CANADA

PROVINCE OF QUEBEC
DISTRICT OF MONTREAL
No.: 500-11-042483-129

S U P E R I O R   C O U R T
Commercial Division
(Sitting as a court designated pursuant to the *Companies' Creditors Arrangement Act,* R.S.C. 1985, c. C-36, as amended)

IN THE MATTER OF THE PROPOSED AMENDED PLAN OF ARRANGEMENT OF:

BOUTIQUE LE PENTAGONE INC.

Debtor

and

RSM RICHTER INC., a duly constituted legal person having its principal place of business at 1981 McGill College, in the city and district of Montreal, Province of Quebec H3A 0G6

Monitor

REPORT OF THE COURT-APPOINTED MONITOR ON THE STATE OF THE DEBTOR'S BUSINESS AND FINANCIAL AFFAIRS AND ON THE AMENDED PLAN OF ARRANGEMENT

JULY 9, 2012

INTRODUCTION

1. On April 10, 2012, Boutique Le Pentagone Inc. (the "Debtor", "Pentagone" or the "Corporation") filed a motion in the Superior Court of Quebec requesting the issuance of an initial order (the "Initial Order") in accordance with the *Companies' Creditors Arrangement Act*, R.S.C. (1985), ch. 36, as amended ("CCAA"). The same day, the Honourable Yves Poirier, J.S.C., issued the Initial Order and appointed RSM Richter Inc. as Monitor ("Monitor"), ordering the stay of proceedings with respect to the Debtor until May 10, 2012.

2. On May 10, 2012, the Court issued an order extending the period during which the proceedings were stayed to July 5, 2012 inclusively and establishing the claims procedure, as it appears from the court record (the "Claims Procedure Order").

3. On June 29, 2012, the Court issued an order extending the period during which the proceedings were stayed to July 17, 2012 inclusively and authorizing the establishment of the creditors' meeting procedure and the filing of the initial plan of arrangement (the "Initial Plan") to be submitted to the creditors (the "Order Authorizing the Filing of the Plan and Establishing the Creditors' Meeting Procedure").

4. On July 3, 2012, the Debtor filed an amended plan of arrangement (the "Amended Plan"). The only change made to the Initial Plan involves the definition of Electing Creditor Claim, the designated amount of which was revised to the lesser of the following two (2) amounts [Translation] ***"i) $1,500 (initially $3,000) or the amount of their Claims or ii) reduce their respective Claims to $1,500 (initially $3,000)"***. Only the Amended Plan was communicated to the creditors.

5. Following the filing of the Amended Plan, on July 4, 2012 the Monitor sent all creditors who had submitted a proof of claim prior to the claims bar date a notice of the creditors' meeting and the hearing on the sanction order which will take place on July 16 and 17 respectively. The notice was accompanied by a copy of the Amended Plan, the proxy and voting form as well as a copy of the order rendered by the Court on June 29, 2012.

6. The Monitor's Report on the State of the Debtor's Business and Financial Affairs and on the Amended Plan is presented in order to provide information about the Corporation and assist creditors and the Court with their review and assessment of the Amended Plan further to the proceedings instituted pursuant to the CCAA. The Amended Plan is submitted to Pentagone's creditors for their consideration and approval at **the creditors' meeting which will be held at 2:00 p.m. on July 16, 2012** at the Office of the Superintendent of Bankruptcy located at 5 Place Ville Marie, 8th Floor, Montreal, Quebec. In addition, in the event the Amended Plan is accepted by the creditors, a motion will be presented before the Court to have it **sanctioned at 9:15 a.m. on July 17, 2012**, in Room 16.12 of the Montreal Courthouse located at 1 Notre-Dame St. W., Montreal, Quebec.

7. The proxy and voting form, a copy of the Amended Plan and this report are available on the Monitor's website at www.rsmrichter.com/Restructuration/Boutique%20Le%20Pentagone.aspx.

REPORT INDEX AND RESERVATIONS

8. This Monitor's Report was prepared to inform creditors and the Court about the following:

A) General information about the Corporation;
B) Events which led Pentagone to ask for protection under the CCAA;
C) Current financial situation;
D) Weekly monitoring of changes in cash flow;

E) Cash flow projections;

F) Business continuity;

G) Actions taken by the Monitor;

H) Restructuring measures;

I) Financing and Subscription Offer;

J) Conversion Agreement;

K) Summary of Amended Plan of Arrangement;

L) Estimated distribution to creditors;

M) Monitor's comments; and

N) Monitor's opinion and recommendation.

9. All amounts referred to in this report are in Canadian dollars unless indicated otherwise. Capitalized terms used or not defined have the same meaning as described in the Amended Plan.

10. We refer creditors to the initial motion, the motion for the issuance of an order extending the stay of proceedings and to establish the claims procedure and the motion to extend the period during which the proceedings are stayed to July 17, 2012 and the related orders. We also refer the Court to the Monitor's first and second reports dated May 9 and June 28, 2012 respectively for a more detailed description of Pentagone's business activities, property, assets, indebtedness, financial situation and why the Corporation considered it necessary to restructure its operations (see the Monitor's web site for copies of these documents at www.rsmrichter.com/Restructuration/Boutique%20Le%20Pentagone.aspx.)

11. We have not officially audited the financial information set forth in this report but it is taken from the Corporation's books and records which were made available to the Monitor and from conversations with its officers. The Monitor does not express an opinion as to the accuracy, truth or completeness of the financial information presented below.

12. The cash flow projections described herein as well as the different analyses estimating the recovery by unsecured creditors were compiled by the officers of the Corporation, with the Monitor's assistance, and are based on economic assumptions. As these projections depend on future events, the results indicated in the projections could differ materially from actual results and the differences could be significant. Accordingly, we cannot be certain that the projections presented will be realized.

A) GENERAL INFORMATION ABOUT THE CORPORATION

13. The Debtor is a corporation constituted under the Quebec *Business Corporations Act* which operates a chain of clothing boutiques across the provinces of Quebec and New Brunswick.

14. The Debtor is a private issuer, as it is 88% owned by Capital régional et coopératif Desjardins ("CRCD"), 4% by Brigitte Duchesne, 4% by Michel Loubert and 4% by Jeannot Langlois.

15. *Les boutiques Pentagone* have grown and expanded considerably over the years, leading to the opening of several fashion clothing boutiques in several regions of Quebec and New Brunswick. When the proceedings were filed under the CCAA, the Debtor was operating sixty-three (63) boutiques under four (4) banners: Les boutiques Pentagone, Löv, Express Pentagone and F17.

16. Following the issuance of the Initial Order, the Debtor closed fifteen (15) boutiques under the F17 and Löv banners. The Debtor currently operates 48 boutiques. The Debtor will also close another ten (10) boutiques around the end of July 2012. Following these closings, 38 boutiques will remain in operation across Quebec only. The Debtor rents the premises in which it operates its boutiques and, with the Monitor's authorization and in accordance with the CCAA, it has sent lease termination notices with respect to the twenty-five (25) boutiques which have been or will be closed.

