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DISTRICT OF QUEBEC
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COURT No.: 500-11-044810-139
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OFFICE No.: 084757-004

SUPERIOR COURT
"Commercial Division"

IN THE MATTER OF THE PROPOSAL OF:

MALAGA INC.

The Proposer

-and-

RAYMOND CHABOT INC.

Jean Gagnon, CPA, CA, CIRP
Trustee in Charge

Trustee

**REPORT OF THE TRUSTEE IN CHARGE ON THE STATEMENT OF THE
PROPOSER'S BUSINESS AND FINANCIAL AFFAIRS**
(Subsections 50(10) and 50(5) of the *Bankruptcy and Insolvency Act*)

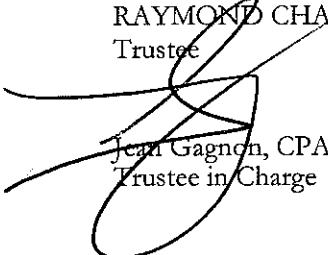
PREAMBLE

The *Bankruptcy and Insolvency Act* orders the Trustee to monitor the business and financial affairs of the Proposer, from the filing of the intention to file a Proposal until the Proposal is approved by the court. The Trustee is also required to make an appraisal and investigation of the affairs and property of the Proposer so as to enable the Trustee to estimate with reasonable accuracy the financial situation of the Proposer and the cause of the Proposer's financial difficulties and report the result thereof to the creditors.

Accordingly, please read this report which deals with the statement of the Proposer's business and financial affairs and summarizes the Proposal to the creditors.

Signed in Montreal on October 8, 2013.

RAYMOND CHABOT INC.
Trustee

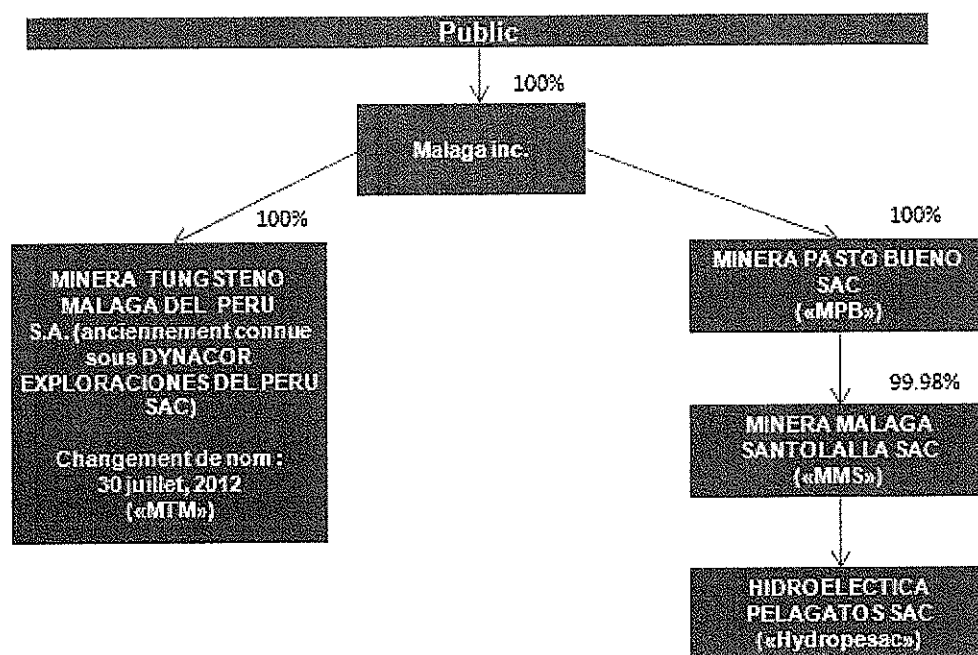

Jean Gagnon, CPA, CA, CIRP
Trustee in Charge

1. BACKGROUND AND CAUSES OF THE DIFFICULTIES

The Debtor, incorporated in November 1993, is a public corporation that owns subsidiaries operating the Pasto Bueno mine located in Peru (the "Mine"). Originally incorporated and doing business under the name "Mines Dynacor", the company changed its name in 2007 to Malaga Inc. ("Malaga"). Until recently, its shares were listed on the Toronto Stock Exchange ("TSX") as well as on the OTC Market Group ("OTCMG") in New York.

Its headquarters are located in Montréal, Quebec. The Board of Directors members are Jean Martineau, René Branchaud, Pierre Monet and Benoit Alain.

