Court File No. CV-17-00582960-00CL

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 TOYS "R" US (CANADA) LTD. TOYS "R" US (CANADA) LTEE

Applicant

REPORT TO COURT OF GRANT THORNTON LIMITED, PROPOSED MONITOR OF THE APPLICANT UNDER THE *COMPANIES' CREDITORS ARRANGEMENT ACT*

SEPTEMBER 19, 2017

Grant Thornton Limited,
Proposed Monitor of the Applicant
under the *Companies' Creditors Arrangement Act*

200 King Street West, 11th Floor
Toronto, Ontario, M5H 3T4

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INTRODUCTION

1. Grant Thornton Limited ("**GTL**" or the "**Proposed Monitor**") understands that Toys "R" Us (Canada) Ltd. Toys "R" Us (Canada) Ltee (the "**Applicant**" or "**Toys Canada**") has brought an application before this Honourable Court for an initial order (the "**Proposed Initial Order**") under the *Companies' Creditors Arrangement Act* (the "**CCAA**"). Toys Canada is the Canadian operating entity in a global corporate group ("**Toys R Us**") that is the leading global dedicated retailer of toy and baby products.

2. The Applicant has proposed that GTL be appointed as Monitor in its CCAA proceedings (the "**CCAA Proceedings**"), to which GTL has consented.

3. Late last night or early this morning, Toys Inc., certain of its U.S. subsidiaries (including Toys Canada's direct parent company referred to herein as "**Toys Delaware**") and Toys Canada (collectively in such capacity, the "**Chapter 11 Debtors**") filed voluntary petitions for relief pursuant to title 11, chapter 11 of the *United States Code* (the "**Chapter 11**

Proceedings") in the United States Bankruptcy Court for the Eastern District of Virginia (the "**U.S. Bankruptcy Court**").

4. This report (the "**Report**") has been prepared by the Proposed Monitor, prior to and in contemplation of its appointment as Monitor in the CCAA Proceedings, in order to provide information to the Court for its consideration on the initial hearing in the CCAA Proceedings.

PURPOSE OF THE REPORT

5. The purpose of this Report is to provide the Court with further information related to the relief sought by the Applicant in the Proposed Initial Order. This Report specifically discusses:

   (a) GTL's qualification to act as a Monitor;

   (b) Background information with respect to the Applicant, the proposed CCAA Proceedings and the Chapter 11 Proceedings;

   (c) The Applicant's capital structure;

   (d) The Applicant's current liquidity situation;

   (e) The Applicant's proposed Debtor-in-Possession ("**DIP**") financing and its efforts in securing same;

   (f) The Proposed Monitor's comments and report on the Applicant's cash flow projection (the "**Cash Flow Projection**");

   (g) A discussion of the proposed Court ordered Charges (defined herein) and such Charges' effect on the Applicant's stakeholders;

   (h) A discussion of the proposed authorization for payment of certain pre-filing amounts; and

   (i) the Proposed Monitor's comments with respect to the proposed CCAA Proceedings and the relief requested via the proposed Initial Order.

SCOPE AND TERMS OF REFERENCE

6. In preparing this Report, the Proposed Monitor has relied upon unaudited financial information, certain of the Applicant's records, financial information and projections, and

discussions with the Applicant's financial advisor, Alvarez & Marsal Canada ULC ("**A&M Canada**") and its legal advisors, Goodmans LLP ("**Goodmans**"). While the Proposed Monitor reviewed various documents provided by the Applicant, Goodmans and A&M (including, among other things, unaudited internal financial statements and financial projections) and believes that the information therein provides a fair summary of the transactions as reflected in the documents, such work does not constitute an audit or verification of such information for accuracy, completeness or compliance with Generally Accepted Accounting Principles ("**GAAP**") or International Financial Reporting Standards ("**IFRS**"). Accordingly, the Proposed Monitor expresses no opinion or other form of assurance pursuant to GAAP or IFRS with respect to such information.

7. Some of the information used in preparing this Report consists of financial projections, including the Cash Flow Projection. The Proposed Monitor cautions that these projections are based upon assumptions about future events and conditions that are not ascertainable. The Applicant's actual results may vary from the Cash Flow Projection, even if the Hypothetical and Probable Assumptions (defined herein) contained therein materialize, and the variations could be significant. The Proposed Monitor's review of the future oriented information used to prepare this Report did not constitute an audit of such information under Generally Accepted Auditing Standards, GAAP or IFRS.

8. In the course of its mandate, the Proposed Monitor has assumed the integrity and truthfulness of the information and explanations presented to it by the Applicant and its Management, within the context in which such information was presented. To date, nothing has come to the Proposed Monitor's attention that would cause it to question the reasonableness of these assumptions. The Proposed Monitor has requested that Management and/or A&M on its behalf, bring to its attention any significant matters which were not addressed in the course of the Proposed Monitor's specific inquiries. Accordingly, this Report is based solely on the information (financial or otherwise) made available to the Proposed Monitor by the Applicant and its Management.

9. This Report has been prepared for the use of this Court and the Applicant's stakeholders as general information relating to the Applicant and to assist the Court in determining whether to grant the relief sought by the Applicant. Accordingly, the reader is cautioned that this Report may not be appropriate for any other purpose. The Proposed Monitor will not assume responsibility or liability for losses incurred by the reader as a result of the

circulation, publication, reproduction or use of this Report contrary to the provisions of this paragraph.

