Raymond Chabot Inc.

An affiliate of
Raymond Chabot Grant Thornton LLP

CANADA
DISTRICT OF QUÉBEC

SUPERIOR COURT
Commercial Division
(Sitting as a court designated pursuant to the *Companies' Creditors Arrangement Act*, R.S.C., c. C-36, as amended)

DIVISION NO.: 01-MONTRÉAL
COURT NO.:
OFFICE NO.:

IN THE MATTER OF THE PLAN OF ARRANGEMENT OR COMPROMISE OF:

JAVA-U GROUP INC., JAVA-U FOOD SERVICES INC., CAFÉ JVA-U INC., JAVA-U RTA INC.

Legal persons incorporated under the laws of Canada, having their principal executive offices at 400-4098 Ste-Catherine Street West, in the city of Westmount, in the province of Québec, H3Z 1P2.

Hereinafter referred to as "Java-U", the "Debtors" or the "Company"

-and-

RAYMOND CHABOT INC.,
Jean Gagnon, CPA, CA, CIRP, LIT

Hereinafter referred to as the "Proposed Monitor"

REPORT OF THE PROPOSED MONITOR ON JAVA-U's BUSINESS AND FINANCIAL AFFAIRS

PREAMBLE

To one of the Honourable Judges of the Superior Court, sitting in Commercial Division, in and for the judicial district of Montréal, we respectfully submit the First Report of the Proposed Monitor on the Debtors' business and financial affairs.

Signed in Montreal on October 5, 2017

RAYMOND CHABOT INC.
Proposed Monitor

Jean Gagnon, CPA, CA, CIRP, LIT

1. INTRODUCTION

We submit our report to the Court on the business and financial affairs of the Debtors in connection with the filing of an application for an Initial Order and a Claims Procedure Order under the Companies' Creditors Arrangement Act (hereinafter referred to as the "Act").

This report of the Proposed Monitor addresses the following topics:

- Context (Section 2);
- Summary analysis of financials (Section 3);
- Projected cash flow (Section 4);
- Conflict of interest (Section 5);
- Interim financing and charges sought by the initial order (Section 6);
- Solicitation process (Section 7);
- Conclusion and recommendation (Section 8).

2. CONTEXT

The Debtor Companies

Java-U is a Montreal-based coffee chain, serving coffee and light meals and offering catering services through franchisees and corporate-owned restaurants in Canada, the UK and the Middle East. It also operates a coffee and food distribution and food processing center located in Montréal, Quebec through its wholly owned subsidiary, which prepares the food served in the different Canadian restaurants of the chain.

The first Java-U coffee shop was opened in 1996 in Montreal, at the corner of Guy and de Maisonneuve streets (at the time, it operated under another corporate entity). Given its success, two additional locations were opened under the same corporate entity in the following years. In 2002, the current shareholders purchased a majority interest in the company, and continued to develop the coffee chain. Starting in 2007, Java-U began the process to convert its business model into that of a franchise company, as it is today,

At the date hereof, the Java-U chain represents:

- Two coffee shops in Montréal, operated by the Company;
- Twelve coffee shops in Montréal, operated by franchisees;
- One coffee shop in Vancouver, operated by a franchisee;
- Three coffee shops in London, United Kingdom, which are operated by franchisees;
- Nineteen coffee shops in the Middle East, operated by franchisees.

Java-U revenues are mainly derived from franchise royalties, the sale of coffee and food to each of the Canadian franchisees, and the sales of the corporate-owned stores.

As of the date of this report, the Company employs a total of 51 employees. According to management, all salaries, deductions at source and employee remittances are up to date.

Below is a description of the Group entities that are still active at this time:

- Java-U Group inc. is a holding company, which holds 100% of the shares of Java-U Food Services inc., Café Java-U inc. and Java-U RTA Inc. It also operates two corporate restaurants, and acts as franchisor, lessee and sub-lessor under various franchise agreements, lease agreements and sub-lease agreements for some of the chain's locations. It was incorporated on April 16, 2004 under the *Canada Business Corporations Act* ("CBCA").

