

EXTREME FITNESS, INC.

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

March 22, 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.

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

March 22, 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.
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 Second Report is to provide this Honourable Court with information and/or the Monitor’s recommendations in respect of the following:
 - a) the Applicant’s debtor-in-possession financing (the “**DIP Financing**”) approved by the Court in the Initial Order;
 - b) the process leading to the proposed sale transaction (the “**Sale Transaction**”) between the Applicant and GoodLife Fitness Centres Inc. (“**GoodLife**” or the “**Purchaser**”);
 - c) the Sale Transaction contemplated by the asset purchase agreement (the “**APA**”) entered into by the Applicant and GoodLife;
 - d) the assignment of the rights and obligations of the Applicant under certain realty leases to GoodLife pursuant to Section 11.3 of the CCAA;
 - e) receipts and disbursements of the Applicant through March 15, 2013; and
 - f) the Applicant’s request for an extension of the Stay Period (as defined in the Initial Order) to and including May 10, 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 affidavit of Alan Hutchens sworn March 22, 2013 (the “**Hutchens Affidavit**”) and in the APA. 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.

FINANCING

10. 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**”).
11. 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.
12. The conditions precedent for a subsequent advance under the DIP Credit Agreement were satisfied on February 27, 2013 and the Applicant made a draw request of US\$150,000 on February 27, 2013 for the purpose of funding working capital requirements and on-going operations.
13. The Monitor has been advised that the Applicant intends to draw an additional US\$300,000 under the DIP Credit Agreement on March 26, 2013.

PROCESS LEADING TO THE PROPOSED SALE TRANSACTION

14. As discussed in the Initial Order Affidavit, on July 4, 2012, the Applicant engaged Integrity Square LLC (“**Integrity Square**”), a specialty finance advisory firm based in New York that focuses on the fitness and wellness sector, to provide financial advisory services with respect to a sale of the Applicant or all or certain of its 13 fitness facilities.
15. As discussed in the Hutchens Affidavit, commencing in mid-August, 2012, Integrity Square contacted 26 potential purchasers that either already had operations in the fitness facility sector or that Integrity Square believed would have interest in the Applicant’s business. Of these 26 parties, 9 executed non-disclosure agreements and received the confidential information memorandum prepared by Integrity Square providing a description of the Applicant’s business, and several of those parties subsequently accessed the confidential electronic data room established to assist with the due diligence process.
16. Interested parties were required to submit written non-binding indications of interest by October 10, 2012, which indications of interest were to include, among other things, information regarding the proposed purchase price, form of consideration, financing sources and due diligence requirements.
17. As discussed in the Hutchens Affidavit, the solicitation process resulted in:
 - a) two written offers to purchase certain of the Applicant’s fitness facilities;
 - b) one written offer to purchase all but one of the Applicant’s fitness facilities;
 - c) one verbal offer to purchase the Applicant’s suburban fitness facilities, representing 6 of the Applicant’s 13 facilities; and
 - d) a verbal expression of interest with respect to a partnership with the Applicant.
18. As discussed in the Hutchens Affidavit, the offer submitted by GoodLife, which was the only offer that contemplated the purchase of substantially all of the Applicant’s member

and personal training contracts, culminated in the LOI after discussions and negotiations between the Applicant and GoodLife.

19. A detailed summary of the solicitation process conducted by Integrity Square, including the identity of the parties contacted and descriptions of offers and indications of interests submitted, is provided in a confidential exhibit to the Hutchens Affidavit. A financial summary of the offers submitted through the solicitation process was also filed with the Court in a confidential supplement in connection with the hearing for the Initial Order.

PROPOSED SALE TRANSACTION

20. As previously reported, on January 18, 2013, the Applicant entered into a letter of intent with GoodLife (as amended, the “**LOI**”). The LOI contemplated the sale of substantially all of the Applicant’s assets to be completed on or prior to March 31, 2013, and precluded the Applicant, the Applicant’s shareholders, National Bank of Canada (“**National Bank**”) and Golub Capital Incorporated (“**Golub**”) from directly or indirectly soliciting or engaging in discussions or negotiations with any third party seeking to purchase the Applicant’s assets.
21. As previously reported, following the commencement of the CCAA Proceedings, the Monitor, National Bank and 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.
22. As discussed in the Hutchens Affidavit, the conditions set out in the LOI were satisfied or waived by the Applicant and Goodlife, and the APA was executed on March 19, 2013. The LOI and the APA contemplate a closing of the Sale Transaction on or before March 31, 2013, or such other date as the parties thereto agree. An unredacted version of the APA is included in the Confidential Supplement to this Second Report.