10. Capitalized terms not defined in this Report have the meanings ascribed to them in the affidavit of Melanie Teed-Murch, the President of the Applicant, sworn September 19, 2017 (the "**Teed-Murch Affidavit**") and filed in connection with the proposed CCAA Proceedings.

11. This Report should be read in conjunction with the Teed-Murch Affidavit as such affidavit contains additional background information concerning the Applicant, its structure, business activities and stakeholders.

12. All references to dollars are in Canadian currency unless otherwise noted.

QUALIFICATIONS TO ACT AS MONITOR

13. GTL is a licensed insolvency trustee within the meaning of section 2(1) of the *Bankruptcy and Insolvency Act* (Canada). In addition, GTL is not subject to any of the restrictions on who may be appointed as Monitor set out in section 11.7(2) of the CCAA.

14. GTL has consented to act as Monitor should the Court grant the Applicant's request for relief in the CCAA Proceedings.

15. The Proposed Monitor has retained Cassels Brock & Blackwell LLP ("**Cassels Brock**") to act as its independent Canadian legal counsel and has retained Allen & Overy LLP to act as its independent counsel with respect to US matters (together with Cassels Brock, the "**Proposed Monitor's Counsel**")

BACKGROUND INFORMATION

16. The Applicant is the leading dedicated toy and baby products retailer in Canada, with a significant retail store and e-commerce presence throughout Canada. The Applicant operates 82 retail stores across Canada and sells a broad selection of children's and baby products from national, international and private label brands.

17. The Applicant was incorporated under the laws of Ontario on January 24, 1983 and is extra provincially registered to conduct business in each of the nine other Canadian provinces.

18. The Applicant is a wholly owned subsidiary of Toys "R" Us-Delaware Inc. ("**Toys Delaware"**), the principal US operating subsidiary in the Toys "R" Us Inc. ("**Toys Inc.**") group of companies. A copy of the organizational chart for the Toys Inc. group of companies is attached as **Exhibit "B"** to the Teed-Murch Affidavit.

19. The Applicant's registered head office is located at 2777 Langstaff Road, Concord, Ontario ("**Head Office**"). This site also serves as the Applicant's primary warehouse and distribution center. The Head Office was sold in July, 2017, and is now leased by the Applicant from the purchaser of the property.

20. Twenty-two of the locations from which the Applicant operates are owned by the Applicant, with the remaining stores operating from leased premises. A chart detailing the number of owned and leased locations by province is included in paragraph 36 of the Teed-Murch Affidavit.

21. As of September 8, 2017, the Applicant had 3,751 active employees; consisting of 635 full-time and 3,116 part-time employees. One hundred and ninety-six of the employees are employed at the Head Office, 126 are employed in the operation of its distribution facility and the remainder are employed at the 82 retail locations. During its peak holiday season, the Applicant hires additional staff at its retail outlets bringing its total workforce to more than 6,000 employees. A chart summarizing the employees by province is provided in paragraph 53 of the Teed-Murch Affidavit. The Applicant does not have any unionized employees.

22. The Applicant does not have a pension plan for employees, but it does contribute to a registered retirement savings plan matching plan and a deferred profit sharing plan. As set out in the Teed-Merch Affidavit, the Applicant intends to continue these programs in the normal course during the proposed CCAA Proceedings.

23. The Applicant participates in a gift card program administered by Toys Inc. and its subsidiaries in the United States. The program is described in the Teed-Merch Affidavit and the Monitor's comments with respect to same are discussed in paragraphs 80-84 below.

24. As set out in the Teed-Murch Affidavit, the Applicant operates as a relatively autonomous business unit within the Toys R Us global operations and has achieved strong financial and operational performance. However, importantly, its financing is

integrated with an ABL credit facility that finances the business of Toys R Us in the United States and Canada (the "**ABL Credit Facility**"), and Toys Canada is not immune from pressures faced by the Toys R Us group stemming from the group's over-levered capital structure.

25. Toys Canada does not have any obligation with respect to the indebtedness of the other Chapter 11 Debtors. The Proposed Monitor understands that the commencement of the Chapter 11 Proceedings has triggered an event of default under the ABL Credit Facility, resulting in the likely termination of any further borrowing and the acceleration of the total obligations to the secured lender of approximately US$1.025 billion, including outstanding Canadian Loans (as defined below) of approximately $246 million plus accrued interest.

26. Further background information concerning the Applicant's business and the events preceding and necessitating the proposed CCAA Proceedings is contained in the Teed-Murch Affidavit.

THE CHAPTER 11 PROCEEDINGS

27. Late last night or early this morning, the Chapter 11 Debtors (including Toys Canada) filed voluntary petitions for relief thereby initiating the Chapter 11 Proceedings. The Proposed Monitor understands that the Chapter 11 Debtors, including Toys Canada, obtained an automatic stay of proceedings in the United States upon the filing of the petitions and that the Chapter 11 Debtors' 'First Day Motions' are scheduled to be heard by the U.S. Bankruptcy Court on September 19, 2017.

