

RICHTER

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KK PRECISION INC.

**REPORT OF RICHTER ADVISORY GROUP INC.,
IN ITS CAPACITY AS PROPOSED MONITOR OF
KK PRECISION INC.**

MAY 29, 2014

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ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

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

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF
KK PRECISION INC.

PRE-FILING REPORT OF RICHTER ADVISORY GROUP INC.
In its capacity as proposed Monitor of the Applicant

May 29, 2014

Introduction

1. Richter Advisory Group Inc. ("**Richter**" or the "**Proposed Monitor**") understands that KK Precision Inc. (the "**Company**" or the "**Applicant**") intends to make an application to the Court for an order (the "**Initial Order**") granting a stay of proceedings in favour of the Company until June 29, 2014 pursuant to the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36, as amended (the "**CCAA**")
2. On the application for the Initial Order, the Company will be seeking an order that Richter be appointed as the CCAA monitor (the "**Monitor**") of the Company in the CCAA proceedings.
3. Richter, in its capacity as the Proposed Monitor, has reviewed the Court materials to be filed by the Applicant in support of its application. The purpose of this limited scope report of the Proposed Monitor is to provide information to this Honourable Court regarding the following:
 - (a) Richter's qualifications to act as Monitor (if appointed);
 - (b) A limited summary of certain background information about the Company and the CCAA proceedings;
 - (c) The objectives of the CCAA proceedings;
 - (d) The Company's statement of projected cash flow for the period from May 10, 2014 to September 19, 2014 (the "**Cash Flow Statement**");
 - (e) The Accommodation Agreement dated May 26, 2014 between the Company, Rolls-Royce Canada Ltd., Rolls-Royce Power Engineering PLC, Bank of Montreal, BMO Capital Partners, and Richter (the "**Accommodation Agreement**");
 - (f) The Company's retention of MVM Industrial Services Limited ("**MVM**") and Mr. Garth Wheldon ("**Weldon**") as an advisor (the "**Advisor**") to provide the Company with strategic advice and services throughout the CCAA proceedings;
 - (g) The proposed Key Employee Retention Plan ("**KERP**"), as set forth in the Accommodation Agreement;

- (h) The charges proposed in the Initial Order;
 - (i) The Proposed Monitor's conclusions and recommendations.
4. Unless otherwise stated, all monetary amounts noted herein are expressed in Canadian dollars. Capitalized terms not otherwise defined herein are as defined in the Company's application materials, including the affidavit of George Koulakian sworn May 28, 2014 (the "**Koulakian Affidavit**") filed in support of the Company's application for relief under the CCAA.
5. The information contained in this report is based on unaudited financial information as well as discussions with representatives of the Company. The Proposed Monitor has not conducted an audit or other verification of such information and, accordingly, no opinion is expressed regarding the accuracy, reliability or completeness of the information contained herein. Future oriented financial information reported or relied on in preparing this report is based on management's assumptions regarding future events; actual results may vary from forecast and such variations may be material.

Richter's Qualifications to Act as Monitor

6. Richter was previously engaged by the Company on December 30, 2013 to provide consulting services and assist the Company in developing and assessing various strategic alternatives which included seeking potential additional financing, equity investment and going concern sale opportunities.
7. Richter is a trustee within the meaning of subsection 2(1) of the *Bankruptcy and Insolvency Act* (Canada). The senior Richter professional personnel with carriage of this matter have acquired knowledge of the Applicant and its business since the commencement of Richter's engagement as consultant. Richter is, therefore, in a position to immediately assist the Company in its CCAA proceedings.
8. Richter 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 and, in particular, neither Richter nor any of its representatives has been at any time in the two preceding years;
- (a) A director, an officer or an employee of the Company;
 - (b) Related to the Company or to any director or officer of the Company; or
 - (c) The auditor of the Company.
9. Richter has consented to act as Monitor, should the Court grant the Applicant's request to commence the CCAA proceedings.