17. The Debtor currently employs approximately 380 people (before the closure of the 10 boutiques planned for the end of July 2012) in its boutiques across the Province of Quebec and 50 people at its head office and at its warehouse located in the City of Rimouski whose duties include planning and logistics, financing, human resources and purchasing.

B) EVENTS WHICH LED PENTAGONE TO APPLY FOR PROTECTION UNDER THE CCAA

18. The Debtor's financial difficulties stem from, among other things:

- the general economic slowdown in the retail trade;
- increased competition in the regions where it operates its boutiques;
- difficulties in retail trade in outlying areas due in particular to the aging of the population and the adverse effect of Internet shopping for retailers like the Debtor which operate boutiques;

- a sharp drop in the Debtor's sales in 2011 by 11% for all the boutiques and 16.1% for the boutiques operating under the F-17 banner;

- the Debtor's high level of debt, i.e. approximately $16 M at the time the proceedings under the CCAA were instituted.

19. During the past few fiscal years, the Debtor has suffered significant financial losses as shown in the following table:

Boutique Le Pentagone Inc.
Income Statement
for the fiscal year ended January 31st

(In thousands of dollars)	**2012**		**2011**		**Restated 2010**	
Sales	45,901	$	52,113	$	52,017	$
Cost of products sold, selling costs, general and administrative costs	47,421		49,934		49,073	
Operating profit	**(1,520)**		**2,179**		**2,944**	
Finance charges	1,089		1,062		1,087	
Amortization	1,193		1,294		1,206	
Loss on devaluation and write-off of tangible fixed assets	329		174		303	
Write-off of goodwill	-		1,313		-	
Other proceeds	(41)		(188)		(23)	
	2,570		3,655		2,573	
Income (loss) before tax expense (recovery)	**(4,090)**	**$**	**(1,476)**	**$**	**371**	**$**
Earnings before tax, interest and amortization (EBITDA)	**(1,520)**	**$**	**2,179**	**$**	**2,944**	**$**
# of boutiques in operation	**63**		**62**		**61**	

20. Despite high sales of over $45 M for the fiscal year ended January 31, 2012, the Corporation recorded a significant before-tax loss of $4.1 M explained essentially by the downward pressure on prices and reduced sales in comparable boutiques.

21. During the fiscal year ended January 31, 2012, the cash flow relating to the Debtor's operating activities resulted in the use of $2.1 M of funds. This negative cash flow variation represents a dramatic aggravation of the pressure on the Debtor's liquidities.

C) CURRENT FINANCIAL SITUATION

22. This section summarizes the financial information considered useful for the purpose of informing creditors about Pentagone's current affairs.

23. This financial information is taken mainly from the most recent unaudited internal financial statements as at May 31, 2012 as well as our discussions with management.

24. This information is presented solely to help creditors understand and evaluate Pentagone's current financial situation. The Monitor does not make any representation or warranty with respect to the accuracy or completeness of the financial information set forth in this report.

(i) Operating results

25. Pentagone's financial performance since the beginning of the current fiscal year, i.e. the four (4) month period ended May 31, 2012, is summarized as follows:

Boutique Le Pentagone Inc.
Operating results
for the 4-month period ended May 31, 2012

(In thousands of dollars)	**4 months – May 2012**		**4 months – May 2011**	
Sales	**13,048**	**$**	**14,245**	$
Cost of products sold, selling costs, general and administrative costs	(14,663)		(15,695)	
Operating loss	**(1,615)**		**(1,450)**	
Finance charges	(375)		(359)	
Amortization	(326)		(382)	
Other proceeds	12		6	
	(689)		(735)	
Loss before tax expense (recovery)	**(2,304)**	**$**	**(2,185)**	**$**
Earnings before tax, interest and amortization (EBITDA)	**(1,615)**	**$**	**(1,450)**	**$**
# of boutiques in operation (48 as of May 12, 2012)	**63**		**62**	

26. The above table shows that, despite certain restructuring measures implemented by management since April 2012, Pentagone continues to record significant financial losses for the current fiscal year. This indicates the need to obtain the support of a strategic investor bringing operational and financial synergies to ensure Pentagone's survival.

(ii) Balance sheet

27. The following table sets out the Debtor's balance sheet as at May 31, 2012:

Boutique Le Pentagone Inc. Unaudited Balance Sheet as at May 31, 2012		
Current assets		
Cash	1,659	$
Accounts receivable	535	
Inventory	5,285	
Inventory paid for in advance and deposits on inventory	60	
Fees paid in advance	121	
	7,660	
Investments	2	
Tangible capital assets	3,462	
Intangible assets	745	
	11,869	$
Current liabilities		
Bank loan	-	$
Accounts payable	6,447	
Government sums payable (receivable)	(67)	
Long-term debt maturing during the next fiscal year	21	
	6,401	
Provision for straight-line rent	249	
Long-term debt	9,026	
Deferred credit on capital assets	292	
Future tax	210	
	16,178	
Shareholders' equity		
Capital stock	1,472	
Retained earnings	(5,781)	
	(4,309)	
	11,869	**$**

a) Assets

- **Cash** represents the funds held in the Corporation's bank account from operating the boutiques. Pentagone's authorized credit line (secured by a movable hypothec on the universality of the Corporation's movable property) with Centre financier aux entreprises Desjardins ("CFE") was repaid during May 2012 and there was no outstanding balance as at May 31, 2012;

- **Accounts receivable** represent the amounts receivable from sales made by credit card and debit card given the approximately 2 to 3 day collection delay;

- **Inventories** are made up of merchandise located in the boutiques and in the warehouse in Rimouski;

- **Capital property** essentially includes leasehold improvements ($2 M) as well as movable property and equipment ($1.4 M) in the boutiques;

- **Intangible assets** include the computer system purchased by the Corporation, among other things.

b) Liabilities

The liabilities as of May 31, 2012 will not be reviewed in detail, other than the following comments **(see iii) for details about the claims covered by the Amended Plan)**:

- **Accounts payable:** The $6.4 M of accounts payable include the accounts payable prior to the filing of the proceedings under the CCAA totalling $5.3 M as well as approximately $1.1 M relating to accounts payable post-filing, which include primarily the $0.8 M outstanding balance of salaries and accrued vacation and the $0.2 M allowance for gift certificates. It is important to note that the pre-filing accounts payable do not include Restructuring Claims stemming from the cancellation of the boutique leases and employment contracts of employees who have been laid off, among other things (see iii) for further details about these claims);

- **Long-term debt**: The long-term debt is broken down as follows:

Nature	Amount		Expiry
CRCD unsecured loan	6,763,145	$	September 2017
CRCD unsecured loan	1,703,876		August 2017
CRCD unsecured loan	549,470		September 2018
	9,016,491		
CFE secured loan	15,278		June 2012
Capital leases	15,673		January 2015
	9,047,442	**$**	

(iii) Update of claims procedure

28. Our comments will discuss the claims covered by the Amended Plan and more specifically those made in accordance with the Claims Procedure Order rendered on May 10, 2012.

29. According to the Claims Procedure Order, the Debtor's creditors had until 5 p.m. on June 22, 2012 to file a proof of claim with the Monitor for any claim other than Restructuring Claims (as that term is defined therein).