23. Following the execution of the APA, the Monitor received a second unsolicited written expression of interest for the purchase of assets of the Applicant from another third party, who was advised of the execution of the APA upon receipt by the Monitor of the expression of interest.

ASSET PURCHASE AGREEMENT

24. Key elements of the APA include the following:
- a) the satisfaction of the Purchase Price as follows:
 - i. a cash portion to be paid to the Monitor on Closing, which amount will be partially paid and satisfied by the application of the Deposit (as defined below);
 - ii. the assumption of the Assumed Capital Leases; and
 - iii. the Additional Consideration, if any, on the Release Date;
 - b) a Holdback from the cash portion of the Purchase Price referred to in 24(a)(i) above to be retained by the Monitor in respect of the Adjustment Amount, if any, under the APA, which 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**”);
 - c) the purchase from the Applicant of substantially all of the property and assets used in connection with the business carried on by the Applicant (other than certain excluded assets described below), including, without limitation, the assumption of the contracts, capital leases, real property leases, subleases and

third party licenses and permits as set out in the APA, pursuant to the terms and conditions of the APA;

- d) the exclusion of certain assets (as more particularly described in the APA) including, among other things, without limitation, third party claims of the Applicant and the proceeds thereof, cash on hand, bank balances, holdbacks and deposits as at the Closing Date, certain non-assumed contracts and excluded leases, tax refunds or reassessments of the Applicant, and the Applicant's insurance policies; and
- e) the assumption by the Purchaser of all security interests and other interests arising exclusively from the Assumed Capital Leases, the Assumed Subleases, Assumed Contracts and the Assumed Realty Leases.

25. The completion of the Sale Transaction is conditional on, among other things:

- a) the granting of the Approval and Vesting Order, which shall not be stayed, varied or vacated and no order shall have been issued and no action or proceeding pending to restrain or prohibit the completion of the transaction contemplated by the APA;
- b) receipt of landlord consents in respect of the assignment of the Assumed Realty Leases, if required, or the granting of a Court order compelling such assignment; and
- c) receipt of lessor consents in respect of the assignment of Assumed Capital Leases, if required, or the granting of a Court order compelling such assignment.

26. The Applicant and its counsel are working with the Purchaser to satisfy these conditions.
27. If any condition precedent set out in Article IV of the APA is not satisfied or waived at or before the Closing Time, the APA may be terminated by the Purchaser or the Applicant by written notice to the other party.
28. The Purchaser has paid a deposit of \$1,500,000 (the “**Deposit**”) to the Monitor to be held in escrow in accordance with the APA.
29. As at the date of this report, no stakeholder has advised the Monitor that it opposes or intends to oppose the Sale Transaction.

ASSIGNMENT OF LEASES

30. In connection with the Sale Transaction and pursuant to the terms of the APA, the Purchaser will be acquiring substantially all of the contracts, leases and subleases of the Applicant, including the Assumed Capital Leases and the Assumed Realty Leases.
31. The Assumed Capital Leases and the Assumed Realty Leases relate to the business operations being acquired by the Purchaser under the APA and the APA requires the assignment of the Assumed Capital Leases and the Assumed Realty Leases to the Purchaser.
32. The Monitor is advised that the Applicant has made commercially reasonable efforts to obtain the consents of the counterparties to the Assumed Capital Leases and the Assumed Realty Leases and that, to date, the Applicant has obtained consents, where required, from all of the counterparties to the Assumed Capital Leases and has reached consensual assignment arrangements with the eight of the counterparties to the Assumed Realty Leases, but has been unable to obtain consensual assignment agreements relating to the remaining Assumed Realty Leases.
33. Only such Assumed Realty Leases in respect of which consent for assignment is required from the counterparty but not obtained, as listed on Schedule A to the Ancillary Order

(collectively, the “**Assigned Leases**”) are sought to be assigned by the Applicant pursuant to the Ancillary Order.