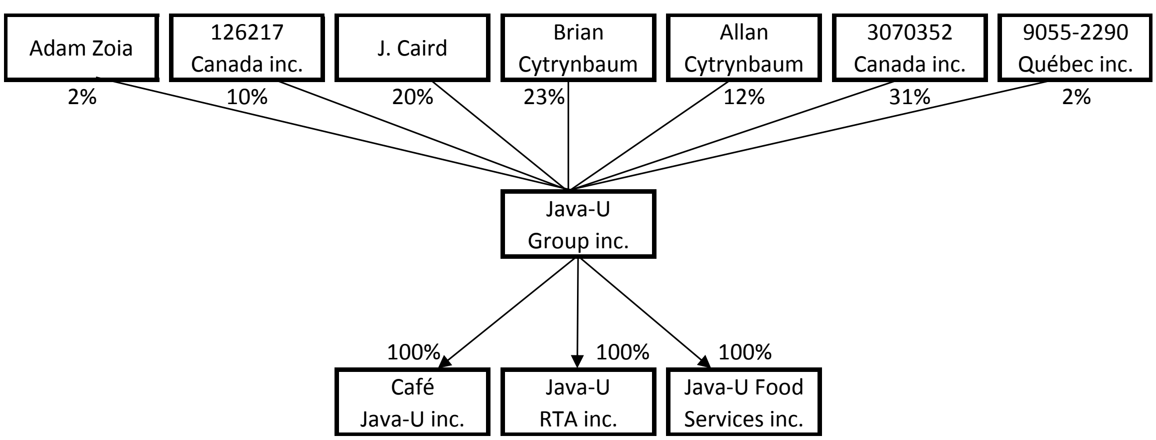
- Java-U Food Services inc. is wholly owned by Java-U Group inc., and acts as franchisor, lessee and sub-lessor under various franchise agreements, lease agreements and sub-lease agreements for some of the chain's locations. It owns the equipment of the food distribution and processing facility. It was incorporated on September 30, 2004 under the CBCA.

- Café Java-U is wholly owned by Java-U Group inc., and acts as lessee and sub-lessor under various lease agreements and sub-lease agreements for some of the chain's locations. It is the entity that employs the employees working in the corporate-owned stores, food processing facility and Java-U offices. It was incorporated on July 22, 1996 under provincial legislation.

- Java-U RTA inc. is wholly owned by Java-U Group inc. and acts as lessee under a lease agreement for the location in Toronto, which recently closed. It was incorporated on February 23, 2016 under the CBCA.

- Java-U Group inc. also holds the shares of multiple numbered companies, all of which are inactive at this time. These were excluded from the table below.

The Debtors' shareholders and the group's active entities are the following:



Causes of financial difficulties

As further described at paragraphs 40 and following of the Application for the Issuance of an Initial Order and a Claims Procedure Order, management namely attributes Java-U's financial difficulties to the following:

- Significant increase in competition;
- Significant increase in costs of goods sold, namely in light of the rise in the value of the US dollar in comparison with the Canadian dollar;
- Failed attempts to diversify its product offering; and
- The purchase by the group of underperforming franchisees, for which substantial financial resources were deployed in order to restore operations.

The Proposed Monitor further understands that Java-U is involved in various litigation proceedings.

As a result, the Company has incurred significant losses over the past few years. Between 2013 and 2015, the audited consolidated financial statements show a total net loss of $1.8 million; and the 2016 audited consolidated financial statements show a net loss of $1.6 million. In an attempt to restore the Java-U's profitability, management has attempted to diversify its product offering by partnering with certain well-known companies such as Natrel, and to minimize its costs by down-sizing and rationalizing its business operations, including reducing the number of corporate-owned locations and reducing its workforce.

The Proposed Monitor understands that, until now, the Company's operations have been funded by advances from shareholders and related parties (i.e. without any financing from a bank or other third-party lender), and that they would no longer be prepared to inject additional funds given the present circumstances.

In this context, Java-U has no choice but to seek protection of the Court through the filing of an Initial Order under the Companies' Creditors Arrangement Act ("CCAA"), in order to initiate a solicitation process with a view of maximizing the value of its assets.

3. SUMMARY ANALYSIS OF FINANCIALS

We have analyzed the latest consolidated financial statements of the Group, which comprise the financial results and balance sheets of Java-U Group inc., Java-U Food Services inc., Café Java-U as well as the inactive numbered companies (9).

