

Court File No. 08-CL-7503

HARD-ROCK PAVING COMPANY LIMITED AND THE HARD-ROCK GROUP OF COMPANIES

MONITOR'S SECOND REPORT TO COURT

June 6th, 2008

APPENDIX "A"	Amended and Restated Initial Order dated May 12, 2008;
APPENDIX "B"	First DIP Loan Report;
APPENDIX "C"	Second DIP Loan Report;
APPENDIX "D"	Monitor's Reports DIP Loan
APPENDIX "E"	Various E-Mails responding to information requests from CFSL and KPMG
APPENDIX "F"	Monitor E-Mail responding to information requests from CFSL and KPMG of June 3, 2008
APPENDIX "G"	Cash Flow results for May 2008
APPENDIX "H"	Revised Forecast Cash Flow, May to September 2008
APPENDIX "I"	Summary of Sales Process
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**ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)**

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

AND IN THE MATTER OF A PLAN OF COMPROMISE OR
ARRANGEMENT OF THE HARD-ROCK PAVING COMPANY LIMITED
AND THE COMPANIES LISTED ON SCHEDULE "A"
(collectively, the "Applicants")

**SECOND REPORT TO THE COURT
SUBMITTED BY BDO DUNWOODY LIMITED
IN ITS CAPACITY AS MONITOR**

INTRODUCTION:

1. On April 28, 2008 the Hard-Rock Paving Company Limited, Diamond Stonebridge Contracting Inc., Hard-Rock Highway Maintenance Inc., Hard-Rock Construction Inc., 942355 Ontario Limited and 942356 Ontario Limited (the "Companies") made an application under the *Companies' Creditors Arrangement Act* (the "CCAA") and on May 2, 2008 an initial order (the "Initial Order") was granted by the Honourable Mr. Justice Spence of the Ontario Superior Court of Justice (Commercial List) (the "Court") granting, *inter alia*, a stay of proceedings against the Companies until June 2, 2008 (the "Stay") and appointing BDO Dunwoody Limited as monitor (the "Monitor"). The proceedings commenced by the Companies under the CCAA will be referred to herein as the "CCAA Proceedings".
2. Further, on April 28, 2008 Caterpillar Financial Services Limited ("CFSL") made an application under section 101 of the *Courts of Justice Act* RSO 1990, c.C .43 as amended, and section 47 (1) of the *Bankruptcy and Insolvency Act* RSC 1985

c.B-3, as amended for an order, *inter alia*, appointing KPMG Inc. ("KPMG") as interim receiver and receiver and manager (the "Receiver") over the assets, undertakings and properties of the Companies. Further, CFSL also made an application under the *Bankruptcy and Insolvency Act* for bankruptcy orders as against each of the Companies (the "CFSL Application").

3. On May 2, 2008 the Court endorsed terms in relation to the Initial Order and the CFSL Application as follows (unofficial transcript):

The issuance of this Order is not deemed to be consent to this Order or these proceedings by Caterpillar Financial Services Limited (CFSL) and subject to the stay contained in the Order, is without prejudice to the rights of CFSL in the bankruptcy and receivership applications that have been commenced by CFSL (the "CFSL Applications").

The CFSL Applications shall be returnable at the hearing of any motion by the Applicants to seek approval of debtor in possession financing or any extension of the stay. CFSL is at liberty and this Order is without prejudice to CFSL bringing on the CFSL Applications in response to any motion that is brought in these proceedings on notice to the service list in response to the service of any such motion.

4. On May 2, 2008 the Court made an endorsement in the CCAA Proceedings that counsel were permitted to appear before the Court on May 7, 2008 at 9:30 a.m. Further, the Initial Order provided that a hearing in the CCAA Proceedings was set for May 12, 2008 for the purpose of approving debtor in possession financing for the Companies, at which time the Initial Order may be supplemented or otherwise varied and the Stay Period extended or terminated.
5. On May 12, 2008 the court made an Endorsement in the CCAA proceedings that ordered:
- a. That CFSL was the Debtor In Possession Lender up to an amount of \$1,250,000
 - b. That the Initial Order was amended at paragraph 7 to reflect rights of trust claimants under the *Construction Lien Act*;