General Background to the Proposed CCAA Proceedings

10. As described in the Koulakian affidavit, the Company manufactures medium-to-large, highly complex gas turbine engine components and sub-assemblies used in the energy, aerospace, marine and defence sectors.
11. The Company's key client base includes Rolls-Royce Canada Ltd. ("**Rolls-Royce**"), Siemens Power Generation, Pratt & Whitney Canada, General Electric, Unison Engine Components, AECL and Husky.
12. The Company's business, affairs, financial performance and position, as well as the causes of its insolvency, are detailed extensively in the Koulakian Affidavit and are, therefore, not repeated herein. The Proposed Monitor has reviewed the Koulakian Affidavit and discussed the business and affairs of the Applicant and the causes of insolvency with senior management personnel of the Company and is of the view that the Koulakian Affidavit provides a fair summary thereof.

Objectives of CCAA Proceedings

13. As noted in the Koulakian Affidavit, the Company, with the assistance of Richter, has undertaken a comprehensive sales process that confirmed several parties' interest in the Company, but has failed to generate final offers.
14. According to the Koulakian Affidavit, the primary purpose of the CCAA proceedings is to allow the Company the opportunity to implement an orderly wind-down of its operations, including ongoing production activities for a period of time to, among other things, permit key customers the opportunity to source alternate supply in the context of a formal proceeding, which would include a stay of proceedings and assistance from a Court-appointed Monitor.
15. It is the Company's expectation that an orderly wind-down will maximize value for all stakeholders by enhancing recoveries from accounts receivable, avoiding set-off claims, optimizing realizations from work-in-process, providing transition employment and retention pay to a significant number of the Company's employees, preventing a costly supply disruption to the Company's direct and indirect customers, and providing for additional discussions and negotiations with interested parties with a view to achieving the highest realizations from the Company's assets.

Applicant's Cash Flow Statement

16. The detailed Cash Flow Statement is attached as **Appendix "A"** to this report and is summarized below:

KK Precision Inc. Cash Flow Forecast From 05/10/2014 to 09/19/2014 (\$000's)	
Cash Receipts	
Operating Cash Receipts	\$ 6,864
Other	412
Total Cash Receipts	\$ 7,276
Cash Disbursements	
Operating Expenses	(875)
Payroll & Benefits	(1,205)
Retention Payments	(412)
Rent & Property Taxes	(223)
Utilities & Insurance	(136)
Sales Tax Remittances	(583)
Professional Fees	(485)
Other	(445)
Total Disbursements	\$ (4,363)
Net Cash Flow	\$ 2,913

17. The Cash Flow Statement estimates that during the period of the projection, the Company will have total receipts of approximately \$7,276,000 and total disbursements of approximately \$4,363,000.
18. The Cash Flow Statement projects that, subject to the Accommodation Agreement being approved by this Court (discussed further below), the Company will have sufficient liquidity to continue operations and to pay professional fees as set out during the period of the forecast.
19. The Proposed Monitor has reviewed the Cash Flow Statement to the standard required of a Court-appointed Monitor by section 23(1)(b) of the CCAA. Section 23(1)(b) requires a Monitor to review the debtor's cash flow statement as to its reasonableness and to file a report with the Court on the Monitor's findings. The Canadian Association of Insolvency and Restructuring Professionals' standards of professional practice include a standard for monitors fulfilling their statutory responsibilities under the CCAA in respect of a monitor's report on Cash Flow Statement.

20. Pursuant to this standard, the Proposed Monitor's review of the Cash Flow Statement consisted of inquiries, analytical procedures and discussion related to information supplied to it by certain key members of management and employees of the Company. Since the probable and hypothetical assumptions need not be supported, the Proposed Monitor's procedures with respect to them were limited to evaluating whether they were consistent with the purpose of the Cash Flow Statement. The Proposed Monitor also reviewed the support provided by the Company for the probable and hypothetical assumptions and the preparation and presentation of the Cash Flow Statement.
21. Based on the Proposed Monitor's review, nothing has come to its attention that causes it to believe, in all material respects, that:
 - (a) The probable and hypothetical assumptions are not consistent with the purpose of the Cash Flow Statement;
 - (b) As at the date of this report, the probable and hypothetical assumptions are not suitably supported and consistent with the plans of the Applicant or do not provide a reasonable basis for the Cash Flow Statement, given the probable and hypothetical assumptions; or
 - (c) The Cash Flow Statement does not reflect the probable and hypothetical assumptions.
22. Since the Cash Flow Statement is based on assumptions regarding future events, actual results will vary from the information presented even if the probable and hypothetical assumptions occur, and the variation could be material. Accordingly, the Proposed Monitor expresses no assurance as to whether the Cash Flow Statement will be achieved. In addition, the Proposed Monitor expresses no opinion or other form of assurance with respect to the accuracy of the financial information presented in the Cash Flow Statement, or relied upon by the Proposed Monitor in preparing this report.
23. The Cash Flow Statement has been prepared solely for the purpose described above, and readers are cautioned that it may not be appropriate for other purposes.

