

**ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST**

BETWEEN:

**PINNACLE CAPITAL RESOURCES LIMITED in its capacity as general partner of RED
ASH CAPITAL PARTNERS II LIMITED PARTNERSHIP**

Applicant

- AND -

KRAUS INC., KRAUS CANADA INC., STRUDEX FIBRES LIMITED and 538626 B.C. LTD.

Respondents

APPLICATION UNDER SUBSECTION 46(1) and SECTION 243 OF THE *BANKRUPTCY AND
INSOLVENCY*

ACT, R.S.C. 1985, c. B-3, as amended

**FIRST REPORT OF PRICEWATERHOUSECOOPERS INC.
AS INTERIM RECEIVER AND PROPOSED RECEIVER**

MAY 29, 2012

INTRODUCTION

1. PricewaterhouseCoopers Inc. (“**PwCI**”) understands that applications (the “**Bankruptcy Application I**”) have been made before the Ontario Superior Court of Justice (Commercial List)(the “**Court**”) by Pinnacle Capital Resources Limited, in its capacity as general partner of Red Ash Capital Partners II Limited Partnership (collectively “**Red Ash**” or the “**Lender**”), for an order (the “**Bankruptcy Order I**”) appointing PwCI as a trustee in bankruptcy (the “**Trustee**”) pursuant to Section 43 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, as amended (the “**BIA**”) over the assets, undertakings and properties (“**Property**”) of Strudex Fibres Limited (“**Strudex**”) and the Property of Kraus Inc. (“**KI**”).
2. PwCI understands that a separate application (“**Bankruptcy Application II**”) has been made before the Court of Queen’s Bench in Winnipeg, Manitoba by Red Ash, for an order (the “**Bankruptcy Order II**”) appointing PwCI as Trustee pursuant to section 43(1) of the BIA over the Property of Kraus Canada Inc. (“**KCI**”). PwCI understands that Red Ash has not made an application to appoint a Trustee of 538626 B.C. Ltd. (“**Kraus BC**”) as Kraus BC is dormant. (Bankruptcy Order I and Bankruptcy Order II are hereinafter collectively referred to as the “**Bankruptcy Orders**”).
3. An application (the “**Receivership Application**”) has been made in these proceedings by Red Ash, for an order (the “**Receivership Order**”) appointing PwCI as receiver (the “**Receiver**”) pursuant to section 243(1) of the BIA over the Property of Strudex, KI, KCI and Kraus BC (together the “**Companies**”).
4. As a result of Bankruptcy Application I and Bankruptcy Application II (together the “**Bankruptcy Applications**”) and the Receivership Application, PwCI was appointed as Interim Receiver on May 28, 2012 (the “**Interim Receiver**”) in respect of KI, KCI and Strudex pursuant to the application brought by Red Ash, in these proceedings. Red Ash, as assignee, is the principal secured creditor of the Companies as described in detail in this report and in the affidavit of Christopher Emmott sworn May 25, 2012 (the “**Emmott Affidavit**”) in support of the relief sought in these proceedings.
5. In anticipation of PwCI’s appointment as Receiver, Kraus Brands LP (“**Kraus Brands**” or the “**Purchaser**”), an affiliate of Red Ash, has made a binding offer to PwCI in its capacity as the proposed receiver (“**Proposed Receiver**”) for the purchase of substantially all of the Property that is subject to the Receivership Application. The offer is set out in an Asset Purchase

Agreement between the Receiver (to be executed upon its appointment, and authorization by the Court to do so) and the Purchaser (the “**KB APA**”).

6. PwCI is a licensed trustee within the meaning of section 2 of the BIA. PwCI has consented to act as Receiver and Trustee in these proceedings in the event that this Court grants the Receivership Order and the Bankruptcy Orders. PwCI has extensive knowledge of the Companies and its affiliates (the “**Kraus Group**”) as it was previously retained to act as the Companies’ financial advisor in addressing liquidity concerns, providing strategic advice and negotiating with the Companies’ various lenders, including the Companies’ Senior Syndicate (as defined below).
7. We are writing this first report of the Interim Receiver and of PwCI in its capacity as the Proposed Receiver of the Companies (the “**First Report**”) in the same manner as if we had already been appointed as Receiver by this Court. This report has been prepared to:
 - a) provide this Court with background information in respect of:
 - (i) an overview of the Kraus Group, including its corporate structure, operations, and debt structure, etc.;
 - (ii) the Kraus Group’s current financial position and liquidity issues; and
 - (iii) the causes of its insolvency;
 - b) report on the marketing and sales process undertaken by PricewaterhouseCoopers Corporate Finance Inc. (“**PwCCF**”), an affiliate of PwCI, to refinance or effect a sale of the Companies’ assets;
 - c) provide this Court with information regarding the proposed asset sale (the “**Sale Transaction**”) of substantially all of the Companies’ assets to be entered into between the Receiver (once appointed and if authorized by the Court to do so) and Kraus Brands and provide their comments on the KB APA;
 - d) provide this Court with information on Priority Claims (as defined in the KB APA) and Deemed Trust Claims (as defined herein);
 - e) provide this Court with the Proposed Receiver’s view that there is no benefit or financial ability of the Companies to conduct a further sales process;
 - f) provide this Court with information regarding the proposed Notice to Stakeholders of the KB APA;
 - g) summarize the results of a liquidation analysis prepared by the Proposed Receiver; and

- h) provide this Court with a summary of the independent security opinions commissioned by the Proposed Receiver in respect of Red Ash's security;
- i) recommend that, in the event this Court appoints PwCI as Receiver, the Court issue an order (the "**Approval and Vesting Order**"):
 - (i) approving the KB APA and the Sale Transaction and authorizing and directing the Receiver to execute the KB APA and take such additional steps as are necessary to complete the Sale Transaction;
 - (ii) sealing the confidential appendices of the First Report filed with this Court from the public record until after the closing of the Sale Transaction, or further order of this Court;
 - (iii) vesting in the Purchaser, as at closing, all of the Receiver's and the Kraus Group's right, title and interest, if any, in and to the Purchased Assets as defined in the KB APA, free and clear of all liens, charges, security interests and other encumbrances, other than Permitted Encumbrances (as identified in the KB APA); and
 - (iv) authorizing the Receiver to change the corporate names of each of KI, KCI and Strudex.

- 8. In preparing this report, the Interim Receiver and the Proposed Receiver have relied upon unaudited and draft, internal financial information of the Companies provided to it by the Companies. The Interim Receiver and the Proposed Receiver have not audited, reviewed or otherwise attempted to verify the accuracy or completeness of the information provided to them and expresses no opinion, or other form of assurance, in respect of the information contained in this report. The Interim Receiver and Proposed Receiver reserve the right to refine or amend their comments and findings as further information is obtained or brought to their attention subsequent to the date of this First Report.
- 9. Unless otherwise noted, all currency amounts contained in this report are expressed in Canadian dollars.

A. BACKGROUND

10. Reference is made to the Emmott Affidavit for a more detailed overview of the Companies.

COMPANY OVERVIEW

11. The Kraus Group is a vertically integrated manufacturer of carpet and a distributor of flooring products for the commercial and residential markets in Canada, the United States and Australia. The Kraus Group operates two carpet mills:
- a) an 850,000 square foot flagship operation in Waterloo, Ontario that includes both carpet and fibre manufacturing; and
 - b) a smaller 80,000 square foot carpet mill in Queensland, Australia, that manufactures carpet using fibre produced in Waterloo.
12. In addition, the Kraus Group has eight leased distribution centres, five in Canada (in Vancouver, Edmonton, Winnipeg, Toronto and Dartmouth, (collectively the “**Leased Premises**”) and three in the United States (Shipperville, Pennsylvania, Renton, Washington and Dalton, Georgia).
13. Ninety four percent of the sales of the Kraus Group are from North America (Canada (52%) and the United States (42%)) with the remaining 6% from sales in Australia and New Zealand. Approximately 60% of the sales of the Kraus Group are to the residential flooring market and approximately 40% of its annual sales are in respect of commercial flooring.
14. Carpet sales make up approximately 60% of the annual revenue of the Kraus Group. The remaining approximately 40% of its revenue is derived from a mixture of sales of private label and branded laminate, hardwood, cork and other flooring product.
15. Anneleen Eckhardt Holdings Limited (“**Anneleen**”), a holding company owned by the Eckhardt family, is the ultimate parent of the Kraus Group. An organization chart in respect of the Kraus Group is attached as Appendix “A”.
- a) As set out in the organization chart, Anneleen owns a majority interest (either directly or indirectly) in the following Canadian based companies: (1) Strudex; (2) KI; (3) KCI; and (4) Kraus BC. These legal entities, except Kraus BC, are subject to these Interim Receivership proceedings and all entities are subject to the Receivership Application. As discussed earlier, Kraus BC is dormant, hence it is not a party to the Bankruptcy Applications.

- b) The Companies also own a majority interest in the following United States based companies: (1) Kraus USA, Inc.; (2) Barrett Carpet Mills, Inc.; (3) Royal Scot Floorcovering Distribution LLC; and (4) Kraus Floors LLC. These United States based legal entities are not subject to the Interim Receivership proceedings, nor are they subject to the Receivership Application or Bankruptcy Applications. The Proposed Receiver understands that only Kraus USA, Inc., and Barrett Carpet Mills, Inc. are currently operating. Royal Scot Floorcovering Distribution LLC and Kraus Floors LLC are dormant companies. It is proposed that the shares of each of these United States entities will be sold to the Purchaser pursuant to the KB APA.
- c) The Kraus Group holds a majority interest in Australia based Northstate Carpet Mills Pty Ltd. (“**Northstate**”), which is also not subject to the Interim Receivership proceedings, or Receivership Application or Bankruptcy Applications. It is proposed that the shares of Northstate owned by the Kraus Group will be sold to the Purchaser pursuant to the KB APA.

SHAREHOLDER BUYOUT

- 16. As noted above, the Kraus Group is wholly owned by the Eckhardt Family. However, prior to June 2007, the Eckhardt family owned only a 50% interest in the Kraus Group with Nelson Kraus Holdings Limited (“**NKHL**”) owning the remaining 50% interest. In June 2007, the Eckhardt family acquired NKHL’s 50% interest in the Kraus Group. PwCCF served as advisor to the Eckhardt family in respect to the acquisition (the “**Shareholder Buyout**”).
- 17. Prior to the Shareholder Buyout, the Kraus Group had a history of strong and consistent financial performance. For the fiscal year ended December 31, 2006 (the fiscal year prior to the Shareholder Buyout), the Kraus Group reported revenue of \$324.6 million and normalized earnings before interest, taxes, depreciation and amortization (“**EBITDA**”) of \$33.9 million. For the five year period ended December 31, 2006, the Kraus Group reported average annual revenue of \$293.2 million and average annual normalized EBITDA of \$36.0 million. (Normalization adjustments to EBITDA in these years consisted of discretionary shareholder bonuses, charitable donations and restructuring related expenses.)
- 18. NKHL’s 50% interest in the Kraus Group was acquired in June 2007 for an amount of approximately \$70.0 million. Consideration for the Shareholder Buyout included a cash payment of \$30.5 million paid on closing and the issuance of a subordinated, secured vendor take back note (the “**VTB Note**”)

in the amount of approximately \$37.7 million. It is relevant to note that the purchase price of this transaction equates to an enterprise valuation multiple of approximately 5.8 times normalized EBITDA for 2006.

19. The terms of the VTB Note included twenty equal quarterly installments of approximately \$1.6 million and a balloon payment in the amount of \$5.0 million at the end of the five year term. The VTB Note was secured by a third ranking security interest in substantially all of the personal property of Strudex, Kraus Carpet Mills Limited (now KI), 1029011 Ontario Inc. (now KI), and W. G. McMahon Canada Ltd. (now KCI), and a third ranking pledge of the shares of Strudex owned by Anneleen. The VTB Note and related security were assigned to Nelson Kraus (“**NK**”) in December 2010.

DEBT STRUCTURE

20. As part of the Shareholder Buyout discussed above, in addition to the VTB Note, the Kraus Group arranged a \$139 million senior debt facility (the “**Senior Debt**”), which was subject to an availability formula, and a \$10 million subordinated debt facility to finance the \$30.5 million cash payment to NKHL and to refinance the existing debt of the Kraus Group.
21. The Senior Debt was underwritten by the National Bank of Canada and the Bank of Montreal (the “**Agents**”), which subsequently syndicated a portion of this facility to certain additional lenders (the “**Senior Syndicate**”).
22. The \$10 million subordinated secured debt facility (the “**BMOCC Debt**”) was provided by the Bank of Montreal Capital Corporation (“**BMOCC**”). The BMOCC debt was assigned to the Bank of Montreal in November 2011.

23. The table below provides a summary of the Kraus Group's outstanding secured debt as at April 30, 2012:

Lender Name	Lien Ranking	Amount Outstanding as at April 30, 2012 (\$'000)	Security	Status
Syndicate led by National Bank of Canada and Bank of Montreal	First	71,115	General security agreement over the property, rights and assets of the Kraus Group; hypothec over the property of KCI located in Quebec; pledge by Anneleen of securities, including shares of Strudex and Northstate; and charge over the manufacturing facility in Waterloo, Ontario (65 Northfield Drive West, Waterloo).	Default as of May 26, 2008; 5 Amendment Agreements, 14 Forbearance Agreements
Bank of Montreal	Second	19,714	General Security Agreement over the property, rights and assets of the Kraus Group; hypothec over the property of KCI located in Quebec; pledge by Anneleen of securities, including shares of Strudex and Northstate; pledge by Anneleen of indebtedness owed to Anneleen by Strudex and KI; and charge over the manufacturing facility in Waterloo, Ontario (65 Northfield Drive West, Waterloo).	4 Agreement Amendments; Assignment of Loan from BMOCC to Bank of Montreal
Nelson Kraus	Third	35,407	General security agreement over the property, rights and assets of the Kraus Group (other than Kraus B.C.) and pledge by Anneleen of shares of Strudex.	Amendment Agreement in November, 2010; Loan extension to January 31, 2020
	Total	126,236		

24. The Interim Receiver and Proposed Receiver understand that on or about May 7, 2012, Red Ash, an affiliate of Hilco UK Limited ("**Hilco**"), took an assignment of all of the Senior Debt, BMOCC Debt and VTB Note (together the "**Secured Debt**") having a face value of approximately \$126.2 million as at April 30, 2012. The Interim Receiver and Proposed Receiver were not privy to the terms of the transaction, but understand that Red Ash purchased the Secured Debt for an amount that was less than the face value of the Secured Debt.

CAUSES OF FINANCIAL DIFFICULTIES

25. Subsequent to the Shareholder Buyout being completed in June 2007, the Kraus Group's financial performance deteriorated significantly, primarily for three reasons:
- Significant Decline in Carpet Sales.** The sharp and sustained downturn in the North American housing market that began in late 2007 and subsequent recession in both Canada and the United States significantly reduced carpet sales. By 2009/2010 carpet volumes had declined 40% from their peak in 2005/2006;
 - Increased Strength of the Canadian Dollar.** As a Canadian based manufacturer and exporter, the strong Canadian dollar negatively impacted revenue and margins as US dollar

denominated revenue was converted back to Canadian dollars at progressively higher exchange rates; and

- c) **Higher Input Prices.** Higher oil prices over the past several years have led to rising prices for resin, the Companies' principal raw material, which has adversely impacted the Companies' margins. While the industry as a whole has consistently raised its prices to recover the increase in resin costs, there is generally a time lag between the rise in input costs and the rise in product prices, which had negatively impacted margins.

RECENT FINANCIAL RESULTS

26. As is evident from the table below, the impact of the cyclical North American economic downturn and resultant sharp decrease in carpet volume demand was particularly challenging for the Kraus Group, as the size and scale of its Waterloo manufacturing facility, with its high fixed cost structure, limited the ability of the Kraus Group to reduce overhead. At the same time, the Kraus Group was challenged by the additional financing costs associated with the Shareholder Buyout. As a result, starting in late 2007, the Kraus Group began incurring declining EBITDA and significant net losses:

The Kraus Group (Consolidated)						
(CAD '000s)						
Year ¹	Revenue Including Discontinued Operations	Net Income/(Loss) Including Disc. Operations	Revenue from Continuing Operations	EBITDA ² from Continuing Operations	Cash flow from Continuing Operations	Net Income/(Loss)
2011	195,089	(14,612)	195,089	4,814	26	(14,612)
2010	202,767	(8,130)	202,767	8,306	(3,043)	(8,130)
2009	230,641	(9,003)	223,076	8,843	19,923	(7,827)
2008	280,408	(35,295)	242,309	7,352	(16,643)	(23,687)
2007	310,291	(2,717)	260,510	22,552	25,670	327
2006	324,639	13,662	324,639	27,575	5,082	13,662
¹ The 2011 Financial Statement figures are unaudited						
² The EBITDA figure is calculated as earnings from operations before Interest, Bank Charges, Depreciation, Amortization of Intangible Assets, FX Currency Translation Gains/Losses, Restructuring Costs, Income Taxes and other non-recurring expenditures.						

27. In 2008, the downturn in flooring demand led to a \$15.2 Million (67.4 %) decline in the Kraus Group's EBITDA to \$7.4 million for the fiscal year and, in particular, the Kraus Group experienced significant losses in its distribution business and exited unprofitable markets in the US Southeast and US Midwest.
28. To address the significant downturn in profitability, in 2008 the Kraus Group commenced an aggressive cost reduction plan which rationalized its distribution operations from 21 locations and

1,000,000 square feet of space in 2007, to 8 locations and 665,000 square feet currently. In addition, the Kraus Group integrated a smaller manufacturing facility located in Dalton, Georgia into its main manufacturing facility in Waterloo, Ontario and centralized the administration of its call centre operations. Management of the Kraus Group (“**Management**”) estimates that as a result of these operational restructuring initiatives, the Kraus Group’s operating costs decreased by approximately \$20 million annually.

29. Since 2008, the Kraus Group has also made a focused effort to discount slow moving inventory and reduce its net working capital investment, resulting in a reduction in inventory levels in the amount of approximately \$24 million or 32% from December 31, 2008 to December 31, 2011.
30. In addition, the Kraus Group has continued to launch new product lines, such as carpet tile and expand its sales channels to include big box stores in an attempt to increase revenue.
31. While the cost reductions and new product line initiatives have had a positive impact on the performance of the Kraus Group, any benefit has been outweighed by the financial constraints imposed on the Kraus Group as a result of servicing the additional debt associated with the Shareholder Buyout and the significant fixed overhead costs required to maintain the 850,000 square foot manufacturing facility in Waterloo, Ontario.
32. Notwithstanding the cost cutting and profitability improvement initiatives implemented by Management, the Kraus Group continued to generate unsatisfactory EBITDA of \$8.8 million, \$8.3 million and \$4.8 million in the fiscal years ended 2009, 2010 and 2011 respectively. During this time period, while the total secured debt was reduced from \$137.8 million as at December 2008 to \$124.7 million as at December 2011 (primarily due to cash generated from working capital investment reductions being applied to the debt), the Kraus Group was unable to make all the significant contractual repayments on the debt incurred from the Shareholder Buyout.

FINANCING ISSUES – DEFAULTS, FORBEARANCES AND INSOLVENCY

33. As a result of the financial decline of the Kraus Group brought on by the factors described above, in 2008 the Kraus Group retained an affiliate of PwCI to assist in negotiating with its various lenders, including negotiating several forbearance agreements and loan amendments and two major debt restructurings.

34. The Kraus Group first breached the covenants on the Senior Debt on May 26, 2008 and subsequently in 2008, an affiliate of PwCI assisted the Kraus Group in negotiating a forbearance on the Senior Debt and VTB Note, and restructuring the terms of the BMOCC Debt to provide warrant considerations in return for revised financial covenants and revisions to the interest payment terms.
35. From July 31, 2008 to November 23, 2010, the Kraus Group entered into 13 additional forbearance agreements in respect of the Senior Debt.
36. By November, 2010, the profitability of the Kraus Group had not recovered and PwCI advised the Kraus Group on a second major debt restructuring including renegotiating and extending the terms of the BMOCC Debt and VTB Note, which were due in June, 2012. The term of the BMOCC Debt was extended from July 2012 to July 2015 and the Kraus Group extended its ability to use payment-in-kind (“**PIK**”) interest until July 2012 in order to preserve liquidity. The revised payment terms of the BMOCC Debt required no scheduled principal repayments until July 2015; however the Kraus Group was required to make principal repayments upon reaching certain threshold levels.
37. The maturity date on the VTB Note was extended from 2012 to 2020 to provide the Kraus Group with increased time to repay the debt once the profitability improved. The revised terms of the VTB Note allowed the Kraus Group to make PIK interest payments until 2020 in order to preserve liquidity until the Kraus Group met certain threshold levels that required the payment of cash interest and principal. As part of the debt restructuring, the Kraus Group entered into a forbearance agreement on the Senior Debt under which it was subject to a number of covenants, including an EBITDA covenant requiring the Kraus Group to meet a minimum EBITDA level.
38. The Kraus Group’s financing issues came to a head in September 2011 when it did not meet the minimum EBITDA covenant set out in the forbearance agreement. In consideration for continued forbearance, the Senior Syndicate requested that Management put the Kraus Group assets up for sale and/or obtain replacement financing, or face a default under the Senior Debt credit agreement.
39. As is described in greater detail below, in the fall and winter of 2011/2012, PwCCF ran an extensive sale and refinancing process (the “**Sale Process**”) in respect of the Kraus Group.

LIQUIDITY CONSTRAINTS

40. Despite concessions from its secured lenders, the sustained weak demand and low carpet volumes, coupled with its high fixed cost structure continued to take its toll on the Kraus Group, because internally generated cash flow was insufficient to sustain operations.
41. In February 2012, the Kraus Group's cash flow had deteriorated to the extent that it was unable to reduce its borrowings to below the maximum permitted under the monthly borrowing base formula specified in the Senior Debt credit agreement. As such, since February 20, 2012, the Kraus Group has at all times exceeded the monthly borrowing base limit by up to \$3.1 million.
42. Unable to access additional trade credit or borrowings under its Senior Debt credit agreement, the Kraus Group drew down on inventory levels to support ongoing sales. As a result, total inventory decreased from \$50.7 million at December 31, 2011 to \$43.0 million at March 31, 2012, which the Interim Receiver and Proposed Receiver understands is \$9.0 million below historical levels required to meet the spring seasonal peak in sales.
43. Based on a cash flow forecast prepared by Management, the consolidated cash balance of the Kraus Group is forecasted to decrease from approximately \$3.8 million to \$0.9 million between May 19 and June 8, 2012, resulting in a net cash outflow of approximately \$2.9 million over the period. The Interim Receiver and Proposed Receiver note this forecast does not assume any potential disruptions to the collection of receivables or procurement of goods and services as a result of the Bankruptcy Applications.
44. In summary, because of its continuing poor operating performance, the Kraus Group has insufficient working capital to efficiently operate the business and is insolvent. Furthermore, there has been a demand for payment of the Senior Debt as described in the Emmott Affidavit.

B. SALE AND MARKETING PROCESS

45. As discussed earlier in this First Report, in September 2011 when the Kraus Group did not meet the minimum EBITDA covenant set out in its forbearance agreement with the Senior Syndicate, the Senior Syndicate requested that, in consideration for its continued forbearance, the Kraus Group put its assets up for sale and/or obtain replacement financing, or face a default under the Senior Debt credit agreement.

46. On September 30, 2011, Management, after consulting with PwCI, sent a letter to the Senior Syndicate outlining the comprehensive plan of the Kraus Group to assess the available options to generate liquidity and allow for a possible restructuring of the balance sheet of the Kraus Group. The plan consisted of a multi-track, parallel process (the “**Strategic Options Review**”) to determine the feasibility of the following three alternative courses of action:
- a) an *en bloc* asset sale;
 - b) the listing and sale of redundant real estate; and
 - c) seeking additional financing or partial replacement financing.
47. Management requested that the Senior Syndicate waive the Kraus Group’s breach of the minimum EBITDA covenant until December 15, 2011 to enable the Kraus Group to pursue the options outlined in the Strategic Options Review, which was agreed to by the Senior Syndicate.
48. As part of the Strategic Options Review, PwCCF was engaged to conduct a Sale Process and to solicit offers to purchase the Kraus Group’s assets or to provide financing for the Kraus Group.

