

**KWG RESOURCES INC.**  
(An exploration stage company)

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**2008 ANNUAL REPORT**



# MANAGEMENT'S DISCUSSION AND ANALYSIS

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This management's discussion and analysis (the "MD&A") follows rule 51-102A of the Canadian Securities Administrators regarding continuous disclosure for reporting issuers. It is a complement and supplement to the annual and quarterly financial statements 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.

## 1.1 DATE

This MD&A for the period ended December 31, 2008 is dated March 16, 2009.

## 1.2 FORWARD LOOKING STATEMENTS

This MD&A contains forward-looking statements that are based on the Company's expectations, estimates and projections regarding its business, the mining industry in general and the economic environment in which it operates as of the date of the MD&A. These statements are reasonable but involve a number of risks and uncertainties, and there can be no assurance that they will prove to be accurate. Therefore, actual outcome and results may differ materially from those expressed in or implied by these forward-looking statements. The risk and uncertainties are further described in section 1.16 of this MD&A and include risks inherent to mining exploration and development, fluctuating prices, operating hazards and risks, management and control, title to assets, government regulation, environmental factors, land claims, and requirement of new capital. The Company cautions that this list of risks and uncertainties is not exhaustive.

## 1.3 NATURE OF ACTIVITIES

KWG Resources Inc., ("KWG" or the "Company"), is an exploration stage company with properties in Ontario, Canada. KWG has two property groups: the chromite, nickel, base metal group and the diamond group held in a wholly owned subsidiary, Debuts Diamonds Inc. ("DDI"). KWG has no income from production since all its properties are at the exploration stage.

## 1.4 RECENT DEVELOPMENTS AND OUTLOOK

KWG is redirecting its strategic objective to the development of the chrome project and as part of this change of strategy, entered into an option to purchase securities agreement with Cliffs Natural Resources Inc., on January 20, 2009, for the purchase and acquisition of certain securities of the Company in the aggregate amount of CAN\$4,516,750 (US\$3,500,000). Significant recent developments since the last interim MD&A dated November 27, 2008 are discussed below under the following headings:

- (A) **Option to purchase securities agreement with Cliffs Natural Resources Inc.**
- (B) **Drilling results from Chromite discovery on Freewest Option**
- (C) **World-wide market liquidity crisis**
- (D) **Debuts Diamonds Inc. becoming a reporting issuer**

### **(A) Option to purchase securities agreement with Cliffs Natural Resources Inc.**

On January 20, 2009, Cliffs Natural Resources Inc. ("**Cliffs**") entered into an Option to Purchase Securities (the "**Option Agreement**") with the Company to purchase and acquire certain securities of the Company in the aggregate amount of US\$3,500,000. As permitted the Option Agreement, on March 16, 2009, Cliffs assigned the Option Agreement to an affiliated entity, Cliffs Greene B.V. ("**Cliffs B.V.**").

On March 16, 2009, Cliffs B.V. exercised the Option and acquired (i) 50,448,987 units comprised of 50,448,987 common shares and 22,224,784 warrants of the Company and (ii) a debenture. As a result, Cliffs B.V. holds, as at the date hereof, approximately 14.9% of the issued and outstanding common shares of the Company. Refer to Section 1.5 "Overall Performance – Financial".

Cliffs is an international mining company, the largest producer of iron ore pellets in North America and a major supplier of metallurgical coal to the global steelmaking industry. It operates six iron ore mines in Michigan, Minnesota and Eastern Canada, and three coking coal mines in West Virginia and Alabama. Cliffs also wholly-owns Portman Limited, a large iron ore mining company in Australia, serving the Asian iron ore markets with direct-shipping fines and lump ore. In addition Cliffs has a 30% interest in the Amapá Project, a Brazilian iron ore project, and a 45% economic interest in the Sonoma Project, an Australian coking and thermal coal project.

**(B) Drilling results from Chromite discovery on Freewest Option:** During 2008, the main exploration focus of the KWG-Spider Joint Venture was the massive chromite occurrence that was first discovered on the Freewest Option property in March of 2006. As a result of the 2008 drilling program that included 19 drill holes, 14 of which continued the testing of this chrome occurrence, the occurrence is now referred to as the "Big Daddy Chromite Deposit". This deposit is located approximately 3.6 kilometers northeast of Noront Resources Ltd's ("Noront") Eagle One Magmatic Massive Sulphide (Nickel Copper and PGM), or five 5 kilometers northeast of Noront's Blackbird (Chromite) discoveries, as well as 4 kilometers southwest of Freewest's Black Thor Chromite discoveries.

**Current Program:** Crews mobilized to the field on January 8<sup>th</sup>, 2009 to resume the linecutting program in preparation for the 2009 program. The current approved phase of exploration includes: line cutting (re-establishing a 2004 drill grid – the J grid - including extensions thereto), ground geophysical surveying (including magnetic gradiometer and gravimetric surveying), re-logging of historical core to standardize lithological units, infill sampling of zones of weaker chromite mineralization, metallurgical tests, as well as the preparation of a NI-43-101 technical report on the project. Future plans, yet to be approved by the Joint Venture committee, include the continued exploration of the project by extensive diamond drilling to delineate and to continue to expand the resource potential of the Big Daddy Chrome Deposit.

**Joint Venture with Freewest:** KWG and Joint Venture partner Spider (the optionees), recently received confirmation notice from Freewest (the optionor), that: (i) pursuant to section 2.04 of the Agreement, each of KWG and Spider has incurred an aggregate of \$1,500,000 of Expenditures on or before October 13, 2009, of which at least \$200,000 was incurred on or before February 28, 2006; and (ii) accordingly, each of KWG and Spider has earned a 15% interest in the Property pursuant to section 2.07 (a) of the Agreement.

Diamond drilling by the KWG/Spider JV, has identified a northeast trending zone of continuous chrome mineralization, that extends from local grid line 9+00 meters NE to 13+00 NE. The mineralized zone dips towards the NW at about 70 degrees and consists of varying widths of a variable tenor of chrome mineralization, forming a series of stacked lenses. Additional infill drilling will be required to confirm continuity of the lenses from section to section.

The deposit remains open to depth as well as along strike in both directions. In addition, near surface drilling of the upwards extension to surface has not been completed. All drill data is being added to a 3-D Gemcom model to visualize the chromite body. Assays, when they become available will be added into this model, to provide average grade estimates. A number of faults were noted in the drilling logs, some of which occur at the contact of the chromite with the surrounding peridotite/dunite; these fault sets are also being modelled, as they also affect the interpretation and continuity of the mineralization from section to section.

**Assay Data Recently Received for Big Daddy:** Analytical results have recently been received for seven holes drilled in 2008: FW-08-15, FW-08-18, FW-08-19, FW-08-20, FW-08-21, FW-08-22 and FW-08-23. Each of these holes intersected massive chromite.

Table 1: Recently received analysis

Hole ID	from (m)	to (m)	int (m)	Cr2O3%	Cr%	Fe%	Cr:Fe	Ni%	Pt(g/t)	Pd(g/t)	Au(g/t)	TPM
<b>FW-08-15</b>	73.5	81.0	<b>7.5</b>	NA	NA	NA	NA	0.16	0.25	1.23	0.01	<b>1.49</b>
followed by	81.0	173.8	92.8	12.20	8.30	10.60	0.78	0.14	0.12	0.21	0.00	0.33
then	159.2	171.3	<b>12.1</b>	<b>32.2</b>	22.00	18.60	1.18	0.11	0.19	0.23	0.01	0.43
then	173.8	179.1	<b>5.3</b>	NA	NA	NA	NA	0.30	0.73	1.63	0.14	<b>2.50</b>
<b>FW-08-18</b>	18.0	33.0	15.0	6.26	4.28	9.68	0.44	0.14	0.05	0.04	0.01	0.10
FW-08-18	67.5	138.0	70.5	24.89	17.02	13.02	1.31	0.13	0.10	0.11	0.00	0.21
incl.	106.0	138.0	<b>32.0</b>	<b>37.47</b>	25.63	15.68	1.63	0.11	0.09	0.06	0.00	0.15
<b>FW-08-19</b>	141.0	161.95	20.95	12.04	8.23	10.13	0.81	0.15	0.12	0.14	0.01	0.27
including	141.5	144.1	<b>2.6</b>	<b>31.32</b>	21.40	13.79	1.55	0.13	0.20	0.22	0.02	0.44
then	161.95	183.0	<b>21.05</b>	NA	NA	NA	NA	0.10	0.73	0.95	0.05	<b>1.73</b>
including	167.2	171.0	<b>3.8</b>	NA	NA	NA	NA	0.14	2.15	2.86	0.17	<b>5.18</b>
then	183.0	229.5	<b>46.5</b>	<b>37.18</b>	25.44	15.30	1.66	0.11	0.21	0.19	0.00	0.40
<b>FW-08-20</b>	261.0	336.95	75.95	23.25	15.90	11.32	1.40	0.13	0.15	0.14	0.01	0.30
including	304.3	336.95	<b>32.65</b>	<b>39.56</b>	27.06	14.37	1.88	0.11	0.22	0.17	0.01	0.40
<b>FW-08-21</b>	259.45	282.0	22.55	1.29	0.88	6.38	0.14	0.30	0.07	0.14	0.00	0.21
then	313.45	318.9	5.45	0.75	0.51	1.90	0.27	0.12	0.27	0.44	0.01	0.72
followed by	318.9	320.95	2.05	17.47	11.93	12.3	0.97	0.45	0.13	0.26	0.00	0.39
then	360.0	417.0	57.0	17.52	11.98	11.64	1.03	0.14	0.11	0.14	0.11	0.36
including	376.0	385.8	<b>9.8</b>	<b>31.90</b>	21.84	18.29	1.19	0.08	0.12	0.07	0.00	0.19
also including	406.2	417.0	<b>10.8</b>	<b>39.22</b>	26.81	17.53	1.53	0.11	0.16	0.11	0.56	0.83

Hole ID	from (m)	to (m)	int (m)	Cr2O3%	Cr%	Fe%	Cr:Fe	Ni%	Pt g/t	Pd g/t	Au g/t	TPMg/t
<b>FW-08-22</b>	54.3	57.0	2.7	6.12	4.19	9.57	0.44	0.08	0.05	0.05	0.01	0.11
followed by	192.2	298.5	106.4	19.42	13.28	11.34	1.17	0.14	0.13	0.15	0.01	0.29
including	263.7	298.5	34.8	42.08	28.79	15.92	1.81	0.11	0.19	0.17	0.01	0.37
then	298.5	303.0	4.5	NSV	NSV	NSV	NSV	0.08	0.43	0.85	0.05	1.33
<b>FW-08-23</b>	263.5	376.5	113.0	17.65	12.07	11.04	1.09	0.13	0.11	0.13	0.00	0.25
including	334.5	376.5	42.0	34.96	23.92	13.95	1.71	0.11	0.18	0.13	0.01	0.32
including	353.0	372.0	19.0	40.00	27.37	14.81	1.85	0.10	0.20	0.10	0.01	0.30
followed by	378.0	382.0	4.0	40.84	27.94	16.75	1.67	0.11	1.08	1.50	0.08	2.66

NSV refers to no significant values; NA refers to not assayed.

The above tabulation of drill intercepts and assay results are core lengths only, and do not represent true width for the mineralized zones. Additional drilling is required to determine true widths.

Drilling took place with reference to a local grid, labeled Grid J. The drills were set to drill grid south 150 degrees in each instance, and the initial dip of each hole was set at -50 degrees. Table 2 provides drill collar co-ordinates for these five holes, as well as other holes previously drilled (and reported upon) on the Big Daddy Chrome occurrence, all azimuth directions are true North readings. The UTM spheroid used for determining location was NAD 83 Zone 16, both UTM and local grid co-ordinates are given.

