

# **KWG RESOURCES INC.**

(An exploration stage company)

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## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

FOR THE PERIOD ENDED JUNE 30, 2010

# MANAGEMENT'S DISCUSSION AND ANALYSIS

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This management's discussion and analysis (the "MD&A") follows rule 51-102 of the Canadian Securities Administrators regarding continuous disclosure for reporting issuers. It is a complement and supplement to the annual and quarterly financial statements of KWG Resources Inc., ("KWG" or the "Company"), and should be read in conjunction with those statements. It represents the view of management on current activities and past and current financial results of the Company, as well as an outlook of the activities of the coming months.

## **DATE**

This MD&A for the period ended June 30, 2010 is dated August 30, 2010.

## **FORWARD LOOKING INFORMATION**

This MD&A contains or refers to forward-looking information. All information, other than information regarding historical fact that addresses activities, events or developments that the Company believes, expects or anticipates will or may occur in the future is forward-looking information. Such forward-looking information includes, without limitation: the continued maintenance, exploration and the development of the Company's properties and the costs related thereto, as well as the Company's expectation of periodically requiring additional funds therefore; the formation of a joint venture with respect to the Big Daddy deposit; the Company's intention to earn an additional 3.5% interest in the Big Daddy deposit; exploration, development and operational plans, objectives and budgets; the potential significance of the deposit at the Freewest Option property; the possibility of the chromite minerals at the Big Daddy deposit being suitable for direct sale without beneficiation; the completion of the rail pre-feasibility study and the geotechnical drilling program with respect to the proposed railroad; the expected strategic importance and value of the Company's mineral property interests outside of the Big Daddy deposit; the expectation that the railway pre-feasibility level engineering document will enable informed consultations regarding the feasibility of constructing a railroad; mineral resource estimates; potential mineral resources; estimates relating to critical accounting policies; the Company's plans with respect to the conversion to IFRS, including the Company's expected timing for completing the phases of its plan and the development of an effective plan; the continuation of assessments relating to the impact of IFRS on, amongst other things, the Company and its reporting; the Company's plans for adopting and/or implementing changes to accounting policies and the impact of same on the Company's financial statements; the Company's expectations with respect to pursuing new opportunities and acquisitions and its future growth; estimated operating expenses; and the Company's ability to raise new funding.

The forward-looking information in this MD&A reflects the current expectations, assumptions or beliefs of the Company based on information currently available to the Company. With respect to forward looking information contained in this MD&A, the Company has made assumptions regarding, among other things, the Company's ability to successfully generate sufficient funds from capital markets to meet its future obligations as and when required, the quality and grade of mineralization at the Big Daddy deposit, the effectiveness of the Company's design relating to the implementation of IFRS, assumptions relating to the Company's critical accounting policies, the Company's business, the economy and the mineral exploration industry in general, the Company's ability to obtain, maintain, renew and/or extend required permits, licences, authorizations and/or approvals from the appropriate regulatory authorities, the Company's ability to continue to obtain qualified staff and equipment in a timely and cost-efficient manner to meet the Company's demand, and has also assumed that no unusual geological or technical problems occur, plant and equipment work as anticipated, that greater interest in the exploration potential of properties adjacent to the Company's MacFadyen Kimberlites will improve the Company's ability to fund the project, that the Company's railway project in the Ring of Fire will be economic, no material adverse change in the price of chromite and diamonds occurs and no significant events occur outside of the Company's normal course of business. Although the Company believes that the assumptions inherent in the forward-looking information are reasonable, forward-looking information is not a guarantee of future performance and accordingly undue reliance should not be put on such information due to the inherent uncertainty therein.

Forward-looking information is subject to a number of risks and uncertainties that may cause the actual results of the Company to differ materially from those discussed in the forward-looking information, and

even if such actual results are realised or substantially realised, there can be no assurance that they will have the expected consequences to, or effects on, the Company. Factors that could cause actual results or events to differ materially from current expectations include, but are not limited to: the possibility that the Big Daddy deposit will not be further explored or developed by its new Operator after March 31, 2011; risks normally incidental to exploration and development of mineral properties; uncertainties in the interpretation of drill results; the possibility that future exploration, development or mining results will not be consistent with expectations; uncertainty of mineral resources estimates; the Company's inability to obtain, maintain, renew and/or extend required licences, permits, authorizations and/or approvals from the appropriate regulatory authorities and other risks relating to the applicable regulatory framework; the Company's inability to maintain its title to its assets; capital and operating costs varying significantly from estimates; inflation; changes in exchange and interest rates; adverse changes in commodity prices; the inability of the Company to obtain required financing; adverse general market conditions; the Company's inability to delineate additional mineral resources and delineate mineral reserves; operating hazards and risks, management and control; environmental risks; adverse land claims; future unforeseen liabilities and other factors including, but not limited to, those listed under "Risks Inherent in Mining Exploration" in this MD&A.

Any mineral resource figures referred to in this MD&A are estimates and no assurances can be given that the indicated levels of minerals will be produced. Such estimates are expressions of judgment based on knowledge, mining experience, analysis of drilling results and industry practices. Valid estimates made at a given time may significantly change when new information becomes available. While the Company believes that the mineral resource estimates in respect of its properties are well established, by their nature mineral resource estimates are imprecise and depend, to a certain extent, upon statistical inferences which may ultimately prove unreliable. If such mineral resource estimates are inaccurate or are reduced in the future, this could have a material adverse impact on the Company. Mineral resources are not mineral reserves and do not have demonstrated economic viability. There is no certainty that mineral resources can be upgraded to mineral reserves through continued exploration. Due to the uncertainty that may be attached to inferred mineral resources, it cannot be assumed that all or any part of an inferred mineral resource will be upgraded to an indicated or measured mineral resource as a result of continued exploration.

Any forward-looking information speaks only as of the date on which it is made and, except as may be required by applicable securities laws, the Company disclaims any intent or obligation to update any forward-looking information, whether as a result of new information, future events or results or otherwise.