SOLICITATION PROCESS

49. PwCCF, with input from Management, prepared a list of potential strategic and financial buyers for the Kraus Group (the “**Prospective Purchasers**”). The list of Prospective Purchasers included domestic and international strategic and financing purchasers, and was prepared based on several sources including:
- a) flooring industry association membership listings;
 - b) analyst reports and research reports on the global carpet and flooring sectors;
 - c) input from Management;
 - d) previous buyer lists from sales processes conducted by PwCCF in respect to other distressed sales mandates; and
 - e) industry research conducted by PwCCF, including research to identify financial buyers with a focus on operational turnaround/distressed situations and/or current or historical investments in the carpet or flooring sectors.
50. The initial contact list (the “**Initial List**”) was completed on September 30, 2011 and consisted of twenty-five (25) Prospective Purchasers, including eleven (11) strategic buyers and fourteen (14) financial buyers. The Initial List also included four (4) potential lenders.

51. The Initial List was provided to the Senior Syndicate. PwCCF also requested that the Senior Syndicate provide PwCCF with its input regarding Prospective Purchasers or financing sources. Similarly, Management sent copies of the Initial List to the holders of the BMOCC Debt and VTB Note.
52. On November 3, 2011, PwCCF contacted both BMOCC and NK and requested that they explore the possibility of making further investments in the Kraus Group. PwCCF also requested that BMOCC identify any additional Prospective Purchasers or financing sources. BMOCC subsequently identified three additional Prospective Purchasers and all three were contacted by PwCCF as part of the Strategic Options Review. NK did not identify any additional Prospective Purchasers.
53. As part of the Sale Process, PwCCF worked with Management to prepare a **“Teaser Letter”** and confidentiality agreement (**“CA”**) to send to Prospective Purchasers and financing sources commencing on October 20, 2011. As is the custom in these processes, the Teaser Letter outlined the acquisition/financing opportunity available on a “no-names” basis, while the CA provided protection for the Kraus Group’s interests during the due diligence process. A copy of the Teaser Letter is attached as Appendix **“B”**.
54. The Teaser Letter was distributed to Prospective Purchasers and financiers on October 20, 2012.
55. PwCCF, with the assistance of Management, prepared a Confidential Information Memorandum (**“CIM”**) and an electronic data room (**“Data Room”**) for the Sale Process. If a Prospective Purchaser/financier was interested in exploring the opportunity, it was required to execute the CA and was then provided with the CIM and given access to the Data Room.
56. The CIM described the Kraus Group’s business in significant detail. It provided an overview of the Kraus Group, an examination of its manufacturing, sales and distribution capacity, an outline of issues concerning Management and employees, an overview of the carpet and flooring industry, a summary of relevant financial information, and a description of the transaction process for both the asset purchase and financing options. The CIM placed a particular emphasis on the operational improvements and restructuring initiatives implemented by the Kraus Group that were expected to improve profitability. A copy of the CIM is attached as Confidential Appendix **“A”**.

57. The Data Room consisted of financial, operational, human resources, legal, customer and supplier information to assist Prospective Purchasers/financiers in analyzing the Kraus Group and determining whether they would submit a non-binding expression of interest (“EOI”). PwCCF distributed a draft EOI template to Prospective Purchasers/financiers.
58. In addition to providing the CIM and access to the Data Room, PwCCF also facilitated due diligence meetings and conference calls between Management and Prospective Purchasers/financiers as required.
59. Given the terms of the covenant waiver provided by the Senior Syndicate, PwCCF set a submission deadline of December 7, 2011 in respect of the receipt of EOIs from Prospective Purchasers/financiers. In some cases, extensions were provided to Prospective Purchasers to allow them to submit EOIs (including, as discussed below, Hilco).
60. The list of Potential Purchasers/financiers ultimately contacted by PwCCF over the course of the Sale Process was significantly larger than the Initial List. In total, PwCCF contacted 48 parties by either phone or email, including sixteen (16) strategic purchasers, twenty-four (24) financial purchasers, and eight (8) lenders.
61. Of the 48 parties contacted, 35 parties (71% of the parties contacted) executed a CA and were provided with copies of the CIM and received access to the Data Room.

THE RESULTS OF THE SOLICITATION PROCESS

62. The Strategic Options Review concluded in mid-December 2011, and PwCCF had received seven (7) EOIs for the purchase of the Kraus Group’s assets and six (6) EOIs for the refinancing of the Kraus Group. Neither BMOCC nor NK provided an offer to purchase the assets or to provide financing to the Kraus Group. The indicated purchase prices for six of the seven EOIs to purchase the Kraus Group’s assets were for less than the amount of debt owing to the Senior Syndicate and the seventh EOI provided for the possibility of a relatively nominal recovery for BMOCC at the high end of the indicated value range included in the EOI, depending on the results of further due diligence.
63. Additionally, all six of the EOIs to refinance the business were for amounts that were less than the amount of the debt due to the Senior Syndicate. As a result, the Senior Syndicate elected to discontinue the refinancing process.

64. As a condition for continued forbearance by the Senior Syndicate, the Kraus Group invited the four Prospective Purchasers that had submitted EOIs with the highest offers in respect to the purchase of the Kraus Group's assets, which included the Hilco Offer, as defined and described below, to participate in the second portion of the Sale Process ("**Phase II**"), which included additional Data Room information, a tour of Kraus Group's facilities, and a presentation by Management.
65. At this time, PwCCF also verbally advised BMOCC and NK that based on the EOIs received pursuant to the Sale Process, BMOCC and NK would receive little, if any, of the proceeds of the sale in the event that Kraus Group was to sell the assets under the terms set out in any of the EOIs.
66. Over the next several weeks, PwCCF and Management negotiated with the four Phase II participants, whose binding offers were due on January 31, 2012. On January 20, 2012, PwCCF distributed a draft asset purchase agreement to the Phase II participants.
67. Of the four Phase II participants, after further due diligence, one participant declined to participate further in the Sale Process. Two other participants submitted revised offers for amounts less than the offers included in their initial EOIs. The highest offer at the end of Phase II was the offer submitted by the final Phase II participant, Hilco (the "**Hilco Offer**"). A detailed summary of the four highest offers received in December 2011 and the three revised offers received in January 2012 are enclosed as Confidential Appendix "**B**".

THE HILCO DEBT ACQUISITION

68. PwCCF received Hilco's initial EOI on December 13, 2011 to purchase the business and assets of the Kraus Group.
69. Over the course of the next five months, after extensive negotiations between Management (with PwCCF) and the Senior Syndicate, Hilco revised the Hilco Offer to wholly acquire the Senior Debt, the BMOCC Debt and the VTB Note (the "**Hilco Debt Acquisition**"), as described in the Emmott Affidavit.
70. The Interim Receiver and Proposed Receiver understand that the Senior Syndicate was advised by the restructuring group of Ernst & Young Inc. and Osler Hoskin and Harcourt LLP, in negotiating the Hilco Debt Acquisition, both of whom were knowledgeable about the Kraus

Group and transactions of this nature.

71. The Interim Receiver and Proposed Receiver understand that BMOCC was advised by the restructuring group of Gowling Lafleur Henderson LLP, in negotiating the Hilco Debt Acquisition, who is knowledgeable about the Kraus Group and transactions of this nature.
72. The Interim Receiver and Proposed Receiver understand that NK was advised by Geneva Merger & Acquisition Services of Canada (Ont.) Inc. and Fasken Martineau DuMoulin LLP, both of whom were knowledgeable of the Kraus Group and transactions of this nature.
73. The Interim Receiver and Proposed Receiver understand that on or about May 7, 2012, Red Ash, an affiliate of Hilco, completed the Hilco Debt Acquisition purchasing the Secured Debt, with a total face value of \$126.2 million as at April 30, 2012, as described in the Emmott Affidavit

C. PROPOSED SALE TRANSACTION

74. As discussed earlier in this report, in anticipation of PwCI's appointment as Receiver, Kraus Brands made an offer to the Proposed Receiver (in the form of the KB APA) for the purchase of the Purchased Assets as defined therein, which is substantially all of the Property that is subject to the Receivership Application.
75. Set out below is a summary of the principal terms and conditions of the KB APA, a copy of which, together with a letter from Kraus Brands confirming that the KB APA constitutes a binding offer capable of acceptance by the Receiver (upon its appointment by the Court), is attached as Appendix "C". All capitalized terms used in this section but not otherwise defined have the meanings given to them in the KB APA.
76. Kraus Brands will acquire, on an "as is, where is" basis, all of the properties, assets, interests and rights which are related to the operation of, and are necessary to conduct, the Business as now conducted (the "**Purchased Assets**"), with the exception of certain Excluded Assets as discussed in greater detail below. A list of the Purchased Assets is included as Schedule A to the KB APA and includes, *inter alia* Accounts Receivable, Inventory, Intellectual Property, Personal Property, Transferred Contracts and Real Property.
77. The Proposed Receiver understands that pursuant to the KB APA, Kraus Brands will also acquire all of the shares of Kraus USA, Inc., Royal Scot Floorcovering Distribution LLC, Barrett

Carpet Mills, Inc., Kraus Floors LLC, and Kraus Inc.'s 84% interest in Northstate.

78. The gross consideration of the KB APA is estimated to be in excess of \$82.8 million, and consists of:
- a) the assumption of certain portions of the Secured Debt owing by the Kraus Group to Red Ash in the amount of approximately \$80.2 million ("**Assumed Secured Debt**");
 - b) the cash payment of certain Priority Claims ranking in priority to the Assumed Secured Debt (being the priority claims under sections 81.3, 81.4, 81.5, and 81.6 of the BIA), as set out in Schedule I of the KB APA, in an amount estimated to be approximately \$220,000; and
 - c) the assumption of the Assumed Liabilities (in an amount currently estimated to be approximately \$2.2 million) and the assumption of other Priority Claims that are not paid or discharged on Closing, as set out in Schedule I of the KB APA, in an amount currently estimated at approximately \$154,000.
79. On Closing, the Purchaser will deposit with the Receiver sufficient funds to cover the payment of certain Priority Claims ranking in priority to the Assumed Secured Debt as set out in Schedule I of the KB APA, which are to be paid by the Receiver. The Proposed Receiver understands that any Priority Claims listed on Schedule I that are not to be paid by the Receiver will be assumed by the Purchaser on Closing.
80. On Closing, the Purchased Assets are to be conveyed by the Receiver to the Purchaser by the Approval and Vesting Order. Furthermore on Closing, the Receiver is to transfer and assign all right, title and interest of the Companies and the Receiver, if any, in the Real Property and any Licenses (including Environmental Permits) related to the Real Property to Kraus Properties Inc., as general partner of Kraus Properties LP. Kraus Properties LP shall assume the Assumed Liabilities (as discussed below) relating solely to the Real Property.
81. Certain assets, principally all of the Real Property Leases and certain other Contracts, are excluded under the KB APA, however the Real Property Leases and Contracts are not being terminated on Closing. Provided the Receiver has sufficient funding, on Closing, the Receiver shall use commercially reasonable efforts to make arrangements with either the Trustee or the landlord of each of the Leased Premises, on terms substantially similar to those currently in place for the Companies, for continued occupation and access to the Leased Premises for a period ending on the earliest of:

- a) 90 days following Closing;
- b) the date upon which the Purchaser elects to assume the Real Property Lease for the Leased Premises and such Real Property Lease is assigned and transferred to the Purchaser pursuant to the KB APA; and
- c) the date upon which the Purchaser advises the Receiver that it will not elect to assume the Real Property Lease for the Leased Premises.

82. With respect to the Contracts (other than Real Property Leases) that are not to be assigned to the Purchaser on Closing, provided the Receiver has sufficient funding, the Receiver shall perform any post-Closing executory obligations of a financial or monetary nature under the Contracts for a period ending on the earliest of:

- a) 30 days following Closing;
- b) the date upon which the Purchaser elects to assume the Contract and such Contract is assigned and transferred to the Purchaser pursuant to the KB APA; and
- c) the date upon which the Purchaser advises the Receiver that it will not elect to assume the Contract.

The Proposed Receiver understands that the Contracts in question are primarily personal property leases with regularly scheduled payment obligations.

83. As was set out in paragraph 78 above, on Closing, the Purchaser will assume, pay and discharge certain liabilities related to the Purchased Assets which include:

- a) all ordinary course debt, liabilities and obligations with respect to the Purchased Assets arising from and or after the Closing Date;
- b) liabilities for any property taxes owing in respect of the Real Property arising on or after the Closing Date;
- c) all debts, liabilities and obligations to the Transferred Employees arising on or after the Closing Date;
- d) all Transfer Taxes arising from or relating to the Sale Transaction;
- e) all debts, liabilities and obligations to the Unionized Employees, but only to the extent provided under the New Collective Agreements (that is, the new collective bargaining agreements to be agreed between the Purchaser and the applicable unions on terms

satisfactory to the Purchaser) or as expressly assumed by the Purchaser;

- f) all accrued but unpaid wages and vacation pay owing to the Transferred Employees and the Unionized Employees by the Companies as at Closing, irrespective of whether such accrued and unpaid wages or vacation pay for Unionized Employees are provided for in the New Collective Agreements or the Collective Agreements (amounts in respect of any accrued or unpaid wages and vacation owing to the Non-Transferred Employees will be paid to the Receiver on Closing by the Purchaser);
- g) all Cure Costs in relation to obtaining any consent to assign any Transferred Contracts assigned to the Purchaser. Transferred Contracts assigned under the KB APA are as set out in Schedule H of the KB APA (and may be added to post-Closing, as described in paragraphs 81 and 82 above);
- h) all Priority Claims to the extent they are not paid or discharged on the Closing Date; and
- i) other specific debts, liabilities and obligations identified in Schedule C of the KB APA, if any.

84. The KB APA states that the following liabilities are not being assumed by the Purchaser:

- a) all debts, obligations and liabilities related to any of the Excluded Assets identified in paragraph 81 above;
- b) all Accounts Payable outstanding at Closing, other than those specifically assumed by the Purchaser and listed on Schedule C of the KB APA;
- c) all intercompany liabilities owing between any member or affiliate of the Kraus Group;
- d) all liabilities of any member of the Kraus Group for any warranty, representation or guaranty made prior to Closing and in any way related to product sold or delivered, or services provided prior to Closing;
- e) all liabilities for or related to Taxes that are not expressly assumed by the Purchaser;
- f) all liabilities arising from ownership or use of the Purchased Assets prior to Closing, other than the Cure Costs payable in connection with Transferred Contracts;
- g) all debts, liabilities and obligations to Employees (including people actively working or those on lay-off or other leaves of absences) that arise prior to the Closing, except as specifically agreed to by the Purchaser in the New Collective Agreements or as otherwise specifically agreed to by the Purchaser in writing (i.e., other than those liabilities assumed

by the Purchaser set out in paragraph 83 above);

- h) all liabilities in respect of the Employee Plans, which includes all employee contracts and agreements, health and benefit plans and pension plans that are maintained, administered or contributed to by or on behalf of the Kraus Group and which cover any employee or former employee of the Kraus Group, except as specifically agreed to by the Purchaser under the New Collective Agreements, or as otherwise specifically agreed to by the Purchaser in writing;
- i) all liabilities under any of the Collective Agreements except to the extent specifically provided for under the New Collective Agreements or as otherwise specifically agreed to be assumed by the Purchaser under the KB APA;
- j) all debts, liabilities and obligations under or in relation to the Excluded Real Property Leases;
- k) all debts, liabilities and obligations relating to, including any Contract related to, the premises located at 2285 Place Transcanadienne, Dorval, Quebec;
- l) all Environmental Liabilities, except as required to be assumed by applicable law; and
- m) the Non-Assumed Secured Debt – the portion of the Secured Debt (the secured debt owed by the Kraus Group to Red Ash) which is not assumed by the Purchaser and remains owing by the Kraus Group at Closing.

CONDITIONS PRECEDENT

85. The obligation of the Purchaser to complete the purchase of the Purchased Assets pursuant to the KB APA is subject to the satisfaction or waiver of, or compliance with, at or before Closing, each of the following significant conditions precedent:
- a) the Receiver shall have performed or complied with, in all materials respects, all of its obligations, covenants and agreements under the KB APA and any ancillary agreements to the KB APA;
 - b) the issuance by the Court of the Appointment Order, Bankruptcy Orders, and the Approval and Vesting Order;
 - c) the Purchaser shall have obtained the Competition Act Approval;
 - d) there shall be no determination by the Court or any other Governmental Authority that any Claims related to any Employee Plans constitute Priority Claims other than Claims

secured by the BIA Charges and there shall have been no determination by the Court or any other Governmental Authority the result of which would be that the Priority Claims exceed the amount of \$500,000;

- e) each of the New Collective Agreements shall have been duly approved and ratified by the applicable Unionized Employees;
- f) there shall have been no determination by the Court or any other Governmental Authority that the Purchaser is liable and responsible for any Claims under any Employee Plans, other than as specifically agreed to by the Purchaser in the New Collective Agreements; and
- g) the Purchaser shall have received at or before Closing all third party consents, approvals and authorizations in connection with the completion of any of the transactions contemplated by the KB APA and any ancillary agreements to the KB APA.

86. The obligation of the Receiver to complete the sale of the Purchased Assets pursuant to the KB APA is subject to the satisfaction or waiver of, or compliance with, at or before Closing, each of the following significant conditions precedent:

- a) the issuance by the Court of the Appointment Order, Bankruptcy Orders, and the Vesting and Approval Order;
- b) the Purchaser shall have obtained the Competition Act Approval;
- c) the Purchaser shall have performed or complied with, in all material respects, all of obligations, covenants and agreements under the KB APA and the Ancillary Agreements;
- d) the Funding Term Sheet shall have been executed and delivered by Red Ash to the Receiver; and
- e) all third party consents, approvals, and authorizations in connection with the completion of any of the transactions contemplated by the KB APA and any ancillary agreements to the KB APA shall have been obtained.

87. The Proposed Receiver understands that the Purchaser is vigilantly pursuing the satisfaction of the conditions precedent. To this end, the Purchaser has completed or has undertaken the following:

- a) on May 25, 2012, the Purchaser submitted an Advance Ruling Request to the Competition Bureau of Canada in respect of Competition Act Approval of its proposed acquisition of

the Kraus Group;

- b) the Purchaser and the Union Representatives (as defined below) for the Old KI CBA and Old Strudex CBA (both as defined below) have negotiated separate memoranda of understanding in respect of amendments to each of the Old CBAs. The Proposed Receiver understands that a ratification vote in respect of the New Collective Agreements will take place shortly after the Interim Receiver is appointed. The Proposed Receiver also understands that the Purchaser intends to meet with the Union Representatives of the Teamsters Union (as defined below) during the Interim Sale Period (as defined below) to discuss and negotiate certain amendments to the Old KCI CBA; and
- c) the Purchaser has advised that in the period between May 25, 2012 and June 11, 2012 (the “**Interim Sale Period**”), it will work with the respective landlords of the Leased Premises to negotiate amendments to the Real Property Leases that are acceptable to the Purchaser, failing which the Real Property Leases will be terminated.

88. The Proposed Receiver intends to file a second pre-appointment report (the “**Second Report**”) with the Court prior to the hearing for the motion to approve the sale to include, among other matters, an update on the status of the conditions precedent.

TERMINATION OF THE KB APA

89. The KB APA may be terminated at any time prior to Closing under the following circumstances:
- a) by mutual written consent of the Purchaser and Receiver;
 - b) by the Purchaser, if any of the Appointment Order, Bankruptcy Orders, or the Approval and Vesting Order have not been issued by June 11, 2012;
 - c) by the Purchaser or the Receiver, if the Closing has not occurred on or before June 25, 2012; or
 - d) by the Purchaser, if there has been material damage to the Purchased Assets prior to Closing.

TRANSITION PERIOD

90. The KB APA requires that the Receiver and the Purchaser shall cooperate and use reasonable efforts to assist each other with certain post-Closing actions, such as, but not limited to the following:

- a) the Receiver shall assist the Purchaser in obtaining any Licenses or consents required for the operation of the Business by the Purchaser from and after Closing in the ordinary course of business;
- b) the Receiver shall transfer to the Purchaser any funds received post-Closing at any bank account of the Kraus Group relating to the Purchased Assets or the Business;
- c) the Receiver shall use commercially reasonable efforts to make arrangements with the Trustee or the landlord of each of the Leased Premises for the continued occupation of and access to the Leased Premises on terms substantially similar to those in place for the Kraus Group (as discussed in paragraph 81 above). If such arrangements are made, the Receiver shall permit full access to the Leased Premises to the Purchaser, on such terms as may be agreed to by the Receiver and Purchaser. However, the Receiver will not be carrying on any activities at these facilities or employing any employees – all such activities will be undertaken by the Purchaser; and
- d) the Purchaser shall assist the Receiver with carrying out its statutory duties regarding the bankruptcy and receivership of the Companies, which includes but is not limited to the following:
 - (i) completing and filing of any outstanding HST and RST returns;
 - (ii) cooperating with Canada Revenue Agency in respect to any required payroll and/or HST audits;
 - (iii) preparing and issuing of records of employment for the Companies' employees terminated by the Bankruptcy Orders and operation of law; and
 - (iv) preparing and issuing of T4s for employees employed by the Companies for the period January 1, 2012 to the date of the Bankruptcy Orders.

IMPACT OF PROPOSED KB APA ON KRAUS GROUP EMPLOYEES

91. At May 23, 2012 the Kraus Group employed 782 unionized and salaried employees as follows:

Kraus Group Employees as at May 23, 2012			
Company Name	Number of Employees		Total
	Non-Unionized ¹	Unionized	
Kraus Inc.	89	185	274
Kraus Canada Inc.	145	5	150
Strudex Fibres Limited	20	127	147
US operations	174	0	174
Australian operations	37	0	37
Total	465	317	782
Note:			
1. Non -Unionized includes all salaried and non-unionized hourly employees.			

92. By operation of law, all employees of KI, KCI and Strudex at the date of Bankruptcy will be terminated on issuance of the Bankruptcy Orders. The Proposed Receiver understands that all Unionized Employees will be employed by the Purchaser post-Closing, under New Collective Agreements. The Proposed Receiver also understands that the Purchaser intends to extend offers of employment to substantially all of the Non-Unionized Employees employed by the Companies on June 8, 2012 (“**Designated Employees**”). Employment offers will be made to Designated Employees in the Interim Sale Period, and for those that accept (“**Transferred Employees**”), employment will be effective on Closing.
93. Designated Employees who do not accept employment offers from the Purchaser (“**Non-Transferred Employees**”), and any employees that are terminated may be entitled to Priority Claims pursuant to Sections 81.3, 81.4, 81.5 and 81.6 of the BIA (“**BIA Charges**”) in respect of accrued and unpaid wages, vacation pay and applicable pension benefits (discussed in greater detail below).

UNION COLLECTIVE BARGAINING AGREEMENTS

94. The Companies are party to the following Collective Agreements (“**CBA**s”):
- Strudex Fibres Limited and United Food & Commercial Workers Canada (“**UFCW**”), Local 175 (March 1, 2008 to February 28, 2011; renewed March 1, 2011 to February 28, 2014) (“**Old Strudex CBA**”);

- b) Kraus Inc. and UFCW, Local 175 (July 1, 2009 to June 30, 2012) (“**Old KI CBA**”); and
 - c) Kraus Canada Inc. and Teamsters Local Union No. 213 (“**Teamsters Union**”) (October 1, 2010 to September 30, 2011) (“**Old KCI CBA**”).
95. The Interim Receiver and Proposed Receiver understand that representatives from Kraus Brands and Management have recently held a number of formal negotiations with the executive and the bargaining committees (together the “**Union Representatives**”) in respect of each of Old Strudex CBA and Old KI CBA regarding the financial challenges facing the Kraus Group, the Kraus Group’s constrained and deteriorating liquidity position and Hilco’s interest in investing in the Companies, provided the members subject to the Collective Agreements agree to certain amendments to be set out in the New Collective Agreements.
96. The Interim Receiver and Proposed Receiver understand that following these formal negotiations between Management, Kraus Brands and the Union Representatives, on May 7, 2012 memoranda of understanding were entered into concerning certain wage concessions and other amendments to the Old KI CBA (the “**New KI CBA**”) and Old Strudex CBA (“**New Strudex CBA**”). The Proposed Receiver understands that representatives of Management and Kraus Brands have not held any discussions or meetings with the Union Representatives of the Old KCI CBA to date. As set out in the Emmott Affidavit, representatives of Kraus Brands intend to meet with Union Representatives of the Old KCI CBA during the Interim Sale Period.
97. The Kraus Group is scheduled to meet with its Unionized Employees shortly after the Interim Receiver is appointed, at which time it intends to notify the Unionized Employees of the Bankruptcy Applications, the Receivership Application, the proposed sale of the business to Kraus Brands and the conditions precedent in the KB APA, specifically that the union members approve or ratify New Collective Agreements.
98. The Interim Receiver and Proposed Receiver understand that the meeting will be followed by separate votes on the New KI CBA and New Strudex CBA by the general members who are subject to each of the New Collective Agreements. Red Ash has advised the Interim Receiver and Proposed Receiver that, in the event the Unionized Employees do not accept the requested wage concessions and other requested amendments and ratify the New Collective Agreements, it will proceed with an immediate liquidation of the Kraus Group’s assets.