**Hole FW-08-15** on local grid section L11+50E intersected a length of platinum and palladium mineralization, where the Total Precious Metals (TPM) averaged 1.49 g/t (gram/tonne) over 7.5 meters, followed by a 92.8 meter section of semi-massive chromite that averaged 12.3% Cr<sub>2</sub>O<sub>3</sub>, including a 12.1 meter section of massive chromite with an average of 33.1% Cr<sub>2</sub>O<sub>3</sub> followed by a 5.3 meter section of peridotite that averaged 2.5 g/t TPM. The higher grade chromite beds had a moderate Cr:Fe ratio of 1.18.

**Hole FW-08-18** on local grid section L12+00E intersected a weakly mineralized chrome section over 15.0 meters containing an average of 6.3% Cr<sub>2</sub>O<sub>3</sub>, followed by a much better mineralized section further down the hole over where a 70.5 meter zone of semi-massive to massive chromite averaged 24.9% Cr<sub>2</sub>O<sub>3</sub> including a section of 32 meters containing 37.5% Cr<sub>2</sub>O<sub>3</sub>. The latter intercept has a very favorable Cr:Fe ratio of 1.63.

**Hole FW-08-19** on local grid section L12+00E intersected a weakly mineralized chrome section that over 21 metres averaged 12.04% Cr<sub>2</sub>O<sub>3</sub> including a short higher grade section that averaged 31.32% Cr<sub>2</sub>O<sub>3</sub> over 2.6 metres. The higher grade interval has a favorable Cr:Fe ratio of 1.55. This section was followed by a relatively enriched section of platinum group metals sandwiched between two chrome layers that averaged 1.69 g/t TPM over 21 metres including 3.8 metres that averaged 5.18 g/t TPM (2.15g/t Pt, 2.86 g/t Pd and 0.17 g/t Au). This was followed by a thick high grade chrome bed that averages 37.18% Cr<sub>2</sub>O<sub>3</sub> over 46.5 metres with a Cr:Fe ratio of 1.66.

**Hole FW-08-20** on local grid section L12+00E intersected a moderately mineralized chrome section over 76.0 metres containing an average of 23.25% Cr<sub>2</sub>O<sub>3</sub>, including a section of 32.7 metres containing 39.56% Cr<sub>2</sub>O<sub>3</sub>. The latter intercept has a very favourable Cr:Fe ratio of 1.88.

**Hole FW-08-21** on local grid section L12+00E intersected a very weakly mineralized chrome section that over 22.5 metres averaged 1.29% Cr<sub>2</sub>O<sub>3</sub>, as well as 0.30% Nickel. This was followed by a 5.5 meter section that averaged 0.75 g/t TPM, followed by 2.1 metres averaging 17.47% Cr<sub>2</sub>O<sub>3</sub>. A third chromite bed was encountered further down the hole, that over 57 metres averaged 17.52% Cr<sub>2</sub>O<sub>3</sub> including 9.8 metres that averaged 31.9% Cr<sub>2</sub>O<sub>3</sub>, as well as another higher grade interval that averaged 39.22% Cr<sub>2</sub>O<sub>3</sub> over 10.8 metres. This latter interval contained 0.83 g/t TPM as well and has a favorable Cr:Fe ratio of 1.53.

**Hole FW-08-22** on local grid section L13+00E intersected two main areas of chromite mineralization, including a short (2.7 metres) section between 54.3 and 57.0 metres that returned 6.12% Cr<sub>2</sub>O<sub>3</sub>. Further down this hole, a much wider zone (106.4 metres) of chromite mineralization was encountered between 192.2 and 298.5 metres that averaged 19.41% Cr<sub>2</sub>O<sub>3</sub>, including a much higher grade interval between 263.7 and 298.5 metres (34.8 metres) that averaged 42.08% Cr<sub>2</sub>O<sub>3</sub> that exhibits a favourable Cr:Fe ratio of 1.81. The chromite mineralization was followed by a 4.5 metre section between 298.5 and 303 metres downhole that averaged 1.33 total precious metals.

**Hole FW-08-23** on local grid section L13+00E undercut hole FW-08-22 and intersected a well mineralized chrome section over 114.5 meters containing an average of 17.65% Cr<sub>2</sub>O<sub>3</sub>, including a much stronger mineralized section where a 43.5 meter zone of massive chromite averaged 34.96% Cr<sub>2</sub>O<sub>3</sub> including a 19.0 meter section averaging containing 40.0% Cr<sub>2</sub>O<sub>3</sub> with a Cr:Fe ratio of 1.85. Then between 378.0 and 382.0 a 4 metre drill interval averaged 40.84% Cr<sub>2</sub>O<sub>3</sub> as well as total precious metals of 2.66 g/t. The latter intercept also has a very favourable Cr:Fe ratio of 1.67.

Table 2 Drill hole locations for Big Daddy Chrome Deposit

Hole ID	UTM Easting (m)	UTM Northing (m)	Local Grid Easting (m)	Local Grid Northing (m)	Azimuth degrees	Inclination degrees	Length (m)
FW-06-03	551087	5845306	10+00 E	15+25 N	120°	-50°	353.5
FW-08-05	551050	5845367	L10+00E	16+00N	150°	-50°	327
FW-08-06	550959	5845324	L9+00E	16+00N	150°	-50°	384
FW-08-07	551136	5845427	L11+00E	16+00N	150°	-50°	405.7
FW-08-12	551111	5845472	L11+00E	16+50N	150°	-50°	354
FW-08-13	551164	5845384	L11+00E	15+50N	150°	-50°	297
FW-08-14	551180	5845451	L11+50E	16+00N	150°	-50°	189
FW-08-15	551158	5845494	11+50E	16+50N	150°	-50°	240
FW-08-18	551192	5845511	12+00E	16+50N	150°	-50°	255
FW-08-19	551168	5845554	12+00E	17+00N	150°	-50°	273
FW-08-20	551134	5845599	12+00E	17+50N	150°	-50°	357
FW-08-21	551118	5845650	12+00E	18+00N	150°	-50°	447
FW-08-22	551208	5845693	13+00E	18+00N	150°	-50°	330
FW-08-23	551171	5845732	13+00E	18+50N	150°	-50°	424

**Additional Anomaly Testing Results:** Two additional drill holes were drilled into a magnetic anomaly located 1.2 kilometres to the NW of the Big Daddy chromite occurrence, near the northwestern corner of the option property. The holes were set up at the same collar location of 550875mE at 5846305mN (UTM co-ordinates). The first was inclined at -50 degrees, the second at -65 degrees, and both were drilled at an azimuth of 315 degrees. The anomaly consisted of a strong magnetic and subtle electromagnetic conductivity response. A sulfide zone within the geophysically rendered NW trending Banded Iron Formation ("BIF"), was intersected returning the following results (Table 4).

Hole ID	from (m)	to (m)	int (m)	Cu%	Ni%
FW-08-16	138.0	139.0	1.0	0.93	2.04
FW-08-17	146.5	148.0	1.5	0.12	0.01

The assay results infer an enrichment in base metals in the BIF, particularly in hole FW-08-16 where 1.0 metre returned an assay of 0.93% Copper and 2.04% Nickel. The significance of this intersection needs to be further investigated.

**(C) World-wide Market Liquidity Crisis:** The current world-wide market liquidity crisis continues. While many companies have put exploration programs on hold, KWG has maintained its mineral properties in good standing. Fortunately, KWG subsidiary, Debuts, has sufficient assessment credits on its MacFadyen Kimberlites claims to maintain its MacFadyen, Pele and Uniform Surround claims in good standing beyond 2010 through the process of assessment credit redistribution. In addition to on going working capital requirements, KWG has sufficient funds for its immediate exploration expenses on the chrome, nickel & base metals claims in northern Ontario and general and administrative costs. KWG intends to pursue a prudent policy allocating available money to maintain existing properties and developing the chrome project in 2009.

**(D) Debuts Diamonds Becoming a Reporting Issuer:** On December 17, 2008, DDI became a reporting issuer in Ontario. DDI has been relatively inactive since then. DDI has a pending application to trade on the CNSX. KWG intends to deliver its DDI's common shares pro rata to the KWG shareholders.

## **1.5 OVERALL PERFORMANCE - FINANCIAL**

During 2008, KWG closed two private placements totaling \$ 569,500 in gross proceeds; KWG also issued 796,000 common shares upon exercise of warrants and compensation options for which KWG received \$69,240. On December 31, 2008, KWG had \$1,528,877 cash and cash equivalents which compared to \$5,472,150 on December 31, 2007.

On March 16, 2009, Cliffs B.V. exercised the Option granted by the Company pursuant to the Option Agreement dated January 20, 2009 between the Company and Cliffs and acquired:

- (1) 50,448,987 units of the Company (each a "Unit") at a subscription price of US\$0.048894 per Unit, with each Unit comprised of one (1) common share in the capital of the Company (each a "Common Share") and approximately 0.44 of a non-transferable Common Share purchase warrant of the Company (each such whole common share purchase warrant, a "Warrant"), with each Warrant entitling Cliffs to purchase one (1) Common Share at US\$0.05 during the first year after issuance thereof and US\$0.10 thereafter. Each Warrant would be exercisable for a period of 20 business days following the issuance by the Company of five (5) Common Shares upon the exercise of any of the warrants, options and other rights to purchase or obligations to issue Common Shares outstanding as at the date of execution of the Option Agreement, and would terminate on the fifth anniversary of the date of issuance of the Warrants; and
- (2) a non-transferable, non-interest bearing, secured convertible debenture of the Company in the principal amount of US\$1,033,398, such amount being equal to the difference between US\$3.5 million and the aggregate subscription price of US\$2,466,602 payable for the Units above (the "Debenture"). The Debenture would not be convertible unless and until all conditions prescribed by the TSX Venture Exchange, including the approval of the shareholders of the Company (the "Shareholder Approval") to the issuance of the Units upon conversion of the Debenture, have been satisfied or waived. In the event that all of such conditions would not be satisfied or waived on or before April 15, 2009, Cliffs would have the right to demand repayment thereof, in which event the Company would be required to pay to Cliffs a credit facility termination fee of US\$50,000 (the "Termination Fee") provided, however, that if the Shareholder Approval is not obtained, the Company would be required to immediately repay, in full, the principal amount of the Debenture and pay to Cliffs the Termination Fee. Upon satisfaction or waiver of such conditions, all of the principal amount of the Debenture is to be converted automatically and without any further action on the part of the Company or Cliffs into Units at the rate of US\$0.048894 per Unit resulting in a further issuance to Cliffs of 21,135,069 Units comprised of 21,135,069 Common Shares and 9,310,839 Warrants. The sole security to be granted by the Company is to be comprised of cash in an amount equal to the principal amount of the Debenture plus the Termination Fee.

Pursuant to its terms, the Debenture may only be converted into Common Shares and Warrants in the event the Shareholder Approval is obtained. As such the Debenture would be automatically converted without any further action of the Company or Cliffs, resulting in a proposed issuance to Cliffs of an additional 21,135,069 Common Shares and 9,310,839 Warrants. The policies of the TSXV require that the issuance of such additional Common Shares and Warrants upon the conversion of the Debenture be approved by the disinterested shareholders of the Company as such conversion would result in Cliffs becoming a new "control person" as defined under the policies of the TSXV.

Following the Shareholders Approval and the conversion of the Debenture, Cliffs would hold approximately 71,584,056 Common Shares and 31,535,623 Warrants, representing approximately 19.9% of the outstanding Common Shares of the Company, on a fully diluted basis calculated as at the date of the Option Agreement.