Our analysis essentially consisted of enquiry, analytical procedures and discussion related to information supplied by management. This work does not constitute an audit or review of the financial statements in accordance with generally accepted auditing standards established by CPA Canada or by the American Institute of Certified Public Accountants (AICPA). No audit work has been carried out by us and, consequently, we do not express an opinion on these financial statements.

Moreover, the reader should be aware that the financial statements may require that additional transactions and/or balances be adjusted for the purposes of consolidating the financial statements.

The following table shows the Group's consolidated statement of operations for the years ended October 31 2014 through 2016. Detailed financial statements are attached in Appendix I.

For the year ended October 31 :	2016	2015	2014
	(Audited)	(Audited)	(Audited)
Revenues	3 150	3 734	4 116
Cost of sales	1 811	2 297	2 535
Gross margin	1 339	1 437	1 581
Operating expenses			
Selling	412	310	113
General and administrative	2 030	1 758	1 304
Financial	488	331	384
	2 930	2 399	1 801
Net loss	**(1 591)**	**(962)**	**(220)**

- Java-U has seen its revenues decrease year after year, as a result of increased competition in the market, the closure of multiple locations due to disappointing sales, and attempts to rationalize its operations.
- Selling expenses include the salaries of the corporate-owned stores as well as marketing and delivery expenses.
- General and administrative expenses include, among others, the office salaries, rents (including those of the corporate stores), professional fees and significant bad debt expenses. The considerable expense is explained in part by the rents Java-U now has to support after buying back some underperforming franchises, as well as the high legal fees resulting from the lawsuits.
- Financial expenses are substantial in comparison to revenues, due to the Company's substantial debt.

The following table presents Java-U Group's consolidated balance sheet as at October 31, 2014, 2015 and 2016. Detailed financial statements are attached in Appendix I.

As at october 31 :	2016	2015	2014
	(Audited)	(Audited)	(Audited)
Assets			
Accounts receivable	477	389	399
Inventory	53	53	70
Prepaid expenses	27	-	2
	557	442	471
Property and equipment	100	125	245
Balance of sale receivable	-	59	-
	100	184	245
	657	**626**	**716**
Liabilities			
Bank indebtedness	23	27	226
Accounts payable	897	716	621
Deferred revenue	-	-	11
	920	743	858
Deferred revenue	99	132	-
Contribution to leasehold improvements	110		
Loans payable, shareholders and company controlled by a shareholder	5 962	5 709	5 455
Loans payable, a shareholder and companies controlled by a shareholder	2 336	1 221	620
Loan payable, a shareholder	118	118	118
	9 545	7 923	7 051
Shareholders' deficiency			
Deficit	(8 888)	(7 297)	(6 335)
	657	**626**	**716**

- The Group's short term assets do not suffice to cover short-term liabilities.
- Accounts receivable relate to the royalties paid by the franchises to Java-U monthly, as well as the food purchases they make.
- Since 2015, Java-U does not have access to bank loans to support its activities.
- Accounts payable are mostly comprised of food and coffee suppliers, as well as general office suppliers.
- As a result of Java-U's losses over the years, the shareholders and related companies have funded activities and saw their loans increase significantly since 2014.
- The financial losses recorded in prior periods have contributed to the Group's net deficit of $8.9 million as at October 31, 2016.

The following table summarizes the liabilities incurred by Java-U as at October 2nd, 2017:

(Unaudited, in thousands of dollars)		Amount
Priority claims		
Deemed trusts		-
Employees - Salaries and vacations		69
		69
Liabilities		
Loans from shareholders and related entities	**Note 1**	9 309
Suppliers and landlords		775
		10 084
Contingent liabilities	**Note 2**	4 434
Total liabilities		**14 587**

Note 1: No opinion has been obtained at this stage regarding the validity of the hypothecs securing the loans from shareholders and related entities.

