CASE STUDY: "ANATOMY OF THE ACQUISITION OF A DISTRESSED COMPANY"

Created for FEI Canada seminar series

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*The facts and analysis presented within this case study have been strictly based on the creative designs and writing of its authors and are not based on any actual events or occurrences. Any similarities between such facts and analysis, on the one hand, and actual events or occurrences, on the other hand, are coincidental and unintended.

GOWLINGS

EXECUTIVE SUMMARY – Case Study: Anatomy of the Acquisition of a Distressed Company

Target: ***Mediena Garden Industries Incorporated ("MGII") and Glass House Growth, Inc. ("Glass House")***

MGII manufactures garden and outdoor living products. MGII is owned 51% by Band Saw, a Lithuanian immigrant who built the business, and 49% by RIP LP, who acquired its interest in 2005 by investing $20MM in MGII. Band Saw set out on an aggressive path to grow gross sales and EBITDA of MGII through the introduction of market leading and innovative garden products. Since peaking at $85MM in 2007, overall corporate sales have dropped 30% to $59.5MM in 2009 with EBITDA going from $8.6MM to $6.0MM in the same period. Projections for 2010 are that sales will increase to $74.1MM and EBITDA will slightly rebound to $7.5MM – MGII's capital and cost structure are misaligned with its revenue.

MGII is a market leader in manufacturing products for the home building/renovation business including:

A. Fence Product - a line of fence products which consists of decorative pre-fabricated panel fence products made from aggregated wood by-products and pre-coated with hardened colours or natural stains. This product line only amounted to between 11 and 14% of total sales but it is a high margin, low volume custom ordered product. Expansion of production requires significant cap-ex as demand is increased. Supply of wood by-products comes from limited sources at this point. The "binding agents" used to hold the wood together are petrochemical based and subject to oil price volatility.

B. Outdoor Lighting – high quality, outdoor lights and landscape fixtures. The product mix include both high-end specialty and low-end lighting products, both of which are generally low to medium margin products, being basically non-customized. Pricing of metallic inputs is experiencing volatility.

C. Wooden Playground Sets - wooden playground structures combined with some plastic components and accessories. They are medium volume, medium price/margin products. A large product liability issue stems from a number of injuries and one death sustained from use of a particular component.

D. Greenhouse Kits - In 2005 MGII acquired Glass House, an Arkansas company. Glass House manufactures pre-fabricated glass/metal greenhouse kits in its Arkansas factory, and distributes these kits predominantly through mail order and internet based sales. These are low-volume, high margin products. Glass House is faced with crowded market for greenhouse "do-it-yourself" kit manufacturers. Sales have seriously declined and no economies have been realized to date as a result of the adoption of the line.

Bank: ***The Canadian Royal Urban Development Bank ("CRUD")***

The primary lender is CRUD Bank and has extended a total of CDN. $26MM in fully secured, guaranteed (by Glass House) credit facilities, which include the following terms:

- **Term Facility** – 5 year term with 1 year remaining; $4.275MM is outstanding plus accrued and unpaid interest; principal repayments of $1,575,000 plus interest is projected to be payable over the 2010 fiscal year by MGII with a bullet payment of $2.7MM being due on December 31.

- **Operating Facility** - Outstanding balance is $10,000,000.

Interest on both facilities accrues at prime plus 1.75%. CRUD Bank is not happy about this rate given its "risk-reward" modeling. CRUD is also concerned about the following: (a) default in the senior debt service ratio; (b) liquidity continues to be an ongoing concern with deep concerns over impending cash flow short falls; (c) access to capital is limited on account of borrowing base issues; and (d) over-limit on borrowing base as a consequence of decline is $360,000. MGII is barely able to service its senior debt and meet daily cash requirements.

CRUD Bank and MGII entered into a forbearance agreement 8 weeks ago which introduced various sales milestones, a tight cash flow budget, the imposition of a “soft monitor”, a higher interest rate of prime plus 4.0% and a strict requirement that $5MM must be infused into MGII by no later than May 1, 2010. No progress has been made in finding a source for this cash infusion. A private sales process has been started - CRUD Bank views such sales process as the only means by which to avoid enforcement and forced liquidation.