30. For the Restructuring Claims, the affected creditors have until the later of the following dates to file their proof of claim:

- Thirty (30) days after their contract is cancelled; or
- August 17, 2012.

31. The value of the proofs of claim submitted to the Monitor by 5:00 p.m. on June 22, 2012 is summarized as follows:

Boutique Le Pentagone Inc. Claim Summary as of June 27, 2012		
(In thousands of dollars)	**According to the proofs of claim**	
	Number	**Amount**
Secured creditors	1	- $
Preferred creditors	-	-
Unsecured creditors		
Unsecured claims (note 1)	129	14,252
Restructuring claims	31	1,565
	160	15,817
Total claims	**161**	**15,817 $**

Note 1: included in CRCD's claim for an amount of approximately $9M.

32. In connection with the claims procedure, 129 creditors filed proofs of claim by the claims bar date, **excluding creditors who may have Restructuring Claims.**

33. Moreover, it is important to note that the Restructuring Claims filed to date do not reflect all the Restructuring Claims since the creditors affected by such claims, i.e. primarily lessors for damage resulting from the cancellation of the leases for the boutiques that have been closed and employees with respect to the termination of their employment contracts, have until August 17, 2012 to file them (see section L iii) for an estimate of the amount of these claims).

34. It should also be mentioned that the Monitor, in conjunction with Pentagone's authorized representatives, has not completed its review of the proofs of claim filed. There could be discrepancies between the Debtor's books and records and the amounts claimed. Pentagone is currently analyzing these discrepancies and, where applicable, will obtain amended proofs of claim before the creditors' meeting is held on July 16, 2012.

35. The Monitor will have to take a position and decide on the validity of the amounts claimed. In this regard, notices of the rejection and/or revision of the amounts claimed will be issued by the Monitor, where applicable, in order to establish the claim held by the creditor for the purpose of voting at the creditors' meeting.

36. In view of the above comments, the Monitor has prepared an estimate of the total value of **claims subject to the Amended Plan which could amount to between $13.1 M and $14.3 M (see section L iii) for further details).**

D) WEEKLY MONITORING OF CHANGES IN CASH FLOW

Period from April 8, to June 23, 2012

37. See the second Monitor's Report dated June 28, 2012 for details about the comparative statement of changes in cash flow for the period from April 8 to June 23, 2012. See Schedule "A" for a copy of that statement. The following are the highlights from it:

38. Since the last extension granted by the Court, Pentagone's operations have continued normally and the Corporation is continuing to honour its commitments as they become due.

39. According to the statement, during the eleven (11) week period ended on June 23, 2012, Pentagone's operations were to generate a negative cash flow of $535 K. In fact, the Corporation's operations generated a positive cash flow of $1.9 M, i.e. a favourable difference of $2.4 M, primarily due to higher than anticipated sales. A portion of this favourable difference is temporary and will be reversed over the coming weeks.

40. The cash (book balance) as of June 23, 2012 was $1.2 M.

41. No material unpaid expense or expense incurred beyond the normal course of business concerning the reference period is known and no provision has been made in this regard.

E) CASH FLOW PROJECTIONS

Period from June 24 to July 28, 2012

42. As indicated in the order rendered by the Court on June 29, 2012, the projected statement of cash flow for the period from June 24 to July 28, 2012 was ordered to be filed marked confidential and not to be available without Court authorization. However, this statement essentially reflects the following:

- the previsions for collections from sales are estimated to be approximately $3.7 M;
- the budgeted expenses are estimated to be $4.4 M;
- the Corporation should incur a cash deficit of approximately $0.7 M during the period; and
- the projected cash balance for the period ending July 28, 2012 is estimated to be $0.5 M. Management does not expect to borrow any amount from the CFE operating credit during the reference period.

43. The Corporation's projected cash deficit during July is due primarily to historically lower sales during this month as well as the need to give several suppliers deposits to secure orders for the fall season.

44. This anticipated drop in the Corporation's cash made it necessary to accelerate the process leading to approval of the Amended Plan by the creditors and its sanction, where applicable, as well as the closing of the proposed transaction, in order to maximize the distribution to the creditors, which will be made up of, among other things, the amount of cash available on the sanction date, as more fully described in section K of this report.

45. The Corporation's economic assumptions involving the financial projections seem realistic.

F) BUSINESS CONTINUITY

46. As provided in the Initial Order, the Monitor has overseen Pentagone's business and financial affairs and reported to the Court in connection with the various motions submitted to the Court.

47. The various motions and orders rendered by the Court as well as the reports of the Monitor have been posted on our web site at http://www.rsmrichter.com/Restructuration/Boutique%20Le%20Pentagone.aspx.

48. Based on the information gathered as part of its oversight, the Monitor is able to confirm that:

- since the Initial Order was issued, Pentagone has continued to operate its business in good faith and in the interests of all stakeholders;
- since April 10, 2012, Pentagone has continued to pay its employees and suppliers of goods and services on time;
- the Corporation has also continued to collect its income in the normal course of business; and
- the Monitor has been kept apprised of the undertakings entered into by Pentagone and has reviewed its disbursements to ensure that they were related to current obligations.

G) ACTIONS TAKEN BY THE MONITOR

49. On April 12, 2012, in accordance with the Initial Order, the Monitor sent all the creditors known to Pentagone a notice advising them of the issuance of the Initial Order and the stay of proceedings. A copy of the notice in question, along with the list of creditors, has been posted on our web site to ensure creditors have access to it.

50. The Monitor has continued to be kept informed of Pentagone's commitments and to review its disbursements to ensure that they were related to current obligations.

51. The Monitor has supported Pentagone's representatives in their various interventions and meetings with Interested Parties (as defined below). In this regard, the Monitor has supervised access to the virtual room containing confidential information and participated in several meetings with various parties who have shown an interest in investing in or purchasing the Corporation.

52. The Monitor has participated with the representatives of the Interested Parties, in connection with their due diligence, in various meetings with Pentagone's major lessors and suppliers.

53. The Monitor has also ensured that all financial information required by CFE for follow-up is sent to it within the required times.

54. On May 14, 2012, in accordance with the Claims Procedure Order, the Monitor sent all Pentagone's known creditors a notice informing them of the claims bar date (including a proof of claim form and an instruction letter), namely:

- no later than 5:00 p.m. Montreal time on June 22, 2012, for claims which arose on or before April 10, 2012 ("CLAIMS BAR DATE"); and / or

- no later than the following dates: (i) 5:00 p.m. Montreal time on August 17, 2012 or (ii) thirty (30) days after the deemed receipt, within the meaning of section [12] of the Claims Procedure Order, of the Instructions to Creditors, for Restructuring Claims which have arisen since April 10, 2012 ("RESTRUCTURING BAR DATE").

55. In addition, on May 16, 2012, in accordance with the Claims Procedure Order, the Monitor had announcements published in two (2) daily newspapers advising of the claims bar date.

