

IN THE COURT OF QUEEN'S BENCH OF NEW BRUNSWICK

TRIAL DIVISION

JUDICIAL DISTRICT OF SAINT JOHN

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

- and -

**IN THE MATTER OF THE APPLICATION
OF ATLANTIC YARNS INC., a body
corporate, AND ATLANTIC FINE YARNS
INC., a body corporate**

FOURTH REPORT OF THE MONITOR
March 27, 2008

I, ROBERT C. SMITH, of the Town of Rothesay, County of Kings, Judicial District of Saint John, and Province of New Brunswick, MAKE OATH AND REPORT TO THE COURT THAT:

1. I am a Chartered Accountant, licensed Trustee in Bankruptcy, and Senior Vice-President of PricewaterhouseCoopers Inc. ("PWC") and have personal knowledge of the matters hereinafter deposed to, except where otherwise stated, and in such cases I do verily believe the truth of the contents deposed to.
2. This is an update to our January 28, 2008 and February 18, 2008 reports to the Court as provided for in the Order of this Court provided to Atlantic Yarns Inc. ("AY") and Atlantic Fine Yarns Inc. (AFY)(or collectively "the Companies"), pursuant to the provisions of the


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Companies' Creditors Arrangement Act, R.S.C. 1985, c.C-36, ("CCAA") on October 26, 2007.

Notices

3. The Monitor believes that the Motion materials filed by GE Canada Finance and the Companies in respect of the hearings scheduled for April 1, 2008 have been served on the required parties.
4. The Monitor advises that the creditor meeting notices provided for in the previous hearing on February 21, 2008 have been sent as directed and that the Creditor Meetings are now arranged for April 2, 2008.
5. The Monitor also caused to be posted to the website www.pwc.com/car-atlyarns (the "website") a copy of all Orders of this Court as well as the supporting motion materials including the Notice of Motion and related affidavits for the hearings on April 1, 2008 and all materials related to the Creditor Meetings on April 2, 2008. Creditors and interested parties have been made aware of this website in several mailings and notices as well as by personal advice by the Monitor.
6. A copy of this report will be filed on the website the same day it is filed with the Court.

Good faith commentary

7. The Monitor believes the management of the Companies has proceeded in good faith and with due diligence subsequent to the Initial Order and Orders issued subsequent thereto.
 8. Since this Court made the Initial Order, no information has come to my attention that would suggest and/or indicate any irregularities on the part of the Companies.
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9. To the best of my knowledge, the Companies have complied with all Orders of this Court in both the letter of the Order and the spirit and intent of the Order.

CCAA cash flow

10. The Companies have filed with the Court cash flows for the stay period and for the projected period through the year 2010. The Monitor has reviewed the cash flows provided and attended in Toronto to review the actual disbursements of the Companies. These cash flows indicate that the Companies have sufficient funds to preserve and protect the assets of the Companies through the next several months in a non-operating state if required.
11. The Companies have now completed the Claims Bar process. The claims that needed to be reconciled have been, and the Monitor has dealt with the claims in respect of employee grievances.
12. All employee claims processes have now been completed and resolved.
13. There are issues still being worked on that impact on the cash flow of the Companies, including:
 - (a) The availability of cotton. We are advised and do believe that the supply of cotton will not be an issue for the startup of the mill;
 - (b) Taxes and duties, including duty remission and Free Trade initiatives discussed more fully below;
 - (c) The influx of funds required in order to sustain operations over the next 12 months while Free Trade Agreements and Duty Remissions are implemented by the Government of Canada; and

(d) The continuing support of its customers. The Companies have been in contact with their customers and brokers and is comfortable that its customer base is largely intact.

