

CANADA
PROVINCE OF QUÉBEC
DISTRICT OF QUÉBEC
DIVISION NO.: 01-MONTREAL
COURT NO.: 500-11-026657-052
ESTATE NO.: 41-332420

SUPERIOR COURT
(Commercial Division)

IN THE MATTER OF THE PROPOSAL OF:

Fly America Furniture Inc.

a body politic and corporate, duly incorporated according to law and having its head office and its principal place of business at:

7225 route Transcanadienne
St-Laurent Quebec H4T 1A2

Debtor

TRANSLATION

REPORT OF THE TRUSTEE ON THE FINANCIAL SITUATION
OF THE DEBTOR AND ON THE PROPOSAL
(Sections 50(10)(b) and 50(5) of the *Bankruptcy and Insolvency Act*)

The purpose of the First Meeting of Creditors is to consider the Proposal filed on October 28, 2005 (hereinafter referred to as the "Proposal") by Fly America Furniture Inc. (hereinafter referred to as the "Debtor Company" or "Fly America").

Pursuant to Sections 50(10)(b) and 50(5) of the *Bankruptcy and Insolvency Act* (hereinafter referred to as the "Act" or "BIA"), and to assist the creditors in considering the Proposal, the Trustee is submitting its report on the financial situation of the Debtor Company and on the Proposal.

We caution the reader that we have neither conducted an audit nor an investigation of the books and records of the Debtor Company. Consequently, we cannot render an opinion as to the accuracy of the information contained herein. The information discussed herein emanates from the books and records of the Debtor Company as well as from discussions with the Management of the Debtor Company.

I. INTRODUCTION

On October 11, 2005, Fly America filed a notice of intention to make a proposal (hereinafter referred to as the "Notice of Intention") to its creditors and RSM Richter Inc. ("Richter") was appointed Trustee. Richter was also appointed Interim Receiver on October 12, 2005, in accordance with the order rendered by Me Flamand, Registrar of the Superior Court of Québec, and has been authorized to supervise and monitor the receipts and disbursements of the Debtor Company and to initiate a process to search for investors or purchasers.

On October 28, 2005, the Debtor Company filed a Proposal to its creditors. We have enclosed herewith the Proposal made by the Debtor Company to its creditors, a proof of claim form, a voting form, a proxy, a notice indicating the place

and time of the first meeting of the creditors to address the Proposal as well as a notice of hearing to have the Proposal ratified in the event that it is accepted by the statutory majority of creditors.

The following summarizes the relevant information and key elements that may assist the creditors in evaluating the Debtor Company's affairs and the Proposal.

II. BACKGROUND OF THE DEBTOR COMPANY

Fly America Furniture Inc. is an innovative furniture retailer selling fashionable contemporary furniture (mainly in ready-to-assemble kits), home furnishings and decorative items. The Debtor Company operates five (5) stores in Quebec generating sales of approximately \$35M with four (4) stores located in the Montreal Metropolitan area and one (1) in Quebec City.

The Fly concept was created in 1978 by Mobilier European S.A. (hereinafter referred to as "ME"), a French privately-held company, which operates approximately 140 Fly stores in France, Switzerland and Spain. Fly offers the latest fashion trends in furniture and decorative items at affordable prices and caters primarily to a young clientele.

In November 2000, Fly America was launched in Quebec by local investors in partnership with ME. The group entered into a licensing agreement providing the exclusive right to exploit the Fly concept in North America (including in Mexico) until 2099.

Fly America has raised in excess of 31 million dollars of equity which was used to fund the significant losses incurred in adapting the Fly concept to North America and the substantial investments made in capital expenditures.

III. CAUSES OF INSOLVENCY

Management of the Debtor Company attributes the causes of its financial difficulties to the competition in the Quebec furniture sector and the longer than expected delay in reaching critical mass. Fly America is facing liquidity pressures. Accordingly, on October 11, 2005, the Debtor Company filed a notice of intention to make a proposal to its creditors under paragraph 50.4(1) of the BIA.

IV. FINANCIAL INFORMATION

The following financial data was extracted either from the Statement of Affairs filed with the Official Receiver on October 28, 2005, the unaudited books and records of the Debtor Company, the audited financial statements or from discussions held with Management. This information is submitted solely for discussion purposes and to assist the reader in assessing the current financial position of the Debtor Company.

The Trustee makes no representation or warranty as to the accuracy of this financial information.