56. On July 4, 2012, in accordance with the Order Authorizing the Filing of the Plan and Establishing the Creditors' Meeting Procedure, the Monitor sent all the creditors who had proven their claims as well as Pentagone's known creditors who may have a Restructuring Claim notice of the creditors' meeting and the sanction hearing scheduled for July 16 and 17, 2012, respectively.

H) RESTRUCTURING MEASURES

57. Since the issuance of the Initial Order and the Order Extending the Stay of Proceedings and establishing the claims procedure, the Debtor has implemented measures to restructure its operations, with the ultimate goal of submitting a Plan to its creditors, in the interest of all interested parties, including the following:

- closing unprofitable boutiques;

- reducing its head office and warehouse staff;

- identifying and implementing measures to reduce its operating costs, including the cancellation of certain unprofitable contracts;

- finalizing the procedure for soliciting offers of strategic alliances;

- identifying an investor interested in financing the Amended Plan and subscribing for shares of the Corporation, which will be issued following the corporate reorganization provided for in the Amended Plan; and

- beginning, with the Monitor's help, the analysis of the proofs of claim filed by the Debtor's creditors.

Closing of unprofitable boutiques

58. Management of the Corporation has identified several unprofitable boutiques in various locations across Quebec and New Brunswick (the "Unprofitable Boutiques").

59. A first series of thirteen (13) Unprofitable Boutiques and a second series of two (2) Unprofitable Boutiques were closed on May 12, 2012 and June 12, 2012 respectively. In addition, a third series of ten (10) Unprofitable Boutiques is planned for the end of July 2012.

60. In this regard, the Debtor, with the consent of the Monitor and according to the provisions of the CCAA and the Initial Order, sent lease cancellation notices to the twenty-five (25) lessors of Unprofitable Boutiques as well as notices terminating the employment contracts of the employees working at them.

61. The Debtor also issued employment termination notices to three (3) employees working at the Corporation's head office. It is important to note that other layoffs will be implemented at the head office and the warehouse before the creditors' meeting takes place. In addition, management of the Corporation has reduced the number of work hours available at the warehouse, without making any layoffs, in accordance with the terms of the collective agreement.

62. The employees laid off following the closing of the Unprofitable Boutiques were given four (4) weeks' notice for the thirteen (13) boutiques that were closed on May 12th and eight (8) weeks for the boutiques closed on June 12, 2012, whereas those at the head office were given four (4) worked weeks of notice.

Cancellation of certain contracts (other than boutique leases)

63. The Debtor cancelled certain unprofitable contracts, including purchase orders for merchandise to be delivered after the CCAA proceedings, further to the reduction of the number of boutiques in operation.

Other restructuring efforts

64. Management of the Corporation has also continued to set up discount programs in several boutiques, including those scheduled to close. These programs have been very successful, leading to increased sales and a drop in inventory levels since the Initial Order was issued.

65. Management of the Corporation has also continued its analysis of administrative costs to determine whether there are other potential cost reductions.

Finalization of process for soliciting offers of strategic alliances

66. On April 23, 2012, the Debtor, with the help and support of the Monitor, began a process to solicit offers of strategic alliances.

67. A teaser (brief solicitation document) as well as a confidentiality agreement were sent to over one hundred thirty (130) businesses or financing companies which might be interested in investing in the Corporation or entering into a strategic alliance with it. According to that document, potential strategic partners had the following deadlines:

- May 18, 2012 for submitting letters of intent ("LOI") to the Monitor;
- June 22, 2012 for submitting firm offers to contain minimum conditions with respect to the proposed investment or strategic alliance.

68. The Debtor, with the help and support of the Monitor, has set up a virtual room for consulting the Corporation's documents ("data room"), intended for interested parties who have signed the confidentiality agreement.

69. On or around May 18, 2012, six (6) interested parties (the "Interested Parties") carrying on business in the retail and/or clothing sector submitted a LOI. Following receipt of the above-mentioned letters of intent, the Corporation and the Monitor contacted each of the Interested Parties to obtain details about the various proposed transactions, the terms thereof and the total amount each of the Interested Parties proposed to invest in the Corporation.

70. Following repeated requests and pressure from several of Pentagone's suppliers to obtain deposits to guarantee the production of orders for merchandise deliverable for the fall/winter 2012 season, it was decided to move up the date for receiving firm offers from Interested Parties. Accordingly, on May 31, 2012,

the Monitor sent a notice to the six (6) Interested Parties notifying them that the filing of a firm offer had been moved up from June 22 to June 4, 2012.

71. On June 1, 2012, a firm offer for the Corporation's assets was received from one of the Interested Parties, the Néro Bianco Group ("Néro Bianco"). This offeror operates a network for the retail sale of shoes in the Province of Quebec. Their offer included certain major conditions such as an exclusivity clause as well as a request to meet the Corporation's key suppliers to firm up the fall/winter purchases and the major lessors in order to renegotiate certain lease terms.

72. With the exception of Néro Bianco and one of the Interested Parties, none of the four (4) other offerors submitted a firm offer before the June 4, 2012 deadline. As the offer submitted by the other Interested Party was less advantageous for the stakeholders than the Néro Bianco offer, it was rejected by the Debtor.

73. The four (4) other Interested Parties then withdrew from the solicitation process. However, two (2) new parties who had not submitted a LOI submitted firm offers after June 4, 2012. The first one was received on June 11, 2012 and the second one on June 15, 2012. These two (2) offers were submitted after the deadline imposed by the Monitor and after exclusivity was given to Néro Bianco. Although the Monitor was not in direct contact with these two (2) new Interested Parties about their offer, according to the Monitor's preliminary analyses, they appeared to be less advantageous in terms of monetary value than Néro Bianco's offer, and more specifically with respect to the cost of implementing the transaction.

74. Following several discussions and negotiations with the representatives of the Debtor and the Monitor, Néro Bianco sent the Debtor and the Monitor amended offers on June 4, 5 and 6, 2012.

75. On June 8, 2012, Néro Bianco sent the Petitioner and the Monitor a final offer to purchase the Corporation's assets, which offer was accepted (the "Offer").

76. Between June 8 and 15, 2012, Néro Bianco completed its due diligence of the Debtor's affairs, including having several meetings with the major lessors to renegotiate the leases for several boutiques and its suppliers in order to secure orders for the fall/winter 2012.

77. Between June 18 and June 28, 2012, the Corporation, the Monitor and Néro Bianco had new discussions and negotiations.