## 1.6 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 December 31, 2008, KWG had working capital of \$1,294,914 compared to \$5,451,501 on December 31, 2007. The 2008 working capital includes \$1,624,956 in cash and accounts receivable (2007 - \$5,532,685) of which \$369,808 is reserved for exploration expenses to be made in Canada before December 31, 2009 (2007 - \$3,363,015). On average, cash required for annual operating activities is approximately \$825,000; while the working capital available for non-exploration activities amounts to approximately \$920,000. KWG has adequate working capital to finance its corporate and administrative activities in 2009.

Refer to Section 1.5 for the details of the subscription by Cliffs B.V. The total subscription of CAN\$4,312,007 (US\$3,500,000) will ensure the financing of the exploration programs as well as provide the necessary working capital funds for 2009.

## 1.7 RESULTS FROM OPERATIONS

The loss for the year ended December 31, 2008 amounted to \$11,131,901 (\$0.04 per share) mainly due to important write-downs of mining assets compared to \$891,655 (\$0.01 per share) in 2007. The following are the main variances of results from operations:

i. ***Interest income – \$93,036 (2007 - \$28,215)***

The average cash balance bearing interest was higher in 2008 than it was in 2007.

ii. ***Gains on disposal of royalty - \$117,751 (2007 - \$ nil)***

In December 2004, the Company disposed of its interest in Haiti in consideration for work commitments from the purchaser and a 1.5% NSR on all mineral products from the Haitian properties. The purchaser has the right to buy back the NSR by paying to the Company US\$750,000 in two installments of (i) US\$250,000 and (ii) US\$500,000 respectively. In 2008, the Company agreed to reduce the remaining price of repurchase of the royalty to US\$100,000 and received the last two installments totaling \$117,751 (US\$100,000). This amount was recorded as a gain on disposal of royalty since all Haitian properties had been written off in accordance with the Company's accounting principle.

iii. ***Administrative expenses - \$1,030,819 (2007 - \$615,198)***

The increase is mainly related to the creation, in 2007 and 2008, of the two wholly-owned subsidiaries (DDI, and SMD Mining Corporation ("SDM"), a wholly-owned subsidiary of DDI), the transfer of the diamond group claims to DDI and the non-offering prospectus. In 2008, DDI and SMD incurred a total of \$336,388 in administrative costs (2007 - \$37,112).

iv. ***Stock compensation costs - \$448,037 (2007 - \$466,432)***

Stock compensation costs constitute a non-cash expense. While the 2008 stock compensation costs were higher than the 2007, actual cash outlay was not affected.

The Company granted 3,379,700 options in 2008 and 11,310,000 in 2007. A significant number of 2007 options vested in 2008.

v. **Write-down and write-off of mining assets - \$10,829,266 (2007 - \$Nil)**

In April 2008, the Company transferred to its wholly-owned subsidiary DDI, the diamond group claims. An independent valuation of the mining assets transferred was made and the fair market value was established at \$7,000,000. Consequently, the Company recorded a write-down of mining assets of \$5,383,821, prior to the transfer. In December 2008, given the market conditions (Refer to Section 1.15), the Company recorded an additional write-down of \$5,311,380 for a total of \$10,695,201.

In 2008, the Company decided to write-off (\$18,000) the Greenstone claims and the Geraldton claims (\$116,605) since no exploration work was performed during the year and no significant expenses are planned for 2009.

**1.8 SELECTED FINANCIAL INFORMATION - THREE YEAR FINANCIAL HIGHLIGHTS**

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

	Fiscal years ended December 31		
	2008	2007	2006
	\$	\$	\$
Working capital	1,295	5,452	640
Total assets	11,502	22,514	16,420
Total income	211	28	146
Loss	(11,132)	(892)	(743)
Loss per share (basic and diluted)	(0.04)	(0.01)	(0.01)

**1.9 SUMMARY OF QUARTERLY RESULTS**

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

Quarter	Total income (\$)	Loss (\$)	Loss per share (basic and diluted) (\$)
December 31, 2008	87	(4,695)	<(0.02)
September 30, 2008	54	(333)	<(0.00)
June 30, 2008	25	(5,673)	<(0.02)
March 31, 2008	45	(431)	<(0.00)
December 31, 2007	25	(492)	<(0.01)
September 30, 2007	3	(219)	<(0.00)
June 30, 2007	-	(226)	<(0.00)
March 31, 2007	-	(125)	<(0.00)

**1.10 FOURTH QUARTER RESULTS**

Administrative costs during the fourth quarter of 2008 amounted to \$ 346,124 (2007 - \$224,112). The increase is related to finalization of the Debut Diamonds non-offering prospectus and the increase in the activities of the Companies. The fourth quarter loss included a write-down of the diamond group claims of \$5,311,380 and an income tax recovery of \$1,140,000.

### **1.11 COMMITMENT**

Pursuant to flow-through financing agreements closed during the year ended December 31, 2008, the Company must incur \$ 369,808 in exploration expenses by December 31, 2009.

If at the general and special meeting of the shareholders of the Company to be held on April 15, 2009, the conversion of the debenture held by Cliffs Greene B.V. there will result a change of control of the Company for purposes of certain employment and consulting agreements between the Company and its directors and officers the Company will make payments in an aggregate amount of \$435,000 to directors and officers.

### **1.12 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 2008, officers and companies controlled by officers were paid consulting fees totalling \$238,244 (2007 - \$89,860) of which \$4,125 remained payable at December 31, 2008 (2007 - \$ 16,352) and directors of the Company and a company controlled by a director of the Company were paid \$ 68,768 (2007 - \$ 60,000) for professional consulting services. Refer to Section 1.11 for payments to be made to directors and officers under certain circumstances.

### **1.13 CHANGES IN ACCOUNTING POLICY**

On January 1, 2008 the Company adopted four new recommendations of the Canadian Institute of Chartered Accountants ("CICA"). Section 3862, "Financial instruments – Disclosures", and 3863 – "Financial instruments Presentation", Section 1535, "Capital disclosures", Section 1400, "General standards of Financial Statements Presentation".

Sections 3862, "Financial instruments – Disclosures", and 3863 – "Financial instruments Presentation" replace handbook Section 3861, "Financial instruments – Disclosure and Presentation", revising and enhancing its disclosure requirements, and carrying forward unchanged presentation requirements. These new sections place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks.

Under Section 1535, "Capital disclosures" establishes standards for disclosing information about an entity's capital and how it is managed. It describes the disclosure of the entity's objectives, policies and processes for managing capital, the quantitative data what the entity regards as capital, whether the entity has complied with any capital requirements, and if it has not complied, the consequences of such non-compliance.

Under Section 1400, "General standards of Financial Statements Presentation" was amended to include requirements to assess and disclose an entity's ability to continue as a going concern.

### **1.14 INTERNATIONAL FINANCIAL REPORTING STANDARDS ("IFRS")**

In February 2008 the Canadian Accounting Standards Board (AcSB) confirmed that the use of IFRS would be required for Canadian publicly accountable enterprises for years beginning on or after January 1, 2011.

We have established a changeover plan to adopt IFRS by 2011. Management has started the process of assessing accounting policy choices and elections that are allowed under IFRS. We are also assessing the impact of the conversion on our business activities including the effect on information technology and data systems, internal controls over financial reporting and disclosure controls. We will continually review and adjust our changeover plan to ensure our implementation process properly addresses the key elements of the plan.

## **1.15 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.

## **1.16 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.

**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. The only current source of future funds available to the Company is the sale of additional equity capital and the borrowings of funds. 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. Failure to obtain sufficient financing may result in delaying or indefinite postponement of exploration, development or production on any or all of the Company's properties or even a loss of property interest.

**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.

## 1.17 OTHER

### i. National Instrument 51-102 - Section 5.3

Below is the detailed analysis of exploration expenditures incurred in 2008 and 2007.

<b>Cost and deferred exploration expenses</b>	<b>2008</b>	<b>2007</b>
	<b>\$</b>	<b>\$</b>
Balance – Beginning of year	16,897,432	15,611,907
Acquisition, staking and permits	165,845	72,891
Write-down and write-off of mining assets	<u>(1,900,130)</u>	<u>-</u>
	(1,734,285)	72,891
Exploration expenses		
Drilling	2,051,619	820,802
Geophysics	391,078	73,494
Sampling	118,640	101,872
Consulting	451,672	35,310
Field preparation	5,859	29,939
Management	145,211	29,459
Line cutting and road	154,931	55,050
Camp expenses	105,914	56,108
Permits	-	10,600
Write-down and write-off of mining assets	<u>(8,929,136)</u>	<u>-</u>
	(5,504,212)	1,212,634
Balance – End of year	9,658,935	16,897,432

ii. National Instrument 51-102 - Section 5.4

Disclosure of Outstanding Share Data (as at March 16, 2009)

Common shares outstanding: 338,583,808

Warrants and compensation options outstanding: 124,399,439

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

Number of Warrants	Compensation options	Exercise Price \$	Expiry Date
11,000,000	1,000,000	0.10	March 2009
5,172,250	500,000	0.10/0.05	April 2009
1,500,000	-	0.10	June 2009
1,106,000	-	0.10	July 2009
106,000	-	0.10	August 2009
6,706,000	-	0.10	September 2009
26,476,923	3,886,692	0.10/0.05	October 2009
9,375,000	-	0.12	October 2009
4,135,000	413,500	0.15	December 2009
7,062,325	1,412,465	0.18/0.185	December 2009
2,000,000	-	0.10	August 2010
18,475,000	1,847,500	0.05/0.10	December 2010
22,224,784	-	0.06/0.13	January 2014

Options outstanding: 23,868,880 - average exercise price of \$0.11

Number of Options	Expiry Date
395,100	July 2009
530,500	April 2010
7,078,580	November 2010
300,000	April 2011
1,800,000	December 2011
2,690,000	June 2012
1,960,000	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

**ADDITIONAL INFORMATION**

Additional information on the Company is available through regular filings of press releases and quarterly financial statements on SEDAR ([WWW.SEDAR.COM](http://WWW.SEDAR.COM))



# MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

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Management is responsible for the preparation of the financial statements and other financial information included in the annual report. The financial statements were prepared in accordance with Canadian generally accepted accounting principles and necessarily include amounts based on estimates and judgments of management.

Management maintains accounting and internal control systems to produce reliable financial statements and provide reasonable assurance that assets are properly safeguarded. PricewaterhouseCoopers LLP, Chartered Accountants, appointed by shareholders, conducted an audit on the Company's financial statements. Their report is included.

The board of directors of the Company is responsible for ensuring that management fulfills its responsibilities for financial reporting. The board of directors carries out this responsibility through its audit committee composed of two independent directors.

The audit committee meets on an annual basis with the external auditors, with and without the presence of management, to review the financial statements and to discuss audit and internal control related matters.

On recommendation of the audit committee, the board of directors approved the Company's financial statements.



