

CANADA
PROVINCE OF QUEBEC
DISTRICT OF MONTREAL
No.: 500-11-033234-085

SUPERIOR COURT
Commercial Division
(Bankruptcy and Insolvency)

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

SHERMAG INC., a legal person constituted under the Companies Act (Québec), having its domicile at 2171 King Street West, in the City of Sherbrooke and District of Saint-François, Province of Québec, J1J 2G1

- and -

JAYMAR FURNITURE CORP., a legal person constituted under the laws of Nova Scotia and continued under the laws of Canada, having its domicile at 75 Jaymar Street, in the City and District of Terrebonne, Province of Québec, J6W 1M5

- and -

SCIERIE MONTAUBAN INC., a legal person constituted under the laws of Canada, having its domicile at 100 Route du Lac George, in the City of Notre-Dame-de-Montauban and District of Saint-Maurice, Province of Québec, G0X 1W0

- and -

MÉGABOIS (1989) INC., a legal person constituted under the Companies Act (Québec), having its domicile at 2171 King Street West, in the City of Sherbrooke and District of Saint-François, Province of Québec, J1J 2G1

- and -

SHERMAG CORPORATION, a legal person constituted under the laws of the State of Delaware, having its chief executive office at Corporation Trust Center, 1209 Orange Street, in the City of Wilmington, State of Delaware, 19801, U.S.A.

-and-

JAYMAR SALES CORPORATION, a legal person constituted under the laws of the State of Nevada, having its chief executive office at Incorp Services, Inc., 3155 East Patrick Lane, Suite 1, in the City of Las Vegas, State of Nevada, 89120-3481, U.S.A.

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

**SECOND REPORT OF THE MONITOR
(June 3, 2008)**

INTRODUCTION

1. On May 5, 2008, Shermag Inc. and its affiliates (hereinafter referred to as "Petitioners" or "Shermag") filed a motion before the Quebec Superior Court asking for the issuance of an Initial Order in accordance with the provisions of the *Companies' Creditors Arrangement Act*, R.S.C. (1985), c. 36 ("CCAA"). In this regard, the Honourable Robert Mongeon, J.S.C., rendered the order in question and designated RSM Richter Inc. as Monitor ("RSM" or "Monitor").
2. On June 4, 2008, Shermag will present a Motion to extend the delay for filing a Plan of Arrangement, to extend the stay of proceedings, as provided for in the Initial Order, until August 8, 2008 and seeking other relief.
3. This is the second report of RSM, the Designated Monitor in the Petitioners CCAA proceedings.
4. The purpose of this second report is to inform this Honourable Court on the following:
 - A. Business overview since the commencement of proceedings;
 - B. Efforts to liquidate surplus assets (inventory, equipment and facilities);
 - C. Cash-flow projections of Petitioners;

- D. Extension of the forbearance agreement;
- E. Financial reporting;
- F. Actions taken by the Monitor;
- G. Monitor's recommendations.

5. The Court should be aware that the information contained herein has not been the subject of a formal audit by us and comes from the unaudited books and records of the Petitioners made available to the Monitor and from conversations with the managers of the Company. RSM has not audited, reviewed or otherwise attempted to verify the accuracy and completeness of the information and, accordingly, RSM expresses no opinion or other form of assurance on the information contained in this report.

A) BUSINESS OVERVIEW SINCE THE COMMENCEMENT OF PROCEEDINGS

- 6. Since the commencement of proceedings, Shermag has worked to stabilize its operations and to develop a long term business plan.
- 7. Management has focused its efforts during this initial period on communicating with its key customers and suppliers to explain its current situation and secure their cooperation for the future, to disposing of surplus assets and generate funds to support its ongoing operations and to the development of a long term restructuring plan (which is not yet completed).
- 8. Since the commencement of the proceedings, management and the Monitor have been in frequent communication with the secured lender, Wachovia Capital Finance Corporation ("Wachovia"), and have kept them informed of all material developments.
- 9. As well, Shermag has advised the employees of its Granby, Quebec, manufacturing plant that it will be temporarily closing this facility in mid-July 2008. A decision with respect to the future of this plant will be made at a later date.