The Accommodation Agreement

24. The Company's major customer is Rolls-Royce. The Company, with the assistance of Richter, has been negotiating extensively with Rolls-Royce over the terms of an Accommodation Agreement that would ensure continued production of component parts for Rolls-Royce during the CCAA proceedings and provide Rolls-Royce the time necessary to transition the supply of component parts sourced from the Company to alternate suppliers. On May 26, 2014, the terms of the Accommodation Agreement were settled.
25. Certain of the key business issues addressed by the Accommodation Agreement are summarized below:
- (a) Confirmation of the amount of accounts receivable owed by Rolls-Royce to the Company;
 - (b) Expedited payment for amounts owed by Rolls-Royce to the Company;
 - (c) Confirmation that the Company will continue to produce and ship component parts to Rolls-Royce during the period of the Accommodation Agreement;
 - (d) Funding of the KERP by Rolls Royce; and
 - (e) The Lenders forbearance, for the duration of the Accommodation Agreement, from enforcing their rights and remedies.
26. In the Proposed Monitor's view, the Accommodation Agreement provides an effective mechanism to stabilize the Company's operations and provide the funding necessary to ensure continued production during the period of the Accommodation Agreement to maximize value for all stakeholders. Accordingly, the Proposed Monitor is supportive of the Company's application for approval of the Accommodation Agreement.
27. A copy of the Accommodation Agreement, without Schedules "A" to "H" (the "**Agreement Schedules**"), is attached as Exhibit "K" to the Koulakian Affidavit. As the Agreement Schedules include certain sensitive commercial and competitive information, the Applicant has requested that this information be filed with the Court on a sealed and confidential basis. In the circumstances, the Proposed Monitor believes it is appropriate for the Agreement Schedules to be filed with the Court on a confidential basis and sealed until further Order of this Court.

Appointment of the Advisor

28. The Company engaged MVM and Wheldon as Advisor on May 23, 2014 to provide strategic advice and services throughout the Company's CCAA proceedings.
29. Wheldon is the former President and CEO of the Company. Subsequent to Wheldon leaving the Company in late 2012, he was retained by the Company to provide advice and guidance, as the Company faced increasing financial pressures.
30. The Proposed Monitor understands that Wheldon currently oversees the Company's financial and operational affairs and has provided the Company with substantial assistance and guidance in the period leading up to the Company's application for relief pursuant to the CCAA.
31. Wheldon's knowledge of the business should facilitate the Company's restructuring activities throughout the CCAA proceedings. It should also assist to reduce the fees and costs of certain of the professionals, which is a primary consideration in these proceedings, given the size of the business, notwithstanding the substantial complexity.
32. A copy of the Advisory Services Agreement between the Company, MVM and Wheldon (the "**Advisory Agreement**") is attached as Exhibit "L" to the Koulakian Affidavit. The Advisory Agreement provides for compensation to be paid by the Company to the Advisor in the amount of \$12,000 bi-weekly plus a success fee based on realizations from the Company's assets. Based on the Proposed Monitor's experience, the bi-weekly fee appears reasonable in the circumstances. The Proposed Monitor also believes that absent the retention of the Advisor, professional fees would increase by at least the bi-weekly fee payable to the Advisor.
33. For the foregoing reasons, the Proposed Monitor is the view that the Advisory Agreement and the retention of the Advisor are appropriate in the circumstances.