78. On June 28, 2012, Néro Bianco sent the Corporation a financing offer and an offer to subscribe for shares of Pentagone (the "Financing and Subscription Offer"), the terms of which are more fully described in section I

of this report. **The terms of the Financing and Subscription Offer as well as the objectives sought are essentially similar to those of the Offer previously accepted on June 8, 2012, with the exception of the legal structure of the transaction and the proposed corporate reorganization, including an amendment of Pentagone's share capital, the terms of which are more fully described below.**

I) FINANCING AND SUBSCRIPTION OFFER

79. The subscription transaction contemplated by the Financing and Subscription Offer provides in particular for the following:

- cancellation of the Corporation's existing share capital following a reorganization of the Corporation pursuant to sections 411 and 413 of the Quebec *Business Corporations Act*;
- the conversion by CRCD of a portion of its unsecured claim for the total amount of $8,878,921 which CRCD holds toward the Corporation (the "CRCD receivable") into preferred shares of the capital stock of the Corporation pursuant to a conversion agreement to be entered into between Pentagone and CRCD (as described in section J of this report);
- the issuance and distribution to a corporation related to Néro Bianco of an as yet to be determined number of voting and participating shares, which will represent all the issued and outstanding shares of the Debtor, with the exception of the preferred shares which will be held by CRCD;
- a subscription price of $1 and the making available to the Debtor of a $1,750,000 loan, which amount may vary according to fluctuations in the value of the Corporation's inventory between now and the closing date and other adjustments described in the Financing and Subscription Offer, where applicable (the "Investment Amount"); and
- the closing of the transaction by July 30, 2012.

the whole as it appears from the Financing and Subscription Offer, a copy of which was filed in support of the motion covered by the order rendered on June 29, 2012.

80. The Financing and Subscription Offer submitted by Néro Bianco is conditional on the following:

- cancellation by the Debtor of certain leases and other contracts identified by Néro Bianco;

- filing of the Amended Plan by July 5, 2012 which should provide for the payment of all the Debtor's claims prior to the closing date;
- completion of the tax due diligence by July 11, 2012; and
- approval of the Amended Plan by the creditors by July 27, 2012 and its sanction by the Court by July 30, 2012.

81. **As of the date hereof, the only two (2) conditions remaining to be filled under the Financing and Subscription Offer are acceptance of the Amended Plan by the creditors and its sanction by the Court, scheduled for July 16 and 17, as well as completion of the tax due diligence.**

J) CONVERSION AGREEMENT

82. In accordance with the terms of the Financing and Subscription Offer entered into between CRCD and Néro Bianco on June 28, 2012, as described above, Pentagone and CRCD have entered into an agreement providing for the conversion of a portion, totalling $4,378,921 (the "Converted Receivable"), of the CRCD receivable, providing for the following (the "Conversion Agreement"):

- conversion of the Converted Receivable into 3,500,000 non-voting and non-participating preferred shares in the capital stock of the Corporation valued at $1 per share (the "Preferred Shares");
- redemption of the Preferred Shares at the option of the Corporation with an undertaking by the Corporation to redeem a number of Preferred Shares annually corresponding in value to 50% of the amount of the Surplus Cash (as defined in the Conversion Agreement) of the Corporation less than $1,000,000 plus, where applicable, a number of Preferred Shares corresponding in value to 75% of the amount of Surplus Cash of the Corporation greater than $1,000,000;
- a full and final release from CRCD in favour of the Corporation with respect to repayment of the Converted Receivable, i.e. a sum of $4,378,921;
- the monthly payment of a preferred and cumulative dividend of 5% per year beginning in February 2013 to which holders of Preferred Shares will be entitled;
- default clauses in the event of non-payment by the Corporation of monthly dividends and undertakings to redeem Preferred Shares annually out of the Surplus Cash. In addition, the

Corporation will be in default if, among other things, all the Preferred Shares have not been redeemed by July 18, 2022 or if they have not been redeemed in the amount of at least $500,000 by July 18, 2017; and

- recourses by CRCD in the event of default, and in particular the request for the immediate redemption of all or part of the Preferred Shares and the payment of accrued and unpaid dividends, or the request, at its complete discretion, that all or part of the Preferred Shares and the accrued and unpaid dividends be exchanged for voting and participating shares in the capital stock of the Corporation.

83. It is important that the Financing and Subscription Offer and the Conversion Agreement close as quickly as possible since it is expected that the Corporation's cash on hand will decrease during the month of July, due primarily to historically lower sales during this month as well as the need to give several suppliers deposits to secure orders for the fall season. **Rapid closing of these transactions is to the advantage of Pentagone's creditors, employees, lessors and suppliers in order to maximize the distribution to creditors under the Amended Plan, which will be made up of, among other things, the amount of cash available and the Investment Amount on the sanction date.**

84. **Please see section L iii), iv) and v) of this report for an estimate of:**

- **the expected recovery under the Amended Plan from the Financing and Subscription Offer and the Corporation's available cash for creditors affected by the Amended Plan; and**

- **the market value of Preferred Shares and the anticipated recovery underlying CRCD's Converted Receivable.**

K) SUMMARY OF AMENDED PLAN OF ARRANGEMENT

85. Following the filing of the Amended Plan and in accordance with the Order Authorizing the Filing of the Plan and Establishing the Creditors' Meeting Procedure, the Monitor sent all the creditors who had filed a proof of claim notice of the creditors' meeting which will take place on July 16, 2012, to which notice is attached a copy of the Amended Plan, a proxy and voting form and the order rendered by the Court on June 29, 2012.

86. Pentagone is proposing an arrangement to its creditors in order to be released from its obligations according to the Amended Plan in order to facilitate the implementation of its reorganization for the purpose of ensuring its recovery and continuity.

87. **It is important, and it is the duty of each creditor, to read the Amended Plan carefully.**

88. The Amended Plan will be financed by:

- **the Corporation's available liquidities at closing of the proposed transaction** with a corporation related to Néro Bianco, made up primarily of cash and accounts receivable (the "Available Cash"); and

- **the Investment Amount of $1,750,000, net of the costs associated with the implementation of this transaction and the various adjustments**, which will be made available to the Corporation by the corporation related to Néro Bianco in the form of financing, according to the terms of the Financing and Subscription Offer described above.

89. The Available Cash as well as the sum from the Investment Amount will be used to set up a fund which will then be distributed to Pentagone's creditors (the "Fund").

90. To ensure that all the Corporation's creditors, including CRCD, are treated fairly, the Amended Plan provides for two (2) classes of creditors:

- **one creditor class covering all the Debtor's creditors, including CRCD, for a portion of the CRCD receivable, i.e. an amount of $4,500,000 ("Class I"); and**

- **one creditor class only covering CRCD, for the amount of the Converted Receivable under the Conversion Agreement, i.e. an amount of $4,378,921 ("Class II").**

91. The Amended Plan contemplates the pro rata distribution of the Fund to Class I creditors and the issuance of Preferred Shares to the only Class II creditor, CRCD.

92. The proposed Class I distribution will take place as follows according to the terms of the Amended Plan **(since the following is only an extract of the Amended Plan, the Monitor reiterates that each creditor has a duty to review the terms of the Amended Plan)**:

[Translation]

2.6 “Treatment of Affected Claims

2.6.1 Creditor class receiving a monetary distribution

2.6.1.1 Election

- “At any time prior to September 14, 2012, an Affected Creditor may elect, by written notice to the Monitor to that effect (in any manner acceptable to the Monitor), to receive the lesser of the following two amounts: (a) $1,500 or the amount of the Proven Claim, and (b) an irrevocable and unconditional reduction of such proven claim to $1,500, whereupon:

  – any such Proven Claim in excess of $ 1,500 shall be deemed, for all purposes, to have been irrevocably and unconditionally reduced to $1,500 and the Affected Creditor having a Proven Claim in excess of $1,500 shall be deemed to have irrevocably and unconditionally waived and renounced to any rights to participate in any further distribution; and

  – any such Affected Creditor shall be treated as an Electing Creditor and such Creditor's Proven Claim shall be treated as an Electing Creditor Claim under this Amended Plan.

