

CANADA
PROVINCE OF QUEBEC
DISTRICT OF MONTREAL
No.: 500-11-040900-116

SUPERIOR COURT
(Commercial Division)
The Companies' Creditors Arrangement Act

**IN THE MATTER OF THE PLAN OF ARRANGEMENT
WITH RESPECT TO:**

KITCO METALS INC., a legal person duly incorporated under the laws of Canada, having its principal place of business at 620 Cathcart, 9th Floor, suite 900, Montreal, Quebec, H3B 1M1

Petitioner

-and-

RSM RICHTER INC., a duly incorporated legal person having its principal place of business at 2 Place Alexis-Nihon, in the city and district of Montreal, Quebec, H3Z 3C2

Monitor

**SECOND REPORT OF THE MONITOR
ON THE STATE OF PETITIONER'S FINANCIAL AFFAIRS
August 31, 2011**

INTRODUCTION

1. On June 8, 2011 Kitco Metals Inc. (the "Petitioner" or "Kitco") filed a Notice of Intention to Make a Proposal and RSM Richter Inc. ("Richter") was named Trustee. Pursuant to a motion filed by Kitco and the resulting Order issued on June 10, 2011 ("Order") by the Honourable Martin Castonguay, J.S.C., Richter was further appointed Interim Receiver to Kitco.

2. On July 5, 2011, Kitco filed with the Quebec Superior Court, a Motion for the Issuance of an Initial Order pursuant to Section 11 of the *Companies' Creditors Arrangement Act*, R.S.C. 1985, C-36, as amended (the "CCAA"). On July 6, 2011, the Honourable Mark Schrager, J.S.C. issued an initial order (the "Initial Order"), which *inter alia* appointed Richter as monitor (the "Monitor") with various duties including duties similar to those that were originally provided for in the Interim Receiver Order.
3. On July 26, 2011, the Petitioner filed a motion requesting an extension to the stay of proceedings until February 29, 2012, in order to allow the Petitioner additional time to litigate and/or negotiate with Agence du Revenu du Québec ("ARQ") regarding its dispute. The Monitor filed its First Report on July 25, 2011 in support of the motion for an extension. On July 27, 2011, the Court granted an order extending the stay of proceedings until October 18, 2011.
4. All amounts reflected in this report are stated in Canadian currency unless otherwise noted.
5. The purpose of this second report of the Monitor is to inform the Court of the following:
 - Financial Position;
 - Movement in Customer Inventory Pool;
 - Customer Deposits;
 - Transactions carried out by the Scrap Gold Purchasing Department;
 - Forward Contracts;
 - Procedural Developments with respect to the Contestation by the Petitioner of the Notices of Assessment issued by the ARQ;
 - Activities of the Monitor.
6. We inform the Court that the Monitor has not conducted an audit or investigation of the information it was provided by the Petitioner and that accordingly, no opinion is expressed regarding the accuracy, reliability or completeness of the information contained within this Report. The information contained herein is based on unaudited financial information provided to the Monitor by the Petitioner's management as well as obtained through discussions with the Petitioner's management and employees.

FINANCIAL POSITION

7. In conjunction with the filing of the Motion for the First Extension of an Initial Order on July 26, 2011, the Petitioner submitted monthly cash flow projections covering the period from July 18, 2011 to February 29,

2012, a copy of which is attached as Appendix “2” to the First Report of the Monitor on the State of the Petitioner’s Financial Affairs.

8. As of August 19th, 2011, the Petitioner’s cash balances amounted to \$8.2 million as compared to the projected balance of \$8.5 million. The \$0.3 million negative variance is attributable to the following:
 - \$1.4 million of reported net results from operations are lower than projected by \$0.2 million, due to timing differences and the inclusion of foreign currency transactions which may reverse in future weeks;
 - \$2.0 million of reported cash disbursements are in line with projected disbursements for the period, with offsetting variances in various expense line items.
9. For additional details of the above noted variances, we refer you to Exhibit “1” attached hereto entitled Comparative Cash Flow for the period July 18, 2011 to August 19, 2011.
10. Since the filing of the CCAA, the Petitioner is paying its suppliers based on negotiated terms or upon receipt of invoices. The Petitioner advises that since the filing, it has not incurred significant liabilities which remain unpaid.