- c. At paragraph 37 of the Initial Order (now paragraph 42 of the Amended and Re-stated Initial Order) to have the Sale Process completed by June 10, 2008;
 - d. To amend paragraph 12 of the Initial Order to extend the Stay Period to June 10, 2008.
6. Attached at Appendix A to this report is a copy of the amended and re-stated Initial Order incorporating the above-noted changes as endorsed dated May 12, 2008 (the "Amended Order").
7. The CFSL Application was adjourned to June 10, 2008.
8. The purpose of this, the Monitor's Second Report, is to inform the Court on the following:
 - i) the Companies' Receipts and Disbursements and operating performance for the period from May 2, 2008 to May 30, 2008;
 - ii) the Companies' revised and extended cash flow forecast for the months of June to September, 2008;
 - iii) the companies forecasted income statement for the months of June to September, 2008 together with the actual figures for the months of March and April and estimated actual figures for May, 2008;
 - iv) the Sale Process and the progress to date;
 - v) the Companies' request for an extension of the Stay Period and the Monitor's recommendation thereon.
9. Unless otherwise stated, all monetary amounts contained herein are expressed in Canadian Dollars. Capitalized terms not otherwise defined are as defined in the Initial Order.

ACTIVITIES OF THE MONITOR

10. The Monitor has been at the Companies' site on a daily business basis since Friday, May 2, 2008.
11. In accordance with paragraph 3 of the Amended Order on May 8, 2008 the Monitor did provide to KPMG Inc. ("KPMG") evidence of insurance of the Equipment.
12. In accordance with sub-paragraph 22(c) of the Amended Order, the Monitor, was to assist the Companies with their dissemination to CFSL, GE and their counsel of weekly reporting of:
 - a. a comparison of actual cash flow to projected cash flow;
 - b. a reporting of the status of all jobs or contracts in which the Companies have bid or which have been awarded to the Companies;
 - c. a reporting on the status of all claims filed with the Ministry of Transportation.(hereinafter the "Weekly Reports")
13. The Weekly Reports were completed by the Companies as follows:
 - a. Weekly Report was e-mailed by the Companies on May 15, 2008 which included the First Report to CFSL, GE and KPMG dated May 12, 2008 with financial information for week ended May 9, 2008;
 - b. Weekly Report was e-mailed by the Companies on May 26, 2008 which included the Second Report (update) to CFSL, GE and KPMG dated May 26, 2008 with financial information for the week ended May 16, 2008;

- c. Weekly report was e-mailed by the companies on May 29, 2008 which included the Third Report (update) to CFSL, GE and KPMG dated May 29, 2008, with financial information for the week ended May 23, 2008;
 - d. Weekly Report was e-mailed by the Companies on June 3, 2008 which included the Fourth Report (update) to CFSL, GE and KPMG dated June 3, 2008 for the week ended May 30, 2008.
14. In accordance with sub-paragraph 22 (d) of the Amended Order, the Monitor advised the Companies in their preparation of the Companies' cash flow statements and reporting required by CFSL and GE, which information was reviewed with the Monitor and delivered to CFSL and GE and their counsel as reported in the preceding paragraph;
15. The Monitor has assisted the Companies with respect to their requests to CFSL as the "DIP Lender" as required under the Commitment Letter.
16. On May 15, 2008 CFSL as the DIP Lender deposited \$349,900 to the Designated Account (as defined in the Commitment Letter).
17. On May 28, 2008 the Companies delivered a signed request with the consent of the Monitor to CFSL as DIP Lender requesting authorization to draw \$600,000 from the Designated Account (as defined in the Commitment Letter). Attached at Appendix B is a copy of the Companies "First DIP Loan Request" dated May 28, 2008.
18. On June 4, 2008 the Companies delivered a second signed request with the consent of the Monitor to CFSL as DIP Lender requesting authorization to draw \$269,500 from the Designated Account (as defined in the Commitment Letter). Attached at Appendix C is a copy of the "Second DIP Loan Request" dated May 28, 2008.
19. Further, the Monitor has reported to CFSL as the DIP Lender as to the use of the DIP Loan by the Companies as follows:

- a. First Report to CFSL dated May 28, 2008;
- b. Second Report to CFSL dated June 3, 2008.

Attached as Appendix D are copies of the Monitor's Reports to CFSL as the DIP Lender dated May 28, 2008 and dated June 3, 2008.

20. The Weekly Reports by the Companies were not initially completed in a timely fashion, and the financial information provided has not been to the entire satisfaction of CFSL or KPMG.