28. The Proposed Monitor understands that the initiation of proceedings in both Canada and the United States was necessary give the integration of the Canadian Loans and the ABL Credit Facility, the integration of the proposed DIP Facility (as defined below), the risk of supplier issues affecting the Applicant's global supply chain, and the possibility of enforcement or other adverse actions that could impact upon the Applicant's business in the absence of a stay of proceedings in both countries.

29. Given that the Applicant is initiating plenary CCAA and Chapter 11 proceedings, the Applicant is seeking approval of a customary protocol (the "**Cross-Border Protocol**") pursuant to the Initial Order with a view to ensuring effective coordination and administration of the CCAA and Chapter 11 proceedings by this Court and the U.S.

Bankruptcy Court. The Proposed Monitor's Counsel has reviewed the proposed Cross-Border Protocol and has advised that it is consistent with the protocols established in other recent cross-border cases. The Proposed Monitor understands that it is the Chapter 11 Debtors' intention to also seek approval of the Cross-Border Protocol by the U.S. Bankruptcy Court as part of the First Day Motions.

30. Further background information concerning the Chapter 11 Proceedings is contained in the Teed-Murch Affidavit and the declaration of David A. Brandon filed in connection with the Chapter 11 Proceedings (the "**Brandon Declaration**"), a copy of which is attached as **Exhibit "A"** to the Teed-Murch Affidavit.

CAPITAL STRUCTURE AND LIQUIDITY

31. The principal secured obligations of the Applicant, being a US$200 million revolving credit facility and a US$125 million secured term loan facility (collectively, the "**Canadian Loans**") are provided under the wider ABL Credit Facility.

32. The Canadian Loans, and the greater ABL Credit Facility, are governed by a Third Amended and Restated Credit Agreement dated March 21, 2014 (as amended, the "**Third Agreement"**), between, among others, Toys Delaware and the Applicant, as borrowers, certain direct or indirect wholly-owned subsidiaries of Toys Delaware, as guarantors, Bank of America, N.A., as administrative agent and Bank of America, N.A., acting through its Canadian branch, as agent in respect of the Canadian Loans (the "**Canadian Agent**"), and the lenders, party thereto.

33. The Applicant is not an obligor with respect to the obligations of the US borrowers party to the Third Agreement. The security and collateral granted by the Applicant secures only the Canadian Loans. Conversely, repayment of the Canadian Loans is guaranteed by the US borrowers and the facility guarantors and secured by the security interests and collateral granted by such parties.

CANADIAN REVOLVING AND TERM FACILITY

34. The portion of the revolving credit facility available to the Applicant has availability equal to the lesser of US$200 million or the value available pursuant to the borrowing base calculation based on the Applicant's eligible assets. As of September 15, 2017 the total

outstanding obligation under the Canadian Revolving Facility was $93,450,000 plus accrued interest.

35. The maximum facility of US$1.85 billion available to the US borrowers is reduced dollar for dollar for any amounts outstanding under the Canadian revolving facility.

36. The Canadian Revolving Facility contains a letter of credit sub-facility pursuant to which Toys Canada can access letters of credit (the "**Canadian Letters of Credit**"), subject to an aggregate limit of US$30 million. The Proposed Monitor understands that there are currently six Canadian Letters of Credit outstanding in the aggregate amount of approximately $1.4 million. Availability under the Canadian Revolving Facility is reduced dollar-for-dollar by the amount of issued and outstanding Canadian Letters of Credit.

37. The portion of the Term Facility available to Toys Canada (the "**Canadian Term Facility**") has availability equal to the lesser of US$125 million and a borrowing base determined by reference to eligible assets of the Canadian Business. As of September 15, 2017, the total outstanding obligations under the Canadian Term Facility were approximately $152.5 million plus accrued interest.

38. The commencement of the Chapter 11 Proceedings has triggered an event of default under the ABL Credit Facility, resulting in the termination of any further borrowing under the facility, including under the Canadian Loans. Absent alternative financing, the ABL Credit Facility default will impose significant liquidity constraints on the Applicant as it moves to build inventory for the 2017 holiday season.

CURRENCY HEDGING

39. A portion of the Applicant's merchandise is purchased in U.S. currency. As a result, exchange rate fluctuations between the Canadian and U.S. dollars may pose a risk to the Applicant's business. In order to minimize this risk, the Applicant uses foreign currency forward contracts to hedge its exchange rate risk, including both annual and monthly spot rate contracts. The Proposed Monitor has been advised that the Applicant presently intends to continue its hedging program in the normal course.

REVIEW OF SECURITY

40. The proposed DIP Facility is in the nature of "take-out" financing with new money to be advanced to repay in full obligations under the existing Credit Facility and to provide

additional liquidity. As counsel to the Proposed Monitor, Cassels Brock has undertaken a security review of the security granted by the Applicant to the Canadian Agent to secure the amounts owing under the Third Agreement (the "**Security Review**"). The Security Review was conducted to assess the validity and enforceability of the security granted by the Applicant to the Canadian Agent.

