

# **KWG RESOURCES INC.**

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## **CONSOLIDATED FINANCIAL STATEMENTS**

DECEMBER 31, 2012 AND 2011

## **MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS**

All of the information in the accompanying financial statements of KWG Resources Inc. is the responsibility of management. The financial statements have been prepared by management in accordance with International Financial Reporting Standards. Where necessary, management had made judgments and estimates in preparing the financial statements and such statements have been prepared within acceptable limits of materiality.

Management maintains appropriate systems of internal control to give reasonable assurance that its assets are safeguarded and the financial records are properly maintained.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control and exercises this responsibility principally through the Audit Committee. The Audit Committee, which is comprised of Directors, none of whom are employees or officers of the Company, meets with management and the external auditors to review the auditor's report and the financial statements to satisfy itself that management is properly discharging its responsibilities to the Directors, who approve the financial statements.

A firm of independent Chartered Accountants, appointed by the shareholders, audits the financial statements in accordance with Canadian generally accepted auditing standards and provides an independent professional opinion thereon. The external auditors have free and full access to the Audit Committee with respect to their findings regarding the fairness of financial reporting and the adequacy of internal controls.

Frank C. Smeenk  
President & CEO

Thomas E. Masters  
Chief Financial Officer

April 17, 2013

## INDEPENDENT AUDITOR'S REPORT

To the Shareholders of KWG Resources Inc.

We have audited the accompanying consolidated financial statements of KWG Resources Inc. and its subsidiaries, which comprise the consolidated balance sheet as at December 31, 2012, and the consolidated statements of operations, consolidated statements of comprehensive income (loss), consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information.

### Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of KWG Resources Inc. and its subsidiaries as at December 31, 2012, and their financial performance and cash flows for the year then ended in accordance with International Financial Reporting Standards.

### Other Matters

The consolidated financial statements of KWG Resources Inc. for the year ended December 31, 2011, were audited by other auditors who expressed an unmodified opinion on those statements on April 30, 2012.

McGOVERN, HURLEY, CUNNINGHAM, LLP



Chartered Accountants  
Licensed Public Accountants

TORONTO, Canada  
April 17, 2013

**KWG RESOURCES INC.**  
**Consolidated Balance Sheets**

(in Canadian dollars)	Notes	As at December 31, 2012	As at December 31, 2011
<b>ASSETS</b>			
<b>Current assets</b>			
Cash and cash equivalents	6	11,066,004	16,030,551
Receivables	7	1,286,148	1,072,320
Marketable securities	8	571,040	3,074,298
Prepaid expenses		41,287	31,058
<b>Total current assets</b>		<b>12,964,479</b>	<b>20,208,227</b>
<b>Non-current assets</b>			
Property and equipment	9	82,698	65,837
Mineral property interests	10	31,117,244	28,442,269
<b>Total non-current assets</b>		<b>31,199,942</b>	<b>28,508,106</b>
<b>Total assets</b>		<b>44,164,421</b>	<b>48,716,333</b>
<b>LIABILITIES AND EQUITY</b>			
<b>Current liabilities</b>			
Trade and other payables	11	810,461	1,112,928
<b>Total current liabilities</b>		<b>810,461</b>	<b>1,112,928</b>
<b>Non-current liabilities</b>			
Warrant liability	12	3,205	1,096,584
<b>Total non-current liabilities</b>		<b>3,205</b>	<b>1,096,584</b>
<b>Equity attributable to the owners of the parent company</b>			
Share capital	14	22,991,304	21,308,113
Warrants	15	3,170,895	7,431,617
Contributed surplus		12,025,684	7,091,101
Accumulated other comprehensive income (loss)		(5,976)	283,674
Retained earnings		5,168,848	10,392,316
<b>Total equity</b>		<b>43,350,755</b>	<b>46,506,821</b>
<b>Total liabilities and equity</b>		<b>44,164,421</b>	<b>48,716,333</b>

**Nature of operations (Note 1)**

**Commitments (Note 22)**

**Subsequent events (Note 27)**

The accompanying notes form an integral part of these consolidated financial statements.

**Approved by the Board of Directors**

Douglas Flett  
 Director

Frank Smeenk  
 Director

**KWG RESOURCES INC.****Consolidated Statements of Operations and Statements of Comprehensive Income (Loss)  
For the years ended December 31, 2012 and 2011**

<b>(in Canadian dollars)</b>	<b>Notes</b>	<b>2012</b>	<b>2011</b>
General and administrative	17	(2,710,145)	(2,796,335)
Amortization of property and equipment	9	(34,622)	(30,151)
Stock-based compensation costs	16	(497,623)	(1,157,799)
Write-down of mineral property interests	10	(25,132)	(202,123)
Gain (loss) on foreign exchange		(968)	511,750
Gain on disposal of mineral property interests	10	-	14,259,115
<b>Profit (loss) before the undernoted</b>		<b>(3,268,490)</b>	<b>10,584,457</b>
<b>Other income (expenses)</b>			
Finance income (loss)	18	(1,616,462)	292,094
Other income		3,125	86,565
Gain (loss) on disposal/write down of marketable securities	8	(220,349)	153,000
Gain on revaluation of warrant liability	12	1,093,379	1,396,188
Write-down of receivables	21	(648,805)	-
		<b>(1,389,112)</b>	<b>1,927,847</b>
<b>Income (loss) from continuing operations</b>		<b>(4,657,602)</b>	<b>12,512,304</b>
<b>Loss from discontinued operations</b>	5	-	<b>(755,872)</b>
<b>Net income (loss) for the year</b>		<b>(4,657,602)</b>	<b>11,756,432</b>
Net loss attributable to non-controlling interest	13	-	250,243
<b>Net income (loss) attributable to equity holders of KWG Resources Inc.</b>		<b>(4,657,602)</b>	<b>12,006,675</b>
<b>Earnings (loss) per share (basic and diluted)</b>	20	<b>(0.01)</b>	<b>0.02</b>

**Consolidated Statements of Comprehensive income (loss)**

<b>(in Canadian dollars)</b>	<b>Notes</b>	<b>2012</b>	<b>2011</b>
Net income (loss) for the year		(4,657,602)	11,756,432
Other comprehensive Income ("OCI")			
Net change in fair value of available for sale assets	8	(289,650)	268,436
<b>Total comprehensive income (loss) for the year</b>		<b>(4,947,252)</b>	<b>12,024,868</b>
Portion attributable to non-controlling interest		-	250,243
<b>Total comprehensive income (loss) attributable to equity holders of KWG Resources Inc.</b>		<b>(4,947,252)</b>	<b>12,275,111</b>

The accompanying notes form an integral part of these consolidated financial statements.

**KWG RESOURCES INC.**  
**Consolidated Statements of Changes in Equity**  
**For the years ended December 31, 2012 and 2011**

(in Canadian dollars)	Notes	Share capital	Warrants	Contributed surplus	Retained earnings	Accumulated other comprehensive income (loss)	Non-controlling Interest	Total
<b>Balance, December 31, 2011</b>		<b>21,308,113</b>	<b>7,431,617</b>	<b>7,091,101</b>	<b>10,392,316</b>	<b>283,674</b>	-	<b>46,506,821</b>
Net loss for the year		-	-	-	(4,657,602)	-	-	(4,657,602)
Other comprehensive income for the year:								
Change in fair value	8	-	-	-	-	(181,750)	-	(181,750)
Transferred to net income upon realization	8	-	-	-	-	(107,900)	-	(107,900)
Private placements, net of share issuance costs	14	1,123,163	-	-	-	-	-	1,123,163
Issued for mineral property interests	8	194,162	176,238	-	-	-	-	370,400
Expired warrants	15	-	(4,436,960)	4,436,960	-	-	-	-
Stock based compensation	16	-	-	497,623	-	-	-	497,623
Normal course issuer bid	14	(200,000)	-	-	-	-	-	(200,000)
Deferred tax effect of previously-incurred share issue costs		565,866	-	-	(565,866)	-	-	-
<b>Balance, December 31, 2012</b>		<b>22,991,304</b>	<b>3,170,895</b>	<b>12,025,684</b>	<b>5,168,848</b>	<b>(5,976)</b>	-	<b>43,350,755</b>
<b>Balance, January 1, 2011</b>		<b>28,685,901</b>	<b>5,316,679</b>	<b>5,895,585</b>	<b>(8,735,274)</b>	<b>15,238</b>	<b>61,186</b>	<b>31,239,315</b>
Net loss for the year		-	-	-	12,006,675	-	(250,243)	11,756,432
Other comprehensive income for the year:								
Change in fair value	8	-	-	-	-	283,674	-	283,674
Transferred to net income upon realization	8	-	-	-	-	(15,238)	-	(15,238)
Private placements, net of share issuance costs	14	2,213,777	336,756	-	-	-	-	2,550,533
Settlement of liability	14	212,766	187,234	-	-	-	-	400,000
Issued for marketable securities	8	1,785,000	1,638,000	-	-	-	-	3,423,000
Exercise of warrants and stock options	14	39,335	(6,485)	(2,850)	-	-	-	30,000
Expired warrants	15	-	(40,567)	40,567	-	-	-	-
Stock based compensation	16	-	-	1,157,799	-	-	763,125	1,920,924
Normal course issuer bid	14	(500,000)	-	-	-	-	-	(500,000)
Non-controlling interest in Debut Diamonds Inc.	13	334,614	-	-	-	-	1,906,464	2,241,078
Distribution of Debut Diamonds Inc. shares	5	(11,463,280)	-	-	7,120,915	-	(2,480,532)	(6,822,897)
<b>Balance, December 31, 2011</b>		<b>21,308,113</b>	<b>7,431,617</b>	<b>7,091,101</b>	<b>10,392,316</b>	<b>283,674</b>	-	<b>46,506,821</b>

The accompanying notes form an integral part of these consolidated financial statements.

**KWG RESOURCES INC.**  
**Consolidated Statements of Cash Flows**  
**For the years ended December 31, 2012 and 2011**

<b>(in Canadian dollars)</b>	<b>Notes</b>	<b>2012</b>	<b>2011</b>
<b>Cash flows from operating activities</b>			
Net income (loss) for the year		(4,657,602)	11,756,433
Adjustments for			
Amortization of property and equipment	9	34,622	30,151
Stock based compensation costs	16	497,623	1,920,922
Write-down of mineral property interests	10	25,132	202,123
Write-down of receivables	21	648,805	-
Loss (gain) on disposal/write down of marketable securities	8	220,349	(153,000)
Fair value changes in marketable securities classified as fair value through profit and loss	8	2,016,748	65,117
Finance income excluding interest	18	(245,655)	(289,420)
Gain (loss) on revaluation of warrant liability	12	(1,093,379)	(1,396,188)
Gain on distribution of Debut Diamonds Inc.	5	-	(758,595)
Gain on disposal of mineral property interest	10	-	(14,259,115)
Net change in non-cash working capital balances		(142,279)	132,321
<b>Net cash used by operating activities</b>		<b>(2,695,636)</b>	<b>(2,749,251)</b>
<b>Cash flows from financing activities</b>			
Share capital issued	14	1,463,900	2,643,420
Warrants and compensation options issued	15	-	322,180
Share and warrant issue expenses		(98,354)	(118,497)
Shares repurchased through normal course issuer bid	14	(407,331)	(292,669)
<b>Net cash provided by financing activities</b>		<b>958,215</b>	<b>2,554,434</b>
<b>Cash flows from investing activities</b>			
Expenditures on exploration and evaluation projects	10	(2,556,672)	(4,313,972)
Proceeds from disposals of mineral property interests	10	-	16,759,117
Purchases of property and equipment	9	(51,483)	(47,756)
Purchase of marketable securities	8	(23,489)	(16,776)
Decrease (increase) in advances to related company	21	(595,482)	583,698
<b>Net cash used by investing activities</b>		<b>(3,227,126)</b>	<b>12,964,311</b>
<b>Net change in cash and cash equivalents during the year</b>		<b>(4,964,547)</b>	<b>12,769,494</b>
Cash and cash equivalents – beginning of the year		16,030,551	3,261,057
<b>Cash and cash equivalents – end of the year</b>		<b>11,066,004</b>	<b>16,030,551</b>
<b>Change in non-cash working capital balances comprises:</b>			
Receivables		(267,151)	(31,405)
Prepaid expenses		(10,229)	(2,979)
Trade and other payables		135,101	166,705
<b>Net change in non-cash working capital balances</b>		<b>(142,279)</b>	<b>132,231</b>
<b>Additional information - non-cash transactions</b>			
Issuance of shares/warrants for exploration and evaluation projects		372,000	-
Acquisition of marketable securities		-	2,838,965
Issuance of agent compensation options		-	35,250
Expired warrants included in contributed surplus		4,436,960	40,567
Additions to exploration and evaluation projects included in accounts payable		96,768	325,333

The accompanying notes form an integral part of these consolidated financial statements.

