

CANADA  
PROVINCE OF QUÉBEC  
DISTRICT OF MONTRÉAL  
No.: 500-11-033234-085

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

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**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 Incomp 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**

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**FOURTH REPORT OF THE MONITOR  
(DECEMBER 5, 2008)**

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**INTRODUCTION**

1. On May 5, 2008, Shermag Inc. and its affiliates (hereinafter referred to as "Petitioners" or "Shermag") filed a Motion before the Québec 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 appointed RSM Richter Inc. as Monitor ("RSM" or "Monitor") and set a Stay Termination Date of June 4, 2008.
2. On June 4, 2008, Shermag was granted an extension of the Stay Termination Date and of the delay for filing a Plan of Arrangement, as provided for in the Initial Order, until September 8, 2008.
3. On July 16, 2008, Petitioners filed a Petition to establish a Claims and Meetings Process ("Claims Process") which was granted by the Court. The Claims Process set the bar date for the filing of Proofs of Claim or Notices of Dispute with the Monitor to September 5, 2008 at 5:00 p.m.
4. On July 30, 2008, Shermag filed a Motion for an Order Approving Various Agreements regarding its financing, which was granted by the Court.
5. On September 8, 2008, Shermag was granted an extension of the Stay Termination Date and of the delay for filing a Plan of Arrangement until December 10, 2008.

6. On December 5, 2008, Shermag filed a Third Motion to the Court for an Order seeking an extension of the Stay Termination Date and of the delay to file a Plan of Arrangement to April 4, 2009, and seeking other requested reliefs.
7. This is the Fourth Report of the Monitor in the Petitioners' CCAA proceedings.
8. The purpose of this Fourth Report of the Monitor is to inform this Honourable Court on the following:
  - A. Business overview since the commencement of the proceedings;
  - B. Efforts to liquidate surplus assets (inventory, equipment and facilities);
  - C. Restructuring Efforts;
  - D. Cash-flow projections of Petitioners;
  - E. Extension of the Forbearance Agreement;
  - F. Actions taken by the Monitor;
  - G. Monitor's recommendations.
9. The Court should be aware that the information contained herein has not been the subject of a formal audit by the Monitor and comes from the unaudited books and records of the Petitioners made available to the Monitor as well as from conversations with the management of the Petitioners. The Monitor has not audited, reviewed or otherwise attempted to verify the accuracy and completeness of the information and, accordingly, the Monitor expresses no opinion or other form of assurance on the information contained in this report.

**A) BUSINESS OVERVIEW SINCE THE COMMENCEMENT OF THE PROCEEDINGS**

10. Since the commencement of the proceedings, Shermag has worked diligently to stabilize its operations and to develop a long term business plan.
11. Management has focused its efforts during the 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.

12. 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 subsequently with Geosam Investments Limited ("Geosam"), the latter having replaced Wachovia as the secured lender as authorized pursuant to an Order Approving Various Agreements rendered on July 30, 2008.
13. Shermag has continued its operations with relative "normality" since the initial filing. Gross sales for the first seven (7) months of the current fiscal year approximate \$37 million.

**B) EFFORTS TO LIQUIDATE SURPLUS ASSETS**

14. Further to the rendering of the Initial Order, Shermag has identified surplus equipment and non-core surplus inventory, which would no longer be required following its restructuring, the details of which are:
  - i) **Inventory** – As early as May 28, 2008, Shermag had identified \$16.9 million (at its current wholesale price) of non-core surplus inventory.

The Company conducted, through a third party, a liquidation sale of part of its surplus inventory at its Montreal warehouse and entered into certain agreements to hold inventory liquidation sales throughout its existing customer base.

Shermag initially conducted its own surplus inventory liquidation clearance sale at its Montreal warehouse. Shermag also offered special prices to selected customers so as to clear the surplus inventory. The foregoing is taking place under the control of Shermag's management, with the approval of the Monitor and its secured lender, Geosam. The Court further approved this process on September 8, 2008.

Finally, since October 2008, Asset Engineering Corporation ("AEC"), is conducting the liquidation clearance sale of Shermag's non-core surplus inventory at the Montreal and Toronto warehouses.