Frank C. Smeenk,  
President and Chief Executive Officer



Martin Nicoletti,  
Chief Financial Officer



March 16, 2009

## Auditors' Report

### To the Shareholders of KWG Resources Inc.

We have audited the consolidated balance sheets of **KWG Resources Inc.** as at December 31, 2008 and 2007, the consolidated statements of operations and deficit, comprehensive income (loss) and cash flows for the years then ended. These consolidated financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2008 and 2007, the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

*PricewaterhouseCoopers LLP*<sup>1</sup>

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<sup>1</sup> Chartered accountant auditor permit No. 20910



# KWG Resources Inc.

(An exploration stage company)

## Consolidated Statements of Operations and Deficit For the years ended December 31, 2008 and 2007

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	2008 \$	2007 \$
<b>Income</b>		
Gain on disposal of royalty (note 6(h))	117,751	-
Interest income	93,036	28,215
	<u>210,787</u>	<u>28,215</u>
<b>Expenses</b>		
Administrative	1,030,819	615,198
Part XII.6 taxes	86,000	-
Stock compensation costs (note 9)	448,037	466,432
Write-down and write-off of mining assets (note 6)	10,829,266	-
Unrealized loss on temporary investment (note 5(b))	88,566	-
Net loss on temporary investment (note 5(c))	-	8,240
	<u>12,482,688</u>	<u>1,089,870</u>
<b>Loss before income tax</b>	(12,271,901)	(1,061,655)
<b>Future income tax recovery (note 12 (i))</b>	<u>1,140,000</u>	<u>170,000</u>
<b>Loss for the year</b>	(11,131,901)	(891,655)
<b>Deficit – Beginning of year</b>	(8,546,676)	(6,650,083)
<b>Share and warrant issue expenses</b>	<u>(1,199,303)</u>	<u>(1,004,938)</u>
<b>Deficit – End of year</b>	<u>(20,877,880)</u>	<u>(8,546,676)</u>
<b>Loss per share (basic and diluted)</b>	<u>(0.04)</u>	<u>(0.01)</u>
<b>Weighted average number outstanding shares (basic and diluted)</b>	265,482,144	189,551,718

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## Consolidated Statements of Comprehensive Income (Loss) For the years ended December 31, 2008 and 2007

	2008 \$	2007 \$
Loss for the year	(11,131,901)	(891,655)
Other Comprehensive Income (loss)		
- Change in unrealized loss on financial assets available-for-sale	(189,210)	(82,714)
<b>Comprehensive Income (loss)</b>	<u>(11,321,111)</u>	<u>(974,369)</u>

# KWG Resources Inc.

(An exploration stage company)

Consolidated Statements of Cash Flows

For the years ended December 31, 2008 and 2007

<b>Cash flows from</b>	<b>2008</b>	<b>2007</b>
	<b>\$</b>	<b>\$</b>
<b>Operating activities</b>		
Loss for the year	(11,131,901)	(891,655)
Adjustments for		
Stock compensation costs (note 9)	448,037	466,432
Write-down and write-off of mining assets	10,829,266	-
Write-off of accounts receivable	2,007	-
Net loss on temporary investments (note 5(c))	-	8,240
Unrealized loss on temporary investment (note 5(b))	88,566	-
Future income tax recovery (note 12 (i))	(1,140,000)	(170,000)
Units issued in payment for consulting fees	-	26,500
	<u>(904,025)</u>	<u>(560,483)</u>
Change in non-cash working capital items	354,619	91,926
	<u>(549,406)</u>	<u>(468,557)</u>
<b>Financing activities</b>		
Share capital issued	537,720	5,805,087
Warrants and compensation options issued	101,020	1,184,399
Share and warrant issue expenses	(46,370)	(457,882)
	<u>592,370</u>	<u>6,531,604</u>
<b>Investing activities</b>		
Additions to mining assets	(3,631,951)	(1,224,094)
Acquisition of temporary investment (note 5)	(354,266)	-
Proceeds on disposal of temporary investments	-	11,760
	<u>(3,986,217)</u>	<u>(1,212,334)</u>
<b>Net change in cash and cash equivalents during the year</b>	<b>(3,943,253)</b>	<b>4,850,713</b>
<b>Cash and cash equivalents – Beginning of year</b>	<b>5,472,150</b>	<b>621,437</b>
<b>Cash and cash equivalents – End of year</b>	<b>1,528,897</b>	<b>5,472,150</b>
Change in non-cash working capital items comprises:		
Accounts receivable	(37,531)	(6,220)
Prepaid	(15,756)	(7,306)
Accounts payable and accrued liabilities	407,906	105,452
	<u>354,619</u>	<u>91,926</u>
<b>Additional information - non-cash transactions</b>		
Issuance of shares for mining assets	68,000	50,525
Issuance of shares for debt settlement	-	120,000
Issuance of shares for commission	-	40,453
Issuance of agent compensation options	12,933	-
Expired warrants included in contributed surplus	182,070	26,509
Additions to mining assets included in accounts payable	77,708	10,906

# **KWG Resources Inc.**

(An exploration stage company)

Notes to Consolidated Financial Statements

**December 31, 2008 and 2007**

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## **1 Nature of operations**

KWG Resources Inc. (the “Company”), an exploration stage company, is involved in the exploration base and precious metals and diamonds. It has interests in properties located in Canada at the exploration stage.

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 find 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 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.

For the year ended December 31, 2008, the Company incurred a loss of \$11,131,901 (\$891,655 for the year ended December 31, 2007). This year’s loss includes a write-down of the Company’s diamond group claims of \$10,695,201, which resulted from the revision for impairment upon occurrences of events or changes in circumstances such as the current capital market conditions. Cash as at December 31, 2008 amounted to \$1,528,897 (\$5,472,150 as at December 31, 2007) including funds reserved for exploration of \$369,808 (\$3,363,015 as at December 31, 2007). Accounts payable and accrued liabilities as at December 31, 2008 amounted to \$505,826 (\$164,722 as at December 31, 2007). In addition to ongoing working capital requirements, the Company must secure on an ongoing basis sufficient funds for its existing commitments for exploration and general and administration costs. While as at December 31, 2008, there is a significant doubt as to the Company’s ability to meet its current obligations and continue its activities as a going concern, since December 31, 2008, the Company entered into an option agreement with Cliffs Natural Resources Inc. (“Cliffs”), whereby the Company granted to Cliffs an option exercisable on or before March 16, 2009 to purchase and acquire certain securities of the Company in the aggregate amount of CAN\$4,516,750 (US\$3,500,000) which was assigned to an affiliated entity on March 12, 2009 and exercised on March 16, 2009 (note 16 (i)). Management considers that this subscription provides sufficient liquidities for year ending December 31, 2009 and therefore, these consolidated financial statements have been prepared using Canadian generally accepted accounting principles applicable to a going concern.

In the future, management will pursue all financing alternatives available to fund its ongoing obligations and exploration activities. Although there is no assurance that the Company will be successful in these actions, management is confident that it will be able to secure the necessary financing through the issuance of new equity to continue as a going concern.

## **2 Significant accounting policies**

### **Basis of consolidation**

These consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries Debuts Diamonds Inc. (“DDI”), incorporated in Ontario, Canada on October 18, 2007, which owns all the issued and outstanding shares of SMD Mining Corporation (“SMD”) incorporated in Ontario, Canada in January, 2008.

# **KWG Resources Inc.**

(An exploration stage company)

Notes to Consolidated Financial Statements

**December 31, 2008 and 2007**

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## **Use of estimates**

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Significant areas where management judgment is applied are assets valuations, future income taxes and compensation options. Actual results could differ from those estimates and such differences could be material.

## **Cash and cash equivalents**

Cash include cash on hand, bank balances and short-term liquid investments with original maturities of three months or less.

## **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.

Proceeds from the sale of exploration properties are applied in reduction of related carrying costs and any excess is recorded as a gain in the Consolidated Statements of Operations and Deficit. In the case of a partial sale, if carrying costs exceed the proceeds, only the losses are recorded.

## **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.

## **Flow-through shares**

The Company may finance a portion of its exploration and development activities through the issuance of flow-through common shares. Under the terms of the flow-through share agreements, the resource expenditure deductions for income tax purposes are renounced to investors in accordance with the appropriate income tax legislation. The Company provides for the future effect on income taxes related to flow through shares as a charge to deficit and future income tax liability when the renunciation forms are filed with the tax authorities.

# **KWG Resources Inc.**

(An exploration stage company)

Notes to Consolidated Financial Statements

**December 31, 2008 and 2007**

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## **Stock option plan**

The Company applies the fair value method to account for options granted to its employees, officers, directors and consultants. Any consideration paid on exercise of stock options is credited to share capital. The stock compensation cost is stated as per the periods of option acquisition. The contributed surplus resulting from the stock compensation is transferred to share capital when the options are exercised.

## **Foreign currency translation**

Monetary assets and liabilities in foreign currencies are translated into Canadian dollars at year-end exchange rates. Other assets and liabilities as well as items from the Consolidated Statements of Operations and Deficit are translated at the rates of exchange on each transaction date. Gains and losses on translation are included in the Consolidated Statements of Operations and Deficit.

## **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.

## **Share and warrant issue expenses**

Share and warrant issue expenses are recorded as an increase in deficit in the year in which they are incurred, with the exception of expenses related to financings not closed at the end of the year, which are deferred.

## **Loss per share**

Loss per share is calculated using the weighted average number of shares outstanding during the year. Diluted loss per share is calculated using the treasury stock method for the calculation of the dilutive effect of stock options and other dilutive securities.

The diluted loss per share is equal to the basic loss per share due to the anti dilutive effect of stock options and other dilutive securities.

# **KWG Resources Inc.**

(An exploration stage company)

Notes to Consolidated Financial Statements

**December 31, 2008 and 2007**

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## **Financial instruments - Recognition and measurement**

All financial instruments are required to be measured at fair value on initial recognition, except for certain related party transactions. Measurement in subsequent periods depends on whether the financial instrument has been classified as held-for-trading, available-for-sale, held-to-maturity, loans and receivables, or other liabilities.

- Financial assets and liabilities classified as held-for-trading are required to be measured at fair value, with changes in fair value recognized in net earnings.
- Financial assets classified as held-to-maturity, loans and receivables and financial liabilities (other than those held-for-trading) are required to be measured at amortized cost using the effective interest method of amortization.
- Available-for-sale financial assets are required to be measured at fair value, with unrealized gains and losses recognized in Other Comprehensive Income (loss). Investments in equity instruments classified as available-for-sale that do not have a quoted market price in an active market should be measured at cost.

The Company has adopted the following classification:

- Cash and cash equivalents are classified as "Financial Assets Held for Trading".
- Receivables are classified as "Loans and Receivables"
- Temporary investments are classified as "Available-for-Sale"
- Accounts payables and accrued liabilities are classified as "Other Financial Liabilities", all of which are measured at amortized cost.

## **3 Changes in Accounting Policies**

On January 1, 2008, in accordance with the applicable transitional provisions, the Company applied the recommendations of Section 1535, "Capital Disclosures" of the Canadian Institute of Chartered Accountants' Handbook. This new section, effective for fiscal years beginning on or after October 1, 2007, establishes standards for disclosing information about the Company's capital and how it is managed. Disclosure and presentation requirements' pertaining to this section is contained in note 7.

On January 1, 2008, in accordance with the applicable transitional provisions, the Company applied the recommendations of Section 3862 "Financial Instruments – Disclosures" and Section 3863 "Financial Instruments – Presentation" describe the required disclosures and presentation of the financial instruments and non financial derivatives. These new requirements came into force for the fiscal periods started on October 1, 2007 and the Company applied them starting on October 1, 2008. They replaced sections 3861 "Financial Instruments – Disclosures and presentation". Disclosure and presentation requirements pertaining to these sections are contained in note 14.

On January 1, 2008, in accordance with the applicable transitional provisions, the Company applied the recommendations of the modified section 1400, "General standards of financial statements presentation", in order to require that management make assessment of the Company's ability to continue its operations over at least, but not limited to, a period of 12 months, from the balance sheet date.



# KWG Resources Inc.

(An exploration stage company)

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

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## 4 Cash

As at December 31, 2008, cash and cash equivalents include an amount of \$369,808 (2007 - \$3,363,015) reserved for new exploration activities to be conducted in Canada before December 31, 2009.

## 5 Temporary investments

The portfolio investments consist of common shares of publicly held companies that are available for sale and are recorded at fair value.