## **KWG RESOURCES INC.**

### **Notes to the Consolidated Financial Statements (in Canadian dollars)**

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#### **1 NATURE OF OPERATIONS**

##### **Nature of Operations**

KWG Resources Inc. (“KWG” or the “Company”) is an incorporated entity domiciled in Canada. The Company’s registered office is located at 600 de Maisonneuve Boulevard West, Suite 2750, Montreal, Quebec, H3A 3J2. KWG is involved in the exploration and evaluation of base and precious metals and in the development of a transportation link to access the remote areas where these are located. It has interests in properties located in Canada. It was incorporated on August 21, 1937.

The Company is listed on the TSX Venture Exchange and on the Canadian National Stock Exchange under the symbol “KWG”.

The Company is in the process of exploring its mineral property interests and has not yet determined whether its mineral property interests contain mineral deposits that are economically recoverable. The Company will periodically have to raise additional funds to continue its exploration activities and, while it has been successful in doing so in the past, there can be no assurance it will be able to do so in the future.

Until it is determined that properties contain mineral reserves or resources that can be economically mined, they are classified as exploration and evaluation properties. The recoverability of deferred exploration expenses is dependent upon: the discovery of economically recoverable reserves and resources; securing and maintaining title and beneficial interest in the properties; the ability to obtain necessary financing to complete exploration, development and construction of processing facilities; obtaining certain government approvals; and attaining profitable production.

Although the Company has taken steps to verify title to the properties on which it is conducting exploration and in which it has an interest, in accordance with industry standards for the current stage of exploration of such properties, these procedures do not guarantee the Company’s title. Property title may be subject to government licensing requirements or regulations, unregistered prior agreements, unregistered claims, aboriginal claims, and non-compliance with regulatory and environmental requirements.

#### **2 BASIS OF PREPARATION**

##### **Statement of Compliance**

The consolidated financial statements have been prepared using accounting policies consistent with International Financial Reporting Standards (“IFRS”) and its interpretations adopted by the International Accounting Standards Board (“IASB”).

These financial statements were approved by the board of directors for issue on April 17, 2013.

##### **Basis of Measurement**

The consolidated financial statements have been prepared under the historic cost convention, except for investments in equity securities and derivatives, including warrants, which are measured at fair value. The methods used to measure fair values are discussed further in Note 24.

#### **3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The accounting policies set out below have been applied consistently to all periods presented in these financial statements.



## **KWG RESOURCES INC.**

### **Notes to the Consolidated Financial Statements (in Canadian dollars)**

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#### **Basis of Consolidation**

These consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries Canada Chrome Corporation (formerly ChromeCana Ltd.) which was incorporated in Ontario, Canada on February 20, 2009, SMD Mining Corporation, which was incorporated in Ontario, Canada on January 16, 2008 and Canada Chrome Mining Corporation which was incorporated federally on June 4, 2010. The latter two companies have been inactive since their inception.

#### **Distribution of Debut Diamonds Inc. (“DDI”)**

The Company accounted for the distribution of DDI, which occurred in December 2011, as a return of capital to its shareholders. This distribution was recognized once it was appropriately authorized and no longer at the discretion of the Company. It was measured initially and subsequently at fair value using the market price of the DDI shares.

DDI was also classified as a discontinued operation and the results of the disposal group are classified as discontinued operations in the statement of operations and the comparative amounts restated for all periods presented.

#### **Foreign Currency**

(i) *Functional and presentation currency*

Items included in the financial statements of each consolidated entity in the KWG group are measured using the currency of the primary economic environment in which the entity operates (the “functional currency”). The functional currency of KWG and all of its subsidiaries is the Canadian dollar.

(ii) *Transactions and balances*

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of foreign currency transactions and from the translation at exchange rates of monetary assets and liabilities denominated in currencies other than an entities’ functional currency are recognized in the consolidated statements of operations in “gain(loss) on foreign exchange”.

#### **Cash and Cash Equivalents**

Cash and cash equivalents include cash on hand, deposits held with banks, and other short-term highly liquid investments with original maturities of three months or less.

#### **Financial Instruments**

Financial assets and liabilities are recognized when the Company becomes a party to the contractual provisions of the instrument. Financial assets are derecognized when the rights to receive cash flows from the assets have expired or have been transferred and the Company has transferred substantially all risks and rewards of ownership. Financial liabilities are derecognized when the obligation specified in the contract is discharged, cancelled or expires.

At initial recognition, the Company classifies its financial instruments in the following categories:

(i) *Financial assets and liabilities at fair value through profit or loss*

A financial asset or liability is classified in this category if acquired principally for the purpose of selling or repurchasing in the short-term.

## KWG RESOURCES INC.

### Notes to the Consolidated Financial Statements (in Canadian dollars)

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Derivatives are also included in this category unless they are designated as hedges. The Company has invested in and has issued warrants that qualify as derivatives. All derivatives have been classified as held-for-trading and are included on the balance sheet within marketable securities or warrant liabilities. Gains and losses on re-measurement of the fair value of warrants are included in the consolidated statements of operations in either finance income or gain (loss) on revaluation of warrant liability.

Financial instruments in this category are recognized initially and subsequently at fair value. Transaction costs are expensed in the consolidated statements of operations. Gains and losses arising from changes in fair value are presented in the consolidated statements of operations in the period in which they arise. Non-derivative financial assets and liabilities at fair value through profit or loss are classified as current except for the portion expected to be realized or paid beyond twelve months of the balance sheet date, which are classified as long-term. Warrants are classified as current.

*(ii) Available-for-sale investments*

Available-for-sale investments are non-derivatives that are either designated in this category or not classified in any of the other categories. The Company's available-for-sale assets comprise investments in equity securities included in marketable securities in the balance sheet.

Available-for-sale investments are recognized initially at fair value plus transaction costs and are subsequently carried at fair value. Gains or losses arising from re-measurement are recognized in other comprehensive income. When an available-for-sale investment is sold or impaired, the accumulated gains or losses are moved from accumulated other comprehensive income to the statement of operations and are included in gain (loss) on marketable securities. Available-for-sale investments are classified as non-current, unless management expects to dispose of them within twelve months.

Dividends on available-for-sale equity instruments are recognized in the statement of operations as dividend income when the company's right to receive payment is established.

*(iii) Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. The Company's loans and receivables comprise trade receivables, and cash and cash equivalents, and are included in current assets due to their short-term nature. Loans and receivables are initially recognized at the amount expected to be received, less, when material, a discount to reduce the loans and receivables to fair value. Subsequently, loans and receivables are measured at amortized cost using the effective interest method less any provision for impairment.

*(iv) Financial liabilities at amortized cost*

Financial liabilities at amortized cost consist of trade and other payables. Trade and other payables are initially recognized at the amount required to be paid, less a discount to reduce the payables to fair value. Subsequently, trade and other payables are measured at amortized cost using the effective interest method. These are classified as current liabilities if payment is due within twelve months. Otherwise, they are presented as non-current liabilities.

## **KWG RESOURCES INC.**

### **Notes to the Consolidated Financial Statements (in Canadian dollars)**

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#### **Impairment of Financial Assets**

At each reporting date, the Company assesses whether there is objective evidence that a financial asset (other than a financial asset classified as fair value through profit or loss) is impaired. The criteria used to determine if objective evidence of an impairment loss include:

- (i) significant financial difficulty of the obligor;
- (ii) delinquencies in interest or principal payments; and
- (iii) it becomes probable that the borrower will enter bankruptcy or other financial reorganization.

For equity securities, a significant or prolonged decline in the fair value of the security below its cost is also evidence that the assets are impaired. If such evidence exists, the Company recognizes an impairment loss, as follows:

(i) *Financial assets carried at amortized cost*

The loss is the difference between the amortized cost of the loan or receivable and the present value of the estimated future cash flows, discounted using the instrument's original effective interest rate. The carrying amount of the asset is reduced by this amount through the use of an allowance account.

(ii) *Available-for-sale financial assets*

The impairment loss is the difference between the acquisition cost of the asset and its fair value at the measurement date, less any impairment losses previously recognized in the statement of operations. This amount represents the loss in accumulated other comprehensive income that is reclassified to net income (loss).

Impairment losses on financial assets carried at amortized cost and available-for-sale debt instruments are reversed in subsequent periods if the amount of the loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized. Impairment losses on available-for-sale equity instruments are not reversed.

#### **Property and Equipment**

(i) *Recognition and measurement*

Items of property and equipment are measured at cost less accumulated depreciation and accumulated impairment losses. Cost includes any expenditure that is directly attributable to the acquisition of the asset.

When parts of an item of property and equipment have different useful lives, they are accounted for as separate items (major components) of property and equipment.

Gains and losses on disposal of an item of property and equipment are determined by comparing the proceeds from disposal with the carrying amount of property and equipment and are recognized net in the statement of operations.

(ii) *Amortization*

Amortization is calculated as a function of the depreciable amount, which is the cost of an asset less its residual value.

## KWG RESOURCES INC.

### Notes to the Consolidated Financial Statements (in Canadian dollars)

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Amortization is recognized through operations as follows over the estimated useful lives of each part of an item of property and equipment.

Amortization is computed using the straight-line method based on the following number of periods:

Computer equipment	-	2 years
Automobiles	-	3 years
Office furniture	-	5 years

Amortization methods, useful lives and residual values are reviewed at each financial year end and adjusted if appropriate.

#### **Impairment of non-financial assets**

The carrying amounts of the Company's non-financial assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated.

The recoverable amount of an asset or cash-generating unit ("CGU") (see definition below) is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For the purpose of impairment testing, assets are grouped together into the smallest group of assets that generates cash inflows that are largely independent of the cash inflows of other assets or groups of assets. Generally, a CGU is analogous to an individual project.

An impairment loss is recognized if the carrying amount of an asset or a CGU exceeds its estimated recoverable amount. Impairment losses are recognized in the statement of operations.

Impairment losses recognized in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that it does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized in prior periods.

#### **Mineral Property Interests**

##### *(i) Exploration & Evaluation expenditures*

Exploration & Evaluation ("E&E") expenditures relate to costs incurred on the exploration for and evaluation of potential mineral reserves and includes costs related to the following: acquisition of exploration rights; conducting geological studies; exploratory drilling and sampling and evaluating the technical feasibility and commercial viability of extracting a mineral resource.

E&E expenditures, including costs of acquiring licenses, are capitalized as Mineral Property Interest ("MPI") assets on an "area of interest basis" which generally is defined as a project. The Company considers a project to be an individual geological area whereby the presence of a mineral deposit is considered favourable or has been proved to exist and, in most cases, comprises of a single mine or deposit.

## KWG RESOURCES INC.

### Notes to the Consolidated Financial Statements (in Canadian dollars)

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MPI assets are recognized if the rights to the project are current and either:

- the expenditures are expected to be recouped through successful development and exploitation of the project, or alternatively by its sale; or
- activities on the project have not, at the reporting date, reached a stage which permits a reasonable assessment of the existence of economically recoverable reserves and active and significant operations in, or in relation to, the project are continuing.