Key Employee Retention Plan

34. To ensure retention of key personnel during the CCAA proceedings (the "**KERP Employees**"), the Company, in consultation with both Rolls-Royce and the Proposed Monitor, has formulated and is seeking the Court's approval of a KERP.

35. The Company has advised the Proposed Monitor that the KERP Employees are critical to the ongoing operation, care and maintenance of the Company's business operations. The Proposed Monitor has been further advised by the Company that the KERP Employees have intimate knowledge of the production equipment, processes and information systems at the Company and are essential to the Company producing the required component parts for Rolls-Royce and other customers during the Company's CCAA proceedings. The Company further believes that additional incentives are required to ensure the KERP Employees continue their employment with the Company during the Applicant's CCAA proceedings.
36. The KERP provides for retention payments to be paid to each of the KERP Employees at specific dates during the term of the Accommodation Agreement. Retention payments will only be made to KERP Employees so long as each eligible participant remains employed by the Company on the date retention payments are due to be paid.
37. A confidential schedule detailing the KERP Employees and their respective retention payments has been provided to the Court as Schedule "C" of the Agreements Schedules.
38. The Proposed Monitor is of the view that the KERP appears appropriate and reasonable in the circumstances. Accordingly, the Proposed Monitor is supportive of the Company's application for approval of the KERP.

Court Ordered Charges

39. The proposed Initial Order provides for an Administration Charge (as defined below) and a D&O Charge (as defined below):
 - (a) **Administration Charge**
40. The proposed Initial Order provides for a first-ranking charge in the maximum amount of \$250,000 charging the assets of the Applicant to secure the fees and disbursements incurred in connection with services rendered to the Applicant both before and after the commencement of the CCAA proceedings by the following entities: the Monitor, the Monitor's legal counsel and legal counsel to the Company (the "**Administration Charge**").

41. The quantum of the Administration Charge sought by the Company was determined in consultation with the Proposed Monitor. The creation of the Administration Charge is typical in CCAA proceedings as is the proposed priority of the Administration Charge as set out in the form of Initial Order filed with the Court.

(b) D&O Charge

42. The proposed Initial Order provides for a charge against the assets of the Applicant in favour of the Applicant's directors and officers in the maximum amount of \$100,000 (the "D&O Charge") for liabilities incurred by the Company that may result in post-filing claims against the directors and officers in their personal capacities.

43. The amount of the D&O Charge was estimated by the Company, taking into consideration hourly and salaried payroll costs, unremitted source deductions, other employment related liabilities that attract liability for directors and officers, vacation pay and sales tax.

44. The Proposed Monitor has been advised that due to the potential for personal liability, the sole remaining director of the Company is unwilling to continue his services and involvement in the Company's CCAA proceedings without the protection of the D&O Charge. As the Company will require the participation and experience of the Company's sole remaining director to successfully wind-down the Company's operations, the Proposed Monitor believes that the D&O Charge is required and reasonable in the circumstances.

45. It is contemplated that the D&O Charge will be subordinate to the Administration Charge as set out in the proposed Initial Order.

Proposed Monitor's Conclusions and Recommendations

46. As a result of the Company's deteriorated financial condition and liquidity issues, it is unable to continue operations in the near term absent (i) a stay of proceedings, and (ii) increased liquidity to be provided as per the terms of the Accommodation Agreement.

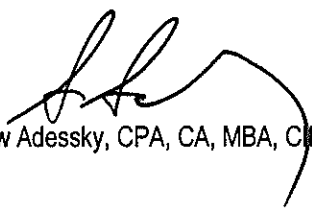
47. If the Company is provided with a reasonable period of protection, its plan is to implement a managed wind-down of its operations to maximize value for its stakeholders.

48. Based on the foregoing, the Proposed Monitor respectfully recommends that this Honourable Court grant the relief sought by the Company in accordance with the Initial Order presented by the Applicant.

All of which is respectfully submitted this 29th day of May, 2014.

Richter Advisory Group Inc.
in its capacity as Proposed Monitor of
KK Precision Inc.