Purchaser: ***Home Outdoor Solutions Integrated Corporation (“Home Solutions”)***

The sales process has led to the procurement of only 1 interested buyer – Home Solutions, a strategic buyer and, in addition, a competitor of MGII. Home Solutions and MGII have closely competing fence product lines, but Home Solutions is interested in the growth potential of MGII’s standardized lower end fence product. Home Solution’s concerns over product liability and insurance issues in respect of the wooden playground sets have led Home Solutions to favour an asset purchase transaction in order to exclude such product line from an acquisition. It favours a court filing to support an expedited sales process: (a) so that the exclusive contract with Glue Wood (see below under “Glue Wood”) can be acquired intact from MGII; and (b) to minimize any adverse impact on MGII’s customers.

Owner/Manager: ***Bandislaw Saw (“Band Saw”)***

Band Saw prefers to maintain MGII as an ongoing business by providing for the $5MM working capital injection required by CRUD Bank. However, Band Saw does not have sufficient cash to do so and has found no “white knight”. Band Saw is gravely concerned about Home Solutions, given the inevitable tension and concerns that will arise surrounding the sharing with Home Solutions of market and proprietary information concerning MGII’s business. As a result of MGII’s decrease in EBITDA, Band Saw has lost his veto right which was put in place when RIP LP invested in MGII.

Private Equity Shareholder: ***Ryklys Investments Pangaea LP (“RIP LP”)***

RIP is a close-ended fund and has expressed its preference to exit the business of MGII. As a consequence, it is refusing to advance its share of the $5MM injection required by CRUD Bank. It supports the sales process even if sales proceeds are not sufficient for RIP LP to fully recover its investment in MGII. RIP LP would prefer to cash-out and deploy such proceeds elsewhere if a reasonable deal can be structured.

Supplier: ***Glue Wood Corp. (“Glue Wood”)***

Glue Wood is MGII’s exclusive supplier of lumber. It manufactures MGII’s lumber inputs through the utilization/licensing of/from MGII of certain proprietary technology relating to the binding agent for the lumber, and through specialized and costly equipment designed by Glue Wood (at a material cost) for this product line. Exclusivity would be lost upon enforcement by CRUD Bank, in which case Glue Wood could then market and sell to others, including directly to Home Solutions.

Glue Wood may be a “bottom feeder” for the “innovative” garden products if things falls apart. Home Solutions is also a customer of Glue Wood. That being said, Glue Wood might be prepared to compete with Home Solutions “if the price is right.

A. Stakeholders

STAKEHOLDER	REPRESENTED BY
Company/Target: Mediena Garden Industries Incorporated ("**MGII**") Glass House Growth, Inc. ("**Glass House**")	Bandislaw Saw (Nickname is "**Band Saw**")
Bank: The Canadian Royal Urban Development Bank ("**CRUD Bank**")	Reg Volver (Nickname is "**Revolver**")
Shareholders: Band Saw Ryklys Investments Pangaea LP ("**RIP LP**")	Edward N. Force (Nickname is "**N'Force**")
Supplier: Glue Wood Corp. ("**Glue Wood**")	Dave Reamer (Nickname is "**Dreamer**")
Strategic Offeror and Competitor: Home Outdoor Solutions Integrated Corporation ("**Home Solutions**")	Mac "Knife" Patonhead (Nickname is "**Mac Knife**")

B. The MGII Group

MGII is a manufacturer of garden and outdoor living products. MGII's head office is located in Barrie, Ontario. A current organizational chart is attached as Schedule "A".

MGII is owned 51% by Band Saw, a Lithuanian immigrant who built the business after acquiring it as a small company, and 49% by RIP LP. MGII's board of directors has 3 members: Band Saw, N'Force and John Deer, an "independent" board member with industry experience.

Band Saw originally started working in 1977 as a line worker in the production line of GLOW Garden Light Industries Ltd. when he first immigrated to Canada. He worked his way up to general manager of that business in 1989 through hard work and an adept ability to foresee what the consumer will want in garden lighting. With a financial partner, he acquired MGII in 1993 from its aging, heirless owner. Sales were $11MM per year in 1993 with EBITDA of $550k. Sales had grown to $35MM in 2003 with EBITDA of $3.2MM.