41. Cassels Brock has verbally advised the Proposed Monitor that it is of the view that, subject to the standard assumptions and qualifications typically contained in security opinions of this nature:

a) the personal property security granted in favour of the Canadian Agent is valid and enforceable and creates valid security interests in the personal property of the Applicant secured thereby; provided that, (i) such personal property excludes a segregated demand deposit account designated by Toys Delaware as the "uncontrolled cash account" and any and all deposits and cash in such account (which deposits and cash may not exceed US$25,000,000), and the Proposed Monitor has been advised that no such account exists; and (ii) the security interest granted in favour of the Canadian Agent over trademarks (and certain other intellectual property) is limited to the non-exclusive right to use such trademarks and other intellectual property in exercising the Canadian Agent's rights in connection with a liquidation (the "**Trademarks Carve-Out**"); and

b) the mortgages granted in favour of the Canadian Agent is valid and enforceable and creates a good and valid fixed charge of the interest of the Applicant in the real property secured thereby.

42. If GTL is appointed as Monitor, Cassels Brock will deliver to the Monitor written security opinions in respect of the Security Review shortly after the commencement of the CCAA Proceedings. The Monitor will provide an update on these security opinions in due course.

SECURED TERM LOAN B FACILITY

43. As set out in the Brandon Declaration, Toys Delaware, as borrower, certain of Toys Delaware's domestic subsidiaries, as guarantors, Bank of America, N.A., as

administrative agent, and the lenders party thereto, are party to an Amended and Restated Credit Agreement, dated as of August 24, 2010 (as amended, novated, supplemented, extended or restated from time to time, the "**Term Loan B Credit Agreement**") which provides for several tranches of term loans, including: (a) term loans maturing on May 25, 2018, in an initial aggregate principal amount of US$400 million (the "**Term B-2 Loans**"); (b) term loans maturing on May 25, 2018, in an initial aggregate principal amount of US$225 million (the "**Term B-3 Loans**"); and (c) term loans maturing on April 24, 2020, in an initial aggregate principal amount of US$1,025,726,000 (the "**Term B-4 Loans**"). The Applicant is not an obligor with respect to the obligations of the US borrowers party to the Term Loan B Credit Agreement, however (a) the Term B-4 Loans are secured by a first priority lien on the pledge of 65% of the voting common equity shares and 100% of the non-voting common equity shares of the Applicant and (b) the Term B-2 Loans and Term B-3 Loans are secured by a second priority lien on the pledge of 65% of the voting common equity shares and 100% of the non-voting common equity shares of the Applicant. As of the date of this Report, approximately US$123 million in aggregate principal amount of Term B-2 Loans remains outstanding, approximately US$61 million in aggregate principal amount of Term B-3 Loans remains outstanding, and approximately US$998 million in aggregate principal amount of Term B-4 Loans remains outstanding.

FINANCIAL POSITION

Financial Performance

44. Toys "R" Us prepares financial statements that report the consolidated financial position and performance of the entire corporate group. Financial statements are also prepared for Toys Canada on a unconsolidated basis. Attached as **Exhibit "C"** to the Teed-Merch Affidavit are unaudited financial statements for Toys Canada for the year ended January 28, 2017 and the seven months ended August 26, 2017.

45. The Applicant has achieved strong financial performance in recent years. Over the past three fiscal years, sales revenue has increased at a compounded annual rate of more than 5% and net earnings nearly doubled. A summary of the Applicant's historical financial performance is contained in the Teed-Merch Affidavit.

46. As at August 26, 2017, the Applicant had assets with a book value of approximately $478 million and liabilities of approximately $380 million.

47. The Applicant's liabilities include approximately $71 million of trade payables and an intercompany payable to Toys Inc. of approximately $1.5 million.

48. Given its strong performance, the Applicant has historically funded surplus cash from its operations to Toys Delaware, including through short-term unsecured loans. In August 2016, Toys Canada commenced a program of loaning amounts to Toys Delaware to support Toys Delaware's cash flow needs. The current aggregate amount of intercompany loans advanced by Toys Canada to Toys Delaware is approximately $101 million. These intercompany loans generally have a short-term maturity and are evidenced by promissory notes issued by Toys Delaware, which notes have historically been rolled on a month-to-month basis. Given the Chapter 11 Proceedings, the Applicant does not anticipate that these intercompany loans will be repaid in the near term.

49. From time to time, the Applicant has paid dividends to its shareholder, Toys Delaware, including most recently aggregate dividends of approximately $72.65 million paid in June, 2017.

PROPOSED DEBTOR-IN-POSSESSION FINANCING

50. Based on discussions with and information provided by A&M and the Applicant's legal counsel, the Proposed Monitor understands that the Chapter 11 Debtors have been able to obtain DIP financing that is intended to provide stability and necessary liquidity for the Toys "R" Us business, including that of Toys Canada.

51. The Cash Flow Forecast contemplates maximum borrowings by Toys Canada under the Canadian DIP Revolving Facility of approximately $92 million during the 13 week Cash Flow Forecast period.

52. The process undertaken by Toys "R" Us to solicit and obtain DIP financing is described in detail in the Brandon Declaration, and in the Declaration of David Kurtz of Lazard Frères & Co. LLC. dated September 18, 2017 (the "**Kurtz Declaration**"), a copy of which is attached as **Exhibit "E"** to the Teed-Merch Affidavit.