E&E expenditures are initially capitalized as MPI assets. Such E&E expenditures may include costs of licence acquisition, technical services and studies, seismic acquisition, exploration drilling and testing, materials and fuels used, rentals and payments made to contractors and consultants. To the extent that a tangible asset is consumed in developing an MPI asset, the amount reflecting that consumption is recorded as part of the cost of the intangible asset.

Once the technical feasibility and commercial viability of the extraction of mineral reserves in a project are demonstrable and permitted, MPI assets attributable to that project are first tested for impairment and then reclassified to *mine property and development projects*. Currently, the Company does not hold any assets classified as *mine property and development projects*.

#### (ii) *Impairment*

MPI assets are assessed for impairment when facts and circumstances suggest that the carrying amount of a MPI asset may exceed its recoverable amount and any impairment loss is recognized as "Write down of mineral property interests" through the consolidated statements of operations. The following facts and circumstances, among other things, indicate that E&E assets must be tested for impairment:

- the term of exploration license for the project has expired during the reporting period or will expire in the near future and is not expected to be renewed;
- substantive expenditure on further exploration for and evaluation of mineral resources in the project area is neither budgeted nor planned;
- exploration for and evaluation of mineral resources in the project area have not led to the discovery of commercially viable quantities of mineral resources and the Company plans to discontinue activities in the specific area; or
- sufficient data exists to indicate that while development activity is likely to proceed, the carrying amount of the MPI asset is unlikely to be recovered in full through such activity.

MPI assets are tested for impairment on an individual project (area of interest) basis. As noted above, a project would also be tested for impairment before being transferred to "Mineral property interests" on the balance sheet.

#### **Borrowing Costs**

Borrowing costs attributable to the acquisition, construction or production of qualifying assets are added to the cost of those assets, until such time as the assets are substantially ready for their intended use. All other borrowing costs are recognized as interest expense in the statement of operations in the period in which they are incurred.

## **KWG RESOURCES INC.**

### **Notes to the Consolidated Financial Statements (in Canadian dollars)**

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#### **Short-term Employee Benefits**

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided. A liability is recognized for the amount expected to be paid under short-term cash bonus plans if the Company has a present legal or constructive obligation to pay this amount as a result of past service provided by the employee and the obligation can be reliably estimated.

#### **Provisions**

A provision is recognized if, as a result of a past event, the Company has a present legal or constructive obligation that can be reliably estimated and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability. The unwinding of the discount is recognized as a finance cost.

In accordance with the Company's environmental policy and applicable legal requirements, a provision for site restoration or decommissioning in respect of land restoration, and the related expense, is recognized when the land is contaminated and there is a legal obligation to restore the site. The Company presently has no decommissioning liabilities.

#### **Finance Income**

Finance income comprises interest income on marketable securities, FV gains of financial assets classified as FVTPL, and flow-through premium. Interest income is recognized as it accrues through operations, using the effective interest method.

Foreign currency gains and losses are reported on a net basis.

#### **Income Taxes**

Income tax expense comprises current and deferred tax. Income tax expense is recognized through operations except to the extent that it relates to items recognized either in other comprehensive income ("OCI") or directly in equity, in which case it is recognized in OCI or in equity respectively.

Current income tax is the expected tax payable on the taxable income for the period, using tax rates enacted or substantively enacted at the reporting date and any adjustment to tax payable in respect of previous years.

Deferred income tax is recognized using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized for the following temporary differences: the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss, and differences relating to investments in subsidiaries and jointly-controlled entities to the extent that it is probable that they will not reverse in the foreseeable future. In addition, deferred tax is not recognized for taxable temporary differences arising on the initial recognition of goodwill. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

## **KWG RESOURCES INC.**

### **Notes to the Consolidated Financial Statements (in Canadian dollars)**

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A deferred tax asset is recognized to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

#### **Share Capital**

##### *Common shares*

Common shares are classified as equity. Incremental costs directly attributable to the issue of common shares and share options are recognized as a deduction from equity, net of any tax effects.

The Company has financed a portion of its exploration and evaluation activities through the issue of flow-through shares. Under the terms of these share issues, the tax attributes of the related expenditures are renounced to subscribers. Common shares issued on a flow-through basis typically include a premium because of the tax benefits associated therewith ("Flow-through Premium"). Flow-through shares may also be issued with a warrant feature. At the time of issue, the Company estimates the proportion of proceeds attributable to the Flow-through Premium, the common share and the warrant with reference to closing market prices and such techniques as the Black-Scholes option-pricing model. The Flow-through Premium is estimated as the excess of the subscription price over the market value of a regular common share and estimate fair value of the warrant and is recorded as a separate liability which is included in trade and other payables on the consolidated balance sheets (Note 11). The proceeds attributable to the warrants issued in the Company's functional currency are also treated as equity and recorded in warrants on the balance sheet until exercise, when the associated proportion is transferred to share capital along with the cash proceeds received on exercise. Upon expiry, the original fair value of the warrants is transferred to contributed surplus. See Note 12 for commentary on US dollar denominated warrants.

The effect of renunciation of the tax benefits to holders of such shares is recognized pro-rata with the associated expenditures being incurred by the Company. This could occur either before or after the formal renunciation of expenditures to the tax authorities have been made. When the eligible expenditures are incurred, the tax value of the renunciation is recorded as a deferred tax liability and charged against operations as a deferred tax provision.

Furthermore, as eligible expenditures are incurred, the Company recognises a pro-rata amount of the Flow-through Premium through "Finance income" in the consolidated statements of operations with a decrement to the liability on the balance sheet. Flow-through shares renunciation of expenditures are subject to the significant judgment of management in determining the eligibility of the expenditures incurred and are potentially subject to challenge by income tax authorities based on the nature of the amounts incurred. Management has taken and will continue to take actions to mitigate the risk of challenge, if any occurs. To the extent these are disallowed, the Company would generate additional tax attributes to assess for recognition in the financial statements. Additional costs may be incurred.

##### *Normal Course Issuer Bid*

On the date the Company's Board of Directors authorizes a repurchase of its shares, a liability is established for the maximum amount authorized to be expended under the plan as the Company appoints an agent to repurchase the shares on its behalf, creating a present obligation with a corresponding reduction in share capital. This liability is drawn down as the shares are repurchased. Any remaining balance in this account will be returned to share capital, if unspent, at the termination date as determined by the Board at the outset.

**Share-Based Payment Arrangements**

*Stock Option Plan*

The Company has a stock option plan (the "Stock Option Plan") which is described in Note 16. All stock-based awards made to employees and others providing similar services are recognized at the date of grant using a fair-value-based method to calculate compensation expense. Compensation expense is charged to operations over the vesting period of the options with a corresponding increase to contributed surplus. Stock options typically vest over an 18-month period. The fair values are determined at the grant date by applying the Black-Scholes option pricing model. Measurement inputs include share price on the measurement date, exercise prices, expected volatility based on available historical volatility of the Company's share price, expected life, expected dividends, expected forfeiture rate and the risk free interest rate. Under graded vesting the fair value of each tranche is recognized over its respective vesting period.

The amount recognized as an expense is adjusted to reflect the actual number of share options for which the related service and non-market vesting conditions are met.

Share-based payment arrangements in which the Company receives properties, goods or services as consideration for its own equity instruments are accounted for as equity-settled share-based payment transactions, regardless of how the equity instruments are obtained by KWG.

**Earnings per Share**

The Company presents basic and diluted earnings per share ("EPS") data for its common shares. Basic EPS is calculated by dividing the results of operations attributable to ordinary shareholders of the Company by the weighted average number of common shares outstanding during the period. Diluted EPS is determined by adjusting the results of operations attributable to common shareholders and the weighted average number of common shares outstanding for the effects of all dilutive potential common shares, which comprise warrants and share options. Options and warrants have a dilutive effect only when the average market price of ordinary shares during the period exceeds the exercise price of the options or warrants.

**Recent Accounting Pronouncements**

Certain pronouncements were issued by the IASB or the International Financial Reporting Interpretations Committee ("IFRIC") that are mandatory for accounting periods on or after January 1, 2013 or later periods. Many are not applicable or do not have a significant impact to the Company and have been excluded. The following have not yet been adopted and are being evaluated to determine their impact on the Company.

IFRS 7 – Financial Instruments: Disclosures ("IFRS 7") was amended by the IASB in December 2011 to amend the disclosure requirements in IFRS 7 to require information about all recognized financial instruments that are offset in accordance with paragraph 42 of IAS 32 Financial Instruments: Presentation. The amendments also require disclosure of information about recognised financial instruments subject to enforceable master netting arrangements and similar agreements even if they are not set off under IAS 32. The amendments to IFRS 7 are effective for annual periods beginning on or after January 1, 2013.

IFRS 9 - Financial Instruments ("IFRS 9") was issued by the IASB in November 2009 with additions in October 2010 and will replace IAS 39 Financial Instruments: Recognition and Measurement ("IAS 39"). IFRS 9 uses a single approach to determine whether a financial asset is measured at amortized cost or fair value, replacing the multiple rules in IAS 39. The



## **KWG RESOURCES INC.**

### **Notes to the Consolidated Financial Statements (in Canadian dollars)**

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approach in IFRS 9 is based on how an entity manages its financial instruments in the context of its business model and the contractual cash flow characteristics of the financial assets. Most of the requirements in IAS 39 for classification and measurement of financial liabilities were carried forward unchanged to IFRS 9, except that an entity choosing to measure a financial liability at fair value will present the portion of any change in its fair value due to changes in the entity's own credit risk in other comprehensive income, rather than within profit or loss. The new standard also requires a single impairment method to be used, replacing the multiple impairment methods in IAS 39. IFRS 9 is effective for annual periods beginning on or after January 1, 2015. Earlier adoption is permitted.

IFRS 10 - Consolidated Financial Statements ("IFRS 10") was issued by the IASB in May 2011 and will replace IAS 27 Consolidated and Separate Financial Statements and SIC 12 Consolidation - Special Purpose Entities. IFRS 10 is a new standard which identifies the concept of control as the determining factor in assessing whether an entity should be included in the consolidated financial statements of the parent company. Control is comprised of three elements: power over an investee; exposure, or rights, to variable returns from involvement with the investee; and the ability to use power over the investee to affect returns. IFRS 10 is effective for annual periods beginning on or after January 1, 2013. Earlier adoption is permitted.

IFRS 11 - Joint Arrangements ("IFRS 11") was issued by the IASB in May 2011 and will replace IAS 31 Interest in Joint Ventures and SIC 13 Jointly Controlled Entities - Non-Monetary Contributions by Venturers. IFRS 11 is a new standard which focuses on classifying joint arrangements by their rights and obligations rather than their legal form. Entities are classified into two groups: joint operations and joint ventures. A joint operation exists when the parties have rights to the assets and obligations for the liabilities of a joint arrangement. A joint venture exists when the parties have rights to the net assets of a joint arrangement. Assets, liabilities, revenues and expenses in a joint operation are accounted for in accordance with the arrangement. Joint ventures are accounted for using the equity method. IFRS 11 is effective for annual periods beginning on or after January 1, 2013. Earlier adoption is permitted.

IFRS 12 - Disclosure of Interests in Other Entities ("IFRS 12") was issued by the IASB in May 2011. IFRS 12 is a new standard which provides disclosure requirements for entities reporting interests in other entities, including joint arrangements, special purpose vehicles and off balance sheet vehicles. IFRS 12 is effective for annual periods beginning on or after January 1, 2013. Earlier adoption is permitted.

IFRS 13 - Fair Value Measurement ("IFRS 13") was issued by the IASB in May 2011. IFRS 13 is a new standard which provides a precise definition of fair value and a single source of fair value measurement considerations for use across IFRS. IFRS 13 clarifies that fair value is the price that would be received to sell an asset, or paid to transfer a liability in an orderly transaction between market participants at the measurement date under current market conditions. It also establishes disclosures about fair value measurement. IFRS 13 is effective for annual periods beginning on or after January 1, 2013. Earlier adoption is permitted.