Band Saw's partner Bill Ledger, an accountant by training, who had adhered to a conservative "grow organically" strategy, died suddenly in 2004. MGII and Band Saw were beneficiaries under a $6MM corporately funded life insurance policy for his partner, the proceeds of which were designated to be used to acquire Ledger's 50% interest in MGII from Ledger's widow at a formula derived price of $3.2MM. With his more conservative partner no longer influencing decisions and strategic direction, and with an additional net $2.8MM in insurance proceeds, Band Saw set out on an aggressive path to grow gross sales and EBITDA of MGII through the introduction of market leading and innovative garden products.

In 2005 MGII acquired Glass House Growth, Inc. ("**Glass House**"), an Arkansas company based in Little Rock. As is often the case, it seemed like a good idea at the time. This acquisition was made based largely on advice and pressure received from investment bankers retained by MGII to structure a growth strategy. The investment banking arm of CRUD Bank was the advisor of the Glass House acquisition. Glass House engages in the business of manufacturing pre-fabricated greenhouse kits made of glass and metal. This business has performed poorly since acquisition and is a net cash drain.

Since peaking at $85MM in 2007, overall corporate sales have dropped 30% to $59.5MM in 2009 with EBITDA going from $8.6MM to $6.0MM in the same period.

Sales and EBITDA for MGII on a consolidated basis are set out below:

	2005 (000,000)	**2006 (000,000)**	**2007 (000,000)**	**2008 (000,000)**	**2009 (000,000)**	**2010 (Projected) (000,000)**
Gross Sales:						
-Fence Products	nil	$6.0	$10.0	$9.0	**$8.5**	$12.0
- Outdoor Lighting	$39.0	$46.0	$49.5	$42.0	**$38.9**	$46.0
- Playground Sets	$12.0	$14.0	$16.0	$12.0	**$9.0**	$11.6
- Greenhouse Kits (Glass House)	$9.0	$9.0	$9.5	$6.7	**$3.1**	$4.5
Total Gross Revenue	$60.0	$75.0	$85.0	$69.7	**$59.5**	$74.1

EBITDA	$6.2	$7.2	$8.6	$7.0	**$6.0**	$7.5

In 2005, in order to fund the capital expenditures and expected growth in the business Band Saw sold 49% of MGII to RIP LP for $20MM. The essential terms of the deal were:

- Band Saw was appointed as the Chief Executive Officer, was given 1 board seat and was granted a veto so long as EBITDA was at all times maintained in excess of $6.2MM.

- RIP LP was granted one board seat. An independent director was jointly agreed upon.

- Any spending over $500k per investment or $2MM in the aggregate in any fiscal year for cap-ex of any nature requires unanimous approval by the board of directors.

- Neither owner was granted any drag-along rights in respect of the other owner.

MGII holds Glass House through a Delaware company, US Holdco Inc. It recently incorporated GH Sales Co. with plans to run manufacturing in Glass House and sales in GH Sales Co. for Glass House and MGII in the U.S. Band Saw has MGII hold real estate property in Lithuania through Lithuanian Tax Co. for personal and corporate use. Details of the value of this property are sketchy.

MGII is a market leader in manufacturing products for the home building/renovation business including:

<u>Fence Products</u>

The development of a new technology led to the introduction of a line of fence products at end of 2005. The product consists of decorative pre-fabricated panel fence products made from aggregated wood by-products and pre-coated with hardened colours or natural stains. It is considered a “green” product because it is made from both recycled wood product and waste wood by-products from forest product industries.

Since introduction, at its best sales and performance production this product line only amounted to between 11 and 14% of total sales but it is a high margin (if you exclude attribution of 100% of the cap-ex to it) low volume custom ordered product. There is some consideration being given to introducing a standardized lower end product which would be non-customizable, reducing the production costs, increasing sales volume distributed through “Big Box” retailers to expand brand awareness. Market testing suggests this has significant upside potential.