53. Based on the Proposed Monitor's review of the above noted materials it appears that during the solicitation process:

a) Toys "R" Us solicited DIP financing proposals from Toys "R" Us' existing lenders, large banks, and other sophisticated alternative investment institutions familiar with Toys "R" Us' complex capital structure.

b) 21 parties entered into non-disclosure agreements for the purpose of evaluating the DIP financing opportunity and received access to due diligence in respect of Toys "R" Us.

c) Toys "R" Us management and advisors engaged in numerous in-person and telephonic discussions with prospective financiers.

d) Toys "R" Us ultimately received DIP financing proposals from 3 parties.

e) An intensive period of negotiation ensued with the parties to improve and enhance the terms of their respective proposals.

54. The Proposed Monitor understands that after this review process, with the advice and assistance of its professional advisors, Toys "R" Us determined that the DIP financing proposal (the "**DIP Facilit**y") led by JPMorgan Chase Bank, N.A. (collectively with the other DIP lenders, the "**DIP Lenders**") offered the most favourable terms and was the best available alternative in the circumstances.[1]

55. Due to the tight timeframe involved in negotiating the DIP Facility, the Proposed Monitor and Proposed Monitor's Counsel have not had a chance to fully review the final DIP Facility. Based on discussions with and information provided to the Proposed Monitor by the Applicant, the Applicant's legal counsel and A&M, the Proposed Monitor understands that the material terms and features of the DIP Facility include:

[1] Certain Chapter 11 Debtors (excluding, for the avoidance of doubt, Toys Canada) are also entering into an additional DIP term loan facility to provide incremental working capital to the U.S. business. It is not proposed that Toys Canada be a borrower, or otherwise have any obligation, under this additional DIP facility.

a) The DIP Lenders will provide a new credit facility to Toys Delaware, as the principal borrower, and the Applicant, as the Canadian borrower, in the aggregate principal amount of up to US$2.3 billion. The DIP Facility includes a US$200 million term loan (the "**Canadian DIP Term Loan**") and a revolving credit facility of up to US$300 million (subject to availability under the Canadian borrowing base) (the "**Canadian DIP Revolving Facility**" and with the Canadian DIP Term Loan, the "**Canadian DIP Facility**") for Toys Canada.

b) The DIP Facility will be used to repay the existing ABL Credit Facility (including cash collateralization of existing letters of credit on behalf of the Applicant), and also to provide incremental additional financing to Toys "R" Us of up to US$725 million based on more favourable borrowing parameters. It is intended that the existing ABL Credit Facility will be paid out on or about September 20, 2017.

c) The Canadian DIP Term Loan and a portion of the Canadian DIP Revolving Facility will be used to repay only the Applicant's obligations under the existing ABL Credit Facility.

d) The DIP Facility will bear interest at only slightly higher marginal interest rates than the existing ABL Credit Facility.

e) Based on the Cash Flow Projection (defined below), the Proposed Monitor understands that the fees to be paid by the Applicant in respect of the DIP Facility are expected to be approximately $20.7 million (the "**Canadian Fees**"). The Monitor understands that under the DIP Facility the Applicant is obligated together with Toys Delaware with respect to all fees but the intention is that it will only pay the Canadian Fees with Toys Delaware paying the remaining fees.

f) The term of the DIP Facility is 16 months – until January 2019 – allowing the Applicant and Toys "R" Us to focus on the operation of the business and giving them the necessary amount of time to explore and consider their restructuring options. Crucially, the DIP Facility contains no significant milestones aside from customary timeframes

for the issuance of approval orders by this Court and the U.S. Bankruptcy Court.

g) As with the existing ABL Credit Facility, the Applicant will only be liable for its own borrowings and related obligations and will not be liable for the U.S. portion of the DIP Facility.

h) In addition to receiving the relevant approvals of both this Court and the U.S. Bankruptcy Court, the closing of the DIP Facility is subject to other customary conditions, including those relating to corporate authority, opinions, certification of borrowing base, no material adverse effect having occurred since the filing date, the registration of security documentation and the discharge of security relating to the ABL Credit Facility.

56. It is contemplated that the Applicant will borrow approximately $271.5 million once the DIP Facility closes – being the full amount of the Canadian Term Loan and approximately $27.5 million under the Canadian DIP Revolving Facility – to provide sufficient funds to repay the Canadian Loans obligations and fund immediate working capital requirements. The Proposed Monitor is advised by counsel to the DIP Lenders that the DIP Lenders would not be prepared to lend on an incremental basis with the pre-filing secured indebtedness remaining in place.

57. Other than milestones relating to the approval of the DIP Facility, the DIP Facility contains no time sensitive milestones which will allow the Applicant to focus on the critical holiday season while also continuing efforts to explore strategic options and alternatives to right-size its capital structure and enhance operational performance.

58. It is contemplated that the DIP Lenders would be granted a Court-ordered charge over substantially all of the Applicant's property subject to the Trademarks Carve-Out, up to a maximum amount of US$500 million, to secure amounts owing by the Applicant pursuant to the DIP Facility (the "**DIP Charge**"). The DIP Charge will only secure obligations in respect of the Canadian DIP Facility and will not secure any other obligation under the DIP Facility. The DIP Charge will not secure any obligation that existed prior to the Initial Order.

