

Province of QUEBEC
District of Montréal

N° Division : 01 – Montréal
N° Cour : 500-11-036722-094

SUPERIOR COURT
« Commercial Division »

Sitting as Tribunal designated under the *Companies' Creditors Arrangement Act* R.S.C. 1985, c. C-36)

IN THE MATTER OF THE PLAN OF ARRANGEMENT
OF:

BLUE NOTE MINING INC., a legal person duly constituted under the *Canada Business Corporations Act* having its head office at 1 Place Ville Marie, Suite 1511, in the city of Montréal, province of Québec H3B 2C6

PETITIONER

- and -

PRICEWATERHOUSECOOPERS INC.

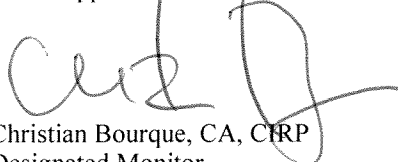
MONITOR

**REPORT OF THE DESIGNATED MONITOR ON THE STATE OF PETITIONER'S FINANCIAL AFFAIRS AND ON THE PLAN OF ARRANGEMENT
Section 9, 10, and 11 of the *Companies' Creditors Arrangement Act* ("CCAA")**

PRICEWATERHOUSECOOPERS INC., (Christian Bourque, CA, CIRP, Designated Monitor), acting in its capacity as Court Appointed Monitor, is reporting to the creditors on the state of the Petitioner's financial affairs and on the plan of arrangement of Blue Note Mining Inc.

Dated at Montreal, this 23rd day of June, 2009.

PRICEWATERHOUSECOOPERS INC.
Court Appointed Monitor



Christian Bourque, CA, CIRP
Designated Monitor

1. Introduction

- 1.1 On June 12, 2009, Blue Note Mining Inc. (“Blue Note” or the “Company”) filed with the Superior Court a Motion to obtain an initial order under Section 11 of the CCAA.
- 1.2 On June 12, 2009, Ms. Justice Christiane Alary issued an Order naming PricewaterhouseCoopers Inc. (“PwC”) as monitor. This Order expires on July 12, 2009.

2. Company Background

- 2.1 Blue Note is an exploration company. The business of the Company is to operate mines and mineral processing facilities through the acquisition, exploration and development of exploration properties or the acquisition of existing mining operations. The minerals being targeted by the Company are zinc, lead, copper, nickel, gold and silver.
- 2.2 In August 2006, Blue Note acquired the Caribou and Restigouche mines (collectively, the “Mines”) from Canzinc Ltd., a wholly-owned subsidiary of Breakwater Resources Ltd. Blue Note also holds a 100% interest in more than 25 other properties which are currently at the exploration stage.
- 2.3 On June 29, 2007, Blue Note transferred the Mines to its wholly-owned subsidiary, Blue Note Caribou Mines Inc. (“BNC”) on a rollover basis pursuant to a transfer agreement dated June 12, 2007. Commencing January 1, 2008, the Caribou Mines properties began commercial operations.
- 2.4 Following significant decrease in zinc prices, Blue Note announced on October 17, 2008 that it initiated a temporary care and maintenance program at its Caribou and Restigouche zinc and lead mines.
- 2.5 On December 10, 2008, Blue Note reported discovery of gold occurrence on its Williams Brook property located close to its Caribou Mine near Bathurst, New Brunswick. Blue Note expects to pursue exploration on this property in the future.
- 2.6 On February 20, 2009, BNC obtained an order from the New Brunswick Court of Queen's Bench giving them creditor protection under the Companies' Creditors Arrangement Act (CCAA). The order has been extended twice, the latest on May 21st, 2009 for an additional six months expiring on November 21, 2009. BNC, through PricewaterhouseCoopers Inc. acting as monitor, has been soliciting potential acquirers for BNC's mining assets.
- 2.7 On March 31, 2009, Blue Note defaulted on its interest payment on its unsecured Senior Notes. It has then engaged negotiations with note holders in order to reach a settlement in cash and equity.
- 2.8 On June 12, 2009, Blue Note obtained an Order from the Superior Court granting it protection under the CCAA from its creditors.