2.6.1.2 Distribution

- The Monitor will distribute the Fund according to the following terms and conditions:

  a) As complete payment of Crown Claims;
  b) As complete payment of Section 6(5) Claims, relating to employee claims;
  c) As complete payment of Section 19(2) Claims;
  d) As complete payment of the Claims of Electing Creditors; and
  e) Any balance remaining in the Fund on the Distribution Date following payment of the amounts referred to in subsections (a) to (d) above will be paid to Affected Creditors, including CRCD for a portion of its receivable, i.e. $4,500,000, on a pro-rata basis.”

- **“Distribution Date” means the first Monday following the 90th day after the Amended Plan Implementation Date.”**

- “Amended Plan Implementation Date” means the date on which all conditions precedent to the implementation of the Amended Plan, as set out in Section **Error! Reference source not found.** of the Amended Plan, have occurred or been satisfied or waived. These implementation conditions include:

- the approval of the Amended Plan by the Required Majorities shall have been obtained, which is expected to take place at the creditors' meeting on July 16, 2012;

- the Sanction Order sanctioning the Amended Plan shall have been rendered enforceable notwithstanding appeal and not appealed from, which sanction is expected to be heard at the hearing to take place in Court on July 17, 2012; and

- the Sanction Order sanctioning the Amended Plan shall have rendered enforceable the Reorganization according to the terms of the Financing and Subscription Offer expected to be heard at the hearing to take place in Court on July 17, 2012."

Accordingly, it is anticipated that the distribution will take place around the end of October 2012, unless there is a delay in implementing the Amended Plan.

93. With respect to the CRCD's Converted Receivable in the amount of $4,378,921, as it is the only Class II creditor, the Corporation will issue 3,500,000 Preferred Shares of Pentagone to CRCD, after the proposed transaction with the corporation related to Néro Bianco closes, pursuant to the terms and conditions of the Conversion Agreement described above, the whole as indicated in the Amended Plan **(since the following is only an extract of the Amended Plan, the Monitor reiterates that each creditor has a duty to review the terms of the Amended Plan)**:

2.6.2 "Creditor class receiving a distribution of shares.

The remainder of the CRCD receivable that has not been committed under paragraph 2.6.1.2 hereof will, once the Sanction Plan and the Reorganization has been approved, be converted into 3,500,000 preferred shares in the Corporation's equity."

94. **The amount of the CRCD receivable which has been committed to Class I and Class II has been established taking account of the fair market value of the Preferred Shares, in order to ensure the fair treatment of both classes of creditors. See section L iv) and v) of this report for an estimate of the fair market value of the Preferred Shares.**

95. **It is important to note that CRCD excludes a significant portion of its receivable which would otherwise be committed to Class I in exchange for Preferred Shares of the new entity. Those shares will be repaid over several years based on the future performance of the new entity and its capacity**

to generate sufficient Surplus Cash to ensure their repayment. CRCD opted for this procedure to favour a greater recovery for Class I creditors in order to encourage a transaction and the Corporation's survival (see section L of this report for an estimate of the anticipated recovery of the two (2) classes of creditors compared to recovery in a liquidation context).

L) ESTIMATED DISTRIBUTION TO CREDITORS

96. In the event the creditors reject the Amended Plan, the proposed transaction with Néro Bianco will not materialize and it is highly likely that there will be no alternative but to initiate a liquidation of the Debtor's assets. Pentagone's creditors must examine and analyze the offer of settlement / arrangement proposed to them in the Amended Plan compared to realization of their claims in a liquidation context, in order to decide whether they agree to (vote for) or reject (vote against) the Amended Plan.

97. The creditors must make their decision based on the following main factors:

- the fair and equitable treatment of all claims;
- the amount they will receive under the Amended Plan compared to any future recovery in a liquidation context; and
- the future business outlook.

<u>Estimated distribution - context of the Amended Plan of Arrangement</u>

i) Néro Blanco's position

98. As the investor whose Financing and Subscription Offer was accepted by the shareholders, Néro Blanco believes that the Amended Plan is fair and equitable toward the creditors and is asking the creditors to accept it, the whole as indicated as a condition precedent to implementation of the proposed transaction.

ii) Pentagone's situation

99. As indicated, in the event the Amended Plan is rejected by the creditors, there is a strong chance that Pentagone will be put into liquidation. Pentagone's current business situation is precarious. It is highly unlikely that Pentagone will be able to remain in business if the Amended Plan is not accepted since Pentagone continues to operate at a loss (as evidenced by the projected cash deficit during July 2012) and the obtaining of financing by conventional means is unlikely. In addition, as its future is not secure, its ability to guarantee its supply of merchandise for the fall/winter depends on Néro Bianco's support.

iii) Monitor's assessment – estimated distribution to Class I creditors

100. As described above, the Amended Plan provides that, for Class I creditors, the Amended Plan will be financed by the Available Cash when the transaction closes and by the Investment Amount of $1,750,000, net of costs associated with the implementation of the transaction and various adjustments, according to the terms set forth in the Financing and Subscription Offer.

101. The following table illustrates **the estimated distribution for Class I creditors**, including the estimate of the projected Available Cash and the projected Investment Amount when the transaction is scheduled to close, i.e. July 17, 2012, based on information available when this report was prepared.

Boutique Le Pentagone Inc. Estimated distribution to unsecured creditors – Class I under Amended Plan			
In thousands dollars		High	Low
Estimated claims of unsecured creditors – Class I			
Suppliers		$ 5,448	$ 5,374
Lessors		3,521	2,481
Employees – severance pay		808	708
CRCD – portion of CRCD Claim		4,500	4,500
Total (Note 1)	**A**	**$ 14,278**	**$ 13,063**
Estimated Fund for unsecured creditors – Class I			
Estimated cash and accounts receivable as of closing (Note 2)		$ 960	$ 1,060
Estimated net funds from Investment Amount (Note 3)		1,060	1,160
Estimated Total Fund	**B**	**$ 2,020**	**$ 2,220**
% Distribution estimate – Class I	**B / A**	**14%**	**17%**
% Distribution estimate – Class I		**16%**	

Note 1: Represents the Monitor's best estimate of the Class I claims under the Amended Plan.

Note 2: According to the projected statement of changes in cash flow submitted to the Court in support of the June 29, 2012 order.

Note 3: According to the Monitor's best estimate of the net funds from the Investment Amount and the adjustments contemplated by the Financing and Subscription Offer (see the detailed analysis in section (v)).

