

**EXTREME FITNESS, INC.**

**REPORT OF FTI CONSULTING CANADA INC.,  
IN ITS CAPACITY AS PROPOSED MONITOR OF  
EXTREME FITNESS, INC.**

**February 7, 2013**

ONTARIO  
SUPERIOR COURT OF JUSTICE  
(COMMERCIAL LIST)

IN THE MATTER OF THE COMPANIES' *CREDITORS ARRANGEMENT*  
*ACT*, R.S.C. 1985, c. C-36, AS AMENDED

AND IN THE MATTER OF A PLAN OF COMPROMISE OR  
ARRANGEMENT OF EXTREME FITNESS, INC.

PRE-FILING REPORT OF FTI CONSULTING CANADA INC.,  
in its capacity as proposed Monitor of the Applicant

February 7, 2013

INTRODUCTION

1. FTI Consulting Canada Inc. (“**FTI**”) understands that Extreme Fitness, Inc. (the “**Applicant**”) intends to bring an application before this Honourable Court seeking certain relief under the *Companies’ Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended (the “**CCAA**”) granting, *inter alia*, a stay of proceedings until March 8, 2013 and appointing FTI as Monitor (the “**Monitor**”) in such proceedings.
  
2. This is the pre-filing report of the proposed Monitor in the CCAA Proceedings. The purpose of this report is to provide this Honourable Court with information and/or the proposed Monitor’s conclusions on the following:
  - FTI’s qualification to act as Monitor (if appointed);
  - insolvency of the Applicant;
  - objectives of the CCAA Proceedings;
  - funding of the CCAA Proceedings, including overview of the cash flow forecast and proposed DIP financing;
  - the Applicant’s cash management system;

- proposed payment of certain pre-filing amounts;
- proposed director and officer protection;
- requested Court-ordered charges;
- financial sale thresholds; and
- proposed creditor notification procedures.

### **TERMS OF REFERENCE**

3. In preparing this report, FTI has relied upon unaudited financial information of the Applicant, the Applicant's books and records, certain financial information prepared by, and discussions with, the Applicant's management. FTI has not audited, reviewed or otherwise attempted to verify the accuracy or completeness of the information and accordingly expresses no opinion or other form of assurance on the information contained in this report.
4. Capitalized terms not defined in this report are as defined in the affidavit of Alan Hutchens sworn February 7, 2013 (the "**Hutchens Affidavit**") filed in support of the Applicant's application for relief under the CCAA. This report should be read in conjunction with the Hutchens Affidavit as certain information contained in the Hutchens Affidavit has not been included herein in order to avoid unnecessary duplication.
5. The proceedings to be commenced by the Applicant under the CCAA will be referred to herein as the "**CCAA Proceedings**".
6. Unless otherwise stated, all monetary amounts contained in this report are expressed in Canadian dollars.

### **FTI'S QUALIFICATION TO ACT AS MONITOR**

7. FTI has been acting since April 18, 2012 as a consultant to National Bank of Canada, one of the Applicant's main senior secured lenders, with respect to its lending arrangements

with the Applicant and has assisted the Applicant in preparing for this CCAA application, including reviewing the cash flow projections of the Applicant for the next 9 weeks.

8. The professionals of FTI who have carriage of this matter, and who will have carriage of this matter for FTI as the Monitor (if appointed), have acquired knowledge of the Applicant and its business since the commencement of FTI's engagement as consultant. FTI is therefore in a position to immediately assist the company in the implementation of any restructuring process.
9. Steven Bissell, the individual within FTI with primary carriage of this matter, is a trustee within the meaning of subsection 2(1) of the *Bankruptcy and Insolvency Act* (Canada). FTI is not subject to any of the restrictions on who may be appointed as monitor set out in section 11.7(2) of the CCAA.
10. FTI has consented to act as Monitor should this Honourable Court grant the Applicant's request to commence the CCAA Proceedings.

## **BACKGROUND**

11. As described in the Hutchens Affidavit, the Applicant is a privately held corporation formed by articles of amalgamation under the laws of Alberta. The Applicant is registered to carry on business in Ontario and all of its assets are located in Ontario.
12. Through acquisitions and expansions, the Applicant currently operates 13 fitness facilities in the GTA and surrounding region with approximately 57,500 members.
13. A copy of the Applicant's ownership structure is attached as Exhibit "B" to the Hutchens Affidavit.
14. The Applicant's business, affairs, financial performance and position, as well as the causes of its insolvency, are detailed extensively in the Hutchens Affidavit and are therefore not repeated herein. The proposed Monitor has reviewed the Hutchens Affidavit and discussed the business and affairs of the Applicant and the causes of its insolvency

with senior management personnel of the Applicant and is of the view that the Hutchens Affidavit provides a fair summary thereof.