3. Financial summary

3.1 Results

The Company's audited consolidated financial results for the last four fiscal years (ending December 31) were as follow:

	2008 k\$	2007 k\$	2006 k\$	2005 k\$
Revenues	60,921	-	-	-
Direct operating expenses	76,034	-	-	-
Gross profit	<u>(15,113)</u>	<u>-</u>	<u>-</u>	<u>-</u>
Corporate general and administration	10,432	8,138	6,310	386
Exploration	2,426	-	-	-
Government incentives	(595)	-	-	-
	<u>12,263</u>	<u>8,138</u>	<u>6,310</u>	<u>386</u>
EBITDA	<u>(27,376)</u>	<u>(8,138)</u>	<u>(6,310)</u>	<u>(386)</u>
Depletion and depreciation	23,382	127	24	-
Foreign exchange loss	675	-	-	-
Interests and financial charges	4,319	1,830	32	5
Accretion expense	7,255	3,111	687	-
Investment and other income	(1,411)	(1,059)	(1,539)	(2)
Revaluation of long-term debt	(2,406)	-	-	-
Impairment loss	112,918	-	-	-
Loss on exercise of convertible debentures	14,949	-	-	-
Loss on disposal of long-lived assets	1,017	3	-	3
Change in fair value of embedded derivatives	(182)	57	-	-
	<u>160,516</u>	<u>4,069</u>	<u>(796)</u>	<u>6</u>
Loss before income taxes and non-controlling interest	(187,892)	(12,207)	(5,514)	(392)
Future income taxes recovered	673	424	-	-
Non-controlling interest	25,391	-	-	-
Net loss	<u>(161,828)</u>	<u>(11,783)</u>	<u>(5,514)</u>	<u>(392)</u>

- The revenues in 2008 were insufficient to generate a profit and a positive EBITDA due to a sharp decrease in the price of zinc ore. Price of zinc per pound fell from \$0.95 in June 2008 to \$0.48 in October 2008. The breakeven point is estimated at \$0.98.
- The Company never generated a positive EBITDA.
- The losses have been growing every fiscal year.
- Following the closure of the Caribou mine, Blue Note has no source of revenues and cannot support its current debt load.

3.2 Non-consolidated balance sheet

	31-May-09 Estimated k\$
ASSETS	
Current assets	
Cash and cash equivalents	3,002
Sales taxes receivable	207
Sundry receivable	321
Prepaid expenses	<u>462</u>
	3,992
Asset held for sale	1,000
Mining properties and deferred exploration costs	5,096
Property and equipment	<u>201</u>
	<u>10,289</u>
LIABILITIES	
Current liabilities	
Credit facility	15,000
Accounts payable and accrued liabilities	1,967
Current portion of long-term debt	<u>1,600</u>
	18,567
Long-term debt	<u>25,000</u>
	<u>43,567</u>
SHAREHOLDERS' EQUITY	
Share capital	111,135
Warrants	2,441
Contributed surplus	16,014
Deficit	<u>(162,868)</u>
	<u>(33,278)</u>
	<u>10,289</u>
Current ratio	0.22
Working capital	(14,575)

- There has been no equity contribution over the past fiscal year. The operating losses were financed with the cash on hand. As a result, the cash position of the Company has significantly declined over the last fiscal year.
- The Company does not have the working capital necessary to meet its short-term obligations. As at May 31st, 2009, the Company had a negative working capital of \$14,575K.
- The Company accumulated losses totalling \$162,868K since its inception.

Assets

- **Sundry receivable:** SRED tax credits (\$293K), other (\$28K). The SRED tax credits are for 2006 and have not been assessed yet.
- **Prepaid expenses:** Rent for the next nine months (\$206K), insurance (\$58K), fees (\$173K), others (\$25K).
- **Asset held for resale:** Components of a used SAG mill located in Bathurst and Val D'Or. The asset has been written down at its estimated fair market value under current economic conditions.
- **Mining properties and deferred exploration costs:** Costs of acquiring properties for exploration of mineral resources and costs related to the exploration of existing projects net of government grants received.
- **Property and equipment:** Depreciated book value of leasehold improvements, office furniture and equipment, and computer equipment.