34. The Monitor is advised that the Purchaser is continuing to negotiate with two counterparties to realty leases with the Applicant with respect to the assignment of such leases to the Purchaser. The Monitor understands that such negotiations are expected to be concluded, and the results are to be communicated to the Applicant, by March 25, 2013 at which time such realty leases will either form part of the Assumed Realty Leases under the APA or will be repudiated by the Applicant.
35. The Monitor has reviewed with the Applicant the Assigned Leases and the reasons and purposes of the proposed assignments, the benefits and costs to the Applicant resulting from such assignments, and the impact of the assignments, or the absence of such assignments, on the Applicant and agrees that the assignment of the Assigned Leases is required under the APA and is therefore required to allow the Applicant to complete the Sale Transaction for the benefit of its stakeholders.
36. The CCAA requires that all monetary defaults in relation to any agreement proposed to be assigned under Section 11.3 of the CCAA (other than those arising by reason only of the company’s insolvency, the commencement of proceedings under the CCAA or the company’s failure to perform a non-monetary obligation) be remedied on or before the day fixed by the Court. The Ancillary Order sought by the Applicant provides for, among other things, the distribution of a portion of the proceeds from the Sale Transaction to the Applicant in an amount agreed to by the Monitor as is required to satisfy the Applicant’s post-filing obligations, including, among other things, any monetary defaults under the Assigned Leases at the time of their assignment, other than monetary defaults arising by reason only of the company’s insolvency, the commencement of proceedings under the CCAA or the company’s failure to perform a non-monetary obligation.
37. The Monitor has worked with the Applicant to estimate the monetary defaults in existence as at the commencement of the CCAA Proceedings in relation to the Assigned

Leases and estimates the aggregate of such monetary defaults to be approximately \$60,000.

38. As discussed in the Hutchens Affidavit, GoodLife was founded in 1979 and is the largest fitness company in Canada with approximately 300 clubs and 750,000 members across Canada. GoodLife has already satisfied the financing conditions set forth in the APA, including providing the Deposit, which the Applicant believes is indicative of GoodLife's financial wherewithal to consummate the Sale Transaction and its ability to perform the obligations under the Assigned Leases. The Applicant does not anticipate that any material prejudice will be caused to the counterparties as a result of the assignment of the Assigned Leases to the Purchaser.

39. For the reasons outlined in the Hutchens Affidavit, and after discussions with the Purchaser and a review of certain financial statements provided by the Purchaser, the Monitor concurs with the Applicant that the Purchaser is an appropriate counterparty to Assigned Leases.

RECEIPTS AND DISBURSEMENTS TO MARCH 15, 2013

40. 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 six-week period ending March 15, 2013.

	Forecast \$000's	Actual \$000's	Variance \$000's
Cash Flow from Operations			
Receipts	5,441.9	4,999.2	(442.7)
Total Receipts	5,441.9	4,999.2	(442.7)
Payroll and related amounts	2,501.5	2,236.5	(265.0)
Facility costs	2,138.4	2,090.6	(47.8)
Operating costs	2,063.4	1,699.1	(364.3)
Professional fees	1,001.3	812.0	(189.3)
Financing charges	154.8	152.8	(2.0)
Total Disbursements	7,859.4	6,991.0	(868.4)
Net Operating Cash Flow	(2,417.5)	(1,991.8)	425.7
Beginning Cash Balance	933.8	1,217.1	283.3
Advances Under DIP Facility	1,730.6	999.3	(731.3)
Ending Cash Balance	246.9	224.5	(22.4)

41. The actual Ending Cash Balance at March 15, 2013 was \$224.5 thousand, or \$22.4 thousand less than forecast. The variance in the Ending Cash Balance includes the impact from lower-than-forecast draws under the DIP Credit Agreement of \$731.3 thousand. For the six weeks ending March 15, 2013, the Applicant reported net operating cash outflows of \$1,991.8 thousand, a positive variance of \$425.7 thousand compared to the Initial Cash Flow Forecast.
42. The positive variance in Net Operating Cash Flow was primarily the result of:
- a) lower-than-forecast disbursements for operating costs primarily due to lower utility costs as well as temporary timing differences due to the lagged receipt of certain utilities-related invoices which are expected to reverse in future periods;

- b) a positive variance in professional fees; and
- c) lower-than-forecast commissions and other payroll related amounts as a result of lower-than-forecast receipts from personal training and paid-in-full sales.