- ii) **Equipment** – The Company identified surplus equipment in eleven (11) plant locations. Shermag had initially decided to liquidate same using internal contacts and via a virtual auction rather than using the liquidators in Canada and the U.S. However, Petitioners ultimately decided to use the services of liquidators. On November 4, 2008, the Court approved the proposed liquidation process pursuant to which Industrial Recovery Services Inc., and M.G. Martin Auctioneers will sell through an auction process the surplus equipment.

We are advised that an auction for all the surplus equipment located in the facilities of Saint-Étienne-de-Lauzon and Bécancour will respectively take place on December 16, 2008 and January 16, 2009.

- iii) **Facilities** – Shermag has identified fourteen (14) facilities in Quebec and New-Brunswick, which are no longer be required in its future operations. All of these facilities, except one, are presently listed for sale with real estate agents.

The premises located at Montauban were subject to an accepted offer to sell. However, the purchase offer, which was subject to the transfer of certain forest cutting rights, failed due to the refusal by the Government to transfer said cutting rights.

The premises located in St-Etienne were sold in June 2008 for net proceeds of \$347,000.

The head office located at 2171 King Street West, Sherbrooke, was sold in October 2008 for a net proceed of \$1,480,000. A lease of part of the premises was also executed on September 8, 2008, the Petitioners obtained Court approval of this transaction.

#### **C) RESTRUCTURING EFFORTS**

- 15. In July, 2008, in accordance with the Petitioners' business plan, Petitioners have, *inter alia*, terminated:
  - i) the lease agreements for the distribution center they operate in Lasalle and the show rooms located at High Point (North Carolina) and Mississauga (Ontario);
  - ii) the employment of more than fifty-three (53) employees whose services were no longer required pursuant to the new business plan; and
  - iii) various licenses, services, consulting and equipment lease agreements which are no longer necessary or useful to Petitioners.
- 16. Shermag is presently leasing the King Street former head office premises until they determine where to relocate to.
- 17. Shermag has entered into a lease agreement for their facilities located in Lennoxville for a five (5) year period starting January 15, 2009, upon which Shermag will collect rent until they find a buyer for such premises.

18. As mentioned previously herein, on July 16, 2008, Petitioners filed a Petition to Establish a Claims and Meeting Process which was granted by this Court according to its conclusions, the whole as it appears from the Court record. The said Petition provides, *inter alia*, that the bar date for the filing of a Proof of Claim or a Notice of Dispute (as defined in the Claims Process) with the Monitor was September 5, 2008 at 5:00 p.m.
19. Petitioners, in collaboration with the Monitor and their advisors, conducted a reviewing process of the various Proofs of Claim and Notices of Dispute received. Notices of review and / or disallowance have been issued by the Monitor and in some cases, said notices were appealed to by the creditors. As at the date of this report, the reviewing process is not completed although it is much advanced. This process, once completed, will enable Shermag to assess the nature and amount to be offered to the creditors upon the filing of a Plan of Arrangement.
20. Petitioners, with the collaboration of their advisors, have prepared an application to seek the protection of the United States Courts under Chapter 15 of the *United States Bankruptcy Code* (the "**US Application**"). The US Application will seek, *inter alia*, the approval by the US Courts of the conclusions contained in the Claims Process Petition and will be filed in the coming days.
21. Furthermore, Petitioners, with the assistance of their attorneys and the Monitor, have begun the work required to formulate and file a Plan of Arrangement.

**D) CASH FLOW PROJECTIONS OF PETITIONERS**

**i) Financial Results**

22. Attached hereto as Schedule A to our report, is the comparative cash flow statement for the period September 1, 2008 to November 29, 2008. The highlights of this statement are the following:
  - Total Bank indebtedness (amounts owed to Geosam) is lower than projected by \$223,000 (\$10,749,000 actual compared to a budget of \$10,972,000);
  - Net operating cash flows generated a surplus of \$2,937,000;
  - Inventory and equipment liquidation sales have been lower than expected by \$3,522,000.
23. Other than post-filing payables, we are unaware of any material unpaid or incurred expense out of the ordinary course of business (aside from timing differences noted above) relating to the initial period following the commencement of proceedings and no allowance has been made in this regard.