Note 2: Contingent and unliquidated claims are outstanding against Java-U, including:

- Java-U Group is currently a defendant in litigation initiated in Court file number 500-11-047199-142 by one of its minority shareholders, 126217, which claims that Java-U Group and its directors would have acted in an oppressive manner against it, and is therefore seeking reimbursement of its 2006 equity investment, which totals $2,500,000 (the "126217 Claim"). The claim is contested by Java-U Group and its directors.
- Java-U is also a defendant to litigation initiated in Court file number 500-17-074452-122, under which one of its minority shareholders requests $1,826,000 alleging that Java-U Group did not open a location in one specific location in Montreal, which resulted in lower profitability. The claim is contested by Java-U Group and its directors.

4. PROJECTED CASH FLOW

Java-U's management prepared a projected cash flow statement for the 10-week period ending December 10, 2017, which is attached in Appendix II.

These projections have been prepared based on assumptions which reflect the general direction that the Group's management intends to adopt given the financial and economic conditions which in the opinion of the Group's management are the most probable. Our compilation was limited to presenting, in the form of a projected cash flow, information provided by management and evaluating the support for the assumptions or other information underlying the forecast.

Given that this financial forecast is based on assumptions regarding future events, actual results will vary from the information presented and the variances may be material.

The projections prepared by management are mainly based on the following assumptions:

- Cash inflows of approximately $910,000 obtained from regular sales and royalties, and through the DIP financing. The DIP advances will be made according to the cash requirements.
- Sales and food purchases consider the downsizing expected through the closure of some locations, as well as expected customer traffic and historical revenues and expenses.

- There are approximately 50 employees, to be paid on a bi-weekly basis.

- Operating expenses as well as occupations fees are based on history and on the existing agreements/contracts.

- Professional fees include restructuring fees as well as legal fees for continuing litigations and the accounting fees.

The main risks associated with the projected cash flows include:

- The capacity to maintain relationships with the franchisees and suppliers;

- Disbursements are limited to known costs and projections. Additional disbursements will be required depending on the restructuring process. It is understood that such costs, if necessary, will require additional funding.

5. CONFLICT OF INTEREST

Raymond Chabot Inc. is not aware of any conflicts of interest that could affect its independence or ability to perform its role as the Proposed Monitor.

6. INTERIM FINANCING AND CHARGES SOUGHT BY THE INITIAL ORDER

Management has sought DIP financing from 3070352 Canada Inc., an affiliated company, whereby the DIP Lender has agreed to provide interim financing to Java-U in an amount of up to $300,000. This should allow the Company to continue to fund the on-going business expenditures and its restructuring fees incurred in respect of the present proceedings. The terms of the DIP financing provide for interest at the rate of 15% per annum, and no other fees (other than reimbursement of expenses). The DIP financing matures at the earliest of (i) 6 months from the date of the DIP term sheet (April 3, 2018), (ii) the closing of a transaction in respect of all or substantially all of the assets of Java-U, (iii) the effective date of a plan of arrangement and (iv) the occurrence of an event of default under the DIP term sheet.

The charges on the Java-U's assets sought by the Initial Order are the following:

- Administration charge: Java-U seeks an "Administration Charge" in an amount of $100,000 in order to secure the payments of the Monitor, as well as the Monitor's and Java-U's respective legal counsels. These parties recognize that their fees may be received over a period of time, as the DIP financing may not be sufficient and/or realized through a potential sale of assets/shares.

- Directors' and officers' ("D&O") charge: Java-U does not hold any D&O insurance. As such, the Company seeks "Directors' Charge" in an amount of $125,000, based on estimated wages, salaries, commissions, vacation pay and sales taxes over a one-month period. This charge would affect Java-U's assets.

- DIP Charge: Java-U seeks an "Interim Lender Charge" in an amount of $360,000 in order to secure the amounts owed under the DIP financing.

7. SOLICITATION PROCESS

While under the protection of the CCAA, Java-U intends to maintain its ongoing operations in order to continue generating revenues and maximize the chances of either finding an acquirer for its assets as a going concern, or finding investors willing to finance its operations.

Accordingly, and with the assistance of the Proposed Monitor, Java-U intends to initiate a public solicitation process seeking parties to either finance the Company's operations going forward, or purchase its assets to the benefit of its creditors. Given the nature of the Company's business and of its assets, the Proposed Monitor is of the view that the proposed solicitation process described in the Application is reasonable under the circumstances.

Meanwhile, Management intends to continue its costs-cutting measures.