REQUEST FOR AN EXTENSION OF THE STAY OF PROCEEDINGS

- 43. Pursuant to the Initial Order, the Stay Period was granted until, and including, March 8, 2013, and was subsequently extended by this Honourable Court to April 5, 2013.
- 44. Additional time is required for the Applicant to pursue its restructuring efforts, including implementation of the Sale Transaction and the wind-up of the remaining business affairs of the Applicant. The continuation of the stay of proceedings to May 10, 2013 is necessary to provide the stability needed during that time.
- 45. It is the Monitor's view based on the Applicant's revised cash flow forecast (the "**Revised Cash Flow Forecast**") submitted with this motion that existing cash on hand combined with proceeds from the Sale Transaction will provide the Applicant with sufficient funding during the requested Stay Period.
- 46. The Monitor understands that National Bank has agreed to the Stay Period, and based on information presently available, including the Revised Cash Flow Forecast, the Monitor believes that unsecured creditors will not be materially prejudiced by an extension of the Stay Period to May 10, 2013.
- 47. 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.
- 48. The Monitor is advised by the Applicant that the Applicant is unaware of any creditor who opposes the requested extension of the Stay Period.

RECOMMENDATION AND CONCLUSIONS

49. The proposed Sale Transaction, if completed, will result in a going concern sale of the Applicant's fitness facilities to GoodLife.
50. The Applicant believes that the purchase price payable under the APA is fair and reasonable in the circumstances, that completion of the Sale Transaction is expected to result in the preservation of approximately 70% of the jobs of the Applicant's employees and will provide for continued supplier relationships and continued operations of the business acquired by the Purchaser, and that the Sale Transaction is in the best interests of its stakeholders.
51. The Monitor considered the process leading to the proposed sale of, and the consideration to be received for, the Purchased Assets in light of the requirements of, *inter alia*, Section 36 of the CCAA. The Monitor is satisfied that the sale process and the consideration to be received for the Purchased Assets are fair and reasonable in the circumstances and that the consideration to be received for the Purchased Assets represents the results of an adequate canvassing of the market.
52. The Monitor is of the view that the Applicant has acted in good faith to maximize value for its stakeholders, has made satisfactory efforts to obtain the best alternative available in the circumstances taking to account such factors as the aggregate value to stakeholders, the timeframe within which the transaction could close, and the probability of closing, and has not acted improvidently.
53. Although the purchase price to be paid under the Sale Transaction is insufficient to repay the Applicant's obligations under its credit facilities with National Bank and with Golub, both National Bank and Golub supported the Applicant's entering into the APA and the Sale Transaction contemplated thereby.
54. The Monitor's counsel is completing its security review of the security held by each of National Bank and Golub in respect of the Applicant's assets and will advise the Court of

the results prior to the Applicant's motion in respect of the distribution of proceeds from the Sale Transaction.

55. The Monitor is advised that all creditors with registered personal property security interests against the Applicant have been served with notice of this motion.
56. The Monitor is advised that the Applicant and the Purchaser are not related persons within the meaning of the CCAA.
57. The Monitor is also advised by the Applicant that it can and will make the payments that would have been required under sections 6(5)(a) or 6(6)(a) of the CCAA¹. Therefore, the proposed sale is in compliance with section 36(7) of the CCAA.
58. Accordingly, the Monitor recommends approval of the Sale Transaction by this Honourable Court.
59. For the reasons outlined above, the Monitor supports the assignment of the Assigned Leases.
60. For the reasons outlined above, the Monitor respectfully recommends that the Stay Period be extended until May 10, 2013.

¹ Section 36(7) of the CCAA states that, "The court may grant the authorization only if the court is satisfied that the company can and will make the payments that would have been required under paragraphs 6(4)(a) and (5)(a) if the court had sanctioned the compromise or arrangement." As there is no section 6(4)(a) in the CCAA, it is the respectful submission of the Monitor that the current s. 36(7) of the CCAA contains a typographical error and the intended reference is to sections 6(5)(a) and 6(6)(a) of the CCAA.

All of which is respectfully submitted this 22nd day of March, 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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GOODMANS LLP
Barristers & Solicitors
333 Bay Street, Suite 3400
Toronto, Canada M5H 2S7

Melaney J. Wagner LSUC#: 44063B
Caroline Descours LSUC#: 58251A

Tel: (416) 979-4258
Fax: (416) 979-1234

Lawyers for the Monitor