Per:


Andrew Adessky, CPA, CA, MBA, CFP

Appendix “A”

KK Precision Inc.

Cash Flow Forecast
From 05/10/2014 to 09/19/2014
(\$5000)

Prepared: Weekly Cash Flow - Enclosed: Sales of Final and Intermediate Assets

	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	TOTAL	
	15-May	23-May	30-May	06-Jun	13-Jun	20-Jun	27-Jun	04-Jul	11-Jul	18-Jul	25-Jul	01-Aug	08-Aug	15-Aug	22-Aug	29-Aug	05-Sep	12-Sep	19-Sep		
Cash Receipts																					
Operating Cash Receipts	\$ -	\$ -	\$ 1,622	\$ 491	\$ 363	\$ 343	\$ 504	\$ 512	\$ 595	\$ 554	\$ 519	\$ 507	\$ 270	\$ 234	\$ 232	\$ -	\$ -	\$ -	\$ -	\$ 120	\$ 6,884
Other	-	-	4	14	4	4	4	55	4	4	4	4	4	4	4	-	-	-	-	261	412
Total Cash Receipts	\$ -	\$ -	\$ 1,626	\$ 505	\$ 367	\$ 347	\$ 508	\$ 607	\$ 599	\$ 558	\$ 523	\$ 511	\$ 274	\$ 238	\$ 232	\$ -	\$ -	\$ -	\$ -	\$ 381	\$ 7,276
Cash Disbursements																					
Operating Expenses	(122)	-	(65)	(65)	(65)	(65)	(65)	(65)	(65)	(65)	(65)	(65)	(65)	(65)	(65)	(10)	(10)	(10)	(5)	(5)	(875)
Payroll & Benefits	-	-	(167)	-	(131)	-	(101)	-	(131)	-	(131)	-	(131)	-	(131)	-	-	-	-	(8)	(1,265)
Retention Payments	-	(223)	(4)	(4)	(4)	(4)	-	(59)	(4)	(4)	-	-	-	-	-	-	-	-	-	-	(412)
Rent & Property Taxes	-	-	(17)	(2)	(2)	-	-	(34)	-	-	-	(22)	-	-	-	(22)	-	-	-	-	(223)
Utilities & Insurance	-	-	(60)	(40)	(50)	(30)	(45)	(72)	(25)	(30)	(35)	(33)	(15)	(9)	(23)	(20)	(20)	-	-	(20)	(135)
Sales Tax Reimbursements	-	-	(18)	(18)	(18)	(18)	(18)	(18)	(18)	(18)	(18)	(18)	(18)	(18)	(18)	(18)	(18)	(18)	(18)	(18)	(983)
Professional Fees	(50)	(20)	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	(445)
Total Disbursements	\$ (172)	\$ (250)	\$ (318)	\$ (157)	\$ (268)	\$ (156)	\$ (253)	\$ (283)	\$ (243)	\$ (282)	\$ (253)	\$ (162)	\$ (233)	\$ (242)	\$ (309)	\$ (49)	\$ (49)	\$ (41)	\$ (23)	\$ (189)	\$ (4,363)
Net Cash Flow	\$ (172)	\$ (250)	\$ 1,310	\$ 348	\$ 99	\$ 191	\$ 245	\$ 324	\$ 356	\$ 286	\$ 270	\$ 350	\$ 42	\$ 143	\$ 309	\$ (49)	\$ (49)	\$ (41)	\$ (23)	\$ (69)	\$ 2,913

- Notes:**
1. Primary compiled of collections of existing A/R, completion of existing WIP and additional customer production needs based on management's estimates. Sales tax (PST) collections and remittances have been included in the forecast based on when the products are completed/delivered, with remittances being made on the 20th for the following month.
 2. Represents funding for retention payments to employees funded pursuant to the Accommodation Agreement.
 3. Represents management's estimate for material and subcontractor costs to be incurred to complete the WIP and customer production needs.
 4. Composed of wages and benefits.
 5. Represents retention payments to employees.
 6. Includes option payment of the motors rent and property taxes and security deposit.
 7. Primary compiled of contingencies based on management's estimate.