IAS 1 - Presentation of Financial Statements ("IAS 1") was amended by the IASB in June 2011. As a result of the amendment, items in other comprehensive income will be required to be presented in two categories: items that will be reclassified into profit or loss and those that will not be reclassified. The flexibility to present a statement of comprehensive income as one statement or two separate statements of profit and loss and other comprehensive income remains unchanged. The amendments to IAS 1 are effective for annual periods beginning on or after July 1, 2012. Earlier adoption is permitted.

## **KWG RESOURCES INC.**

### **Notes to the Consolidated Financial Statements (in Canadian dollars)**

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IAS 27 - Separate Financial Statements ("IAS 27") was amended during 2011 and replaces IAS 27 Consolidated and Separate Financial Statements. IAS 27 has been reissued to reflect the change of including the consolidation guidance in IFRS 10. In addition, IAS 27 will now only prescribe the accounting and disclosure requirements for investments in subsidiaries, joint ventures and associates when the Company prepares separate financial statements. The amendments to IAS 27 are effective for annual periods beginning on or after January 1, 2013. Earlier adoption is permitted.

IAS 28 - Investments in Associates and Joint Ventures ("IAS 28") was issued by the IASB in May 2011 and supersedes IAS 28 Investments in Associates and prescribes the accounting for investments in associates and sets out the requirements for the application of the equity method when accounting for investments in associates and joint ventures. IAS 28 defines significant influence as the power to participate in the financial and operating policy decisions of the investee but is not control or joint control of those policies. IAS 28 also provides guidance on how the equity method of accounting is to be applied and also prescribes how investments in associates and joint ventures should be tested for impairment. The amendments to IAS 28 are effective for annual periods beginning on or after January 1, 2013. Earlier adoption is permitted.

IAS 32 - Financial Instruments: Presentation ("IAS 32") was amended by the IASB in December 2011 to clarify certain aspects of the requirements on offsetting. The amendments focus on the criterion that an entity currently has a legally enforceable right to set off the recognized amounts and the criterion that an entity intends either to settle on a net basis, or to realize the asset and settle the liability simultaneously. The amendments to IAS 32 are effective for annual periods beginning on or after January 1, 2014. Earlier adoption is permitted.

#### **4 CRITICAL ACCOUNTING ESTIMATES AND JUDGEMENTS**

The preparation of financial statements requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

It is reasonably possible that, on the basis of existing knowledge, outcomes in the next financial year that are different from the assumptions used could require a material adjustment to the carrying amount of the asset or liability affected.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimates are revised and in any future periods affected.

Management has made a number of significant estimates and valuation assumptions based on present conditions and management's planned course of action as well as assumptions about future business and economic conditions which include, but are not limited to, the following:

##### **Capitalization of exploration and evaluation costs**

Management has determined that exploration and evaluation costs incurred during the year have future economic benefits and are economically recoverable. In making this judgement, management has assessed various sources of information including but not limited to the geologic and metallurgic information, history of conversion of mineral deposits to proven and probably mineral reserves, scoping and feasibility studies, proximity of operating facilities,

## **KWG RESOURCES INC.**

### **Notes to the Consolidated Financial Statements (in Canadian dollars)**

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operating management expertise and existing permits. See Note 10 for details of capitalized exploration and evaluation costs.

#### **Impairment of mineral property interests**

While assessing whether any indications of impairment exist for mineral properties and deferred exploration expenditures, consideration is given to both external and internal sources of information. Information the Company considers includes changes in the market, economic and legal environment in which the Company operates that are not within its control that could affect the recoverable amount of mineral properties and deferred exploration expenditures. Internal sources of information include the manner in which mineral properties and deferred exploration expenditures are being used or are expected to be used and indications of expected economic performance of the assets. Estimates include but are not limited to estimates of the discounted future after-tax cash flows expected to be derived from the Company's mining properties, costs to sell the properties and the appropriate discount rate. Reductions in metal price forecasts, increases in estimated future costs of production, increases in estimated future capital costs, reductions in the amount of recoverable mineral reserves and mineral resources and/or adverse current economics can result in a write-down of the carrying amounts of the Company's mineral properties and deferred exploration expenditures.

#### **Income taxes and recoverability of potential deferred tax assets**

In assessing the probability of realizing income tax assets recognized, management makes estimates related to expectations of future taxable income, applicable tax planning opportunities, expected timing of reversals of existing temporary differences and the likelihood that tax positions taken will be sustained upon examination by applicable tax authorities. In making its assessments, management gives additional weight to positive and negative evidence that can be objectively verified. Estimates of future taxable income are based on forecasted cash flows from operations and the application of existing tax laws in each jurisdiction. The Company considers whether relevant tax planning opportunities are within the Company's control, are feasible, and are within management's ability to implement. Examination by applicable tax authorities is supported based on individual facts and circumstances of the relevant tax position examined in light of all available evidence. Where applicable tax laws and regulations are either unclear or subject to ongoing varying interpretations, it is reasonably possible that changes in these estimates can occur that materially affect the amounts of income tax assets recognized. Also, future changes in tax laws could limit the Company from realizing the tax benefits from the deferred tax assets. The Company reassesses unrecognized income tax assets at each reporting period.

#### **Share-based payments**

Management determines costs for share-based payments using market-based valuation techniques. The fair value of the market-based and performance-based share awards are determined at the date of grant using generally accepted valuation techniques. Assumptions are made and judgment used in applying valuation techniques. These assumptions and judgments include estimating the future volatility of the stock price, expected dividend yield, future employee turnover rates and future employee stock option exercise behaviours and corporate performance. Such judgements and assumptions are inherently uncertain. Changes in these assumptions affect the fair value estimates.

#### **Contingencies**

Refer to Note 22.

**KWG RESOURCES INC.****Notes to the Consolidated Financial Statements (in Canadian dollars)**

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**5 DISTRIBUTION OF DEBUT DIAMONDS INC.**

On December 28, 2011 the Company distributed, by way of a return of capital, all of its shares of DDI, which consisted of 38,210,934 common shares, to its shareholders on the basis of 6 shares of DDI for every 100 shares of KWG held. The transaction was recorded in these financial statements as a demerger of the business to the Company's existing shareholders. The record date was December 15, 2011 and the market value of DDI on this date was \$0.30 per share. At the date the distribution was authorized and at the date the dividend was paid, the fair value of the dividend payable was \$11,463,280 based on the market value of DDI of \$0.30 per share. The book value of DDI on this date was \$10,704,685. Therefore the Company recorded a gain on the divestiture in the amount of \$758,595. This amount is included in loss on discontinued operations shown on the consolidated statement of operations which consists of the following:

<u>Year ended December 31</u>	<u>2012</u>	<u>2011</u>
Expenses		
General and administrative	-	(312,065)
Stock compensation cost	-	(763,125)
Exploration expenses	-	(439,277)
Loss from operations	-	(1,514,467)
Gain on distribution of DDI shares	-	758,595
<b>Loss from discontinued operations</b>	<b>-</b>	<b>(755,872)</b>

The following table provides information on the cash flows affected by the divestiture:

<u>Year ended December 31</u>	<u>2012</u>	<u>2011</u>
Cash flows from operating activities	-	(751,342)

**6 CASH AND CASH EQUIVALENTS**

	<u>As at December 31, 2012</u>	<u>As at December 31, 2011</u>
Bank balances	3,131,032	2,065,186
Short-term deposits	7,934,972	13,965,365
<b>Cash and cash equivalents</b>	<b>11,066,004</b>	<b>16,030,551</b>

**7 RECEIVABLES**

	<u>As at December 31, 2012</u>	<u>As at December 31, 2011</u>
Trade receivables	-	22,374
Sales taxes receivable	358,755	210,607
Due from Debut Diamonds Inc. (Note 21)	752,824	783,772
Other receivables	174,569	55,567
<b>Receivables</b>	<b>1,286,148</b>	<b>1,072,320</b>

# KWG RESOURCES INC.

## Notes to the Consolidated Financial Statements (in Canadian dollars)

### 8 MARKETABLE SECURITIES

	As at December 31, 2012	As at December 31, 2011
AFS:		
GoldTrain Resources Inc. ("GoldTrain") (i)		
7,270,000 common shares	290,800	472,550
Eloro Resources Ltd. ("Eloro") (ii)		
3,080,580 common shares	107,820	415,900
Debut Diamonds Inc.		
166,000 common shares	3,320	-
<b>Total AFS</b>	<b>401,940</b>	<b>888,450</b>
Financial assets at fair value through P&L (FVTPL):		
GoldTrain Resources Inc. (i)		
7,000,000 warrants	21,000	196,000
Eloro Resources Ltd. (ii)		
3,080,580 premium warrants	43,100	123,186
1,540,290 regular warrants	-	45,062
Debut Diamonds Inc. (iii)		
9,702,666 warrants exercisable at \$0.07	105,000	960,600
7,000,000 warrants exercisable at \$0.07	-	861,000
<b>Total FVTPL</b>	<b>169,100</b>	<b>2,185,848</b>
<b>Marketable securities</b>	<b>571,040</b>	<b>3,074,298</b>

- (i) On June 9, 2011 KWG acquired 7,000,000 common shares and 7,000,000 warrants (each warrant entitling the holder to purchase one common share for \$0.10 on or before June 9, 2013) in GoldTrain Resources Inc. ("GoldTrain") in exchange for the settlement of a debt (debt settlement agreement between KWG and GoldTrain). Prior to the signing of this agreement, KWG sold its investment in 3,452,217 common shares of Strike Minerals Inc. to GoldTrain. GoldTrain subsequently sold these shares in a series of transactions. Both parties agreed to have this debt settled through the issuance of the GoldTrain shares and warrants. On June 9, 2011 the market value of the GoldTrain shares was \$280,000. The warrants were valued at \$151,200 on the date of acquisition using the Black-Scholes option pricing model based on the following assumptions: dividend yield of 0%, volatility of 144%, risk free interest rate of 1.21% and an expected life of 2 years. KWG's holdings represent approximately 14.71% of the issued and outstanding common shares of GoldTrain and approximately 32.67% of the outstanding warrants. The Company realized a gain on the disposal of the Strike Mineral Inc. shares in the amount of \$153,000, which is included in gain (loss) on marketable securities on the consolidated statements of operations for the year ended December 31, 2011. Subsequent to this transaction, the Company acquired an additional 270,000 common shares through purchases on the open market.
- (ii) On December 21, 2011 KWG acquired 3,080,580 common shares, 3,080,580 premium warrants and 1,540,290 regular warrants of Eloro Resources Ltd ("Eloro") in exchange for 100% of the issued and outstanding common shares of 6949541 Canada Inc ("6949541"), a wholly-owned subsidiary of KWG. Prior to the sale, KWG transferred 11 claims in Louvicourt Township and \$200,000 in cash to 6949541 (Note 10(vii)). The premium warrants entitle the holder to purchase one common share for \$1.00 on or before

## KWG RESOURCES INC.

### Notes to the Consolidated Financial Statements (in Canadian dollars)

November 18, 2016. If the closing price of the common shares is over \$1.50 for 20 consecutive trading days following the expiry of the 4 month hold period, the premium warrants must be exercised within 10 business days of Eoro providing written notice, or they will be cancelled. The premium warrants were valued at \$71,187 on the acquisition date using the Black-Scholes options pricing model based on the following assumptions: fair value of shares at grant date of \$0.10, dividend yield of 0%, volatility of 83.93%, risk free interest rate of 1.417% and an expected life of 5 years. The regular warrants entitle the holder to purchase one common share for \$0.24 on or before May 18, 2013. If the closing price of the common shares is over \$0.60 for 20 consecutive days following the expiry of the 4 month hold period, the regular warrants must be exercised within 10 business days of Eoro providing written notice, or they will be cancelled. The regular warrants were valued at \$23,398 on the acquisition date using the Black-Scholes options pricing model based on the following assumptions: fair value of shares at grant date of \$0.10, dividend yield of 0%, volatility of 86.76%, risk free interest rate of 1.02% and an expected life of 1.5 years.