14. The Companies are revising cash flow projections and profit projections as more information is forthcoming and negotiations with GE and the Province reach a conclusion. On the basis of the information currently available, it would appear that the Companies may require up to \$8 million of additional working capital funds over the next 12 months, which was the subject of an earlier application which was withdrawn and will be brought to the Court again shortly.
15. The Companies insurance has been renewed and arrangements satisfactory to the Company and the insurers are now in place. A further Order extending the insurance coverage may be required as the Plan is implemented.
16. The Company is working on planning its activities and preparing a range of activities leading to starting new production.

The Plan of Arrangement

17. The Companies have filed a plan of arrangement with the Court. Subsequent to the filing, the Province and First Treasury have requested amendments to the Plan which we believe are fair and reasonable, which amendments in draft form is attached hereto as Exhibit A. This will, when finalized, form part of the final plan to be voted on by the creditors.
18. To date of this report, the Monitor reports that he has proxies or voting ballots as follows:

Unsecured class	Votes for	Votes against	\$ for	\$ against
Atlantic Yarns Inc.	46	0	\$25,202,586.84	\$0.00

Atlantic Fine Yarns Inc.	Votes for	Votes against	\$ for	\$ against
	42	1	\$17,407,669.63	\$1,875.00


Secured class

Atlantic Yarns Inc.	Votes for	Votes against	\$ for	\$ against
	1	0	\$31,275.18	\$0.00

Atlantic Fine Yarns Inc.	Votes for	Votes against	\$ for	\$ against
	1	0	\$31,275.18	\$0.00

19. The Monitor believes the Company has achieved successful resolution of the issues with First Treasury and the Province of New Brunswick and these two creditors will be voting in favour of the plan as well with aggregate debt of \$75,907,220 in addition to the above.
20. In addition, the Monitor believes that the cotton suppliers are in favour of the plan, and these two creditors will be voting in favour of the plan with aggregate debt of \$4,204,132.
21. The Monitor is not aware of any other creditor other than GE who may be voting against the plan. GE has not filed a voting ballot on the plan as yet, but has indicated that it is not satisfied with its treatment under the plan and has a motion before the Court to be heard on April 1, 2008 at 1200 noon. GE has aggregate votes in the secured class of \$14,095,422.
22. There are taxation initiatives reaching conclusion which will have a material impact on the Plan of the Company and the amounts which can be paid to the creditors. These include Free Trade Agreements with Peru and other Caribbean and Central American countries and the Outward Processing Initiative proposed by the Government of Canada.
23. The conclusion of these negotiations is not required for the plants to restart operations, but indeed is vital to the long term viability of the industry in Canada and these Companies.



24. The Outward Processing Initiative announced by the Minister of Finance for the Government of Canada is progressing and is still expected to be passed and was originally scheduled for implementation in March, 2008. We are awaiting word from the Government on this initiative and asked the Minister of Trade and the Minister of Finance to provide us with a further update for this hearing. The Government of Canada has not been forthcoming with information and the House of Commons adjourned for a March vacation without dealing with this matter. It appears that this could be dealt with in the next 6 weeks.
25. The Free Trade Agreements with foreign countries appears to be on track for implementation later this year.
26. Another variable in the Companies cash flow and profitability forecasts is the value of the US dollar relative to the Canadian dollar. The cash flow problems of 2007 were emphasized by the very strong Canadian dollar which reached a high of almost \$1.10 versus the US dollar in the fall of 2007. The Canadian dollar is now falling relative to the US dollar and is forecasted to continue a slight decline to the \$.95 range. The Companies have an automatic hedge with the purchase of cotton in US dollars for approximately 60% of its sales, and a further 60% of sales are sold in US dollars. Every penny is approximately \$300,000 in annual profit for the combined companies.
27. The Monitor has met with the ultimate principal shareholder of the Companies, who has confirmed ongoing support for the future operation of the Companies.
28. The Monitor has attended at the plant facilities in Atholeville and Pokemouche, and confirms that the plants appear to be properly maintained, heated and ready to restart operations. 