Its corporate structure is as follows:



- Minera Tungsteno Malaga del Peru SAC ("MTM"): Having previously operated under the name "Dynacor Exploraciones", this Peruvian company was active in the gold extraction sector until Malaga acquired it in 2005. Its company name was then changed, and in 2007 it started operating the tungsten mine.
- Minera Pasto Bueno SAC ("MPB"): This Peruvian company was incorporated in 2005 as part of the acquisition of Malaga Santolalla SAC. It is a management company that has no other assets than the Malaga Santolalla SAC shares.
- Minera Malaga Santolalla SAC ("MMS"): This Peruvian company was acquired in 2005 when it held the mining rights to the Mine as well as the rights to produce hydroelectricity in the same sector. The majority of assets were later transferred to MTM and Hidroelectrica Pelagatos SAC;
- Hidroelectrica Pelagatos SAC ("Hydrosac"): Incorporated in 2007, this Peruvian company operates a hydroelectric power plant that mainly serves the Mine.

The Mine was acquired in 2007 on the basis of certain production and profitability objectives. These objectives were not met, mainly because of a liquidity crisis. The Mine could not commence operations

without the construction of a tailings site at a cost initially evaluated at \$750,000. However, more than \$6M had to be invested over time because of numerous engineering problems. This resulted in depriving Malaga of the funds that would have otherwise been used in the exploration required to increase extraction volume.

At the beginning of 2012, management already foresaw a difficult year and a potential liquidity problem, so it began searching for new investors and/or purchasers for their subsidiaries.

Malaga encountered severe difficulties during this year ended as at December 31, 2012. Production was smaller and of lower grade, which resulted in a drop in volume while the sales price of tungsten was very low. Additionally, it had to face a major break in its electrical power line that caused a shutdown lasting several weeks. Consequently, this considerably affected the Mine's productivity and generated additional costs. Alternative solutions such as using generators proved too costly to be implemented in the short term. In order to pay for the repairs and replenish its cash resources, Malaga was forced to liquidate certain assets, such as tungsten and copper (by-product) inventories, in addition to selling a portion of its equity investments.

In September 2012, management made the decision to suspend mining operations and to maintain only those operations required to protect and safeguard the assets. Management then approached some 10 investors and/or potential purchasers, five of which had access to the data room and visited the Mine.

In December 2012, a letter of intent was received from a new investor who was to inject about \$5M into the Group. However, the investor later withdrew the offer.

Because the company was short of cash, management solicited purchase offers for Malaga and/or its Peruvian subsidiaries. Eight groups then had access to the data room, but at the end of the solicitation process, only a single letter of interest was submitted to management.

On June 6, 2013, since it was no longer able to meet its obligations as they became due, Malaga filed a notice of intention to file a Proposal to its creditors. The Court then granted it two deadline extensions to October 4, 2013. As management was laid off last June, the Chairman of the Board held discussions with the potential acquirer that had expressed interest in the subsidiary shares. The acquirer submitted a purchase offer for MTM and MPB shares, which was accepted by the Board on July 31, 2013 and approved by the Court on August 20, 2013. This transaction is described in more detail in Section 3 of this report.

On October 4, 2013, in accordance with the ruling, the Proposer subsequently filed a Proposal, summarized in Section 5 of this Report, with the Official Receiver.

2. FINANCIAL SITUATION

We have analyzed the financial statements for the years ended December 31, 2011 and 2012 as well as those of the three-month period ended March 31, 2013.

We have not carried out an audit or review engagement in relation to these financial statements and, consequently, we express no assurance on the latter.

The balance sheet is summarized as follows:

(In thousands of dollars, unaudited)	March 31, 2013	December 31, 2012	December 31, 2011
Assets			
Cash	-	523	146
Accounts receivable – Related corporations	175	167	468
Prepaid expenses	33	92	64
	208	782	678
Advances to subsidiaries	25,792	26,152	25,806
Advances to related corporations	108	108	108
Investments in subsidiaries	6,260	6,260	6,260
Investments in listed shares	1,341	1,358	2,050
Property, plant and equipment	9	29	34
	33,718	34,689	34,936
Liabilities			
Bank overdraft	5	-	-
Accounts payable and accrued liabilities	7,474	7,690	7,317
Deferred revenue	1,100	1,400	800
Note payable	-	-	972
Current portion of long-term debt	2,522	1,108	950
	11,101	10,198	10,039
Long-term debt	-	1,328	2,026
Deferred revenue	298	372	669
Warrant	-	-	18
	11,399	11,898	12,752
Shareholders' equity			
Share capital	39,239	39,239	39,239
Warrants	-	-	30
Contributed surplus	3,983	3,976	3,827
Other accumulated income	(17)	(1)	(1,583)
Deficit	(20,886)	(20,423)	(19,329)
	33,718	34,689	34,936

Our analysis revealed the following:

- As at March 31, 2013, Malaga invested more than \$32.3M in its subsidiaries.
- These subsidiaries are not in a financial position to reimburse the advances. The subsidiaries' acquirer does not intend to assume these debts.