	2008 \$	2007 \$
Spider Resources Inc. ("Spider") 250,000 common shares, quoted market value of \$7,500 (2007 – 250,000 common shares, quoted market value of \$30,000)	15,000	15,000
Copper Mesa Mining (formerly Ascendant Copper Corporation) ("Mesa") 353,488 common shares, quoted market value of \$12,372 (a) (2007 – 2,311,600 common shares of St. Geneviève Resources Ltd. ("St. Geneviève") quoted market value of \$46,232)(a)	97,596	97,596
Strike Minerals Inc. ("Strike") 2,952,217 common shares, quoted market value of \$132,850 (2007 – \$ nil) (b)	265,700	-
Cost	378,296	112,596
Unrealized loss	(225,574)	(36,364)
Fair value of temporary investments	152,722	76,232

- (a) On March 27, 2008, Mesa completed the acquisition of all of St. Geneviève's issued and outstanding shares. As a result, St. Geneviève is now a wholly-owned subsidiary of Mesa. In connection with the acquisition, St. Geneviève's shareholders received one Mesa share for each 6.5394054 St. Geneviève shares held.
- (b) As at December 31, 2008 the assets of SMD included 2,952,217 shares of Strike purchased at a price of \$354,266. As the purchase price exceeded the quoted market value at the date of purchase, an unrealized loss of \$88,566 has been recorded in the Consolidated Statements of Operations and Deficit. In February 2009, SMD acquired a further 500,000 shares of Strike for \$60,000 which were committed in 2008.
- (c) In May 2007, the Company disposed of 400,000 shares of St. Geneviève for a total net cash consideration of \$11,760 resulting in a loss on disposal of investment of \$8,240 shown in the Consolidated Statements of Operations and Deficit under "Net loss on disposal of temporary investment".

# KWG Resources Inc.

(An exploration stage company)

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

## 6 Mining assets

	2008 \$	2007 \$
Cost and deferred exploration expenses	9,658,935	16,897,432
Deposits on mining assets	42,380	-
	<u>9,701,315</u>	<u>16,897,432</u>

## Exploration properties

	Cost		Deferred exploration expenses		Total	Total
	2008 \$	2007 \$	2008 \$	2007 \$	2008 \$	2007 \$
Canada – Ontario						
Spider No. 1 / MacFadyen and Kyle (a)(b)(c)(d)	264,867	1,284,615	2,187,948	9,578,038	2,452,815	10,862,653
Spider No. 3 / McFaulds Lake (a)(e)	156,281	156,281	4,033,414	4,030,914	4,189,695	4,187,195
Wawa (a)(b)(f)	64,995	319,829	91,949	452,469	156,944	772,298
Greenstone (g)	-	18,000	-	-	-	18,000
Freewest (a)(h)	58,900	30,463	1,940,474	163,200	1,999,374	193,663
Diagnos (a)(b)	19,065	31,690	78,800	66,736	97,865	98,426
Geraldton (g)	-	115,765	-	300	-	116,065
Pele Mountain (a)(b)(i)	109,676	539,700	242,856	51,573	352,532	591,273
Uniform Surround (b)(j)	7,747	52,966	203	1,000	7,950	53,966
East West option (k)	128,849	-	264,373	-	393,222	-
Other	5,289	644	3,249	3,249	8,538	3,893
	<u>815,669</u>	<u>2,549,953</u>	<u>8,843,266</u>	<u>14,347,479</u>	<u>9,658,935</u>	<u>16,897,432</u>

- (a) On May 15, 2006, the Company and Spider Resources Inc. (“Spider”) 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 Spider agreed to have their respective interest established at 50% in all the current projects of the joint venture.

Each party agreed to have its interest diluted by not contributing further to the other party’s exploration program until its interest has reached 33<sup>1/3</sup>%. 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.

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Notes to Consolidated Financial Statements

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The following table outlines the estimated cumulative interest by projects for the Company and Spider as at December 31, 2008.

	<b>KWG</b>	<b>SPIDER</b>	<b>Total</b>
MacFadyen kimberlites project	61.26%	38.74%	100%
McFaulds Lake VMS project	42.25%	57.75%	100%
Kyle kimberlites project	50.00%	50.00%	100%
Wawa project	43.79%	56.21%	100%
Freewest option project	51.74%	48.26%	100%
Diagnos project	50.52%	49.48%	100%
<b>Total</b>	<b>50.66%</b>	<b>49.34%</b>	<b>100%</b>

The following table outlines the estimated cumulative interest by projects for the Company and Spider as at December 31, 2007.

	<b>KWG</b>	<b>SPIDER</b>	<b>Total</b>
MacFadyen kimberlites project	58.35%	41.65%	100%
McFaulds Lake VMS project	43.08%	56.92%	100%
Kyle kimberlites project	50.00%	50.00%	100%
Wawa project	48.29%	51.71%	100%
Freewest option project	50.74%	49.26%	100%
Diagnos project	50.61%	49.39%	100%
<b>Total</b>	<b>50.19%</b>	<b>49.81%</b>	<b>100%</b>

- (b) In April 2008, the Company transferred to its wholly-owned subsidiary DDI, the diamond group claims. The fair market value of the mining assets transferred was evaluated at \$7,000,000. Consequently, the Company recorded a write-down of mining assets of \$5,383,821 prior to the transfer. In December 2008, the Company recorded an additional write-down of \$5,311,380 for a total of \$10,695,201.

<b>Write-down and write-off of mining properties</b>	<b>2008</b>	<b>2007</b>
	<b>\$</b>	<b>\$</b>
<b>Write-down</b>		
MacFadyen	9,120,028	-
Wawa	615,355	-
Pele Mountain	885,104	-
Uniform	31,170	-
Diagnos	43,544	-
	<hr/>	<hr/>
	10,695,201	-
<b>Write-off</b>		
Geraldton (g)	116,065	-
Greenstone (g)	18,000	-
	<hr/>	<hr/>
	134,065	-
<b>Total</b>	<b>10,829,266</b>	<b>-</b>

# KWG Resources Inc.

(An exploration stage company)

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

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- (c) Ashton Mining Canada Ltd. holds a 25% claw back entitlement to any kimberlite property found or developed by KWG/Spider 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/Spider an amount equal to 300% of all exploration expenditures on said property.
- (d) The Kyle project was optioned to the new operator, Renforth Resources Inc. (formerly Wycliffe Resources Inc) ("Renforth"), who may earn a 55% interest by transferring a group of adjacent claims and incurring a total of \$6 million of exploration expenditures, over a period of three years. The Company's interest will then be reduced to 22.5% and may be further reduced to 15% by Spider incurring exploration expenditures equal to its prior capital in the KWG/Spider Joint Venture ("KWG/Spider").
- (e) Following work performed in 2002 and the discovery of massive sulphide mineralization, KWG/Spider and De Beers Canada Exploration Inc. ("De Beers") entered into a royalty agreement whereby De Beers transferred the acquired participating interest in the Spider No. 3 project in consideration of a 1.5% (NSR) royalty on all mineral products that may be produced from the property. KWG/Spider did not exercise the option to buy back one third (0.5%) of the royalty for a purchase price of \$1,500,000 prior to April 30, 2008.

On March 7, 2007, Spider and UC Resources Limited ("UC") signed a letter of intent regarding a four-year exploration program on the McFaulds Lake volcanic hosted massive sulphide project. UC shall be the operator of the property during the term of the option and shall have the option to earn up to a 55% undivided interest in the property. UC can earn a 55% interest by incurring a total of \$4.5 million of exploration expenditures over a period of four years. On March 6, 2009, an option agreement was signed (note 16 (ii)).

- (f) The project consists of 45 square kilometers of exploration land located 35 kilometers north of the town of Wawa, Ontario.
- (g) In 2008, the Company decided to write-off (\$18,000) the Greenstone claims and the Geraldton claims (\$116,065) since no exploration work was performed during the year and no significant expenses are planned for 2009.
- (h) In December 2005, KWG/Spider entered into an agreement with Freewest Resources Canada Inc. for the acquisition of a 25% interest in 76 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 Spider has earned a 25% interest of the property.
- (i) In July 2006, the Company acquired from Pele Mountain Resources Inc. forty seven (47) Attawapiskat River claims located in the Porcupine Mining Division in the Province of Ontario in consideration for 10,127,860 treasury shares. The transaction was recorded at the fair value of the common shares given up at the date of the transaction. The fair value of the common share was determined based on the quoted value of the shares. Some claims are situated in an area of interest (within two kilometres) of the MacFadyen claims. The mineral rights transferred are subject to a 1.0% net product royalty, of which 0.5% may be purchased at any time for \$5,000,000.

# KWG Resources Inc.

(An exploration stage company)

Notes to Consolidated Financial Statements

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- (j) In February 2007, the Company acquired a 28.12% participating interest and a 2% NSR on a group of 61 claims adjoining the east side of the MacFadyen JV property. These mineral claims surround the DeBeers claims that host the Uniform Pipe (note 7(xiv)).
- (k) On July 23, 2008, the Company acquired an option to earn a 65% interest in a 12-claim group held by East West Resource Corporation. The Company issued 2,000,000 shares of the Company at a price of \$ 0.034 per share and paid \$50,000 for the option for a total of \$118,000. The Company must 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 the year, the Company incurred \$264,373 in exploration expenses.
- (l) In December 2004, the Company disposed of its interest in Haiti in consideration for work commitments from the purchaser and a 1.5% NSR on all mineral products from the Haitian properties. The purchaser has the right to buy back the NSR by paying to the Company US\$750,000 in two installments of (i) US\$250,000 and (ii) US\$500,000 respectively. In 2008, the Company agreed to reduce the remaining price of repurchase of the royalty to US\$100,000 and received the last two installments totaling \$117,751 (US\$100,000). This amount was recorded as a gain on disposal of royalty since all Haitian properties had been written off in accordance with the Company's accounting principle.

<b>Cost and deferred exploration expenses</b>	<b>2008</b>	<b>2007</b>
	<b>\$</b>	<b>\$</b>
Balance – Beginning of year	16,897,432	15,611,907
Acquisition, staking and permits	165,845	72,891
Write-down and write-off of mining assets	(1,900,130)	-
	<u>(1,734,285)</u>	<u>72,891</u>
Exploration expenses		
Drilling	2,051,619	820,802
Geophysics	391,078	73,494
Sampling	118,640	101,872
Consulting	451,672	35,310
Field preparation	5,859	29,939
Management	145,211	29,459
Line cutting and road	154,931	55,050
Camp expenses	105,914	56,108
Permits	-	10,600
Write-down and write-off of mining assets	(8,929,136)	-
	<u>(5,504,212)</u>	<u>1,212,634</u>
Balance – End of year	<u>9,658,935</u>	<u>16,897,432</u>

# KWG Resources Inc.

(An exploration stage company)

Notes to Consolidated Financial Statements

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## 7 Share capital

### Authorized

An unlimited number of common shares

### Issued

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

	2008		2007	
	Number of shares	Amount \$	Number of shares	Amount \$
Balance – Beginning of year	262,863,821	27,212,107	165,085,268	21,141,367
Issued for Canadian exploration expenses (i)(iii)(vi)(xii)(xiii)	18,475,000	369,500	49,074,650	4,004,958
Less: Value of warrants	-	(66,510)	-	(543,951)
Issued for working capital requirements (ii)(iv)(v)(vii)(ix)(x)	4,000,000	200,000	39,711,923	2,538,500
Less: Value of warrants	-	(34,510)	-	(640,448)
Issued for acquisition of mining asset (note 6 (b))(xiv)	2,000,000	68,000	842,100	50,525
Less: Value of warrants	-	-	-	(10,947)
Issued for commission (xii)(xiii)(xiv)	-	-	799,210	40,453
Less: Value of warrants	-	-	-	(640)
Issued for consulting fees (xi)	-	-	490,250	26,500
Less: Value of warrants	-	-	-	(5,499)
Issued for debt settlement (viii)	-	-	2,400,000	120,000
Issued following exercise of options	-	-	60,420	7,489
Issued for following exercise of warrants and compensation options	796,000	86,672	4,400,000	483,800
Balance – End of year	288,134,821	27,835,259	262,863,821	27,212,107

The capital of the Company consists of items included in the shareholder's equity of \$10,996,229 as of December 31, 2008 (\$22,348,933 as of December 31, 2007). In order to maximize its ongoing exploration activities, the Corporation does not pay any dividend in cash.