29. The Monitor has met with employees of both facilities and the union representatives of the plants and confirms their ongoing support for the Companies in their efforts to restart operations.
30. The Monitor has had discussions with representatives of First Treasury, GE Canada and the Province of New Brunswick, and while negotiations will likely continue, we believe that there is a likelihood of a successful plan of arrangement being implemented.
31. Notwithstanding the good faith attempts of the parties and the Monitor to achieve a resolution of the issues, GE and the Companies have not reached a resolution.
32. The Monitor expects that there will be changes to the plan of arrangement subsequent to its filing as these negotiations continue, however the changes should be of little consequence to other creditors.
33. The Monitor and the Companies are mindful of the impact that delays in filing the plan have on the employees and their families, and it is with this in mind that the plan will be filed in order to finalize the affairs and allow the plants to restart as soon as possible. It is reasonable that the plants cannot restart, however, without certainty of continued operation.
34. The Companies continue to seek financing for the "February DIP" of approximately \$8 million and the Monitor believes that such funds are available in the market. The delays in finalizing matters with the Province of New Brunswick, First Treasury and GE result in corresponding delays in progressing negotiations with these lenders.
35. The delays in restarting operations have been for good and valid reason, including:
 - (a) The failure to arrive at a negotiated settlement with GE Canada to date.



- (b) The ongoing delays at the Government of Canada in failing to implement the Outward Processing Initiative; and
- (c) The uncertainty that a plan would be acceptable to the secured creditors as a class makes restarting operations a high risk decision. The Province of New Brunswick and First Treasury have just recently reached a joint conclusion on this matter.

36. The CCAA is an Act designed to continue rather than liquidate companies, and it is the intention of the Companies to begin operations again.

37. The major benefit of a successful restructuring will be significant, including:

- (a) The continuing employment of approximately 400 direct employees with high paying jobs in New Brunswick and Ontario;
- (b) The continuing employment of a further approximately 600 indirect jobs as a result of a high export content of the sales of the Companies;
- (c) The payment of a significant portion of the outstanding unsecured debt of the Companies owed to its suppliers; and
- (d) The future expenditure of significant amounts other than payroll in Canada and New Brunswick, which expenditures and payroll are of significance to the economy of the areas around the mills and the Province of New Brunswick.

AND THAT

38. The Monitor is presently satisfied that the Company is making progress and is working diligently on its restructuring plan, and is deserving of the ongoing support and protection of the Court.

39. The Monitor believes it has conducted itself with objectivity and neutrality in this process and the negotiations, and has received no adverse comments from any party on its activities.

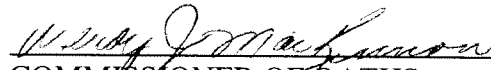


40. The Monitor believes that on balance the Plan of Arrangement as filed (including the proposed amendment #1) is viable and fair to all parties subject to the Plan.

Respectfully submitted and

SWORN TO at the City of Saint John,)
in the County of Saint John, and)
Province of New Brunswick, this 28th)
day of March, 2008.)

BEFORE ME:)


COMMISSIONER OF OATHS)



Robert C. Smith

WENDY J. MACKINNON
Commissioner of Oaths in & for
The Province of New Brunswick
My Commission Expires Dec. 31/2008

Amendment to plan of arrangement #1

The following clauses to be removed

4.2 Treatment of Unsecured Claims

All Unsecured Claims will be compromised and the following distributions shall be made to the applicable Unsecured Creditor:

(a) Unsecured Claims of the Province of New Brunswick

- (i) In relation to Unsecured Claims of the Province of New Brunswick arising from or related to loans evidenced by account numbers 530499, 530230 and 529231, in the aggregate amount of approximately \$3.3 million and by the loan account number 530500 in the approximate amount of \$640,559.00:
 - a. the agreements in respect of these loans shall be re-instated and be in good standing allowing the Companies to draw advances and make repayments in respect of these agreements in accordance with their terms; and
 - b. all principal payments that may have been required prior to December 31, 2008 shall be deferred to, and begin amortization in, January of 2009.
- (ii) In relation to the Unsecured Claim of the Province of New Brunswick arising from or related to the loan evidenced by account number 528851, in the principal amount of approximately \$3.7 million plus accrued interest, no payment will be made by the Atlantic Yarn Companies and such Claim fully compromised and forgiven.
- (iii) In relation to the Unsecured Claim of the Province of New Brunswick in relation to the \$1 million loan pursuant to a letter of offer dated April 18, 2007 for capital investment in waste recovery equipment, this agreement shall remain in force and the Atlantic Yarn Companies shall provide a first fixed charge on the equipment to be purchased pursuant to this loan agreement as required and make all payments required under the letter of offer dated April 18, 2007.

The Following clause to be substitute therefore

4.2 Treatment of Unsecured Claims

All Unsecured Claims will be compromised and the following distributions shall be made to the applicable Unsecured Creditor:

- (a) *Unsecured Claims of the Province of New Brunswick*
- (i) In relation to Unsecured Claims of the Province of New Brunswick arising from or related to loans evidenced by:
 - a. Account number 530499 in the amount of \$984,385, which loan was advanced for payment of property taxes, shall survive and interest shall continue to accrue in accordance with the loan agreement. Repayment of the loan and all accrued interest shall commence in January 2009 and be repaid over a period of 36 months;
 - b. Account number 530230 in the approximate amount of \$600,000 shall be written off;
 - c. Account number 529231 in the approximate amount of \$1,678,000 shall be written off;
 - d. Account number 530500 in the approximate amount of \$640,000, which loan was advanced for payment of property taxes shall survive and interest shall continue to accrue on this loan in accordance with the loan agreement. Repayment of the loan and all accrued interest shall commence in January 2009, to be repaid over a period of 36 months.
 - (ii) In relation to the Unsecured Claim of the Province of New Brunswick arising from or related to the loan evidenced by account number 528851, in the principal amount of approximately \$3.7 million plus accrued interest, no payment will be made by the Atlantic Yarn Companies and such Claim fully compromised and forgiven.
 - (iii) In relation to the Unsecured Claim of the Province of New Brunswick in relation to the \$1 million loan pursuant to a letter of offer dated April 18, 2007 for capital investment in waste recovery equipment, this agreement shall be terminated and rescinded.

Any vote in favour of this plan by the Province of New Brunswick is not binding on the Province of New Brunswick until and unless the above is approved by the Government of New Brunswick and, if necessary, the Lieutenant Governor in Council.

In respect of the secured loans owed to the Province of New Brunswick and First Treasury

The plan currently provides the following, which shall be deleted

(c) First Treasury Financial Inc. ("First Treasury")

First Treasury shall receive 100% of its Proven Distribution Claim excluding any Claim for costs, penalties, accelerated payments or increased interest rates resulting from any default of either of the Atlantic Yarn Companies occurring prior to the Plan Implementation Date as follows:

- (i) All accrued interest not paid as of the Plan Implementation Date shall be paid within 30 days;
- (ii) Interest shall accrue at the non-default rate and be paid in accordance with the existing loan agreements;
- (iii) Principal repayment shall be deferred in accordance with existing agreements except there shall be no payments until the maturity of the loan in December 2012;
- (iv) The Proven Distribution Claims of First Treasury shall be secured by the existing Charges held by First Treasury, subject to the February DIP Order; and
- (v) This section shall be binding on any guarantor of the Companies obligations.