- (iii) On August 29, 2011 KWG acquired 7,000,000 common shares and 7,000,000 warrants (each warrant entitling the holder to purchase one common share for \$0.40 on or before August 29, 2016) in DDI in exchange for 21,000,000 common shares and 21,000,000 warrants (each warrant entitling the holder to purchase one common share for \$0.15 on or before August 29, 2016) in KWG. The value attributed to the shares was based on KWG's market value on August 29, 2011, which was \$0.085 per share since there was no comparable information for DDI. The warrants were valued at \$1,638,000 on the acquisition date using the Black-Scholes options pricing model based on the following assumptions: fair value of share at grant date \$0.085, dividend yield of 0%, volatility of 163%, risk free interest rate of 1.65% and an expected life of 5 years. The common shares of DDI were subsequently distributed to KWG's shareholders as a return of capital (Note 5). During the first quarter of 2012, the Company purchased 166,000 common shares of DDI on the open market. On July 24, 2012 DDI announced that it was reducing the exercise price on all of its warrants to \$0.07 per warrant effective as of that day. There are no other changes to the terms of the warrants.

#### Warrants

The financial assets at fair value through P&L consist of warrants which are not publicly-traded. However, their valuation can be obtained through the use of a valuation model, the inputs for which are readily determinable. Any change in fair value after initial recognition, is recorded through the consolidated statements of operations as a finance income (loss). The fair value of the warrants decreased by \$2,016,748 during the year.

The following table summarizes the inputs that were used to calculate the fair value of the warrants as at December 31, 2012:

	GoldTrain	Eoro Premium	Eoro Regular	DDI	DDI
Expiry date	Jun 9/13	Nov 18/16	May 18/13	Aug 29/16	Jan 15/13
Average dividend per share	Nil	Nil	Nil	Nil	Nil
Estimated volatility	120.00%	136.85%	78.60%	150.00%	120.00%
Risk-free interest rate	1.13%	1.32%	1.13%	1.32%	1.13%
Expected life of the options granted	160 days	1,417 days	138 days	1,336 days	15 days
Calculated value per warrant	\$0.003	\$0.014	\$0.000	\$0.015	\$0.000

**KWG RESOURCES INC.****Notes to the Consolidated Financial Statements (in Canadian dollars)****Sensitivity Analysis - Equity Price Risk**

All of the Company's financial assets classified as AFS are listed on public stock exchanges. For such investments, a 10% increase in the equity prices at the reporting date would have increased equity by approximately \$40,000, (as at December 31, 2011 - an increase of \$89,000) an equal change in the opposite direction would have had the equal but opposite effect on the amounts shown above.

For financial assets classified at fair value through P&L, the impact on operations of a 10% increase in the fair value of these warrants at the reporting date would have been approximately \$17,000 (\$228,000 as at December 31, 2011).

The analyses were performed on the same basis for 2012 and 2011.

**9 PROPERTY AND EQUIPMENT**

	Automobiles	Computer Equipment	Office Equipment	Leasehold Improvements	Totals
Balance, January 1, 2011					
Cost	37,550	18,939	22,000	-	78,489
Accumulated amortization	(15,543)	(11,047)	(3,667)	-	(30,257)
<b>Net book value</b>	<b>22,007</b>	<b>7,892</b>	<b>18,333</b>	<b>-</b>	<b>48,232</b>
Additions	41,140	5,741	875	-	47,756
Amortization	(15,945)	(9,777)	(4,429)	-	(30,151)
Balance, December 31, 2011					
Cost	78,690	24,680	22,875	-	126,245
Accumulated amortization	(31,488)	(20,824)	(8,096)	-	(60,408)
<b>Net book value</b>	<b>47,202</b>	<b>3,856</b>	<b>14,779</b>	<b>-</b>	<b>65,837</b>
Additions	-	5,902	18,275	27,307	51,484
Amortization	(20,591)	(5,288)	(6,468)	(2,276)	(34,623)
Balance, December 31, 2012					
Cost	78,690	30,582	41,150	27,307	177,729
Accumulated amortization	(52,079)	(26,112)	(14,564)	(2,276)	(95,031)
<b>Net book value</b>	<b>26,611</b>	<b>4,470</b>	<b>26,586</b>	<b>25,031</b>	<b>82,698</b>

**KWG RESOURCES INC.**
**Notes to the Consolidated Financial Statements (in Canadian dollars)**
**10 MINERAL PROPERTY INTERESTS**

Cumulative costs relating to the acquisition of mineral property interests and exploration and evaluation expenditures have been incurred on the following projects:

	Balance as at January 1, 2012	Current Expend- itures	Write Downs	Disposals	Balance as at December 31, 2012
Canada – Ontario					
Spider No. 1 / MacFadyen and Kyle (i)(ii)(iii)	25,132	-	(25,132)	-	-
Spider No. 3 / McFaulds Lake (i)	4,189,695	-	-	-	4,189,695
Big Daddy (i)(iv)	8,813,117	1,252,247	-	-	10,065,364
Diagnos (i)(ii)	178,014	-	-	-	178,014
Railroute Corridor (vi)	15,236,311	847,860	-	-	16,084,171
The Temagami Iron L.P. (x)	-	100,000	-	-	100,000
CME Project (xi)	-	500,000	-	-	500,000
	28,442,269	2,700,107	(25,132)	-	31,117,244

	Balance as at January 1, 2011	Current Expend- itures	Write Downs	Disposals (vi)(ix)	Balance as at December 31, 2011
Canada – Ontario					
Spider No. 1 / MacFadyen and Kyle (i)(ii)(iii)	2,516,896	(6,866)	-	(2,484,898)	25,132
Spider No. 3 / McFaulds Lake (i)	4,189,695	-	-	-	4,189,695
Wawa (i)(ii)	156,944	-	-	(156,944)	-
Big Daddy (i)(iv)	6,454,391	2,358,726	-	-	8,813,117
Diagnos (i)(ii)	189,120	-	-	(11,106)	178,014
Pele Mountain (i)(ii)	556,878	85,905	-	(642,783)	-
Uniform Surround (ii)	7,950	15,835	-	(23,785)	-
East West option (v)	202,123	-	(202,123)	-	-
Railroute Corridor (vi)	14,313,571	999,277	-	(76,537)	15,236,311
Smelter Royalty (vii)	2,682,587	20,000	-	(2,702,587)	-
Victor West	119,979	78,018	-	(197,997)	-
Nakina Project	-	570,855	-	(570,855)	-
	31,390,134	4,121,750	(202,123)	(6,867,492)	28,442,269

- (i) On May 15, 2006, the Company and Cliffs Chromite Far North Inc. (“Cliffs”), formerly Spider Resources Inc., agreed to amend and revise their joint venture agreement. The companies agreed to treat each project in their joint venture as a separate joint venture, to enable each company to either increase or decrease its interest in a project based upon their respective strategic objectives. The Company and Cliffs agreed to have their respective interest established at 50% in all the current projects of the joint venture.

Each party’s interest is diluted by not contributing further to the other party’s exploration program until its interest has reached 33 1/3%. At that level, a party’s interest in a project may be maintained by contribution to subsequent programs, or suffer further dilution. When an interest has been reduced to less than 10%, it will be automatically converted to a 0.5% Net Smelter Royalty (“NSR”) in base metals and a 1% NSR in precious metals and diamonds.



## **KWG RESOURCES INC.**

### **Notes to the Consolidated Financial Statements (in Canadian dollars)**

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- (ii) Ashton Mining Canada Ltd. holds a 25% claw back entitlement to any kimberlite property found or developed by KWG/Cliffs within the geographic limits of the Spider No. 1 project area, with the exception of Kyle Lake No. 1 where Ashton Mining relinquished its rights, which can be executed by paying KWG/Cliffs an amount equal to 300% of all exploration expenditures on said property.
- (iii) The Kyle project is optioned to Renforth Resources Inc. ("Renforth") the operator and on October 18, 2010 Renforth had earned a 55% interest in the Kyle project by transferring a group of 39 adjacent claims and by incurring a total of \$6 million of exploration expenditures over a period of three years. Debut's interests have been reduced to 22.5% and may be further reduced to 15% by Cliffs incurring exploration expenditures equal to its prior capital in the joint project.
- (iv) In December 2005, KWG/Cliffs entered into an agreement with Freewest Resources Canada Inc. ("Freewest") for the acquisition of a 25% interest in certain mining property claims contiguous to McFauld's Lake in Ontario. The contribution of the Company included a commitment to carry out exploration work in the amount of \$1,500,000 before October 13, 2009 of which at least \$200,000 was incurred before February 28, 2006; and accordingly, each of KWG and Cliffs earned a 25% interest of the property.

On March 27, 2009, the Company negotiated an amendment to the Freewest Option Agreement whereby the option earn-in calls for a \$15,000,000, three-year commitment. As a result of this amendment, the Company is no longer required to prepare a bankable feasibility study within 18 months, as had been called for in the 2005 agreement. Under the amendment, KWG would have options for up to a \$7,500,000 commitment over the next three years, of which \$2,500,000 was required to be spent before March 31, 2010. In early 2010, Freewest was served with a notice that this first commitment had been met. A further \$2,500,000 was required to be spent before March 31, 2011. This requirement was satisfied through the direct payment to Freewest early in the second quarter of 2011. Each such option increases the Company's ownership by 1.5%. The final \$2,500,000 must be spent by March 31, 2012 and this requirement has been met. Each option increases the Company's ownership by 1.5% with the result being that KWG now owns 30% of the Big Daddy project.

- (v) On July 23, 2008, the Company acquired an option to earn a 65% interest in a group of claims held by Rainy Mountain Royalty Corp. (formerly East West Resources Corporation). The Company issued 2,000,000 shares at a price of \$0.034 per share and paid \$50,000 for the option for a total of \$118,000. The Company was required to incur exploration expenditures of \$250,000 in each of 2008 and 2009 and an additional \$1,000,000 by August 2012 to earn 60%. An additional 5% may be earned in any mineral deposit discovered by the Company providing development and production financing. During both 2010 and 2011, the Company incurred no expenditures on these claims.

In early 2011 the Company received notice that, since it had not made an outstanding option payment on approximately one-half of these claims, the agreement was terminated for this portion of the claims. As a result, the Company recognized a write down during 2010 in the amount of \$202,123 on these properties. Later in 2011, the Company decided not to perform any further work on this property and, as a result, wrote off the remaining balance.

- (vi) During 2009, the Company commenced efforts to explore and develop a transportation link to the Company's properties in Northern Ontario in order to increase the economic

## **KWG RESOURCES INC.**

### **Notes to the Consolidated Financial Statements (in Canadian dollars)**

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viability of these properties. These operations entailed a detailed analysis of railroad route alternatives, preliminary soils analysis and claim staking. Concurrent with this activity the Company is performing exploration activities on these claims. This project and exploration activity was continued throughout 2010 and 2011. All costs related to this project have been capitalized. On March 2, 2012, the Company acquired 49 unpatented claims from INV Metals Inc. for consideration consisting of 3,000,000 common shares and 3,000,000 warrants (Note 14(ii)). These claims are contiguous to the claims already held by the Company and are located on the railroad route.

- (vii) On July 22, 2009, the Company completed the purchase of a 1% NSR in the Black Thor, Black Label and Big Daddy chrome discoveries in the James Bay lowlands for cash consideration of \$1,635,000 including \$635,000 payable at the closing of the transaction and a further \$1 million payable within one year, and the issuance of 15 million common shares and 15 million common share purchase warrants, with each share purchase warrant entitling the holder to purchase a common share at a price of 10 cents for a period of five years. The common shares have been valued at \$600,000 and the warrants at \$370,000 making the total cost of the purchase \$2,605,000. Additional ancillary costs of \$27,587 were also incurred and these have been capitalized. Under the original terms of the purchase the remaining purchase price of \$1,000,000 was to be paid in July 2010. An agreement was reached with the vendor prior to the required payment date whereby \$950,000 of this amount was deferred to October 2010. In October 2010, a further agreement was reached whereby the amount owing would be paid out as follows: \$50,000 in October 2010, \$450,000 in December 2010 and \$450,000 in February 2011. The balance owing was increased by a \$50,000 financing fee which is also due in February 2011. A final agreement was negotiated on February 24, 2011 for the remaining payment owing of \$500,000. The Company paid \$100,000 in cash (\$50,000 in February 2011 and \$50,000 in March 2011) and in satisfaction of the remaining \$400,000 KWG issued 4,000,000 treasury units (Note 14(v)) to complete the transaction. Each unit is valued at \$0.10 and is comprised of one treasury share and one purchase warrant enabling its holder to acquire one further treasury share at any time within two years upon payment of \$0.15. Additional financing payments of \$20,000 were paid during the first six months of 2011 due to timing delays in issuing these shares. All financing payments have been capitalized in accordance with the Company's reporting policies.