While the Company is not exposed to any external capital requirements, neither regulatory nor contractual, funds from the flow-through financing to be spent on the Company's exploration properties are restricted for this use.

The Company's objectives while managing capital are to safeguard its ability to continue its operations as well as its acquisitions and exploration programs. As needed, the Company raises funds through private placements. The Company does not use long term debt financing since it does not generate operating revenues.

# KWG Resources Inc.

(An exploration stage company)

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

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- (i) On December 31, 2008, the Company completed a private placement totalling 18,475,000 units at \$0.02 each for an aggregated amount \$369,500. Each unit is comprised of one flow-through common share and one common share purchase warrant at a price of \$0.05 per share until December 31, 2009 and thereafter, at a price of \$0.10 until December 31, 2010. Limited Market Dealer Inc. acted as agent and was paid a due diligence fee of \$11,085 as well as a finder's fee consisting of a cash payment of \$18,475 and 1,847,500 compensation options. Each compensation option is exercisable into one non-flow-through unit having the same other terms and conditions as the units issued in the private placement, at a price of \$0.05 until December 31, 2009 and thereafter at a price of \$0.10 until December 31, 2010.

The fair value of the purchase warrants included in the units was estimated using the Black-Scholes model based on the following assumptions: dividend yield of 0%, volatility of 120%, risk-free interest rate of 2.22% and an expected life of two years. As a result, the fair value of the purchase warrants was estimated at \$66,510 after a pro-rata allocation of the fair value of the units' components.

The fair value of the agent's compensation options was estimated using a binominal pricing model based on the following assumptions: dividend yield of 0%, volatility of 120%, risk-free interest rate of 2.22% and an expected life of two years. As a result, the fair value of the compensation options was estimated at \$12,933.

- (ii) On August 26, 2008 the Company completed a private placement totalling 2,000,000 units at a price of \$0.10 each for an aggregate amount of \$200,000. Each unit is comprised of two common shares and one purchase warrant exercisable at a price of \$0.10 for a period of 24 months from closing.

The fair value of the purchase warrants included in the units was estimated using the Black-Scholes model based on the following assumptions: dividend yield of 0%, volatility of 119%, risk-free interest rate of 3.32% and an expected life of two years. As a result, the fair value of the purchase warrants was estimated at \$34,510 after a pro-rata allocation of the fair value of the units' components.

- (iii) In December 2007, the Company completed a private placement of 14,124,650 units at a price of \$0.12 each for an aggregate amount of \$1,694,958. Each unit comprised one flow-through common share and half-one purchase warrant. Each purchase warrant entitles the holder thereof to subscribe for one common share of the Company at a price of \$0.18 for a period of 24 months from closing.

The fair value of the purchase warrants included in the units was estimated using the Black-Scholes model based on the following assumptions: dividend yield of 0%, volatility of 88.53%, risk-free interest rate of 4.13% and an expected life of two years. As a result, the fair value of the purchase warrants was estimated at \$201,276 after a pro rata allocation of the fair value of the units' components.

The Company paid brokerage fees to an agent comprised of 1,412,465 compensation options which expire on December 28, 2009. The compensation options entitle the holder to subscribe for an equal number of units. Each unit comprises one common share and one purchase warrant. Each

# **KWG Resources Inc.**

(An exploration stage company)

Notes to Consolidated Financial Statements

**December 31, 2008 and 2007**

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purchase warrant entitles the holder to subscribe for one common share of the Company at a price of \$0.185 for a period of 24 months from closing.

The fair value of the agent's compensation options was estimated using a binomial pricing model based on the following assumptions: dividend yield of 0%, volatility of 88.53%, risk-free interest rate of 4.13% and an expected life of two years. As a result, the fair value of the compensation options was estimated at \$90,398.

- (iv) In December 2007, the Company completed a private placement of 4,135,000 units at a price of \$0.10 each for an aggregate amount of \$413,500. Each unit comprised one common share and one purchase warrant. Each purchase warrant entitles the holder thereof to subscribe for one common share of the Company at a price of \$0.15 for a period of 24 months from closing.

The fair value of the purchase warrants included in the units was estimated using the Black-Scholes model based on the following assumptions: dividend yield of 0%, volatility of 88.53%, risk-free interest rate of 4.13 % and an expected life of two years. As a result, the fair value of the purchase warrants was estimated at \$99,240 after a pro rata allocation of the fair value of the units' components.

The Company paid brokerage fees to an agent comprised of 413,500 compensation options which expire on December 20, 2009. The compensation options entitle the holder to subscribe for an equal number of units. Each unit comprises one common share and one purchase warrant. Each purchase warrant entitles the holder to subscribe for one common share of the Company at a price of \$0.15 for a period of 24 months from closing.

The fair value of the agent's compensation options was estimated using a binomial pricing model based on the following assumptions dividend; yield of 0%, volatility of 88.53%, risk-free interest rate of 4.13% and an expected life of two years. As a result, the fair value of the compensation options was estimated at \$28,532.

- (v) In October 2007, the Company completed a private placement of 10,000,000 units at a price of \$0.05 each for an aggregate amount of \$500,000. Each unit comprised one common share and one purchase warrant. Each purchase warrant entitles the holder thereof to subscribe for one common share of the Company at a price of \$0.10 for a period of 24 months from closing.

The fair value of the purchase warrants included in the units was estimated using the Black-Scholes model based on the following assumptions: dividend yield of 0%, volatility of 112.06%, risk-free interest rate of 4.45 % and an expected life of two years. As a result, the fair value of the purchase warrants was estimated at \$126,400 after a pro rata allocation of the fair value of the units' components.

- (vi) In October 2007, the Company completed a private placement of 18,750,000 units at a price of \$0.08 each for an aggregate amount of \$1,500,000. Each unit comprised one flow-through common share and one-half purchase warrant. Each purchase warrant entitles the holder thereof to subscribe for one common share of the Company at a price of \$0.12 for a period of 24 months from closing.



# **KWG Resources Inc.**

(An exploration stage company)

Notes to Consolidated Financial Statements

**December 31, 2008 and 2007**

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The fair value of the purchase warrants included in the units was estimated using the Black-Scholes model based on the following assumptions: dividend yield of 0%, volatility of 99.21%, risk-free interest rate of 4.45% and an expected life of two years. As a result, the fair value of the purchase warrants was estimated at \$196,875 after a pro rata allocation of the fair value of the units' components.

- (vii) In October 2007, the Company completed a private placement of 23,076,923 units at a price of \$0.065 each for an aggregate amount of \$1,500,000. Each unit comprised one common share and one purchase warrant. Each purchase warrant entitles the holder thereof to subscribe for one common share of the Company at a price of \$0.10 for a period of 24 months from closing.

The fair value of the purchase warrants included in the units was estimated using the Black-Scholes model based on the following assumptions: dividend yield of 0%, volatility of 99.21%, risk-free interest rate of 4.45% and an expected life of two years. As a result, the fair value of the purchase warrants was estimated at \$392,308 after a pro rata allocation of the fair value of the units' components.

The Company paid brokerage fees to an agent comprised of 4,182,692 compensation options which expire on October 31, 2009. The compensation options entitle the holder to subscribe for an equal number of units. Each unit comprises one common share and one purchase warrant. Each purchase warrant entitles the holder to subscribe for one common share of the Company at a price of \$0.10 for a period of 24 months from closing.

The fair value of the agent's compensation options was estimated using a binomial pricing model based on the following assumptions: dividend yield of 0%, volatility of 99.21%, risk-free interest rate of 4.45% and an expected life of two years. As a result, the fair value of the compensation options was estimated at \$172,673.

- (viii) In August 2007, the Company issued an aggregate of 2,400,000 common shares from treasury at a price of \$0.05 each, the fair value of common shares, in full and final settlement of a \$120,000 lawsuit by former employees of a former subsidiary of the Company.

- (ix) In July 2007, the Company completed a private placement of 1,000,000 units at a price of \$0.05 each for an aggregate amount of \$50,000. Each unit comprised one common share and one purchase warrant. Each purchase warrant entitles the holder thereof to subscribe for one common share of the Company at a price of \$0.10 for a period of 24 months from closing.

The fair value of the purchase warrants included in the units was estimated using the Black-Scholes model based on the following assumptions: dividend yield of 0%, volatility of 78.74%, risk-free interest rate of 4.83% and an expected life of two years. As a result, the fair value of the purchase warrants was estimated at \$9,000 after a pro rata allocation of the fair value of the units' components.

- (x) In June 2007, the Company completed private placements of 1,500,000 units at a price of \$0.05 each for an aggregate amount of \$75,000. Each unit comprised one common share and one purchase warrant. Each purchase warrant entitles the holder to subscribe for one common share of the Company at a price of \$0.10 for a period of 24 months from closing.

# **KWG Resources Inc.**

(An exploration stage company)

Notes to Consolidated Financial Statements

**December 31, 2008 and 2007**

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The fair value of the purchase warrants included in the units was estimated using the Black-Scholes model based on the following assumptions: dividend yield of 0%, volatility of 80.09%, risk-free interest rate of 4.51% and an expected life of two years. As a result, the fair value of the purchase warrants was estimated at \$13,500 after a pro rata allocation of the fair value of the units' components.

- (xi) In 2007, the Company issued 490,250 units in payment of services rendered for an aggregate amount of \$26,500. Each unit comprised one common share and one purchase warrant. Each purchase warrant entitles the holder to subscribe for one common share of the Company at a price of \$0.10 for a period of 24 months from closing.

The fair value of the purchase warrants included in the units was estimated using the Black-Scholes model based on the following assumptions: dividend yield of 0%, average volatility of 87.71%, average risk-free interest rate of 4.70% and an expected life of two years. As a result, the fair value of the purchase warrants was estimated at \$5,499 after a pro rata allocation of the fair value of the units' components.

- (xii) In April 2007, the Company completed private placements of 5,000,000 units at a price of \$0.05 each for an aggregate amount of \$250,000. Each unit comprised one flow-through common share and one purchase warrant. Each purchase warrant entitles the holder to subscribe for one non flow-through common share of the Company at a price of \$0.10 for a period of 24 months from closing.

The fair value of the purchase warrants included in the units was estimated using the Black-Scholes model based on the following assumptions: dividend yield of 0%, volatility of 77.90%, risk-free interest rate of 4.18% and an expected life of two years. As a result, the fair value of the purchase warrants was estimated at \$45,000 after a pro rata allocation of the fair value of the units' components.

The Company paid brokerage fees to an agent comprised an amount in cash of \$12,500 and 250,000 common shares and 500,000 compensation options which expire on April 26, 2009. The compensation options entitle the holder to subscribe for an equal number of units. Each unit comprises one common share and one purchase warrant. Each purchase warrant entitles the holder to subscribe for one common share of the Company at a price of \$0.05 for a period of 24 months from closing.

The fair value of the agent's compensation options was estimated using a binomial pricing model based on the following assumptions dividend; yield of 0%, volatility of 77.90%, risk-free interest rate of 4.18% and an expected life of two years. As a result, the fair value of the compensation options was estimated at \$13,000.

