

EXTREME FITNESS, INC.

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

May 1, 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.

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

May 1, 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**"). The stay of proceedings was subsequently extended by this Honourable Court to April 5, 2013, and further extended to May 10, 2013.
3. At the time the CCAA Proceedings were commenced, the Applicant operated 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 were: (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, filed in support of the Applicant's application for the Initial Order (the "**Initial Affidavit**") 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 Third Report is to provide this Honourable Court with information and/or the Monitor's recommendations in respect of the following:
 - a) the status of the CCAA Proceedings;
 - b) the completion of the sale transaction (the "**Sale Transaction**") between the Applicant and GoodLife Fitness Centres Inc. ("**GoodLife**") pursuant to the asset purchase agreement (the "**APA**") entered into by the Applicant and GoodLife;
 - c) the Applicant's debtor-in-possession financing (the "**DIP Financing**") approved by the Court in the Initial Order;
 - d) the distribution of proceeds from the Sale Transaction;
 - e) the Danforth Lease Motion (as defined below);
 - f) the Notices of Assessment received by the Applicant from Canada Revenue Agency ("**CRA**") dated April 10, 2013 (the "**Notices of Assessment**");
 - g) receipts and disbursements of the Applicant through April 26, 2013; and
 - h) the Applicant's request for an extension of the Stay Period (as defined in the Initial Order) to and including July 12, 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.
8. Capitalized terms not otherwise defined herein have the meaning given to them in the Initial Affidavit and the affidavit of Alan Hutchens sworn May 1, 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.
9. Unless otherwise stated, all monetary amounts contained in this report are expressed in Canadian dollars.

STATUS OF THE CCAA PROCEEDINGS

10. On March 27, 2013, this Honourable Court made an Order (the "**Approval and Vesting Order**"), *inter alia*: (i) approving the Sale Transaction; and (ii) vesting in the Purchaser all of the Applicant's right, title and interest in and to the Purchased Assets (as defined in the APA).
11. On March 27, 2013, this Honourable Court made an Order (the "**Ancillary Order**"), *inter alia*: (i) extending the stay of proceedings to May 10, 2013; (ii) assigning the lease between the Applicant and 1079268 Ontario Inc. (the "**Danforth Landlord**") dated October 30, 2006, as amended by letter agreement dated October 12, 2007 (the "**Danforth Lease**") in respect to the premises known municipally as 635 Danforth Avenue, Toronto, Ontario (the "**Danforth Premises**") to GoodLife pursuant to the APA; and (iii) authorizing the Monitor to make certain distributions from the proceeds of the Sale Transaction (the "**Sale Proceeds**") to Golub Capital Incorporated, as agent (the "**DIP Agent**"), on behalf of the DIP Lenders (as defined below), the Applicant, Golub Capital Incorporated, as agent (the "**Priority Agent**"), on behalf of the lenders under the

Priority Credit Agreement (the “**Priority Lenders**”), and National Bank of Canada (“**National Bank**”), as agent (the “**National Bank Agent**”), on behalf of the lenders under the National Bank Credit Agreement (the “**National Bank Lenders**”).

12. A motion has been scheduled for May 28, 2013, to resolve certain outstanding matters relating to the Danforth Lease (the “**Danforth Lease Motion**”) and \$430,000 is being held from the Sale Proceeds by the Monitor pending the determination thereof, as further discussed below.

COMPLETION OF THE SALE TRANSACTION

13. The Sale Transaction closed at 11:59 p.m. on March 31, 2013 (the “**Closing Date**”) and the Effective Time of the Sale Transaction under the APA was 12:01 a.m. on April 1, 2013. In connection with the closing of the Sale Transaction and pursuant to the Approval and Vesting Order, the Monitor delivered the Monitor’s Certificate effective 11:59 p.m. on March 31, 2013.
14. Pursuant to the APA, the Monitor is holding in escrow the Holdback (as defined in the APA) in respect of the Adjustment Amount (as defined in the APA), if any, under the APA from the cash portion of the purchase price paid by GoodLife under the APA. The Holdback, less any such Adjustment Amount, will be released to the Monitor for the benefit of the Applicant on the date that is the later of 90 days following the Closing Date and the date on which the Adjustment Amount, if any, is settled between the parties (the “**Release Date**”).
15. The Applicant has advised that it is working to finalize its accounting records for the month ending March 31, 2013. Upon completion, the Applicant intends to calculate any Additional Consideration (as defined in the APA) or Adjustment Amount and will provide such calculations to GoodLife for its review.

