

**RSM Richter Inc.**

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CANADA  
PROVINCE OF QUÉBEC  
DISTRICT OF QUÉBEC  
DIVISION NO.: 01-MONTRÉAL  
COURT NO.: 500-11-028119-069  
ESTATE NO.: 41-336505

**SUPERIOR COURT**  
(Commercial Division)

**IN THE MATTER OF THE PROPOSAL OF:**

**D & F Furniture Ltd.**

a body politic and corporate, duly incorporated according to law  
and having its head office and its principal place of business at  
8965 Pascal Gagnon, St-Léonard, Québec H1P 1Z4

**Debtor**

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

On the 28<sup>th</sup> day of July 2006, D & F Furniture Ltd. (hereinafter referred to as "D & F" or "Company") filed a Proposal to its creditors. We have enclosed herewith the Proposal of the Company to its Creditors as well as a Notice of the time and place of the meeting of creditors ("First Meeting of Creditors") to consider the Proposal. The highlights of the Proposal can be summarized as follows:

- Secured claims shall be paid in accordance with arrangements existing between the Company and the holder of the secured claim or as may be arranged between the Trustee and the holder of the secured claim;
- Amounts owing to Her Majesty in right of Canada or a Province that could be subject to a priority will be paid in full within six (6) months after the ratification of the Proposal;
- Amounts owing to employees and former employees for which they would have been entitled to receive under paragraph 136(1)(d) of the Act, will be paid in full immediately after the ratification of the Proposal;

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- Proposal expenses are to be paid in priority to all preferred claims and ordinary claims of creditors;
- Preferred claims without interest, will be paid in full in priority to all claims of ordinary creditors;
- The Company will, in full and final satisfaction of all amounts due to the ordinary creditors, pay dividends as follows, subject to the availability of liquidation proceeds:
  - (a) On December 15, 2006 an amount equal to the liquidation proceeds available at that time, if any;
  - (b) An amount of \$400,000 to be paid by the related company within ten (10) days from its receipt of the final net proceeds of sale of the Property (owned by the landlord – related party); and in any event no later than December 15, 2007.
  - (c) To the extent the amount of \$400,000 is not paid by the related company on or before December 15, 2006, such additional liquidation proceeds, if any, available as at December 15, 2007.
- The related company and parent company agree to waive their rights and defer receipt of any dividend distribution until all creditors receive their dividends under the terms of the Proposal.
- There will be the formation of a committee of five (5) individuals to be named by the creditors to approve, authorize, confirm and advise the Trustee on matters relating to the Proposal ("Committee of Creditors") .

**The Creditors are advised to review the more detailed and legal version of the Proposal as well as associated definitions.**

Pursuant to Sections 50(10)b and 50(5) of the Act and to assist the Creditors in considering the Proposal, the Trustee is submitting its report on the financial situation of the Company. The Creditors may in person at the forthcoming meeting of creditors, or by Voting Letter on or before the First Meeting of Creditors, accept or reject the Proposal.

**We would caution the reader that we have not conducted an audit nor an investigation of the books and records of the Company and, consequently, we cannot render an opinion with respect to the accuracy of the information contained herein. The information discussed herein emanates from the books and records made available to us, as well as from discussions with the Management of the Company.**

## **1. INTRODUCTION**

On May 17, 2006, D & F filed a Notice of Intention to Make a Proposal ("NOI") to its Creditors. RSM Richter Inc. ("RSM") was named as Trustee under the NOI. On May 23, 2006 RSM was appointed by the Court as Interim Receiver for the purpose of entering into an Agency Agreement with Century Services Inc. ("Century") and controlling receipts and disbursements. On June 15, 2006, a Motion to Extend the time for filing the Proposal was granted by the Court, thus extending the delay for filing the Proposal to July 31, 2006. On July 28, 2006, the Company filed the present Proposal to its creditors.

## **2. BACKGROUND OF THE COMPANY**

D & F is a Canadian corporation which was incorporated and commenced operations in 1972 as a manufacturer of high quality nursery and juvenile furniture which was sold under the registered trade name of *Ragazzz*®. In 2004 in order to widen the Company's customer base, the Company introduced the *Bambino*® product line, a mid-market line manufactured overseas. The Company's products are mostly sold on the U.S. market, through specialized furniture stores. The filing for protection was a result of the Company having encountered significant operating losses. The financial difficulties are a consequence of a globalized manufacturing market place and the variation of the Canada/U.S. currency exchange rates to which the Company was unable to counter.