- (xiii) In March 2007, the Company completed private placements of 11,200,000 units at a price of \$0.05 each for an aggregate amount of \$560,000. Each unit comprised one flow-through common share and one purchase warrant. Each purchase warrant entitles the holder to subscribe for one non flow-through common share of the Company at a price of \$0.10 for a period of 24 months from closing.

The Company paid brokerage fees to an agent comprised of an amount in cash of \$28,000 and 500,000 common shares and 1,000,000 compensation options which expire on March 22, 2009. The compensation options entitle the holder to subscribe for an equal number of common shares at a price of \$0.10 per share for a period of 24 months from closing.

# KWG Resources Inc.

(An exploration stage company)

Notes to Consolidated Financial Statements

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The fair value of the purchase warrants included in the units was estimated using the Black-Scholes model based on the following assumptions: dividend yield of 0%, volatility of 82.00%, risk-free interest rate of 4.04% and an expected life of two years.

As a result, the fair value of the purchase warrants was estimated at \$100,800 after a pro rata allocation of the fair value of the units' components. The fair value of the compensation options was estimated at \$32,000.

The fair value of the agent's compensation options was estimated using a binomial pricing model based on the following assumptions dividend; yield of 0%, volatility of 82.00%, risk-free interest rate of 4.04% and an expected life of two years.

(xiv) In February 2007, the Company acquired a 28.12% participating interest and a 2% NSR on a group of 61 claims adjoining the east side of the MacFadyen property. These minerals claims surround the De Beers claim that hosts the Uniform Pipe. The Company issued 842,100 units at an average price of \$0.06 each for an aggregate amount of \$50,525 and paid a finder's fee of 49,210 units at an average price of \$0.06 each for an aggregate amount of \$2,953. The transaction has been recorded at the fair value of the units given up at the date of the transaction. Each unit comprised one common share and one purchase warrant; each warrant entitles the holder to subscribe for one common share of the Company at a price of \$0.10 for a period of 24 months from closing.

The fair value of the purchase warrants included in the units was estimated using the Black-Scholes model based on the following assumptions: dividend yield of 0%, volatility of 78.74%, risk-free interest rate of 4.23% and an expected life of two years. As a result, the fair value of the purchase warrants was estimated at \$10,947 and \$640 after a pro rata allocation of the fair value of the units' components.

## 8 Warrants and compensation options

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

**Year ended  
December 31, 2008**

**Year ended  
December 31, 2007**

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# KWG Resources Inc.

(An exploration stage company)

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	Warrants	Compensation options	Amount \$	Warrants	Compensation options	Amount \$
<b>Issued</b>						
Balance – Beginning of year	91,830,808	7,987,157	1,723,358	25,042,500	478,500	255,579
Issued as part of private placement of units (note 7(i)(ii)(iv)(v)(vii)(ix)(x))	20,475,000	-	101,020	72,349,248	-	1,184,399
Issued as part of private placement of units (note 7(xiv))	-	-	-	842,100	-	10,947
Issued for acquisition of mining assets (note 7(xiv))	-	-	-	49,210	-	640
Agent's compensation options (note 7(i)(iii)(iv)(vii)(xii)(xiii))	-	1,847,500	12,933	-	7,508,657	336,603
Issued for consulting fees (note 7(xi))	-	-	-	490,250	-	5,499
Exercised	(500,000)	(296,000)	(17,432)	(4,400,000)	-	(43,800)
Expired	(17,800,000)	(478,500)	(182,070)	(2,542,500)	-	(26,509)
Balance – End of year	94,005,808	9,060,157	1,637,809	91,830,808	7,987,157	1,723,358

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, 2008 is presented below:

Number of warrants	Compensation options	Exercise price \$	Expiry date
891,310	-	0.10	February 2009
11,000,000	1,000,000	0.10	March 2009
5,172,250	500,000	0.10/0.05	April 2009
1,500,000	-	0.10	June 2009
1,106,000	-	0.10	July 2009
106,000	-	0.10	August 2009
6,706,000	-	0.10	September 2009
26,476,923	3,886,692	0.10/0.05	October 2009
9,375,000	-	0.12	October 2009
4,135,000	413,500	0.15	December 2009
7,062,325	1,412,465	0.18/0.185	December 2009
2,000,000	-	0.10	August 2010
18,475,000	1,847,500	0.05/0.10	December 2010
<b>94,005,808</b>	<b>9,060,157</b>		

# KWG Resources Inc.

(An exploration stage company)

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

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## 9 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.

As at December 31, 2008, the Plan provides (i) that the maximum number of common shares that may be reserved for issuance under the Plan shall be equal to 26,280,000 common shares (as at December 31, 2007 – 24,400,000); (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 at a fixed price

	2008		2007	
	Number of shares	Average exercise price \$	Number of shares	Average exercise price \$
Balance – Beginning of year	23,881,080	0.11	14,198,000	0.11
Granted	3,379,700	0.10	11,310,000	0.11
Exercised (note 7)	-	-	(60,420)	0.10
Cancelled or expired	(3,391,900)	0.13	(1,566,500)	0.15
Balance – End of year	23,868,880	0.11	23,881,080	0.11

# KWG Resources Inc.

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Notes to Consolidated Financial Statements

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The following table summarizes information about options outstanding and exercisable as at December 31, 2008:

		<b>Outstanding options</b>	<b>Exercisable options</b>	
	<b>Exercise price</b>	<b>Number of options</b>	<b>Average contractual life (in years)</b>	
	\$			
	0.10	17,033,280	3.45	15,363,005
	0.12	5,940,500	3.05	4,588,000
	0.15	895,100	2.19	770,100
		<u>23,868,880</u>		<u>20,721,105</u>

Total stock compensation costs for the year ended December 31, 2008 amounted to \$448,037 (2007 – \$466,432).

The fair value of the options granted in 2008 and 2007 was estimated using the Black-Scholes option pricing model based on the following assumptions:

	<b>2008</b>	<b>2007</b>
Average dividend per share	Nil	Nil
Estimated volatility	85%	82%
Risk-free interest rate	3.85%	4.54%
Expected life of the options granted	5 years	5 years
Weighted average of estimated fair value of each option granted	\$0.063	\$0.062

## 10 Contributed surplus

	<b>2008</b>	<b>2007</b>
	\$	\$
Balance – Beginning of year	1,996,508	1,505,028
Stock compensation costs (note 9)	448,037	466,432
Expiry of warrants (note 8)	182,070	26,509
Exercise of options (note 9)	<u>-</u>	<u>(1,461)</u>
Balance – End of year	<u>2,626,615</u>	<u>1,996,508</u>

# KWG Resources Inc.

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Notes to Consolidated Financial Statements

December 31, 2008 and 2007

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## 11 Accumulated other comprehensive income (loss)

	2008 \$	2007 \$
<b>Accumulated other comprehensive income (loss) - beginning of year</b>	(36,364)	-
Modification following the adoption of Section 3855 "Financial instruments" (a)	-	46,350
Latent loss on temporary investments available for sale	<u>(189,210)</u>	<u>(82,714)</u>
<b>Accumulated other comprehensive income (loss) - end of year</b>	<u>(225,574)</u>	<u>(36,364)</u>

	2008 \$	2007 \$
<b>Latent loss on temporary investments - beginning of year</b>	(82,714)	-
Unrealized gain (loss) for the year on Spider investment	(22,500)	13,750
Unrealized loss for the year on St. Genevieve investment	-	(96,464)
Unrealized loss for the year on Mesa investment	(33,860)	-
Unrealized loss for the year on Strike investment	<u>(132,850)</u>	<u>-</u>
<b>Latent loss on temporary investments – end of year</b>	<u>(225,574)</u>	<u>(82,714)</u>

With respect to the Company's investments, the latest loss on temporary investments available for sale adjustments represents the unrealized gain or loss on the Company's net investments (note 5).

As at January 1, 2007 following the adoption of section 3855, which applied retroactively without restatement, temporary investment were classified under "Available-for-sale financial assets". The carrying value and fair value of portfolio investments were \$132,596 and \$178,946, respectively. The initial valuation resulted in a net unrealized gain of \$46,350. The net unrealized gain was presented as an adjustment to Accumulated Other Comprehensive Income (loss) ("AOCI").

# KWG Resources Inc.

(An exploration stage company)

Notes to Consolidated Financial Statements

December 31, 2008 and 2007

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## 12 Income taxes

The future income tax balances are summarized as follows:

- (i) The provision for income taxes presented in these Consolidated Financial Statements is different from what would have resulted from applying the combined Canadian Statutory tax rate as a result of the following:

	2008 \$	2007 \$
Loss before income taxes	(12,271,901)	(1,061,655)
Combined federal and provincial income tax at 32.85% (32.02% in 2007)	(4,031,319)	(339,942)
Impact of decrease (increase) income tax rate on future income tax balances	(107,611)	3,466,801
Expired tax losses	75,226	200,301
Stock compensation costs	147,180	149,352
Non-taxable portion of capital gain	318	1,319
Other	(18,547)	(6,831)
Valuation allowance	<u>2,794,753</u>	<u>(3,641,000)</u>
Recovery of future income taxes	<u>(1,140,000)</u>	<u>(170,000)</u>

- (ii) Future income tax assets

	2008 \$	2007 \$
Current future income tax assets		
Non-capital losses	100,000	62,000
Share and warrant issue expenses	<u>54,000</u>	<u>74,000</u>
	154,000	136,000
Valuation allowance	<u>(154,000)</u>	<u>(136,000)</u>
Current future income tax assets	<u>-</u>	<u>-</u>
Long-term future income tax assets		
Mining assets and deferred exploration expenses	6,546,000	5,225,000
Non-capital losses	1,277,000	936,000
Capital losses	12,544,000	11,411,000
Share and warrant issue expenses	108,000	156,000
Investments	41,000	-
Exploration equipment	<u>660,000</u>	<u>624,000</u>
	21,176,000	18,352,000
Valuation allowance	<u>(21,176,000)</u>	<u>(18,352,000)</u>
Long-term future income tax assets	<u>-</u>	<u>-</u>
Total future income tax assets	<u>-</u>	<u>-</u>



# KWG Resources Inc.

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Notes to Consolidated Financial Statements

December 31, 2008 and 2007

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In 2008 the Company issued flow-through units for gross proceeds of \$369,500 (2007 – \$4,004,958). Under the flow-through share agreements, the Company agreed to renounce \$369,500 of qualifying expenditures to the investors effective December 31, 2008, although under Canadian tax law, the expenditures may actually be incurred up to December 31, 2009.

The Company is required to record a provision at the time the renunciation is filed with the tax authorities, by an increase in the share and warrant issue expenses relating to the flow-through shares, for the future income taxes related to the tax deductions the Company has forgone. The Company has filed and renounced to the authorities in early 2008, therefore estimated future income taxes of \$1,140,000 were recorded as at December 31, 2008 (2007 – \$170,000). Consequently, the Company has recognized such expenses as share and warrant issue expenses in 2008 (2007 – \$170,000).

- (iii) As at December 31, 2008, the cost for income tax purposes of exploration equipment, mining assets and deferred exploration expenses and temporary investments totaled approximately \$36,431,958. The difference between the fiscal cost and the amount capitalized in these Consolidated Financial Statements arises from the write-off of certain assets for accounting purposes, rollover transactions and the tax benefits related to some exploration expenses being renounced in favour of subscribers.

The Company has accumulated non-capital losses for income tax purposes amounting to approximately \$4,753,000. These losses will expire as follows:

	\$
Year ending December 31, 2009	307,000
2010	359,000
2014	535,000
2015	653,000
2026	737,000
2027	888,000
2028	1,274,000

- (iv) The Company's balance of capital losses amounts to approximately \$88,853,404 and can be carried forward indefinitely against capital gains.
- (v) The unamortized balance for tax purposes of share and warrant issue expenses amounting to approximately \$571,000 is deductible over the next four years.
- (vi) The tax values of assets and liabilities arising from the year ended December 31, 2008, have not been agreed with the relevant tax authorities nor have they been disputed.