Liabilities

- **Credit facilities:** Amount due to the New Brunswick Government for repayment of the credit facilities of Scotia Bank as guarantor. The credit facilities of Scotia Bank were also guaranteed by Blue Note.
- **Accounts payable and accrued liabilities:** Include an amount of \$1,860K, due to three employees which are also members of the Board. Under their contractual arrangements, they were entitled to three years of salaries in case of a change of control of the Board. Following a change of control in 2008, the amount was accrued.
- **Current portion of long-term debt:** Interest payable on the long-term debt (\$1,375K) and financing fees on the credit facilities (\$225K).
- **Long-term debt:** Secured Senior Notes in the principal amount of \$25M with a coupon rate of 11% payable on a semi-annual basis on March 31 and September 30 of each year. The notes are secured by a first lien on all the assets of the subsidiary, Blue Note Caribou Mines Inc. The net recovery value of these assets is estimated between \$3M and \$4M.

3.3 Considering the following:

- decreasing cash on hand;
- the Company has no source of cash inflows;
- the debt load of the Company;
- the incapacity of the Company to raise equity to pursue its exploration work under the current conditions.

The Company has decided to make a proposal to its creditors under the CCAA.

4. Blue Note's current operation

- 4.1 Blue Note is pursuing its operations. The Company still has eight employees at its Montreal office.
- 4.2 The Company expects to raise \$2M from flow through shares for exploration work at Williams Brook gold property.

5. Monitor's actions

- 5.1 The Monitor has helped Blue Note in the preparation of financial information and settlement scenario for the settlement of its debt, in particular the notes due.
- 5.2 The Monitor has assisted Blue Note in negotiation with note holders. Following those negotiations, an agreement was reached with a majority of note holders, namely RBC, ABC, Trapeze, Bruce Mitchell and BMO. All together they represent 91% of the notes and 50% of all liabilities subject to plan. In addition, Employees, TD and Octagon Capital also gave their support to the proposed settlement. In summary, creditors representing 28.4M or 59% of all liabilities subject to the Plan have confirmed their support.
- 5.3 The Monitor has assisted Blue Note in the preparation of its cash flow projection.
- 5.4 The Monitor has prepared all documents supporting the claim bar process.

6. Plan of Arrangement

- 6.1 The Company has presented its Plan of Arrangement to the most important note holders. The purpose of the Plan of Arrangement is to effect a compromise and arrangement between Blue Note and its creditors with respect to all the debts and obligations of the Company.
- 6.2 The Plan of Arrangement involves the settlement of the Company's obligations through a cash and shares compensation arrangement. The summary of the plan is as follows:
 - a) Such number of Common Shares that represent, immediately following the Effective Date, 75% of the Post-Plan Common Shares;
 - b) \$1,500,000, payable on the Effective Date; and
 - c) \$1,000,000, payable within one year of the Effective Date (the "Outstanding Balance"), which shall bear interest at the rate of 10% per year. Until the Outstanding Balance is fully paid, Blue Note shall pay to the Creditors, immediately upon receipt, on account of the Outstanding Balance, the following:
 - i. Any monies received from the sale of any assets owned at the Effective Date (including the SAG Mill);
 - ii. Any tax refunds received from any tax authority; and
 - iii. Any amounts received by Blue Note as repayment of the credit facility extended to Blue Note Caribou Mines Inc. under the initial order dated February 20, 2009, made in the CCAA proceedings relating to that initial order.

The distribution table is included as Appendix A.

- 6.3 The share portion will be through issuance of common shares representing 75% of all outstanding shares on a pro forma basis. This settlement represents 36,326,932 shares.