MOVEMENT IN CUSTOMER INVENTORY POOL

11. The position of the customer inventory pool is summarized below:

Kitco Metals Inc. Customer Inventory Pool Variation								
	June 8, 2011		July 15, 2011		Aug 19, 2011		June 8/11 vs. Aug 19/11	
	Ounces	Value	Ounces	Value	Ounces	Value	Ounces	Value
	(in thousands)	(in \$ millions)	(in thousands)	(in \$ millions)	(in thousands)	(in \$ millions)	(in thousands)	(in \$ millions)
Gold	96	\$ 145.9	84	\$ 129.1	85	\$ 157.0	(11)	\$ 11.1
Silver	4,848	176.8	4,287	162.7	4,203	180.8	(645)	4.0
Platinum	6	11.7	7	11.8	6	10.5	-	(1.2)
Palladium	23	18.7	21	15.6	16	11.8	(7)	(6.9)
Rhodium	6	13.5	6	12.0	6	12.4	-	(1.1)
	4,979	\$ 366.6	4,405	\$ 331.2	4,316	\$ 372.5	(663)	\$ 5.9
			-11.5%	-9.7%			-13.3%	1.6%

12. In terms of precious metals, the customer inventory pool has declined 13.3% from June 8, 2011 (vs. a 11.5% decline as of July 15, 2011). Kitco attributes the further decline in the customer pool primarily to the fluctuations in the price of metals and customers investment decisions.

13. Due to recent increases in the price of gold and silver, the value of the customer pool has actually increased from June 8, 2011 notwithstanding the 13.3% decline in ounces during this period.

CUSTOMER DEPOSITS

14. Customer deposits, which represent cash balances held by Kitco in segregated bank accounts on behalf of its customers, amount to \$71.8 million as of August 19, 2011 vs. \$54.9 million on July 7, 2011, the date of the issuance of the Initial Order at the start of the restructuring proceedings. According to Petitioner's management, the increase in customer deposits is consistent with the higher levels of activity Kitco is experiencing due to significant increases in the prices of various precious metals. We refer to Exhibit "2" attached hereto for a chart summarizing the movement in customer deposits.

TRANSACTIONS CARRIED OUT BY THE SCRAP GOLD PURCHASING DEPARTMENT

15. We refer to Exhibit "3" attached hereto for a summary of the operations of the Petitioner's scrap metals department since it filed for protection on June 8, 2011. We note that the value of scrap metals as of August 19, 2011 (as reflected in Exhibit "3") is based on spot pricing at that date. Kitco does not value its scrap metal position on a daily basis, but rather tracks the unit movement in ounces of scrap metals daily.
16. In respect of the more material scrap metal positions, we comment as follows:
- a) Gold:
- From June 8, 2011 to August 19, 2011, Kitco purchased approximately 3,200 ounces of scrap gold for \$5.0 million and during the same period, shipped approximately 3,100 ounces of scrap gold to the Royal Canadian Mint ("RCM") for processing. As such, the level of scrap gold (in terms of ounces) is relatively unchanged on August 19, 2011 at approximately 2,700 ounces vs. 2,600 ounces at June 8, 2011;
 - On August 11, 2011, Kitco concluded its new contract with the RCM which enabled it to resume shipping scrap gold to be refined. The RCM has also resumed supplying Kitco with new bullion products in August 2011;
 - The \$5.0 million of scrap gold purchases consisted of approximately 1,030 transactions with an average of approximately 3 ounces per transaction. According to Kitco, this volume is significantly below its normal level of scrap gold purchases and it is due to Kitco's inability to recover its input tax credits.

b) Silver:

- Scrap silver inventory has declined from approximately 102,000 ounces at June 8, 2011 to approximately 54,000 ounces as of August 19, 2011, as shipments to various refineries outpaced scrap purchases (valued at \$1.2 million) during this period;
- The \$1.2 million of scrap silver purchases consisted of approximately 630 transactions with an average of 50 ounces per transaction. According to Kitco, this volume is significantly below its normal level of scrap silver purchases and it is due to Kitco's inability to recover its input tax credits.