## 13 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 2008, officers and companies controlled by officers were paid consulting fees totalling \$238,244 (\$89,860 in 2007) of which \$4,125 remained payable at December 31, 2008 (\$16,352 in 2007) and directors of the Company and a company controlled by a director of the Company were paid \$68,768 (\$60,000 in 2007 for professional consulting services).

# **KWG Resources Inc.**

(An exploration stage company)

Notes to Consolidated Financial Statements

**December 31, 2008 and 2007**

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## **14 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.

Cash, accounts receivable and accounts payable and accrued liabilities are non-interest bearing.

### **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**

It is management's opinion that the Company is not exposed to significant foreign exchange risk. As at December 31, 2008, there were no financial assets and financial liabilities denominated in U.S. dollars.

### **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 December 31, 2008, the Company had enough funds available to satisfy its obligations under accounts payable and accrued liabilities.

In the past few years, the Company 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 (note 1).

# KWG Resources Inc.

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Notes to Consolidated Financial Statements

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## Fair Value

The fair value of financial instruments is summarized as follows:

	2008		2007	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
<b>Financial assets</b>				
<u>Held for trading:</u>				
Cash and cash equivalent	1,528,897	1,528,897	5,472,150	5,472,150
<u>Available-for-sale:</u>				
Temporary investments	152,722	152,722	76,232	76,232
<u>Loans and receivables:</u>				
Accounts receivable	96,059	96,059	60,535	60,535
<b>Financial liabilities</b>				
<u>Other liabilities:</u>				
Accounts payable and accrued liabilities	505,826	505,826	164,722	164,722

Fair value estimates are made at the balance sheet date, based on relevant market information and other information about financial instruments.

As at December 31, 2008, all financial instruments (cash, accounts receivable, and accounts payable and accrued liabilities) have fair values which approximate their carrying values due to the relatively short period to maturity of the instruments. For temporary investments refer to note 5.

## 15 Commitments

In February 2004, the Company and two other companies signed jointly a five-year lease for office premises. The annual rent of approximately \$150,000 is divided on a pro-rata basis on office space occupied. In January 2008, the office premises were subleased covering the total amount of the lease payments.

Pursuant to flow-through financing agreements closed during the year ended December 31, 2008, the Company must incur \$369,808 in exploration expenses by December 31, 2009.

## 16 Subsequent events

- (i) On January 20, 2009, Cliffs Natural Resources Inc. (“Cliffs”) entered into an Option to Purchase Securities (the “**Option Agreement**”) with the Company to purchase and acquire certain securities of the Company in the aggregate amount of CAN\$4,453,400 (US\$3,500,000). Pursuant to the Option Agreement, the Company granted to Cliffs an option exercisable on or before March 16, 2009 (the “**Option**”) to subscribe for:
  - (1) 50,448,987 units of the Company (each a “**Unit**”) at a subscription price of CAN\$0.062213 (US\$0.048894) per Unit, with each Unit comprised of one (1) common share in the capital of the Company (each a “**Common Share**”) and approximately 0.44 of a non-transferable Common Share purchase warrant of the Company (each such whole common share purchase

# KWG Resources Inc.

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warrant, a “**Warrant**”), with each Warrant entitling Cliffs to purchase one (1) Common Share at CAN\$0.063620 (US\$0.05) during the first year after issuance thereof and CAN\$0.127240 (US\$0.10) thereafter, subject to the undertaking of the Company to reduce such price to CAN\$0.063620 (US\$0.05) upon receipt of all necessary regulatory approvals. Each Warrant would be exercisable for a period of 20 business days following the issuance by the Company of five (5) Common Shares upon the exercise of any of the warrants, options and other rights to purchase or obligations to issue Common Shares outstanding as at the date of execution of the Option Agreement, and would terminate on the fifth anniversary of the date of issuance of the Warrants; and

- (2) a non-transferable, non-interest bearing, secured convertible debenture of the Company in the principal amount of CAN\$1,314,832 (US\$1,033,398) maturing on April 16, 2009, such amount being equal to the difference between CAN\$4,453,400 (US\$3.5 million) and the aggregate subscription price of CAN\$3,138,568 (US\$2,466,602) payable for the Units above (the “**Debenture**”). The Debenture would not be convertible unless and until all conditions prescribed by the TSX Venture Exchange (“TSXV”), including the approval of the shareholders of the Company (the “**Shareholder Approval**”) to the issuance of the Units upon conversion of the Debenture, have been satisfied or waived. In the event that all of such conditions would not be satisfied or waived on or before April 15, 2009, Cliffs would have the right to demand repayment thereof, in which event the Company would be required to pay to Cliffs a credit facility termination fee of CAN\$63,620 (US\$50,000) (the “**Termination Fee**”). Upon satisfaction or waiver of such conditions, all of the principal amount of the Debenture is to be converted automatically and without any further action on the part of the Company or Cliffs into Units at the rate of CAN\$0.062213 (US\$0.048894) per Unit resulting in a further issuance to Cliffs of 21,135,069 Units comprised of 21,135,069 Common Shares and 9,310,839 Warrants. The sole security to be granted by the Company is to be comprised of cash in an amount equal to the principal amount of the Debenture plus the Termination Fee.

As permitted by section 7(c) of the Option Agreement, on March 12, 2009, Cliffs assigned the Option Agreement to an affiliated entity, Cliffs Greene B.V. (“**Cliffs B.V.**”).

On March 16, 2009, Cliffs B.V. exercised the Option and acquired (i) 50,448,987 Units comprised of 50,448,987 Common Shares and 22,224,784 Warrants and (ii) the Debenture. As a result, Cliffs B.V. holds, as at the date hereof, approximately 14.9% of the issued and outstanding Common Shares of the Company.

In connection with the exercise of the Option, the Company and Cliffs B.V. entered into a shareholder agreement dated March 16, 2009, pursuant to which:

- (1) Cliffs B.V. was granted rights of first refusal with respect to the issuance (whether by private placement, public offering or otherwise) of securities of the Company, allowing Cliffs B.V. to purchase (with enumerated exceptions) all such securities offered by the Company in respect of any issuances.
- (2) Cliffs B.V. was granted pre-emptive rights with respect to the issuance (whether by private placement, public offering or otherwise) of securities of the Company, allowing it to purchase from the Company (on the same terms as applicable in the particular issuance) such number of securities as is necessary to ensure that Cliffs B.V.’s percentage ownership of securities (calculated on a fully diluted basis) immediately after such issuance would be as nearly equal as possible to its percentage ownership immediately before such issuance.

# **KWG Resources Inc.**

(An exploration stage company)

Notes to Consolidated Financial Statements

**December 31, 2008 and 2007**

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- (3) As long as Cliffs B.V. and its affiliates own at least 10% of the outstanding voting securities of the Company, Cliffs B.V. is entitled to appoint one nominee to the Board for election at the annual general meeting of the shareholders. Any vacancy in the Board created by the removal or resignation of the nominee of Cliffs B.V. shall be filled with a new designee of Cliffs B.V. The appointment of any nominee or designee is subject to any applicable securities law and stock exchange requirements.

On the receipt of Shareholder Approval, the Debenture would be automatically converted without any further action of the Company or Cliffs B.V., resulting in a proposed issuance to Cliffs B.V. of an additional 21,135,069 Common Shares and 9,310,839 Warrants. The policies of the TSXV require that the issuance of such additional Common Shares and Warrants upon the conversion of the Debenture be approved by the disinterested shareholders of the Company as such conversion would result in Cliffs B.V. becoming a new "control person" as defined under the policies of the TSXV. In the event Shareholder Approval is not obtained before April 16, 2009, the principal amount of the Debenture is required to be repaid together with the Termination Fee.

In the event Shareholder Approval is obtained, the conversion of the Debenture will result in a change of control payments of an aggregate amount of \$456,787 to directors and officers.

- (ii) On March 6, 2009, UC Resources Ltd. ("UC"), Spider Resources Inc. and the Company have signed an option agreement pertaining to the McFaulds east and west properties held jointly by Spider and the Company in the James Bay Lowlands area of Northern Ontario.

The option agreement provides that UC Resources can earn up to a 55% interest in these properties by expending a total of \$4.5-million prior to March 6, 2011. In addition, UC is the operator of the exploration program during its earn in, after which operatorship is dictated by the terms of a joint venture agreement, where operatorship resides with the party holding the greatest interest in the project.

Under the terms of the option agreement, UC had to spend \$1 million on exploration prior to March 6, 2008, to earn a 10% interest, which were included in the letter of intent (note 6(e)), in the land package. In year two, UC had to spend an additional \$1 million prior to March 6, 2009, to obtain an additional 15% of the property package. Both commitments have been completed by UC at this time for a completed 25% interest.

Two additional increments of 15% interest each can be earned by UC. The company must spend \$1.25 million prior to March 6, 2010, to earn an additional 15% interest, and spend a final \$1.25 million prior to March 6, 2011, for a total of \$4.5 million in expenditures and earned 55% interest.

- (iii) On March 16, 2009, the Board of directors of the Company approved, subject to regulatory and shareholders' approvals, an increase in the maximum number of shares to be reserved for issuance under the Stock Option Plan from 26,280,000 to 28,800,000.

- (iv) On March 16, 2009, the Board of directors of the Company approved, subject to shareholders' approval, the reduction of the issued and paid-in capital account of the Company by \$20,000,000 without reimbursement to the shareholders with a corresponding reduction in the Deficit.

# CORPORATE INFORMATION

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## DIRECTORS

**Frank C. Smeenk**  
Kleinburg, Ontario

**Michael S. Harrington**  
Aurora, Colorado, USA

**Michel Côté**  
Montréal, Québec

**Mousseau Tremblay**  
Williamstown, Ontario

**Douglas M. Flett**  
Toronto, Ontario

**Leonard Teoli**  
Terrebonne, Québec

## ANNUAL MEETING

The Annual General Meeting of Shareholders of KWG Resources Inc. will be held on Wednesday, April 15, 2009, at 10:00 a.m., at Saint-James Club of Montréal, 1145 Union Avenue, Montréal, Québec.

## SOLICITORS

Macleod Dixon LLP  
Toronto-Dominion Centre  
Canadian Pacific Tower  
500 - 100 Wellington Street West  
Toronto, Ontario M5K 1H1

## AUDITORS

PricewaterhouseCoopers LLP  
1250 René-Lévesque Blvd. West  
Suite 2800  
Montréal, Québec H3B 2G4

## EXCHANGE LISTING

TSX-Venture Exchange  
Symbol: KWG

## CUSIP

48277D 20 5

## OFFICERS

**Mousseau Tremblay**  
Chairman of the Board

**Frank C. Smeenk**  
President and Chief Executive Officer

**Michael S. Harrington**  
Vice-Chairman of the Board

**Martin Nicoletti**  
Chief Financial Officer

**Luce L. Saint-Pierre**  
Corporate Secretary

## REGISTRAR AND TRANSFER AGENT

Computershare Investor Services Inc.  
1500 University Street  
Suite 700  
Montréal, Québec H3A 3S8

Computershare Investor Services Inc.  
151 Front Street  
8<sup>th</sup> Floor  
Toronto, Ontario M5J 2N1

## ANNUAL REPORT

Additional copies of this report may be obtained upon written request to:

KWG Resources Inc.  
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Fax: (514) 866-6193  
E-mail: [lsPierre@kwgresources.com](mailto:lsPierre@kwgresources.com)

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