(d) The Province of New Brunswick shall receive the following as a compromise of its Proven Distribution Claim:

- (i) a non-interest bearing promissory note in the amount of \$1 million, payable on demand after GE has been paid in accordance with this Plan, which note shall be full payment and satisfaction of obligations of Atlantic Yarns Inc. to the Province as a result of the Province's payment of the \$5 million guarantee to Integrated Private Debt. This note shall continue to be secured by the existing Charges of the Province providing a Charge on the inventory of Atlantic Yarns Inc. subject to the February DIP Order; and
- (ii) a non interest bearing promissory note in the amount of \$12 million to be repaid on terms to be agreed (but in any event no amount shall be paid in respect of this note until GE has been paid in full in accordance with this Plan) over a period of 20 years. This note shall be full payment and satisfaction of the obligations of the Atlantic Yarn Companies to the Province for the remaining balance of the Province's Proven Distribution Claim of approximately \$39 million. After the demand, or at the agreed upon commencement date, the principal amount of this promissory note shall be amortized over a 20 year

period in equal monthly instalments sufficient to repay the note in full. This note shall continue to be secured by the existing Charges of the Province subject to the February DIP Order.

And be replaced with the following

4.3 Treatment of Secured Claims

All Secured Claims will be compromised and the following distributions shall be made to the applicable Secured Creditor in full satisfaction of such Secured Claim:

(c) First Treasury Financial Inc. ("First Treasury")

First Treasury shall receive 100% of its Proven Distribution Claim excluding any Claim for costs, penalties, accelerated payments or increased interest rates resulting from any default of either of the Atlantic Yarn Companies occurring prior to the Plan Implementation Date as follows:

- (i) The Province of New Brunswick shall pay out the balance of the guaranteed loan without penalty and take an assignment of the First Treasury security interests. It is the intention of the parties that the full amount of the loan will be paid by the Guarantor shortly after the Sanction Order is issued.
- (ii) The Proven Distribution Claims of First Treasury (and after payout, the Province of New Brunswick) shall continue to be secured by the existing Charges held by First Treasury, subject to the February DIP Order;
- (iii) The Company shall have the right to prepay the principal amount owed without penalty at any time; and
- (iv) This section shall be binding on any guarantor of the Companies obligations.

Thereafter, this loan shall be settled and repaid to the guarantor by the issue of a \$12 million debenture, which debenture shall provide that the Province will continue to hold as security the existing First Treasury security, and that no interest or principal shall be payable on this debenture until after GE loan has been repaid in full or such later date as the parties may agree, and thereafter interest shall accrue and be payable at a rate of 5% per annum, payable monthly not in advance, with principal repayment over 20 years with an agreement that excess cash generated will be used to repay the loan.

- (d) The Province of New Brunswick shall receive the following as a compromise of its Proven Distribution Claim:
- (iii) a promissory note in the amount of \$2.5 million, which note shall be full payment and satisfaction of obligations of Atlantic Yarns Inc. to the Province as a result of the Province's payment of the \$5 million guarantee to Integrated Private Debt. This note shall continue to be secured by the existing Charges of the Province providing a Charge on the inventory of Atlantic Yarns Inc. subject to the February DIP Order, and shall accrue interest at 5% commencing after GE is repaid in full, with principal repayment terms such that the loan principal amount shall be repaid over a period of 20 years; and
 - (iv) a debenture (or promissory note) in the amount of \$23 million to be repaid on terms to be agreed (but in any event no amount shall be paid in respect of this debenture until GE has been paid in full in accordance with this Plan) over a period of 20 years. This debenture shall be full payment and satisfaction of the obligations of the Atlantic Fine Yarns Inc. to the Province for the remaining balance of the Province's Proven Distribution Claim of approximately \$39 million. No interest shall be paid on this debenture until GE has been repaid in full. After GE has been repaid, or at the agreed upon commencement date thereafter, interest shall accrue at a rate of 5% per annum, and be paid monthly, and the principal amount of this debenture shall be amortized and repaid over a 20 year period in equal monthly instalments sufficient to repay the debenture in full. This debenture shall continue to be secured by the existing Charges of the Province subject to the February DIP Order.

Any vote in favour of this plan by the Province of New Brunswick is not binding on the Province of New Brunswick until and unless the above is approved by the Government of New Brunswick and, if necessary, the Lieutenant Governor in Council.