On August 4, 2011, the Company completed the sale of this 1% NSR for total proceeds of US\$18 million. Half of the purchase price was paid in cash and the remaining 50% was received by an escrow agent to be held in escrow for a period not to exceed three months and was to be paid to KWG upon confirmation of warranties made to the purchaser in connection with the transaction. The amount held in escrow was received on November 3, 2011. The sale of the NSR was effected by way of the sale of shares of 7207565 Canada Inc., the KWG subsidiary that held the royalty. The resulting gain of \$14,056,530 on this transaction is shown as gain on sale of mineral property interests on the Consolidated Statement of Operations for the year ended December 31, 2011 in these financial statements.

- (viii) On December 21, 2011, the Company sold 11 claims in the Louvicourt Township to Eloro for consideration consisting of 3,080,580 common shares, 3,080,580 premium warrants and 1,540,290 regular warrants of Eloro (Note 8(ii)). Prior to the sale, KWG had transferred these claims in Louvicourt Township and \$200,000 in cash into 6949541 Canada Inc and the transaction was accomplished through the sale of the shares of 6949541 Canada Inc. These claims had been written off by the Company a number of years ago. The resulting gain in the amount of \$202,585 is included in gain on sale of

**KWG RESOURCES INC.****Notes to the Consolidated Financial Statements (in Canadian dollars)**

mineral property interests on the Consolidated Statement of Operations in these financial statements.

- (ix) As a result of the distribution of the DDI shares (Note 5), the Company divested itself of the following mineral property interests during the year ended December 31, 2011:

Property Description	Amount
Spider No. 1 / MacFadyen and Kyle	2,484,898
Wawa	156,944
Diagnos	11,106
Pele Mountain	642,783
Uniform Surround	23,785
Railway infrastructure	76,537
Victor West	197,997
Nakina project	570,855
	<u>4,164,905</u>

- (x) On June 1, 2012 the Company purchased, for \$100,000 in cash, 2,000,000 units (representing 6.3% of the outstanding units) and 2,000,000 warrants of The Temagami Iron Limited Partnership ("Temagami"). The warrants may be exercised to acquire additional partnership units at \$0.05 each at any time within 90 days after the receipt of a compilation report on the property. These funds will be used by Temagami to update studies and provide KWG with an opportunity to review and participate further, if appropriate.
- (xi) On November 22, 2012 the Company signed an agreement with China Metallurgical Exploration Corp ("CME") to mutually undertake due diligence investigations of the "Field Goal #1, #2 and #3" claim groups by way of an airborne geophysical survey. KWG's share of the costs of these investigations was \$500,000. Within thirty days of delivery of the survey data and report, each of KWG and CME will engage a professional valuator to provide a written evaluation of the claim groups. Within sixty days of delivery of the survey data CME will either execute an agreement to sell KWG the property for such consideration as will be agreed upon at that time or CME will repay to KWG the \$500,000 expended on the survey.

**11 TRADE AND OTHER PAYABLES**

	Notes	December 31, 2012	December 31, 2011
Trade payables			
Exploration and evaluation projects	10	146,755	325,428
Non-project related		287,417	147,493
Accrued liabilities			
Project related		44,366	-
Non-project related		41,309	187,020
Flow-through premium liability (see table below)		243,983	245,656
Share repurchase liability (re Normal Course Issuer Bid)	14(vii)	-	207,331
Lease inducement	22(ii)	46,631	-
		<u>810,460</u>	<u>1,112,928</u>

**KWG RESOURCES INC.**  
**Notes to the Consolidated Financial Statements (in Canadian dollars)**

The following table shows the transactions and balances of the flow-through premium liability:

	Notes	December 31, 2012	December 31, 2011
Balance, as at beginning of year		245,656	268,504
Flow-through premium adj through finance income		-	(268,504)
Flow-through premium from financing – Jan 2011	14(vi)	-	20,915
Flow-through premium adj through finance income		-	(20,915)
Flow-through premium from financing – Dec 2011 (net of share issue costs of \$16,845)	14(iii)	-	245,656
Flow-through premium adj through finance income		(245,656)	-
Flow-through premium from financing – Dec 2012		243,983	-
Balance, as at end of year		243,983	245,656

**12 WARRANT LIABILITY**

Included in the warrants listed in Note 15 are 640,940 warrants (26,518,854 in 2011) issued in March and April of 2009 exercisable in United States dollars. The fair value of these warrants is recorded as a warrant liability at the date of issuance. These warrants are revalued at each balance sheet date with the corresponding gain (loss) recorded in gain (loss) on warrant revaluation through the statement of operations and comprehensive income (loss). A gain on the revaluation of \$1,093,379 was recognized in 2012 (\$1,396,188 in 2011). The fair value of these warrants was estimated using the Black-Scholes option pricing model based on the following assumptions:

	Dec 31, 2012	Dec 31, 2011
U.S. exchange rate	0.9949	1.0170
Market price of shares	\$0.050	\$0.085
Average dividend per share	Nil	Nil
Estimated volatility	65.89%	94.37%
Risk-free interest rate	1.13%	0.95%
Expected life of the warrants	15 months	27 months

A 10% decrease in the market price of the common shares would result in an increase in the gain on revaluation in the amount of approximately \$1,000 (\$70,000 in 2011). An increase of 10% would have an equal effect in the opposite direction.

**13 NON-CONTROLLING INTEREST**

The amount shown for non-controlling interest in the financial statements is in relation to a non-controlling interest ownership in the shares of DDI. The original investment, valued at \$70,000, was in the form of services rendered in relation to one of DDI's mineral properties and was accordingly recorded as an increase to the cost of this property. During 2011, DDI received additional funds in the amount of \$2,241,078, after deducting share issuance costs from non-related third party investors. Non-controlling interests' share of DDI expenses are reflected in the statement of operations (Note 5) and were charged as a reduction to the Balance Sheet account non-controlling interests. This balance was eliminated as a result of the DDI distribution (Note 5).

**KWG RESOURCES INC.**  
**Notes to the Consolidated Financial Statements (in Canadian dollars)**

**14 SHARE CAPITAL**

Authorized

An unlimited number of no par value common shares

Issued

Changes in the Company's share capital were as follows:

	Year ended December 31, 2012	Year ended December 31, 2011
<b>Issued</b>	<b>Number of shares</b>	<b>Number of shares</b>
Balance – beginning of year	671,323,941	623,458,941
Issued through private placements (i)(iii)(vi)	24,398,332	26,620,000
Issued for Mineral Property Interests (ii)	3,000,000	-
Issued in exchange for marketable securities (iv)	-	21,000,000
Issued for settlement of liability re acquisition of mining assets (v)	-	4,000,000
Issued following exercise of warrants and compensation options	-	250,000
Issued following exercise of stock options	-	50,000
Cancelled following repurchase through normal course issuer bid (vii)	(7,145,000)	(4,055,000)
<b>Balance – end of year</b>	<b>691,577,273</b>	<b>671,323,941</b>

- (i) On December 31, 2012, the Company completed a non-brokered private placement of 24,398,332 "flow-through" common shares at a price of \$0.06 per share for a total consideration of \$1,463,900. The Company allocated proceeds of \$243,983 to the flow-through premium (Note 11). Finder's fees of \$96,754 in cash were paid in relation to this placement.
- (ii) On March 2, 2012, the Company issued 3,000,000 common shares and 3,000,000 warrants (each warrant entitling the holder to purchase one common share for \$0.12 on or before March 2, 2017) for the acquisition of 49 unpatented claims from INV Metals Inc. (Note 8(vi)). The warrants were valued at \$177,000 on the date of issue using the Black-Scholes options pricing model based on the following assumptions: market value of \$0.065 per share, dividend yield of 0%, volatility of 159%, risk free rate of return of 1.42% and an expected life of 5 years
- (iii) On December 30, 2011, the Company completed a non-brokered private placement of 17,500,000 units for a total consideration of \$1,750,000. These units were issued at \$0.10 each and comprised one common share of the Company and one-half of a common share purchase warrant exercisable at a price of \$0.12 per warrant to acquire one common share for a period of thirty months. The Company allocated proceeds of \$262,500 to the flow-through premium (Note 11).

The fair value of the purchase warrants included in the units was estimated using the Black-Scholes method based on the following assumptions: market value of \$0.085 per share, dividend yield of 0%, volatility of 110.46%, risk free interest rate of 0.95% and an expected life of thirty months. As a result, the fair value of the purchase warrants was estimated at \$322,180.

## **KWG RESOURCES INC.**

### **Notes to the Consolidated Financial Statements (in Canadian dollars)**

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Finders' fees totalling \$75,000 in cash and 750,000 compensation units were paid to one qualified party in relation to this placement. Each compensation unit was comprised of one non flow-through common share purchase warrant exercisable at a price of \$0.12 per warrant to acquire one common share for a period of 30 months.

The fair value of the warrant portion of the agents' compensation units was estimated using the Black-Scholes method based on the following assumptions: market value of \$0.085 per share, dividend yield of 0%, volatility of 110.46%, risk free interest rate of 0.95% and an expected life of thirty months. As a result, the fair value of the purchase warrants was estimated at \$35,250.

- (iv) On August 29, 2011, the Company issued 21,000,000 common shares and 21,000,000 warrants (each warrant entitling the holder to purchase one common share for \$0.15 on or before August 29, 2016) to Debut in exchange for 7,000,000 common shares and 7,000,000 warrants (each warrant entitling the holder to purchase one common share for \$0.40 on or before August 29, 2016) in Debut. The warrants were valued at \$1,638,000 using the Black-Scholes model based on the following assumptions: market value of \$0.085 per share, dividend yield of 0%, volatility of 163%, risk free interest rate of 1.65% and an expected life of 5 years.
- (v) On February 24, 2011, the Company issued 4,000,000 treasury units valued at \$0.10 per unit in satisfaction of a debt owing in the amount of \$400,000. This debt related to the purchase of a 1-percent NSR (Note 10(vii)). Each unit consists of one common share and 1 purchase warrant which entitles the holder to purchase one common share at a price of \$0.15 for a period of two years.

The fair value of the purchase warrants included in the units was estimated using the Black-Scholes method based on the following assumptions: market value of \$0.12 per share, dividend yield of 0%, volatility of 165.43%, risk free interest rate of 1.35% and an expected life of two years. As a result, the fair value of the purchase warrants was estimated at \$187,234 after a pro-rata allocation of the fair value of the units' components.

- (vi) On January 31, 2011, the Company completed the final tranche of a non-brokered private placement of 9,120,000 "flow-through" shares for a total cash consideration of \$1,185,600. These shares were issued for \$0.13 each. The Company allocated proceeds of \$20,915 to the flow-through premium (Note 11).
- (vii) On October 5, 2011, the Company's Board of Directors authorized the purchase of up to 31,900,000 of its common shares by way of normal course purchases on the TSX Venture Exchange. This represented 5% of the common shares outstanding at the time. The cap on these purchases was \$500,000 and the purchases will terminate within one year from the date of commencement. On August 22, 2012 the Company's Board of Directors authorized an increase in this cap to \$700,000. To December 31, 2011 the Company had purchased and cancelled 4,055,000 shares under this plan for a total consideration of \$292,669. During 2012, the Company purchased a further 7,145,000 shares for a total consideration of \$409,686. All of these shares have been cancelled and the purchases have terminated.