- The Debtor's sole secured creditor is Global Tungsten & Powders Corporation ("GTP"), which is also Malaga's sole client. GTP has a moveable hypothec on shares held in Mine d'or Dynacor Inc. ("Dynaco") as well as on the Peruvian subsidiaries' assets. These guarantees were granted in connection with a supply contract and an advance made in 2009.
- Until very recently, Malaga owned shares in Dynacor, a public corporation, which was listed on the Toronto Stock Exchange. As at December 31, 2012, the debtor held just over one million shares after having sold 1.74 million shares in 2012 and approximately 775,000 shares in 2011. These share disposals generated losses of \$384,000 and \$18,000, respectively. They were sold with GTP's approval in the last few days. The proceeds of the sale, around \$1.4M, were remitted to GTP by virtue of the moveable hypothec on the shares.
- The total of the debtor's obligations towards GTP following the sale of the shares is currently around \$2.2M.

Earnings

Earnings are summarized as follows:

(In thousands of dollars, unaudited)	March 31, 2013 (3 months)	December 31, 2012 (12 months)	December 31, 2011 (12 months)
Sales	74	12,218	19,136
Cost sales	-	10,588	16,705
	74	1,630	2,431
Expenses			
Overhead	404	1,930	2,369
Financial expenses	129	440	510
Loss (gain) on exchange rate	4	(12)	172
Loss on disposal of Dynacor shares	-	384	18
Gain on warrant revaluation	-	(18)	(2,667)
	537	2,724	402
Profit (loss) before other income	(463)	(1,094)	2,029
Other income (net of taxes)			
Change in market value of the listed shares'	(17)	1,583	(1,583)
Net profit (loss)	(480)	489	446

Our analysis revealed the following:

- The agreement between MTM and Malaga states that Malaga must purchase MTM's entire tungsten production and resell it to GTP. Therefore, the cost sales essentially consists in purchases from MTM, with the sale price being established according to the same index as that on which the GTP supply contract is based, plus a profit of around 4%, which should allow Malaga to pay for its operating costs;
- Sales plummeted during 2012 because Mine operations were suspended and the overhead could not be reduced proportionately, even though management tightly controlled costs.

3. SALE OF MTM AND MPB SHARES AND IMPACT ON CREDITORS

On August 20, 2013, the Court approved the sale of MTM and MPB shares following Malaga's request for permission to sell goods outside the normal course of business. This sale must be completed with Domingo Salaverry or a related corporation ("Salaverry") over the next few weeks and provides the following consideration:

- a) US\$500,000 payable to the Debtor in two instalments, that is, a first instalment of US\$250,000 that was paid upon the signing of the purchase offer, and a second instalment of US\$250,000 instalment to be paid upon completion of the transaction;
- b) Assumption of the liabilities and obligations of MTM and MPB (excluding amounts due to Malaga Inc.);
- c) Assumption of the Debtor's obligations towards GTP, which amount to approximately \$2.2M as of today;
- d) Payment by GTP to Malaga of an amount equivalent to the realizable value of Dynacor's shares, that is, approximately, \$1.4M;
- e) Quarterly payment of a permanent royalty calculated on tungsten sales from the Pasto Bueno mine and exceeding the first 40,000 metric tons extracted;
- f) The other debts to Malaga will not be assumed by the acquirer.

The amounts provided for in c) payables to GTP and those in d) payables to Malaga will be paid in 18 equal instalments commencing 18 months after closing. These payments will be guaranteed by a hypothec on certain subsidiary assets. The amounts will bear interest at 8%.

Therefore, the total consideration amounts to at least \$10.2M without considering the royalties to be paid subsequently to the debtor.

Furthermore, Salaverry will also assume the tungsten supply contract with GTP.

4. PRIOR BUSINESS RELATIONSHIP WITH THE PROPOSER

Prior to the filing of this procedure, Raymond Chabot inc. did not provide any services to the Proposer, the nature of which would place Raymond Chabot inc. in a conflict of interest.