FORWARD CONTRACTS

17. RSM Richter's First Report dated July 25, 2011 noted Kitco's and Kitco International Limited's ("KIL") involvement in various forward contracts, on which we provide the following update:

a) **Contracts with Heraeus Precious Metals Inc. ("Heraeus")** – Kitco and Heraeus have been unable to reach a settlement concerning various forward contracts relating to both Kitco and KIL.

i. KIL contract with a value date of June 29, 2011:

Prior Status: Heraeus notified KIL that it has liquidated this Rhodium position and suffered a loss of \$1.6 million for which it is requesting payment.

Heraeus maintains that it is entitled to hold approximately \$1.8 million of inventory as collateral in the event it suffers a loss on this contract. Kitco contests Heraeus' attempt to hold this inventory as collateral.

Current Status: There has been no further update from Heraeus in respect of this contract. According to Kitco's management, no guarantee has been provided to Heraeus by Kitco in support of KIL's obligations, nor has Heraeus provided the Monitor with any documentation in support of such a guarantee.

ii. Kitco contract with a value date of July 25, 2011:

Prior Status: Kitco's obligation was to purchase from Heraeus 4,000 ounces of Rhodium at a price of \$2,331 per ounce for approximately \$9.3 million. On May 26, 2011, prior to its filing, Kitco provided \$1.5 million to Heraeus as a deposit against this contract.

Heraeus believes that this \$1.5 million is collateral for this forward contract. The Monitor, through its counsel, has notified Heraeus that it intends to review the facts surrounding the

payment of the \$1.5 million deposit to determine if that payment can be reviewed and if not, whether Heraeus has valid security on this deposit and has requested that Heraeus provide any relevant documentation in support of its position.

Current Status: On July 27, 2011, Heraeus notified Kitco that since Kitco had not purchased the Rhodium by the July 25, 2011 maturity date, it would proceed to liquidate the Rhodium covered by this contract. To date, Heraeus has not notified Kitco of the proceeds received from the liquidation of this contract.

iii. KIL contract with a value date of August 18, 2011:

Prior Status: KIL's obligation was to purchase from Heraeus 11,000 ounces of Rhodium at a price of \$2,155 per ounce for approximately \$23.7 million. On July 20, 2011, Heraeus notified KIL that it considered KIL to be in anticipatory breach of this contract and that it had begun to sell this Rhodium to minimize its damages.

Current Status: On August 31, 2011, Heraeus notified Kitco that it has completed the liquidation of the 11,000 ounces of Rhodium and has suffered a loss of \$2.9 million for which it is requesting payment. According to Kitco's management, no guarantee has been provided to Heraeus by Kitco in support of KIL's obligations, nor has Heraeus provided the Monitor with any documentation in support of such a guarantee.

- b) **Contract with Standard Bank PLC ("Standard")** – Kitco repurchased the 1,200 ounces of Rhodium from Standard on or about the value date of August 15, 2011 and subsequently entered into a sale repurchase transaction with Standard such that Kitco is now obligated to purchase 700 ounces of Rhodium from Standard at a price of \$1,836 per ounce for \$1.3 million on November 15, 2011. The cost (~\$400K) of the extension of the majority of this contract is included in net results from operations during this reporting period.

PROCEDURAL DEVELOPMENTS RELATING TO THE NOTICES OF ASSESSMENT

18. We refer to the attached memo from Petitioner's tax counsel (Exhibit "4") which sets out the status of recent developments relating to the notices of assessment.

ACTIVITIES OF THE MONITOR

19. The Monitor's activities have included the following:

- The Monitor has been at the premises of the Company on a regular basis to carry out its duties including the requirement to monitor: i) the Petitioner's cash flow, ii) the position of the precious metals and participations in pool accounts, iii) position of segregated accounts and storage accounts and iv) transactions carried out by the scrap gold purchasing department. As well, the Monitor has had numerous meetings and conference calls with the Petitioner's management and legal counsel with a view to keeping all parties apprised of material developments and to seek input with respect to the restructuring process;
- The Monitor has responded to queries from the Petitioner's suppliers, customers and other unsecured creditors;
- The Monitor has communicated with Petitioner's counsel to follow the status of developments relating to the notices of assessment;
- The Monitor reviewed the Petitioner's financial affairs and results;
- The Monitor has been in communication with the representatives of the ARQ, and has provided them with a copy of this report;
- The Monitor has prepared and filed this Report;
- Other administrative and statutory matters relating to the Monitor's appointment.