102. As indicated in the above table, the anticipated recovery by Class I creditors under the Amended Plan is estimated to vary between 14% and 17% of the total proven claims. **As payment from the Fund under the Amended Plan would be in a single cash payment around the end of October 2012, the volatility of the anticipated recovery is less than that for Class II.**

103. The following table explains the reconciliation between the Investment Amount of $1,750,000 (before adjustments) and the estimate of net funds from the Investment Amount after taking into account the various adjustments according to the terms of the Financing and Subscription Offer, i.e. $1,160,000 (according to the "High" estimate of the foregoing table, the "Low" estimate being reduced by $100,000):

Boutique Le Pentagone Inc. Estimate of funds available for unsecured creditors		
Description	**As at July 17, 2012**	
Projected cash balance at closing	$ 630	
Estimated accounts receivable – credit and debit cards	430	
	1,060	**1,060**
Estimate of Investment Amount (before adjustments)	**1,750**	
Estimated adjustment of inventory (according to terms of Financing and Subscription Offer)	(490)	
	1,260	
Adjustment for security deposits	500	
Balance payable GST/QST (July 2012)	(235)	
Repayment of rent of boutiques maintained – July 18 to 31, 2012	225	
Professional fees – finalization of file	(200)	
Other	(150)	
Accrued salaries and benefits	(165)	
Accrued and accumulated vacation	(75)	
Estimated investment amount (after adjustments)	**1,160**	**1,160**
Estimated Fund available for creditors		**$2,220**

104. **Nonetheless, it is important to note that the final distribution will vary depending on the final result of the Claims Procedure. In this regard, the Monitor reiterates that, in conjunction with Pentagone's authorized representatives, it has not completed its review of the proofs of claim submitted. In addition, the creditors who may hold Restructuring Claims have not all submitted their claims. There could be discrepancies between the Debtor's books and records, the Monitor's estimate and the amounts claimed.**

iv) Monitor's evaluation – estimated distribution to Class II creditors

105. As described above, the Amended Plan provides that the only Class II creditor, i.e. CRCD for the Converted Receivable, will be issued 3,500,000 Preferred Shares of Pentagone by the Corporation after the proposed transaction with the corporation related to Néro Bianco closes, in exchange for the conversion of $4,378,921 of the CRCD receivable.

106. The following table illustrates **the estimated distribution for the sole Class II creditor**, including the estimate of the market value of the Preferred Shares based on information available when this report was prepared:

Boutique Le Pentagone Inc. Estimated distribution to unsecured creditors – Class II under Amended Plan			
In thousand dollars		Low	High
Estimated claims of Unsecured Creditors - Class II			
CRCD – Converted Receivable		$ 4,379	$ 4,379
Total (Note 1)	**A**	**$ 4,379**	**$ 4,379**
Estimated FMV of Preferred Shares – Class II			
Par value of Preferred Shares (Note 2)		$ 3,500	$ 3,500
Estimated discount (Note 3)		(3,150)	(2,200)
FMV of Preferred Shares	**B**	**$ 350**	**$ 1,300**
% Distribution estimate – Class II	**B / A**	**8%**	**30%**
% Distribution estimate – Class II		**19%**	

Note 1: Represents the amount of the Claim converted under the Conversion Agreement and the Amended Plan.

Note 2: Based on 3,500,000 Preferred Shares to be issued to CRCD valued at $1 per Preferred Share under the Conversion Agreement.

Note 3: Represents the Monitor's best estimate of the discount in order to determine the FMV of the Preferred Shares according to their estimated discounted value.

107. **As indicated in the above table, the anticipated recovery of the CRCD's Converted Class II receivable under the Amended Plan is estimated to vary between 8% and 30% of the total amount of the said claim. According to this analysis, the average 19% estimated Class II recovery is consistent with the 16% estimate for Class I.**

108. **Accordingly, these analyses show a fair and equitable treatment among the two (2) classes of creditors. Nonetheless, as the estimate of the fair market value of the Preferred Shares depends on a large number of assumptions which it is impossible to ensure will materialize, the volatility of the**

anticipated recovery for Class II is greater than that for Class I creditors who would receive a single cash payment around the end of October 2012 given, in particular, the following risks and factors:

- uncertainty with respect to the Corporation's ability resulting from the proposed transaction to achieve the projected level of sales, gross profit, profitability and cash flow to support the evaluation of the Preferred Shares, as more fully described below given, among other things, Pentagone's history of losses;

- the uncertainty surrounding the retail sector given, among other things, increased competition in the areas where the Corporation operates its boutiques and the general economic slowdown in this business sector;

- the ability of the new entity to generate sufficient Surplus Cash to ensure the redemption of the Preferred Shares; and

- the lack of reliability of financial projections covering a long period of time.

Accordingly, the estimated fair market value of the Preferred Shares and the resulting estimated recovery of CRCD's Class II Converted Receivable will vary significantly given, in particular, the risks and factors mentioned above.

Accordingly, the procedure offered to CRCD under the Amended Plan pursuant to which CRCD will receive Preferred Shares for a portion of its claim favours a greater recovery for Class I creditors. The determination of the amount of the CRCD receivable to be converted into Class II was established based on the fair market value of the Preferred Shares in order to ensure fair treatment among the two (2) creditor classes.

CRCD therefore agrees to bear the risk that the anticipated recovery of the Preferred Shares depends on the capacity of the new entity to achieve a sufficient level of profitability to allow them to be reimbursed.

v) Monitor's evaluation – fair market value of the Preferred Shares

The fair market value of the Preferred Shares as at July 4, 2012 (the "Valuation Date") was calculated using the **discounted cash flow method**. The application of this method included the following steps:

- With the help of Néro's representatives, two scenarios of financial projections for the Corporation for the next five (5) years were prepared by the Monitor—one conservative and one optimistic;

- Based on these two (2) scenarios, the dividend and projected annual repayment of capital on the Preferred Shares was estimated based on the Surplus Cash projections applying a discount rate, as defined in the Conversion Agreement;

- the discounted cash flow method requires the determination of an appropriate discount rate based on the risks associated with the Preferred Shares. The discount rate used by the Monitor is 25% and was determined as follows:

  - the starting point for this method is the risk-free rate of 2.6% estimated according to the yield rate on long-term Canadian government bonds;

  - a 4.3% general risk premium is then added, corresponding to the evaluated investment risk, based on the "2012 Duff and Phelps Equity Risk Premium Report - 1963 to 2011";

  - an 8.5% additional risk premium was also added to take account of the size of the Corporation, according to the "2012 Duff and Phelps Equity Risk Premium Report - 1963 to 2011";

  - a 10% specific risk premium was also added taking account of internal and external factors relating to the Corporation, including the risk of financial projections being realized, the status of the corporate assets as well as the financial losses incurred over the past few years; and

  - to assess the reasonability of the 25% global discount rate, the Monitor considered the current rates for exchange-traded unsecured debentures (with a S&P rating of CCC).

- the discounted value of future dividends and repayments of capital on the Preferred Shares as of the Valuation Date were determined for each period;

- the value of the Preferred Shares was also analyzed compared to the liquidation scenario and in the event the Corporation is sold.