**ii) Financial Projections November 30, 2008 to April 4, 2009**

24. Attached hereto as Schedule B to our report, is the projected cash flow statement for the period November 30, 2008 to April 4, 2009 ("Period").
25. The Monitor assisted management of Shermag in the preparation of this cash flow which utilized unaudited financial information, management's projections relating to future events and management's assumptions with respect to results of operations during the forecast Period.
26. The projected cash flow reflects the following:
- i) Net cash flow from operations should amount to a surplus of approximately \$1.9 million prior to consideration of other receipts from sale of redundant assets, restructuring costs and debt servicing;
  - ii) Management expects to generate approximately \$3.2 million during the Period from the sale of the surplus equipment and the liquidation of already identified non-core surplus inventory;
  - iii) The cash flow assumes anticipated payments for restructuring professionals;
  - iv) Projected indebtedness to Geosam is expected to decrease by \$3.3 million during the Period, to \$7.5 million.
27. 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 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.

**E) EXTENSION OF FORBEARANCE AGREEMENT**

28. As a result of the Order granted on July 30, 2008, approving various agreements, Geosam had entered into an assignment agreement with Wachovia, the former secured lender. Geosam has amended and extended the previous Forbearance Agreement which will expire on December 10, 2008.
29. It is anticipated that the Forbearance Agreement will be further extended to April 4, 2009, and the secured lender will continue to review the financial results and performance of Shermag.

**F) ACTIONS TAKEN BY THE MONITOR**

30. On May 14, 2008, in accordance with the Initial Order, the Monitor sent to all known creditors of Shermag a notice informing them of the issuance of the Initial Order and the stay of proceedings. The aforementioned notice advised creditors to regularly review the website of the Monitor for relevant information. A copy of the notice, along with a list of creditors, has been published on our website to ensure that all creditors have access to it. In addition, the Monitor posted on its website the May 30, 2008 Motion for an Order Extending the Stay Period and Other Requested Relief as well as the June 4, 2008 Extension Order along with the Second Monitor's Report.
31. On July 23, 2008, the Monitor mailed to all known creditors of Shermag, in accordance with the Claims Process Order, a Notice to Creditors of the Bar Date relating to the Filing of Claims. The Notice along with the Claims Process Order were posted on the Monitor's website.
32. Furthermore, the said Notice was published in the July 30, 2008 editions of the Globe and Mail (National Edition), La Presse as well as La Tribune (Sherbrooke).
33. The present report, as well as all previous reports and associated Motions, have been posted on the website of the Monitor prior to the hearing thereon.
34. Throughout the process, the Monitor has assisted management of Shermag in their initial meeting with employees and sales representatives as well as in meetings and communications with specific suppliers and the Company's lenders.
35. The Monitor has been kept informed of the Petitioners' cash receipts and disbursements on a timely basis.
36. The Monitor has assisted management in its efforts to identify and dispose of surplus assets.
37. The Monitor is currently dealing with issues relating to the Claims Process and holding discussions with Petitioners and its legal counsel in the formulation of a Plan of Arrangement.



**G) MONITOR'S RECOMMENDATIONS**

38. The Motion filed by Shermag to grant a further delay until April 4, 2009 is reasonable and the Monitor supports the order sought for the following reasons:

- i) The delay requested is essential to allow Shermag to complete its restructuring initiatives and to formulate its Plan of Arrangement which will be in the best interests of all stakeholders;
- ii) The Company has continued to act diligently, in good faith and in the best interest of all involved, including its creditors;
- iii) The Company's principal secured lender (Geosam) supports the restructuring efforts and this Motion to Extend and for other relief;
- iv) To the best of our knowledge, as of the date hereof, no creditor has been adversely affected by the procedures instituted under the CCAA, and none will be adversely affected by the proposed extension.

Dated at Montreal, this 5<sup>th</sup> day of December, 2008.