Respectfully submitted at Montreal, this 31st day of August, 2011.

RSM Richter Inc.

Monitor



Gilles Robillard, CA, CIRP

Kitco Metals Inc.

Exhibit "1"

Comparative Cash Flow

For the period July 18, 2011 to August 19, 2011

(in millions \$CAD) - Unaudited

	Reported	Projected	Variance	Notes
<u>Net results from Operations</u>	1.4	1.6	(0.2)	1
<u>Disbursements</u>				
Salary and benefits	0.9	1.0	0.1	2
General and administrative	0.7	0.7	-	
Restructuring costs	0.4	0.3	(0.1)	2
	<u>2.0</u>	<u>2.0</u>	<u>-</u>	
Net Cash Flow	<u>(0.6)</u>	<u>(0.4)</u>	<u>(0.2)</u>	
Opening consolidated bank balance per book	7.9	8.0	(0.1)	
Add: return of seized funds	0.9	0.9	-	
Closing consolidated bank balance per book	<u>8.2</u>	<u>8.5</u>	<u>(0.3)</u>	3

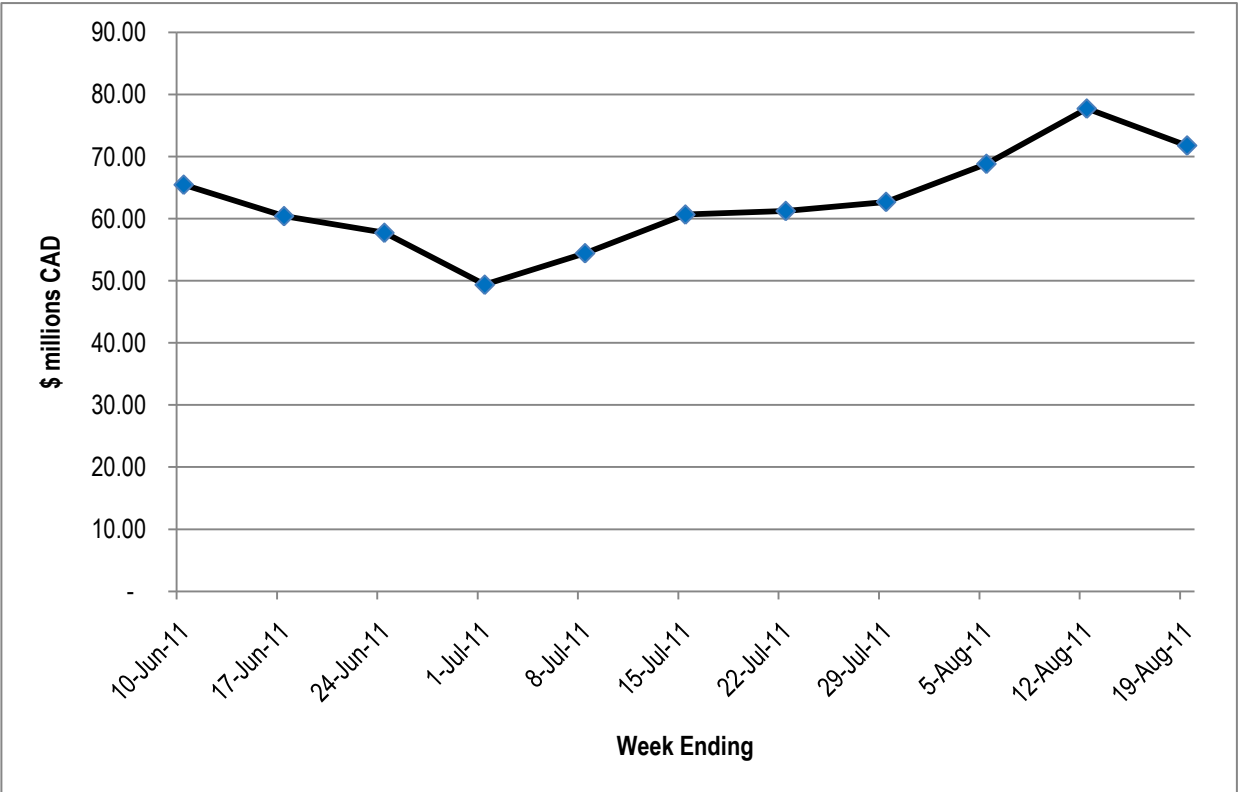
Note 1: The negative variance is attributed in part to timing differences as well as the inclusion of foreign currency losses which may reverse in subsequent periods.