21. The Weekly Reports have resulted in numerous questions from CFSL and KPMG to both the Companies and the Monitor. In responding to these requests the Companies and the Monitor have used best efforts to respond as fully as possible to satisfy KPMG and CFSL's inquiries. The Monitor has responded to KPMG or CFSL with respect to inquiries as follows:

- a. By way of e-mail dated June 2, 2008;
- b. By way of e-mail dated June 3, 2008; and
- c. By way of e-mail dated June 4, 2008.

Attached as Appendix E are copies of the above-mentioned e-mails.

22. The Monitor's position is that the Companies' ability to deal with the detailed accounting and frequent reporting required of them under the Initial Order and the Amended Order has been limited. The Companies do not have the human resources in the accounting area to deal with the reporting and the inquiries made of them in a timely fashion or with the detail requested, while at the same time handling the Sale Process and the numerous inquiries and requests for information related thereto, managing trust claims under the *Construction Lien Act* (CLA") and addressing customer and creditor concerns so as to maintain and re-build normalized day-to-day business relationships and manage day-to-day operations.

23. These constraints have most certainly led to frustrations on behalf of CFSL and KPMG and have made it difficult for the Companies to satisfy the request made of them by CFSL, KPMG and the Monitor to produce detailed Weekly Reports and a revised cash flow in a timely fashion. The Monitor understands that CFSL requires the information sought by CFSL and KPMG. The Monitor has communicated with CFSL and KPMG regarding their requests for information and has advised CFSL and KPMG of the Companies' limitations in dealing with the requests made. Attached at Appendix F is a copy of the Monitor's e-mail of June 3, 2008 to CFSL.
24. In accordance with paragraph 43 of the Initial Order, the Applicant under the supervision of the Monitor did deliver to the known creditors of the Companies, other than employees and creditors to which the Companies owe less than \$1,000, a copy of the Initial Order.
25. The Monitor has also been providing ongoing assistance to the Companies in their dealings and discussions with suppliers, customers and various parties interested in purchasing some or all of the assets of the companies pursuant to the Sale Process referred to in paragraphs 42 to 47 of the Amended and Restated Initial Order.
26. The Monitor has relentlessly pressed the Companies to improve their financial reporting so as to provide more timely and complete information to CFSL, KPMG, GE and any other affected stakeholder. Accordingly, the Companies have prepared normal monthly financial statements for the months of March and April 2008 and an estimated income statements for May 2008. Further, the Companies have prepared operating forecasts for the months of June to September 2008, and amended cash flow forecasts for the same period. This information was finalized only on June 4 and 5, 2008 and was reviewed by the Monitor simultaneously.

RECEIPTS & DISBURSEMENTS FOR THE MONTH OF MAY 2008

27. A schedule showing the Companies' actual cash flow for the period May 2 to May 30, 2008 is attached as Appendix G. The actual cash balance at May 30, 2008 was approximately \$320,000 higher than forecast at the time of filing the CCAA application. The actual cash flow for the month is summarized below:

	<u>Actual</u> \$	<u>CCAA Forecast</u> \$	<u>Variance</u> \$
Total Receipts	1,500,727	2,800,000	(1,299,273)
Disbursements	(2,121,731)	(3,812,300)	1,690,569
DIP Financing	949,980	1,012,300	(62,320)
Cash on hand	328,976	0	(328,976)

28. Actual receipts were \$1,299,273 lower than CCAA forecast, and actual disbursements were \$1,690,569 lower than CCAA forecast. When the Companies prepared their cash flow forecasts at the time of filing the CCAA application, they assumed business "as per normal" and also expected to immediately obtain a \$6,000,000 debtor in possession financing from GE. Negotiations between CFSL, GE and the Companies, which extended over a period of approximately two weeks and resulted in the initial debtor financing of \$1,250,000 caused the Companies to temporarily cease operations for lack of funds. The Companies' re-start of business in earnest on about May 15, 2008 delayed a number of jobs in progress, or about to start, thereby reducing cash flow from receivables. Further the Companies' customers were concerned, having become aware of the Companies' financial difficulties, that trust fund obligations under the CLA would have to be properly discharged and accordingly were hesitant to pay.