**RSM Richter Inc.**  
Monitor designated by the Court

  
Yves Vincent, FCA, CIRP

## **SCHEDULE A**

<b>Shermag Inc. and Subsidiaries</b>			
<b>Cash Flow Results</b>			
<b>For the period September 1 to November 29, 2008</b>			
(In '000 \$ - Unaudited)			
	Actual	Budget	Variance
<b>RECEIPTS</b>			
Cash Collections - Accounts Receivable	14,220	11,511	2,708
<b>DISBURSEMENTS</b>			
Payroll Expenditures (including benefits)	(2,749)	(3,200)	451
Inventory Disbursements - Raw Material	(1,887)	(2,293)	406
Inventory Disbursements - Finish Goods	(4,204)	(5,088)	884
	<u>(6,091)</u>	<u>(7,381)</u>	<u>1,290</u>
Operating Disbursements			
Production expenditures	(761)	(304)	(457)
Selling expenditures	(2,853)	(1,457)	(1,396)
General & Administrative expenditures	(898)	(608)	(290)
Insurance Payments	-	-	-
Sales Tax	(148)	(450)	302
Carrying costs - Assets for sale	-	(323)	323
	<u>(4,660)</u>	<u>(3,142)</u>	<u>(1,518)</u>
Total Operations Expenditures	<u>(13,500)</u>	<u>(13,723)</u>	<u>223</u>
<b>Net Operations Cash Flow</b>	<u>720</u>	<u>(2,212)</u>	<u>2,932</u>
Sale of Redundant Assets / Other Receipts			
Liquidation sales to the public	1,181	4,440	(3,259)
Real Estate Sales	1,490	1,480	10
Machinery & Equipment Sales	99	950	(851)
Income tax refund	491	-	491
Other	87	-	87
	<u>3,348</u>	<u>6,870</u>	<u>(3,522)</u>
Restructuring Costs	(481)	(900)	419
Financing Expenditures			
Revolver and Term Debt Interest	(432)	(552)	120
Principle Amortization	(1,490)	(2,430)	940
Monitoring and other fees	210	(65)	275
	<u>(1,712)</u>	<u>(3,047)</u>	<u>1,334</u>
<b>Net Cash Flow</b>	<u>1,874</u>	<u>711</u>	<u>1,163</u>
Opening revolver	(6,980)	(6,980)	-
<b>Closing Revolver</b>	<u>(5,105)</u>	<u>(6,269)</u>	<u>1,163</u>
Opening term loan	(7,134)	(7,134)	-
Cash applied to term loan	1,490	2,430	(940)
<b>Closing term loan</b>	<u>(5,644)</u>	<u>(4,704)</u>	<u>(940)</u>
<b>Closing total advances</b>	<u>(10,749)</u>	<u>(10,972)</u>	<u>223</u>
<b>Cumulative Incr. / (decr). of indebtedness</b>	<u>(3,364)</u>	<u>(3,141)</u>	<u>(223)</u>

**SCHEDULE B**

**SHERMAG Inn. And Subsidiaries****Cash Flow Projections****For the period November 30, 2008 to April 4, 2009**

(in '000\$ - Unaudited)

**RECEIPTS**

Cash Collections - Accounts Receivable		18,369
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**DISBURSEMENTS**

Payroll Expenditures		3,858
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Inventory purchases:

Raw Material	2,880	
Finished Goods	6,262	9,143

Operating Disbursements:

Production expenditures	455	
Selling expenditures	1,217	
General & Administrative expenditures	859	
Sales Tax	600	
Carrying costs - Assets for sale	300	3,432

Total Operations Expenditures		16,433
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<b>Net Operations Cash Flow</b>		<b>1,937</b>
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Sale of Redundant Assets / Other Receipts:

Liquidation sales (Lion du Meuble, Surplus RD and others)	2,115	
Real Estate Sales	-	
Machinery & Equipment Sales	950	
Other	135	3,200

Restructuring Costs		(1,420)
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Financing Expenditures

Revolver and Term Debt Interest - Geosam	(344)	
Principle Amortization - Geosam	(950)	
Monitoring and other fees - Geosam	(90)	(1,384)

<b>Net Cash Flow</b>		<b>2,333</b>
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<b>Total Indebtedness</b>		<b>(7,467)</b>
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Note: Detailed assumptions to the cash flow projections and the "weekly" skewing are available upon request.

No. 500-11-033234-085

**S U P E R I O R C O U R T**  
**(Commercial Division)**  
District of Montréal

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**IN THE MATTER OF THE PLAN OF  
COMPROMISE OR ARRANGEMENT OF:  
SHERMAG INC. ET ALS.**

Petitioners

and

**RSM RICHTER INC.**

Monitor

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**EXHIBIT R-2 IN SUPPORT OF  
PETITIONERS' THIRD MOTION FOR AN  
ORDER EXTENDING THE STAY PERIOD**

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**ORIGINAL**

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Attorneys for Petitioners  
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**DAVIES**

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