## **COMPANY OVERVIEW**

KWG is an exploration stage company that currently owns 26.5% of the *Big Daddy* chromite deposit located in the "Ring of Fire" area of the James Bay Lowlands of Northern Ontario. The Big Daddy deposit contains an indicated resource of 23.2 million tonnes grading 40.66% chromite and an inferred resource of 16.3 million tonnes grading 39.09% as reported in the Micon International Ltd. "Technical Report on the Mineral Resource Estimate for the Big Daddy Chromite Deposit", dated March 30, 2010 and prepared by Richard M. Gowans, P.Eng, Jane Spooner, M.Sc., P.Geo., Alan J. San Martin, MAusIMM and Charley Z. Murahwi, M.Sc., P.Geo, Pr.Sci.Nat., MAusIMM, all of whom are independent of KWG, as determined in accordance with National Instrument 43-101 ("NI 43-101"). Such technical report is available on KWG's SEDAR profile at [www.sedar.com](http://www.sedar.com). The adjacent *Black Thor* deposit now owned by Cliffs Natural Resources Inc. ("Cliffs") contains an inferred resource of 69.5 million tonnes of 31.9% chromite based on a NI 43-101 report cited in January 2010. These deposits are a very large and globally significant source of high grade chromite minerals which may be refined into ferrochrome, a principal ingredient in the manufacture of stainless steel. The quality and grade of mineralization in the *Big Daddy* deposit may suit it for direct sale without beneficiation, to an international clientele of steelmakers.

The Company has the right to increase its interest in the *Big Daddy* deposit to 30% and is the Operator under terms of the Freewest Option Agreement until March 31, 2011.

KWG also owns a 1% net smelter royalty ("NSR") in the *Big Daddy* deposit and the other two chromite deposits presently-defined and owned by Cliffs.

Also of major significance, through Canada Chrome Corporation ("CCC") - a wholly-owned subsidiary - KWG has staked mining claims covering a unique linear sand ridge that appears to be the best suited route to construct a railroad for transporting materials into the discovery area as well as transporting the mined ores out. Krech Ojard & Associates have been engaged to undertake pre-feasibility engineering of the embankment alignment and water crossings. This is being supported by a geotechnical study being carried out by Golder Associates who collected soil samples from 744 borings using hollow stem auger

drills. The sampling along the 330 kilometer study corridor was completed in May 2010. The pre-feasibility level engineering document will enable informed consultations, with affected First Nations and all other local and regulatory constituencies, on the feasibility of constructing a railroad.

In addition to the ownership of *Big Daddy* interest, the potential transportation corridor and the 1% NSR in the chromite deposits, the Company owns Debuts Diamonds Inc. (“DDI”), a wholly-owned subsidiary which holds all the Company’s diamond exploration properties. KWG controls the MacFadyen Kimberlites and other important contiguous exploration properties that are all adjacent to the De Beers Victor Diamond Mine.

## **RECENT EVENTS AND OUTLOOK**

Spider Resources Inc. (“Spider”) also owns a 26.5% interest in the *Big Daddy* deposit with the same option as KWG to earn another 1.5% this year and 2.0% next year by each incurring \$2.5 million of additional exploration expenditures in each year. On completion of the earn-in, a joint venture (“JV”) will be formed and its operator will be selected by the holders of a majority of the JV interests. The non-operating interest in the *Big Daddy* deposit as well as the adjacent *Black Thor* and *Black Label* deposits are now the property of Cliffs after it acquired all of the outstanding shares of Freewest Resources Canada Inc. (“Freewest”) in January 2010 for \$240 million. On July 26<sup>th</sup>, 2010, Cliffs announced that it had also acquired approximately 85% of the outstanding shares of Spider (see “Recent Development”) at \$0.19 per share, or an aggregate of \$125 million. This followed the termination of an agreement between KWG and Spider to merge the two companies. The combined interests of KWG and Spider in the *Big Daddy* deposit would have formed a majority in the JV, giving the combined company operatorship.

The recent takeover of Spider by Cliffs has:

- established the relative premium value of the *Big Daddy* deposit and our interest in it, at a minimum of almost \$0.19 per KWG share
- added considerably to the value and currency of KWG’s net smelter royalty interests in both the *Big Daddy* and *Black Thor* deposits, and
- has highlighted the most important strategic value of the claims staked by CCC to provide transportation to and from the area’s deposits.

The proposed purchase of Spider by Cliffs valued Spider’s proportionate share of the *Big Daddy* deposit’s presently indicated and inferred chrome resources (23.2 million tonnes of 40.66% chromite and 16.3 million tonnes grading 39.09%) at some 1.5 cents per pound in the ground. Cliffs’ previous purchase of Freewest had valued the similarly-defined resource at 0.9 cents per pound in the ground. On completion of the Spider takeover, Cliffs has now spent some \$365 million to acquire these chromite resources.

As noted, the previously planned combination of KWG and Spider was rendered impossible by the Cliffs takeover of Spider. The merger would have combined into one company up to a 60% operating interest and a 1% NSR in the *Big Daddy* chrome deposit plus the complete interest in CCC and its potential transportation corridor and railroad engineering feasibility study data, *with Cliffs, the principal supplier to North America’s steelmakers, as a 40% contributing joint-venturer*. The whole was thus demonstrably greater than the sum of the parts.

After discussions extending over many months, KWG and Spider had agreed on the principal terms of merging the two companies on Tuesday, May 18th and counsel was instructed that evening to prepare a draft agreement. In a meeting in Cleveland on the Friday before, we had confirmed to Cliffs that the holders of a majority of the outstanding shares of KWG not held by Cliffs would be attracted to an opportunity to convert their shares into Cliffs’ shares and warrants. In discussions about a ratio, we advised of the range of values we felt would be indicated given the requirement that KWG’s shareholders must first be provided with an independent valuation. But, as that was a multiple of the value Cliffs was prepared to consider, it was agreed that further discussions would serve no purpose. Recent events have shown that KWG’s expectation of value were supportable.

Late on Friday afternoon May 21st, Cliffs’ delivered an offer of \$0.13 cash per KWG share and indicated the same offer might be made to Spider instead, unless an acceptance was communicated within 40 hours.

The combination agreement between KWG and Spider was documented while the Boards of both companies formed Special Committees to retain independent counsel and financial advisors, as the law

requires, in order to respond to the Cliffs proposed offers. In KWG's case, Cliffs next requested that its Special Committee retain a valuator to prepare an independent valuation of KWG, at Cliffs' expense as required by securities regulations.