**KWG RESOURCES INC.****Notes to the Consolidated Financial Statements (in Canadian dollars)****15 WARRANTS AND COMPENSATION OPTIONS**

Changes in the Company's outstanding common share purchase warrants and compensation options were as follows:

Issued	Year ended December 31, 2012		Year ended December 31, 2011	
	Warrants	Compensation options	Warrants	Compensation Options
Balance – beginning of year	196,448,893	750,000	165,365,162	-
Issued for mineral property interests (Note 14(ii))	3,000,000	-	-	-
Issued as part of private placement of units (Note 14(iii))	-	-	8,750,000	-
Issued in exchange for marketable securities (Note 14(iv))	-	-	21,000,000	-
Issued for settlement of debt re: acquisition of mining assets (Note 14(v))	-	-	4,000,000	-
Issued for agents' compensation (Note 14(iii))	-	-	-	750,000
Exercised *	-	-	(250,000)	-
Expired	(120,657,953)	-	(2,416,269)	-
<b>Balance – end of year</b>	<b>78,790,940</b>	<b>750,000</b>	<b>196,448,893</b>	<b>750,000</b>

\* Exercise price was \$0.10 at date of exercise with a market share price of \$0.13.

Outstanding common share purchase warrants and compensation options entitle their holders to subscribe for an equivalent number of common shares.

A summary of the Company's outstanding warrants and compensation options as at December 31, 2012 is presented below:

Number of warrants	Number of compensation options	Exercise price \$	Expiry date
4,000,000	-	0.15	February 2013
640,940	-	0.10 U.S.	April 2014
8,750,000	750,000	0.12	June 2014
15,000,000	-	0.10	July 2014
26,400,000	-	0.10	August 2014
21,000,000	-	0.15	August 2016
3,000,000	-	0.12	March 2017
<b>78,790,940</b>	<b>750,000</b>	<b>0.12</b>	

**16 STOCK OPTION PLAN**

The Company maintains a stock option plan (the "Plan") whereby the Board of Directors may from time to time grant to employees, officers, directors and consultants of the Company or any subsidiary thereof options to acquire common shares in such numbers, for such terms and at such exercise prices as may be determined by the Board, provided that the exercise price may not be lower than the market price of the common shares at the time of the grant of the options.

On May 19, 2010, the shareholders of the Company approved the conversion of the Company's Employee Incentive Stock Option Plan into a rolling option plan pursuant to which a maximum of 10% of the number of issued and outstanding common shares of the Company from time to time may be reserved and allocated for the granting of stock options.

**KWG RESOURCES INC.****Notes to the Consolidated Financial Statements (in Canadian dollars)**

As at December 31, 2012, the Plan provides (i) that the maximum number of common shares that may be reserved for issuance under the Plan shall be equal to 10% of the number of issued and outstanding common shares; (ii) that the maximum number of common shares which may be reserved for issuance to any one optionee pursuant to a share option may not exceed 5% of the common shares outstanding at the time of the grant; and (iii) that the maximum number of common shares that may be reserved for issuance to insiders of the Company is limited to 10% of the common shares outstanding at the time of the grant.

Options vest over an 18-month period: 25% at the date of the grant and 12.5% in each of the following six quarters. Options granted must be exercised over a period no longer than five years after the date of grant, and they are not transferable.

A summary of changes in the Company's stock options outstanding is presented below:

**Options**

	Year ended December 31, 2012		Year ended December 31, 2011	
	Number of shares	Average exercise price	Number of shares	Average exercise price
Balance – beginning of year	60,593,200	0.114	58,343,200	0.114
Granted	7,100,000	0.100	4,300,000	0.112
Exercised	-	-	(50,000)	0.100
Expired	(10,420,000)	0.100	(2,000,000)	0.100
<b>Balance – end of year</b>	<b>57,273,200</b>	<b>0.113</b>	<b>60,593,200</b>	<b>0.114</b>

Information on exercised options is contained in the following table:

Date of exercise	Number Exercised	Exercise Price	Market Value
February 11, 2011	50,000	0.10	0.13

The following table summarizes information about options outstanding and exercisable as at December 31, 2012:

Exercise price	Number of options	Outstanding options	Exercisable options
		Average contractual life (in years)	
0.100	27,728,200	3.34	24,865,700
0.115	3,500,000	3.48	3,500,000
0.125	24,545,000	2.60	24,545,000
0.140	1,500,000	2.75	1,500,000
<b>0.113</b>	<b>57,273,200</b>	<b>3.00</b>	<b>54,410,700</b>

Total stock-based compensation costs for the year ended December 31, 2012 amounted to \$497,623 (2011 – \$1,157,799).



**KWG RESOURCES INC.****Notes to the Consolidated Financial Statements (in Canadian dollars)**

The fair value of the options granted in 2012 and 2011 was estimated using the Black-Scholes option pricing model based on the following assumptions:

	Mar 2012	Nov 2011	Mar 2011
Average dividend per share	Nil	Nil	Nil
Estimated volatility	159.30%	161.36%	164.85%
Risk-free interest rate	1.63%	1.46%	1.3%
Expected life of the options granted	5 years	5 years	5 years
Weighted average of estimated fair value of each option granted	\$0.064	\$0.079	\$0.108

**17 GENERAL AND ADMINISTRATIVE EXPENSES**

The Company's general and administrative expenses consist of the following:

Years ending December 31	2012	2011
Advertising and promotion	22,366	97,058
Consultants' fees	595,114	562,647
Directors' fees and insurance	117,739	132,356
Filing fees	47,785	62,299
Investor relations fees	191,030	44,398
Professional fees	806,615	429,790
Office overheads	268,222	264,996
Salaries and benefits	1,042,028	1,371,484
Travel and accommodation	103,645	82,946
Administrative recovery	(484,399)	(251,639)
	2,710,145	2,796,335

**18 FINANCE INCOME / (LOSS)**

Years ended December 31	2012	2011
Interest income	154,631	67,791
Net change in fair value of financial assets through P&L	(2,016,748)	(65,117)
Premium on flow-through spending	245,655	289,420
Finance income / (loss)	(1,616,462)	292,094

**19 INCOME TAXES**

A reconciliation between tax expense and the product of accounting loss multiplied by the Corporation's domestic tax rate is as follows:

	2012	2011
Statutory tax rate	26.50%	28.25%
Income (loss) before income taxes	(4,008,797)	12,732,185
Tax (benefit) expense at statutory rate	(1,052,000)	3,596,842
Impact of rate changes	-	202,374
Effect of flow-through renunciation	437,000	334,932
Stock based compensation	-	327,078
Effect of tax benefits not previously recognized	713,000	(4,377,680)
Other	(98,000)	(83,546)
Total tax expense	-	-

**KWG RESOURCES INC.****Notes to the Consolidated Financial Statements (in Canadian dollars)**

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The 2012 statutory tax rate of 26.5% differs from the 2011 statutory tax rate of 28.25% because of the reduction in both federal and Ontario substantively enacted tax rates.

The Company offsets tax assets and liabilities if and only if it has a legally enforceable right to set off the current tax assets and current tax liabilities or deferred tax assets and liabilities and they relate to taxes levied by the same tax authority.

The tax benefit of the following unused tax losses and deductible temporary differences have not been recognized in the financial statements due to the unpredictability of future earnings.

<b>Deductible Temporary Differences</b>	<b>Dec 31, 2012</b>	<b>Dec 31, 2011</b>
Mineral property interests	2,562,000	1,422,874
Non capital loss carry-forwards	2,830,000	-
Capital loss carry-forwards	79,861,000	84,202,192
Share issue costs	528,000	706,441
Marketable securities	226,000	230,706
Property and equipment	2,416,000	2,375,796
	<b>88,423,000</b>	<b>88,938,009</b>

At December 31, 2012, the Company has unclaimed non-capital losses of \$2,830,000 which will expire in 2032 (2011 - nil).

The Company's balance of capital losses at December 31, 2012 amounts to approximately \$79,861,000 (2011 - \$84,202,000), and can be carried forward indefinitely against capital gains.

As at December 31, 2012, the Company has unclaimed Cumulative Canadian Exploration Expenses, Cumulative Canadian Development Expenses and Foreign Exploration and Development Expenses of approximately \$4,121,000, \$372,000 and \$29,184,000 respectively. These amounts can be carried forward indefinitely.

**KWG RESOURCES INC.****Notes to the Consolidated Financial Statements (in Canadian dollars)****20 EARNINGS (LOSS) PER SHARE**

The following table sets forth the computation of basic and diluted earnings per share:

Years ended December 31	2012	2011
Weighted average number of shares outstanding – basic	671,207,343	642,650,516
Effect of dilutive securities:		
Stock options	-	-
Warrants and compensation options	-	-
Weighted average number of shares and assumed Conversions – diluted	671,207,343	642,650,516
Income (loss) from continuing operations	(4,008,797)	12,512,304
Loss from discontinued operations	-	(505,629)
Net income (loss) for the year	(4,008,797)	12,006,675
Earnings (loss) per share from continuing operations:		
Basic and diluted	(0.01)	0.02
Earnings (loss) per share from discontinued operations:		
Basic and diluted	-	-
Earnings (loss) per share for the year		
Basic and diluted	(0.01)	0.02
Non-dilutive securities:		
Stock options	57,273,200	60,593,200
Warrants and compensation options	79,540,940	197,198,893

**21 RELATED PARTY TRANSACTIONS**

The Company defines its officers (CEO, CFO and corporate secretary) and directors as Key Management Personnel (“KMP”). During 2012, officers and companies controlled by officers charged consulting fees totalling \$229,357 (\$280,103 in 2011) and salaries and bonuses in the amount of \$403,692 (\$667,916 in 2011) of which \$19,898 remained payable at December 31, 2012 (\$18,305 in 2011). Directors’ fees paid for the year totalled \$97,372 (\$147,060 in 2011). KMP received 7,100,000 stock options in 2012 (1,500,000 in 2011). In 2012 stock compensation expenses totalled \$469,613 for KMP (\$948,954 in 2011).

**Debut Diamonds Inc.**

The Company shares management, administrative assistance and facilities and other technical personnel with DDI. This is not covered by a written agreement. The costs charged to DDI are equal to the costs incurred by the Company. During 2012, the Company charged DDI for overhead and personnel charges in the amount of \$251,325 (\$58,570 in 2011) and for project costs in the amount of \$248,121 (\$60,870 in 2011) and it also advanced funds in the form of loans to DDI in the amount of \$297,913 (\$664,332 in 2011). Due to adverse market conditions which are affecting the value of DDI’s shares, the Company has decided to write down the receivable from DDI by \$648,805.

**22 COMMITMENTS AND CONTINGENCIES**

- (i) Pursuant to flow-through financing agreements closed during the year ended December 31, 2012 the Company must incur \$1,463,900 in exploration expenses by December 31, 2013.

## **KWG RESOURCES INC.**

### **Notes to the Consolidated Financial Statements (in Canadian dollars)**

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The Company has incurred approximately \$10 million of expenditures which have been passed through to shareholders as eligible expenditures for their purposes under flow-through agreements. As noted in Note 3 to these financial statements, there is a risk that some or all of these claims may be disallowed. No provision has been made for potential cost to the Company, if any, of such disallowance. To the extent that the costs are disallowed as deductions to shareholders, additional tax attributes would be created for the Company which would be considered for recognition at that time. Additional costs may be incurred.

Certain conditions may exist at the date the financial statements are issued which may result in a loss to the Company but which will only be resolved when one or more future events occur or fail to occur. The Company does not record any liability for such future events until such time as the events are probable and reasonably determinable.

- (ii) The Company has signed an operating lease for its premises located at 141 Adelaide St. W., Suite 420, Toronto, On, M5H 3L5. The lease is a net lease with a term of five years commencing on August 1, 2012. Monthly minimum rental payments are \$5,326 for October 1, 2012 through July 31, 2014 and \$5,568 for August 1, 2014 through July 31, 2017. There are no payments due for August and September 2012. The Company is also responsible for its proportionate share of the operating costs in relation to this space. In addition to waiving the first two months rental payments, the landlord reimbursed the Company for the amount of \$28,002 in relation to leasehold improvements and moving costs. The total amount of these inducements will be amortized over the life of the lease (Note 11).