59. Given its resources and the circumstances of the ABL Credit Facility, the Proposed Monitor is of the view that it would be difficult and impractical for the Applicant to obtain alternative financing outside of creditor protection proceedings and separate from Toys Inc. and the rest of the corporate group.

60. Based on the information it has received, the Proposed Monitor is of the view that the DIP Facility and the DIP Charge are appropriate in the circumstances.

CASH FLOW PROJECTION

61. In order to fulfill the requirements of section 10(2)(a) of the CCAA, the Applicant has prepared a weekly cash flow projection ("**Cash Flow Projection**") for the period September 19, 2017 to December 16, 2017 (the "**Cash Flow Period**"). The Cash Flow Projection has been prepared by management using probable and hypothetical assumptions set out therein (the "**Probable and Hypothetical Assumptions**").

62. The Proposed Monitor has reviewed the Cash Flow Projection to the standard required of a Court-appointed Monitor by s. 23(1)(b) of the CCAA. The Proposed Monitor's review of the Cash Flow Projection consisted of inquiries, analytical procedures, and discussions related to information supplied to the Proposed Monitor by A&M, the financial advisor to the Applicant. Since the Probable and Hypothetical Assumptions need not be supported, the Proposed Monitor's procedures with respect to same were limited to evaluating whether they were consistent with the purpose of the Cash Flow Projection. The Proposed Monitor has also reviewed the support provided by the Applicant for the Probable and Hypothetical Assumptions and the preparation and presentation of the Cash Flow Projection. Based on the Proposed Monitor's review, nothing has come to its attention that causes it to believe that, in all material respects:

    (a) the Probable and Hypothetical Assumptions are not consistent with the purpose of the Cash Flow Projection;

    (b) as at the date of this Report, the Probable and Hypothetical Assumptions developed by management are not suitably supported and consistent with the Applicant's plans or do not provide a reasonable basis for the Cash Flow Projection, given the Probable and Hypothetical Assumptions; or

    (c) the Cash Flow Projection does not reflect the Probable and Hypothetical Assumptions.

63. The Applicant's cash position at the commencement of the CCAA Proceedings is estimated to be approximately $3,291,000. The Cash Flow Projection estimates the Applicant will require incremental advances under the DIP facility of approximately $92 million to fund its cash shortfall during the Cash Flow Period. The Applicant is projecting total receipts of approximately $386 million and total disbursements of approximately $661 million. The disbursements can be broken down as follows:

a) Non- Merchandise Disbursements and Operating Expenses approximately $86,500,000

b) Merchandise Vendor Purchases approximately $281,00,000 (including approximately $60,000,000 of Pre-filing Merchandise Vendor Purchases)

c) Taxes $13,600,000

d) Capital expenditures $3,935,145

e) Professional costs $2,979,000

f) Repayment of pre-filing debt $246,473,638

g) DIP Fees & Interest $26,467,862

General Comments

64. In addition, the Proposed Monitor makes the following general comments on the Cash Flow Projection:

(a) receipts are forecast based on the Applicant's current sales forecast, inclusive of sales tax, adjusted for certain CCAA filing assumptions related to sales levels and a projected increase in gift card redemptions during the forecast period;

(b) disbursements appear to be consistent with the level of operations contemplated by management for the Applicant during the Cash Flow Period;

(c) the Cash Flow Projection contemplates paying employee wage and other employees obligations and related source deductions in the ordinary course, whether such obligations are incurred pre-filing or post-filing;

(d) the Cash Flow Projection contemplates paying vendors in accordance with existing credit terms, with provisions for the possibility of different credit terms.;

(e) capital expenditures are forecast based on Toys Canada's existing capital plan and include disbursements for sustaining and growth expenditures, including the completion of the new Barrie store, scheduled to open November 2017;

(f) disbursements include sales tax remittances and income tax instalments;

(g) Disbursements include DIP fees and interest that relate to the DIP ABL facility and the Canadian FILO facility; and

(h) disbursements include forecast payments to Toys Canada's legal counsel and financial advisors, the Proposed Monitor and its legal counsel and legal counsel to the DIP lender.

PROPOSED COURT ORDERED CHARGES

65. The Proposed Initial Order provides for a number of charges that rank as follows:

(a) first – the Administrative Charge;

(b) second – the D&O Charge; and

(c) third – the DIP Charge.

(collectively, the "**Charges**"). The Proposed Initial Order states that the Charges are to rank ahead of all security, interests, trusts, liens, charges and encumbrances, claims of secured creditors, statutory or otherwise (the "**Encumbrances**") in favour of any Person (as defined in the Proposed Initial Order), however does not prime any secured creditor not served with the initial application. The Applicant is requesting to return to Court at a date to be designated at which time, upon broader service, the Proposed Monitor understands it may seek elevation of the priority of the Charges.

Administrative Charge

66. The Proposed Initial Order contemplates the Proposed Monitor, the Proposed Monitor's Counsel, the Applicant's counsel, and A&M Canada, be granted a court-ordered charge on the assets of Applicant as security for professional fees and disbursements relating to services rendered in respect of the Applicant (whether incurred prior to or after the commencement of the CCAA proceedings) at the standard rates and charges in an amount not to exceed $2 million (the "**Administration Charge**").