IMPACT OF PROPOSED SALE TRANSACTION ON THE PENSION AND BENEFIT PLANS

DEFINED BENEFIT PLANS

99. The Kraus Group is party to the following four company-sponsored defined benefit (“**DB**”) pension plans (together the “**DB Plans**”), each of which is discussed in greater detail below:
- a) Registered Pension Plan For Employees of Kraus Canada Inc. (the “**Kraus Canada Plan**”);
 - b) Pension Plan for Employees of Kraus Inc. and Strudex Fibres Limited (the “**Strudex Plan**”);
 - c) Pension Plan for Executive Employees of Kraus Inc. (the “**Executive Plan**”); and
 - d) Pension Plan for Union Employees of Kraus Inc. (the “**Union Plan**”).

The Kraus Canada Plan

100. KCI sponsors the Kraus Canada Plan, which was established on May 1, 1963 and is registered in Manitoba. The Proposed Receiver understands that a pension committee was not established as required under *The Pension Benefits Act* of Manitoba, and therefore, KCI acts as the *de facto* administrator of the Kraus Canada Plan.
101. The Proposed Receiver understands that effective December 31, 2009, Management closed the DB component of the Kraus Canada Plan, at which point the DB component was closed to new members and existing members ceased accruing benefits on a DB basis. Effective January 1, 2010, a Defined Contribution (“**DC**”) component was added, and effective that date all new and existing members of the Kraus Canada Plan commenced accruing pension benefits on a DC basis.
102. Management advised the Proposed Receiver that, as at May 23, 2012, the DB component of the Kraus Canada Plan had 187 members, composed of 94 active members who are currently active employees (the “**Active Members**”), 56 retired employees, or the surviving spouse or beneficiary thereof (the “**Retirees**”), and 37 other members, including former or current employees that are not retired and still have an entitlement in the DB component of the Kraus Canada Plan (the “**Deferred Members**”). The Kraus Canada Plan includes five members of the Teamsters Union as well as the salaried employees of KCI.

103. Management has advised the Proposed Receiver that the last actuarial valuation for the DB component of the Kraus Canada Plan was prepared by AON Hewitt as at December 31, 2010 (the “**AON Hewitt Report**”). The AON Hewitt Report stated that as at December 31, 2010 the Kraus Canada Plan had a surplus of \$956,000 on a going concern basis, and a deficiency of \$2,072,000 on a solvency basis. The going concern valuation looks at the plan’s funded status on the basis that the plan will continue to operate indefinitely, whereas the solvency valuation tests whether the plan has sufficient assets to provide an immediate payout of all benefits if the plan were to be wound-up on the valuation date. The Proposed Receiver understands that the Kraus Canada Plan would experience a sizeable deficiency if the plan were wound-up as at the date of this First Report.
104. The Proposed Receiver understands that the Kraus Canada Plan is not being assumed by the Purchaser.

Strudex Plan

105. The Strudex Plan was established on January 1, 1965 and registered in Ontario. The plan sponsor and administrator is KI, and the custodian is Manulife Insurance Company. Each full-time non-union employee of KI and Strudex became a member of the Strudex Plan after one year of continuous service.
106. The Proposed Receiver understands that effective December 31, 2009, Management closed the DB component of the Strudex Plan, at which point the DB component was closed to new members and existing members ceased accruing benefits on a DB basis. Effective January 1, 2010, a DC component was added, and effective that date all new and existing members of the Strudex Plan commenced accruing pension benefits on a DC basis.
107. Management advised the Proposed Receiver that as at December 31, 2011, the DB component of the Strudex Plan had 150 members, composed of 81 Active Members, 41 Retirees and 28 Deferred Members.
108. Management has advised the Proposed Receiver that the last actuarial valuation for the DB component of the Strudex Plan was prepared by Morneau Shepell Ltd. (“**Morneau**”) as at January 1, 2011 (the “**Morneau Salaried Report**”). The Morneau Salaried Report stated that as at January 1, 2011:
- a) “On a going-concern basis, the actuarial liability exceeds the actuarial value of assets by \$316,836”;

- b) “According to the solvency test required by the Ontario *Pension Benefits Act* (“**PBA**”), the actuarial liability exceeds the actuarial value of assets by \$1,064,765”; and
- c) “The Plan assets would be less than the actuarial liability by \$1,776,693 if the Plan were to be wound up on the valuation date”

The Proposed Receiver understands that the Strudex Plan would experience a sizeable windup deficiency if the plan were wound-up as at the date of this First Report.

- 109. The Proposed Receiver understands that the Strudex Plan is not being assumed by the Purchaser.

The Union Plan

- 110. KI is the sponsor of the Union Plan, which is registered in Ontario. The plan sponsor and administrator is KI. Prior to this plan being closed effective December 31, 1989, each Unionized Employee of KI and Strudex became a member of the Union Plan on the first day of the month after one year of continuous service.
- 111. The Proposed Receiver understands that effective December 31, 1989, Management closed the Union Plan to new members and existing members ceased accruing benefits.
- 112. Effective January 1, 1990, all existing members of the Union Plan and all new Unionized Employees of Strudex and KI have been enrolled and participate in a UFCW multi-employer sponsored pension plan, known as the Canadian Commercial Workers Industry Pension Plan (“**CCWIPP**”). Pursuant to the applicable Collective Agreements, KI and Strudex are required to make fixed per hour contributions to the CCWIPP on behalf of KI and Strudex Unionized Employees.
- 113. Management advised the Proposed Receiver that as at December 31, 2011, the Union Plan had 330 members, composed of 180 Active Members, 107 Retirees and 43 Deferred Members.
- 114. Management has advised the Proposed Receiver that the last actuarial valuation for the Union Plan was prepared by Morneau as at December 31, 2010 (“**Morneau Union Report**”). The Morneau Union Report stated that as at December 31, 2010;
 - a) “The Plan is fully funded. The actuarial value of the assets, on a going-concern basis, exceeds the actuarial liability by \$29,986”;
 - b) “According to the solvency test required by the Ontario *Pension Benefits Act*, the

actuarial liability exceeds the value of assets by \$216,494”; and

- c) “The Plan assets would be less than the actuarial liability by \$309,875 if the Plan were to be wound up as at the valuation date”.

The Proposed Receiver understands that the Union Plan would experience a windup deficiency if the plan were wound-up as at the date of this First Report.

- 115. The Proposed Receiver understands that the Union Plan is not being assumed by the Purchaser.

The Executive Plan

- 116. The Executive Plan is a DB plan that was established on May 1, 1968 and is registered in Ontario. The plan sponsor and administrator is KI, and the custodian is Manulife Insurance Company. Executive employees are eligible to participate in the Executive Plan after two years of continuous service.
- 117. Management advised the Proposed Receiver that as at December 31, 2011, the Executive Plan had 13 members, composed of seven Active Members, six Retirees and no Deferred Members.
- 118. The Proposed Receiver understands that the last actuarial valuation for the Executive Plan was prepared by Morneau as at April 30, 2011 (“**Morneau Executive Report**”). The Morneau Executive Report stated that as at April 30, 2011;
 - a) “The Plan is not fully funded on a going-concern basis. The actuarial liabilities exceed the actuarial value of assets by \$2,373,591”;
 - b) “The Plan is not fully funded on a Maximum Funding basis. The actuarial value of liabilities exceeds the actuarial value of assets by \$990,238”;
 - c) “According to the solvency test required under the Ontario *Pension Benefit Act*, the Plan is not funded. On a solvency basis, the actuarial liabilities exceed the value of assets by \$2,097,154”;and
 - d) “The Plan assets would have been less than the actuarial liability by \$3,930,792 if the Plan had been wound up on the valuation date”.

The Proposed Receiver understands that the Executive Plan would experience a significant windup deficiency if the plan were wound-up as at the date of this First Report.

- 119. The Proposed Receiver understands that the Executive Plan is not being assumed by the Purchaser.
- 120. In summary, pursuant to the KB APA, the Purchaser does not intend to assume the liability or obligations associated with any of the four DB Plans.
- 121. As discussed in greater detail later in this First Report, the Lender is expected to experience a deficiency on its Secured Debt and, as a result, no recovery is expected for the unsecured creditors. As such, there will be no assets available to fund the deficiencies under the DB Plans and consequently, the Proposed Receiver expects that the DB Plans will be wound up post bankruptcy with deficits.

THE DC BENEFITS

- 122. As discussed briefly above, the Kraus Canada Plan and the Strudex Plan each has a DC component.
- 123. Pursuant to the terms of the KB APA, the Purchaser will not be assuming the DC component of the Kraus Canada Plan or the Strudex Plan. The Proposed Receiver understands that the Purchaser will be establishing new DC plans for the Employees on similar terms and conditions, which will be discussed in the Second Report, once those terms are finalized.

EMPLOYEE BENEFIT PLANS

- 124. In addition to the changes to the Pension Plans as discussed above, there are a number of other material changes to the conditions of employment required by the Purchaser.
- 125. As discussed in paragraph 84 in respect of Excluded Liabilities under the KB APA, in addition to Pension Plans, the Purchaser will not be assuming the other Employee Plans (including Benefit Plans) or any pre-Closing accrued liability in respect of the other Employee Plans, and on Closing, Transferred Employees will cease to accrue benefits under the other Employee Plans.
- 126. The Proposed Receiver understands that the Purchaser intends to put in place its own benefit plan (“**New Benefit Plan**”) post-Closing. Details of the New Benefit Plan were not available at the date of filing this First Report. The Proposed Receiver will provide further details in respect of the benefits contemplated under the New Benefit Plan in its Second Report.

D. PRIORITY CLAIMS

127. As discussed above, by operation of law all employees of KI, KCI and Strudex at the date of the Bankruptcy Orders (if granted) will be terminated, and may be entitled to Priority Claims pursuant to the BIA Charges.
128. As discussed earlier in this First Report, pursuant to the KB APA, the Purchaser intends to assume all liabilities in respect of all accrued but unpaid wages and vacation pay owing to the Transferred Employees and the Unionized Employees as at Closing. These amounts will be paid in the normal course. However, the Purchaser is not assuming any liabilities in respect of the Employee Plans, including any accrued but unpaid pension contributions. As such, the Unionized Employees, Transferred Employees and Non-Transferred Employees may be entitled to a Priority Claim for unpaid pension contributions pursuant to the BIA Charges. The Purchaser has agreed to make a cash payment to the Receiver on Closing to satisfy these amounts.
129. Non-Transferred Employees under Sections 81.5 and 81.6 may also be entitled to any amounts owing in respect of the priority for unpaid wages and vacation pay under Sections 81.3 and 81.4 of the BIA.
130. Non-Transferred Employees and any Terminated Employees may also be entitled to a claim under the *Wage Earner Protection Plan Act*.
131. As noted earlier in this First Report, the Proposed Receiver understands that claims in connection with the BIA Charges estimated as of May 25, 2012, including amounts owing to Unionized Employees and Transferred Employees under Sections 81.5 and 81.6 of the BIA, total approximately \$220,000. This amount will be updated and will be commented on in the Second Report. The KB APA provides that on Closing, the Purchaser shall pay the Receiver sufficient cash to fund the BIA Charges (subject to the Purchaser's condition precedent that there is no judicial determination that would result in the Priority Claims exceeding \$500,000 (the "**Priority Claims Cap**"). Pursuant to the KB APA, and as discussed earlier in this First Report, if there is a judicial determination that the actual value of Priority Claims exceeds the Priority Claims Cap, the Purchaser has the ability to terminate the KB APA and not close the Sale Transaction.

132. Once the Sale Transaction closes, however, any Priority Claims that are not paid or discharged on Closing will be assumed by the Purchaser. Even if the Priority Claim is not identified on Schedule I of the KB APA, if a judicial determination is made that a claim constitutes a Priority Claim, the Purchaser is obliged to assume it.
133. The estimate of the potential Priority Claims is subject to adjustment depending on the number of employees who do not receive or decline offers of employment from the Purchaser and therefore may be entitled to a Priority Claim.

DEEMED TRUST CLAIM

134. In addition to the Priority Claim in respect of the BIA Charges described above, the Proposed Receiver understands, based on its discussions with Management, that as at the date of the Bankruptcy Orders (if granted), the Canada Revenue Agency may be entitled to a priority claim in respect of deducted but unremitted source deductions (“**Deemed Trust Claim**”) in the amount of approximately \$154,000. The Proposed Receiver understands that the Purchaser will assume the liability in respect of the Deemed Trust Claim on Closing.

E. NECESSITY FOR RECEIVER TO CONDUCT ANOTHER SALES PROCESS

135. The Interim Receiver and Proposed Receiver have determined that it is not economic, necessary or feasible to run a further sales process in respect of the Property for the following reasons:
- a) as detailed earlier in this First Report, PwCCF recently ran a comprehensive Sale Process that fully canvassed the market, and the highest and best offer for the Property generated from the Sale Process was the Hilco Offer;
 - b) the Interim Receiver and Proposed Receiver understand that, following the Sale Process conducted by PwCCF, the Senior Lenders, each of which was represented by reputable and knowledge financial and legal advisers, agreed to sell their debt to Hilco at a discount from its face value, which reflects an informed view of the market value of the Property, although the Interim Receiver and Proposed Receiver were not a party or privy to the terms thereof;
 - c) based on the unaudited fiscal 2011 EBITDA of \$4.8 million reported by the Kraus Group, an EBITDA multiple of at least 26 times would have to be offered by a third party purchaser before any such offer would exceed the Secured Debt held by Red Ash. This multiple compares to the multiple of approximately 5.8 times annual EBITDA paid in the

2007 Shareholder Buyout (with NKHL) and current public company transaction comparables of 7.4 times annual EBITDA. In the current circumstances of the Kraus Group, receiving an offer greater than 26 times 2011 annual EBITDA is highly improbable;

- d) under the circumstances, the only creditor with an economic interest in the sale is the secured creditor, Red Ash. As at April 30, 2012, the Kraus Group had outstanding Secured Debt in the amount of approximately \$126.2 million. The proceeds from a sale would need to be in excess of \$126.2 million plus any Receiver's borrowings and professional fees and expenses in respect of the enforcement, before the unsecured creditors would be entitled to any recovery. The offers received during the recent Sale Process run by PwCCF were substantially below the amount of Secured Debt currently owing to Red Ash;
- e) the Liquidation Analysis (as discussed later in this First Report) indicates that Red Ash would incur a significant shortfall on the Secured Debt should the Companies' business and assets be liquidated; and
- f) the Kraus Group is insolvent. Red Ash has advised the Proposed Receiver that it does not intend to support or provide funding to the Companies during another sales process.

F. NOTICE TO STAKEHOLDERS

- 136. The KB APA requires the appointment of the Trustee, followed by the appointment of the Receiver and the same day sale of the Purchased Assets.
- 137. Notice of a motion to approve the Sale Transaction (the "**Sale Approval Motion**") has been served to known stakeholders, such as the Department of Justice Canada, Ontario Ministry of Finance, Financial Services Commission of Ontario, Manitoba Finance - Taxation Division, British Columbia Ministry of Finance, CCWIPP, the Teamsters Union, UFCW, and the Office of the Superintendent of the Manitoba Pension Commission.
- 138. In addition, the Interim Receiver is required to mail a notice (as attached to the Interim Receivership Order) advising of the appointment of the Interim Receiver and of the Sale Approval Motion scheduled to be heard on June 11, 2011 to all members of the DB Plans, all members of the DC Plans, and all members of CCWIPP for which Management has provided mailing addresses.
- 139. The Interim Receiver will also establish a dedicated toll free telephone number (1-877-332-1688) by which members of the DB Plans, the DC Plans and/or CCWIPP (collectively the

“Pension Plan Members”) can contact the Interim Receiver to request copies of the court materials, which will be emailed or couriered upon request. The Interim Receiver will also establish a website at which Pension Plan Members can access additional information and court materials in respect of the proceedings (www.pwc.com/car-krauscarpets). However, neither the Interim Receiver nor the Proposed Receiver will be providing advice on how to respond to the applications and will advise all Pension Plan Members who inquire to contact their own legal counsel.

140. As at the date of this Report, Management has advised that the Company does not have current mailing addresses for approximately 67 of the Pension Plan Members. The Interim Receiver will work with Management to attempt to contact these individuals.

G. LIQUIDATION ANALYSIS

141. The Proposed Receiver conducted a liquidation analysis of the assets and business of the Kraus Group as an alternative to the proposed KB APA discussed herein. The liquidation analysis (the **“Liquidation Analysis”**) of the assets of the Kraus Group is based on net book values as of March 31, 2012, unless otherwise stated, and the book values used are assumed to be representative of the assets of the Kraus Group at or about the date of this Report.
142. In preparing the Liquidation Analysis, the Proposed Receiver relied upon unaudited Company prepared financial information, records and discussions with Management. Furthermore, the estimated realizations are based upon a desktop review of the assets of the Kraus Group, as a physical inspection has not been made. However, where possible, the Proposed Receiver relied upon recent third party appraisals/estimates of value, and current market conditions, in determining the estimated recovery values through an orderly liquidation.
143. The Liquidation Analysis is based upon the following significant assumptions:
- a) immediate shut down of the Kraus Group’s operations and the disposition of all assets pursuant to the following proceedings. As Kraus USA, Inc., Barrett Carpet Mills, Inc., and Northstate are each economically dependent upon the Companies for the supply of goods and distribution, a liquidation of the Companies would likely result in an immediate shutdown of operations for each of the aforementioned entities:
 - (i) liquidation of the assets of the Companies through a non-operating court-appointed receivership with concurrent bankruptcy;

- (ii) liquidation of Kraus USA, Inc. and Barrett Carpet Mills, Inc., through Chapter 7 filings in the U.S. The Proposed Receiver has not obtained an independent review of the validity of the security over the assets owned by these U.S. companies, but has assumed the security is valid. In the event it was invalid, the deficit to the Secured Lenders would be greater than calculated; and
 - (iii) liquidation of Northstate through a non-operating court-appointed receivership in Australia. The Proposed Receiver has not obtained an independent review of the validity of the security over the Australian assets, but has assumed it is valid. In the event it was invalid, the deficit to the Secured Lenders would be greater than calculated;
- b) sale of substantially all of the inventory of the Kraus Group over a two to six month period;
 - c) sale of the real property owned by the Kraus Group over a 12 to 18 month period;
 - d) sale of substantially all of the fixed assets of the Kraus Group over a three month period;
 - e) collection of substantially all of the receivables of the Kraus Group over a six month period;
 - f) priority for pension contributions limited to normal cost payments only and excludes any potential priority for solvency deficiencies; and
 - g) asset realizations were at nominal amounts and did not consider the discounting of values over time.

144. In its Liquidation Analysis, the Proposed Receiver took into account such things as:

- a) quality of the outstanding receivables and inventory;
- b) potential volume rebates and other set-offs by customers and the impact on outstanding accounts receivable collections;
- c) third party appraisals of machinery and equipment of Strudex and KI, and estimated realizable values in a liquidation;
- d) third party formal appraisals or estimates of value of the real property in Waterloo, Canada and Queensland, Australia;
- e) third party appraisal of the inventory, and the estimated realizable values in an orderly liquidation;
- f) potential priority claims and/or amounts that may need to be paid by a receiver; and

g) holding costs related to liquidation, excluding professional fees.

145. Attached as Confidential Appendix “C” is a copy of the Liquidation Analysis prepared by the Proposed Receiver which will be filed with the Court on a sealed and confidential basis. If the KB APA is not approved by this Court or does not close, it would be prejudicial to the interests of the creditors of the Kraus Group if this Liquidation Analysis became available to future prospective purchasers or liquidators of the assets of the Kraus Group. In summary, the Liquidation Analysis reflects that Red Ash would incur a substantial shortfall on the Senior Debt owed to it by the Kraus Group should the business and assets of the Kraus Group be liquidated.

H. REVIEW OF SECURITY POSITION

146. The Proposed Receiver has obtained independent legal opinions in respect of Red Ash’s security interests as against Strudex, KI, KCI and Kraus BC (as assigned by each of the Agents, BMO and NK to Red Ash) from (i) its independent Ontario, Quebec, Alberta and British Columbia counsel, Blake, Cassels & Graydon LLP (“**Blakes**”), (ii) its independent Nova Scotia counsel, Cox & Palmer LLP (“**C&P**”) and (iii) its independent Manitoba counsel, Pitblado LLP (“**Pitblado**”) as follows:

- a) Pitblado has opined that such security interests in the personal property of KCI to which the Personal Property Security Act (“**PPSA**”) of Manitoba applies are valid under the laws of Manitoba and have been properly registered under the PPSA of Manitoba;
- b) C&P has opined that such security interests in the personal property of KCI to which the PPSA of Nova Scotia applies are valid under the laws of Nova Scotia and have been properly registered under the PPSA of Nova Scotia; and
- c) Blakes has opined that (i) the documents creating such security interests are legal, valid and binding obligations of each Company that is a party to the relevant security document, (ii) such security interests in the personal property of the relevant Company to which the PPSA of the relevant province applies are valid and would be enforceable against a trustee in bankruptcy under the laws of Ontario, British Columbia and Alberta, (iii) such security interests (i.e., hypothec) in the property of KCI to which the *Civil Code* of Quebec (“**CCQ**”) applies are valid under the laws of Quebec and would be enforceable against a trustee in bankruptcy of KCI (iv) such security interests have been properly registered under the Ontario PPSA (in the case of the security interests granted by KI, KCI and Kraus BC), the British Columbia PPSA (in the case of the security interests granted by KCI and

Kraus BC), the Alberta PPSA (in the case of the security interests granted by KCI) and CCQ (in the case of the security interests granted by KCI).

147. The Proposed Receiver notes that each of these opinions remain subject to the standard assumptions, qualifications and limitations contained in the respective opinion and in the case of the Blakes opinion, to an assumption that the BMOCC Debt was validly assigned to BMO.

I. RECOMENDATION

148. The Proposed Receiver recommends, for the following reasons, that in the event this Court appoints PwCI as Receiver, that this Court issue an order approving the KB APA and Sale Transaction and authorizing and directing the Receiver to execute the KB APA and take such steps as necessary to complete the Sale Transaction:

- a) a comprehensive Sale Process was recently conducted and all offers received during the Sale Process were substantially less than the consideration under the KB APA, which is in excess of \$82.8 million;
- b) the Liquidation Analysis demonstrates that Red Ash would incur a significant shortfall on approximately \$126.2 million of the indebtedness owed to it should the assets and business of the Kraus Group be liquidated;
- c) the Senior Syndicate, BMOCC and NK, each of which was represented by reputable financial and/or legal advisors in the insolvency and restructuring industry, sold their respective components of the Secured Debt to Red Ash at a discount thereby recognizing that the market value of the Secured Debt was less than its face value;
- d) the unsecured creditors are not being prejudiced by the Sale Transaction as the only creditor with an economic interest in the Sale Transaction is Red Ash, which will also suffer a shortfall on the Senior Debt extended to the Kraus Group under this Sale Transaction; and
- e) the KB APA provides for continued employment for all of the Kraus Group employees employed as of June 8, 2012.

All of which is respectfully submitted on this 29th day of May, 2012.

PricewaterhouseCoopers Inc.