## **3. EVENTS SUBSEQUENT TO THE FILING OF THE NOTICE OF INTENTION**

Since the filing of the NOI by the Company on May 17, 2006, Management has explored various alternatives to maintain its manufacturing and import activities. Management subsequently realized that it would be unable to turn the business around. During this interim period the Company has continued to produce and sell its products in the normal course of business. However upon deciding that the business was no longer viable, the Company via the Interim Receiver entered into an Agency Agreement with Century to act as the Company's agent in conducting a sale ("Sale") of the Company's equipment and residual inventory.

#### **4. AGENCY AGREEMENT AND THE LIQUIDATION PROCESS**

In consideration for the Sale, Century has provided a minimum guaranteed commitment in respect of the proceeds to be realized from the equipment and inventory, totalling approximately \$3.6MM. As a guarantee of Century's performance under the Agency Agreement, the minimum guarantee amount was paid to RSM in trust contemporaneously with the execution of the Agency Agreement. RSM is remitting the minimum guarantee amount to the secured creditor (HSBC Bank Canada ("HSBC")) in reduction of the secured debt, subject to any prior claims. The Agency Agreement also provides the payment of any surplus by Century, inasmuch as the Sale yields amounts in excess of the minimum guarantee, It is expected that Century's liquidation will be complete by August 31, 2006 and a detailed accounting will follow in September 2006. Concurrently with Century's liquidation, the Company is collecting its receivables, being the other primary assets.

#### **5. FINANCIAL INFORMATION**

The financial information relating to the affairs of D & F as at July 28, 2006 is submitted solely for discussion purposes and to assist the reader in assessing the present financial position of the Company, as not all of the books and records of the Company are not necessarily up to date. The Trustee makes no representations or warranty as to the accuracy of said financial information.

##### **A. ASSETS**

Pursuant to the Agency Agreement between Century and RSM as Interim Receiver, we are controlling the receipt of funds from the following assets:

##### **i) Trust Account**

The Interim Receiver maintains a Trust bank account ("Trust Account") to fund current operating costs. There are approximately \$887,000 in the Trust Account which are required to pay current post filing obligations (see liabilities section). As such there presently remain no funds available to creditors from the Trust Account until such time other assets may be realized and the secured creditor has been repaid in full.

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**ii) Funds held in Escrow**

The Interim Receiver has, in escrow, \$1,643,566, which represents the remaining net minimum guarantee amount from the Sale of the inventory and equipment to Century and which is to be remitted to the secured lender in reduction of its advances, less any funds required by the Interim Receiver in respect of its undertakings.

**iii) Input Tax Credits Receivable**

As at July 28, 2006, the Company has approximately \$275,000 of GST/QST receivable relating to pre-filing operations. The tax authorities are conducting an audit of the Company to determine the amount of GST/QST input tax credits ("ITC's") that have been claimed by the Company relating to unpaid invoices as at May 17, 2006. It is our understanding that the government will reverse the ITC's for unpaid amounts to suppliers as at the date of the filing of the Notice of Intention. The amount and timing of this adjustment is not yet known.

**iv) Accounts Receivable**

The book value of D & F's accounts receivable totals approximately \$1,407,000. This includes approximately \$1,200,000 of litigious receivables. As per the Statement of Affairs, Management has estimated the realization value of the accounts receivable at \$500,000 including amounts recoverable through EDC insurance. This time frame for the collection of these litigious accounts receivable is unknown. The accounts receivable are secured by a first charge in favour of HSBC and proceeds of collection will be utilized to reduce its indebtedness.

**v) Other Assets**

The Company is in the process of liquidating Company owned Sunlife shares with a market value of approximately \$60,000. This is also subject to the security of HSBC.

**vi) Surplus from Century Sale**

As Century is still in the process of selling the equipment and inventory, the amount of surplus proceeds, if any, to be paid by Century in excess of the minimum guarantee, is currently not determinable.