When Cliffs subsequently advised that it had decided to offer to purchase only Spider, it also asked that the KWG Board's Special Committee discontinue the independent valuation. Cliffs then bought a large proxy to vote against the merger by making that a condition to buy 13.8% of Spider's outstanding shares from its principal shareholder. Simply buying the shares would not have provided Cliffs with the right to vote them against the merger, because the record date had passed. The MineralFields group of mutual funds accepted a conditional \$0.19 per share offer and agreed to vote against the merger and not to change that vote or their agreement to sell unless another purchaser offered more than \$0.21 per share. Spider and KWG subsequently terminated their combination agreement and KWG was paid a break fee of \$2.3 million.

While the opportunity to be the operator of the *Big Daddy* deposit was lost by these events, KWG will nevertheless have the right to receive up to 30% of the mine's outturn for its own account. This will provide it with future access to markets for chrome, independently of Cliffs. In seeking financing to enable completion of the combination with Spider, we became acquainted with a number of potential purchasers of or investors in our share of future chromite production.

When Cliffs was unprepared to enter a standstill agreement with KWG as part of its initial subscription for treasury shares in January 2009, it became imperative for KWG to acquire assets with which to improve the economic potential of its minority interest in the *Big Daddy* deposit, as acquiring any further part of the Freewest retained interest soon became impossible and combining with the Spider interest appeared unachievable. Thus the acquisition of the net smelter royalty interests (NSR) was completed to provide KWG with direct participation in the chromite developments no matter which deposit is first exploited, as there was always a risk that it might not be *Big Daddy*. To then further assure the value of the NSR asset and the economic potential and competitiveness of our minority interest in *Big Daddy*, we created CCC to begin development of the most viable transportation option, which it presently controls. A number of off-balance sheet financing alternatives are being studied to fund the first phases of consultation, assessment and construction of this transportation corridor.

We feel that recent events have not only vindicated our view of the value accruing from these globally significant chromite discoveries, but have also established KWG's interest in *Big Daddy* as having a comparable value to the \$125 million paid for Spider by Cliffs – or approximately \$0.19 per KWG share on a fully-diluted basis. We therefore intend to exercise our options to earn the additional 1.5% and further 2% interests by first completing a drilling program designed to further increase the resources and thus the value of the deposit. The very significant investment made in these resources thus far by Cliffs, dictates that the project moves forward to development as rapidly as possible and we look forward to the opportunity of now working with Cliffs to that end.

With the high profile events occurring recently in relation to the Company's chromite assets, its other assets should not be disregarded. KWG also has a substantial and important joint venture interest in the McFaulds Lake properties, where ten discoveries of economically interesting grades of copper and zinc have been previously found. As the viability of the railroad is enhanced from increased investments in the Ring of Fire, such as Cliffs and others have made, as well as the support for development expressed publicly by the government of Ontario, these other mineral property interests of the Company will gain in strategic importance and value.

Production of diamonds at De Beers' Victor Mine has recently returned to previous volumes. The opportunity to identify additional diamondiferous kimberlite resources to augment the Victor plant's production and defer its ultimate closure, describes an increasingly timely prospect for DDI and its MacFadyen and other Victor area properties. Similarly, the recent discovery of diamonds announced by Metalex Ventures is highly encouraging for DDI's interest in the Kyle Kimberlites that are nearby. It is hoped that the value of DDI may soon be utilized to pursue these opportunities, as has been planned for some time.

## **RECENT DEVELOPMENT HIGHLIGHTS**

### **(A) Special Committee Formed to Consider Strategic Alternatives**

On May 24, 2010, the Company announced that it received a non-binding take-over bid proposal. In response to such proposal and to consider strategic alternatives, the Board of Directors of the Company met and formed a Special Committee of independent directors.

### **(B) Proposed Take-Over Bids by Cliffs Natural Resources Inc.**

On May 24, 2010, Cliffs announced that it intended to make take-over bids for all of the issued and outstanding common shares (not already owned by Cliffs or its affiliates) of KWG and/or Spider for cash consideration of \$0.13 per share. Cliffs advised that neither bid would be conditional upon the completion of the other.

### **(C) Adoption of a Shareholder Protection Rights Plan**

On May 25, 2010, the Company announced that the Board approved the adoption of a shareholder rights plan, effective May 25, 2010. The objective of the rights plan was to ensure, to the extent possible, that all shareholders of the Company are treated equally and fairly in connection with any initiative to acquire control of the Company.

### **(D) Appointment of Financial Advisor**

On May 25, 2010, the Company announced that Canaccord Genuity Corp. had been appointed as the financial advisor to the Special Committee of independent directors. Canaccord Genuity Corp. would assist the Special Committee in considering various responses and strategic alternatives to the announcement by Cliffs that it intended to make a take-over bid to acquire all of KWG's common shares.

### **(E) KWG & Spider Enter Into Binding Letter Agreement Regarding Proposed Merger**

On May 25, 2010, the Company and Spider announced that they entered into a binding letter agreement which set out the principal terms upon which it is proposed that the two corporations would complete a business combination (the "Merger"), at the conclusion of which the shareholders of each corporation would hold 50% of the outstanding shares of the ongoing public corporation. The combined company would hold a current interest of 53% in the Big Daddy deposit, with the option to earn a further 7% to achieve a 60% interest in the project. It was anticipated that the ongoing public corporation would continue to be named "KWG Resources Inc." for a period of time after the Merger and would continue to be listed on the TSX Venture Exchange ("TSXV") and on the Canadian National Stock Exchange (the "CNSX"). Following the Merger, it was proposed that the name of the ongoing public company would be changed to "Spider-KWG Resources Inc." subject to shareholder and regulatory approvals.

### **(F) KWG Responds to Comments By Cliffs**

On May 28, 2010, the Company noted the press release issued by Cliffs with respect to the announcement of the proposed merger between KWG and Spider.

The proposed merger between Spider and KWG was a logical next step in the continued exploration and development of their jointly held mineral projects in Northern Ontario and would represent the culmination of a partnership that has endured for over 18 years. KWG believed that this combination would have created value for both sets of shareholders by securing control of their respective assets, and in particular a majority interest in the Big Daddy Deposit. The merger as announced had been structured to ensure each shareholder group would hold an equivalent interest in the assets to what they held at the time, but with additional scale, market liquidity, and ultimate control over the assets. The combined company would then have the flexibility to develop the Big Daddy deposit, as well as its other assets, to maximize value to its combined shareholder base.