In its capacity as Interim Receiver of
Kraus Inc., Kraus Canada Inc.,
Strudex Fibres Limited, and Proposed
Receiver of the Respondents,
and not in its personal capacity.



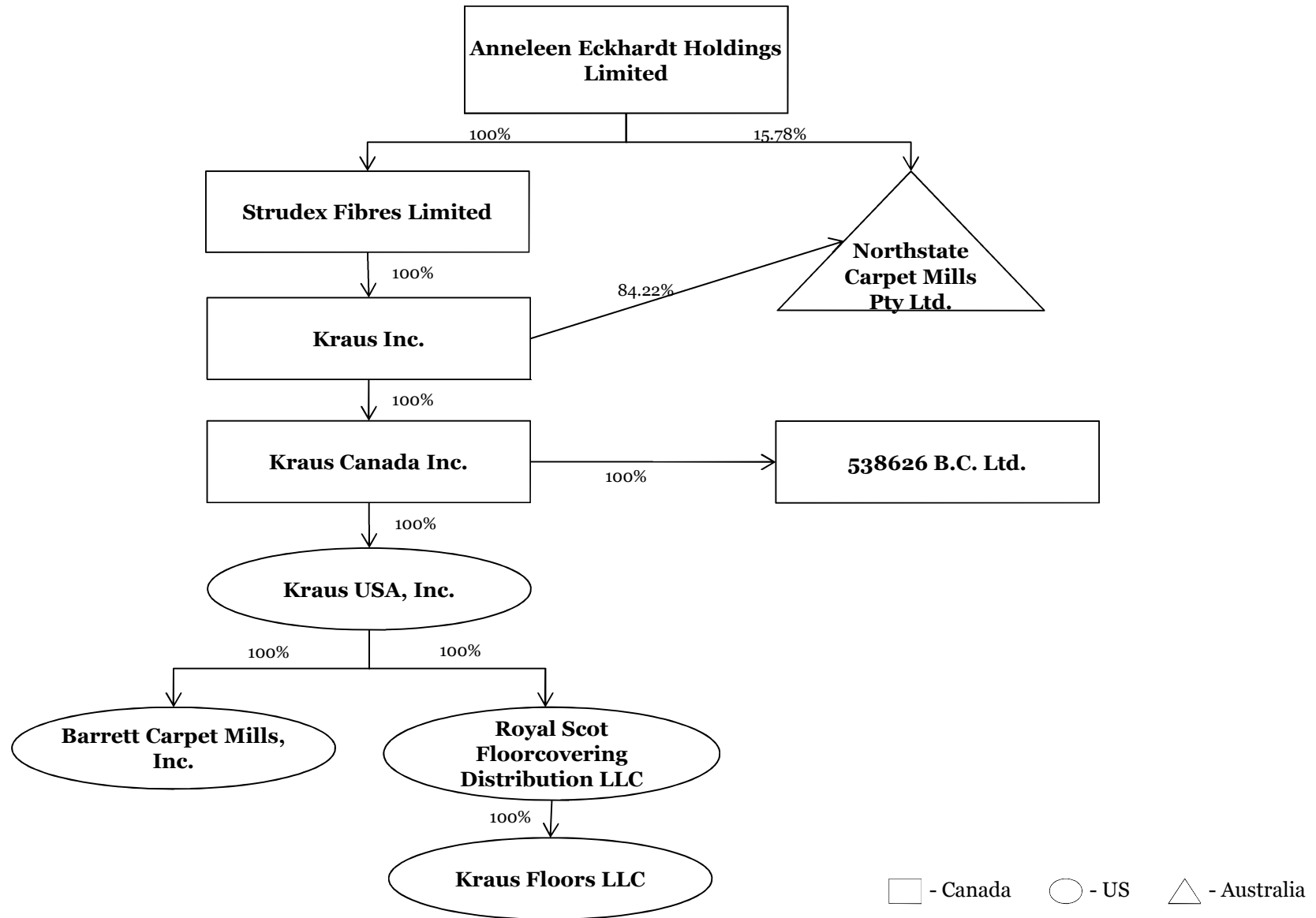
John McKenna
Senior Vice President



Michelle Pickett
Vice President

APPENDIX A

Kraus Group Corporate Chart



APPENDIX B

ACQUISITION OPPORTUNITY

Manufacturer and Distributor of Flooring Products

COMPANY OVERVIEW

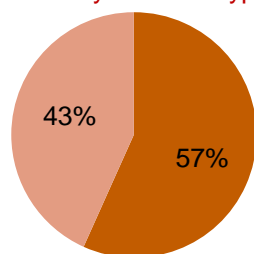
The Company is a leading manufacturer of carpet and a distributor of carpet and flooring products with operations across North America and in Oceania. A key success factor for the Company is its vertical integration both backward into carpet fiber production and forward into flooring distribution. Its ability to produce its own fiber enables it to differentiate its carpet products by adding certain styling features. By controlling its distribution network, the Company is able to push higher margin products through the sales channels while maintaining a high level of customer service and responsiveness.

PRODUCT AND CHANNEL OVERVIEW

The Company has both a diversified product line and the geographic presence to help insulate it against changes in customer preferences and regional economic conditions. Its strategy is focused on manufacturing value-added niche products while providing superior customer service, which allows it to charge premium pricing on many of its product lines.

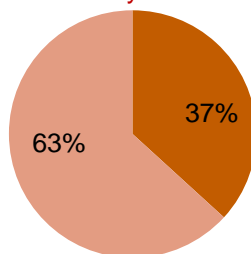
- Almost 60% of the Company's revenue is achieved through the sale of carpet. Carpet sales translate into the highest profit margins for the Company due to the vertically integrated production process. To provide a comprehensive product offering to its customers, the Company also sells a vast array of private label and branded laminate, hardwood, cork and other products.
- Approximately 40% of the Company's products are designed for the commercial market which helps to partially offset cyclical in the residential segment. The Company has a diverse customer mix that includes both independent stores as well as big box retailers. The Company is not economically dependent on any one customer.
- The Company's sales are geographically diversified with Canada accounting for approximately 52% of sales, the US accounting for 42% of sales with the remaining 6% in Oceania.

Sales by Product Type



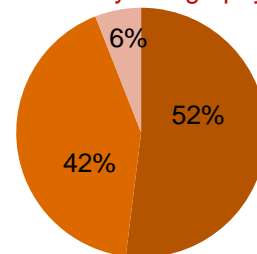
■ Carpet ■ Flooring

Sales by Market



■ Commercial ■ Residential

Sales by Geography

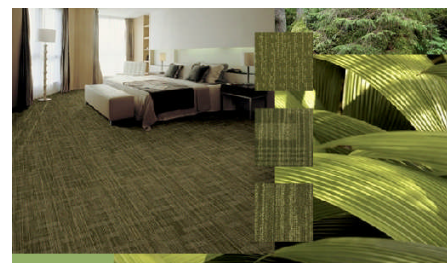


■ Canada ■ US ■ Oceania

OPERATIONS

The Company's primary manufacturing facility is one of the largest in the industry and allows it to capitalize on economies of scale. The facility is outfitted with equipment that utilizes leading technology and includes extrusion lines, a backing line, as well as finishing, dyeing and tufting equipment. The Company's equipment and manufacturing capabilities are critical to supporting its product development and premium pricing strategy.

In addition to its core facility, the Company has a second manufacturing plant which represents approximately 10% of its production. The Company also maintains 8 distribution facilities across North America which enhances its speed to market and enables it to stock products suited for local tastes.



ACQUISITION OPPORTUNITY

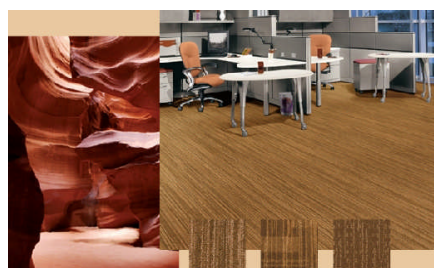
Manufacturer and Distributor of Flooring Products

FINANCIAL INFORMATION

The Company is currently generating approximately \$200 million in annual revenue.

Over the last several years, the flooring industry has been under pressure, driven primarily by the prolonged recession and credit crisis that began in 2008 and has negatively impacted volumes and margins in both residential and commercial markets across North America. To address the downturn in market demand, the Company has implemented a number of profitability enhancement initiatives, including:

- Increased emphasis on product development with the launch of several new specialty products in fiscal 2011.
- Product development has been supported by continued investment in technology to improve manufacturing capabilities.
- Restructuring and centralization of certain manufacturing and distribution operations, including the closure of one manufacturing facility, centralizing call centre operations and rationalizing warehouse space where appropriate.
- Headcount reductions in administration and warehousing and replacement and reduction in sales personnel.



INVESTMENT HIGHLIGHTS

- ✓ Turn-key, world class manufacturing operations with significant potential to achieve economies of scale
- ✓ Excellent product development capabilities with expertise in highly engineered and stylish specialty products
- ✓ Sizeable in-house distribution network catering to both residential and commercial markets
- ✓ Strong management team with a long history in the carpet and flooring industry
- ✓ Diversified customer base across multiple geographies, product lines and channels
- ✓ Lean cost structure driven by recent operational enhancements
- ✓ Well positioned to capitalize on future growth driven by a market recovery and flooring market "catch up" resulting from renovation deferrals that have occurred during the housing downturn

PROCESS OVERVIEW

The Company is reviewing its strategic alternatives and is seeking either a partner or an acquirer of the Company to position it for growth. ***Non-binding expressions of interest are due by December 7, 2011.*** More detailed information will be made available to those who execute a Confidentiality Agreement. To obtain a Confidentiality Agreement, or to discuss specific questions regarding this opportunity, please contact the Company's exclusive financial advisor in this matter.

PRICEWATERHOUSECOOPERS CORPORATE FINANCE INC.

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APPENDIX C

May 25, 2012

PricewaterhouseCoopers Inc.
PwC Tower
18 York Street, Suite 2600
Toronto, Ontario
M5J 0B2

Attention: John McKenna

Re: Binding Offer for the Acquisition of Substantially All Assets of Strudex Fibres Limited, Kraus Inc., Kraus Canada Inc. and 538626 B.C. Ltd. (collectively, the "Kraus Group")

Kraus Brands LP (the "**Purchaser**") is pleased to submit this binding proposal to acquire substantially all assets of the Kraus Group in the form of the asset purchase agreement executed by the Purchaser and attached hereto as Schedule "A" (the "**Offer**"). Capitalized terms used but not defined herein have the meaning given in the Offer.

The Offer will remain open and irrevocable by the Purchaser and will be capable of acceptance by PricewaterhouseCoopers Inc. ("**PwC**"), in its capacity as court-appointed receiver (the "**Receiver**") of the Kraus Group (subject to PwC being appointed as such), until June 11, 2012 or such later date as agreed to in writing by the Purchaser, subject to the Purchaser's right to modify the Offer by amending or supplementing certain Schedules pursuant to Section 7.9 of the Offer.


Once this Offer is accepted by the Receiver, by the Receiver executing the Offer where so indicated, the Offer will become a binding agreement between the Purchaser and the Receiver, subject to the terms and conditions therein. The closing of the transaction will be conditional upon the issuance of the Bankruptcy Order, the issuance of the Vesting Order and the other conditions precedent more specifically set out in the Offer.

This Offer and all other documents relating thereto will be governed in accordance with the laws of the Province of Ontario and the federal laws of Canada applicable therein.

We look forward to PwC's acceptance of the Offer, in its capacity as Receiver, once so appointed.

Yours very truly,

KRAUS BRANDS LP, by its general partner
KRAUS BRANDS INC.


Name: Walter Eckhardt
Title: CEO

**PRICEWATERHOUSECOOPERS INC., solely in its capacity
as court-appointed receiver of Strudex Fibres Limited, Kraus
Inc., Kraus Canada Inc. and 538626 B.C. Ltd. and not in its
personal or corporate capacity**

- and -

KRAUS BRANDS LP

ASSET PURCHASE AGREEMENT

JUNE 11, 2012

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THIS ASSET PURCHASE AGREEMENT is made the 11th day of June, 2012

BY AND AMONG:

PRICEWATERHOUSECOOPERS INC., solely in its capacity as court-appointed receiver of the assets, undertakings and properties of **STRUDEX FIBRES LIMITED, KRAUS INC., KRAUS CANADA INC. AND 538626 B.C. LTD.** and not in its personal or corporate capacity,

(the “**Receiver**”)

- and -

KRAUS BRANDS LP, a limited partnership formed under the Laws of Ontario,

(the “**Purchaser**”)

RECITALS:

- A. PricewaterhouseCoopers Inc. was appointed as the receiver of all of the assets, undertakings and properties of Strudex Fibres Limited (“**Strudex**”), Kraus Inc. (“**KI**”), Kraus Canada Inc. (“**KCI**”) and 538626 B.C. Ltd. (and collectively with Strudex, KI and KCI, the “**Kraus Group**”) pursuant to an order (the “**Appointment Order**”) of the Superior Court of Justice (Commercial List) (the “**Court**”) dated June 11, 2012.
- B. The Appointment Order authorizes the Receiver to enter into this Agreement (as defined herein) with the Purchaser to sell, assign and transfer to the Purchaser the Purchased Assets (as defined herein).
- C. The Receiver has agreed to sell, assign and transfer to the Purchaser and the Purchaser has agreed to purchase all of the Receiver’s right, title and interest, if any, and all of the Kraus Group’s right, title and interest in and to the Purchased Assets subject to and in accordance with the terms and conditions of this Agreement.
- D. The transactions contemplated by this Agreement are subject to the approval of the Court and will be consummated only pursuant to the Vesting Order (as defined herein) to be entered in the Receivership Proceedings (as defined herein).

THEREFORE in consideration of the foregoing and their respective representations, warranties, covenants and agreements herein contained, and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, and intending to be legally bound hereby, the Parties (as defined herein) hereby agree as follows:

ARTICLE 1 DEFINITIONS AND PRINCIPLES OF INTERPRETATION

1.1 Definitions

Whenever used in this Agreement the following words and terms shall have the meanings set out below:

“Accounts Payable” means amounts relating to the Business owing to any Person as of the Closing Time, which are incurred in connection with the purchase of goods or services in the ordinary course of business of the Kraus Group;

“Accounts Receivable” means all accounts receivable, book debts, surpluses, refunds, trade accounts, notes receivable and other debts due or accruing due to any member of the Kraus Group that remain uncollected and unreceived as of the Closing Time, together with all invoices, chattel paper, sale or purchase orders and other records, howsoever stored or recorded, in respect thereof, including any receivables, credits, surpluses or refunds related to Taxes, Employee Plans, freight and duties, together with any security interests or letters of credit granted in favour of the Kraus Group as security therefor and, for greater certainty, includes any Accounts Receivable due or owing from Kraus USA, Inc., Royal Scot Floorcovering LLC, Barrett Carpet Mills, Inc., Northstate Carpet Mills Pty Ltd. and Kraus Floors LLC;

“Affiliate” of any Person means, at the time such determination is being made, any other Person controlling, controlled by or under common control with such first Person, where “control” means the possession, directly or indirectly, of the power to direct the management and policies of such Person whether through the ownership of voting securities or otherwise;

“Agreement” means this asset purchase agreement, including all schedules, and all amendments or restatements, as permitted, and references to **“Article”**, **“Section”** or **“Schedule”** mean the specified Article or Section of, or Schedule to, this Agreement;

“Ancillary Agreements” means the Bill of Sale, the Assignment and Assumption Agreement, the Assignment and Assumption Agreement (Real Property), the Assumption of Charge Agreement, the Secured Debt Assignment and Assumption Agreement, the Assignment of Intellectual Property and any other agreement, document or instrument contemplated in this Agreement or that the Receiver or the Purchaser enter into in connection with the consummation of the transactions contemplated hereby;

“Appointment Order” has the meaning given in the Recitals;

“Assignment and Assumption Agreement” means one or more assignment and assumption agreements in form and substance satisfactory to the Parties, acting reasonably, evidencing the assignment to and assumption by the Purchaser of all of the Assumed Liabilities (other than those relating to the Real Property), including the rights and obligations under the Transferred Contracts;

“Assignment and Assumption Agreement (Real Property)” means an assignment and assumption agreement in form and substance satisfactory to the Parties, acting reasonably, evidencing the assignment to and assumption by the Purchaser of all of the Assumed Liabilities relating to the Real Property;

“Assignment of Intellectual Property” means an agreement in form and substance satisfactory to the Parties, acting reasonably, evidencing the assignment of all of the Receiver’s right, title and interest, if any, and all of the Kraus Group’s right, title and interest in and to the Intellectual Property to the Purchaser;

“Assumed Liabilities” has the meaning given in Section 2.3;

“Assumed Real Property Leases” means the Contracts relating to the Leased Premises listed on Schedule M;

“Assumed Secured Debt” has the meaning given to it in Section 2.7(b);

“Assumption of Charge Agreement” means an agreement in form and substance satisfactory to the Parties between the Receiver, Kraus Properties LP and Red Ash pursuant to which the charges on title to the Real Property in favour of Red Ash are assumed by Kraus Properties LP on closing;

“Bankruptcy Orders” means the order or orders of the Court dated June 11, 2012 pursuant to Section 43 of the BIA adjudging each of Strudex, KI and KCI bankrupt;

“Bankruptcy Proceedings” means, collectively, the bankruptcy proceedings with respect to each of Strudex, KI and KCI commenced by the Bankruptcy Orders;

“Bankruptcy Trustee” means PricewaterhouseCoopers Inc. in its capacity as trustee in bankruptcy of each of KI, KCI and Strudex, appointed pursuant to the Bankruptcy Orders;

“BIA” means the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c.B-3;

“BIA Charges” means the charges created by Sections 81.3, 81.4, 81.5 and 81.6 of the BIA;

“Bill of Sale” means a bill of sale in form and substance satisfactory to the Parties, acting reasonably, duly executed by the Receiver, conveying to the Purchaser all of the Receiver’s right, title and interest, if any, and all of the Kraus Group’s right, title and interest in and to the Purchased Assets;

“Books and Records” means all financial records and all other books, records, files and papers relating to the Business and/or the Purchased Assets, including financial, corporate, operations and sales books, records, books of account, advertising material, sales and purchase records, lists of suppliers and customers, business reports, plans and projections and all other documents, surveys, plans, files, records, assessments, correspondence and other data and information, financial or otherwise, including all data, information and databases stored on computer-related or other electronic media and all plans and specifications relating to the plant, buildings,

structures, Improvements and fixtures situated on the Real Property used in the Business (including all electrical, mechanical and structural drawings related thereto);

“**Business**” means the carpet manufacturing and carpet and other flooring distribution business of the Kraus Group;

“**Business Day**” means any day other than a Saturday, Sunday or statutory holiday in the Province of Ontario;

“**Capital Stock**” means any and all shares, interests, participations or other equivalents (however designated) of capital stock of a corporation and any and all ownership interests in a person (other than a corporation), including membership interests, limited liability company interests, partnership interests, joint venture interests and beneficial interests, and any and all warrants, options or other rights to purchase any of the foregoing, including all such Capital Stock of Kraus USA, Inc., Royal Scot Floorcovering Distribution LLC, Barrett Carpet Mills, Inc., Northstate Capital Mills PTY Ltd. and Kraus Floors LLC;

“**Claims**” includes claims, demands, complaints, grievances, actions, applications, suits, causes of action, orders, charges, indictments, prosecutions or other similar processes;

“**Closing**” means the consummation and effectuation of the transactions contemplated hereby pursuant to the terms and conditions of this Agreement;

“**Closing Date**” is the day on which the Closing occurs;

“**Closing Time**” is the time of day on the Closing Date at which Closing occurs;

“**Collective Agreements**” means all collective bargaining agreements and all other union agreements governing the employment of any of the Employees, including the following:

- (a) the collective agreement dated March 20, 2008 between Strudex and United Food & Commercial Workers Canada, Local 175, as amended by Memorandum of Settlement dated June 13, 2011;
- (b) the collective agreement dated July 1, 2009 between KI and United Food & Commercial Workers Canada, Local 175; and
- (c) the collective agreement dated October 1, 2010 between KCI and Teamsters Local Union No. 213 (affiliated with the International Brotherhood of Teamsters, of the City of Vancouver, Province of British Columbia);

“**Competition Act**” means the *Competition Act*, R.S.C., 1985, c. C-34;

“**Competition Act Approval**” means either: (i) the Commissioner of Competition appointed under the Competition Act shall have issued an advance ruling certificate under section 102 of the Competition Act; or (ii) (A) the Commissioner of Competition shall have advised the Purchaser, in writing, that the Commissioner of Competition has no intention to file an

application under Part VIII of the Competition Act in connection with the transactions contemplated by this Agreement and (B) the waiting period under section 114 of the Competition Act shall have expired or been terminated or shall have waived, pursuant to section 113(c) of the Competition Act, the Parties' obligations under section 114 of the Competition Act;

"Contaminants" means any pollutant, contaminant, waste, toxic, corrosive or hazardous substance, deleterious substance, dangerous substance, or hazardous or special waste as defined in, or prohibited or regulated by, any Environmental Laws, including asbestos, asbestos-containing materials, radioactive materials, urea formaldehyde and PCBs (polychlorinated biphenyls);

"Contracts" means contracts, licences, leases, agreements, obligations, promises, undertakings, understandings, arrangements, documents, commitments, entitlements or engagements to which any member of the Kraus Group is a party, by which any member of the Kraus Group is bound or under which any member of the Kraus Group has, or will have, any liability or contingent liability (in each case, whether written or oral, express or implied) relating to the Purchased Assets and/or the Business, as same may be amended and/or restated, and including any and all related quotations, orders, proposals or tenders which remain open for acceptance, warranties, guarantees and documents ancillary thereto. For greater certainty, "Contracts" shall include the Collective Agreements and the Employee Plans;

"Court" has the meaning given in the Recitals;

"Cure Costs" means all amounts that must be paid, if any, to obtain a consent necessary to effect an assignment of a Transferred Contract;

"Designated Employees" means the Non-Unionized Employees to whom offers of employment will be made by the Purchaser under this Agreement;

"Documents" means all files, documents, instruments, papers, Books and Records, reports, tapes, microfilms, photographs, letters, budgets, forecasts, ledgers, journals, title policies, customer lists, invoices, regulatory filings, operating data and plans, technical documentation (design specifications, functional requirements, operating instructions, repair data, manuals, flow charts, etc.), user documentation (installation guides, user manuals, training materials, release notes, working papers, etc.), marketing documentation (sales brochures, flyers, pamphlets, web pages, etc.), cost of pricing information, business plans, quality control records and procedures, blueprints, accounting and tax files, all files, customer files and documents (including credit information), personnel files for employees, supplier lists, records, literature and correspondence, including materials relating to Inventory, services, marketing, advertising, promotional materials, Intellectual Property, and other similar materials to the extent related to, used in, held for use in, or with respect to, the Business or the Purchased Assets, in each case whether or not in electronic form, whether or not physically located at a Facility, but excluding any materials exclusively related to any Excluded Assets;

"Employees" means any and all (i) employees or contractors of the Kraus Group who are actively at work (including full-time, part-time or temporary employees); and (ii) employees or

contractors of the Kraus Group who are on lay-off or other leaves of absence (including maternity leave, parental leave, disability leave, sickness leave, workers' compensation and other statutory leaves) and for greater certainty includes those employees of the Kraus Group whose employment was terminated by operation of law as a result of the Bankruptcy Orders;

"Employee Plan" means all contracts, agreements, plans, arrangements or policies (whether written or oral) providing for:

- (a) wages, salaries, incentive compensation, deferred compensation, bonuses, profit-sharing, severance or termination pay, share appreciation, share option, share purchase or other stock related rights relating to the Business;
- (b) health or other medical benefits (other than the Canada Pension Plan, the Ontario Health Insurance Plan and other similar health plans established and administered by any other province or state and workers' compensation insurance provided pursuant to applicable Law), life or other insurance (including any self-insured arrangements), dental, disability, salary continuation, vacation, automobile, supplemental unemployment benefits, post-employment, retirement or supplemental retirement benefits (including compensation, pension, health, medical or life insurance benefits);
- (c) employee loan, employee assistance, pension, retirement or supplemental retirement plan or agreement (including any defined benefit or defined contribution pension plan and any group registered retirement savings plan); or
- (d) any other employee benefit plan or agreement (whether oral or written, formal or informal, funded or unfunded, including any post-retirement benefits), sponsored, maintained or contributed to or required to be contributed to by the Kraus Group for the benefit of any of the Employees, whether or not insured and whether or not subject to any applicable Law),

which are maintained, administered or contributed to by or on behalf of the Kraus Group and which cover any Employee or former employee of the Kraus Group, including the Pension Plans;