29. The effect of all of these issues was to significantly reduce cash flow, but the Companies were able to compensate for this reduction by also dramatically reducing their costs. Also, of course, idle jobs did not incur new wage or sub-trade costs.
30. The Companies have been working diligently to assure customers of their ability to continue with the work, and to implement measures to fully comply with the provisions of the CLA. The Monitor is not aware of any significant jobs having been lost to the companies in the meantime.
31. However, the Companies are unable at this time to quote on any additional bonded jobs, as bonding is no longer available to them. Accordingly they are seeking to obtain non-bonded jobs and have made arrangements to work together with other contractors who would bid on jobs and share the work with Hard Rock. In addition they have been in discussions with an insurer and have sent them a preliminary business plan in an effort to obtain new bonding. Also, the Monitor has spoken to Dufferin which has advised that Dufferin is prepared to continue to work with Hard Rock, provided it continues in business and can normalize its finances. Dufferin has also advised that it is willing to provide further milling, pulverizing and grinding work, and is prepared to furnish the Companies with a letter of support.

REVISED AND EXTENDED CASH FLOW FORECAST FOR MAY TO SEPTEMBER, 2008

32. The Companies have prepared a revised cash flow forecast for the months from May to September, 2008 ("Revised Forecast"). The sales for the month of May represent actual results and the expenses for May represent estimate amounts (pending finalization of the May results). The Revised Forecast is attached as Appendix H and is summarized below:

Receipts	\$12,962,596 (net of trust payments)
Disbursements	\$18,443,666
Net cash deficiency	\$5,412,403

33. The major changes and assumptions underlying the Revised Forecast as compared to the forecast filed by the Companies in conjunction with the CCAA Proceedings are as follows:

- CCAA costs increased dramatically to reflect current realities;
- sales reduced as a result of bonding issues, and as a result of delayed job start ups;
- costs have been reduced to reflect lower levels of activity than initially forecast.

34. The Companies have also prepared balance sheets and income statements for March and April 2008, an estimated income statement for May 2008 (pending finalization of the actual figures for the month) as well as forecast income statements for the months of June to September 2008.

35. While these estimates and forecasts as detailed above could not yet be reviewed in full detail by the Monitor at the time of drafting this Report as the figures were presented to the Monitor by the Companies only on June 4 and 5. The Monitor's preliminary review indicates that the Companies May operations resulted in a loss of approximately \$450,000 on sales of approximately \$1,200,000. While disbursements for May totalled approximately \$1,900,000, \$250,000 of that amount pertained to capital improvements to the asphalt plant, \$400,000 was paid for prior period employee remuneration and benefits, and approximately \$300,000 was paid at the end of May to suppliers for work to be done in June.

36. Additional work needs to be done by the Companies to finalize the May financial results and verify the accuracy of the currently estimated loss of \$450,000. However, it should be noted that the indicated loss includes CCAA costs of \$340,000. Thus the indicated operating loss (EBITDA) is shown as \$112,000, before depreciation and interest costs. If this is accurate, the loss in the Monitor's view is not excessive under the circumstances.
37. The main focus of the Companies leading up to the Amended Order was obtaining debtor in possession financing. Following the Amended Order, the Companies' focus was on the Sales Process. Only in the last two (2) weeks have the Companies' been able to focus on compiling their financial information.
38. The Revised Forecast indicates that the Companies' sales would increase over the period from June to September as jobs get under way, in the construction season. Accordingly, the indicated loss for June reduces to approximately \$50,000 and the months of July to September reflect positive earnings before interest, taxes, depreciation and amortization ("EBITDA") even after CCAA costs. The challenges for the Companies' lie in maintaining existing work, obtaining new work, and maintaining profit margins.
39. Further, due to normal delays in collecting the Companies' accounts receivable, aggravated to some degree by customer concerns that CLA trust fund obligations be dealt with promptly, the Companies appear to be short of cash every month until September and these shortfalls need to be financed. The Revised Forecasts indicate additional financing requirements of \$1,000,000 for June, and an additional total sum of \$3,200,000 for July, August and September 2008.

PROGRESS OF THE SALES PROCESS

40. Pursuant to paragraph 42 of the Amended Order, it was ordered that the Monitor and the Applicants were authorized and directed to conduct a process for the solicitation of offers for and sale of, the Property (the "Sale Process"). The Sales

Process was to be completed by June 10, 2008 in accordance with such steps as the Monitor and the Companies reasonably determined in consultation with, and as approved by CFSL and GE.