5. SUMMARY OF PROPOSAL

The Proposal is summarized below.

In the event of any discrepancy, the complete text shall prevail over this summary.

Amount offered

The Proposer offers to pay the following to the creditors as full payment of their claims:

- The proceeds of the sale of MTM and MPB shares, that is, US\$500,000, which will be paid to the trustee within 30 days following the Court's approval of the Proposal;
- Eighteen monthly payments of \$80,000 beginning 18 months following the Court's approval of the Proposal;
- The royalties received from Salaverry for a total maximum amount equal to unsecured claims.

Secured creditors

The Proposal provides that GTP will realize its guarantees to reduce its debt. Salaverry will assume the balance of its debt, and GTP will not take part in the distribution of amounts provided under the Proposal.

The value attributed to Trapèze Asset Management's security is null, and any claim from the latter will be considered as an unsecured claim.

Other claims

The amount offered will therefore serve to pay the following claims:

- Fees and disbursements of the Trustee in the Proposal;
- Crown Claims, which should be nil;
- Preferred claims, including those of employees, under Section 136(1)(2) of the Act;
- The full amount of unsecured claims.

6. CONDUCT OF THE PROPOSER

6.1 Accounting investigation

The study of undervalued transactions and preferred treatments did not reveal any contentious issues.

6.2 Statement of Projected Changes in Cash and Monitoring of Operations

Since the filing of the notice of intention, the Trustee exercised its power to monitor the Proposer's business and financial affairs in accordance with Subsection 50.4(7) of the *Bankruptcy and Insolvency Act* and obtained all the necessary cooperation.

The changes in cash for the period from June 6 to October 4, 2013 are summarized as follows:

(Unaudited)	Actual	Budget	Variance
Receipts	\$	\$	\$
Provincial tax refund	4,262	-	4,262
Sale of subsidiaries' shares	250,000	500,000	(250,000)
	255,184	500,000	(245,738)
Disbursements			
Professional fees	-	7,500	7,500
Restructuring fees	-	70,000	70,000
Legal fees	-	55,000	55,000
Miscellaneous	239	452	213
	239	132,952	132,713
Increase (decrease) in cash	254,945	367,048	(113,025)
Cash, beginning of year	7 036	7 036	-
Cash, end of year	261,981	374 084	(113,025)

The sale of MTM and MPB shares was approved by the Court on August 21, 2013. An amount of US\$250,000 as a first instalment of the purchase price was placed in trust with the Debtor's attorneys, and the second instalment of US\$250,000 will be received upon the completion of the transaction, which should take place in the next few weeks.

There has been as yet no disbursement for professional, restructuring and legal fees, which amount to around \$150,000 as of today and will be paid from the amount offered for distribution as part of the Proposal.

7. STATEMENT OF ESTIMATED DISTRIBUTION

According to the information in the Proposer's statement of affairs, the estimated dividend payable to unsecured creditors would be as follows:

	\$
Selling price of the shares of MTM & MPB	500
18 monthly payments of \$80,000	1,440
Royalties	<u>Undetermined</u>
	1,940
Less:	
Restructuring and legal fees	200
Preferred claims	<u>4</u>
Amount available for unsecured creditors	<u><u>1,736</u></u>
According to the Statement of affairs, unsecured claims amounted to	<u><u>1,204</u></u>
Estimated dividend	<u>100%</u>

In the event of Malaga's bankruptcy, the realizable value would probably be identical.

8. CONCLUSION AND RECOMMENDATIONS

Considering that:

- The Proposal provides for the complete reimbursement to creditors;
- The first instalment of US\$500,000 will be paid to the trustee promptly.

We consider that the Proposal is advantageous to all creditors and therefore recommend its acceptance.

9. INSTRUCTIONS FOR VOTING ON THE PROPOSAL

You will find enclosed a proof of claim and voting form. All creditors are required to complete the proof of claim and attach a statement of account or copy of their invoices. Creditors who are unable to attend or arrange representation for the meeting on October 25, 2013 at 10:00 a.m. may also complete and mail in the attached voting form, indicating whether they are voting for or against accepting the Proposal.

We remind creditors that to vote on the Proposal they must submit their proof of claim to the Trustee before the start of the meeting on October 25, 2013 at 10:00 a.m. To be accepted, the Proposal must be approved by a majority in number and a majority of two-thirds in value of the claims of each category of creditors who vote in person, by proxy, by fax at 514-878-2100 or by mail.