DIP FINANCING

16. 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**”).
17. As previously reported, the conditions for the initial advance under the DIP Credit Agreement were satisfied on February 11, 2013, with US\$100,000 made immediately available to cover certain DIP Financing charges, followed by a draw of US\$750,000 in the week ending February 15, 2013 for the purpose of funding working capital requirements and on-going operations.
18. Subsequent advances under the DIP Credit Agreement were made on February 27, 2013, and March 26, 2013, in the amounts of US\$150,000 and US\$300,000, respectively, for the purpose of funding working capital requirements and on-going operations.
19. As further discussed below, the amounts outstanding under the DIP Credit Agreement were repaid in full, including all interest and fees, in accordance with the terms of the Ancillary Order and the DIP Credit Agreement.

DISTRIBUTIONS OF SALE PROCEEDS

20. Pursuant to the Ancillary Order, the Monitor made the following distributions from the Sale Proceeds to date:
 - a) US\$1,310,327.78, inclusive of interest and costs, was distributed to the DIP Agent on behalf of the DIP Lenders;
 - b) \$3,500,000 was distributed to the Applicant to satisfy (i) the Applicant's post-filing obligations, including, without limitation, the liabilities intended to be protected by the Administration Charge and the D&O Charge; and (ii) any monetary defaults under applicable leases at the time of their assignment, other

than monetary defaults arising by reason only of the Applicant's insolvency, the commencement of proceedings under the CCAA or the Applicant's failure to perform a non-monetary obligation;

- c) US\$8,027,911.11 to the Priority Agent on behalf of the Priority Lenders in respect of the amounts advanced to the Applicant under the Priority Credit Agreement, inclusive of interest and costs payable in accordance with the Priority Credit Agreement; and
 - d) \$2,320,000 to the National Bank Agent on behalf of the National Bank Lenders on account and in partial satisfaction of the Applicant's outstanding indebtedness to the National Bank Lenders for principal, interest and costs.
21. After completion of the Sale Transaction and with the consent of the Applicant and National Bank, an initial payment of \$360,000 in respect of an advisory fee was paid to Integrity Square LLC (“**Integrity Square**”) pursuant to its engagement agreement with the Applicant in connection with financial advisory services provided to the Applicant relating to the marketing and sale of the Applicant’s assets and business, which culminated in the Sale Transaction. An additional amount may be payable to Integrity Square in respect of its advisory fee based on the amount of the Holdback released to the Monitor for the benefit of the Applicant on the Release Date.

DANFORTH LEASE MOTION

22. At the time of the motion for the Ancillary Order, there remained outstanding matters between the Applicant and the Danforth Landlord relating to the Danforth Premises subject to the Danforth Lease and the monetary defaults claimed by the Danforth Landlord in respect thereof (the “**Danforth Claims**”).
23. As discussed above, the Danforth Lease Motion has been scheduled for May 28, 2013, to resolve the outstanding matters relating to the Danforth Lease and a corresponding schedule for the exchange of motion materials by the parties was also set by the Court.

24. Pursuant to the endorsement of the Honourable Justice Morawetz dated March 27, 2013, with respect to the Ancillary Order, the assignment of the Danforth Lease was without prejudice to: (i) the rights and arguments of the parties regarding whether the basement premises at the Danforth Premises constitute part of the Danforth Lease; and (ii) GoodLife's right to occupy the Danforth Premises in the same manner as the Applicant's occupation of the Danforth Premises as at the Closing Date pending the determination of the Danforth Lease Motion.

25. The parties have begun the exchange of motion materials with respect to the Danforth Lease Motion and the Monitor is holding \$430,000 from the Sale Proceeds pending the determination of the Danforth Claims.