B) EFFORTS TO LIQUIDATE SURPLUS ASSETS

10. Prior to and following commencement of CCAA proceedings, the Company had identified certain assets which it did not believe would be required following its restructuring. With the assistance of the Monitor, the Company has worked diligently to seek offers for these assets. More specifically, the Company has taken the following measures:

- A. Inventory – Shermag has communicated with multiple interested parties to solicit en-bloc offers for an estimated \$16 million (at its current wholesale price) of surplus inventory. On May 27 and 28, 2008, Shermag received four (4) offers from liquidators in Canada and the US. These offers are currently being analyzed by the Company and the Monitor with a view to determining the best offer and negotiating a contract to maximize the return to all stakeholders, the whole subject to approval of Shermag's Board of Directors ("Board") and its secured lender. In addition, Shermag has (through a third party) conducted a liquidation sale at its Montreal warehouse and is negotiating the sale of certain surplus inventory on an en-bloc basis to existing customers;
- B. Equipment – Shermag has solicited offers for surplus equipment at eleven (11) plant locations. Following visits by various interested parties, Shermag received four (4) proposals to liquidate the surplus equipment from liquidators in Canada and the US. Similar to the inventory, and subject to the same approvals, these offers are being analyzed with a view to negotiating a contract which will maximize the return to all stakeholders;
- C. Facilities – Shermag has identified twelve (12) facilities which have already been or will shortly be listed for sale in Quebec and New Brunswick. In addition, it has two (2) facilities in Quebec under contract. One sale is expected to be completed in June 2008 while the other sale is contingent on the transfer of certain forest cutting rights, the timing of which is currently unknown.

C) CASH FLOW PROJECTIONS OF PETITIONERS

i) April 28, 2008 to May 24, 2008

11. Attached hereto as Schedule A to our report is the comparative cash flow statement for the period April 28, 2008 to May 24, 2008. This statement reflects that actual indebtedness to Wachovia was reduced by approximately \$0.6 million as compared to a forecasted increase of \$1.7 million. The favourable cash flow results are attributed in part to timing differences which are expected to reverse as well as better than forecast results.

12. Based on the Company's margining formula, as of May 24, 2008, the Company was in an overadvance position of approximately \$0.4 million versus a budgeted overadvance of \$1 million.
13. We are unaware of any material unpaid or incurred expense out of the ordinary course of business (aside from timing differences noted above) during this initial period following the commencement of proceedings and no allowance has been made in this regards.
 - ii) **May 26, 2008 to August 10, 2008**
14. Attached hereto as Schedule B to our report is the projected cash flow statement for the period May 26, 2008 to August 10, 2008 ("Period").
15. The Monitor assisted management of Shermag in the preparation of this cash flow which utilized unaudited financial information, management's projections related to future events and management's assumptions with respect to results of operations during the forecast Period.
16. The projected cash flow reflects the following:
 - A. Net Cash flow from operations should amount to a deficit of approximately \$1.8 million prior to consideration of other receipts from sales of redundant assets, restructuring costs and debt servicing;
 - B. Management expects to generate approximately \$4.5 million during the Period relating to the sale of surplus equipment, the liquidation of already identified excess inventory and the sale of two facilities;
 - C. The cash flow assumes anticipated payments for utility deposits as well as restructuring professionals;
 - D. As of August 9, 2008, the book value of accounts receivable and inventory which secure Wachovia's indebtedness (along with other assets) are projected to approximate \$29.9 million;
 - E. Projected indebtedness to Wachovia is expected to decrease by \$1.2 million during the Period, to \$14 million.
17. The projected cash flow attached hereto was compiled by the officers of the Petitioners and is based on economic assumptions which appear reasonable based on the limited review performed thereon. However, as these projections depend on future events, which are beyond the control of the parties involved, the actual results will differ and such differences may be substantial.

D) EXTENSION OF FORBEARANCE AGREEMENT

18. On June 3, 2008, Shermag and Wachovia entered into an agreement by which they agree to amend and extend the forbearance agreement currently in effect until June 30, 2008 ("Amendment"). Pursuant to the terms of the Amendment, Shermag commits to moving forward to conclude agreements to dispose of surplus inventory and equipment, to respect the projected cash flow (Exhibit B) as well as to submit a definitive business plan to Wachovia.
19. It is anticipated that the forbearance agreement will then be further extended as the secured lender wants to regularly review the financial results and performance of Shermag.

E) FINANCIAL REPORTING

20. As noted in this report, management of Shermag has devoted and is continuing to devote all of its efforts to restructuring the business with the goal of formulating a plan of arrangement for the benefit of all stakeholders. We understand that included in the Motion for the extension of the stay being presented to this honourable Court, Shermag is requesting that:

"Shermag be relieved of any obligation to prepare any quarterly financial statements for any quarter ending after the Initial Order, except for the one quarter which will end immediately after the Stay Termination Date, and then, Petitioners shall have four (4) months from said Stay Termination Date to prepare the said quarterly financial statement".

21. The Monitor concurs that absent such relief, management of Shermag would have to divert resources from its restructuring efforts to complete such reporting and this would impact their restructuring efforts.