## **OBJECTIVES OF CCAA PROCEEDINGS**

15. The Applicant's stated principal objectives of the CCAA Proceedings are: (i) to ensure the ongoing operations of the Applicant; (ii) to ensure the Applicant has the necessary availability of working capital funds to maximize the ongoing business of the Applicant for the benefit of its stakeholders; and (iii) to complete a going concern sale and transfer of the Applicant's fitness facilities.
16. The Applicant has entered into a letter of intent (the "**LOI**") with Goodlife Fitness Centres Inc. (the "**Proposed Purchaser**") in connection with a sale of substantially all of the Applicant's assets, the material terms of which are described in the Hutchens Affidavit. The transaction is subject to the satisfaction of certain conditions, including the execution of an asset purchase agreement and Court approval thereof, and contemplates completion by March 31, 2013.
17. The proposed Monitor is not providing any recommendations with respect to the transaction at this time and will provide same (if appointed) in advance of any motion to approve the transaction.

## **FUNDING OF THESE PROCEEDINGS**

### ***Cash Flow Forecast***

18. The Applicant, with the assistance of the proposed Monitor, has prepared a consolidated 9-week cash flow forecast of its receipts, disbursements and financing requirements (the "**Cash Flow Forecast**"), reflecting the anticipated period to complete the sale to the Proposed Purchaser. A copy of the Cash Flow Forecast and a report containing the prescribed representations of the Applicant regarding the preparation of the Cash Flow Forecast are appended to the Hutchens Affidavit.

19. As shown in the Cash Flow Forecast, the Company is expected to have a beginning balance in cash at the commencement of the CCAA Proceedings of approximately \$0.9 million. It is estimated that for the 9-week period ending April 5, 2013, the Applicant will have total receipts of approximately \$9.0 million, DIP Financing of approximately \$2.0 million, operating disbursements (including payroll, facility and other operating costs) of approximately \$9.9 million, professional fees (including legal and financial advisors associated with the restructuring) totalling approximately \$1.3 million and financing charges (including interest and fees on the DIP Financing and under the Priority Credit Agreement) of approximately \$0.2 million resulting in a forecast ending balance in cash at the end of the 9-week period of \$0.5 million.
  
20. Section 23(1) (b) of the CCAA states that the Monitor shall: “*review the company’s cash-flow statement as to its reasonableness and file a report with the court on the monitor’s findings*”.
  
21. Pursuant to section 23(1)(b) of the CCAA and in accordance with the Canadian Association of Insolvency and Restructuring Professionals Standard of Practice 09-1 (“**CAIRP SOP 09-1**”), the proposed Monitor hereby reports as follows:
  - a) The Cash Flow Forecast has been prepared by the management of the Applicant for the purpose described in Note 1 on the face of the Cash Flow Forecast, using the Probable and Hypothetical Assumptions set out in Notes 2 to 9.
  
  - b) The proposed Monitor’s review consisted of inquiries, analytical procedures and discussion related to information supplied by certain of the management and employees of the Applicant. Since Hypothetical Assumptions need not be supported, the proposed Monitor’s procedures with respect to them were limited to evaluating whether they were consistent with the purpose of the Cash Flow Forecast. The proposed Monitor has also reviewed the support provided by management of the Applicant for the Probable Assumptions, and the preparation and presentation of the Cash Flow Forecast.

- c) Based on its review, nothing has come to the attention of the proposed Monitor that causes it to believe that, in all material respects:
    - i. the Hypothetical Assumptions are not consistent with the purpose of the Cash Flow Forecast;
    - ii. as at the date of this report, the Probable Assumptions developed by management are not suitably supported and consistent with the plans of the Applicant or do not provide a reasonable basis for the Cash Flow Forecast, given the Hypothetical Assumptions; or
    - iii. the Cash Flow Forecast does not reflect the Probable and Hypothetical Assumptions.
  - d) Since the Cash Flow Forecast is based on assumptions regarding future events, actual results will vary from the information presented even if the Hypothetical Assumptions occur, and the variations may be material. Accordingly, the proposed Monitor expresses no assurance as to whether the Cash Flow Forecast will be achieved. The proposed Monitor expresses no opinion or other form of assurance with respect to the accuracy of any financial information presented in this report, or relied upon by the proposed Monitor in preparing this report.
  - e) The Cash Flow Forecast has been prepared solely for the purpose described in Note 1 on the face of the Cash Flow Forecast, and readers are cautioned that it may not be appropriate for other purposes.
22. As set out in the Cash Flow Forecast, the Applicant does not have sufficient funds from operations to satisfy its projected uses of cash during the next 9-week period. The Applicant will require external funding to finance its operations and meet its post-CCAA filing liabilities during the 9-week Cash Flow Forecast period as further described below.