### **(G) Cormark Securities Inc. Engaged for Formal Valuation**

On June 3, 2010, the Special Committee announced that it engaged Cormark Securities Inc. to complete a formal valuation of the Company's common shares in response to Cliffs Greene B.V.'s ("Cliffs BV") stated intention to commence a takeover bid of all of the common shares of KWG (the "Proposed Bid"). Since Cliffs BV held 19.4% of the outstanding securities of KWG, the Proposed Bid was considered an "insider bid" under Multilateral Instrument 61-101 - Protection of Minority Security Holders in Special Transactions. Accordingly, the Special Committee was required to supervise the preparation of a formal valuation by an independent valuator at Cliffs BVs' expense,

which formal valuation was to be included, in summary or in its entirety, in any circular prepared by Cliffs BV and circulated to the Company's shareholders in connection with the Proposed Bid.

**(H) Formal Valuation Commences**

On June 8, 2010, the Company announced that the previously announced formal valuation of the Company's common shares had been commenced by the independent valuator, Cormark Securities Inc. In a letter delivered by Cliffs to KWG on June 7th, after the news release issued by Cliffs on the same date, Cliffs requested the continuation of the valuation. The formal valuation was required to be completed in response to Cliffs BV's stated intention to commence a takeover bid of all of the common shares of KWG (the "Proposed Bid").

**(I) KWG & Spider Enter Into Definitive Business Combination Agreement**

On June 14, 2010, the Company announced the signing of a definitive business combination agreement with Spider pursuant to which KWG and Spider proposed to complete a business combination (the "Amalgamation").

The Amalgamation would be effected by way of a three cornered amalgamation. Pursuant to the Amalgamation, and subject to regulatory approval and the approval of the shareholders of Spider, each outstanding common share of Spider would be exchanged for 1.21 common shares of KWG, subject to adjustment in certain circumstances relating to the shareholder rights plans of each of KWG and Spider. As well, the Combination Agreement contained provisions dealing with the exchange or exercise of outstanding Spider share purchase warrants and options.

**(J) Notice of Superior Proposal Respecting Proposed Combination of KWG & Spider Addressed**

On June 18, 2010, the Company received notification from Spider that Cliffs had made a Spider Alternative Proposal (as defined in the combination agreement among KWG, its wholly-owned subsidiary, 7569076 Canada Inc ("KWG Subco") and Spider dated as of June 11, 2010 (the "Combination Agreement"), and that the board of directors of Spider determined such proposal to be a Spider Superior Proposal (as defined in the Combination Agreement). If the Spider Superior Proposal was proceeded with, Cliffs would increase the offer price under its take-over bid for the outstanding common shares of Spider and associated rights under Spider's shareholder rights plan (collectively the "Spider Shares") to \$0.165 per Spider Share.

Pursuant to the Combination Agreement, KWG had the opportunity, but not the obligation, to offer in writing to amend the terms of the Combination Agreement and the Amalgamation before 12:01 a.m. on June 24th, 2010. KWG considered making such an offer. If KWG made an offer that matched the Spider Superior Proposal, KWG, KWG Subco and Spider would enter into an amended agreement reflecting KWG's amended proposal. If such an offer was not made by KWG or was made but not accepted by Spider as matching the Spider Superior Proposal, then as a condition to the right of Spider to terminate the Combination Agreement in order to enter into an agreement with respect to the Spider Superior Proposal or otherwise accept, approve or recommend the Spider Superior Proposal, Spider would be required, on or prior to the date of such termination, to pay to KWG a cash payment equal to \$2,300,000.

**(K) Conditional Approval of TSXV Received for Proposed Business Combination with Spider**

On June 22, 2010, the Company announced that it had received conditional approval from the TSXV with respect to the previously announced Amalgamation with Spider. Pursuant to the Amalgamation, and subject to required regulatory approvals and the approval of the shareholders of Spider, each outstanding common share of Spider would be exchanged for 1.21 common shares of KWG, subject to adjustment in certain circumstances relating to the shareholder rights plans of each of KWG and Spider.

Completion of the Amalgamation and final acceptance from the TSXV was subject to a number of conditions and approvals, including fulfilling all required filing requirements pursuant to the policies of the TSXV. The Amalgamation also required the approval of a majority of not less than two-thirds of the votes cast in respect of the resolution to approve the Amalgamation by shareholders of Spider entitled to vote at a meeting to be held on July 8, 2010.

**(L) KWG & Spider Announce Match and Agree to Proceed with Amalgamation**

On June 25, 2010, the Company along with Spider announced that Spider had determined that the offer made to it by KWG (the "New KWG Offer") proposing certain amendments to the terms of the Combination Agreement had matched the proposal from Cliffs to acquire the common shares of

Spider for \$0.165 per share. Accordingly, Spider and KWG proceeded with the Combination Agreement and the Amalgamation.

Under the terms of the New KWG Offer, the Combination Agreement would be amended not only to increase the exchange ratio (from 1:1.21) to 1:1.30 but KWG would also retain the 50% interest in the 2% net smelter returns royalty that it currently owns in respect of the Big Daddy, Black Thor and Black Label deposits, as well as its railway assets. These assets were to have been "spun out" prior to the Amalgamation; however, under the New KWG Offer they would remain as assets of the combined company allowing Spider shareholders to share in these assets. All other terms and conditions of the Combination Agreement would remain unamended.

**(M) KWG Considered Whether Cliffs' Amended Offer Respecting Proposed Combination of KWG & Spider is a Spider Superior Proposal**

On June 28, 2010, the Company received notification from Spider that Cliffs had amended its offer in response to Spider accepting KWG's matching offer, and that the board of Spider had determined such amended offer to be a Spider Superior Proposal (as defined in the Combination Agreement).

KWG, in consultation with its financial adviser, Canaccord Genuity Corp., considered whether Cliffs' amended offer was in fact a Spider Superior Proposal.

