

EXTREME FITNESS, INC.

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

February 26, 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.

FIRST REPORT OF FTI CONSULTING CANADA INC.,
in its capacity as Monitor of the Applicant

February 26, 2013

INTRODUCTION

1. By Order of this Court dated February 7, 2013 (the "**Initial Order**"), Extreme Fitness, Inc. (the "**Applicant**") obtained protection from its creditors under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended (the "**CCAA**").
2. The Initial Order, among other things, granted a stay of proceedings until March 8, 2013, or such later date as this Honourable Court may order, and appointed FTI Consulting Canada Inc. ("**FTI**") as monitor (the "**Monitor**") of the Applicant in these proceedings (the "**CCAA Proceedings**").
3. The Applicant operates 13 fitness facilities in the GTA and surrounding region with approximately 57,500 members.
4. 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.

5. Further background information regarding the Applicant and the CCAA Proceedings is provided in the affidavit of Alan Hutchens sworn February 7, 2013 (the “**Initial Order Affidavit**”) filed in support of the Applicant’s application for the Initial Order and FTI’s pre-filing report dated February 7, 2013, copies of which have been posted on the Monitor’s website for the CCAA Proceedings at <http://cfcanada.fticonsulting.com/ExtremeFitness> (the “**Monitor’s Website**”).

PURPOSE OF THIS REPORT

6. The purpose of this First Report is to provide this Honourable Court with information and/or the Monitor’s recommendations in respect of the following:
- a) communications by the Applicant and the Monitor with the Applicant’s stakeholders since the commencement of the CCAA Proceedings;
 - b) the Applicant’s debtor-in-possession financing (the “**DIP Financing**”) approved by the Court in the Initial Order;
 - c) the proposed sale transaction contemplated by the letter of intent (the “**LOI**”) between the Applicant and GoodLife Fitness Centres Inc. (“**GoodLife**”);
 - d) the key employee retention plan (the “**KERP**”) offered or to be offered by the Applicant to certain employees determined critical to complete the proposed transaction with GoodLife;
 - e) receipts and disbursements of the Applicant through February 22, 2013; and
 - f) the Applicant’s request for an extension of the Stay Period (as defined in the Initial Order) to and including April 5, 2013.

TERMS OF REFERENCE

7. 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.

8. Capitalized terms not otherwise defined herein have the meaning given to them in the affidavit of Alan Hutchens sworn February 26, 2013 (the “**Hutchens Affidavit**”). 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. A copy of the Hutchens Affidavit is available on the Monitor’s website for the CCAA Proceedings.
9. Unless otherwise stated, all monetary amounts contained in this report are expressed in Canadian dollars.

COMMUNICATIONS WITH STAKEHOLDERS

10. In order to inform the general public and the Applicant’s stakeholders of its restructuring efforts and anticipated sale transaction with GoodLife, the Applicant issued a press release on February 8, 2013 announcing that it had entered into the LOI for the acquisition of all of its facilities by GoodLife and describing the commencement of its CCAA Proceedings.
11. Pursuant to the Initial Order, the Monitor (i) published in the Globe and Mail a notice containing the information prescribed in the CCAA; (ii) made a copy of the Initial Order available on the Monitor’s Website; (iii) sent, in the prescribed manner, a notice to every known creditor who has a claim against the Applicant of more than \$1000; and (iv) prepared a list of those creditors and the estimated amounts of those claims, and made such list publicly available on the Monitor’s Website.
12. In addition, the Monitor has made available on the Monitor’s Website responses to frequently asked questions directed at answering potential questions that the Applicant’s members may have in connection with the CCAA Proceedings.

13. Furthermore, the Monitor has received and responded to sixteen email inquiries via the Monitor's email address and twelve voicemails received via the Monitor's hotline.