In summary, the salient facts are:

A. Results and Cumulative Deficit

	<i>Internal Financial Statements for the five (5) month period ended August 14, 2005</i>	<i>Audited Financial Statements for the fiscal years ended</i>	
		<i>March 27, 2005</i>	<i>March 28, 2004</i>
Sales	\$ <u>14,025,384</u>	\$ <u>21,199,995</u>	\$ <u>23,573,206</u>
Gross Margin	\$ <u>5,343,636</u>	\$ <u>11,758,240</u>	\$ <u>9,221,007</u>
Net loss before income taxes	\$ <u>(1,890,819)</u>	\$ <u>(5,223,539)</u>	\$ <u>(4,725,539)</u>
Net loss	\$ <u>(1,890,819)</u>	\$ <u>(7,399,893)</u>	\$ <u>(4,725,539)</u>

B. Assets

The Statement of Affairs of the Debtor Company as at October 28, 2005 reflects the following:

	<i>Net Book Value</i>	<i>Estimated Realization Value</i>
Cash in the Interim Receiver's account	\$ 751,525	\$0
Accounts receivable	15,000	Unknown
Inventory	\$ 7,642,505	Unknown
Equipment, office furniture, leasehold improvements, computer equipment	\$ <u>4,644,014</u>	<u>Unknown</u>
Total assets	\$ <u>13,053,044</u>	<u>Unknown</u>

The cash held by the Interim Receiver currently amounts to \$751,525 (including an amount of \$55,145 held in trust for client deposits). However, at present, the Debtor Company incurred an equivalent amount in liabilities, leaving no current available funds.

The liquidation value of the inventory is currently unknown. We refer you to Section VI hereinafter to take note of the process implemented by the Interim Receiver to solicit potential investors or purchasers of the Debtor Company's assets.

Furthermore, the above-mentioned inventory excludes any inventory in transit (estimated at \$411,000 before duty and freight) as it is currently in dispute.

C. Liabilities

The liabilities summarized hereinafter are based upon Management's representations. The allocation of the Debtor Company's indebtedness, between preferred and unsecured creditors, is to date estimated as follows:

Liabilities of Fly America Furniture Inc.	
Secured creditors	\$1 567 277
Unsecured creditors:	
Preferred creditors	
Employees – Vacations pay due	\$ 157 865
Ordinary Creditors	<u>\$6 615 104</u>
Total	<u>\$8 340 246</u>

The Debtor Company has provided us with a list of creditors. Notices have been forwarded to the creditors. At the present date, we have been unable to confirm whether the Debtor Company's records are in conformity with those of its creditors. As proofs of claim will be received, we shall enter the exact amounts claimed by the creditors and prior to paying any dividend, a reconciliation will be done.

V. INTERIM RECEIVER

On October 12, 2005, Richter was appointed Interim Receiver pursuant to the order rendered by Me Flamand, Registrar of the Superior Court of Québec. Pursuant to the order, Richter has been authorized as follows:

- to supervise and monitor the receipts and disbursements of the Debtor Company and to open a separate bank account for this purpose
- to assist and provide counsel to the Debtor Company in its negotiations with any potential purchaser and/or investors.

Subsequently, on October 14, 2005, a second order was rendered by the Honorable Judge Pierre Journet ordering the establishment of a change in favour of the directors of the Debtor Company, as well as to expand the Interim Receiver's powers to include the solicitation of potential investors and/or purchasers, as described hereinafter.

VI. PROCESS IN SEARCHING FOR INVESTORS AND/OR AUCTIONEERS

a) Seeking Investors/Purchasers

In accordance with the orders rendered, the Interim Receiver has been authorized to take any action necessary to solicit potential interested investors or purchasers of the assets of the Debtor Company and to solicit offers for the disposition of their assets. The order also allows the Interim Receiver to request permission from the Court to sell the assets.

The Interim Receiver prepared and sent a summary information document to potential investors and purchasers in order to solicit their interest with regard to Fly America Furniture Inc. and created a virtual dataroom of relevant information that should enable them to make an investment offer or an offer to purchase the assets.

Access to this virtual dataroom has been given to potential investors and buyers who signed a confidentiality agreement.

Pursuant to the process initiated by the Interim Receiver, the offers must be submitted to the Interim Receiver, at the latest, by noon, Eastern Standard Time, November 1, 2005, which is subsequent to the date of this report.

b) Seeking Liquidators / Auctioneers

The Interim Receiver has been authorized to obtain offers to liquidate the Debtor Company's assets. We have thus contacted four liquidators/auctioneers to obtain offers in the context of an inventory liquidation. These offers must also be received by the Interim Receiver, at the latest, by noon, Eastern Standard Time, November 1, 2005.

c) Investment or Transaction

Based on the process initiated by the Interim Receiver, the Debtor Company may conclude an investment transaction pursuant to which funds will be generated by the issuance or the sale of Fly America shares (the "Investment").