7. Conclusion and recommendations

- 7.1 The Monitor concludes and recommends that the Company's Plan of Arrangement be accepted by Blue Note's creditors for the following reasons:

- 7.1.1 The total consideration offered to the creditors in accordance with the proposed plan of arrangement (\$5.2M) exceeds the amount the creditors would obtain under a forced liquidation of the Company's assets (\$3.8M). In addition, shares consideration could increase in value with time.
- 7.1.2 The note holders, creditors and the employees, who represent 59% of the total claims, already gave their support to this Plan of Arrangement.
- 7.1.3 With a restructured balance sheet, Blue Note will be able to raise financing to pursue its exploration projects and create potential value for its creditors as majority shareholders.

8. Procedure to vote on the Plan of Arrangement

You will find under cover a proof of claim form and a voting letter form. All creditors must fill this proof of claim form and attach a statement of account or invoice. Creditors that cannot or do not expect to attend the meeting of creditors on July 17th, 2009 at 2PM EST can vote, for or against the Plan of Arrangement, by filling and returning the above-mentioned voting letter form. We wish to remind the creditors that in order to vote on the Plan of Arrangement, their proof of claim must be received by the Court Appointed Monitor before July 10th 2009 at 5PM EST. To be accepted, the Plan of Arrangement must be approved by the absolute majority of the creditors and 2/3 of the value of all amounts due to the creditors that vote in person or by proxy at the meeting of creditors, by fax at (514) 205-5694 or by e-mail at julie.roberge@ca.pwc.com.

APPENDIX A

**BLUE NOTES MINING
SETTLEMENT OFFER**

	Notes payable										Other							Total
	RBC*	Trapeze	ABC	Bruce Mitchell	Silvercreek	BMO	Blackmont	Chunkerhead	Employees	Subtotal	Government of New Brunswick	Atlas Copco	TD and Octogone Capital	Employees	New Brunswick Provincial holding	Osler, Hoskin & Harcourt LLP	Monitor in trust for the benefit of RBC*	
Unsecured claim (incl. accrued interests)	\$ 12,365,655	\$ 4,747,500	\$ 3,165,000	\$ 2,637,500	\$ 2,110,000	\$ 1,055,000	\$ 105,500	\$ 52,750	\$ 136,095	\$ 26,375,000	\$ 15,000,000	\$ 520,000	\$ 2,400,000	\$ 1,860,000	\$ 225,000	\$ 19,960	\$ -	\$ 46,399,960
	<u>26.7%</u>	<u>10.2%</u>	<u>6.8%</u>	<u>5.7%</u>	<u>4.5%</u>	<u>2.3%</u>	<u>0.2%</u>	<u>0.1%</u>	<u>0.3%</u>	<u>56.8%</u>	<u>32.3%</u>	<u>1.1%</u>	<u>5.2%</u>	<u>4.0%</u>	<u>0.5%</u>	<u>0.0%</u>	<u>0.0%</u>	<u>100.0%</u>
Cash payment	\$ 666,254	\$ 255,792	\$ 170,528	\$ 142,107	\$ 113,685	\$ 56,843	\$ 5,684	\$ 2,842	\$ 7,333	\$ 1,421,068	\$ 808,190	\$ 28,017	\$ 129,310	\$ 100,216	\$ 12,123	\$ 1,075	\$ -	\$ 2,500,000
Share issued	4,716,924	3,716,859	2,477,906	2,064,922	1,651,937	825,969	82,597	41,298	106,550	15,684,962	11,743,630	407,113	1,878,981	1,456,210	176,154	15,627	4,964,255	36,326,932
% of market capitalization	9.7%	7.7%	5.1%	4.3%	3.4%	1.7%	0.2%	0.1%	0.2%	32.4%	24.2%	0.8%	3.9%	3.0%	0.4%	0.0%	10.2%	75.0%
Shares already owned	<u>126,667</u>																	
Total share owned	<u>4,843,590</u>																	
% of market capitalization	10.0%																	

*RBC has informed us that the % of ownership they have in a Company must be less than 10% of the total shares outstanding. Therefore, the shares will be put in trust for the benefit of RBC and sold by the monitor in an orderly fashion.