F) ACTIONS TAKEN BY THE MONITOR

22. On May 14, 2008, in accordance with the Initial Order, the Monitor sent to all the known creditors of Shermag a notice informing them of the issuance of the Initial Order and the stay of proceedings. A copy of the notice, along with a list of creditors, has been published on our web site to ensure that all creditors have access to it. In addition, on May 30, 2008, the Monitor posted a notification of the Motion for an Order Extending the Stay Period and Other Requested Relief.

23. The Monitor has assisted the management of Shermag in their initial meeting with employees and sales representatives as well as in meetings and communications with suppliers and the Company's lenders.
24. The Monitor has been kept informed of the Company's cash receipts and disbursements on a timely basis.
25. The Monitor has assisted management in its efforts to identify and dispose of surplus assets.

G) MONITOR'S RECOMMENDATIONS

26. The Motion presented by Shermag to grant a further delay until August 8, 2008 is reasonable and the Monitor supports the order sought for the following reasons:
 - A. The delay requested is essential to permit Shermag to complete its restructuring initiatives and to formulate its Plan of Arrangement which will be in the best interests of all stakeholders;
 - B. The Company has continued to act diligently, in good faith and in the interest of all involved, including its creditors;
 - C. The Company's principal secured lender is in support of the restructuring efforts and of this Motion to Extend and for other relief;
 - D. To the best of our knowledge, as of the date hereof, no creditor has been adversely affected by the procedures instituted under the CCAA;
 - E. The relief sought regarding the filing of quarterly financial statements will enable management to remain focused on its restructuring efforts.

Dated at Montreal, this 3rd day of June, 2008.

RSM Richter Inc.
Monitor designated by the Court


Philip Manel, CA, CPA, CIRP

Shermag Inc. and Subsidiaries
Cash Flow Results
For the Period April 28 to May 24, 2008
(In Thousands) (Unaudited)

Exhibit A

	April 28, 2008 to May 24, 2008		
	Actual	Budget	Variance
Cash Collections - Accounts Receivable	\$ 5,039	\$ 4,886	\$ 152
Payroll Expenditures (including benefits)	(957)	(1,135)	178
Inventory Disbursements - domestic	(501)	(767)	267
Inventory Disbursements - foreign	(1,984)	(2,830)	846
Operating Disbursements			
Production expenditures	(112)	(100)	(12)
Selling expenditures	(495)	(511)	16
General & Administrative expenditures	(77)	(146)	69
Insurance Payments	0	0	0
Carrying costs - Assets for sale	0	(41)	41
Total Operations Expenditures	(4,126)	(5,531)	1,405
Net Operations Cash Flow	913	(645)	1,558
Sale of Redundant Assets / Other Receipts			
Liquidation sales to the public	503	429	75
Real Estate Sales	0	0	0
	503	429	75
Restructuring Costs	(718)	(1,360)	642
Financing Expenditures			
Revolver and Term Debt Interest - Wachovia	(103)	(98)	(5)
Principle Amortization - Wachovia	(104)	(104)	(0)
Monitoring and other fees - Wachovia	(15)	(20)	5
Adjustments & Other Fees	(26)	0	(26)
	(248)	(223)	(25)
Net Cash Flow	451	(1,799)	2,249
Opening revolver	(7,957)	(7,957)	-
Closing Revolver	(7,506)	(9,756)	2,249
Opening term loan	(7,793)	(7,793)	-
Cash applied to term loan	104	104	0
Closing term loan	(7,689)	(7,689)	0
Closing total advances	\$ (15,195)	\$ (17,444)	\$ 2,249
Cumulative Incr. / (decr.) In total Wachovia Indebtedness	\$ (555)	\$ 1,694	\$ 2,249

SHERMAG**Weekly Cash Flow Projection****May 26, 2008 to August 9, 2008****(In Thousands) (unaudited)****Exhibit B****Week Ending Saturday:**

	May 26/08 to August 9/08 Forecast
Cash Collections - Accounts Receivable	\$ 11,014
Payroll Expenditures (including benefits)	3,026
Inventory Disbursements - domestic	565
Inventory Disbursements - foreign	6,065
Operating Disbursements	
Production expenditures	350
Selling expenditures	1,830
General & Administrative expenditures	554
Insurance Payments	140
Sales Tax	120
Carrying costs - Assets for sale	138
Total Operations Expenditures	12,788
Net Operations Cash Flow	(1,774)
Sale of Redundant Assets / Other Receipts	
Liquidation sales	1,695
Real Estate Sales	345
Machinery & Equipment Sales	2,000
Income tax refund	500
	4,540
Restructuring Costs	(1,265)
Financing Expenditures	
Revolver and Term Debt Interest - Wachovia	(197)
Principle Amortization - Wachovia	(2,658)
Monitoring and other fees - Wachovia	(60)
	(2,915)
Net Cash Flow	\$ (1,414)
Total Wachovia Indebtedness	\$ (13,952)