Glue Wood is MGII’s exclusive supplier of lumber. It manufactures MGII’s lumber inputs through the utilization/licensing of/from MGII of certain proprietary technology relating to the formula/compound which comprises the binding agent for the lumber, and through specialized and costly equipment designed by Glue Wood specifically for this product line.

These products are sold in the US, as to 90%, and Canada, as to 10%. They are picked up in limited quantities by major home improvement retailers including Big Lumber Stores and House Source Incorporated.

MGII's fence products are manufactured at a new plant located in Mackenzie, and currently has 63 non-management employees and 7 executives including a key product development engineer managing the production roll-out. Production requires significant cap-ex to expand production as demand is increased. Supply of wood by-products comes from limited sources at this point. The "binding agents" used to hold the wood together are petrochemical based and subject to oil price volatility.

Outdoor Lighting

MGII produces high quality, durable, outdoor lights and landscape fixtures. In this regard, MGII has diversified into 2 distinct product lines, being:

- high-end specialty lighting: sold to regional and local distributors in Canada and the US. (both "mom and pop" and "big box" sales)
- low-end lighting: sold in both Canada and the US to big box stores such as The Builder's Depot and House Source Incorporated.

These items are, however, generally a low to medium margin product, being basically non-customized.

MGII's outdoor lighting products are manufactured at a 20 year-old plant in Perth, Ontario, and currently employs 84 non-management employees and 5 executives. A sales force of 6 persons facilitates the distribution of these products.

Pricing of metallic inputs is experiencing volatility since domestic aluminum producers are restricting supply and scrap sources are down as vehicle production remains at historically low levels.

Wooden Playground Sets

MGII produces wooden playground structures combined with some plastic components and accessories. They are medium volume, medium price/margin products.

These products are distributed in both Canada and the U.S. through PriceCo, The James Bay Company and House Source Incorporated.

The components for these structures are manufactured on a separate line at the Mackenzie plant.

A large product liability issue surrounds these products. Litigation exists which stems from a number of injuries and one death sustained from use by children of the "Green Vortex" – one of the plastic slide options that can be annexed to these playground sets. As a consequence, this segment of the business has become very difficult to insure and at this time MGII is "self-insured" for the Wooden Playground product line.

Greenhouse Kits

Glass House manufactures pre-fabricated greenhouse kits made of glass and metal in its Little Rock, Arkansas factory, and distributes these kits predominantly for direct sale through mail order and internet based sales. These are low-volume, high margin products.

Glass House is faced with a crowded market for greenhouse "do-it-yourself" kit manufacturers.

Management has failed to grow the business geographically and, as a result, sales are mostly confined on a regional basis to Glass House's location. Furthermore, sales have seriously declined in the wake of the economic crisis in the US; particularly in respect of the housing market.

MGII has struggled to integrate the Glass House business into the MGII family. No economies have been realized to date and it is considered a "stand alone" business.

C. The Debt Financing of the MGII Group

The primary lender is CRUD Bank and has extended a total of CDN. $26MM in credit facilities, subject to some availability criteria. The following terms attach to the credit facilities currently in place for the MGII Group.

- **Term Facility** – 5 year term with 1 year remaining (i.e., maturity occurs on December 31, 2010). The indebtedness is amortized over such 5 year term.
  - Amount: Limit $9,000,000
  - Amount Outstanding: $4.275MM plus accrued and unpaid interest.
  - Equal quarterly principal payments of $393,750 plus accrued interest are payable in the last day of each fiscal quarter in respect of that quarter.
  - 30% of the principal amount together with accrued and unpaid interest is payable at maturity being a "bullet payment" of $2.7MM.
  - Principal repayments under the Term Loan of $1,575,000 plus interest is projected to be payable over the 2010 fiscal year by MGII with the bullet payment of $2.7MM being due on December 31.
- **Operating Facility** (which includes a letter of credit facility and foreign exchange hedging arrangements).
  - Amount: Limit $17,000,000
  - Outstanding Balance: $10,000,000

- The operating and term loans are fully secured, including a guarantee and collateral security granted by Glass House.
- Interest on operating and term debt accrues at prime plus 1.75%. CRUD Bank is not happy about this rate given its "risk-reward" modeling.