Note 2: Variances attributed to timing differences.

Note 3: Closing bank balance includes \$0.3 million of cash on hand and \$1.4 million of cash in transit relating to foreign currency sale, which funds were received on August 24, 2011.

Kitco Metals Inc.
Summary of Customer Deposits
For the Period June 8, 2011 to August 19, 2011
Unaudited

Exhibit "2"



Kitco Metals Inc.

Exhibit "3"

Summary of Scrap Transactions

For the period June 8, 2011 to August 19, 2011

	Gold	
	Ounces	\$
	(in \$ millions)	
Beginning balance	2,623	
Purchase	3,204	
Sale	(19)	
Sent to refinery	(3,097)	
Ending balance	2,711	\$ 5.0
	Silver	
	Ounces	\$
	(in \$ millions)	
Beginning balance	101,633	
Purchase	31,477	
Sale	(2,188)	
Sent to refinery	(77,311)	
Ending balance	53,611	\$ 2.3
	Platinum	
	Ounces	\$
	(in \$ millions)	
Beginning balance	1,293	
Purchase	189	
Sale	(0)	
Sent to refinery	(560)	
Ending balance	922	\$ 1.7
	Palladium	
	Ounces	\$
	(in \$ millions)	
Beginning balance	266	
Purchase	5	
Sale	-	
Sent to refinery	(81)	
Ending balance	191	\$ 0.1
	Irridium	
	Ounces	\$
	(in \$ millions)	
Beginning balance	102	
Purchase	58	
Sale	-	
Sent to refinery	-	
Ending balance	160	\$ 0.2
	Rhodium	
	Ounces	\$
	(in \$ millions)	
Beginning balance	48	
Purchase	3	
Sale	-	
Sent to refinery	(17)	
Ending balance	34	\$ 0.1

Exhibit 4

Memo from the Petitioner's Tax Counsel

Le 23 août 2011

PAR COURRIEL ET
PAR COURRIER

Me Yves Ouellette

Ligne directe : (514) 392-9521

Téléc. : (514) 878-1450

yves.ouellette@gowlings.com

Adjointe : Tél. : (514) 878-1041

Poste n° : 65205

Monsieur Gilles Robillard CA
RSM RICHTER INC.
2, Place Alexis Nihon
Bureau 18120
Montréal (Québec) H3Z 3C2

**Objet : In the matter of the Companies' Creditors Arrangement Act, R.S.C. 1985, ch. C-36
Kitco Metals Inc. and RSM Richter Inc. and l'Agence du revenu du Québec
Cour supérieure, chambre commerciale
NO. 500-11-040900-116
Notre dossier : L121970003**

Cher Monsieur Robillard,

Suite à l'ordonnance initiale rendue par l'honorable juge Marc Schrager et à votre nomination comme contrôleur conformément à la *Loi sur les arrangements avec les créanciers des compagnies*, L.R.C. (1985), ch. C-36, nous en comprenons qu'en vertu de l'alinéa vi) du sous-paragraphe c. du paragraphe [30] du « INITIAL ORDER », vous devez produire à la Cour un rapport mensuel et suite à la prolongation du « INITIAL ORDER », nous désirons vous faire part des derniers développements à l'égard des dossiers de contestation des avis de cotisation émis en vertu de la *Loi sur la taxe de vente du Québec*, L.R.Q., c. T-0.1 (ci-après la « L.T.V.Q. ») et en vertu de la *Loi sur la taxe d'accise – Partie IX – taxe sur les produits et services*, L.R.C. (1985), ch. E-15 (ci-après la « L.T.V.A. »).