***DIP Financing***

23. In addition to drawing down the approximately USD\$600,000 available under the Priority Credit Agreement, the Cash Flow Forecast indicates that the Applicant will require DIP financing (the “**DIP Financing**”) to implement its restructuring initiatives and continue operations.
24. It is anticipated that the Applicant will require DIP Financing in the amount of USD\$2 million to allow for payment of operating and other financial obligations during the proposed period to implement a sale transaction, including obligations to employees, trade creditors and advisors and to maintain required operating liquidity levels.
25. The Applicant was offered DIP Financing by certain of the lenders under the Priority Credit Agreement (the “**DIP Lenders**”) on what the Applicant viewed as reasonable terms in the circumstances. The Applicant also viewed the following aspects of the DIP proposal from the DIP Lenders as advantageous:
  - a) it was based on the terms of the Priority Credit Agreement and the structure of the priority facility thereunder;
  - b) it did not require any alteration of the Applicant’s bank accounts or cash management system; and
  - c) the proposed DIP Lenders are already familiar with the Applicant’s business and financial profile as well as its restructuring options as a result of their involvement in discussions with the Applicant’s advisors throughout the Applicant’s strategic review process and as a result of their pre-existing lending relationship with the Applicant.
26. Accordingly, the Applicant is of the opinion that any offer from other lenders would have required a great deal of time and expense to pursue and there was no commercial advantage to pursuing other options for DIP Financing. As a result, the Applicant did not



canvas the market for other potential lenders. The terms and conditions of the DIP Financing are described in the Hutchens Affidavit.

27. Subject to certain terms and conditions (described in the Hutchens Affidavit), the Applicant has negotiated a debtor-in-possession credit agreement (the “**DIP Credit Agreement**”) with the DIP Lenders whereby the DIP Lenders agree to provide the DIP Financing in the form of one or more advances to a maximum amount of USD\$2 million. The Repayment Date under the DIP Credit Agreement is the earlier of: (i) the date of demand by the DIP Lenders; (ii) the date on which all or substantially all of the assets of the Applicant are sold; and (iii) March 31, 2013. The original scheduled Repayment Date of March 31, 2013 may be extended at the discretion of the DIP Lenders.
28. The DIP Financing is proposed to be secured by a Court-ordered super priority security interest, lien and charge (the “**DIP Lenders’ Charge**”) on the assets and property of the Applicant (the “**Charged Property**”) that will secure all post-filing advances. The DIP Lenders’ Charge is proposed to rank behind the Administration Charge of \$500,000 and the Directors’ Charge of \$2,880,000. The DIP Lenders’ Charge will not secure any obligation that exists before the Initial Order is made.
29. The Monitor has reviewed the terms of the proposed DIP Financing and the Applicant’s circumstances, including (a) the necessity for DIP Financing to continue in operations pending completion of the proposed going concern sale; (b) the efficiencies and minimization of costs and expenses associated with the lenders under the Priority Credit Agreement providing DIP Financing based on the Priority Credit Agreement; (c) the difficulty in finding any other lenders to provide DIP financing in the circumstances and in the timeframe required together with the associated increased costs and expenses; and (d) the fact that National Bank has reviewed the terms of the DIP Financing and consents to the DIP Financing. In the circumstances, the proposed Monitor supports the Applicant’s request for approval of the proposed DIP Financing to accommodate its anticipated liquidity requirements during the proposed restructuring period to implement a sale transaction.

## **CASH MANAGEMENT SYSTEM**

30. The Applicant has advised the proposed Monitor that the cash management system, as outlined in the Hutchens Affidavit, is critical to the orderly management of the Applicant's business affairs. Accordingly, the Applicant is seeking to continue to operate its cash management systems post-filing in substantially the same manner as before the commencement of the CCAA Proceedings. The proposed Monitor supports this request.

## **PAYMENTS OF CERTAIN PRE-FILING AMOUNTS**

31. The Applicant relies on its network of independent contractors providing fitness services to its members to ensure the Applicant's ability to continue its business operations.
32. The Applicant intends to continue to rely on certain independent contractors with which it has contracts or arrangements that were entered into prior to the date of the filing. In order to ensure continued essential services, the Applicant requires the ability to pay certain pre-filing amounts and post-filing payables to those independent contractors it considers essential to its business, as approved by the Monitor. The Applicant must ensure continued good relations with its essential independent contractors to continue business in the ordinary course.
33. Accordingly, the Applicant is seeking Court approval to allow (but not require) it to pay pre-filing amounts to independent contractors, subject to the prior approval of the Monitor.
34. The proposed Monitor concurs with the Applicant's view that interruption of services provided by essential independent contractors could have a significant and immediate detrimental impact on the Applicant's business, operations and cash flow. However, the proposed Monitor also recognizes that the Applicant's funding is limited and will work with the Applicant to ensure that payments to independent contractors in respect of pre-filing liabilities are minimized. Accordingly, the proposed Monitor supports the Applicant's request to allow (but not require) it to pay certain pre-filing amounts to critical independent contractors, but only with the prior approval of the Monitor.

