

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)
IN BANKRUPTCY AND INSOLVENCY

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

AND IN THE MATTER OF A PLAN OF COMPROMISE OR
ARRANGEMENT OF QUALITY RUGS OF CANADA
LIMITED AND THE APPLICANTS LISTED IN SCHEDULE
"A" (the "**Applicants**")

SUPPLEMENTAL AFFIDAVIT OF JOHN A. PACIONE
(affirmed Aug 17, 2023)

I, John Pacione, of the City of Vaughan, in the Province of Ontario, MAKE OATH AND SAY AS FOLLOWS:

1. I am a Co-Chief Executive Officer of Quality Rugs of Canada Limited (variously referred to herein as "QRCL and the "Company"), which with various affiliates does business as the Quality Sterling Group of Companies (variously referred to below as the "QSG Group" or the "Group" or the "Companies"). As such, I have knowledge of the matters to which I depose in this supplemental affidavit, save and except for such facts or matters which are stated to be based on information and belief, and where so stated, I believe same to be true. This supplemental affidavit is sworn in support of the Group's CCAA filing. All defined terms used in my original affidavit apply herein unless otherwise indicated.

Response to Waygar Critiques of QSG

2. Waygar highlighted that there is a shortfall on its loan if the Ironbridge deal proceeds. But a comprehensive SISP was run and the market of plausible counterparties with the wherewithal to complete a transaction – strategic, semi-strategic and financial buyers – was canvassed. The Ironbridge deal is the best option and if that creates a shortfall, that is simply what the market value of the business is in the current interest rate environment.

3. Waygar noted QSG had financial challenges it could not overcome. But That is why Waygar and QSG agreed a SISP should be run - to recapitalize the business via financing sale or restructuring to solve those challenges
4. Waygar complained about disclosure concerning the Ironbridge process. There has been no lack of disclosure. Waygar has been provided with ample information by QSG and A&M and participated in negotiations. In QSG's view, the problem was the converse – Waygar was not communicative enough in response to efforts made to get this deal finalized.
5. Waygar says the SISP was inadequate in some way but offers no reason why or why it would need to be repeated. As far as I am aware, at no time did Waygar or Fuller suggest approaching any specific parties that were not included in the SISP process. The fact is that the SISP produced the best possible buyer - a financial buyer with a strategic interest.

Waygar's Alternative Realization Proposal is Unrealistic

6. Waygar has been underfunding the business and that has caused accelerating contract losses as builders became impatient with delayed installations. Continuing in that mode will lead to holdbacks set off and loss of more contracts. The company has a "911 List of installations to be funded. Waygar has not been funding them in full since June 29 and it only got worse after the court appearance on August 4. In addition to the 7 lost contracts in July, the company has been notified of other proposed terminations by builders. This is a direct result of underfunding the business causing delayed installations. Continuing in this fashion will drive down the receivables collections through delay holdbacks set offs, undermine the going concern value of the business, and leave fewer contracts to sell due to terminations.
7. In addition to that, many of the builder contracts are non-assignable.
8. Moreover the logistics of an accounting firm trying to run multiple flooring installations for multiple builder installation sites in multiple locations, or to source alternatives to fulfill QSG's obligations as Fuller winds down QSG's head count and installer count (as

its cash flow shows is the plan), is operationally unrealistic and cannot realistically succeed. to put this view into context:

- (a) QSG has 100+ projects in various states of completion, from early stage to warranty period.
 - (b) Fullers would have to sort through all 100+ projects and figure out how to present each one of these to 3rd party contractors
 - (c) Each project has its own economic complexities such as service work for already completed lots, warranty only contracts, acceptable margins for 3rd party contractor,
 - (d) QSG serves a broad geographic market from Kingston to Niagara to Muskoka. Fullers would also have to determine which contractors could undertake work based on geographic location of each project.
 - (e) QSG is an all product supply and install company. There is no other company with scale of operations in all three products. This means that Fullers would have to find three different contractors for each project, this also means three separate contracts for same project with a given builder, at the same time Fullers would have to deal with geographic service radius of contractors
 - (f) Fullers would have to solve all the above considerations in order to present options to builders projects, that the builder would need to approve.
 - (g) On the other hand each builder can far more easily remedy this by cancelling the QSG contract and solving their own project for themselves. Builders have a trusted short list of contractors they would reach out to help them solve this. this is much more practical as they can simply hold QSG receivable and reconcile at the end of project.
9. Waygar started its CCAA process on July 4 and yet, despite requests from QSG, provided no liquidation analysis nor any projection of realizations from its proposed process until August 16. There is no time to properly review what Fuller has now tabled but from a cursory review, it appears to be based on assumptions that will not pan out for the reasons noted above. It does not present a plan that is clearly or unequivocally equal to let alone superior to the Ironbridge deal. The Waygar proposal is asking the company to give up a going concern sale, and bring the life of a nearly 60 year old business to an end, without proving that a better outcome is attainable.

CAAA Issues

10. The CAAA provided the framework for the SISP to recapitalize the business. The CAAA provided that QSG was entitled to borrow \$2.5 million to fund the SISP search. Waygar reneged on the final \$250K advance at the end of April. That was a clear breach of the CAAA which undermined operations during the SISP period. As well, QSG is of the view that the failure to allow it to continue using its cash, as was also contemplated under the CAAA, while the negotiations were ongoing to finalize a deal with the successful SISP party, was inconsistent with the spirit of the CAAA and not in good faith.