Plus précisément, nous désirons vous faire part de ce qui suit :

1. En date des présentes et suite à la rencontre en date du 27 avril 2011 à la direction des oppositions de l'Agence du revenu du Québec, aucune décision n'a été rendue par la direction des oppositions de l'Agence du revenu du Québec suite aux avis d'opposition notifiés et présentés par la société Métaux Kitco Inc.
2. En ce qui concerne l'enquête de l'Agence du revenu du Québec initiée le 7 juin 2011 par l'exécution de trois (3) mandats de perquisition, l'enquête n'est pas complétée et les conclusions de l'enquête ne sont pas encore connues.
3. Tel que mentionné dans notre rapport portant la date du 25 juillet 2011, des questions fondamentales relatives au secret professionnel des avocats et des comptables ont été

MTL_LAW\1709044\1]

soulevées et des ordonnances interlocutoires ont été rendues par la Cour supérieure, chambre civile, du district de Montréal le 13 juillet 2011.

4. Le 25 juillet 2011, nous avons indiqué que plus de quatre cent (400) boîtes de documents avaient déjà été examinées et que nous avons mis les ressources requises pour un tel examen et une telle identification des documents confidentiels, privilégiés et protégés par le secret professionnel et notre objectif était de respecter le délai du 31 août 2011 fixé par la Cour supérieure, chambre civile, dans les ordonnances interlocutoires.
5. Effectivement, l'examen des sept cent quatre-vingt-six (786) boîtes a été complété le 25 juillet 2011 et, le 4 août 2011, quatre (4) autres boîtes laissées en suspend ont été examinées.
6. Ainsi, en date du 4 août 2011, l'examen de toutes les boîtes pour identifier les documents confidentiels, privilégiés et protégés par le secret professionnel afin qu'ils soient confiés à l'avocate indépendante Me Danielle Ferron a été complété par les avocats de la société Métaux Kitco Inc.
7. De plus, au niveau de l'avocate indépendante désignée par la Cour supérieure, chambre civile, et notamment à l'égard des boîtes qui lui ont été confiées suite à l'exécution des mandats de perquisition en date du 7 juin 2011 et à l'égard des boîtes qui lui ont été confiées suite à l'examen des sept cent quatre-vingt-six (786) boîtes saisies dont il a été question dans les paragraphes précédents, nous désirons vous faire part de ce qui suit :
 - a) Huit (8) boîtes comportant des éléments informatiques ont été copiées au cours de la semaine du 15 août 2011 par l'expert, M. Gilles Létourneau.
 - b) Toutes les autres boîtes, à l'exception d'une seule boîte, ont été examinées et plusieurs documents ont été considérés comme étant non confidentiels, non privilégiés et non protégés par le secret professionnel.
 - c) L'examen de la dernière boîte sera complété au cours de la semaine du 22 août 2011 de sorte qu'à l'exception des différents fichiers informatiques, l'examen de tous les documents aura été complété de façon à permettre à l'avocate indépendante de dresser une liste des documents confidentiels, privilégiés et protégés par le secret professionnel.
8. La société Métaux Kitco Inc. n'a pas encore reçu l'inventaire définitif des documents saisis par les fonctionnaires enquêteurs de l'Agence du revenu du Québec afin de lui permettre d'identifier les documents qui pourraient être utiles et utilisés pour la contestation des avis de cotisation devant les tribunaux et dans le but d'en obtenir des photocopies.
9. Sous réserve de la décision de la Cour supérieure, chambre civile, le 31 août 2011, au cours des prochaines semaines, l'examen des documents informatiques devrait débuter en présence de l'avocate indépendante afin d'identifier tous les documents privilégiés, confidentiels et protégés par le secret professionnel.

10. Nous précisons que, selon les informations préliminaires obtenues de l'expert, des milliers de documents devront être examinés.

Nous espérons ces quelques informations à votre satisfaction et nous vous prions d'agréer, cher Monsieur Robillard, l'expression de notre plus entière collaboration si vous désirez des précisions ou des informations additionnelles.

Veillez agréer, cher Monsieur Robillard, l'expression de notre très haute considération.

GOWLING LAFLEUR HENDERSON S.E.N.C.R.L., s.r.l.

A handwritten signature in black ink, appearing to be 'Yves Ouellette', written over a horizontal line.

Yves Ouellette

YO/nh