KWG had the opportunity, but not the obligation, to offer in writing to amend the terms of the Combination Agreement and the amalgamation of Spider and KWG Subco (the Amalgamation) before 12:01 a.m. on July 6, 2010. In order to enter into an agreement with respect to Cliffs' amended offer or otherwise accept, approve or recommend Cliffs' amended offer, Spider would be required to terminate the Combination Agreement and, on or prior to the date of such termination, to pay to KWG a cash payment equal to \$2,300,000.

**(N) KWG Special Committee Determines that Cliffs' Amended Offer is not a Spider Superior Proposal**

On June 29, 2010, the Special Committee determined that the amended offer of Cliffs (the "Amended Offer") in respect of the common shares of Spider was not a Spider Superior Proposal (as defined in the combination agreement among KWG, its wholly-owned subsidiary, 7569076 Canada Inc., and Spider dated as of June 11, 2010). KWG understood that Spider's Board concluded that the Amended Offer constituted a Spider Superior Proposal within only one hour or less of receipt of the Amended Offer.

The Special Committee of KWG, with the assistance of its financial and legal advisers, continued to consider what steps to take as a result of the foregoing determination.

**(O) Termination of Combination Agreement**

On July 2, 2010, the Company announced that Spider had terminated the Combination Agreement among KWG, its wholly-owned subsidiary, 7569076 Canada Inc., and Spider dated as of June 11, 2010 and paid to KWG a break-fee of \$2,300,000 in connection with such termination.

**(P) Spider Shares to be Retained**

On July 9, 2010, the Company advised that it would not tender its holdings of common shares in Spider to the takeover offer made by a subsidiary of Cliffs. Based on the independent valuations recently undertaken by KWG, it determined to retain its Spider shares until such time as Cliffs proceeds with its stated intention of acquiring the remainder of the Spider shares held by shareholders who do not accept the offer, pursuant to an amalgamation or other acquisition transaction or a statutory squeeze-out. At that time KWG would have the statutory right to dissent and to demand to be paid the fair value of its Spider shares, which KWG believes will exceed the \$0.19 per share being offered by Cliffs.



**(Q) KWG & Spider Announce Discovery of a New Kimberlite on Diagnos Initiative Project "Ring of Fire" Area**

On June 29, 2010, the Company along with Spider announced the discovery of a new kimberlite located on the eastern edge of the "Ring of Fire" exploration area and in the vicinity of the Kyle swarm of kimberlites. The new kimberlite is called Kyle #6 and was hidden beneath 35 metres of Palaeozoic carbonate cover rock including limestone and dolomite. Vertical Hole DGN-10-01 intersected diatreme facies kimberlite between 35 metres and 111 metres down hole. Drilling continues with one drill rig on this new discovery. A second hole is being planned to continue the test of this new kimberlite. Samples will be sent for diamond content testing upon completion of the program. The Diagnos Initiative project is funded equally by Spider and KWG on a 50:50 basis.

**OVERALL PERFORMANCE - FINANCIAL**

During the second quarter ended June 30, 2010, the Company improved its financial situation with the closing of a private placement with total subscriptions of \$6,141,212 and exercises of warrants and stock options for total proceeds of \$1,987,300. The net proceeds from the private placements have been used to finance the exploration work on the Freewest Option in the *Ring of Fire* and to continue its work to develop a proposed route for a railroad link to the *Ring of Fire*. The proceeds from the flow-through Units included in these private placements will be used for eligible flow-through exploration expenses and they will be renounced for the 2010 taxation year. The proceeds from the exercise of warrants and options will be used to fund ongoing working capital requirements.

The Company has maintained its focus on its strategic planning to develop what it expects could become a major North American ferro-chrome supplier deposit as well as a route to export the materials. Exploration activities on the Freewest optioned properties have been steady and progress is being made to understand the value of the deposit.

KWG's railway infrastructure project has been well timed and the need for a railway in the Ring of Fire seems highly economic. KWG continues to raise funds for its subsidiary CCC to develop the engineering plan to develop a railroad link to the Ring of Fire.

**LIQUIDITY & CAPITAL RESOURCES**

The main source of financing for KWG is the issuance of equity shares. Each of KWG's projects has demonstrated sufficient evidence of geological merit to warrant additional exploration. However, it is not presently possible to estimate the cost of further exploration programs, which may or may not bring individual properties to a subsequent stage of development, since they are all exploration projects and their development depends on the results of exploration. On June 30, 2010, the Company had a working capital deficiency of \$243,125 (working capital of \$471,754 as at December 31, 2009) including \$1,303,725 in cash and cash equivalents. While the Company's expenditures for the first six months of 2010 were consistent with budgeted amounts, the deterioration in working capital was mainly caused by outlays related to the proposed combination of KWG and Spider. Subsequent to the June 30, 2010 quarter end, the Company's working capital was increased by \$2.3M through the receipt of a termination fee from Spider. The Company forecasts operating expenses of approximately \$3 million for 2010. KWG currently does not have adequate working capital to finance its corporate and administrative activities for the entire 2010 year. However, the Company expects to raise additional funds through further equity financings throughout 2010 to cover these costs as well as its upcoming exploration programs.

**RESULTS FROM OPERATIONS**

During the three-month period ended June 30, 2010 the Company recorded an operating loss of \$2,708,890 (\$0.00 per share) for a cumulative loss of \$2,202,062 (\$0.00 per share) for the six-month period ended June 30, 2010 (losses of \$1,883,834 (\$0.01 per share) and \$2,358,410 (\$0.01 per share) for the comparable periods in 2009, respectively). This accumulated loss includes the recording of a future income tax recovery in the amount of \$1,022,000 (\$105,000 in 2009) related to the renunciation to investors of resource expenditure deductions for income tax purposes. In accordance with its accounting policy, the related charge was accounted for as an increase in the deficit through share issue expenses. The quarterly pre-tax loss increased mainly due to higher professional fees incurred. The period results are explained as follows:

## **Income**

Interest and other income amounted to \$5,624 for the three months ended June 30, 2010 (\$6,602 for the six months ended June 30, 2010) compared with \$14,026 for the same period in 2009 (\$17,191 for the six months ended June 30, 2009). This decrease in interest revenue is due to a lower average level of cash on hand during the period compared to 2009 and lower interest rates.