D& O Charge and Insurance

11. The company has acted in good faith and endeavoured to keep statutory liabilities current as required before and after August 4. Waygar made this harder by restricting cash pre filing. The directors and officers should be protected from liability for staying in office to help facilitate the sale as that benefits stakeholders.
12. There is \$1 million in D&O insurance but the policy is complex and coverage uncertain. If a claim is made under the charge, efforts will be made to recover under the insurance and reimburse the estate to the extent insurance proceeds are received for amounts paid through the charge.

Negotiations between QSG Waygar and Ironbridge

13. Both before the LOI was signed, and after, including after August 4, there have been ongoing negotiations to attempt to align the Sale transaction with Waygar's objectives. Those discussions are ongoing, and an adjournment to permit same is in management view, advisable.

A&M Agreement & Success Fee Charge

14. A&M was introduced by Waygar. Its engagement letter with QSG was extensively negotiated with Waygar involvement, and management believes the terms for the success fee are customary for a transaction of this nature. QSG supports approval of the

agreement and protecting the payment of the success fee provided under the A&M Agreement by a charge on the sales proceeds.

15. The agreement commits the company to seek protection of this fee in the event of a restructuring. Waygar was fully aware of this requirement when it approved QSG entering into the A&M engagement, which Waygar then appended to the CAAA.

OSG Supports the Selection of RSM as CCAA Monitor

16. RSM has assisted the company to prepare for restructuring proceedings. It has shown an appreciation of management's views as to the importance of funding builder installations to protect contracts builder relationships goodwill and receivables. There is a good working relationship which will be needed for a CCAA process to succeed.
17. Fuller has been the front line of implementing Waygar's funding restrictions which management sees as destructive of business value, and as a result the working relationship has been different than it QSG's experience with RSM.

Dip Financing

18. Management now has 2 weeks of experience with Waygar as DIP funder under a system where Fuller had to sign off on spending. That experience has increased QSG's concern that managements vision of protecting builder relationships to preserve value will not easily align with the Waygar – Fuller approach.
19. Ironbridge is offering to provide DIP financing to complete a going concern acquisition. They have an incentive to align better with management vision on the question of builder relationships and bring installation schedules current by funding what is needed to accomplish that.

Note

20. QSG owes a note for \$1.0 million payable to Joseph R. Pacione which pays interest only and has a maturity date of May 31, 2023

HST and Payroll Update

21. The Group is current in its obligations to the Government of Canada in respect of H.S.T., having remitted the amounts outstanding as of August 3, 2023 since the Interim CCAA order was made on August 4, 2023.
22. Payroll is current and nothing is owing other than the accrued amount since the last payroll. Vacation Pay amounts are declining as employees take vacations.

Cash Restriction and August 3 Cash Sweep

23. On August 3, 2023, the day before the parties were scheduled to be in court, and after submitting its rights to the court by serving its own CCAA Application, Waygar swept over \$6 million in cash from QSG's receipts account at its bank, including a large customer prepaid amount; n(a roughly \$3 million advance payment by a builder to fund QSG to acquire supplies and services for the builder's project)
24. From February through June, the status quo provided by the CAAA was that 100% of the Receipts should be utilizable, despite the Blocked Account Agreement, in order to facilitate the SISF and the conclusion of a transaction. There was no good faith reason for changing that policy. Waygar changed it by limiting cash use from 100% to 85% on June 29 and then stopped funding on July 28, and then swept the resulting \$ 6 million + cash on August 3. Doing so damaged the value of the Company, as the loss of working capital to pay suppliers meant that builder installations fell further behind. That resulted in an accelerated loss of contracts in July and August. In short, Waygar pulled \$6 million in liquidity out of the Group at a time when it was trying to conclude a deal which Waygar has asked it to seek. Waygar presumably has already received a \$6 million loan paydown from this, at the expense of the health of the business which it was supposedly wanted to see sold as a going concern.

Initial Order Appropriate

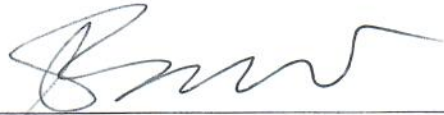
25. The QSG Group has worked with its advisors and the Proposed Monitor to limit the relief sought on this initial application to only the relief that is reasonably necessary in the circumstances for the continued operation of its businesses and to protect the option of completing a going concern sale - which management believes is by far the best value

maximization solution. In each case, the QSG Group considered whether the requested relief is necessary for the immediate stabilization of their businesses to protect them and the interests of its various stakeholders. In cases where immediate relief is necessary, the QSG Group has attempted to limit any authorizations from the Court to what is required within the proposed initial stay period and will only seek additional authorization on the Comeback Hearing

Insolvency OF QSG

- 26. The companies in the QSG Group are insolvent and are unable or are expected to soon become unable to meet obligations generally as they become due, absent the Sale Transaction and additional financing or access to its cash flow including the cash swept on August 3.

AFFIRMED by John Pacione at the City of Toronto, in the Province of Ontario, before me at the City of Toronto, in the Province of Ontario, on August 17, 2023 in accordance with O. Reg. 431/20, Administering Oath or Declaration Remotely



Commissioner for Taking Affidavits

(or as may be)

Christopher W. Bevan
(LSO#) 248820



JOHN PACIONE