FINANCING

14. As part of the Initial Order, the Court approved the DIP Financing in the form of one or more advances to a maximum amount of US\$2 million on the terms set forth in the debtor-in-possession credit agreement (the "**DIP Credit Agreement**") between the Applicant and the lenders party thereto (the "**DIP Lenders**").
15. The conditions for the initial advance under the DIP Credit Agreement were satisfied on February 11, 2013, with \$100,000 made immediately available to cover certain DIP Financing charges, followed by a draw of \$742,500 in the week ending February 15, 2013 for the purpose of funding working capital requirements and on-going operations.

PROPOSED SALE TRANSACTION

16. As discussed in the Initial Order Affidavit, the Applicant has entered into the LOI with GoodLife in connection with a sale of substantially all of the Applicant's assets. The material terms of the LOI are described in the Initial Order 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. As described in the Initial Order Affidavit, the LOI contains an exclusivity provision pursuant to which the Applicant agreed that neither the Applicant, its shareholders nor its lenders would solicit or engage in negotiations with third parties who may be interested in acquiring the assets of the Applicant.
17. Following the commencement of the CCAA Proceedings, the Monitor, National Bank of Canada ("**National Bank**") and Golub Capital Incorporated ("**Golub**"), the Applicant's senior secured creditors, received an unsolicited expression of interest for the purchase of assets of the Applicant from a third party. After review of the expression of interest, and in light of the exclusivity provision in the LOI, it was determined, with the support of

National Bank and Golub, to continue to pursue the transaction contemplated by the LOI with GoodLife at this time.

18. The Applicant and GoodLife have been working towards satisfying the conditions set out in the LOI and negotiating the form of the APA. The Monitor has been advised by the Applicant that once the conditions set out in the LOI are satisfied and the form of the APA is settled, it is the Applicant's intention to return to Court to seek approval of the APA.
19. Under the terms of the LOI, GoodLife's due diligence must be completed by March 4, 2013. The Monitor will provide a status update to the Court at the hearing scheduled in connection with the Applicant's request for the stay extension (currently March 7, 2013).
20. The Monitor is not providing any recommendations with respect to the transaction at this time and will provide same in advance of any motion to approve the transaction.

KERP

21. In order to ensure the continued participation of certain employees who have been identified by management as being key to a successful sale transaction and the CCAA Proceedings, the Applicant has offered or will offer a limited number of employees rights under the KERP, as further described in the Hutchens Affidavit. A copy of the unredacted KERP containing the personal information of each of the individuals offered or to be offered participation in the KERP (collectively, the "**KERP Participants**") is included in the confidential supplement to this First Report (the "**Confidential Supplement**"). The Applicant is requesting a sealing order in respect of the Confidential Supplement in order to protect the KERP Participants and to minimize disruption during these CCAA Proceedings.
22. The list of the KERP Participants was formulated by the Applicant in consultation with its Board of Directors and the Monitor and was approved by the Board of Directors of the Applicant. It is the opinion of the Applicant's Board of Directors that all of the KERP

Participants are critical to the Applicant and to these CCAA Proceedings as they are experienced employees who have played significant roles in the initiatives taken to date, which have provided them with knowledge and information that is critical to the success of the sales process and these CCAA Proceedings.

23. Each of the KERP Participants will receive a single payment as incentive to continue their respective employment with the Applicant for the duration of the CCAA Proceedings. Pursuant to the KERP, the KERP Participants will receive their respective cash payment due under the KERP following the successful closing of the proposed transaction with GoodLife.
24. In order to receive payments under the KERP, the transaction with GoodLife must have successfully closed and each of the KERP Participants cannot have resigned, been terminated with cause or have failed to perform his or her duties and responsibilities diligently, faithfully and honestly.
25. The Monitor has been advised by the Applicant that the DIP Lenders and the Applicant's senior secured creditors, National Bank, Golub and Falconhead Capital, LLC, do not oppose the motion to approve the KERP.
26. The aggregate cash amount payable under the KERP is up to \$230,000. The Monitor is satisfied that the quantum of the proposed payments under the KERP, both to individuals and in the aggregate, may be required to facilitate a successful closing of a transaction with GoodLife and the CCAA Proceedings, is supported by the DIP Lenders and the Applicant's senior secured creditors, and is therefore reasonable in the circumstances. Accordingly, the Monitor supports the Applicant's request that the KERP be approved.