"Encumbrances" means, to the extent not considered a Lien, all encumbrances, interests and Claims, including any security interest, lien, collateral assignment, right of set-off, debt, obligation, liability, pledge, levy, charge, escrow, encumbrance, option, right of first refusal, restriction (whether on transfer, disposition or otherwise), third party right, right limited to any one or more of the members of the Kraus Group personally, other agreement term tending to limit any right or privilege of any one or more of the members of the Kraus Group under any Contract, conditional sale contract, title retention contract, mortgage, lease, deed of trust, hypothecation, indenture, security agreement, easement, license, servitude, proxy, voting trust, transfer restriction under any shareholder or similar agreement, or any other agreement, arrangement, contract, commitment, understanding or obligation of any kind whatsoever, whether written or oral, or imposed by any Law, equity or otherwise;

“Environment” means the air above the land, the water (including surfacewater and groundwater) in, on and under the lands and the land (including soil, sediments and lands submerged under water) as well as all animals, plants, fish and other species using or living in such areas;

“Environmental Laws” means any domestic or foreign statute, Law, ordinance, rule, regulation, by-law or Order relating to the Environment, in each case binding on the Person referred to in the context in which such words are used including, for greater certainty, relating to the storage, generation, use, handling, manufacture, processing, transportation, import, export, treatment, remediation, release or disposal of any Contaminants, but excluding those relating to occupational health and safety;

“Environmental Liabilities” means any and all liability, claim, demand, obligation, cause of action, remediation, cost recovery action, investigation, proceeding, Order, violation, damage, Loss, judgment, penalty, or fine asserted by any third party (including any private party or Government Authority), arising out of, or relating to, the Environment or Environmental Laws. “Environmental Liabilities” includes any liability or responsibility for costs of removing or disposing of any Contaminants, any costs relating to enforcement or legally required remedial actions, and any other costs or expense whatsoever, related to emissions or effluent containing Contaminants, whether onto or from the Real Property;

“Environmental Permits” means all permits, certificates, approvals, consents, authorizations, registrations, licences, exemptions, waivers or other Orders issued, granted, conferred, created or required by any Governmental Authority pursuant to any Environmental Laws;

“Excluded Assets” means the assets listed in Schedule B;

“Excluded Liabilities” has the meaning given in Section 2.4;

“Excluded Real Property Leases” means any Contracts relating to the lease or occupation of the Leased Premises unless listed on Schedule M;

“Existing Senior Security” means the security granted in favour of Red Ash (as assignee) by the Kraus Group securing the Senior Secured Debt;

“Existing Subordinated Security” means the security granted in favour of Red Ash (as assignee) by the Kraus Group securing the Subordinated Secured Debt;

“Facilities” means the facilities located on the Real Property or the Leased Premises;

“FF&E” means all equipment, machinery, fixtures, furniture, motor vehicles, computers, printers, tools, telephone systems, furnishings, artwork and plates and any related capitalized items and other tangible property of every kind, nature and description, or used or useful in the operation of the Business and the Purchased Assets, including any of the foregoing in possession of suppliers, customers and other third parties (including all such property that is damaged);

“Funding Term Sheet” means a term sheet between the Receiver and Red Ash in form and substance satisfactory to the Receiver and Red Ash, acting reasonably, pursuant to which Red Ash agrees to fund the Receiver for certain costs and expenses incurred by the Receiver in connection with the Receivership Proceedings;

“General Intangibles” means, other than the Intellectual Property, all intangible assets now owned or leased (or acquired or leased by the Kraus Group prior to the Closing Date), including all right, title and interest, if any, the Kraus Group has in or under any Contract, all payment intangibles, interest in business associations, Licenses, permits, approvals and authorizations which the Kraus Group holds for the Business from any Governmental Authority that relate to the Business, proprietary or confidential information, technical information, procedures, uncertificated securities, chequing and any other bank accounts, rights of the Kraus Group to receive payments, rights to receive dividends, distributions, cash, instruments, investment property and rights of indemnification.

“Governmental Authority” means governments, regulatory authorities, governmental departments, agencies, commissions, bureaus, officials, ministers, Crown corporations, courts, bodies, boards, tribunals or dispute settlement panels or other law or regulation-making organizations or entities: (a) having or purporting to have jurisdiction on behalf of any nation, province, territory, state or other geographic or political subdivision thereof; or (b) exercising, or entitled or purporting to exercise, any administrative, executive, judicial, legislative, policy, regulatory or taxing authority or power;

“Improvements” means buildings, structures, systems, facilities, easements, rights-of-way, privileges, improvements, licences, hereditaments, appurtenances and all other rights and benefits belonging, or in any way related to the Real Property;

“Intellectual Property” means all (a) patents, patent applications and patent disclosures, together with all reissuances, continuations, continuations in part, revisions, extensions, re-examinations, provisionals, divisions, renewals, revivals, and foreign counterparts thereof and all registrations and renewals in connection therewith, (b) trademarks, service marks, trade dress, logos, trade names and corporate names and other indicia of origin and corporate branding, together with all translations, adaptations, derivations and combinations thereof and including all goodwill associated therewith, and all applications, registrations and renewals in connection therewith, (c) works of authorship, copyrightable works, copyrights and all applications, registrations and renewals in connection therewith, (d) mask works and all applications, registrations and renewals in connection therewith, (e) trade secrets, inventions and confidential business information (including ideas, research and development, know-how, formulas, compositions, manufacturing and production processes and techniques, technical data, designs, drawings, specifications, customer and supplier lists, pricing and cost information, business and marketing plans and proposals, assembly, test, installation, service and inspection instructions and procedures, technical, operating and service and maintenance manuals and data, hardware reference manuals and engineering, programming, service and maintenance notes and logs), (f) Software, (g) internet addresses, uniform resource locaters, domain names, websites, internet service provider contracts, e-mail accounts and web pages, (h) any and all other intellectual property and proprietary rights, (i) company-wide telephone numbers, and (j) goodwill related to

all of the foregoing; in each case to the extent used or useful in the operation of the Business or related to any Purchased Asset, including such Intellectual Property listed on Schedule F;

“Inventory” means items that are held by the Kraus Group for sale, license, rental, lease or other distribution in the ordinary course of business, or are being produced for sale, or are to be consumed, directly or indirectly, in the production of goods or services to be available for sale, of every kind and nature and wheresoever situate relating to the Business including inventories of raw materials, work-in-progress, finished goods and by-products, operating supplies and packaging materials;

“KCI” has the meaning given in the Recitals;

“KI” has the meaning given in the Recitals;

“Kraus Group” has the meaning given in the Recitals;

“Law” means any federal, state, provincial, county, territorial, district, municipal, local, foreign, supranational or international law, statute, ordinance, regulation, by-law, rule, code, treaty or rule of common law or otherwise of, or any order, judgment, injunction, decree or similar authority enacted, issued, promulgated, enforced or entered by, any Governmental Authority;

“Leased Premises” means the premises leased and occupied by any of the Kraus Group and listed on Schedule K, but for greater certainty, shall not include the premises located at 2285 Place Transcanadienne, Dorval, Quebec;

“Licenses” means all the licences, permits (including any Environmental Permits), certificates, approvals, consents, registrations, orders, grants, permission and other authorizations and rights held by any members of the Kraus Group and related to the Purchased Assets or the Business and listed on Schedule J;

“Lien” means any lien (statutory or otherwise), mortgage, charge, hypothec, trust (whether express, deemed, constructive or remedial), pledge, security interest, prior assignment option, warrant, lease, sublease, right of possession, encumbrance, claim, right or restriction which affects, by way of a conflicting ownership interest or otherwise, the right, title or interest to or in any particular property, and includes Claims relating to Taxes, the BIA Charges and all charges created by the BIA, the Appointment Order, the Bankruptcy Orders or any other order of the Court in the Receivership Proceedings or the Bankruptcy Proceedings;

“Loss” means any and all loss, liability, damage, cost or expense actually suffered or incurred by a Party (including the costs and expenses of all actions, suits, proceedings, hearings, investigations, charges, complaints, claims, demands, injunctions, assessments, judgments, Orders, rulings, dues, penalties, fines, amounts paid in settlement or compromise, including court costs and reasonable legal fees and expenses);

“New Collective Agreements” means collective bargaining agreements to be agreed to by the Purchaser and each of United Food & Commercial Workers Canada, Local 175 and Teamsters

Local Union No. 213 to replace or modify each of the Collective Agreements on terms satisfactory to the Purchaser;

“Nelson Secured Debt” has the meaning given in Schedule G.

“Non-Assumed Secured Debt” means the secured indebtedness owing by the Kraus Group to Red Ash after the assumption of the Assumed Secured Debt by the Purchaser on Closing;

“Non-Unionized Employees” means all Employees who are not Unionized Employees;

“Non-Transferred Employees” means all Non-Unionized Employees who are not Transferred Employees. For greater certainty, “Non-Transferred Employees” includes (i) Non-Unionized Employees who are not Designated Employees and (ii) Designated Employees who are not Transferred Employees;

“Order” means any legally binding order, decision, determination, judgment, injunction, decree, award or writ of any court, arbitrator or Governmental Authority, or other Person who is authorized to make legally binding determinations;

“Parties” means the Receiver and the Purchaser collectively, and **“Party”** means any one of them;

“Pension Plans” means the Pension Plan for Employees of Kraus Inc. and Strudex Fibres Limited (FSCO Reg. No. 330621), the Registered Pension Plan for Employees of Kraus Canada Inc. (Manitoba Reg. No. 279992), the Pension Plan for Union Employees of Kraus Inc. (FSCO Reg. No. 942979) and the Pension Plan for Executive Employees of Kraus Inc. (FSCO Reg. No. 551580);

“Permitted Encumbrances” means the Liens and Encumbrances listed in Schedule D;

“Person” means any individual, sole proprietorship, partnership, firm, entity, unincorporated association, unincorporated syndicate, unincorporated organization, trust, body corporate, Governmental Authority, and where the context requires any of the foregoing when they are acting as trustee, executor, administrator or other legal representative;

“Personal Information” means information about an identifiable individual as defined in Privacy Law;

“Personal Property” means:

- (i) all machinery, plants, equipment, trade fixtures, furnishings, goods in process and accessories (including all FF&E) now or previously used in or related to the operation of the Business and situated on the Real Property, the Leased Premises and/or with a bailee as at the date of this Agreement, including all spare parts, supplies and equipment including those described in Schedule L Schedule J, and any machinery and equipment held under a lease or title retention agreement used in or related to the operation of the Business;

- (ii) all maintenance and repair supplies and spares, supplies (including fuels, grease and chemicals and containers in which any of these are stored), related to the operation of the Business which are stored or situate upon the Real Property, the Leased Premises, and/or with a bailee as at the Closing Time;
- (iii) all computer hardware located at the Facilities;
- (iv) all trucks, cars, mobile equipment and other vehicles, plants, machinery and other equipment at or upon the Real Property, the Leased Premises or the Facilities and/or used by the Kraus Group or any one of them in connection with the Business, including, but not limited to, those listed in Schedule L;
- (v) any lease or conditional sales agreement of any equipment, plant, machinery or vehicles used in connection with the Business including, but not limited to, those listed in Schedule L; and
- (vi) any additional personal or movable property related to the Business and acquired by the Kraus Group subsequent to the date of this Agreement in the ordinary course of the operation of the Business or as otherwise acquired in accordance with the terms of this Agreement;

“Prepaid Expenses and Deposits” means the unused portion of amounts prepaid by or on behalf of the Kraus Group or any one of them relating to the Business or the Purchased Assets including Taxes, assessments, rates and charges, utilities, rents, tenant allowances, insurance and deposits with any public utility or any Governmental Authority, but excluding income or other Taxes which are personal to the Kraus Group;

“Priority Claims” means any obligations to the extent secured by any Liens or Encumbrances against the Purchased Assets ranking in priority to the Existing Senior Security and/or Existing Subordinated Security as at the Closing Time;

“Privacy Law” means the *Personal Information Protection and Electronic Documents Act*, S.C. 2000, c. 5, the *Freedom of Information and Protection of Privacy Act*, R.S.O. 1990, c.F. 31, and any comparable Law of any other jurisdiction related to or applicable to the Employees;

“Purchase Price” has the meaning given in Section 2.6;

“Purchased Assets” means all intangible and tangible properties, assets, interests, claims and rights which are related to the operation of, and necessary to conduct, the Business as now conducted, wherever located, as of the Closing, which for greater certainty includes the properties, assets and interests listed in Schedule A but does not include the Excluded Assets;

“Real Property” means the lands and other real and immovable property owned by the Kraus Group, together with all premises, buildings, structures, appurtenances, fixtures, easement, rights of way, private roads and other Improvements situated thereon, therein and thereunder located at

65 Northfield Drive West, Waterloo, Ontario, and legally described as: Part of Lot 8, German Company Tract, Township of Waterloo, designated as Parts 1, 2, 3, 4, 5 & 6 on Plan 58R-4092; subject to Instruments 369437, 465123E and B45015; Waterloo;

“Real Property Tax Refunds” means any and all rebates, credits or refunds for realty taxes relating to the Real Property;

“Receiver” has the meaning given in the Recitals;

“Receiver’s Certificate” has the meaning given in Section 8.3;

“Receivership Proceedings” means the receivership proceedings with respect to the Kraus Group commenced by the Appointment Order;

“Red Ash” means Red Ash Capital Partners II Limited Partnership;

“Senior Secured Debt” has the meaning given in Schedule G.

“Secured Debt Assignment and Assumption Agreement” means an assignment and assumption agreement in form and substance satisfactory to the Parties, acting reasonably, evidencing the assignment to and assumption by the Purchaser of the Assumed Secured Debt;

“Software” means any computer program, operating system, application, system, firmware or software of any nature, point-of-entry system, peripherals, and data whether operational, active, under development or design, nonoperational or inactive, including all object code, source code, comment code, algorithms, processes, formulae, interfaces, navigational devices, menu structures or arrangements, icons, operational instructions, scripts, commands, syntax, screen designs, reports, designs, concepts, visual expressions, technical manuals, tests scripts, user manuals and other documentation therefor, whether in machine-readable form, virtual machine-readable form, programming language, modeling language or any other language or symbols, and whether stored, encoded, recorded or written on disk, tape, film, memory device, paper or other media of any nature, and all databases necessary or appropriate in connection with the operation or use of any such computer program, operating system, application, system, firmware or software.

“Strudex” has the meaning given in the Recitals;

“Subordinated Secured Debt” has the meaning given in Schedule G.

“Target Date” means June 11, 2012;

“Tax” and **“Taxes”** means any taxes, duties, fees, premiums, assessments, imposts, levies and other charges of any kind whatsoever imposed by any Governmental Authority, including all interest, penalties, fines, additions to tax or other additional amounts imposed by any Governmental Authority in respect thereof, and including those levied on, or measured by, income, gross receipts, profits, capital, transfer, land transfer, sales, goods and services, harmonized sales, use, excise, withholding, business, franchising, property, development,

occupancy, payroll, health, social services, education and social security taxes, all surtaxes, all customs, duties and import and export taxes, countervail and anti-dumping, all licence, franchise and registration fees and all employment insurance, health insurance and Canada, and other government pension plan premiums or contributions;

“**Transfer Taxes**” has the meaning given in Section 7.3(c);

“**Transferred Contracts**” means, collectively, those Contracts listed on Schedule H, Schedule F and shall include the Assumed Real Property Leases and the Licences, but, for greater certainty, shall not include any Employee Plans;

“**Transferred Employees**” means all Designated Employees who accept offers of employment made by the Purchaser pursuant to Section 4.1;

“**Unionized Employees**” means all Employees whose employment is governed by any of the Collective Agreements; and

“**Vesting Order**” means an order issued by the Court approving this Agreement and the transactions contemplated by this Agreement, authorizing the Receiver to enter into this Agreement and the Ancillary Agreements and to consummate the transactions contemplated by this Agreement, and vesting in the Purchaser all of the Receiver’s right, title and interest, if any, and all of the Kraus Group’s right, title and interest, in and to the Purchased Assets free and clear of all Liens and Encumbrances (other than Permitted Encumbrances), substantially in the form attached at Schedule E subject to such amendments as the Receiver and the Purchaser may mutually agree acting reasonably.

1.2 Certain Rules of Interpretation

In this Agreement:

- (a) **Currency** – All references to money amounts are to lawful currency of Canada;
- (b) **Governing Law** – This Agreement is a contract made under and shall be governed by and construed in accordance with the Laws of the Province of Ontario and the federal Laws of Canada applicable in the Province of Ontario;
- (c) **Headings** – Headings of Articles and Sections are inserted for convenience of reference only and shall not affect the construction or interpretation of this Agreement;
- (d) **Including** – Where the word “including” or “includes” is used in this Agreement, it means “including (or includes) without limitation”;
- (e) **No Strict Construction** – The language used in this Agreement is the language chosen by the Parties to express their mutual intent, and no rule of strict construction shall be applied against any Party;

- (f) **Number and Gender** – Unless the context otherwise requires, words importing the singular include the plural and vice versa and words importing gender include all genders;
- (g) **Severability** – If, in any jurisdiction, any provision of this Agreement or its application to any Person or circumstance is restricted, prohibited or unenforceable, such provision shall, as to such jurisdiction, be ineffective only to the extent of such restriction, prohibition or unenforceability without invalidating the remaining provisions of this Agreement and without affecting the validity or enforceability of such provision in any other jurisdiction or without affecting its application to any other Person or circumstance;
- (h) **Time Periods** – Unless otherwise specified, time periods within or following which any payment is to be made or act is to be done shall be calculated by excluding the day on which the period commences and including the day on which the period ends and by extending the period to the next Business Day following if the last day of the period is not a Business Day; and
- (i) **Legislation** - A reference to any legislation or to any provision of any legislation shall include any amendment to, and any modification or re-enactment thereof, any legislative provision substituted therefore and all regulations and statutory instruments issued thereunder or pursuant thereto.

1.3 Entire Agreement

This Agreement and the agreements and other documents required to be delivered pursuant to this Agreement, constitute the entire agreement between the Parties and set out all the covenants, promises, warranties, representations, conditions, understandings and agreements between the Parties relating to the subject matter of this Agreement and supersede all prior agreements, understandings, negotiations and discussions, whether oral or written. There are no covenants, promises, warranties, representations, conditions, understandings or other agreements, oral or written, express, implied or collateral between the Parties in connection with the subject matter of this Agreement except as specifically set forth in this Agreement and the Purchaser shall acquire all of the Receiver's right, title and interest, if any, and all of the Kraus Group's right, title and interest in and to the Purchased Assets on an "as is, where is" basis. Any cost estimates, projections or other predictions contained or referred to in any other material that has been provided to the Purchaser or any of its Affiliates, subsidiaries, agents or representatives are not and shall not be deemed to be representations or warranties of the Receiver or any of its Affiliates, subsidiaries, agents, employees or representatives.

1.4 Schedules

The schedules to this Agreement, listed below, are an integral part of this Agreement:

<u>Schedule</u>	<u>Description</u>
Schedule A	– Purchased Assets
Schedule B	– Excluded Assets
Schedule C	– Assumed Liabilities
Schedule D	– Permitted Encumbrances
Schedule E	– Vesting Order
Schedule F	– Intellectual Property
Schedule G	– Secured Debt
1	– Transferred Contracts
Schedule I	– Estimated Priority Claims
Schedule L	– Licenses
Schedule M	– Leased Premises
Schedule L	– Personal Property
Schedule M	– Assumed Real Property Leases

1.5 Conflict

In the event of any conflict between the provisions of the body of this Agreement and the Schedules, the provisions of the body of this Agreement shall prevail.

ARTICLE 2 PURCHASE AND SALE

2.1 Purchase and Sale of Purchased Assets

On the terms and subject to the conditions of this Agreement, at the Closing, the Receiver shall transfer, sell, convey, assign and deliver unto the Purchaser, and the Purchaser shall purchase, acquire and accept from the Receiver all of the Receiver's right, title and interest, if any, and all of the Kraus Group's right, title and interest, in and to the Purchased Assets, which will, pursuant to the Vesting Order, be free and clear of all Liens and Encumbrances other than Permitted Encumbrances.

2.2 Excluded Assets

Notwithstanding any provision of this Agreement to the contrary, nothing herein shall be deemed to transfer, sell, convey or assign any of the Excluded Assets.

2.3 Assumed Liabilities

On the terms and subject to the conditions of this Agreement, the Purchaser agrees, effective at the Closing Time, to assume and be responsible for and thereafter honour, perform, discharge and pay as and when due the Assumed Secured Debt and the following obligations and liabilities of the Kraus Group:

- (a) all ordinary course debts, liabilities and obligations with respect to the Purchased Assets arising on or after the Closing Date, including all ordinary course debts, liabilities and obligations for goods to be sold, delivered or provided to the Purchaser in connection with the Business and services to be rendered to the Purchaser in connection with the Business solely in relation to the Purchased Assets for the period from and after the Closing Date;
- (b) all debts, liabilities and obligations for any property taxes owing in respect of the Real Property arising on or after the Closing Date;
- (c) all Transfer Taxes arising from or relating to the purchase by the Purchaser of all of the Receiver's right, title and interest, if any, and all of the Kraus Group's right, title and interest in and to the Purchased Assets hereunder;
- (d) all debts, liabilities and obligations to the Transferred Employees arising on or after the Closing Date;
- (e) all debts, liabilities and obligations to the Unionized Employees but only to the extent provided for under the New Collective Agreements or as otherwise expressly assumed by the Purchaser hereunder;
- (f) all accrued but unpaid wages and vacation pay owing to the Transferred Employees and Unionized Employees by the Kraus Group as at Closing (irrespective of whether such accrued and unpaid wages or vacation pay for Unionized Employees are provided for in the New Collective Agreements or the Collective Agreements);
- (g) all Cure Costs, if any, in relation to obtaining any consent to assign any Transferred Contracts, but only to the extent that the Purchaser requests such consent to be obtained and such Transferred Contract is effectively assigned to the Purchaser, provided however that the Receiver shall have no liability for Cure Costs;
- (h) all Priority Claims to the extent not paid or discharged on the Closing Date; and

- (i) certain other debts, liabilities and obligations, if any, specifically identified in Schedule C,

(Sections 2.3(a) – (i) are referred to herein collectively as, the “**Assumed Liabilities**”).

2.4 Excluded Liabilities

Other than the Assumed Liabilities and the Assumed Secured Debt, the Purchaser shall not assume and shall not be liable for any debts, liabilities or obligations of the Kraus Group (the “**Excluded Liabilities**”). Without limiting the generality of the foregoing, except to the extent constituting a Priority Claim, the Excluded Liabilities include:

- (a) all debts, liabilities and obligations related to any Excluded Assets;
- (b) all Accounts Payable other than those Accounts Payable, if any, specifically listed as Assumed Liabilities on Schedule C;
- (c) all debts, liabilities and obligations owing by any member of the Kraus Group to any other member(s) of the Kraus Group or any Affiliate thereof;
- (d) all debts, liabilities and obligations of any member of the Kraus Group pursuant to any warranty, representation or guarantee, whether written, oral or implied, made prior to Closing in any way related to product sold or delivered, or services provided, prior to the Closing in connection with the Business;
- (e) all debts, liabilities and obligations for or related to Taxes that are not expressly listed as Assumed Liabilities;
- (f) other than the Cure Costs, if any, payable in connection with the Transferred Contracts, all debts, liabilities and obligations arising from the ownership or use of the Purchased Assets prior to the Closing;
- (g) all debts, liabilities and obligations to the Employees arising prior to the Closing, except as specifically agreed to by the Purchaser in the New Collective Agreements or as otherwise specifically agreed to by the Purchaser in writing, provided that, other than as provided for in Sections 2.3(d), (e) and (f), nothing in this Agreement shall be deemed to constitute such agreement;
- (h) all debts, liabilities and obligations under or related to the Employee Plans, except as specifically agreed to by the Purchaser in the New Collective Agreements or as otherwise specifically agreed to by the Purchaser in writing, provided that nothing in this Agreement shall be deemed to constitute such agreement;
- (i) all debts, liabilities and obligations under any of the Collective Agreements except to the extent specifically provided for in the New Collective Agreements or as expressly assumed by the Purchaser hereunder;

- (j) all debts, liabilities and obligations under or in relation to the Excluded Real Property Leases;
- (k) all debts, liabilities and obligations relating to, including under any Contract related to, the premises located at 2285 Place Transcanadienne, Dorval, Quebec;
- (l) all Environmental Liabilities, except as required to be assumed by applicable Law; and
- (m) the Non-Assumed Secured Debt.