67. The Administration Charge threshold has been established based on the various professionals' previous history and experience with restructurings of similar magnitude and complexity. If an Initial Order under the CCAA is granted, the Proposed Monitor believes that the proposed Administration Charge is required and reasonable in the circumstances.

D&O Charge

68. The Proposed Initial Order also contemplates the indemnification of the directors and officers of the Applicant (the "**D&Os**") and the creation of a charge on the assets of the Applicant (the "**Directors' Charge**"), to the maximum amount of $41.5 million, to protect such individuals from all obligations and liabilities that they may incur as D&Os of the Applicant post filing.

69. Ms. Teed-Murch, in the Teed-Murch Affidavit, advises the D&Os wish to have certainty about their potential personal liability if they continue in their current capacities during the CCAA Proceeding. As such, the Applicant seeks a charge on the Property of the Applicant. Such charge would be provided in favour of the D&Os as security for the Applicant's indemnification for possible liabilities that may be incurred by the D&Os as directors and officers of the Applicant after the date of the Proposed Initial Order, which would rank second in priority behind the Administrative Charge.

70. GTL understands that there is currently a D&O policy in place that provides coverage to existing D&Os for the above noted obligations; however, the Directors' and Officers' want the additional comfort of a charge, in the event that there is not sufficient coverage under the existing insurance policy.

71. The quantum of the D&O Charge has been established based on these particular circumstances and is commensurate with D&O Charges granted in the context of restructurings of similar magnitude and complexity. The Proposed Monitor has reviewed information provided by A&M in respect of the various obligations that may accrue to the directors including in respect of salary and wages, payroll remittances, vacation pay, harmonized sales taxes and goods and services taxes. If the Proposed Initial Order is granted, the Proposed Monitor believes that the D&O Charge, and the proposed quantum of same, is required and reasonable in the circumstances.

DIP CHARGE

72. It is a condition of the DIP Facility that it be secured by a charge over the assets of the Applicant.

73. Based on discussions with A&M and relying on the Teed-Merch Affidavit, the Brandon Declaration and the Kurtz Declaration, the Proposed Monitor is of the view that the DIP Charge is reasonable and appropriate in the circumstances

PAYMENTS OF PRE-FILING AMOUNTS

74. As set out in the proposed Initial Order, the Applicant is seeking the authorization to pay certain expenses, whether incurred prior to or after the date of the Initial Order, in respect of:

a) outstanding and future wages, salaries, commissions, compensation, incentive payments, employee benefits, vacation pay, salary continuance, expenses and director fees and expenses, in each case incurred in the ordinary course of business and consistent with existing compensation policies and arrangements, and all other payroll and benefits processing and servicing expenses;

b) all outstanding and future contributions to or payments in respect of the Group RRSP and the DPSP in the ordinary course of business and consistent with existing compensation policies and arrangements and applicable law;

c) the fees and disbursements of any Assistants (as defined in the Initial Order) retained or employed by the Applicant;

d) all outstanding and future amounts related to honouring customer obligations, including customer financing, deposits, layaways, product warranties, pre-payments, refunds, exchanges, customer loyalty and reward programs, incentives, offers and benefits, in each case incurred in the ordinary course of business and consistent with existing policies and procedures;

e) all outstanding and future amounts related to honouring gift cards and merchandise credits;

f) with the consent of the Monitor and subject to the DIP documents, amounts owing for goods or services supplied to the Applicant prior to the Initial Order by:

i. logistics or supply chain providers, including transportation providers, customs brokers, freight forwarders, warehouse providers and other logistics providers, including amounts payable in respect of customs and duties for goods;

ii. providers of information, internet and other technology, including e-commerce providers and related services;

iii. providers of credit, debit, gift card or other payment processing and related services; and

iv. other third party suppliers if such payment is necessary, in the opinion of the Applicant, to maintain the uninterrupted operations of the Canadian Business.

75. The Applicant advises that it is in the best interests of its stakeholders that it has the authority to continue to pay these expenses in the normal course, regardless of whether such expenses were incurred prior to, on or after the date of the Initial Order, so that it can ensure the continued operation of the Canadian Business during the CCAA Proceedings.

76. As set out in the Teed-Merch Affidavit, the Applicant believes it should be granted such authorization as:

a) the Applicant's ability to operate successfully in its upcoming busy season and meet customer demand is dependent on its ability to obtain continued supply of inventory on commercially-reasonable terms;

b) The Applicant has long-term relationships with key industry suppliers, many of which have enabled the Applicant to ensure product availability and reliability of supply and to obtain access to high-demand and limited availability products;

c) The Applicant has already experienced tightening of the trade terms of certain suppliers in advance of these proceedings;

d) Toys Canada obtains a significant amount of merchandise from suppliers outside of Canada and the United States, particularly those located in China. While foreign suppliers are subject to the relief granted in CCAA and Chapter 11 proceedings, in the Monitor's experience there are likely to be difficulties with enforcing the stays of proceedings extraterritorially and there is no guarantee of continued supply without payment of pre-filing amounts.

77. If the Applicant is unable to obtain uninterrupted access to goods and services from its key suppliers on acceptable terms during the CCAA proceedings, it may become necessary for the Applicant to bring a motion seeking the designation of certain suppliers as critical suppliers of the Canadian Business and related relief pursuant to section 11.4 of the CCAA.