## **Expenses**

### *Administrative Expenses*

Administrative expenses for the three months ended June 30, 2010 amounted to \$1,569,552 (\$2,059,431 for the six months ended June 30, 2010) compared to \$910,000 for the same period in 2009 (\$1,390,064 for the six months ended June 30, 2009) for a net increase of \$659,552 (\$669,367 cumulative). The following discusses variances in the main components of the administrative expenses:

- DDI, which became a reporting issuer in Ontario in late 2008, incurred administrative and corporate expenses amounting to \$13,000 for the three months ended June 30, 2010 (\$14,000 for the first six months of 2010) compared to \$64,000 for the same period in 2009 (\$178,000 for the first six months of 2009) as DDI has been virtually inactive during the current year;
- Increased salaries of \$136,000 (cumulative of \$241,000), directors fees of \$5,000 (cumulative of \$10,000) and consulting fees of \$50,000 (cumulative of \$67,000) were incurred due to greater involvement of certain officers, directors and outside consultants in relation to the reorganization and operation of the Company, the proposed amalgamation of the Company with Spider as described above and the private placements completed in the first six months;
- In 2009 a special bonus of \$435,000 was paid to certain officers and directors of the company. The company has not incurred any such expenses in 2010.
- Professional fees increased by \$869,000 (cumulative increase of \$851,000) in the three months ended June 30, 2010 versus the same period in 2009. These increased costs are all directly related to the series of events noted above under "Recent Events and Outlook" and "Recent Development Highlights" regarding the attempted restructuring of the Company.
- Promotional and investor relations expenses decreased by \$14,000 (cumulative decrease of \$24,000) as the Company focused on increasing its operating efficiencies in this area; and
- Corporate expenses increased by \$99,000 (cumulative increase of \$123,000) which included an increase in filing fees of \$53,000 (cumulative increase of \$28,000) due to a greater number of private placement issuances in 2010, a reduction in expenditures on seminars and conferences of \$8,000 (cumulative decrease of \$3,000), increased overheads in the Toronto office of \$31,000 (cumulative increase of \$70,000) and increased travel costs of \$23,000 (cumulative increase of \$28,000).

### *Realized Loss on Temporary Investments*

For the three months ending June 30, 2010, the Company recognized a loss of \$97,596 on its investment in Copper Mesa Mining Corporation ("Copper Mesa"). The shares of Copper Mesa were delisted on February 19, 2010 and since there is no known market for these shares the Company has determined that their value has been permanently impaired. There was no such loss in the previous year.

### *Stock Compensation Costs*

Stock compensation costs constitute a non-cash expense. Stock Compensation Costs for the second quarter of 2010 totaled \$1,040,545 (\$1,108,368 cumulative to June 30, 2010) compared with \$11,270 (\$40,736 cumulative to June 30, 2009) in 2009. This resulted from the issuance of new stock options in the latter part of 2009 and in the second quarter of 2010. These stock options vest throughout 2010, 2011 and early 2012. The calculated cost of these stock options is recognized as an expense over the vesting period.

### *Foreign Exchange Gain (Loss)*

For the three months ending June 30, 2010, the company realized a foreign exchange loss of \$606 (cumulative gain of \$46,581) compared to a loss of \$315,711 (cumulative loss of \$341,422) in the comparable period of 2009. This was a result of the Company holding a net negative US working capital balance throughout the first six months of 2010 while the Canadian dollar strengthened against its US

counterpart. There was virtually no change to the exchange gain (loss) during the second quarter of 2010.

## **SUMMARY OF QUARTERLY RESULTS**

*(Thousands of dollars, except amount per share)*

Quarter	Total income (\$)	Income (loss) (\$)	Income (loss) per share (basic and diluted) (\$)
June 30, 2010	6	(2,709)	<(0.01)
March 31, 2010	1	507	<0.01
December 31, 2009	2	(689)	<(0.01)
September 30, 2009	1	(949)	<(0.01)
June 30, 2009	14	(1,883)	<(0.01)
March 31, 2009	3	(474)	<(0.00)
December 31, 2008	87	(4,695)	<(0.02)
September 30, 2008	54	(333)	<(0.00)

The higher losses in certain quarters are attributable mainly to mineral property write-offs during such quarters. The profit in the first quarter of 2010 was caused by the recording of a future income tax recovery caused by the renunciation of Canadian exploration expenses.

The foregoing financial data has been prepared in accordance with Canadian GAAP and the reporting currency of such financial data is Canadian dollars.

## **COMMITMENTS**

Pursuant to flow-through financing agreements closed during the year ended December 31, 2009, the Company was required to incur \$1,433,801 in Canadian exploration expenses by December 31, 2010. This requirement was met in the first quarter of 2010.

Pursuant to flow-through financing agreements closed during the six-month period ended June 30, 2010 the Company must incur an additional \$1,506,685 in exploration expenses by December 31, 2010.

## **RELATED PARTY TRANSACTIONS**

Related party transactions occurred in the normal course of business and were recorded at the exchange value, reflecting the consideration determined and agreed to by the parties. In the first six months of 2010, officers and companies controlled by officers charged consulting fees totalling \$166,750 (June 30, 2009 - \$148,140) of which \$44,380 remained payable at June 30, 2010 (June 30, 2009 - nil) and directors of the Company and a company controlled by a director of the Company charged \$163,133 (June 30, 2009 - \$156,427) for professional consulting services and directors fees of which nil remained payable at June 30, 2010 (June 30, 2009 - nil).

## **FUTURE ACCOUNTING CHANGES**

### **Business Combinations/Consolidated Financial Statement/Non-Controlling Interest**

In January 2009, the CICA adopted sections 1582, "*Business Combinations*", 1601, "*Consolidated Financial Statements*" and 1602, "*Non-Controlling Interest*" which superseded current sections 1581, "*Business Combinations*" and 1600, "*Consolidated Financial Statements*". These sections will be applied prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011. Earlier adoption is permitted. If an entity applies these sections before January 1, 2011, it is required to disclose that fact and apply each of the new sections concurrently. These new sections were created to converge Canadian GAAP to International Financial Reporting Standards.