## **23 FINANCIAL INSTRUMENTS AND FAIR VALUES**

### **Overview**

The Company has exposure to the following risks from its use of financial instruments:

- credit risk;
- liquidity risk;
- market risk; and

This note presents information about the Company's exposure to each of the above risks, the Company's objectives, policies and processes for measuring and managing risk, and the Company's management of capital. Further quantitative disclosures are included throughout these financial statements.

### **Risk Management Framework**

The Board of Directors has overall responsibility for the establishment and oversight of the Company's risk management framework. The Board fulfils its responsibility through the Audit Committee, which is responsible for overseeing the Company's risk management policies.

The Company's risk management policies are established to identify and analyze the risks faced by the Company, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management practices are reviewed regularly to reflect changes in market conditions and the Company's activities. The Company has an established code of conduct which sets out the control environment within which framework all directors' and employees' roles and obligations are outlined.

The Company's risk and control framework is facilitated by the small-sized and hands-on executive team.

## KWG RESOURCES INC.

### Notes to the Consolidated Financial Statements (in Canadian dollars)

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#### Credit Risk

Credit risk is the risk of an unexpected financial loss to the Company if a customer or third party to a financial instrument fails to meet its contractual obligations, and arises principally from the Company's cash and cash equivalents, receivables and marketable securities.

#### Cash and Cash Equivalents

The Company's cash and cash equivalents are held through large Canadian financial institutions. The Company has a corporate policy of investing its available cash in Canadian government instruments and certificates of deposit or other direct obligations of major Canadian banks, unless otherwise specifically approved by the Board. The Company does not own asset-backed commercial paper.

#### Receivables

The Company's receivables consist primarily of trade receivables and amounts due from related and unrelated parties.

When necessary, the Company establishes an allowance for impairment that represents its estimate of incurred losses in respect of receivables.

Furthermore, when the Company engages in corporate transactions, it seeks to manage its exposure by ensuring that appropriate recourse is included in such agreements upon the counterparty's failure to meet contractual obligations.

#### Marketable Securities

The Company invests only in securities of companies listed on public stock exchanges and warrants of those companies. There is no active market for these warrants. Such strategic investments are approved by the Board of Directors of the Company. Management actively monitors changes in the markets and management does not expect any counterparty to fail to meet its obligations. The Company's investments are generally in the junior natural resources sector and these companies are subject to similar areas of risk as the Company itself.

#### Guarantees

The Company's policy is to provide financial guarantees only to wholly-owned subsidiaries or under business arrangements where the benefit of the guarantee will enure to the Company. At December 31, 2012, the Company had \$nil in guarantees outstanding (2011 - \$nil).

The Company's maximum exposure to credit risk at the reporting date was:

	Notes	December 31, 2012	December 31, 2011
Carrying amount			
Cash and cash equivalents	6	11,066,004	16,030,551
Receivables	7	927,393	861,713
Financial assets classified as AFS	8	401,940	888,450
Financial assets classified at FVTPL	8	169,100	2,284,000
		12,564,437	20,064,714

#### Liquidity Risk

Liquidity risk is the risk that the Company will encounter difficulty in meeting the obligations associated with its financial liabilities that are settled by delivering cash or another financial asset. The Company's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due without incurring unacceptable losses or risking undue damage to the Company's reputation.

## **KWG RESOURCES INC.**

### **Notes to the Consolidated Financial Statements (in Canadian dollars)**

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The Company's objective is to maintain sufficient capital in order to meet short-term business requirements after taking into account cash flows from operations and the Company's holdings of cash and cash equivalents and marketable securities. This is accomplished by budgets and forecasts which are updated on a periodic basis to understand future cash needs and sources. Spending plans are adjusted accordingly when possible to provide for liquidity.

The Company manages its liquidity risk through the mechanisms described above and as described in Capital Management Disclosures below. The Company has historically relied on issuances of shares to develop projects and to finance day-to-day operations and may do so again in the future.

The Company has no significant long-term liabilities. All other contractually obligated cash flows are payable within the next fiscal year.

#### **Market Risk**

Market risk is the risk that changes in market prices, such as foreign exchange rates, interest rates, commodity prices and equity prices will affect the Company's income or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters while optimizing the return.

#### **Foreign Currency Risk**

The Company is exposed to foreign currency risk on purchases and other payables that are denominated in a currency other than the functional currency of the Company; the Canadian dollar. The currencies in which these transactions are denominated, when they occur, are the United States dollars (US\$). The Company does not actively hedge its foreign currency exposure. A 10% strengthening or weakening of the Canadian dollar would not have a material impact on the Company's equity or results of operations.

#### **Interest Rate Risk**

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Company's cash equivalents earn interest at variable short-term rates. The estimated effect of a 0.50% change in interest rates would not have a material effect on the Company's results of operations. None of the Company's other financial instruments are interest-bearing. Consequently, the Company is not exposed to any significant interest rate risk which could be caused by a sudden change in market interest rates.

#### **Other Market Price Risk**

The Company's marketable securities and strategic investments are subject to equity price risk. The values of these investments will fluctuate as a result of changes in market prices, the price of metals or other factors affecting the value of the investments.

Commodity price risk is the potential adverse impact on earnings and economic value due to commodity price movements and volatilities. Historically, such prices have fluctuated and are affected by numerous factors outside of the Company's control, including, but not limited to: industrial and retail demand, central bank lending, forward sales by producers and speculators, levels of worldwide production, short-term changes in supply and demand because of speculative hedging activities and other factors such as significant mine closures. The Company does not have any hedging or other commodity-based risks respecting its operations. The value of the Company's strategic investments is also related to the price of, and outlook for, base and precious metals and other minerals.

## KWG RESOURCES INC.

### Notes to the Consolidated Financial Statements (in Canadian dollars)

#### 24 DETERMINATION OF FAIR VALUES

##### Measurement Categories

As explained in Note 3, financial assets and liabilities have been classified into categories that determine their basis of measurement and, for items measured at fair value, whether changes in fair value are recognized in the statement of operations or comprehensive income (loss). Those categories are: fair value through profit or loss; loans and receivables; available for sale assets; and, for liabilities, amortized cost. The following table shows the carrying values of financial assets and liabilities for each of these categories at the reporting date.

	Notes	December 31, 2012	December 31, 2011
<b>Assets</b>			
Loans and receivables			
Cash	6	3,131,032	2,065,186
Receivables	7	927,393	861,713
Available for sale			
Marketable securities	8	401,940	888,450
Fair value through profit and loss			
Cash equivalents	6	7,934,972	13,965,365
Marketable securities	8	169,100	2,284,000
<b>Liabilities</b>			
Amortized cost			
Trade and other payables	11	810,461	1,112,929
Fair value through profit and loss			
Warrant liability	12	3,205	1,096,584

A number of the Company's accounting policies and disclosures require the determination of fair value for both financial and non-financial assets and liabilities. Fair values have been determined for measurement and/or disclosure purposes based on the methods described below. When applicable, further information about the assumptions made in determining fair values is disclosed in the notes specific to that asset or liability.

##### (i) Marketable securities

The fair value of marketable securities included in financial assets at fair value through operations or OCI is determined by reference to their quoted closing bid price at the reporting date.

##### *Fair Value Hierarchy*

The different levels of valuation are defined as follows:

- Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and
- Level 3: Inputs for the asset or liability are not based on observable market data (unobservable inputs).

## KWG RESOURCES INC.

### Notes to the Consolidated Financial Statements (in Canadian dollars)

The table below analyzes financial instruments carried at fair value by valuation method:

	Level 1	Level 2	Level 3	Total
<b>As at December 31, 2012</b>				
<b>Assets</b>				
Cash equivalents	-	7,934,972	-	7,934,972
Marketable securities classified as AFS	401,940	-	-	401,940
Marketable securities classified as FVTPL	-	169,100	-	169,100
<b>Total assets</b>	<b>401,940</b>	<b>8,104,072</b>	<b>-</b>	<b>8,506,012</b>
<b>Liabilities</b>				
Warrant liability classified as FVTPL	-	810,461	-	810,461
<b>Total liabilities</b>	<b>-</b>	<b>810,461</b>	<b>-</b>	<b>810,461</b>
<b>As at December 31, 2011</b>				
<b>Assets</b>				
Cash equivalents	-	13,965,365	-	13,965,365
Marketable securities classified as AFS	888,450	-	-	888,450
Marketable securities classified as FVTPL	-	2,284,000	-	2,284,000
<b>Total assets</b>	<b>888,450</b>	<b>16,249,365</b>	<b>-</b>	<b>17,137,815</b>
<b>Liabilities</b>				
Warrant liability classified as FVTPL	-	1,096,584	-	1,096,584
<b>Total liabilities</b>	<b>-</b>	<b>1,096,584</b>	<b>-</b>	<b>1,096,584</b>

#### (ii) Warrants and Warrant Liability

The fair values of equity warrants and the warrant liability are based upon the Black-Scholes option-pricing model. Measurement inputs include share price on measurement date, exercise price of the instrument, expected volatility (based on weighted average historic volatility adjusted for changes expected due to publicly available information), weighted average expected life of the instruments (based on historic experience and general option-holder behaviour), expected dividends and the risk-free interest rate (based on government bonds). Notes 8 and 12 contain details of these inputs.

#### (iii) Receivables

The fair value of receivables is estimated at their book value due to their short term nature.

#### (iv) Non-derivative Financial Liabilities

Fair value, which is determined for disclosure purposes, is calculated based on the present value of future principal and interest cash flows, discounted at the market rate of interest at the reporting date.

## 25 CAPITAL MANAGEMENT DISCLOSURES

The Company's objective when managing capital is to safeguard its accumulated capital in order to provide an adequate return to shareholders by maintaining a sufficient level of funds to support continued project development and corporate activities. Capital is defined by the Company as the aggregate of its shareholders' equity. Shareholders' equity totalled \$43,350,755 at December 31, 2012 and \$46,506,820 at December 31, 2011.

The Company manages its capital structure and makes adjustments to it based on the level of funds available to the Company to manage its operations. In order to maintain or adjust the capital structure, the Company expects that it will be able to obtain equity, long-term debt, equipment-based financing and/or project-based financing sufficient to maintain and expand its operations. There are no assurances that these initiatives will be successful. In order to achieve these objectives, the Company invests its unexpended cash in highly-liquid, rated financial instruments. There were no changes in the Company's approach to capital



**KWG RESOURCES INC.****Notes to the Consolidated Financial Statements (in Canadian dollars)**

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management during the year. The Company is not subject to externally imposed capital requirements.

**26 SEGMENTED INFORMATION**

Operating segments are reported in a manner consistent with the way in which the Company's executive officers review business performance on a quarterly basis. The Company's operations comprise a single reporting operating segment engaged in mineral exploration in Canada. As the operations comprise a single reporting segment, amounts disclosed in the consolidated financial statements also represent segment amounts.

**27 SUBSEQUENT EVENT**

On March 4, 2013 the Company signed an agreement with Bold Ventures Inc. ("Bold") to fund Bold as the Operator to drill off the Black Horse chromite discovery. The intent of the program is to determine whether this chromite mineralization occurs in sufficient quantity and quality to demonstrate the feasibility of mining it. Bold recently concluded a four-stage option to acquire the Black Horse claims from Fancamp Exploration Ltd. ("Fancamp"), subject to Fancamp retaining a price-variable gross metal royalty (the "Fancamp Option"). Under the terms of the agreement between KWG and Bold Ventures, KWG can acquire up to 80% of Bold's interest in the Fancamp Option by funding 100% of Bold's earn-in expenditures and option payments. The current program has budgeted \$2 million to drill the chromite horizon. An additional \$1 million has been budgeted to drill a contiguous possible nickel target. For nickel and other non-chromite minerals identified during the exploration programs, the parties have agreed to form a joint venture in which KWG has a 20% working interest. KWG will have a right of first refusal to purchase all ores or concentrates produced by such joint venture whenever its joint venture interest exceeds 50%.