2.5 Assignment and Assumption of Transferred Contracts

- (a) Subject to any rights of consent by counterparties thereto, the terms and conditions of this Section 2.5, the Assignment and Assumption Agreement and the Vesting Order, the Transferred Contracts shall be assigned and transferred to the Purchaser at Closing, the consideration for which is included in the Purchase Price.
- (b) The Purchaser will assume and agree to perform and discharge the Assumed Liabilities under the Transferred Contracts pursuant to this Agreement and the Assignment and Assumption Agreement.
- (c) Up to the Closing Date and for a period of 30 days following the Closing, the Purchaser shall have the right, but not the obligation, to elect to add to or supplement the list of Transferred Contracts (other than the list of Assumed Real Property Leases) by providing written notice to the Receiver, and upon any such election being made, such Contract shall be considered a Transferred Contract for all purposes in this Agreement.
- (d) Up to the Closing Date and for a period of 90 days following the Closing, the Purchaser shall have the right, but not the obligation, to elect to add to or supplement the list of Assumed Real Property Leases by providing written notice to the Receiver, and upon such election being made, such Assumed Real Property Lease shall be considered an Assumed Real Property Lease and a Transferred Contract for all purposes in this Agreement.
- (e) If any necessary consent for the effective assignment of a Transferred Contract is not obtained as of Closing, the Receiver shall use commercially reasonable efforts to obtain such consent in order to assign the Transferred Contracts to the Purchaser for a period of 90 days following Closing, provided that the Purchaser shall be responsible for the Receiver's costs and expenses related thereto. During such 90 day period, the Receiver shall take such actions and do such things as may be reasonably and lawfully designed, and designated by the Purchaser, to provide the benefits of those non-assignable Transferred Contracts to the Purchaser, including holding those Transferred Contracts in trust for the benefit of the Purchaser or acting as agent for the Purchaser.

- (f) Except in relation to any Contracts which are Transferred Contracts as of the Closing Date, the Receiver shall perform any post-Closing executory obligations of a financial or monetary nature under the Contracts for a period ending on the earliest of (i) the date that is 30 days following the Closing, (ii) the date upon which the Purchaser elects to include the Contract as a Transferred Contract pursuant to Section 2.5(c) and the Contract is assigned and transferred to the Purchaser under this Agreement, and (iii) the date upon which the Purchaser advises the Receiver in writing that it will not elect to include such Contract as part of the list of Transferred Contracts pursuant to Section 2.5(c), provided, however, that the Receiver has sufficient funding for all post-Closing financial and monetary obligations under such Contracts.
- (g) Notwithstanding anything in this Agreement to the contrary, this Agreement shall not constitute an agreement to assign any Transferred Contract or any right thereunder to the extent that such Transferred Contract is not assignable under applicable Law without the consent of any other Person party thereto where the consent of such Person has not been given or received. For greater certainty, if such consent is required but not obtained, neither the Receiver nor the Purchaser shall be in breach of this Agreement nor shall the Purchase Price be adjusted or the Closing delayed.

2.6 Purchase Price

In consideration for the sale of all of the Receiver's right, title and interest, if any, and all of the Kraus Group's right, title and interest in and to the Purchased Assets, to the Purchaser, and upon the terms and conditions of this Agreement, the purchase price, exclusive of all applicable Transfer Taxes, shall be the aggregate of (i) the amount of the Priority Claims paid on Closing, (ii) the amount of the Assumed Secured Debt, and (iii) the amount of the Assumed Liabilities (collectively, the "**Purchase Price**"). All applicable Transfer Taxes shall be paid by the Purchaser by certified cheque or bank draft, subject to the terms hereof and the availability of any exemptions or elections under any applicable legislation for such applicable Transfer Taxes.

2.7 Satisfaction of Purchase Price

The Purchaser shall satisfy the Purchase Price at Closing as follows:

- (a) by making a cash payment (by way of certified cheque, bank draft or wire transfer) to the Receiver to satisfy certain Priority Claims as set out on Schedule I; and
- (b) by assuming an amount equal to (i) \$62,711,721.68 of the Senior Secured Debt and (ii) \$17,500,578.32 of the Subordinated Secured Debt (collectively, the "**Assumed Secured Debt**") by the execution and delivery by the Purchaser on Closing of the Secured Debt Assignment and Assumption Agreement; and

- (c) by assuming the Assumed Liabilities by the execution and delivery by the Purchaser on Closing of the Assignment and Assumption Agreement and by the execution and delivery by Kraus Properties LP of the Assignment and Assumption Agreement (Real Property).

2.8 Purchase Price Allocation and Priority Claim Calculation

- (a) At the Closing the Purchaser shall prepare and deliver to the Receiver a written initial allocation of the Purchase Price in respect of each of the Purchased Assets. The Purchaser and the Receiver shall use their commercially reasonable efforts to agree, at or as soon as practicable following the Closing, on such allocation, for purposes of the *Income Tax Act* (Canada).
- (b) The Purchaser acknowledges and agrees that Claims listed on Schedule I hereto constitute Priority Claims to be paid or assumed by the Purchaser at the Closing Time, which Schedule I also includes a line by line estimate of the quantum of such Priority Claims as at the Target Date and indicates which Priority Claims shall be paid on Closing and which Priority Claims shall be assumed on Closing. The quantum of the Priority Claims estimated in Schedule I shall be updated on Closing, as mutually agreed to by the Parties, to reflect an updated estimate and the quantum of such Priority Claims to be paid or assumed on Closing. To the extent a creditor of the Kraus Group has a Claim or is owed an obligation that is not listed on Schedule I Schedule G, such Claim or obligation shall not constitute a Priority Claim for the purposes of this Agreement unless and until it is determined to be so by final Order of the Court or other Governmental Authority after which time such Claim or obligation shall constitute a Priority Claim assumed under this Agreement and an Assumed Liability.

2.9 Closing

- (a) Unless otherwise agreed by the Parties, the Parties shall use commercially reasonable efforts to cause the Closing to occur on the Target Date.
- (b) Closing shall take place at the offices of Cassels Brock & Blackwell LLP, 40 King Street West, Suite 2100, Toronto, Ontario, Canada, or at such other location as the Parties may agree upon in writing. Any tender of documents or money hereunder may be made upon the Receiver or the Purchaser or upon the solicitors acting for the Party on whom tender is desired.

2.10 Receiver's Deliveries

At the Closing,

- (a) the sale, transfer, assignment, conveyance and delivery by the Receiver all of the Receiver's right, title and interest, if any, and all of the Kraus Group's right, title and interest in and to the Purchased Assets to the Purchaser, free and clear of any Liens and Encumbrances (other than Permitted Encumbrances), shall be effected

by the issued and entered Vesting Order and by execution and delivery by the Receiver of (i) the Bill of Sale, (ii) the Secured Debt Assignment and Assumption Agreement, (iii) the Assignment and Assumption Agreement, (iv) a deed or deeds to the Real Property, (v) the Assignment of Intellectual Property, (vi) the Assignment and Assumption Agreement (Real Property) and (vii) any other Ancillary Agreements reasonably required by the Parties, in each case in form and substance satisfactory to the Parties, acting reasonably;

- (b) the Receiver shall execute and deliver to the Purchaser, to the extent reasonably required by the Purchaser, the Ancillary Agreements;
- (c) the Receiver shall deliver, pursuant to the Vesting Order, free and clear title (subject to Permitted Encumbrances) and possession of the Purchased Assets (including all keys to the Facilities, combinations to any safes thereon and passwords for all computers thereon and any security devices therein which are reasonably available or known to the Receiver) on an “as is, where is” basis in accordance with Section 7.5, provided that delivery shall occur in situ wherever such Purchased Assets are located on the Closing Date;
- (d) the Kraus Group, by the Receiver, shall make and deliver the elections referred to in Section 7.3 to the extent available and applicable;
- (e) the Receiver shall deliver a certified copy of the Vesting Order, as entered by the Court;
- (f) the Receiver shall deliver a certificate executed by the Receiver, in a form satisfactory to the Purchaser, acting reasonably, certifying that all of the representations and warranties of the Receiver hereunder remain true and correct in all material respects as of the Closing Date;
- (g) the Receiver shall deliver an updated version of Schedule I (Priority Claims) pursuant to Section 2.8(b);
- (h) the Receiver, without payment of funds, shall deliver any Licenses obtained as of the Closing provided that the failure of the Receiver to deliver any License requested by the Purchaser shall not constitute a failure to satisfy a condition precedent to Closing; and
- (i) the Receiver shall deliver to the Purchaser on Closing the Receiver’s Certificate, which shall be filed with the Court as soon as practical following delivery to the Purchaser and a copy of such filed Receiver’s Certificate shall be delivered to the Purchaser promptly thereafter.

2.11 Purchaser’s Deliveries

At the Closing,

- (a) the Purchaser shall make the payments, if any, referred to in Section 2.7(a),
- (b) the Purchaser shall execute and deliver to the Receiver to the extent reasonably required by the Receiver, the Ancillary Agreements;
- (c) the Purchaser shall make and deliver the elections referred to in Section 7.3 to the extent available and applicable;
- (d) the Purchaser shall deliver a certified copy of the Appointment Order and the Bankruptcy Orders, each as entered by the Court; and
- (e) the Purchaser shall deliver a certificate executed by the Purchaser in a form satisfactory to the Receiver, acting reasonably, certifying that all of the representations and warranties of the Purchaser hereunder remain true and correct in all material respects as of the Closing Date.

2.12 Transfer of Real Property

Notwithstanding anything else in this Agreement, on Closing, the Receiver will transfer and assign all of the Receiver's right, title and interest, if any, and all of the Kraus Group's right, title and interest in the Real Property and any Licences (subject to and in accordance with Section 2.5) related to the Real Property to Kraus Properties Inc. as general partner of Kraus Properties LP and Kraus Properties LP shall assume the Assumed Liabilities relating solely to the Real Property.

ARTICLE 3 REPRESENTATIONS AND WARRANTIES OF THE PARTIES

3.1 Representations and Warranties of the Receiver

The Receiver hereby represents and warrants to the Purchaser the matters set out below.

- (a) Subject to entry of the Vesting Order:
 - (i) the Receiver has, or at the time of execution will have, all necessary corporate power and authority to execute and deliver this Agreement and to perform its obligations hereunder; and
 - (ii) this Agreement has been, or when executed will be, duly and validly executed and delivered by the Receiver and (assuming the due authorization, execution and delivery by the Purchaser) this Agreement constitutes, or will constitute, when executed and delivered, a valid and binding obligation of the Receiver enforceable against the Receiver in accordance with its terms, except as enforcement may be limited by Laws of general application and bankruptcy, insolvency and other similar laws affecting creditors' rights generally and general principles of equity.

- (b) Each of KI, KCI and Strudex are registered for purposes of tax imposed under Part IX of the *Excise Tax Act* (Canada) with the following registration numbers: 10288 2438 RT0001 (KI), 10566 1672 RT0001 (KCI) and 11939 0623 RT0001 (Strudex).
- (c) The Receiver is not a non-resident of Canada for the purposes of the *Income Tax Act* (Canada).
- (d) The Receiver has not engaged in any act that has or could result in an Encumbrance affecting any of the Purchased Assets (other than any charge created by the Appointment Order).

3.2 Representations and Warranties of the Purchaser

The Purchaser hereby represents and warrants to the Receiver the matters set out below.

- (a) Kraus Brands Inc. has been duly incorporated and is validly subsisting under the Laws of the jurisdiction of its incorporation, and has all requisite corporate capacity, power and authority to carry on its business as now conducted by it and to own its properties and assets and is qualified to carry on business under the Laws of the jurisdictions where it carries on a material portion of its business.
- (b) The Purchaser is a limited partnership duly formed and existing under the laws of Ontario and has the power and authority to enter into, and to perform its obligations under, this Agreement.
- (c) Kraus Properties LP is a limited partnership duly formed and existing under the laws of Ontario.
- (d) The execution, delivery and performance by Kraus Brands Inc. for and on behalf of the Purchaser of this Agreement:
 - (i) has been duly authorized by all necessary corporate action on the part of the Kraus Brands Inc. for and on behalf of the Purchaser;
 - (ii) does not (or would not with the giving of notice, the lapse of time or the happening of any other event or condition) require any consent or approval under, result in a breach or a violation of, or conflict with, any of the terms or provisions of its constating documents or by-laws or any contracts or instruments to which it is a party or pursuant to which any of its assets or property may be affected; and
 - (iii) will not result in the violation of any Law.
- (e) This Agreement has been duly executed and delivered by Kraus Brands Inc. for and on behalf of the Purchaser and constitutes a legal, valid and binding obligations of the Purchaser, enforceable against it in accordance with its terms

subject only to any limitation under applicable Laws relating to: (i) bankruptcy, winding-up, insolvency, arrangement and other similar Laws of general application affecting the enforcement of creditors' rights; and (ii) the discretion that a court may exercise in the granting of equitable remedies such as specific performance and injunction.

- (f) The Purchaser is or will become registered for the purposes of the tax imposed under Part IX of the *Excise Tax Act* (Canada) effective on or prior to Closing.

3.3 Merger of Warranties

The representations and warranties made by the Receiver and the Purchaser contained in this Agreement will merge and terminate on Closing.

ARTICLE 4 EMPLOYEE MATTERS

4.1 Offers of Employment

- (a) At least four (4) Business Days prior to the Target Date but conditional upon the Closing and with effect as of the Closing Date, the Purchaser shall offer to employ the Designated Employees on terms and conditions acceptable to the Purchaser, in its sole discretion.
- (b) The Purchaser agrees that it will be bound by and will comply with the New Collective Agreements.
- (c) For greater certainty, except to the extent constituting a Priority Claim, nothing herein shall be deemed to make the Purchaser responsible or liable for:
 - (i) any severance payments, damages for wrongful dismissal and all related costs in respect of the termination of any Non-Transferred Employees;
 - (ii) any liabilities for claims for injury, disability, death or workers' compensation arising from or related to employment of the Employees prior to the Closing Date; and
 - (iii) any employment-related claims, penalties and assessments in respect of the Purchased Assets arising out of matters which occur prior to the Closing Date,

any and all of which shall, for greater certainty, be deemed to be Excluded Liabilities under this Agreement.

4.2 Employee Plans

Except as may be specifically agreed to by the Purchaser in the New Collective Agreements or otherwise specifically agreed to by the Purchaser in writing (provided that nothing in this Agreement shall be deemed to be such an agreement), the Purchaser shall not assume any of the Employee Plans (including the Pension Plans) or liability for accrued benefits or any other liability under or in respect of any of the Employee Plans, all of which will, for greater certainty, not form part of the Purchased Assets, the Transferred Contracts or the Assumed Liabilities. The Transferred Employees will, as of the Closing Date in respect of their employment by the Kraus Group, cease to accrue further benefits under the Employee Plans.

4.3 Privacy Laws

The Purchaser will, following the date of this Agreement, observe all requirements of any applicable Privacy Law with respect to the Personal Information relating to the Transferred Employees and the Unionized Employees, as well as any Personal Information provided to or obtained by the Purchaser relating to any Employee who is not employed by the Purchaser following the Closing.

ARTICLE 5 CONDITIONS PRECEDENT

5.1 Conditions Precedent of the Purchaser

The obligations of the Purchaser to complete the transactions contemplated by this Agreement shall be subject to the satisfaction of or compliance with, at or before the Closing Time, each of the following conditions precedent (each of which is acknowledged to be inserted for the exclusive benefit of the Purchaser and may be waived by it in whole or in part in its sole discretion):

- (a) all of the representations and warranties of the Receiver made in or pursuant to this Agreement shall be true and correct at the Closing Time and with the same effect as if made at and as of the Closing Time (except as such representations and warranties may be affected by the occurrence of events or transactions expressly contemplated and permitted by this Agreement);
- (b) the Receiver shall have performed or complied with, in all material respects, all its obligations, covenants and agreements under this Agreement and the Ancillary Agreements;
- (c) the Receiver shall have executed and delivered, or caused to be executed and delivered, to the Purchaser on or prior to the Closing Date the documents required to complete the transactions contemplated in this Agreement and the Ancillary Agreements as may reasonably be required by the Purchaser or its solicitors;
- (d) there shall be no Order issued by any Governmental Authority delaying, restricting or preventing, and no pending or threatened Claim or judicial or

administrative proceeding, or investigation against any Party by any Person, for the purpose of enjoining, delaying, restricting or preventing, the consummation of the transactions contemplated in this Agreement and the Ancillary Agreements or otherwise claiming that this Agreement and the Ancillary Agreements or the consummation of such transactions is improper or would give rise to proceedings under any Laws;

- (e) the Purchaser shall have obtained the Competition Act Approval;
- (f) the Appointment Order, the Bankruptcy Orders and the Vesting Order shall have been issued and entered by the Court in form and substance acceptable to the Purchaser, acting reasonably, and shall not be subject to a stay and such orders shall not have been stayed, vacated or subject to pending appeal and no Order shall have been issued which restrains or prohibits the completion of the transaction contemplated hereby;
- (g) there shall have been no determination by the Court or any other Governmental Authority that any Claims related to any Employee Plans constitute Priority Claims other than Claims secured by the BIA Charges;
- (h) there shall have been no determination by the Court or any other Governmental Authority the result of which would be that Priority Claims exceed the amount of \$500,000;
- (i) each of the New Collective Agreements shall have been duly approved and ratified by the applicable Unionized Employees;
- (j) there shall have been no determination by the Court or any other Governmental Authority that the Purchaser is liable and responsible for any Claims under any Employee Plans (other than as specifically agreed to by the Purchaser in the New Collective Agreements); and
- (k) all consents, approvals and authorizations of any Person required in connection with the completion of any of the transactions contemplated by this Agreement, the execution of this Agreement and the Ancillary Agreements, the Closing or the performance of any of the terms and conditions of this Agreement and the Ancillary Agreements, shall have been obtained at or before the Closing Time on terms acceptable to the Purchaser, acting reasonably.

If any of the foregoing conditions in this Section 5.1 has not been fulfilled by the Closing Time, the Purchaser may terminate this Agreement by notice to the Receiver. However, the Purchaser may waive compliance with any condition in whole or in part if it sees fit to do so, without prejudice to its rights of termination in the event of non-fulfilment of any other condition, in whole or in part, or to its rights to recover damages, if any, for the breach of any representation, warranty, covenant or condition contained in this Agreement.

5.2 Conditions Precedent of the Receiver

The obligations of the Receiver to complete the transactions contemplated by this Agreement shall be subject to the satisfaction of or compliance with, at or before the Closing Time, each of the following conditions precedent (each of which is acknowledged to be inserted for the exclusive benefit of the Receiver and may be waived by it in whole or in part in its sole discretion):

- (a) all of the representations and warranties of the Purchaser made in or pursuant to this Agreement shall be true and correct at the Closing Time and with the same effect as if made at and as of the Closing Time (except as such representations and warranties may be affected by the occurrence of events or transactions expressly contemplated and permitted by this Agreement);
- (b) the Purchaser shall have performed or complied with, in all material respects, all its obligations, covenants and agreements under this Agreement and the Ancillary Agreements;
- (c) the Purchaser shall have obtained the Competition Act Approval;
- (d) the Purchaser shall have executed and delivered or caused to be executed and delivered to the Receiver on or prior to the Closing Date the documents required to complete the transactions contemplated in this Agreement and the Ancillary Agreements as may reasonably be required by the Receiver or its solicitors, including an indemnity in respect of applicable Transfer Taxes as contemplated by Section 7.3(d) hereof;
- (e) there shall be no Order issued by any Governmental Authority delaying, restricting or preventing, and no pending or threatened Claim or judicial or administrative proceeding, or investigation against any Party by any Person, for the purpose of enjoining, delaying, restricting or preventing, the consummation of the transactions contemplated in this Agreement and the Ancillary Agreements or otherwise claiming that this Agreement and the Ancillary Agreements or the consummation of such transactions is improper or would give rise to proceedings under any Laws;
- (f) the Funding Term Sheet shall have been executed and delivered by Red Ash to the Receiver;
- (g) the Appointment Order, the Bankruptcy Orders and the Vesting Order shall have been issued and entered by the Court in form acceptable to the Receiver, acting reasonably, and such orders shall not have been stayed, vacated or subject to pending appeal and no Order shall have been issued which restrains or prohibits the completion of the transaction contemplated hereby; and
- (h) all consents, approvals and authorizations of any Person required in connection with the completion of any of the transactions contemplated by this Agreement

and the Ancillary Agreements, the execution of this Agreement and the Ancillary Agreements, the Closing or the performance of any of the terms and conditions of this Agreement and the Ancillary Agreements, shall have been obtained at or before the Closing Time on terms acceptable to the Receiver, acting reasonably.

If any of the foregoing conditions in this Section 5.2 has not been fulfilled by the Closing Time, the Receiver may terminate this Agreement by notice to the Purchaser. However, the Receiver may waive compliance with any condition in whole or in part if it sees fit to do so, without prejudice to its rights of termination in the event of non-fulfilment of any other condition, in whole or in part, or to its rights to recover damages, if any, for the breach of any representation, warranty, covenant or condition contained in this Agreement.

ARTICLE 6 TERMINATION

6.1 Termination

This Agreement may be terminated at any time prior to Closing as follows:

- (a) by mutual written consent of the Receiver and the Purchaser;
- (b) by the Purchaser if any of the Appointment Order, the Bankruptcy Orders or the Vesting Order have not been issued by the Court by June 11, 2012;
- (c) by either the Receiver or the Purchaser if the Closing has not occurred on or before June 25, 2012; or
- (d) by the Purchaser pursuant to Section 7.6 hereof.

6.2 Effects of Termination

If this Agreement is terminated pursuant to Section 6.1 all further obligations of the Parties under or pursuant to this Agreement shall terminate without further liability of any Party to the other, provided that nothing herein shall relieve any Party from liability for any breach of this Agreement occurring before the termination hereof.

ARTICLE 7 OTHER COVENANTS OF THE PARTIES

7.1 Books and Records

At Closing, the Receiver shall deliver to the Purchaser, at the Purchaser's sole expense, original versions of the Documents, if any, that are in the possession of the Receiver or that are reasonably within the Receiver's control, provided that delivery shall occur in situ wherever such Documents are located at the Closing Time.

7.2 Access of the Receiver to Books and Records

The Receiver and its representatives and the Bankruptcy Trustee appointed under the Bankruptcy Orders and its representatives shall, for a period of six (6) years from the Closing Date, have access to, and the right to copy, at their expense for bona fide business purposes, to the extent necessary or useful in connection with the filing of any Tax return or the defence or settlement of any litigation or to comply with any applicable Law and during usual business hours, upon reasonable prior notice to the Purchaser, all Books and Records relating to the Business, the Purchased Assets and the Assumed Liabilities which are to be transferred and conveyed to the Purchaser pursuant to this Agreement. The Purchaser shall use reasonable efforts to retain and preserve all such Books and Records for such six (6) year period.

