent closure of the manufacturing facility in Toronto, Ontario and transfer of the operations to Sherbrooke, Quebec;
- b) implementation of a sale process for the Toronto facility;
- c) reductions in the administrative salaries;
- d) reduction in the number of employees;
- e) ongoing negotiations of royalty agreements;
- f) closure of a sales office located in Cleveland Ohio;
- g) numerous negotiations with the HSBC Bank, which resulted on July 12, 2009, in the assignment of the Bank debt to a new party;
- h) initiatives taken to dispose of redundant equipments which are located in the Toronto facility;
- i) initiatives taken to reduce inventory levels through overseas and internet sales;
- j) negotiations with FSTQ with respect to its convertible debenture.

22. The sale of the Toronto facility and other assets will result in the reimbursement of the associated loans and mortgages, thus reducing the Petitioners' financial burden as well as improve their gross margins on sales.
23. On September 2, 2009 the Court issued an order (the "Claims and Meeting Order") establishing a claims process for the determination of the claims of creditors and for setting the procedures with respect to the calling and conduct of a meeting of creditors.
24. On November 10, 2009 the shareholders of Blue Mountain Wallcoverings Group Inc. approved and authorized the filing of the Plan attached herewith.

CURRENT FINANCIAL POSITION OF THE PETITIONERS

25. The Petitioners' current balance sheet as at August 31, 2009 reflects the following:

ASSETS	
Current	\$ 15,680
Long-Term	25,283
TOTAL ASSETS	\$ 40,963
LIABILITIES	
Current	
Bank Indebtedness	\$ 19,698
Accounts Payable & Accruals	15,706
	35,404
Long-Term	
Secured Long-Term Debt	25,361
Convertible Debenture	12,000
	37,361
SHAREHOLDER EQUITY	(31,802)
TOTAL LIABILITIES AND SHAREHOLDER'S EQUITY	\$ 40,963

26. As at August 31, 2009, the assets of the Petitioners consisted of the following:
- Accounts Receivables of \$5.9 million consisting primarily of trade accounts receivable, net of allowances for doubtful accounts;
 - Inventory of \$9.1 million consisting of inventory on hand net of reserves for slow moving and obsolete inventory;
 - 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.

27. The evolution of the Petitioners' cash position from March 20, 2009 to October 30, 2009 is summarized below:

Cash Receipts	\$ 21,968
Cash Disbursements	
Salaries, Commissions & Benefits	6,444
Purchases, Brokerage, Freight & Royalties	10,380
Mortgage & Interest	1,312
Rent, Utilities, Insurance & Other	2,394
	20,529
Cash flow from operations	\$ 1,440
Non recurring expenses	
Forbearance fees	120
Professional fees	744
	864
Total cash flow	\$ 575
Opening Bank position	(20,627)
Closing Bank position before L/C	(20,052)
Outstanding L/C	(693)
Closing Bank position	\$ (20,745)

28. The cash receipts of \$22.0 million consist of sums received from the following sources:
- Collection of accounts receivable (approximately \$21.8 million);
 - Recovery of sales tax refunds (approximately \$0.2 million).

29. The cash disbursements consisted of payments made to sustain the operations and restructuring costs including the payments of professional fees.
30. The Petitioners anticipates that its cash balance will remain constant up until the sanctioning of the Plan, as illustrated below:

Cash Receipts	\$ 3,948
Cash Disbursements	
Salaries, Commissions & Benefits	881
Purchases, Brokerage, Freight & Royalties	1,690
Mortgage & Interest	399
Rent, Utilities, Insurance & Other	489
	3,458
Cash flow from operations	\$ 490
Non recurring expenses	
Professional fees	105
	105
Total cash flow	\$ 385
Opening Bank position	(20,052)
Closing Bank position before Operating Loan	(19,667)
Outstanding L/C	(693)
Closing Bank position	\$ (20,360)

31. Projected cash receipts consist primarily of estimated collection of accounts receivables and sales tax refunds.
32. Projected cash disbursements consist of operating expenses and restructuring cost, including professional and consultant fees.

CLAIMS PROCESS

33. In accordance with the terms of the Claims and Meeting Order, all known creditors of BMWG received Creditor's Instructions including a notice of deadline to file proofs of claim, a Proof of Claim, instructions to complete the proof of claim and a copy of the Claims and Meeting Order. The Monitor also published Newspaper Notices in La Presse (Montreal) and The Gazette (Montreal), to advise any potential creditors of the Claims Bar Date and Creditor's Instructions. Creditors were advised to notify the Monitor of any claims by no later than October 5, 2009 at 5 p.m. (the "Claims Bar Date").
34. Pursuant to the Claims Process, the Secured Creditors filed Secured Claims in the aggregate amount of \$47.4 million and Unsecured Creditors filed Unsecured Claims in the aggregate amount of \$36.8 million.
35. The Secured Claims are not affected by the Plan and will be paid in full or dealt with in accordance with terms agreed to between the Secured Creditors and the Petitioners, after the Sanction Order.
36. As a result of the Petitioners' review of the Unsecured Claims filed, \$8.0 million of the Unsecured Claims were disallowed, in whole or in part, resulting in \$28.8 million of Unsecured Claims for voting and distribution purposes under the Plan.
37. One of the most significant Unsecured Claim which was partially disallowed is currently being appealed by the Unsecured Creditor. The outcome of the appeal is uncertain at this time.
38. It is unclear at this time if any other Unsecured Claims that were disallowed by the Petitioners will be disputed by the Creditors. The Monitor, the Petitioners and/or the Court will resolve and adjudicate these claims, where necessary.