8. CONCLUSION AND RECOMMENDATION

- Java-U is currently unable to meet its obligations as they become due unless additional funding is made by its current shareholders, which they are unwilling to do under the present circumstances.
- In a bankruptcy scenario, the value of the assets would most probably be jeopardized. Indeed, should the operations of the franchisor stop, the value of its franchises would be highly impacted, and so would the operations in the different coffee shop. This would limit the amount any interested party would be willing to pay for the assets of the Company.
- The end of Java-U's activities would have a significant impact on the viability of the franchisees.

Therefore, the Proposed Monitor supports the issuance of the Initial Order (including namely the approval of a DIP financing) and of the Claims Procedure Order.

APPENDIX I

APPENDIX II

JAVA-U GROUP INC.
JAVA-U FOOD SERVICES INC.
CAFÉ JAVA-U INC.
JAVA-U RTA INC.

PROJECTED CASH FLOW

FOR THE PERIOD ENDING DECEMBER 10, 2017

Raymond Chabot inc.

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CANADA
DISTRICT OF QUÉBEC
DIVISION NO: 01-MONTRÉAL
COURT NO:
FILE NO.:

SUPERIOR COURT
« Commercial Division »

IN THE MATTER OF THE PERSON APPLYING FOR THE INITIAL ORDER UNDER THE CCAA:

JAVA-U GROUP INC.
JAVA-U FOOD SERVICES INC.
CAFÉ JAVA-U INC.
JAVA-U RTA INC.

Insolvent Persons

REPORT ON CASH FLOW STATEMENT BY THE PERSON APPLYING FOR AN INITIAL ORDER UNDER THE CCAA

The management of Java-U Group inc., Java-U Food Services inc., Café Java-U inc. and Java-U RTA inc. (hereafter "Java-U" or the "Insolvent Persons").

The hypothetical assumptions are reasonable and consistent with the purpose of the projection described in Note 1, and the probable assumptions are suitably supported and consistent with the plans of the Insolvent Persons and provide a reasonable basis for the projection. All such assumptions are disclosed in Note 3.

Since the projections are based on assumptions regarding future events, actual results will vary from the information presented, and the variations may be material.

The projections have been prepared solely for the purpose described in Note 1, using a set of probable and hypothetical assumptions set out in Notes 3. Consequently, readers are cautioned that it may not be appropriate for other purposes.

Dated at Montreal this 5 day of October, 2017.

JAVA-U GROUP INC.
JAVA-U FOOD SERVICES INC.
CAFÉ JAVA-U INC.

Louis Varoutsos
President

JAVA-U GROUP INC.
JAVA-U FOOD SERVICES INC.
CAFÉ JAVA-U INC.
JAVA-U RTA INC.
CASH FLOW STATEMENT
FOR THE PERIOD OF OCTOBER 2, 2017 TO DECEMBER 10, 2017

(Unaudited)

Week number	1	2	3	4	5	6	7	8	9	10	
For the week ending	8-Oct-17	15-Oct-17	22-Oct-17	29-Oct-17	5-Nov-17	12-Nov-17	19-Nov-17	26-Nov-17	3-Dec-17	10-Dec-17	Total
Inflows											
Net Sales	98 376	47 888	47 888	47 888	98 376	47 888	47 888	47 888	98 376	47 888	**630 344**
Temporary financing (DIP)	50 000	-	-	-	25 000	25 000	50 000	-	50 000	-	**200 000**
Commission for the sale of a franchise	-	80 000	-	-	-	-	-	-	-	-	**80 000**
	148 376	127 888	47 888	47 888	123 376	72 888	97 888	47 888	148 376	47 888	**910 344**
Outflows											
Food purchases	30 367	33 697	30 802	29 628	29 628	32 958	30 802	29 628	29 628	32 958	**310 099**
Salaries	55 049	-	55 049	-	50 583	-	50 583	-	50 583	-	**261 847**
Operating expenses											
Selling	1 500	517	8 440	-	1 500	517	7 684	-	1 500	517	**22 176**
General and administrative	740	-	6 829	-	740	-	6 829	-	-	740	**15 878**
Occupation fees											
Rent	29 091	-	-	-	29 091	-	-	-	29 091	-	**87 273**
Utilities	-	437	-	313	-	3 618	-	313	-	3 618	**8 299**
Maintenance	751	51	651	671	401	51	292	671	401	51	**3 991**
Sales tax	7 402	-	-	-	4 001	-	-	-	4 001	-	**15 403**
Consultant fees / Accounting fees	9 000	-	7 000	-	9 000	-	7 000	-	9 000	-	**41 000**
Restructuring fees	15 000	15 000	15 000	15 000	15 000	15 000	15 000	15 000	15 000	15 000	**150 000**
Financial fees	-	-	-	625	-	-	-	-	2 500	-	**3 125**
	148 900	49 702	123 771	46 237	139 944	52 145	118 190	45 612	141 704	52 885	**919 091**
Cash - Beginning of period	**65 365**	**64 841**	**143 027**	**67 144**	**68 794**	**52 226**	**72 969**	**52 667**	**54 943**	**61 615**	**65 365**
Inflows (outflows) for the period	(524)	78 186	(75 883)	1 651	(16 568)	20 743	(20 302)	2 276	6 672	(4 997)	**(8 747)**
Cash - End of period	**64 841**	**143 027**	**67 144**	**68 794**	**52 226**	**72 969**	**52 667**	**54 943**	**61 615**	**56 618**	**56 618**