Alternatively, one or more transactions may be concluded pursuant to which funds will be generated by the sale of all or part of Fly America's assets (the "Transaction").

Monies will be required to be disbursed in order to conclude the Investment or the Transaction, including, without limitation, any amount disbursed in the context of a reorganization or an arrangement initiated pursuant to the provisions of the *Canada Business Corporations Act*. The Proposal provides the method in which the net funds generated will be distributed ("Net Amount Derived from the Investment or Transaction").

VII. PROPOSAL

We have enclosed herewith the Proposal introduced to the Debtor Company's creditors. According to this Proposal, claims shall be paid as follows:

- The secured claims shall be paid in accordance with the arrangements existing between the Corporation and the holders of secured claims or as may be arranged between the corporation and the holders of secured claims. For greater certainty, the corporation agrees that nothing herein contained will in any way affect the rights of the holders of the secured claims;

- Amounts owing to Her Majesty in right of Canada or a Province that could be subject to a demand under Section 224 (1.2) of the Income Tax Act, or under any provision of the Canada Pension Plan or of the Employment Insurance Act that refers to subsection 224 (1.2) of the Income Tax Act and provides for the collection of a contribution, as defined in the Canada Pension Plan, or an employee's premium, or employer's premium, as defined in the Employment Insurance Act, and of any related interest, penalties or other amounts, or under any substantially similar provision of provincial legislation, outstanding at the time of the filing of the Notice of intention, will be paid, without interest, in full within six (6) months after proposal approval;
- Amounts owing to employees and former employees, that they would have been entitled to receive under Section 136(1)(d) of the ACT if the employer became bankrupt on the date of proposal approval, will be paid in full immediately after proposal approval;
- The proposal expenses will be paid in priority to all preferred claims and claims of ordinary claims;
- The preferred claims, without interest, will be paid in full in priority to ordinary claims, within sixty (60) days of proposal approval;
- Post-filing obligations will be paid in full in the ordinary course of business;
- The net proceeds available after payment of the above-mentioned amount ("Net Proceed") is the amount to be distributed to ordinary creditors as follows:
- Each of the unsecured creditors will receive, in full and final settlement of its ordinary claim, without interest, an amount equal to its pro-rata share of the Net Proceed, payable after the completion of the Investment or the Transaction as soon as the amount of the ordinary claims will have been determined. Interim dividends may be paid from time to time, the amount and timing of which, and the reserves to be retained, to be determined by the trustee, in consultation with the committee described hereinafter;

The Debtor Company agrees to the formation of a committee of up to three (3) individuals ("Committee") to be named by the creditors at the proposal meeting. The Committee will have the following powers:

- a) to advise the Trustee on matters relating to the administration of the proposal;
- b) to waive any default in the performance of any provision in the proposal;
- c) to confirm that the corporation has complied with the terms and conditions of the proposal; and
- d) to postpone the payment of any dividends to ordinary creditors herein provided.

VIII. REALIZATION ESTIMATE

In the event that the creditors do not accept the Proposal, the Debtor Company will be automatically in bankrupt. The net proceeds from the liquidation of the assets after fees and expenses of the Trustee would be distributed to the creditors according to the Act.

In view of the fact that the process for soliciting investors and/or liquidators is still in progress at the time of this report, we are unable to determine the amount that could be available for distribution to creditors, whether it be in the context of a bankruptcy or proposal. However, at the creditors' meeting scheduled for November 7, 2005, we will have taken cognizance of the offers received and will be in a position to report to creditors and make our recommendation.

IX. CONCLUSION

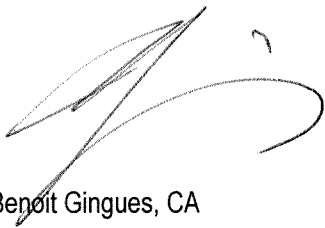
As previously indicated, offers that are to be received from investors or purchasers no later than November 1, 2005, should allow us to determine if one or more investors are interested in proceeding with the recapitalization of the Debtor Company. Should there be no investor, an orderly liquidation of assets should be considered.

Given the lack of information presently available, we are unable to make a recommendation as to whether this proposal should or should not be accepted. A recommendation will therefore be presented during the first creditors' meeting.

DATED at Montréal, Province of Québec, this 28th day of October, 2005.

RSM Richter Inc.

Trustee

A handwritten signature in black ink, appearing to read 'Benoit Gingues', with a large, sweeping flourish extending to the right.

Benoit Gingues, CA

Administrator