NOTICES OF ASSESSMENT

26. Following its audit of the Applicant, CRA has taken the position that certain group fitness instructors under contract with the Applicant prior to completion of the Sale Transaction were employees of the Applicant and not independent contractors. As such, CRA issued the Notices of Assessment to the Applicant on April 10, 2013 in respect of taxation years 2011, 2012 and 2013 in connection with Canada Pension Plan and Employment Insurance amounts CRA posits should have been deducted in relation to these group fitness instructors. The Applicant, the Monitor and National Bank are reviewing the Notices of Assessment and next steps in this regard.

RECEIPTS AND DISBURSEMENTS TO APRIL 26, 2013

27. The Affidavit of Alan Hutchens sworn March 22, 2013, in support of the Applicant’s motion for the Approval and Vesting Order and the Ancillary Order included a cash flow forecast for the Applicant for the eight-week period ending May 10, 2013 (the “**March Cash Flow Forecast**”). The table below presents the actual versus forecast results of the Applicant’s March Cash Flow Forecast for the six-week period ending April 26, 2013.

For the Period March 18 to April 26, 2013			
	Forecast	Actual	Variance
	\$000's	\$000's	\$000's
Cash Flow from Operations			
Receipts ¹	1,184.3	3,120.4	1,936.1
Total Receipts	1,184.3	3,120.4	1,936.1
Payroll and related amounts	2,895.0	2,742.6	152.4
Facility costs	359.9	250.3	109.6
Operating costs	1,111.5	1,131.0	(19.5)
Professional fees	686.8	679.3	7.5
GoodLife - April 1 Billing ¹	-	1,586.7	(1,586.7)
Financing charges	75.3	54.1	21.2
Total Disbursements	5,128.5	6,444.0	(1,315.4)
Net Operating Cash Flow	(3,944.2)	(3,323.5)	620.7
Beginning Cash Balance	224.5	224.5	-
Advances Under DIP Facility	296.7	299.5	2.8
Funds from Sale Proceeds	4,000.0	3,500.0	(500.0)
Ending Cash Balance	577.0	700.5	123.5

NOTES:

1. The Actual Receipts include collections from the April 1, 2013 billings which were acquired by GoodLife as per the Asset Purchase Agreement.

28. For the six weeks ending April 26, 2013, the Applicant reported net operating cash outflows of approximately \$3.3 million, a positive variance of approximately \$621 thousand compared to the March Cash Flow Forecast.

29. The positive variance in Net Operating Cash Flow was primarily the result of:
- a) lower-than-forecast payroll related disbursements, mostly as a result of lower-than-forecast vacation accrual payouts;
 - b) lower-than-forecast disbursements for facility costs due to timing differences related to cure payments associated with the assignment of certain leases;
 - c) higher-than-forecast operating costs primarily due to the timing of the March HST remittance offset by supplier and utility costs which are expected to partially reverse in future periods due to the lagged receipt of certain invoices;
 - d) a positive variance in professional fees; and
 - e) lower-than-forecast financing charges due to accumulated interest on the DIP financing being paid directly from the sale proceeds held by the Monitor, instead of by the Applicant.

REQUEST FOR AN EXTENSION OF THE STAY OF PROCEEDINGS

30. Pursuant to the Initial Order, the Stay Period was granted until, and including, March 8, 2013. The Stay Period was subsequently extended by this Honourable Court to April 5, 2013, and further extended to May 10, 2013.
31. Additional time is required for the Applicant to resolve the outstanding matters relating to the Danforth Lease and to wind-up the remaining business and affairs of the Applicant. The continuation of the stay of proceedings to July 12, 2013, is necessary to provide the stability needed during that time.
32. It is the Monitor's view based on the Applicant's cash flow forecast submitted with this motion (the "**Current Cash Flow Forecast**") that the Applicant will have sufficient funding during the requested Stay Period.

33. The Monitor understands that National Bank has agreed to the Stay Period, and based on information presently available, including the Current Cash Flow Forecast, the Monitor believes that unsecured creditors will not be materially prejudiced by an extension of the Stay Period to July 12, 2013.
34. 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.
35. The Monitor is advised by the Applicant that the Applicant is unaware of any creditor who opposes the requested extension of the Stay Period.
36. For the reasons outlined above, the Monitor respectfully recommends that the Stay Period be extended until July 12, 2013.

All of which is respectfully submitted this 1st day of May, 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 fluid and cursive, with a long horizontal stroke at the beginning.

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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