JAVA-U GROUP INC.
JAVA-U FOOD SERVICES INC.
CAFÉ JAVA-U INC.
JAVA-U RTA INC.

Louis Varoutsos
President

JAVA-U GROUP INC.
JAVA-U FOOD SERVICES INC.
CAFÉ JAVA-U INC.
JAVA-U RTA INC.
NOTES TO THE PROJECTED CASH FLOW STATEMENT
FOR THE PERIOD ENDING ON DECEMBER 10, 2017

(Unaudited)

1. Purpose of the Projected Cash flow Statement

The Insolvent Persons' management prepared the cash flow statement on October 2, 2017 from pertinent information.

The purpose of this projected cash flow statement is to present relevant prospective financial information within the scope of the filing of a Plan of Arrangement. This financial information may not be relevant for other purposes.

These projections have been prepared based on assumptions which reflect the general direction that the Insolvent Persons' management shall be adopting given the financial and economic conditions which in the opinion of the Insolvent Persons' management is the most probable.

Since this projected cash flow statement is based on assumptions regarding future events, actual results for the period covered will vary from the information presented, and the variations may be material.

2. Continuation of Operations

The projections are based on the fact that the company continues its operations in the normal course of business, while conducting a solicitation process to find a potential buyer or a financial partner. The projections do not reflect any adjustments that should be required if some assets were sold outside the normal course of affairs.

3. Hypothetical and probable assumptions

The projected cash flow statement is mostly based on hypothetical assumptions listed below:

3.1. Inflows

Sales

Management has estimated the expected royalties, food and coffee sales to the franchisees, as well as the gross sales occurring in the corporate-owned coffee shops. These are based on the restaurants that management expects to keep open, and takes into consideration the restaurants that will be closed as part of the restructuring process.

DIP

The Debtor-in-possession advances will be made based on the cash requirements of the Insolvent Persons.

3.2. Outflows

Food purchases

Food purchases are based on management's best estimated, based on the coffee shops it expects to keep open through the restructuring process and the anticipated customer traffic.

Salaries

Salaries are based on the staff assessment required by management and are paid on a bi-weekly basis.

Operating expenses

The operating expenses are based on the recent history and the existing agreements and/or contracts. They will be paid upon reception of the invoice.

Occupation fees

The operating expenses are based on the recent history and the existing lease agreements and/or contracts. They will be paid upon reception of the invoice or per the terms of the agreements.

Sales tax

Sales taxes are estimated based on the volume of taxable sales and purchases for the period.

Professional fees

Professional fees include restructuring fees as well as legal fees for continuing litigations and accounting fees. They are estimated based on experience and payable upon receipt of the invoice.

4. RISK RELATED TO THE ACHIEVEMENT OF THE PROJECTIONS

- The capacity to maintain relationships with the franchisees and suppliers;

- The disbursements are limited to known costs and projections. Additional disbursements will be required depending on the restructuring process. It is understood that such costs, if necessary, will require additional funding.