## B. LIABILITIES

The allocation of D & F's indebtedness, as at July 28, 2006, between secured, preferred and ordinary creditors as well as proposal expenses and post filing goods and service expenses (to be paid in priority to preferred creditors) are estimated as follows:

### i) Secured Creditor

The Company currently is indebted to its operating lender (HSBC) for \$2,141,000 with respect to advances. The Bank holds security on substantially all of the Company's assets including the funds held by the Interim Receiver.

The Trustee has obtained an independent legal opinion ("Opinion") as to the validity of the Bank's security. The Opinion determines that, subject to the customary qualifications contained therein, the Bank holds a validly perfected hypothec and security interest in the assets of the Company, as set out in the Bank's security agreements.

### ii) Preferred Creditors

As at July 28, 2006, the Company is unaware of any amounts owing to governmental authorities which would be considered a priority. A related party landlord is owed approximately \$360,000. This constitutes a preferred claim which the landlord is prepared to waive and defer in favour of D & F's creditors, if the Proposal is accepted by the creditors and approved by the Court. The Company is unaware of any other known preferred claims, however, notice has been sent to other possible preferred creditors. The ultimate amount of this category of claims will only be subsequently determined.

### iii) Proposal Expenses

As at July 28, 2006, the unpaid professional fees are estimated as follows:

Unpaid Trustee/Interim Receiver fees:	\$150,000
Unpaid legal fees	<u>50,000</u>
	<u>\$200,000</u>

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**Note:** *The above does not include a provision for the professional fees relating to the services rendered after July 28, 2006.*

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**iv) Post Filing Goods and Services Expenses**

As at July 28, 2006, the Company has estimated that its post filing obligations for unpaid goods and services are approximately \$1,190,000.

**v) Ordinary Creditors**

The Company has provided us with a listing of its ordinary creditors. Notices have been forwarded, concurrently with this report, to the aforementioned creditors and as at the present date, we are unable to comment on whether the Company's records agree with those of the creditors. As proofs of claims are received, we shall enter the amounts claimed by D & F's creditors and prior to paying any dividend distributions, we shall reconcile any differences. In order to be entitled to receive a dividend, creditors are required to file a proof of claim with the Trustee.

**6. REVIEW OF BOOKS AND RECORDS**

The Trustee has commenced but is yet to complete its review of the Company's transactions with suppliers in the three (3) months prior to the filing of the NOI and in the twelve (12) month prior period in respect of related parties. Upon completion of its review of the Company's transactions, the Trustee will either report to the Creditors at the First Meeting of Creditors or Committee of Creditors.

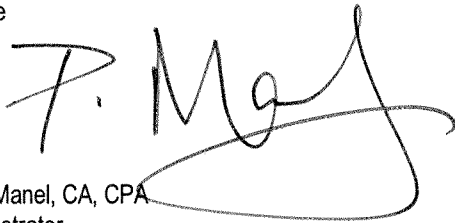
## 7. CONCLUSION AND RECOMMENDATION

The Company is undergoing a self-liquidation with the assistance of its Management and Century, the whole under the purview of the Trustee. That is, all receipts and disbursements are presently being controlled by RSM. It is not definite at the present whether the aforementioned liquidation will produce sufficient proceeds to result in a dividend to D & F's ordinary creditors. What is relatively definite, however, is a forthcoming \$400,000 payment for the benefit of the creditors, to be remitted by the landlord (related company), providing the Proposal is accepted, and subsequently ratified by the Court. In addition subject to the aforementioned approvals, any claim by the landlord and the related company will be deferred in favour of the creditors pending payment of the amounts due under the Proposal. As such, the Proposal, in the opinion of the Trustee, is more favourable than a bankruptcy where the \$400,000 would not be available. In addition, in a bankruptcy situation there would be greater professional fees and preferred claims (including the landlord) which would significantly reduce the chances of any dividend.

We therefore recommend that the Creditors accept the Proposal as there may be no funds available in a bankruptcy.

DATED AT MONTRÉAL, this 4<sup>th</sup> day of August 2006.

RSM Richter Inc.  
Trustee

A handwritten signature in black ink, appearing to read 'P. Manel', with a large, sweeping flourish underneath.

Philip Manel, CA, CPA  
Administrator