## **INTERNATIONAL FINANCIAL REPORTING STANDARDS (“IFRS”)**

In February 2008, the Canadian Accounting Standards Board (“AcSB”) confirmed that publicly accountable enterprises will be required to adopt International Financial Reporting Standards (“IFRS”) for fiscal years beginning on or after January 1, 2011, with earlier adoption permitted. Accordingly, the conversion to IFRS will be applicable to the Corporation’s reporting no later than in the first quarter of 2011, with restatement of comparative information presented. The conversion to IFRS will impact the Corporation’s accounting policies, information technology and data systems, internal control over financial reporting, and disclosure controls and procedures. The transition may also impact business activities, such as foreign currency and hedging activities, certain contractual arrangements, debt covenants, capital requirements and compensation arrangements.

The Corporation has substantially completed the scoping and planning phase of its changeover plan and commenced the detailed assessment phase. The Corporation has designated the appropriate resources to the project to develop an effective plan and will continue to assess resource and training requirements as the project progresses. The Corporation has identified the following four phases of its conversion plan; scoping and planning, detailed assessment, operations implementation and post implementation. The scoping and planning phase requires obtaining stakeholder support for the project, identifying major areas and development of a project charter, implementation plan and communication strategy. The Corporation has substantially completed the scoping and planning phase. The detailed assessment phase (“Phase 2”) will result in accounting policies and transitional exemption decisions, quantification of financial statement impact, preparation of shell financial statements and identification of business processes and resources impacted. The operations implementation phase (“Phase 3”) includes the design of business, reporting and system processes to support the compilation of IFRS compliant financial data for the opening balance sheet at January 1, 2010, fiscal 2010 and thereafter. Phase 3 also includes ongoing training and updated processes for disclosure controls and procedures. Post implementation (“Phase 4”) will include sustainable IFRS compliant financial data and processes for fiscal 2011 and beyond. The Corporation will continue to monitor changes in IFRS throughout the duration of the implementation process and assess their impacts on the Corporation and its reporting.

## **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

### **Mining Assets**

Exploration properties include rights in mining properties and deferred exploration expenses. Exploration costs are deferred until the economic viability of the project has been established, at which time costs are added to mining properties. Costs are written off when properties are abandoned or when cost recovery is uncertain. Management has defined uncertainty as either there being no financial resources available from the Company or its joint venture partners for development of a mining property over a three-year period, or results from exploration work not warranting further investment.

### **Impairment of Long-Lived Assets**

Long-lived assets are reviewed for impairment upon the occurrence of events or changes in circumstances indicating that the carrying value of the assets may not be recoverable, as identified by comparing their net book value to the estimated undiscounted future cash flows generated by their use and eventual disposal. Impairment is measured as the excess of the carrying value over the fair value, determined principally by discounting the estimated net future cash flows expected to be generated from the use and eventual disposal of the related asset. In the event that the Company has insufficient information about its exploration properties to estimate future cash flows to test the recoverability of the capitalized costs, the Company will test for impairment by comparing the fair value to the carrying amount, without first performing a test for recoverability.

### **Income Taxes**

The Company provides for income taxes using the liability method of tax allocation. Under this method, future income tax assets and liabilities are determined based on deductible or taxable temporary differences between the accounting values and tax values of assets and liabilities using substantively enacted or enacted income tax rates expected to be in effect for the year in which the differences are expected to reverse. The Company establishes a valuation allowance against future income tax assets if, based upon available information, it is more likely than not that some or all of the income tax assets will not be realized.

## **FINANCIAL INSTRUMENTS\***

The Company is exposed to various financial risks resulting from both its operations and its investments activities. The Company's management manages financial risks. The Company does not enter in financial instrument agreements including derivative financial instruments for speculative purposes. The Company's main financial risk exposure and its financial risk management policies are as follows:

### **Interest Rate Risk**

Interest rate risk is the risk that the future cash flows of a financial instrument will fluctuate because of changes in the market interest rates.

### **Credit Risks**

It is management's opinion that the Company is not exposed to significant credit risks.

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. The Company is subject to concentrations of credit risk through cash and accounts receivable. The Company reduces its credit risk by maintaining part of its cash in financial instruments guaranteed by and held with a Canadian chartered bank.

### **Foreign Exchange Risk**

Foreign exchange risk is the potential adverse impact on earnings and economic value due to movements and volatilities in foreign exchange rates. The Company maintains cash denominated in US dollars and it also engages suppliers whose payments are required to be made in US dollars. As a result, the Company is exposed to US dollar fluctuations. As at June 30, 2010 US dollar denominated balances included cash of US\$46,710 (US\$1,043,645 in 2009) and accounts payable of US\$291,011 (nil in 2009).

### **Liquidity Risk**

Liquidity risk is the risk that the Company will not be able to meet the obligations associated with its financial liabilities. As at June 30, 2010, the Company did not have enough funds available to satisfy its obligations under accounts payable and accrued liabilities. However, this was rectified through cash received as a result of the termination payment mentioned above in early July 2010.

In the past few years, the Company has financed its liquidity needs primarily by issuing equity securities. As the Company is currently incurring operating losses, additional capital will be required to continue exploration activities on the properties.

## **RISKS INHERENT TO MINING EXPLORATION**

The Company is engaged in the business of acquiring and exploring mineral properties in the hope of locating economic deposits of minerals. The Company's property interests are in the exploration stage only and are without a known body of commercial ore. Accordingly, there is little likelihood that the Company will realize any profits in the short to medium term. Any profitability in the future from the Company's business will be dependent upon locating an economic deposit of minerals. However, there can be no assurance, even if an economic deposit of minerals is located, that it can be commercially mined.

### **Additional Equity Financing**

The advancement, exploration and development of KWG's properties, including continuing exploration and development projects, and, if warranted, construction of mining facilities and commencement of mining operations, will require substantial additional financing. The most likely source of such future financing that would be available to KWG is through the sale of additional equity capital. However, there can be no assurance that such financing will be available to KWG or that it will be obtained on terms favourable to KWG or will provide KWG with sufficient funding to meet its objectives or capital or operating requirements, which may adversely affect KWG's business, financial condition and results of operations. Additional financing may not be available when needed or, if available, the terms of such financing might not be favourable to KWG and might involve substantial dilution to existing shareholders.