The various defaults/concerns/work-arounds regarding these debt facilities are as follows:

1. default in the senior debt service ratio;
2. a few months ago, MGII needed $800,000 to meet payroll obligations; $400,000 was loaned from RIP LP, while $400,000 was loaned by Band Saw. These loans were made on a fully subordinated and unsecured basis. Liquidity continues to be an ongoing concern with deep concerns over impending cash flow short falls.
3. Access to capital is limited on account of borrowing base issues, namely:
   - Increase in aged A/R (i.e., over 110 days) has reduced the A/R component of the operating loan borrowing base. A/R is margined at 75% of eligible receivables.
   - Increases in inventory aging (i.e., greater than 12 months) has caused the inventory component of the Borrowing Base to decline as well. The advance rate is 50% of "eligible inventory".
4. **Over-limit on the borrowing base as a consequence of this decline is $360,000.**

D. <u>Forbearance and Sales Process</u>

CRUD Bank and MGII entered into a forbearance agreement approximately 8 weeks ago. These arrangements contain various sales milestones that must be met by MGII. The forbearance agreement also includes a tight cash flow budget. Specifically, capital expenditure is restricted, except in respect of expenditures for the repair and replacement of old equipment that forms part of any core product-line. A "soft monitor" has been appointed as financial advisor to MGII at the request of CRUD Bank.

The forbearance agreement served to increase the interest rate on the operating and term debt from prime plus 1.75% to prime plus 4.0%. The forbearance agreement also set out a strict requirement that $5MM must be infused into MGII by no later than May 1, 2010. No progress has been made in finding a source for this cash infusion.

A private sales process has been conducted over the course of the past 8 weeks by iSell Group Ltd., a mid-market investment bank focused in the home products manufacturing sector. The marketing process involved led to the procurement of only 1 interested buyer – Home Solutions. Home Solutions is a strategic buyer and, in addition, a competitor of MGII. The closest nature of competition between Home Solutions and MGII exists within their competing fence product lines.

E. Economic Background

The following macro-economic factors have had material impacts on MGII's business and strategic considerations by its various stakeholders: (1) the US housing crisis, (2) the US mortgage crisis, (3) the US consumer crisis, (4) the liquidity crisis, (5) a strong Canadian dollar, and (6) higher input prices for certain commodities such as glue (petro-chemicals/resins) and metals.

MGII is a market leader in niche areas; in particular with respect to fence products and wooden playground sets.

Band Saw has expanded the costs/operating structure of MGII over the past few years so that it is now scaled to generate $90MM per annum of revenue. However, actual revenue was $59.5 MM for the year-ended 2009, leaving the capital and cost structure misaligned with MGII's revenue.

These downward trends have resulted in a liquidity crisis for the business. Further, the business is barely able to service its senior debt and meet daily cash requirements. The only saving grace is low interest rates!

Projections for 2010 show EBITDA slightly rebounding to $7.5MM.

For these reasons, stakeholders have to various degrees considered the merits of a sales process.

F. Stakeholder Positions

Band Saw:

Band Saw prefers to maintain MGII as an ongoing business by providing for the $5MM working capital injection required by CRUD Bank. However, Band Saw does not have sufficient cash to do so and has found no "white knight".

He would have preferred a more robust sales process that, in Band Saw's view, may have generated more bidding interest and, by consequence, a greater potential sales recovery. iSell believes it is a full process and is supported by RIP LLP and CRUD Bank in this view.

Band Saw is gravely concerned about going further down the sales process with Home Solutions, given the inevitable tension and concerns that will arise surrounding the sharing with Home Solutions of market and proprietary information concerning MGII's business. A form of non-disclosure agreement is currently proving to be a very contentious stage in preliminary discussions/negotiations with Home Solutions.

RIP LP:

RIP LP has expressed its preference to exit the business of MGII. As a consequence, it is refusing to advance its share of the $5MM required by CRUD Bank to be invested in MGII.

