

CANADA

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

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

IN THE MATTER OF THE 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/Petitioners

- and -

RSM RICHTER INC.

Monitor

REPORT OF THE MONITOR WITH RESPECT TO AN
APPLICATION FOR THE SECOND POSTPONEMENT OF THE DELAY TO MAKE THE DISTRIBUTIONS
UNDER THE SANCTIONED PLAN OF ARRANGEMENT

INTRODUCTION

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 "**Petitioners**" or "**BMWG**") were companies to which the CCAA applies;
 - b) a stay of proceedings in respect of the Petitioners up to and including April 20, 2009; and
 - c) that RSM Richter Inc. be 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 operation 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 BMW was unable to secure a financing in time to make the initial 50% Option 2 distribution under the Plan and that the Petitioners would 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.
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 the date of this report, the Petitioners 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.

9. The Petitioners informed us that they are planning once again, to present to the Court a further application requesting a further 6 month postponement of the delays to make the remaining Option 2 distributions under the Plan. This Report deals with the consequences of the postponement in question as well as with the recommendations of the Monitor.
10. The Monitor will mail the present Report to all Unsecured Creditors entitled to the Option 2 Distributions under the Plan.
11. This Report of the Monitor has been prepared in order to inform the Court and the Unsecured Creditors and is presented under the following headings:
 - a) State of affairs of the Petitioners;
 - b) Projected cash flow;
 - c) Petitioners' application to Court for the postponement of the delay to make the distributions under the Plan and the recommendation of the Monitor.
12. We hereby confirm that the information contained herein is based upon unaudited financial information provided to the Monitor by the Petitioners' management. The Monitor has not conducted an audit or investigation of the information it was provided by the Petitioners 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

13. The Petitioners remain unable to secure sufficient financing to enable them to fund the Option 2 Distributions, the first of which was scheduled for August 3, 2010 (distribution estimated at approximately \$1.4 million). We understand that whatever discussions the Petitioners have had with financial institutions in order to refinance the operations were unsuccessful. The financial institutions appear unwilling to finance the Petitioners until they emerge from CCAA and return to profitability.

14. The Petitioners have been able to maintain their operations without a further deterioration of their accounts payable and accrued liabilities since the sanctioning of the Plan. BMWG anticipate increased sales revenues in the upcoming year, resulting from new client contracts, new programs and an improvement in the US economy.
15. In order to finance its operations, BMWG's management and shareholders have been seeking additional financing to fund its cash flow requirements. Although BMWG has obtained a term loan of \$1.5 million from one of its existing creditors, it remains insufficient to finance both the operations and the dividend payment. Accordingly, the Petitioners are still seeking a financing of approximately \$4 million to cover its current operations and the dividend payments,
16. In addition, the Petitioners are presently negotiating two major contracts with customers, which could result in a significant increase in the Company's liquidities and profitability. The successful negotiation of these contracts could enable the Petitioners to pay the Option 2 dividend during the upcoming delay, without having to depend on new financing.
17. Accordingly the Petitioners are requesting that the two distributions be postponed by 6 months, namely to February 3, 2011 for the first payment and to May 3, 2011 for the second payment.
18. 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.
19. 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, many of which remain on a COD basis.
20. Since the sanctioning of the Plan, BMWG's projected increased sales have not materialized at the anticipated levels and accordingly neither has its cash flow.
21. In the interim, BMWG has been managing its daily cash flow in order to ensure that it meets its financial obligations.

22. BMWG's accounts payable and accrued liabilities as at July 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.
23. 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.

PROJECTED CASH FLOW - For the period August 1, 2010 to February 28, 2011

24. We refer you to **Schedule "A"**, which contains a copy of the summary projected monthly cash flow statement for the period August 1, 2010 to February 28, 2011 ("Period"), which essentially reflects the following:
 - a) the projected cash receipts for the period are estimated at approximately \$18.6 million;
 - b) the projected operating expenses are estimated at approximately \$17.9 million;
 - c) BMWG projects a positive operating cash flow of approximately \$0.7 million for the Period;
 - d) BMWG projects to have cash on hand of \$938K at the end of January, before consideration of the Option 2 Distribution.
25. The summary cash flow projection attached to this Report was prepared by the Petitioners' management and is based on underlying financial 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.
26. Albeit the attached cash flow reflects an improvement during the Period, the funds generated are insufficient to make the Option 2 Distributions provided under the Plan, without financing. The contracts that are presently under negotiation are not reflected in the projections.
27. The Monitor is of the opinion that the assumptions used by management of BMWG with respect to the financial projections are in general realistic, other than with respect to the projected sales, which may be optimistic.

PETITIONERS' APPLICATION TO THE COURT

28. We understand that the Petitioners have already approached two financial institutions and were unable to secure additional financing. The Monitor is of the view that a further delay may not result in a different outcome.
29. There is no certainty that the Petitioners' application for the further postponement of the delay to make the distributions under the Plan will enable the Petitioners to pay the dividend provided for under the original Plan. Management however believes that it can generate the required funds for the Option 2 Distributions by successfully completing the negotiations on new contracts and increasing its sales through new clients and new product lines.
30. A limited number of creditors have voiced their dissatisfaction with the current situation and the continued delays in obtaining the payment of the dividend. These creditors are suppliers that no longer deal with the Petitioners.
31. Should the Petitioners be declared Bankrupt, no dividend will be paid to preferred and unsecured creditors, as the existing secured debt is significantly higher to the potential liquidation value of the assets.
32. The Monitor believes that **a final additional delay** would be advisable, considering the following factors:
 - a. the delay will not further prejudice the creditors entitled to the Option 2 Distributions;
 - b. in a bankruptcy situation, the unsecured creditors would definitively receive nothing given that all of the Petitioners' assets are pledged in favour of the secured creditors, who are owed significantly more than the estimated realizable liquidation value of the said assets;
 - c. approximately 170 employees still work for the Petitioners;
 - d. some limited credit has been extended to the Petitioners by suppliers of goods and services. A bankruptcy would in all likelihood jeopardize the payment of these debts.

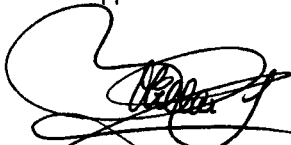
- e. the Petitioners continue to act diligently, in good faith and in the interest of their creditors;
- f. if the postponement of delays to make distributions under the Plan as requested by the Petitioners is not granted, we understand that the Petitioners will immediately go bankrupt;

33. Given the economic impact that a bankruptcy would generate, the Monitor hereby supports the Petitioners' application to the Court.

Respectfully submitted,

DATED AT MONTREAL, this 8th day of October 2010.

RSM Richter Inc.
Court-appointed Monitor

A handwritten signature in black ink, appearing to read "Gilles Robillard", is written over a horizontal line.

Gilles Robillard, CA, CIRP

<u>Blue Mountain Wallcoverings Group Inc.</u> <u>Projected Combined Summary Monthly Cash Flow</u> <u>For the period August 1, 2010 to February 28, 2011</u> <u>\$(,000)</u>								
	Aug-10	Sep-10	Oct-10	Nov-10	Dec-10	Jan-11	Feb-11	Total
Cash Receipts	2,151	2,241	2,525	3,158	3,177	2,811	2,501	18,564
Cash Disbursements	2,344	2,211	2,520	3,129	2,864	2,471	2,353	17,892
Cash flow from operations	(193)	30	5	29	313	340	148	672
Opening Bank position	415	222	252	257	286	599	939	415
Closing Bank position	222	252	257	286	599	939	1,087	1,087