78. As it relates to the pre-filing amounts owing to the Applicant's vendors, the Applicant is only permitted to pay such amounts if they are determined by the Applicant, in consultation with the Monitor, to be necessary to the continued operation of the business or the preservation of the property and such payments are approved in advance by the Monitor or by further Order of the Court and such amounts are consistent with the DIP documents.

79. GTL has reviewed the Applicant's accounts payable and believes that authorizing the Applicant to pay certain pre-filing amounts as contemplated in the Proposed Initial Order, along with the oversight and, in certain instances, consent of the Monitor, is reasonable and necessary in the circumstances to allow for the operations to continue uninterrupted throughout the CCAA Proceedings. An interruption of supply or service could have a significant adverse impact on the Applicant's operations, which would in turn jeopardize the Applicant's ability to explore strategic options and alternatives and execute on a restructuring plan. The control proposed by the involvement of the Proposed Monitor will also ensure consideration of stakeholder interests when payment of pre-filing amounts is considered on a case-by-case basis. Accordingly, the Proposed Monitor supports the Applicant's requested relief.

GIFT CARD PROGRAM

80. As set out in the Teed-Merch Affidavit, the Applicant participates in a gift card program that is centrally operated and administered by Toys “R” Us. The gift cards are redeemable for in-store and online purchases from Toys “R” Us. The proposed Initial Order provides that the Applicant is authorized to honour obligations in respect of gift cards issued prior to the granting of the Initial Order.

81. The Proposed Monitor understands based on the Teed-Merch Affidavit and discussions with A&M that the gift card program is centrally administered by Toys “R” Us and gift card transactions by Toys Canada are accounted for as intercompany transactions. When Toys Canada sells a gift card, the proceeds from the sale of the gift card give rise to an intercompany payable to TRU-SVC, Inc. (“**TRU-SVC**”), a Chapter 11 Debtor.

82. When a gift card is used by a consumer to purchase merchandise from Toys Canada, it gives rise to an intercompany receivable from TRU-SVC. The amounts owing to and from TRU-SVC are netted on a monthly basis. If redemptions of gift cards exceed the sales of the gift certificates in a given period, it will result in a net amount owing to Toys Canada from TRU-SVC (which would be paid/settled on approximately six week terms).

83. The Monitor understands that as at August 26, 2017, the intercompany amount receivable by Toys Canada relating to gift cards was approximately $637,000. If gift card sales outpace redemptions during the initial CCAA stay period due to the seasonality of gift card purchases, this will give rise to an intercompany receivable due to Toys Canada by TRU-SVC.

84. It is anticipated that this balance will be reconciled and paid in the normal course to Toys Canada and the Proposed Monitor understand that it is contemplated that any intercompany obligations arising following the commencement of the CCAA and Chapter 11 Proceedings with respect to the operation of the gift card program (or any other normal course intercompany transactions) will be afforded priority administrative status pursuant to the terms of the Chapter 11 Cash Management Order (as defined in the Teed-Merch Affidavit).

NEED FOR A STAY OF PROCEEDINGS AND THE CCAA PROCEEDINGS

85. The Applicant has and continues to be profitable; however, its access to required financing has been unexpectedly constrained. The proposed CCAA Proceedings, including the stay of proceedings and DIP Facility, will allow the Applicant to continue its operations in the ordinary course, including through its busiest season. The relief requested will provide the opportunity to implement the required restructuring of the global Toys R Us capital structure in a stabilized environment, which is in the interests of the Applicant and its stakeholders.

86. As outlined previously, without a stay of proceedings and debtor-in-possession financing contemplated as part of these proceedings, the Applicant lacks the liquidity required to purchase adequate inventory from suppliers to meet its inventory requirements for its approaching peak holiday sales season.

87. For the reasons set out in this Report, the Proposed Monitor is of the view that the relief requested by the Applicant is reasonable and respectfully recommends that this Court make the Order granting the Applicant's requested relief.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 19th day of September, 2017.

GRANT THORNTON LIMITED,
SOLELY IN ITS PROPOSED ROLE AS COURT-APPOINTED MONITOR
OF THE APPLICANT, AND NOT IN ITS PERSONAL CAPACITY

Per: _____

Michael Creber, CPA, CA, CIRP, LIT
Senior Vice-President

Court File No: CV-17-00582960-00CL

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 TOYS "R" US (CANADA) LTD. TOYS "R" US (CANADA) LTEE

Applicant

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)
Proceeding commenced at Toronto

PRE-FILING REPORT OF THE PROPOSED MONITOR

CASSELS, BROCK AND BLACKWELL LLP
Scotia Plaza
40 King Street West, Suite 2100
Toronto, ON
M5H 3C2

Shayne Kukulowicz LSUC#30729S
Tel: 416.860.6463
Fax: 416.640.3176
Email: skukulowicz@casselsbrock.com

Jane Dietrich LSUC#49302U
Tel: 416.860.5223
Fax: 416.640.3144
Email: jdietrich@casselsbrock.com

Ryan C. Jacobs LSUC#59510J
Tel: 416.860.6465
Fax: 416.640.3189
Email:rjacobs@casselsbrock.com

Lawyers for the Proposed Monitor