It supports the sales process even if sales proceeds are not sufficient for RIP LP to fully recover its investment in MGII. RIP LP would prefer to cash-out and deploy such proceeds elsewhere if a reasonable deal can be structured.

CRUD Bank:

Since CRUD Bank has serious concerns about the ability of MGII to meet its working capital obligations, and is well aware of the tensions between the two ownership factions regarding a strategic direction, CRUD Bank views a sales process as the only means by which to avoid enforcement and forced liquidation. It supports the existing sales process.

Home Solutions:

Home Solutions originally expressed a preference to engage in a share purchase transaction with Band Saw and RIP LP regarding the shares of MGII because of favourable "tax losses" and the stigma of an insolvency sale process. However, concerns over product liability and insurance issues in respect of the wooden playground sets manufactured by MGII have led Home Solutions to require an asset purchase transaction (i.e., Home Solutions is strongly considering excluding the wooden playground set business from an acquisition of assets from MGII) with the sale structuring issues that brings.

It is a strong advocate of a court filing to support any sales process so that the exclusive contract with Glue Wood can be acquired intact from MGII.

Home Solutions also supports a pre-packaged and expedited sales process in order to minimize any adverse impact on MGII's customers.

It is attracted to the growth potential in introducing a standardized lower end fence product which would be non-customizable, reducing production costs, increasing sales volume and expanding brand awareness. Home Solutions has sufficient cash to fund the capital expenditures required to do so.

Glue Wood:

As MGII's sole supplier of glue-wood materials it has a significant investment in MGII's product, having invested a large amount of capital in designing a production line to manufacture the lumber inputs required by MGII.

Glue Wood is not materially opposed to enforcement by CRUD Bank since a termination of its contract with MGII may enable Glue Wood to then market and sell to others, including directly to Home Solutions. Glue Wood also recognizes that a sales process that is supported by a court filing may likely render Glue Wood unable to terminate its existing exclusive contract with MGII and, by consequence, a future acquiror would be able to "step into" such contract.

The Glue Wood contract with MGII is not assignable without Glue Wood's consent.

It may be a "bottom feeder" for the "innovative" garden products if things fall apart.

Home Solutions is also a customer of Glue Wood. That being said, Glue Wood might be prepared to compete with Home Solutions "if the price is right".