SUMMARY OF THE PLAN

39. The purpose of the Plan is to compromise all Claims against the Petitioners other than Excluded Claims and Secured Claims in order to allow for the distributions to the Unsecured Creditors. As indicated below, the only realistic alternative to the Plan is bankruptcy which would result in no recovery to the Unsecured Creditors.

40. Unsecured Creditors shall constitute a single class under the Plan for all purposes. Any Excluded Creditors and Secured Creditors shall not be entitled to vote at the Meeting of Creditors or to receive any distributions under Article 3.3.3 of the Plan in respect of such Excluded Claims or Secured Claims.
41. If the Plan is approved by the majority in number of Unsecured Creditors representing 2/3 in value of the Unsecured Claims, and sanctioned by the Court, the Plan will be binding on BMWG and all Persons affected by the Plan.
42. The implementation of the Plan is dependent upon the support of the Unsecured Creditors, the sanctioning of the Plan by the Court and the filing in Court of the signed Monitor's Certificate.
43. The Plan provides for the Petitioners to remit to the Monitor a total of \$3.0 million ("Basket") to be distributed to satisfy holders of Crown Claims and for distribution to Unsecured Creditors.
44. Based on the Petitioners books and records and Claims filed to date, there appears to be no amounts owing for Crown Claims. However, should the Monitor be made aware of Crown Claims within the six months following the sanctioning of the Plan, the Crown Claims will be paid in full and in priority to Unsecured Creditors.
45. The Plan calls for the distribution of the Basket to the Unsecured Creditors, after the payment of all Crown Claims, based on the following options:
 - Unsecured Creditors have the option to receive payment of the lesser of the amount of their Unsecured Claim and \$1,500, in full and final settlement of all of their Unsecured Claims ("Option 1 Distribution"), provided they complete and return the Election and Voting Form (with the Proxy form) by the deadline of December 9, 2009;
 - Unsecured Creditors who do not elect for the Option 1 Distribution on the Election and Voting Form will be entitled to receive their *pro rata* share of the balance of the Basket, after payment of Crown Claims and distributions to the Unsecured Creditors who elected for Option 1 Distribution.
46. Within thirty (30) days of the Sanction Order, BMWG will remit to the Monitor the portion of the Basket required to enable the first distribution to creditors, namely the Option 1 Distribution.

47. In accordance with the Plan the timing of the distributions to Unsecured Creditors will be as follows:
- a) The Option 1 Distribution will be made within 30 days of the Sanction Order;
 - b) 50% of the pro-rate distribution of the balance of the Basket to Unsecured Creditors who did not elect for an Option 1 Distribution, within 3 months of the Sanction Order;
 - c) 50% of the pro-rate distribution of the balance of the Basket to Unsecured Creditors who did not elect for an Option 1 Distribution, within 6 months of the Sanction Order.
48. The above time line is based on the assumption that all Crown Claims, if any, are settled and all disputed Claims are resolved before the final distributions are made.
49. The following is a summary of the Unsecured Claims filed, Unsecured Claims allowed and Unsecured Claims disallowed or rejected as well as the calculations of the estimated distribution to creditors:

	Filed Claims	Allowed Claims	Disallowed and Rejected Claims
Total \$ value of Unsecured Claims	\$ 36,809,771	\$ 28,828,221	\$ 7,981,550
# claims	229	216	
Basket (before payment of Crown Claims)	3,000,000	3,000,000	
Estimated % Dividend, prior to Option 1 Distribution	8.15%	10.41%	

50. The ultimate amount of Unsecured Claims will depend on whether Creditors, whose claims were disallowed by the Petitioners, in whole or in part, will contest the disallowances and the outcome thereof. As illustrated above, the proposed Basket will yield a dividend ranging from approximately 8.15% of filed Unsecured Claims to 10.41% of allowed Unsecured Claims, the whole, before consideration of Crown Claims.
51. To further illustrate to the Unsecured Creditors the option that is being presented to them under the Plan, if all Unsecured Creditors having claims of \$15,000 or less elect for a \$1,500 distribution (Option 1 Distribution), then the Unsecured Creditor's having claims greater than \$15,000 would likely receive pro-rata dividends, over the course of the 6 months following the Sanction Order, ranging from of 7.9 % of filed Unsecured Claims to 10.0% of allowed Unsecured Claims, the whole before consideration of Crown Claims.

52. Should the Plan be accepted by the Unsecured Creditors, the Petitioners plan on reducing their operating loan by \$10 million to ensure the long-term viability of the Companies.

MONITOR'S ASSESSMENT OF THE PLAN AND RECOMMENDATION

53. It is the Monitor's recommendation that all Unsecured Creditors vote in favour of the Plan, as not only does it provide for a dividend payment, it will enable continued business relationships for the future. As indicated above, should the Plan not be approved, the only realistic alternative to the Plan is bankruptcy which would result in no recovery to the Unsecured Creditors.
54. **To become effective, the Plan must be voted upon and approved by the Required Majorities of the Unsecured 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 Election and Voting Form and Proxy for receipt by the Monitor by no later than December 9, 2009 5:00 p.m. preferably by fax or email, or alternatively, by mail or courier.**

Respectfully submitted,
Montreal, November 12, 2009.

RSM Richter Inc.
Court-appointed Monitor



Gilles Robillard, CA, CIRP