Failure to obtain sufficient financing as and when required by KWG will result in a delay or indefinite postponement of the advancement, exploration or development on any or all of KWG's properties or even a loss of a property interest, which would have a material adverse effect on KWG's business, financial condition and results of operations. Global securities markets are currently experiencing volatility, which

may result in difficulty in raising equity capital and market forces may render it difficult or impossible for KWG to secure purchasers of KWG's securities at prices which will not lead to severe dilution to existing shareholders, or at all.

### **Going Concern**

KWG's ability to continue as a going concern is dependent upon its ability in the future to achieve profitable operations and, in the meantime, to obtain the necessary financing to meet its obligations and repay its liabilities arising from normal business operations when they become due. There can be no assurance once a decision is made with respect to future activities that KWG will be able to execute on its plans. The consolidated financial statements of KWG do not include any adjustments related to the carrying values and classification of assets and liabilities should KWG be unable to continue as a going concern.

### **Regulation and Environmental Requirements**

The activities of the Company require permits from various governmental authorities and are governed by laws and regulations governing prospecting, development, mining, production, exports, taxes, labour standards, occupational health, environmental protection and other matters. Increased costs and delays may result of the need to comply with applicable laws and regulations. If the Company is unable to obtain or renew licenses, approvals and permits, it may be curtailed or prohibited from proceeding with exploration or development activities.

### **Capital Needs**

The exploration, development, mining and processing of the Company's properties will require substantial additional financing. KWG's liquidity as at the date hereof is insufficient to meet KWG's corporate, administrative and exploration expenses and commitments for the remainder of 2010. KWG's only source of liquidity is cash and cash equivalent balances. Liquidity requirements are managed based upon forecast cash flows to ensure that there is sufficient working capital to meet KWG's obligations. KWG's ability to continue its business operations is dependent on management's ability to secure additional financing. There is no assurance that such funding will be available to the Company or that it will be obtained on terms favourable to the Company or will provide the Company with sufficient funds to meet its objectives, which may adversely affect the Company's business and financial position. KWG's main funding requirements for 2010 are for its corporate overheads and continuation of its mineral exploration, property and project obligations, including professional fees, consultants' fees, investor relations, salaries and benefits and office overheads of approximately \$1,800,000 in the aggregate. As a result, KWG will be required to seek additional sources of equity financing before the end of the 2010 financial year, if not sooner, and has begun planning in this respect and is actively considering proposals. While KWG has been successful in raising such financing in the past, KWG's ability to raise additional equity financing may be affected by numerous factors beyond KWG's control, including, but not limited to, adverse market conditions and/or commodity price changes and economic downturn and those other factors listed under this "Risk Factors" section, and there can be no assurance that KWG will be successful in obtaining any additional financing required to continue its business operations and/or maintain its property interests or that it will be obtained on terms favourable to KWG or will provide KWG with sufficient funds to meet its objectives. Failure to obtain sufficient financing as and when required may result in delaying or indefinite postponement of exploration and/or development on any or all of KWG's properties or even a loss of property interest, which would have a material adverse effect on KWG's business, financial condition and results of operations.

### **Commodity Prices**

The market price of the Company's common shares, its financial results and its exploration, development and mining activities have previously been, or may in the future be, significantly adversely affected by declines in the price of precious or base minerals.

### **Uninsured Risks**

KWG's business is subject to a number of risks and hazards, including adverse environmental conditions, industrial accidents, labour disputes, unusual or unexpected geological conditions, ground or slope failures, cave-ins, and natural phenomena such as inclement weather conditions, floods and earthquakes. Such occurrences could result in damage to mineral properties or production facilities, personal injury or death, environmental damage to the KWG's properties or the properties of others, delays in mining, monetary losses and possible legal liability.

### **Land Title**

Although KWG has taken reasonable measures to ensure proper title to its properties, there is no guarantee that title to any of its properties will not be challenged or impugned. Third parties may have valid claims against the KWG properties.

### **OTHER**

<b>Administrative Expenses</b>	<b>Six Months Ended June 30, 2010</b>	<b>Six Months Ended June 30, 2009</b>
	\$	\$
Advertising & Promotion	12,068	21,825
Audit Fees	87,696	66,818
Change in Control/Special Bonuses	-	481
Consultant's Fees	391,126	410,179
Corporate Development	-	4,937
Directors Fees & Insurance	34,223	23,647
Filing Fees	71,192	54,635
Investor Relations Fees	89,283	111,352
Legal Fees	917,573	124,193
Office Overhead	104,091	49,050
Salaries	292,784	486,861
Seminars & Conferences	3,170	7,532
Travel & Accommodation	56,225	28,554
	<hr/>	<hr/>
Total Administrative Expenses	2,059,431	1,390,064

### **National Instrument 51-102 - Section 5.4**

Disclosure of Outstanding Share Data (as at August 30, 2010)

**Common shares outstanding:** 589,549,206

**Rights to acquire common shares pursuant to KWG's shareholder rights plan:** 589,549,206

**Warrants and compensation options outstanding:** 184,487,494

Each warrant entitles the holder to purchase one common share of the Company at the following prices:

<b>Number of Warrants</b>	<b>Exercise Price \$</b>	<b>Expiry Date</b>
1,000,000	0.10	August 2010
12,219,960	0.10	November 2010
6,852,373	0.10	December 2010
250,000	0.10	February 2011
19,545,000	0.15	March 2012
24,424,849	0.15	April 2012
503,824	0.15	May 2012
1,500,000	0.10	June 2012
1,000,000	0.10	July 2012
29,327,809	0.10	October 2012
8,697,500	0.12	October 2012
4,135,000	0.15	December 2012
7,062,325	0.18	December 2012
26,518,854	0.10 U.S.	March 2014
15,000,000	0.10	July 2014
26,450,000	0.10	August 2014

**Options outstanding:** 55,856,780 - average exercise price of \$0.115

<b>Number of Options</b>	<b>Expiry Date</b>
6,328,580	November 2010
300,000	March 2011
1,700,000	December 2011
2,690,000	June 2012
1,820,000	September 2012
500,000	October 2012
3,410,000	November 2012
2,000,000	December 2012
2,216,600	February 2013
588,100	May 2013
400,000	October 2013
6,358,500	October 2014
26,045,000	May 2015
1,500,000	June 2015

#### **ADDITIONAL INFORMATION**

Additional information relating to the Company is available on SEDAR ([WWW.SEDAR.COM](http://WWW.SEDAR.COM)).