41. Pursuant to sub-paragraph 22 (h) of the Amended Order, the Monitor was to supervise the Sales Process and otherwise assist the Companies in carrying out the Sale Process.
42. Attached at Appendix I is a memorandum summarizing the Sale Process agreed upon as between the Companies and the Monitor along with the Monitor's email of May 13, 2008 detailing the Monitor's suggested approach for the Sale Process.
43. As detailed in the Sale Process, the Monitor and the Companies placed advertisements in the Globe & Mail on Monday, May 26, 2008, in the Daily Commercial News on May 27 and May 28, 2008, and in the Journal of Commerce on May 28, 2008. The advertisements requested that written offers to purchase the assets of the Companies were to be received by no later than June 4, 2008.
44. The Monitor and the Companies prepared a confidential information memorandum ("CIM") and forwarded the CIM to a number of prospective purchasers.
45. At the time of drafting this report the Monitor had received approximately fourteen offers from purchasers for various assets, parcels of assets, or the assets in their entirety. These offers have been furnished on a confidential basis, to CFSL and CAT and their counsel.

THE CONSTRUCTION LIEN ACT

46. Counsel for the Companies and the Monitor have been in discussions with counsel for Guarantee Company of North America ("GCNA"), a bonding company in respect of certain construction projects where one or more of the Companies is

the contractor. GCNA has expressed to the Companies and the Monitor a concern that trust monies (as defined in section 8 of the CLA) retain the impression of trust and should not be the subject of any security granted by the Initial Order. Further, GCNA wishes to ensure that such trust monies be disbursed by the Companies only pursuant to the terms of a protocol in place to ensure that the trust provisions under the CLA are adhered to. The Monitor, GCNA and the Companies' have agreed to an Undertaking to comply with the Construction Lien Act Trust Fund Obligations, a copy of which is attached at Appendix J.

47. The Companies and their counsel have been contacted by two (2) suppliers of improvements to Companies' projects (Emco Corporation and Lafarge Canada Inc.) to seek the Companies and the Monitor's consent to the lifting of the Stay Period to permit these suppliers to preserve and protect their lien rights under the *Construction Lien Act*. The Companies and the Monitor have consented to these requests.

ACTIVITIES OF THE COMPANIES

48. The principals of the Companies have been engaged in re-building relationships with their customers and creditors and in attempting to secure debtor in possession financing, in addition to dealing with the requests of the Monitor.

49. The principals of the Companies, together with the Companies staff, have been engaged in the ongoing undertakings of the Companies, including corresponding with customers, planning and arranging for the completion of contracts and jobs, collection of accounts receivable and communicating with employees.

50. The principals of the Companies continue to communicate and meet regularly with the Ministry of Transportation (the "MTO") regarding various claims filed with MTO, with a view to resolving the claims in an expeditious manner. It appears there is some willingness by MTO to expedite settlement of the companies' claims, but no definitive results have been achieved to date. The Monitor has had

discussions with MTO and was advised that MTO was attempting to expedite a speedy resolution of the claims, and was supportive of the Companies' generally, and specifically so as to maintain a healthy competitive construction environment in the Niagara Region.

THE COMPANIES' REQUEST FOR AN EXTENSION OF THE STAY PERIOD

51. The Companies' records indicate a loss for May, which appears to be within reasonable limits considering the circumstances encountered by the Companies in the month of May. The Revised Forecasts indicate an improvement in the Companies' profitability over the coming months as the construction season gets fully under way, and customers appear to be generally supportive of the Companies.
52. Further, the Sales Process appears to have identified a number of serious purchasers and accordingly time will be needed to finalize potential sales of the assets.
53. The Revised Forecasts indicate the Companies require additional financing to meet cash flow shortfalls expected in the month of June and subsequently. The Revised Forecast indicate that approximately \$1,000,000 will be required in the month of June, in addition to the debtor in possession financing of \$269,500 (which was drawn on June 4, 2008). Additional funds will be required in the coming months.
54. In summary, the Monitor believes that the Companies have acted and are acting in good faith and with due diligence and that circumstances exist that make an extension of the Stay Period appropriate. The Monitor therefore respectfully recommends that the Company's request for an extension of the Stay Period for 90 days be granted, so as to allow time to finalize negotiations with purchasers and complete sales transactions under the Sales Progress, while at the same time indicating to customers of the Companies' that its restructuring process was continuing in a satisfactory manner.

Respectfully submitted,

Dated this 6th day of June 2008.

A handwritten signature in black ink, appearing to read 'M. Rashid', written in a cursive style.

BDO Dunwoody Limited

In its capacity as Monitor of The Hard-Rock Paving Company Limited
and the companies listed at schedule "A" to the Initial Order