7.3 Tax Matters

- (a) The Purchaser and the Receiver agree to furnish or cause to be furnished to each other, as promptly as practicable, such information and assistance relating to the Purchased Assets and the Assumed Liabilities as is reasonably necessary for the preparation and filing of any Tax return, claim for refund or other required or optional filings relating to Tax matters, for the preparation for and proof of facts during any Tax audit, for the preparation for any Tax protest, for the prosecution of any suit or other proceedings relating to Tax matters and for the answer to any governmental or regulatory inquiry relating to Tax matters.
- (b) For all Tax purposes, the Purchaser and, to the extent applicable, the Receiver, agree to report the transactions contemplated in this Agreement in a manner consistent with the Purchase Price allocation determined in accordance with Section 2.8, and the Purchaser and the Receiver shall not voluntarily take any action inconsistent therewith in any Tax return, refund claim, litigation or otherwise, unless required by applicable Tax laws. The Purchaser and the Receiver shall each be responsible for the preparation of their own statements required to be filed under the *Income Tax Act* (Canada) and other similar forms in accordance with applicable Tax laws.
- (c) All consideration from the Purchaser and all amounts payable by the Purchaser to the Receiver pursuant to this Agreement do not include any federal, provincial, state or local goods and services, harmonized sales, value-added, sale, use, consumption, multi-staged, ad valorem, personal property, customs, excise, stamp, transfer, land transfer, or similar Taxes, duties, or charges, or any recording or filing fees or similar charges (collectively, "**Transfer Taxes**") and all Transfer Taxes are the responsibility of and for the account of the Purchaser. The Purchaser and the Receiver agree to cooperate to determine the amount of Transfer Taxes payable in connection with the transactions contemplated under this Agreement. If the Receiver is required by applicable Law or by administration thereof to collect any applicable Transfer Taxes from the Purchaser, the Purchaser shall pay such Transfer Taxes to the Receiver concurrent with the payment of any consideration payable pursuant to this Agreement, unless

the Purchaser qualifies for an exemption from any such applicable Transfer Taxes, in which case the Receiver shall not collect any such applicable Transfer Taxes from the Purchaser provided the Purchaser, in lieu of payment of such applicable Transfer Taxes to the Receiver, delivers to the Receiver such certificates, elections or other documentation required by applicable Law or the administration thereof to substantiate and affect the exemption claimed by the Purchaser.

- (d) The Purchaser shall indemnify and save the Receiver harmless from and against all claims and demands for payment of the Transfer Taxes referenced in this Section, including penalties and interest thereon and any liability or costs incurred as a result of any failure to pay such Transfer Taxes when due.
- (e) If applicable, at the request of the Purchaser, each member of the Kraus Group by the Receiver shall, together with the Purchaser, jointly make the elections provided for in paragraph 167(1)(b) of the *Excise Tax Act* (Canada) to have subsection 167(1.1) of the *Excise Tax Act* (Canada) apply in respect of the transactions contemplated by this Agreement. If such election or elections are applicable and if the Purchaser requests the Receiver on behalf of any member of the Kraus Group to make such election or elections, the Purchaser shall:
 - (i) file such election(s) within the time prescribed by subsection 167(1.1) of the *Excise Tax Act* (Canada); and
 - (ii) at all times indemnify and hold harmless each member of the Kraus Group and the Receiver and their respective shareholders, directors, officers and employees, against and in respect of any and all amounts assessed by the Minister of National Revenue (Canada) or other Governmental Authority (including all reasonable legal and professional fees incurred by the Receiver or its directors, officers and/or employees, as a consequence of or in relation to any such assessment) as a consequence of the Minister of National Revenue (Canada) or other Governmental Authority determining, for any reason, that either election is unavailable, inapplicable, invalid or not properly made.
- (f) If applicable, each member of the Kraus Group, by the Receiver, and the Purchaser shall jointly execute, and each of them will file promptly following the Closing Date, elections under section 22 of the *Income Tax Act* (Canada), and any corresponding provisions of any applicable provincial income Tax legislation with respect to any debts referred to in such section 22 and corresponding provisions of any applicable provincial income Tax legislation. For the purposes of such elections, the Purchaser, acting reasonably and in consultation with the Receiver, will designate the portion of the Purchase Price allocable to the debts in respect of which such elections are made. For greater certainty, the Receiver and the Purchaser agree to prepare and file their respective Tax returns in a manner consistent with such election(s).

7.4 Post-Closing Cooperation

For the period from the Closing to the later of (i) 90 days following the Closing Date and (ii) the date upon which the Receiver is discharged:

- (a) upon the terms, and subject to the conditions of this Agreement, each of the Parties shall use its commercially reasonable efforts to take, or cause to be taken, all actions and to do, or cause to be done, and cooperate with each other in order to do, all things necessary, proper or advisable under applicable Law to consummate the transactions contemplated by this Agreement as soon as practicable, including the preparation and filing of all forms, registrations and notices required to be filed to consummate the Closing, and the taking of such actions as are necessary to obtain any requisite consent, provided that the Receiver shall not be obligated to make any payment or deliver anything of value to any Person (other than filing with and payment of any application fees to any Governmental Authority, all of which shall be paid or reimbursed by the Purchaser) in order to obtain any consent;
- (b) the Receiver shall, without payment of funds to counterparties, use reasonable efforts to obtain, and assist the Purchaser in obtaining, any Licences or consents required for the operation of the Business by the Purchaser from and after the Closing in the ordinary course of business. For greater certainty, if any Licence or consent is required but not obtained, neither the Receiver nor the Purchaser shall be in breach of this Agreement nor shall the Purchase Price be adjusted or the Closing delayed; and
- (c) in the event that any payments or funds relating to the Purchased Assets or the Business are made to or received at any bank account of the Kraus Group following the Closing, the Receiver shall collect those payments or funds as the agent, and on behalf, of the Purchaser and shall cause such payments or funds to be transferred to the Purchaser as soon as practicable following receipt.

7.5 Acquisition of Assets on “As Is, Where Is” Basis

The Purchaser hereby acknowledges and agrees as follows:

- (a) all of the Receiver’s right, title and interest, if any, and all of the Kraus Group’s right, title and interest in and to the Purchased Assets are being purchased on an “as is, where is” basis at the Closing Date;
- (b) it has conducted or will conduct its own searches and investigations relating to the Purchased Assets;
- (c) it has conducted such inspections of the Purchased Assets as it deemed appropriate, satisfied itself with respect to the Purchased Assets and all matters connected with or related to the Purchased Assets, and has relied entirely upon its own investigations and inspections in entering into this Agreement to acquire all

of the Receiver's right, title and interest, if any, and all of the Kraus Group's right, title and interest in and to the Purchased Assets without regard to any information made available or provided by the Receiver or its officers, directors, employees or agents;

- (d) it will accept the Purchased Assets in their state, condition and location as at the Closing Time and except as expressly set forth in this Agreement, the Receiver makes no representations, warranties, statements or promises on its own behalf or on behalf of the Kraus Group in favour of the Purchaser concerning the Purchased Assets, or the Receiver's or the Kraus Group's right, title or interest in or to the Purchased Assets which the Purchaser acknowledges are being acquired on an as-is, where-is basis, or the uses or applications of the Purchased Assets, whether express or implied, statutory or collateral, arising by operation of Law or otherwise, including express or implied warranties of merchantability, fitness for a particular purpose, title, description, quantity, condition or quality, and that any and all conditions and warranties expressed or implied by the *Sale of Goods Act* (Ontario) do not apply to the transactions contemplated by this Agreement and are hereby waived by the Purchaser; and
- (e) without limiting the generality of the foregoing, the description of the Purchased Assets and any portion thereof contained in the Schedules hereto is for the purpose of identification only; and that no representation, warranty or condition has or will be given by the Receiver or any other party concerning completeness or the accuracy of such descriptions or with respect to any data room set up by the Kraus Group or the Receiver.

7.6 Title and Risk

If there occurs any material damage to the Purchased Assets prior to Closing, then the Purchaser may, at its option: (a) complete the Closing without reduction of the Purchase Price, in which event all applicable proceeds of insurance or compensation shall be payable to the Purchaser; or (b) terminate this Agreement, with the result that the Parties shall be released from all obligations and liabilities arising under this Agreement.

7.7 Use of Kraus / Strudex Names

As soon as practicable following Closing, the Receiver shall cause (i) the Kraus Group to discontinue use of the "Kraus" or "Strudex" names and (ii) each of KI, KCI and Strudex to change its name, to a name that does not include "Kraus" or "Strudex", as applicable, or any variations thereof.

7.8 Access to Leased Premises and Continuation of Contracts

- (a) Except in relation to any Leased Premises for which an Assumed Real Property Lease is already transferred to the Purchaser on Closing pursuant to this Agreement, the Receiver shall use commercially reasonable efforts to make

arrangements with either the Bankruptcy Trustee or the landlord of each of the Leased Premises for continued occupation and access to the applicable Leased Premises on terms substantially similar to those in place for the Kraus Group for a period ending on the earliest of (i) the date that is 90 days following the Closing, (ii) the date upon which the Purchaser elects to include the Contract in respect of the Leased Premises as part of the list of Assumed Real Property Leases pursuant to Section 2.5(d) and such Contract is assigned and transferred to the Purchaser under this Agreement, and (iii) the date upon which the Purchaser advises the Receiver in writing that it will not elect to include the Contract in respect of the Leased Premises as part of the list of Assumed Real Property Leases pursuant to Section 2.5(d), provided, however, that the Receiver has sufficient funding for all occupancy costs for any occupancy period requested by the Purchaser. If such arrangements are made, the Receiver shall permit full access to the Leased Premises during such occupancy period to the Purchaser (or such Person designated by the Purchaser) on such terms as may be agreed to by the Parties acting reasonably.

7.9 Amendments to Schedules

Without limiting the rights of the Purchaser contained in Section 2.5(c), the Purchaser, by written notice to the Receiver, shall be entitled to amend or supplement (including adding to or deleting from) any of the Schedules to this Agreement up to the Closing, other than Schedule D (Permitted Encumbrances), Schedule E (Vesting Order), Schedule G (Secured Debt), Schedule I (Estimated Priority Claims) and Schedule K (Leased Premises), which Schedules may only be amended by mutual agreement of the parties. For greater certainty, the Purchase Price shall not be adjusted (other than changes to the amounts to be paid or assumed on Closing resulting from amendments to Schedule I) and the Closing shall not be delayed as a result of any such amendment.

ARTICLE 8 GENERAL

8.1 Receiver's Capacity

The Purchaser and Kraus Properties LP each acknowledge and agree that in all matters pertaining to this Agreement, including in its execution, PricewaterhouseCoopers Inc. is acting solely in its capacity as receiver of the undertakings, properties and assets of the Kraus Group and not in its personal, corporate or any other capacity, and as such, its liability under this Agreement, if any, will be in its capacity as Receiver, and the Receiver, its agents, officers, directors and employees shall have no personal, corporate or other liability of any kind, whether in contract, in tort or otherwise. In no circumstance will the Receiver be liable for any consequential damages including loss of profit.

8.2 Press Releases

The Parties will cooperate and consult with one another, to the extent reasonably practical, with respect to the issuance of any press release or another other statement to press or media regarding this Agreement or the transaction contemplated hereunder.

8.3 Receiver's Certificate

The Parties hereby acknowledge and agree that the Receiver shall be entitled to file a certificate, substantially in the form attached to the Vesting Order (the "**Receiver's Certificate**"), with the Court upon receiving written confirmation from the Purchaser that all conditions of Closing have been satisfied or waived, and the Receiver shall have no liability to the Purchaser or any other person as a result of filing the Receiver's Certificate.

8.4 Notices

Any notice, consent or approval required or permitted to be given in connection with this Agreement shall be in writing and shall be sufficiently given if delivered (whether in person, by courier service or other personal method of delivery), or if transmitted by facsimile:

- (a) in the case of a notice to the Receiver at:

PricewaterhouseCoopers Inc.
PwC Tower, Suite 2600
18 York Street
Toronto, Ontario, Canada
M5H 0B2

Attention: John P. McKenna
Fax No.: (416) 941-8378
Email: john.p.mckenna@ca.pwc.com

with a copy (which shall not constitute notice) to:

Blake Cassels & Graydon LLP
Commerce Court, Suite 4000
199 Bay Street
Toronto, Ontario, Canada
M5L 1A9

Attention: Pamela L. J. Huff / Linc A. Rogers
Fax No.: (416) 863-2653
Email: pamela.huff@blakes.com / linc.rogers@blakes.com

- (b) in the case of a notice to the Purchaser at:

KRAUS BRANDS LP
65 Northfield Drive West
Waterloo, Ontario
N2J 4J4

Attention: Howard Gunn
Fax No.: 020 7317 2051
Email: howard.gunn@hilcouk.com
with a copy (which shall not constitute notice) to:

Cassels Brock & Blackwell LLP
Scotia Plaza, Suite 2100
40 King Street West
Toronto, Ontario, Canada
M5H 3C2

Attention: Larry Ellis
Fax No.: (416) 640-3004
Email: lellis@casselsbrock.com

Any notice delivered or transmitted to a Party as provided above shall be deemed to have been given and received on the day it is delivered or transmitted, provided that it is delivered or transmitted on a Business Day prior to 5:00 p.m. local time in the place of delivery or receipt. However, if the notice is delivered or transmitted after 5:00 p.m. local time or if such day is not a Business Day then the notice shall be deemed to have been given and received on the next Business Day.

Any Party may, from time to time, change its address by giving notice to the other Party in accordance with the provisions of this Section.

8.5 Assignment

Neither Party shall assign this Agreement or any rights or obligations arising under this Agreement without the prior written consent of the other Party.

8.6 Time of the Essence

Time shall be of the essence in respect of the obligations of the Parties arising prior to Closing under this Agreement.

8.7 Enurement

This Agreement shall enure to the benefit of and be binding upon the Parties and their respective successors (including any successor by reason of amalgamation of any Party) and permitted assigns.

8.8 Amendment

Other than the amendments to Schedules contemplated by Sections 2.5(c), 2.5(d), 2.8(b) and 7.9 or any amendment to Section 8.4, no amendment, supplement, modification or waiver or termination of this Agreement and, unless otherwise specified, no consent or approval by any Party, shall be binding unless executed in writing by the Party to be bound thereby.

8.9 Further Assurances

The Parties shall, provided that the Receiver has not been discharged, with reasonable diligence, do all such things and provide all such reasonable assurances as may be required to consummate the transactions contemplated by this Agreement, and each Party shall provide such further documents or instruments required by any other Party as may be reasonably necessary or desirable to effect the purpose of this Agreement and carry out its provisions, whether before or after the Closing provided that the reasonable costs and expenses of any actions taken after Closing at the request of a Party shall be the responsibility of the requesting Party.

8.10 Execution and Delivery

This Agreement may be executed by the Parties in counterparts and may be executed and delivered by facsimile or other electronic means and all such counterparts and facsimiles (or other electronic deliveries) shall together constitute one and the same agreement.

[Remainder of page intentionally left blank]

IN WITNESS OF WHICH the Parties have executed this Agreement.

PRICEWATERHOUSECOOPERS INC.,
solely in its capacity as court-appointed receiver
of the assets, undertakings and properties of
STRUDEX FIBRES LIMITED, KRAUS
INC., KRAUS CANADA INC. AND 538626
B.C. LTD., and not in its personal or corporate
capacity

By: _____
Name:
Title:

KRAUS BRANDS LP, by its general partner
KRAUS BRANDS INC.

By: W Eckhardt
Name: W. Eckhardt
Title: CEO

[Signature Page to Asset Purchase Agreement]

SCHEDULE A
PURCHASED ASSETS

- (a) all Accounts Receivable;
- (b) all Inventory;
- (c) all Intellectual Property;
- (d) all Personal Property;
- (e) the Real Property and all rights of the Kraus Group under each Assumed Real Property Lease and any related agreement, in each case together with the Receiver's interest, if any, and the Kraus Group's interest in and to all Improvements and fixtures located thereon or attached thereto, and other appurtenances thereto, and the Receiver's interest, if any, and the Kraus Group's rights in respect thereof;
- (f) all Prepaid Expenses and Deposits (including with respect to the Purchased Assets or the Business), customer deposits and security deposits (whether maintained in escrow or otherwise) and prepaid charges and expenses as they relate to the Purchased Assets or the Business;
- (g) all Documents;
- (h) all Licences, to the extent such Licences are assignable under applicable Law;
- (i) all rights under or arising out of all insurance policies relating to the Purchased Assets or the Business and all claims thereunder, unless non-assignable as a matter of Law;
- (j) any rights, claims or causes of action for claims arising out of the operation of the Business;
- (k) all rights under or pursuant to all warranties, representations and guarantees, whether written, oral or implied, made by suppliers, manufacturers and contractors to the extent relating to products sold, or services provided, in connection with the Business or to the extent affecting any Purchased Asset;
- (l) all goodwill and other General Intangibles associated with the Business and the Purchased Assets, including customer and supplier lists;
- (m) all Capital Stock;

- (n) the Transferred Contracts and all rights of the Kraus Group under each Transferred Contract;
- (o) all cash and cash equivalents;
- (p) any Real Property Tax Refund or credits, prepaid expenses and workers compensation refunds and other similar refunds, rebates or credits related to the Business; and
- (q) all proceeds of any or all of the foregoing.

SCHEDULE B
EXCLUDED ASSETS

1. Excluded Real Property Leases.
2. All Contracts other than the Transferred Contracts.

SCHEDULE C
ASSUMED LIABILITIES

None.

SCHEDULE D
PERMITTED ENCUMBRANCES

The Permitted Encumbrances shall include:

- (a) The reservations, limitations, exceptions, provisos and conditions, if any, expressed in any original grants from the Crown relating to the Real Property including, without limitation, the reservation of any mines and minerals in the Crown or in any other Person.
- (b) Applicable municipal by-laws, development agreements, subdivision agreements, site plan agreements, airport zoning regulations and other similar agreements with government authorities or private or public utilities affecting the development or use of the Real Property, other agreements, building and other restrictions, easements, servitudes, rights of way and licences.
- (c) Defects or irregularities in title to the Real Property which are of a minor nature.
- (d) In respect of the Real Property, instrument No. B45015 being a Transfer of Easement in favour of the The Hydro - Electric Power Commission of Ontario for the purpose of installing and maintaining power transmission lines and underground conductors.
- (e) In respect of the Real Property, instrument No. 369437 being a Transfer of Easement in favour of The Public Utilities Commission of the City of Waterloo for the purpose of installing and maintaining underground power lines and cables.
- (f) In respect of the Real Property, instrument No. Z373176 being a Restrictive Covenant Agreement between The Corporation of the City of Waterloo and Kraus Carpet Mills Limited, partially released by instrument No. 571904.
- (g) In respect of the Real Property, instrument No. Z411919 being a Restrictive Covenant Agreement between The Corporation of the City of Waterloo and Kraus Carpet Mills Limited, partially released by instrument No. 571904.
- (h) In respect of the Real Property, instrument No. E465123 being a Transfer of Easement in favour of The Corporation of the City of Waterloo for the purpose of constructing and maintaining a storm and sanitary sewer.
- (i) In respect of the Real Property, instrument No. Z465123 being a Restrictive Covenant Agreement between The Corporation of the City of Waterloo and 236753 Investment Limited, partially released by instrument No. 571904.
- (j) In respect of the Real Property, instrument No. 767172 being an Agreement between The Corporation of the City of Waterloo and Kraus Carpet Mills Limited.

- (k) In respect of the Real Property, instrument No. WR305984 being a Charge registered in favour of National Bank of Canada securing the principal sum of \$165,000,000.00 as assigned to Pinnacle Capital Resources Limited as general partner of Red Ash Capital Partners II Limited Partnership by instrument No. WR687890.
- (l) In respect of the Real Property, instrument No. WR312710 being a Charge in favour of BMO Capital Corporation securing the principal sum of \$12,500,000.00 as assigned to Pinnacle Capital Resources Limited as general partner of Red Ash Capital Partners II Limited Partnership by instrument No. WR687891.
- (m) Existing Senior Security.
- (n) Existing Subordinated Security.
- (o) Liens and Encumbrances to the extent they secure a Priority Claim and to the extent not paid or discharged on Closing.
- (p) Any validly perfected purchase money security interest relating to the Purchased Assets.

**SCHEDULE E
VESTING ORDER**

See attached.

Court File No.

**ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST**

THE HONOURABLE MR)	MONDAY, THE 11 th
)	
JUSTICE MORAWETZ)	DAY OF JUNE, 2012

B E T W E E N:

PINNACLE CAPITAL RESOURCES LIMITED in its capacity as general
partner of RED ASH INVESTMENTS II LIMITED PARTNERSHIP

Applicant

- and -

KRAUS INC., KRAUS CANADA INC., STRUDEX FIBRES LIMITED
and 538626 B.C. LTD.

Respondents

APPLICATION UNDER SUBSECTION 46(1) and SECTION 243 OF THE *BANKRUPTCY AND INSOLVENCY ACT*, R.S.C. 1985, c. B-3, as amended

SALE APPROVAL AND VESTING ORDER

THIS MOTION, made by PricewaterhouseCoopers Inc. (“**PWC**”) in its capacity as Interim Receiver (the “**Interim Receiver**”) appointed by Order of this Court dated May 28, 2012 (the “**Interim Receivership Order**”) and in its capacity as the proposed Court-appointed receiver pursuant to section 243 of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 (the “**BIA**”) now appointed by Order of this Court dated June 11, 2012 with such appointment to be effective as of the Effective Time as defined in such Order (the “**Receiver**”) of the undertaking, property and assets of Kraus Inc. (“**KI**”), Kraus Canada Inc. (“**KCI**”), Strudex Fibres Limited

(“**Strudex**”) and 538626 B.C. Ltd. (collectively, the “**Debtor**”) for an order approving the sale transaction (the “**Transaction**”) contemplated by an asset purchase agreement between the Receiver and Kraus Brands LP (the “**Purchaser**”) dated June 11, 2012 (the “**Sale Agreement**”) the form of which is appended to the Report of the Interim Receiver dated May 28, 2012 (the “**Report**”), and vesting in the Purchaser, or any replacement or substitute thereof, the Receiver’s right, title and interest, if any, and the Debtor’s right, title and interest in and to the Purchased Assets other than the Real Property (as all such terms are defined in the Sale Agreement) (the “**LP Purchased Assets**”), and vesting in Kraus Properties LP, or any replacement or substitute thereof, the Receiver’s right, title and interest, if any, and the Debtor’s right, title and interest in and to the Real Property as defined in the Sale Agreement and as listed in **Schedule “B”** hereto, was heard this day at 330 University Avenue, Toronto, Ontario.

ON READING the Report and the Affidavit of Chris Emmott sworn May 25, 2012 (the “**Emmott Affidavit**”), and on hearing the submissions of counsel for the Interim Receiver, the Receiver, counsel for the Applicant, [NAMES OF OTHER PARTIES APPEARING], no one appearing for any other person on the service list, although properly served as appears from the affidavit of [NAME] sworn [DATE] filed, and upon bankruptcy orders having been issued in respect of each of KI, KCI and Strudex earlier this day (the “**Bankruptcy Orders**”),

AND ON BEING ADVISED that the beneficiaries of the Pension Plans (as defined in the Emmott Affidavit) were sent a copy of the Notice as directed by the Interim Receivership Order, and on reading the consent of PwC to act as the Receiver, and upon bankruptcy orders and a receivership order (the “**Receivership Order**”) having been issued earlier this day in respect of the Debtor (other than 538626 B.C. Ltd., except in the case of the Receivership Order, together with 538626 B.C. Ltd) to be effective immediately prior to the Effective Time (defined in the Receivership Order),

1. **THIS COURT ORDERS** that that the time for service of the Notice of Motion and the Motion Record, including the Report, be and is hereby abridged and that the Motion is properly returnable today and further that the requirement for service of the Notice of Motion and Motion Record, including the Report, upon interested parties, other than those served, is hereby dispensed with and that the service of the Notice of Motion and Motion Record, including the

Report, as effected by the Interim Receiver and proposed Receiver is hereby validated in all respects.

2. **THIS COURT ORDERS AND DECLARES** that the Transaction is hereby approved, and the execution of the Sale Agreement, along with any ancillary agreement contemplated therein, by the Receiver is hereby authorized and approved, with such minor amendments as the Receiver may deem necessary. The Receiver is hereby authorized and directed to take such additional steps and execute such additional documents as may be necessary or desirable for the completion of the Transaction and for the conveyance of the Purchased Assets for the Purchase Price as defined in the Sale Agreement all in accordance with the Sale Agreement.