<u>Estimated distribution – liquidation context</u>

109. To help creditors understand the financial impact of a liquidation of Pentagone's assets, the Monitor has prepared the following analysis of the estimated liquidation in the context of a forced liquidation, including the eventual distribution to unsecured creditors:

Boutique Le Pentagone Inc.
Analysis of Estimated Liquidation – Forced Liquidation

In thousand dollars	Projected book value as at July 28, 2012	Estimated realization upon liquidation	
		Low scenario	High scenario
<u>Estimated gross realization of assets</u>			
Cash and accounts receivable	$ 906	$ 856	$ 906
Inventory	3,982	1,593	2,787
Leasehold and other improvements	3,257	127	188
	$ 8,145	**2,576**	**3,881**
<u>Less:</u>			
Estimated general expenses and professional fees		(1,229)	(922)
Estimated prior claims		(545)	(480)
Estimated secured claims		NIL	NIL
Estimated amount available for unsecured claims		**802**	**2,480**
Estimated claims of secured creditors		**$ 27,804**	**$ 24,230**
% Estimated recovery for unsecured creditors		**3%**	**10%**
% Estimated average recovery		**6%**	

110. As indicated in the above table, the anticipated recovery of unsecured creditors in a forced liquidation context is estimated to vary between 3% and 10% of the total amount of the claims. **It is important to note that such a process could take several weeks and involve risks which could have an adverse impact on the liquidation results estimated by the Monitor. It is also important to consider that such a liquidation would take place during the "low season" for retail trade during which most merchants are conducting sales and thus generating a lower recovery as compared to a liquidation during the "high season". Finally, the quality and age of inventories on hand, which has deteriorated over the past few weeks given the low level of purchasing, negatively affects the estimated recovery of inventories.**

111. The estimated liquidation analysis was prepared by the Monitor with the assistance of the Debtor, based on the following main assumptions:

- the cash and accounts receivable from credit and debit cards were established based on cash flows submitted to the Court in support of the June 29, 2012 order;

- the gross realizable value of inventories was established according to the Monitor's experience in similar situations and based on discussions with liquidators working in retail trade, taking into account the anticipated liquidation period. This estimate, which varies between 40% and 70% of the projected book value of the inventory, takes into account that offers would be solicited from liquidators in order to obtain a cash offer for the inventories, net of the direct operating costs of the boutiques during the liquidation period;

- No realization is expected for leasehold improvements in the boutiques and the estimate for the liquidation of the other capital property takes equipment obsolescence into account;

- the estimate of general expenses includes expenses for the head office and warehouse, including salaries and benefits as well as the cost of asset safekeeping and protection;

- the results of the claims procedure to date;

- the trustee's administration requires, among other things, taking possession of and safekeeping the assets as well as setting up a liquidation program;

- the trustee will have to hire experts in asset realization in the retail trade and provide for the payment of all costs relating to the safekeeping of the assets;

- the estimated amount of unsecured claims in such a scenario includes additional claims resulting from the cancellation of leases for the boutiques and breach of employment contracts stemming from the close of business which are estimated to be $13M (compared to $4.3M according to the Amended Plan). In a forced liquidation context, the additional claims of the lessors and employees would be significantly greater than the estimate used according to the Amended Plan given that 63 boutique leases would be cancelled (vs. 25 leases according to the Amended Plan) and over 500 employees would be laid off (vs. approximately 170 employees according to the Amended Plan); and

- no realization was anticipated from any proceeds of disposition from the sale of the trade-mark and/or the 48 boutique leases since the Interested Parties who analyzed the investment opportunity gave very little value to these assets in a business continuity context.

112. It is important to note that the estimate of the realizable value of the Debtor's assets is not necessarily representative of actual values. In the Monitor's analysis, to estimate their realizable value, we used a certain number of assumptions involving the procedure, duration and potential purchasers as well as other relevant factors.

<u>Analysis of preferential payments</u>

113. In the event the Amended Plan is approved, the creditors are deemed to have waived the recourses provided for in section 36.1 of the CCAA. These recourses deal with the possibility of recovering certain amounts in the event there are reviewable transactions, preferential payments and/or dispositions of assets by the Debtor.

114. The Monitor has conducted a brief analysis of the main transactions which have taken place over the three (3) month period (with parties at arm's length) and the 12-month period (for major transactions with parties not at arm's length) preceding the issuance of the Initial Order on April 10, 2012. Following our review of these transactions, it appears that they were entered into in the normal course of business according to the terms of payment offered by the creditors to the Debtor and/or according to the historical payment trend observed.

M) MONITOR'S COMMENTS

115. The filing of the Amended Plan results from steps initiated when the Initial Order was obtained. Despite its precarious financial situation and operating shortfalls, Pentagone has managed a difficult period and maintained its goal of preserving its business continuity.

116. The offers submitted for the purchase of Pentagone are the result of a process for soliciting investors which was approved the Court and the conditions related to it have been met.

117. The Néro Blanco Financing and Subscription Offer was accepted by the shareholders of the Debtor following their analysis and the evaluation of the offers received.

118. The creditors' acceptance of the Amended Plan will allow the restructuring and turnaround of Pentagone and most of the creditors will have the opportunity to continue their business relationship with the Debtor, and in particular:

- Over 400 employees will continue to be employed in 38 boutiques as well as at the head office and warehouse;
- Suppliers of merchandise and services will have an entity with which they can continue to do business; and
- The lessors of 38 boutiques will continue to have Pentagone as a tenant.

N) MONITOR'S OPINION AND RECOMMENDATION

119. The Monitor is of the opinion that if the Amended Plan is rejected, it is very likely that the Debtor will have to begin liquidating its assets. According to this scenario, the closure of the 48 boutiques (lessor / employees) would lead to an approximately $13M increase in unsecured claims. Considering the risks and uncertainty inherent in a liquidation, it is estimated that the unsecured creditors would receive less than what is offered under the Amended Plan (as illustrated in section L of this report).

120. The analysis conducted by the Monitor shows that all creditors will be treated fairly under the Amended Plan. The fact that CRCD agrees to take Preferred Shares for part of its claim is to the benefit of the unsecured Class I creditors, giving them greater recovery under the Amended Plan. Thus, according to this scenario, the unsecured Class I creditors will receive a single dividend payment approximately 90 days after the Amended Plan is sanctioned, whereas CRCD will only be paid over a period of time greater than five (5) years.

121. Accordingly, the Monitor is of the opinion that acceptance of the Amended Plan would be more advantageous to the creditors than the liquidation of the Debtor's assets.

122. The Amended Plan was prepared seriously and diligently, taking into account Pentagone's anticipated financial performance and the investments which the investor will have to make to comply with the terms of the Plan in the event it is accepted and to meet future liquidity needs related to the Debtor's business activities.

123. **The Monitor therefore recommends the acceptance (favourable vote) of the Amended Plan by the creditors.**

124. Creditors are asked to submit their voting form to the Monitor, indicating how they wish to vote, before the creditors' meeting or, in the alternative, to attend the creditors' meeting, which will be held on July 16, 2012, to obtain any additional clarifications they consider necessary to exercise their voting right at that time.

Respectfully submitted,

Montreal, July 9, 2012.

RSM Richter Inc.
Court-appointed Monitor

Stéphane De Broux, CPA, CA, CIRP