

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

**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

Proposed Monitor

REPORT OF THE PROPOSED MONITOR

INTRODUCTION

1. RSM Richter Inc. (RSM) understands that the Debtors/Petitioners (hereinafter referred to as "Petitioners" or "Shermag") will bring a motion before this Honourable Court seeking commencement of proceedings under the *Companies' Creditors Arrangement Act*, R.S.C. (1985), c. 36 ("CCA") in order to restructure the business of the Petitioners;
2. This is the first report of RSM, the Proposed Monitor in the Petitioners CCA proceedings. RSM has consented to act as Monitor in these CCA proceedings;
3. The purpose of this report is to inform this Honourable Court on the following:
 - A. Current liquidity crisis
 - B. Commencement of formal insolvency proceedings
 - C. Cash-flow projections of Petitioners
 - D. D&O and Administration Charges and financial thresholds
 - E. Key Employee Retention
 - F. Restructuring options
 - G. Conclusions and recommendations

4. 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 Proposed 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) CURRENT LIQUIDITY CRISIS

5. Shermag Inc. is a public company trading on the TSX. It is comprised of various subsidiaries and divisions, all of which report for financial statement purposes on a consolidated basis and most of which are subject to one lending agreement with Wachovia Capital Finance of Canada ("Wachovia");
6. As declared in the Initial Petition, Shermag's financial situation has been deteriorating since 2005 notwithstanding the implementation by Management of significant "operational" restructuring measures. Net consolidated sales have declined on a year over year basis since 2005 and its cumulative losses from 2005 to December 28, 2007 are approximately \$88 million;
7. As set out in the Initial Petition, Shermag is unable to meet its obligations as they become due. Further, the Petitioners' principal secured creditor, Wachovia notified Shermag on April 16, 2008 of a reduction in its borrowing capacity;
8. Petitioners advise that in addition to their current indebtedness to Wachovia, they currently have an estimated \$10 million of trade payables and that this amount could ultimately exceed \$25 million as a result of contingent liabilities which are not fully quantifiable at this time. We also understand that numerous suppliers have recently sent demand letters and/or instituted legal proceedings to recover amounts due. A creditor has even recently threatened the filing of a Petition for Receiving Order.
9. Petitioners include numerous companies and even more numerous asset categories, including receivables inventory, plant equipment, and real estate. These assets require the protection offered by the CCAA, so Petitioners can be restructured. This process will also entail possible disposition of certain assets which can best be accomplished from CCAA proceedings.

B) COMMENCEMENT OF FORMAL INSOLVENCY PROCEEDINGS

10. In light of the current liquidity crisis and in order to enable it to continue to implement its restructuring program, Shermag has determined, in conjunction with its advisors, that it is in the best interests of all stakeholders to commence formal restructuring proceedings;

11. Court protection may enable Petitioners to stabilize operations and to continue to develop and implement restructuring plans. Management is of the belief that Petitioners may be able to return to profitability following the restructuring;

C) CASH FLOW PROJECTIONS OF PETITIONERS

12. Attached hereto as Schedule A to our report is the cash flow for the **period April 28, 2008 to June 7, 2008 (“Period”)** as prepared by the Management of the Company. The Proposed 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;

13. The projected cash flow reflects the following:

- A. Net Cash flow from operations should amount to a deficit of approximately \$1.3 million prior to consideration of other receipts from sales of redundant assets, restructuring costs and debt servicing;
- B. Management expects to generate approximately \$1.2 million during the Period relating to the sale of the former saw mill property in Notre-Dame-de-Montauban, Quebec and from the liquidation of already identified excess inventory;
- C. The cash flow assumes anticipated payments for utility deposits, critical vendor payments as well as restructuring professionals;
- D. As of June 7, 2008, the book value of accounts receivable and inventory which secure Wachovia’s indebtedness (along with other assets) are projected to approximate \$35.7 million;
- E. Projected indebtedness to Wachovia is expected to increase by \$1.9 million during the Period to \$17.7MM and may peak at an increase of \$1.8MM before reducing to the aforementioned amount.

14. 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 may be substantial.

D) D&O AND ADMINISTRATION CHARGES AND FINANCIAL THRESHOLDS

15. The Initial Motion contains the following charges and thresholds:
- A. Directors and Officer charge of \$1,500,000 to indemnify each of the Directors (details can be found in the Initial Motion);
 - B. Administration Charge of \$500,000 in favour of the Monitor, the Monitor's legal counsel as well as Petitioners' legal counsel and other advisors;
 - C. Asset sales out of the "normal course of business" of \$900,000 or \$5,000,000 in aggregate excluding the liquidation of the inventory located in the Montreal distribution center and the sawmill located in Notre-Dame-de-Montauban;
 - D. Notices to be sent to creditors with outstanding balances of \$250 or more.
16. The Proposed Monitor is of the view that these charges and thresholds are reasonable in the circumstances;

E) KEY EMPLOYEE RETENTION PROGRAM

17. Petitioners recognize that a key component of a successful restructuring will be the dedicated efforts of its employees. Following discussions with the Proposed Monitor, Petitioners formulated a Bonus Plan designed to address the necessity of the continued employment of Key Employees.
18. The Retention Bonus Plan provides for a retention bonus payable to the Key Employees in three (3) equal installments, the first payment being in May 2008, the second in September 2008 and the last in January 2009.
19. The Retention Bonus Plan is designed to provide the necessary incentive for the Key Employees to remain with Petitioners throughout the restructuring with a view to preserving value for the stakeholders through positive contributions to the restructuring while taking into account Petitioners' financial constraints.
20. We understand that payments provided for under the Retention Bonus Plan will only be made to the Key Employees who have fulfilled their employment obligations to Petitioners throughout the restructuring process, who have not resigned or been terminated for cause when each of the three (3) installments becomes due.

F) RESTRUCTURING OPTIONS

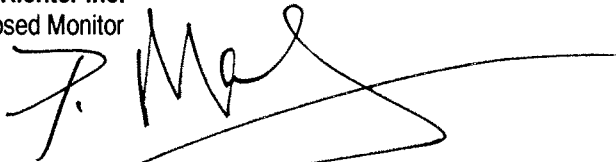
21. We understand that Management is continuing with its Transformation Plan (as defined in the Initial Motion) which includes among other aspects the continued implementation of the MTO model, consolidation of domestic operations including the disposal of redundant assets and to further develop a business plan which will lead to the filing of a plan of arrangement. However, as Management is continuing to examine its future business model it is too preliminary at this stage to comment on the Petitioners' restructuring options;

G) CONCLUSIONS AND RECOMMENDATIONS

22. The Proposed Monitor believes that Petitioners should be granted the benefit of protection normally accorded by the CCAA, to permit it to restructure and formulate a plan of arrangement for the interest of all stakeholders;
23. Based on the Proposed Monitor's review of the Proposed Initial Order, we support the orders sought, the charges and thresholds reflected in the Proposed Initial Order, including:
- A. An Administration charge of \$500,000;
 - B. A D&O charge of \$1,500,000;
 - C. Key Employee Retention Program;
 - D. Asset sales out of the normal course of business of \$900,000 or \$5,000,000 in aggregate excluding the liquidation of the inventory located in the Montreal distribution center and the sawmill located in Notre-Dame-de-Montauban;
 - E. Notices to be sent to creditors with outstanding balances of \$250 or more;
 - F. All other relief sought including, without limitation, with respect to the annual shareholders' meeting and the cash management.

Dated at Montreal, this 5th day of May, 2008.

RSM Richter Inc.
Proposed Monitor



Philip Manel, CA, CPA, CFP