RECEIPTS AND DISBURSEMENTS TO FEBRUARY 22, 2013

27. The Initial Order Affidavit filed as part of the initial application record included a cash flow forecast for the Applicant for the nine week period ending April 5, 2013 (the "**Initial Cash Flow Forecast**"). The table below presents the actual versus forecast

results of the Applicant's Initial Cash Flow Forecast for the period ending February 22, 2013.

	Forecast \$000's	Actual \$000's	Variance \$000's
Cash Flow from Operations			
Receipts	1,793.3	1,634.4	(158.9)
Total Receipts	1,793.3	1,634.4	(158.9)
Payroll and related amounts	1,076.5	1,007.5	(69.0)
Facility costs	875.4	824.9	(50.5)
Operating costs	604.1	405.1	(199.0)
Professional fees	519.8	310.8	(209.0)
Financing charges	100.0	100.0	-
Total Disbursements	3,175.8	2,648.3	(527.5)
Net Operating Cash Flow	(1,382.5)	(1,013.9)	368.6
Beginning Cash Balance	933.8	1,217.1	283.3
Advances Under DIP Facility	741.7	842.5	100.8
Ending Cash Balance	293.0	1,045.7	752.7

28. The actual ending cash balance at February 22, 2013 was \$1.046 million, or \$753,000 better than forecast.
29. The positive variance in cash was primarily the result of:
 - a) a larger beginning cash balance than forecast due to the timing of the filing resulting in a higher level of creditors subject to the Stay of Proceedings than anticipated;
 - b) lower-than-forecast disbursements for facility and operating costs due to the timing of the filing which resulted in lower-than-forecast rent disbursements and lower than forecast utilities-related disbursements; and
 - c) lower-than-forecast professional fees.

30. The positive variances listed above were offset by lower-than-forecast receipts primarily due to a winter storm in the first week of the filing which negatively affected sales at certain facilities.

REQUEST FOR AN EXTENSION OF THE STAY OF PROCEEDINGS

31. Pursuant to the Initial Order, the Stay Period was granted until, and including, March 8, 2013, or such later date as the Court may order.
32. Additional time is required for the Applicant to pursue the implementation of the proposed sale transaction contemplated by the LOI with GoodLife by March 31, 2013, including the execution of a binding asset purchase agreement by March 18, 2013. The continuation of the stay of proceedings to April 5, 2013 is necessary to provide the stability needed during that time.
33. It is the Monitor's view based on the Applicant's cash flow forecast submitted with its application for the Initial Order that the Applicant has sufficient available cash resources during the requested Stay Period.
34. Based on the information presently available, the Monitor believes that creditors will not be materially prejudiced by an extension of the Stay Period to April 5, 2013.
35. The Monitor is not aware of any non-compliance by the Applicant with requirements under the CCAA or pursuant to any Order issued by this Court in the CCAA Proceedings. The Monitor also believes that the Applicant has acted, and is continuing to act, in good faith and with due diligence and that circumstances exist that make an extension of the Stay Period appropriate.
36. The Monitor is advised by the Applicant that the Applicant is unaware of any creditor who opposes the requested extension of the Stay Period.
37. For the reasons outlined above, the Monitor respectfully recommends that the Stay of Proceedings be extended until April 5, 2013.

All of which is respectfully submitted this 26th day of February, 2013.

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

Per

A handwritten signature in blue ink, appearing to read "Steven Bissell". The signature is written in a cursive style with a long, sweeping underline that extends to the left.

Steven Bissell
Managing Director

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Court File No. CV-13-10000-00CL

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Proceeding commenced at Toronto

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CANADA INC., IN ITS CAPACITY AS
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