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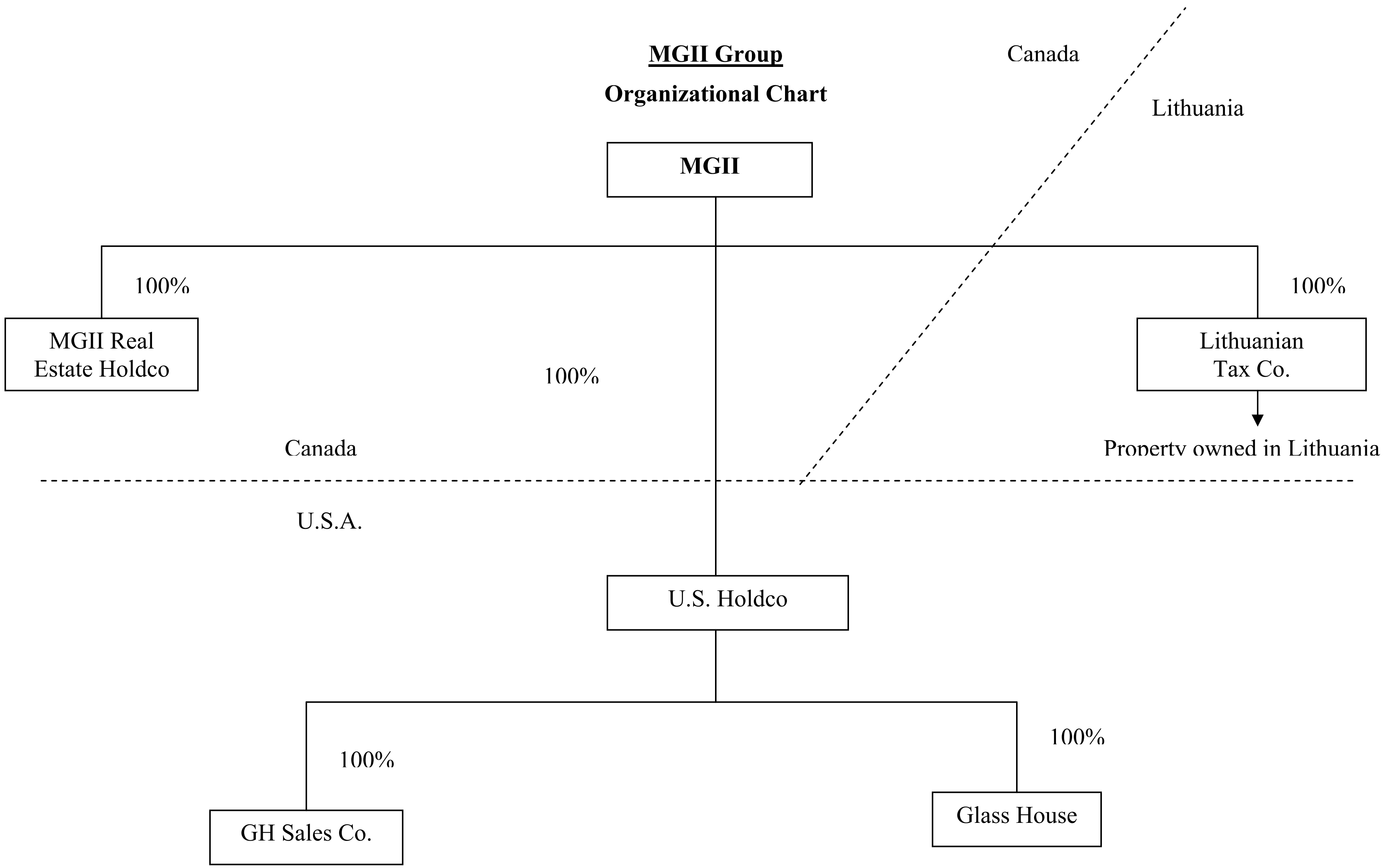
SCHEDULE "A"

<u>MGII Group</u>

Organizational Chart



Anatomy of the Acquisition of a Troubled Business

Speaker Biographies March 16, 2010

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 **Phillip Marshall** Gowlings	Phillip Marshall is a partner in the Gowlings Vancouver office, practising in the areas of real estate and commercial law. Phillip has broad experience in corporate commercial matters. He is involved in structuring commercial transactions, drafting agreements and providing commercial law advice to business of all sizes. Phillip's real estate practice includes all aspects of real estate development, use, acquisitions and dispositions. He has extensive experience in multi-unit residential developments and in doing so, deals with all levels of government and governmental agencies. phillip.marshall@gowlings.com Telephone: (604) 891-2260
 **John McLean** Gowlings	John McLean is a partner in the Advocacy Department of Gowlings' Vancouver office. His practice is focussed on insolvency matters, including bankruptcy, CCAA proceedings, foreclosures and creditor and debtor rights. John has acted as counsel for Trustees in Bankruptcy, Monitors under CCAA proceedings and creditors and debtors in a wide variety of industries and has been involved in most major insolvency matters in British Columbia. He also has extensive cross-border insolvency experience in the United States and the United Kingdom. john.mclean@gowlings.com Telephone: (604) 891-2285
 **Kevin Brennan** Ernst & Young	Kevin Brennan is a partner with Ernst & Young LLP and Senior Vice-President with Ernst & Young Inc. and located in Vancouver, British Columbia. He is Chair of the Canadian Association of Insolvency and Restructuring Professionals (CAIRP) and a member of the Insolvency Institute of Canada IIC. Kevin is a Chartered Accountant, Chartered Insolvency and Restructuring Professional and licensed trustee in bankruptcy. He has led restructuring engagements in many diverse industries over his 20 year career as a restructuring professional. In addition, Kevin has been very active in the legislative reform process pertaining to corporate restructuring proceedings. kevin.b.brennan@ca.ey.com Telephone: (604) 899-3551