3. **THIS COURT ORDERS AND DECLARES** that upon the delivery of the Receiver's Certificate to the Purchaser substantially in the form attached as **Schedule "A"** hereto (the "**Receiver's Certificate**"), all of the Receiver's right, title and interest, if any, and the Debtor's right, title and interest in and to the LP Purchased Assets shall vest absolutely in the Purchaser, or any replacement or substitute thereof, free and clear of and from any and all security interests (whether contractual, statutory, or otherwise), hypothecs, mortgages, trusts or deemed trusts (whether contractual, statutory, or otherwise), liens, executions, levies, charges, or other financial or monetary claims, whether or not they have attached or been perfected, registered or filed and whether secured, unsecured or otherwise (collectively, the "**Claims**") including, without limiting the generality of the foregoing: (i) any encumbrances or charges created by the Order of the Honourable Mr. Justice Morawetz dated June 11, 2012; (ii) all charges, security interests, hypothecs, or claims evidenced by registrations pursuant to the *Personal Property Security Act* (Ontario) or any other personal property registry system (all of which are collectively referred to as the "**Encumbrances**", which term shall not include the permitted encumbrances, easements and restrictive covenants listed on **Schedule "D"** hereto) and, for greater certainty, this Court orders that all of the Encumbrances affecting or relating to the LP Purchased Assets are hereby expunged and discharged as against the LP Purchased Assets.

4. **THIS COURT ORDERS AND DECLARES** that upon the delivery of the Receiver's Certificate to Kraus Properties LP, all of the Receiver's right, title and interest, if any, and the Debtor's right, title and interest in and to the Real Property described in the Sale Agreement and listed on **Schedule "B"** hereto shall vest absolutely in Kraus Properties LP, or any replacement

or substitute thereof, free and clear of and from any and all Claims and Encumbrances (except those permitted encumbrances, easements and restrictive covenants listed on **Schedule “D”** hereto) and, for greater certainty, this Court orders that all of the Encumbrances (except those permitted encumbrances, easements and restrictive covenants listed on **Schedule “D”** hereto) affecting or relating to the Real Property are hereby expunged and discharged as against the Real Property.

5. **THIS COURT ORDERS** that upon the registration in the Land Registry Office for the Land Titles Division of Waterloo North (No. 58) of an Application for Vesting Order in the form prescribed by the *Land Titles Act*, the Land Registrar is hereby directed to enter Kraus Properties LP as the owner of the Real Property as identified in **Schedule “B”** hereto in fee simple, and is hereby directed to delete and expunge from title to the Real Property all of the Claims and Encumbrances listed in **Schedule “C”** hereto.

6. **THIS COURT ORDERS AND DECLARES** that the Receiver and/or any director or officer of each Debtor, following the completion of the Transaction, is authorized to execute, deliver and file any document, including without limitation, any articles of amendment, required in order to effect a change of the corporate name of each of KI, KCI and Strudex, and waives any third party requirement or required consent pursuant to any Canadian federal or provincial legislation.

7. **THIS COURT ORDERS AND DIRECTS** the Receiver to file with the Court a copy of the Receiver's Certificate, as soon as practicable after delivery thereof.

8. **THIS COURT ORDERS** that, pursuant to clause 7(3)(c) of the Canada *Personal Information Protection and Electronic Documents Act*, the Receiver is authorized and permitted to disclose and transfer to the Purchaser all human resources and payroll information in the Debtor's records pertaining to the Debtor's past and current employees. The Purchaser shall maintain and protect the privacy of such information and shall be entitled to use the personal information provided to it in a manner which is in all material respects identical to the prior use of such information by the Debtor.

9. **THIS COURT ORDERS** that, notwithstanding:

- (a) the pendency of these proceedings; and

(b) the Bankruptcy Orders,

the vesting of the LP Purchased Assets in the Purchaser and the Real Property in Kraus Properties LP pursuant to this Order shall be binding on the trustee in bankruptcy appointed in respect of the Debtor (and any replacement or substitute thereof) and shall not be void or voidable by creditors of the Debtor, nor shall it constitute nor be deemed to be a settlement, fraudulent preference, assignment, fraudulent conveyance, transfer at undervalue, or other reviewable transaction under the BIA or any other applicable federal or provincial legislation, nor shall it constitute oppressive or unfairly prejudicial conduct pursuant to any applicable federal or provincial legislation.

10. **THIS COURT ORDERS AND DECLARES** that the Transaction is exempt from the application of the *Bulk Sales Act* (Ontario), section 31 of the Ontario *Mortgages Act* and subsection 63(4) of the Ontario *Personal Property Security Act*.

11. **THIS COURT HEREBY REQUESTS** the aid and recognition of any court, tribunal, regulatory or administrative body having jurisdiction in Canada or in the United States to give effect to this Order and to assist the Receiver and its agents in carrying out the terms of this Order. All courts, tribunals, regulatory and administrative bodies are hereby respectfully requested to make such orders and to provide such assistance to the Receiver, as an officer of this Court, as may be necessary or desirable to give effect to this Order or to assist the Receiver and its agents in carrying out the terms of this Order.

Schedule A – Form of Receiver’s Certificate

Court File No.

**ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST**

B E T W E E N:

PINNACLE CAPITAL RESOURCES LIMITED in its capacity as general
partner of RED ASH INVESTMENTS II LIMITED PARTNERSHIP

Applicant

- and -

KRAUS INC., KRAUS CANADA INC., STRUDEX FIBRES LIMITED
and 538626 B.C. LTD

Respondents

RECEIVER’S CERTIFICATE

RECITALS

A. Pursuant to an Order of the Honourable Mr. Justice Morawetz of the Ontario Superior Court of Justice (the "**Court**") dated June 11, 2012, PricewaterhouseCoopers Inc. was appointed as the receiver (the "**Receiver**") of the undertaking, property and assets of Kraus Canada Inc., Kraus Inc., Strudex Fibres Limited and 538626 B.C. Ltd. (collectively, the "**Debtor**") effective as of the Effective Time as defined in such Order.

B. Pursuant to an Order of the Court dated June 11, 2012, the Court approved sale transaction (the "**Transaction**") contemplated by the asset purchase agreement made as of June 11, 2012 (collectively, the "**Sale Agreement**") between the Receiver and Kraus Brands LP (the "**Purchaser**") and provided for the vesting in the Purchaser and Kraus Properties LP (the "**Purchasing Entities**") the Receiver’s, if any, and the Debtor’s right, title and interest in and to the Purchased Assets as defined in the Sale Agreement, which vesting is to be effective upon the

delivery by the Receiver to the Purchasing Entities of a certificate confirming (i) the satisfaction of the Purchase Price for the Purchased Assets pursuant to the Sale Agreement; (ii) that the conditions to Closing as set out in Article 5 of the Sale Agreement have been satisfied or waived by the Receiver and the Purchaser; and (iii) the Transaction has been completed to the satisfaction of the Receiver.

C. Unless otherwise indicated herein, terms with initial capitals have the meanings set out in the Sale Agreement.

THE RECEIVER CERTIFIES the following:

1. The Purchase Price for the Purchased Assets was satisfied on the Closing Date pursuant to the Sale Agreement;
2. The conditions to Closing as set out in Article 5 of the Sale Agreement have been satisfied or waived by the Receiver and the Purchaser; and
3. The Transaction has been completed to the satisfaction of the Receiver.
4. This Certificate was delivered by the Receiver at [_____] TIME on _____ [DATE].

PricewaterhouseCoopers Inc., solely in its capacity as Receiver of the undertaking, property and assets of Kraus Canada Inc., Kraus Inc., Strudex Fibres Limited and 538626 B.C. Ltd. and not in its personal capacity

Per: _____

Name:

Title:

Schedule B

Description of Real Property

Legal Description:

PIN: 22280-0071 (LT)

Part of Lot 8 German Company Tract Township of Waterloo, Parts 1, 2, 3, 4, 5 & 6 on Plan 58R-4092;
Subject to Instruments 369437, 465123E and B45015; Waterloo.

Municipal Address:

65 Northfield Drive West
Waterloo, Ontario

Schedule C

Claims to be deleted and expunged from title to Real Property and the LP Purchased Assets

1. Nil.

Schedule D

Permitted Encumbrances, Easements and Restrictive Covenants related to the Real Property and the LP Purchased Assets

The Permitted Encumbrances shall include:

- (a) The reservations, limitations, exceptions, provisos and conditions, if any, expressed in any original grants from the Crown relating to the Real Property including, without limitation, the reservation of any mines and minerals in the Crown or in any other Person.
- (b) Applicable municipal by-laws, development agreements, subdivision agreements, site plan agreements, airport zoning regulations and other similar agreements with government authorities or private or public utilities affecting the development or use of the Real Property, other agreements, building and other restrictions, easements, servitudes, rights of way and licences.
- (c) Defects or irregularities in title to the Real Property which are of a minor nature.
- (d) In respect of the Real Property, instrument No. B45015 being a Transfer of Easement in favour of the The Hydro - Electric Power Commission of Ontario for the purpose of installing and maintaining power transmission lines and underground conductors.
- (e) In respect of the Real Property, instrument No. 369437 being a Transfer of Easement in favour of The Public Utilities Commission of the City of Waterloo for the purpose of installing and maintaining underground power lines and cables.
- (f) In respect of the Real Property, instrument No. Z373176 being a Restrictive Covenant Agreement between The Corporation of the City of Waterloo and Kraus Carpet Mills Limited, partially released by instrument No. 571904.
- (g) In respect of the Real Property, instrument No. Z411919 being a Restrictive Covenant Agreement between The Corporation of the City of Waterloo and Kraus Carpet Mills Limited, partially released by instrument No. 571904.
- (h) In respect of the Real Property, instrument No. E465123 being a Transfer of Easement in favour of The Corporation of the City of Waterloo for the purpose of constructing and maintaining a storm and sanitary sewer.
- (i) In respect of the Real Property, instrument No. Z465123 being a Restrictive Covenant Agreement between The Corporation of the City of Waterloo and 236753 Investment Limited, partially released by instrument No. 571904.
- (j) In respect of the Real Property, instrument No. 767172 being an Agreement between The Corporation of the City of Waterloo and Kraus Carpet Mills Limited.
- (k) In respect of the Real Property, instrument No. WR305984 being a Charge registered in favour of National Bank of Canada securing the principal sum of \$165,000,000.00 as assigned to Pinnacle Capital Resources Limited as general

partner of Red Ash Capital Partners II Limited Partnership by instrument No. WR687890.

- (l) In respect of the Real Property, instrument No. WR312710 being a Charge in favour of BMO Capital Corporation securing the principal sum of \$12,500,000.00 as assigned to Pinnacle Capital Resources Limited as general partner of Red Ash Capital Partners II Limited Partnership by instrument No. WR687891.
- (m) Existing Senior Security.
- (n) Existing Subordinated Security.
- (o) Liens and Encumbrances to the extent they secure a Priority Claim and to the extent not paid or discharged on Closing.
- (p) Any validly perfected purchase money security interest relating to the Purchased Assets.

31041532.3

SCHEDULE F INTELLECTUAL PROPERTY

1. PATENTS

Registrations:

OWNER	REGISTRATI ON NUMBER	REGISTRATI ON DATE	COUNTRY	DESCRIPTI ON
Nil				

Applications:

OWNER	APPLICATIO N NUMBER	APPLICATIO N DATE	COUNTRY	DESCRIPTI ON
Nil				

2. TRADEMARKS

Registrations:

OWNER	REGISTRATI ON NUMBER	REGISTRATI ON DATE	COUNTRY	DESCRIPTI ON
Strudex Fibres Limited	186,095	Oct. 13, 1972	Canada	Strudon
	638,055	Apr. 21, 2005	Canada	Softrelle
Kraus Inc.	219,716	Mar. 25, 1977	Canada	Omega
	290,596	May 4, 1984	Canada	Ultra Point
	290,598	May 4, 1984	Canada	Omni Graph
	290,597	May 4, 1984	Canada	Omni Point
	629,346	Jan. 5, 2005	Canada	Zipperlock
	647,821	Sept. 13, 2005	Canada	@work

	686,562	Apr. 25, 2007	Canada	Kraus
	Application Serial No. 85439414	Filed Oct. 5, 2011	United States	Tabz
Kraus Carpet Mills Limited	3,049,197	Jan. 24, 2006	United States	Kraus
	3,133,792	Aug. 22, 2006	United States	Zipperlock

Applications:

OWNER	APPLICATION N NUMBER	APPLICATION N DATE	COUNTRY	DESCRIPTI ON
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Nil

3. BUSINESS NAMES:

Nil.

4. DOMAIN NAMES:

(a) www.krauscarpet.com

(b) www.barrettcarpets.com

5. COPYRIGHT:

Nil.

SCHEDULE G SECURED DEBT

1. As of April 30, 2012, \$71,115,000 secured debt facility established in favour of, amongst others, Strudex Fibres Limited, Kraus Canada Inc. and Kraus Inc. under the Credit and Guarantee Agreement dated as of June 28, 2007 as amended, restated, supplemented or otherwise modified from time to time between Strudex Fibres Limited, Kraus Carpet Mills Limited (now Kraus Inc.) and W.G. McMahon Canada Ltd. (now Kraus Canada Inc.), the subsidiaries of Strudex Fibres Limited party thereto, National Bank of Canada, as Canadian Administrative Agent, Bank of Montreal, as U.S. Administrative Agent, the lenders party thereto, National Bank of Canada, as Co-Lead Arranger, as Co-Syndication Agent and Joint Bookrunner and Bank of Montreal, as Co-Lead Arranger, as Co-Syndication Agent and Joint Bookrunner together with all of the documents, agreements, instruments and certificates executed and/or delivered at any time in connection therewith, all as assigned to Red Ash under the master assignment agreement dated May 7, 2012 between, amongst others, Red Ash, National Bank of Canada, as Canadian Administrative Agent, Bank of Montreal, as U.S. Administrative Agent, National Bank of Canada, National Bank of Canada, New York Branch, Bank of Montreal, Bank of Montreal, Chicago Branch, Comerica Bank, Comerica Bank, Canada Branch, The Royal Bank of Scotland, N.V. (formerly known as ABN Amro Bank N.V.), The Royal Bank of Scotland, N.V. (Canada) Branch (formerly known as ABN Amro Bank N.V. Canada), The Toronto-Dominion Bank and the Toronto Dominion (Texas) LLC and a Promissory Note dated as of May 9, 2012 made by, amongst others, Strudex Fibres Limited, Kraus Inc. and Kraus Canada Inc., Kraus USA, Inc. and Barrett Carpet Mills, Inc. in favour of Red Ash (reflecting advances made under the Credit Agreement as Supplementary Advances (as defined in the Consent and Authorization dated May 7, 2012 by and among, amongst others, Strudex Fibres Limited, Kraus Inc., and Kraus Canada Inc.), Kraus USA, Inc., Barrett Carpet Mills, Inc., and Red Ash, along with any interest, costs and other fees accrued and accruing therewith (collectively, the “**Senior Secured Debt**”);
2. As of April 30, 2012, \$19,714,000 secured debt facility established by BMO Capital Corporation in favour of Kraus Inc. under the Amended and Restated Credit Agreement dated November 23, 2010 as amended, restated, supplemented or otherwise modified from time to time between Kraus Inc., Strudex Fibres Limited and BMO Capital Corporation together with all documents, agreements, instruments and certificates executed and/or delivered at any time in connection therewith, all as assigned to Red Ash under the master assignment agreement dated May 7, 2012 between Red Ash and Bank of Montreal, as assignee of all rights, entitlements and interests of BMO Capital Corporation pursuant to the assignment and assumption agreement dated November 1, 2011 between, amongst others, BMO Capital Corporation and Bank of Montreal, along with any interest, costs and other fees accrued and accruing therewith (collectively, the “**Subordinated Secured Debt**”); and
3. As of April 30, 2012, \$35,407,000 secured Amended and Restated Promissory Note dated November 23, 2010 granted to Nelson Kraus Holdings Limited by Strudex Fibres

Limited as amended, restated, supplemented or otherwise modified from time to time as assigned to Nelson Kraus personally together with all documents, agreements, instruments and certificates executed and or delivered at any time in connection therewith, all as assigned to Red Ash under the master assignment agreement dated May 7, 2012 between, amongst others, Red Ash, Nelson Kraus Holdings Limited and Nelson Kraus, along with any interest, costs and other fees accrued and accruing therewith (collectively, the “**Nelson Secured Debt**”).

SCHEDULE H

TRANSFERRED CONTRACTS

1. Supplier Agreements

- (a) Master Supplier Agreement with between CCA Global Partners Inc. and Kraus Carpet Mills Inc (now Kraus Inc).

2. License Agreements:

- (a) License Agreement between Dancik International and Strudex Fibres Ltd. d.b.a Kraus Carpet Mills Distribution Group, dated December 17, 2010
- (b) License Agreement between Dancik International and Kraus Carpet Mills Distribution Group (comprising Kraus-McMahon, Kraus-Royal Scot, Kraus-Sound and Kraus-Sorce), dated November 1, 2005, as amended on April 28, 2011.
- (c) Trademark License Agreement between INVISTA North America S.a.r.l, INVISTA Technologies S.a.r.l. and Kraus Inc., dated July 1, 2008, as amended on November 1, 2011.

3. Equipment Agreements:

- (a) Lease Agreement between IBM Canada Ltd. and Kraus Carpet Mills Limited, dated July 27, 2009
- (b) Services Agreement between IBM Canada Ltd. and Kraus Inc., dated August 19, 2009
- (c) Lease Agreement between CBSC Capital Inc. and Kraus Inc.
- (d) IBM Global Services provides maintenance and technical support services to Kraus Canada pursuant to a letter agreement, dated April 5, 2012.
- (e) Lease Agreement between Pitney Bowes of Canada Ltd. and Kraus Carpet Mills Limited, dated July 13, 2011.

4. Insurance Policies:

- (a) Executive Protection Policy from Chubb Insurance Company of Canada effective as of September 26, 2011 (Policy No. 8224-4160, Policy Period: September 26, 2011 to June 1, 2012).
- (b) Marine Open Cargo/Inland Policy from AXA Insurance (Canada) effective as of June 19, 2007 (Policy No. 7823767, Policy Period: Expires June 1, 2012).

- (c) Canadian Fire Insurance Policy from Affiliated FM Insurance Company effective as of June 27, 2011 (Policy No. RW519, Policy Period: June 1, 2011 to June 1, 2012).
- (d) Commercial Umbrella Liability Policy from Liberty International Underwriters effective as of June 1, 2011 (Policy No. UMT0-667230-011, Policy Period: June 1, 2011 to June 1, 2012).
- (e) Private Company Directors, Officers, and Employees Liability and Reimbursement Policy from Zurich Specialties and Technical Lines Management Solutions Group effective as of June 1, 2011 (Policy No. 8430822-04, Policy Period: June 1, 2011 – June 1, 2012).
- (f) Excess D&O Policy from Chubb Insurance Company of Canada effective as of June 1, 2011 (Policy No. 8210-1989, Policy Period: June 1, 2011 to June 1, 2012).
- (g) Automobile Insurance Policy from Chubb Insurance effective as of June 1, 2011 (Policy No. C03375982, Policy Period: June 1, 2011 to June 1, 2012).
- (h) Workers Compensation and Employers Liability Policy from The Hartford effective as of April 30, 2011 (Policy No. 39 WE JI6368, Policy Period: April 30, 2011 to April 30, 2012).
- (i) Commercial Auto Policy from Sentine Insurance Company, Limited effective as of April 30, 2011 (Policy No. 39 UEN JT0672, Policy Period: April 30, 2011- April 30, 2012).
- (j) Commercial General Liability Policy from Chubb Insurance effective as of June 1, 2011 (Policy No. 35392183, Policy Period: June 1, 2011 to June 1, 2012).
- (k) Crimeguard Comprehensive Crime Policy from Chartis effective as of June 1, 2011 (Policy No. 01-894-78-48, Policy Period: June 1, 2011 to June 1, 2012).

5. Letters of Credit:

- (a) Letter of Credit of Kraus Inc. in favour of Moneris Solutions Corporation, bearing reference no 504-020010692 dated April 14, 2010, as amended

6. Independent Contractor Agreements

- (a) Escrow Agreement between Strudex Fibres Limited, 0894802 B.C. Ltd. and Miller Thomson LLP, dated January 11, 2012.
- (b) Independent Contractor Agreement between Strudex Fibres Limited and 0894802 B.C. Ltd., dated January 16, 2012.

(c) Indemnification of Trish Saltys and 0894802 B.C. Ltd by Strudex Fibres Limited,
dated January 11, 2012.

**SCHEDULE I
ESTIMATED PRIORITY CLAIMS**

These figures reflect estimates made on May 25, 2012 of what the Priority Claims as at June 11, 2012 will be. These figures are to be updated on Closing to reflect an updated estimate of Priority Claims as of Closing.

Deemed Trust – Source Deductions	\$ 153,735 (Note 1) Closing	To be assumed by Purchaser on Closing
BIA Charges	\$ 220,000 (Note 2)	To be paid by Purchaser to Receiver on Closing
Property Taxes	\$ _____ 0 (Note 3)	N/A
Total Estimated Priority Claims	<u>\$ 373,735</u> (Note 4)	

Notes:

Note 1 – The estimated Priority Claim in respect of accrued but unremitted employee source deductions owing by KI, KCI and Strudex as at June 11, 2012.

Note 2 – The estimated Priority Claim in respect of BIA Charges above includes the following: (1) unpaid wages and vacation pay arising from Non-Transferred Employees (who, for the purposes of calculating the quantum of this item, shall be the Non-Unionized Employees who are not Designated Employees and the Designated Employees who decline the Purchaser's offer of employment by 10:00 a.m. (Toronto Time) on the Closing Date) and employees of the Kraus Group terminated prior to the Bankruptcy Orders taking effect; and (2) earned but unremitted contributions to the Kraus Group's defined contribution pension plans for all Employees and all former employees.

The estimated BIA Charges do not include any amount that may be a Priority Claim owing to Transferred Employees or Unionized Employees (all of whom will be employed by the Purchaser from and after Closing) in respect of wages and vacation pay under Sections 81.3 and 81.4 of the BIA at the date of bankruptcy. Pursuant to Section 2.3 of this Agreement, these amounts are Assumed Liabilities.

Note 3 – Management of the Kraus Group has advised that property taxes in respect of the Real Property have been paid in advance for the period ending June 30, 2012.

Note 4 – The estimated Priority Claims do not include (1) Claims of holders of purchase money security interests who may have a Priority Claim because the Encumbrances related thereto are Permitted Encumbrances; or (2) any amount that may be a directors' and officers' liability that is not otherwise a Priority Claim.

SCHEDULE J LICENCES

(a) Environmental Licences:

- (a) Water permit number 72-P-0432 from the Government of Ontario to Strudex Fibres Ltd. dated May 5, 2010.
- (b) Certificate of Approval (Air) No. 9650-6GFHWG issued by the Ministry of the Environment to Strudex Fibres Limited on December 16, 2005.
- (c) Certificate of Approval (Air) No. 0554-6GFHTN issued by the Ministry of the Environment to Strudex Fibres Limited on December 16, 2005.
- (d) Renewal of Basic Comprehensive Certificate of Approval (Air) No. 0554-6GFHTN issued by the Ministry of the Environment to Kraus Inc. on January 18, 2011.
- (e) Renewal of Basic Comprehensive Certificate of Approval (Air) No. 9650-6GFHWG issued by the Ministry of the Environment on January 18, 2011.

(b) Equipment Licences:

- (a) Mobile Radio License issued by Industry Canada to Kraus Inc.
- (b) High Pressure Power Plant License issued by the Technical Standards & Safety Authority to Kraus Inc.
- (c) Ontario Elevating Device License issued by the Technical Standards & Safety Authority to Kraus Inc.

(c) Other Licences:

- (a) Sanitary Sewer Surcharge Agreement issued by the Region of Waterloo to Kraus Inc.

SCHEDULE K
LEASED PREMISES

1. 701 E. Audley Blvd, Vancouver, British Columbia;
2. 15210 – 135th Avenue, NW Edmonton, Alberta;
3. 1551 Church Ave., Winnipeg, Manitoba;
4. 375 Pendant Drive, Toronto, Ontario; and
5. 10 Ilsley Avenue, Dartmouth, Nova Scotia.

SCHEDULE L
PERSONAL PROPERTY

None.

SCHEDULE M
ASSUMED REAL PROPERTY LEASES

None.