35. The form of Initial Order also contemplates payment of scheduled interest payments under the Priority Credit Agreement. The Monitor understands the scheduled payments of interest are included in the Cash Flow Forecast and is advised that National Bank does not oppose such payments.

#### **DIRECTOR AND OFFICER PROTECTIONS**

36. The Applicant is requesting a Court-ordered charge in the amount of \$2,880,000 over the Charged Property to indemnify the Directors, Officers and Interim Officers of the Applicant in respect of liabilities they may incur in such capacities from and after the commencement of these proceedings (the “**Directors’ Charge**”).
37. The Applicant maintains a Director and Officer Insurance policy (as described in the Hutchens Affidavit) (the “**D&O Policy**”). The D&O Policy contains several exclusions and limitations to the coverage provided by such policies, and there is a potential for there to be insufficient coverage in respect of the potential directors’ liabilities for which the directors and/or officers may be found to be responsible. The proposed Initial Order provides that the Directors, Officers and Interim Officers of the Applicant shall only be entitled to the benefit of the Directors’ Charge to the extent they do not have coverage under any directors’ and officers’ insurance policy or to the extent such coverage is insufficient.
38. The proposed Monitor has reviewed the underlying calculations upon which the Applicant has based the estimate of the potential liability in respect of directors’ and officers’ potential post-filing statutory obligations and is of the view that the Directors’ Charge is reasonable in relation to the quantum of the estimated potential liability.

#### **ADMINISTRATION CHARGE**

39. The proposed Initial Order provides for a charge in the maximum amount of \$500,000 charging the Charged Property in favour of the Monitor, its legal counsel, the Applicant’s legal counsel and Alvarez & Marsal Canada ULC in respect of their fees and

disbursements incurred at their standard rates and charges (the “**Administration Charge**”).

#### **SUMMARY OF THE PROPOSED RANKINGS OF CHARGES**

40. It is contemplated that the priorities of the charges sought by the Applicant (collectively, the “**Charges**”) will be as follows:
- a) First – the Administration Charge to a maximum of \$500,000;
  - b) Second – the Directors’ Charge to a maximum of \$2,880,000; and
  - c) Third – the DIP Lenders’ Charge.
41. The Initial Order sought by the Applicant provides that the Charges will rank in priority to all security interests and encumbrances, statutory or otherwise. The proposed Monitor is advised that the Service List includes all parties with a security interest registered under the *Personal Property Security Act* (Ontario).
42. The proposed Monitor believes that the Charges and rankings are required and reasonable in the circumstances of the CCAA Proceedings in order to preserve going concern operations of the Applicant and maintain its enterprise value and, accordingly, supports the granting and the proposed ranking of the Charges.

#### **FINANCIAL THRESHOLDS**

43. The proposed Initial Order reviewed by the proposed Monitor permits the Applicant, subject to the requirements of the CCAA, to sell or dispose of property not exceeding \$250,000 in any one transaction or \$500,000 in the aggregate. In the proposed Monitor’s view these thresholds are reasonable.

#### **CREDITOR NOTIFICATION**

44. The draft Initial Order requires the Monitor to:

- a) publish a notice containing the information prescribed under the CCAA without delay; and

within five days of the issuance of the Initial Order to:

- b) send notice of the Initial Order to every known creditor having a claim in excess of \$1,000;
- c) make the Order publicly available in the manner prescribed under the CCAA; and
- d) prepare a list showing the names and addresses of those creditors (except those creditors that are individuals) and the estimated amounts of those claims, and make it publicly available in the prescribed manner.

45. If appointed, FTI will also post the Initial Order on its website at <http://cfcanda.fticonsulting.com/ExtremeFitness>.

#### **PROPOSED MONITOR'S CONCLUSIONS**

46. The proposed Monitor is of the view that the relief requested by the Applicant is necessary, reasonable and justified. The proposed Monitor is also of the view that granting the relief requested will provide the Applicant the best opportunity to undertake a going concern sale or other restructuring under the CCAA Proceedings thereby preserving value for the benefit of the Applicant's stakeholders.

All of which is respectfully submitted this 7<sup>th</sup> day of February, 2013.

FTI Consulting Canada Inc.,  
in its capacity as the proposed Monitor of Extreme Fitness, Inc.

Per

A handwritten signature in blue ink, appearing to read "Steven Bissell", with a long horizontal stroke extending to the left.

Steven Bissell  
Managing Director

**IN THE MATTER OF THE COMPANIES' CREDITORS ARRANGEMENT ACT,  
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**COMMERCIAL LIST**

Proceeding commenced at Toronto

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