

# Canaf Group Inc.

## Management Discussion & Analysis

For the Period Ended  
July 31, 2012

(Expressed in U.S. Dollar)

### INTRODUCTION

The following Management's Discussion and Analysis ("MD&A") is intended to assist the reader to assess material changes in financial condition and results of operations of Canaf Group Inc. ("the Corporation") as at July 31, 2012 and for the nine month period then ended in comparison to the same period in 2011.

This MD&A should be read in conjunction with the unaudited condensed consolidated interim financial statements for the three and nine months ended July 31, 2012 and supporting notes. These unaudited condensed consolidated interim financial statements have been prepared using accounting policies consistent with IFRS and in accordance with International Accounting Standard 34 ("IAS 34") - Interim Financial Reporting. A reconciliation of the previously disclosed comparative periods' financial statements prepared in accordance with Canadian generally accepted accounting principles to IFRS is set out in Note 28 to these unaudited condensed consolidated interim financial statements

The effective date of this MD&A is September 25, 2012.

### DESCRIPTION OF BUSINESS

Canaf Group Inc., (the "Company") is incorporated in the Province of Alberta and wholly owns a company in South Africa, Quantum Screening and Crushing (Proprietary) Limited ("Quantum"). Quantum processes anthracite coal into de-volatised (calcined) anthracite for sale to steel and ferromanganese manufacturers as a substitute product for coke.

#### Quantum - Calcined Anthracite, South Africa

The company produces calcined anthracite, a product used as a substitute to coke in the manufacturing process of steel and manganese. The company's two largest clients are world leaders in steel and ferromanganese production, namely ArcelorMittal and BHP Billiton respectively. Quantum has an operation near Newcastle, KwaZulu Natal, where its two kilns operate, de-volatising the raw material anthracite, known as calcining. The majority of Quantum's feedstock anthracite is supplied by the neighbouring Springlake Colliery, which has reserves in excess of 20 years.

Calcining is a process whereby anthracite coal is fed through a rotary kiln (at temperatures between 850 and 1100 degrees centigrade) and de-volatilisation takes place; the volatiles are burnt off and the effective carbon content increased. The final product, referred to as 'calcined anthracite' is used as a coke substitute with a high carbon content of between 80% and 85%. Calcined anthracite is used as a reductant in the manufacture of steel and manganese. Quantum, through its wholly owned subsidiary Southern Coal (Proprietary) Limited, ("Southern Coal") has been profitably carrying on this business since 2004.

## OVERALL PERFORMANCE AND OUTLOOK

During the last quarter the Company continued to further increase sales volumes, further invested in its South African operation and again significantly reduced total debt.

The highlight of the period was the completion of the trial supply of product to BHP Billiton, which proved to be very successful. Subsequently, the Company reached an agreement with BHP over the terms relating to a long-term contract to supply calcined anthracite. The contract has now been approved and is for a period of 3 years from 01 September 2012 until 31 August 2015. Supply of product under the terms of the contract has effectively commenced and delivery of the final signed contract is anticipated to be completed by the end of September 2012. The contract will offer the Company security of sales with one of the largest mining companies in the world to supply one of their ferromanganese facilities in South Africa. In addition to the contract with BHP Billiton the Company has also entered into long term supply contracts for its feedstock material with the neighbouring anthracite mine, Springlake Colliery, operated by Shanduka Coal. The Company now has a secure supply of feedstock and a long-term contract for sale of its product. In addition to the contract with BHP Billiton, the Company continues to supply its long-term customer of ArcelorMittal with calcined anthracite for their steel facility in the neighbouring town of Newcastle.

At the end of the last quarter, the Company further invested in Quantum by completing on the acquisition of a freehold property in Newcastle, KwaZulu Natal, South Africa, which was capitalized at the value of \$132,001. The property is now being used as Quantum's new main office, extra storage space for the operation and will eventually accommodate for Company directors and management visiting the operation. The acquisition will act as a way of optimising cash and reducing rental and accommodation expenses – the Company believes the acquisition to be a sound investment in one of the fastest growing towns in the province of KwaZulu Natal.

Addressing Company's long-term debt has continued to remain a focus, and the Company significantly reduced related party debt by \$208,664 during the quarter. The Company had a cash balance of \$1,489,884 and saw its total assets return to a level above \$4 million.

Revenue increased by 23.4%, compared to the previous quarter due to increased tones of product sold and an increase in sale price of one product during the entire quarter. Gross margins were reduced mostly due to the fact that operating costs were above normal levels during period, as June and July are two of the three 'peak season' months for electricity supply in South Africa. The Company will see a significant reduction in electricity costs next quarter as the peak season ends on 31 August of each year. In addition to the seasonal increase in operating costs in the quarter, the Company was running the trial supply at BHP Billiton at slightly discounted rates. The Company can however confirm that as from September 2012, new contract prices have been implemented and management expects to see an increase in margins over the coming quarters.

The Company expects to see a similar level of sales next month, but anticipates margins to increase as operating costs decrease and new sale prices become effective.

The goals for the coming 3 months remain to further reduce the Company's debt and increase Quantum's operating margins by reducing operating costs and further increasing sales, although management anticipates margins and profits to increase as the contract with BHP becomes to active.

For the long-term outlook, the Company remains confident that orders for its product of calcined anthracite will continue to improve as is being illustrated by industry's interest to secure contracts for Quantum to supply. Calcined anthracite is considered as a more secure source reductant as industries in South Africa become concerned at the future availability of coke for the manufacture of steel in ferromanganese. The Company is currently looking at opportunities to grow its sales.

Over the past few years, high-quality anthracites have gained more interest as a replacement to the more expensive reductant, coke, in the sintering and smelting industries. In the current environment, industries are looking to save on their feedstock costs by blending in anthracite and calcined anthracite into their feedstocks. The Company is optimistic that as long as coking coal remains around and above the \$180/metric tonne level, then there will be a strong market for replacement materials, such as the Company's product, calcined anthracite.

Furthermore, the company recognises that there is an opportunity to sell the product for export as world demand for smokeless and environmentally friendly reductants (such as calcined anthracite) increases, not to mention the forecasted increase in price of coking coal. Opportunities to expand the operations and investigate selling for the export market are ongoing.

The Company continues to focus on generating positive free cash flow and addressing the outstanding debt owed by the Company. The Company is not actively looking at any high-risk ventures in the immediate future but anticipates that alternative mining related ventures will be considered during the next financial year, as the Company continues to solidify its core business and continues to accumulate cash reserves as management plans its investments for the coming year.

## **RESULTS OF OPERATIONS**

### *Nine Month Period Ending July 31, 2012*

During the last 9 months, the Company continued to see growth in sales, however sales are still down in comparison to the same entire period the previous year. Sales volumes were down 23% compared to the same period the previous year; the reduction in sales is primarily due to the effect of exchange rate fluctuations and a marginal reduction in total sales volumes.

The company continues to make progress on reducing total debt, both through decreasing reliance on related party credit and through lower interest expense charges. The Company's investment in Quantum remains a focus, with the company further investing \$145,614 in the business; this investment was the purchase of a new property and its capital improvements.

For the nine month ended July 31, 2012, the Company reported an income after tax of \$265,958 (2011-\$314,835).

	<u>July 2012</u>	<u>July 2011</u>
Sales	\$ 8,271,095	\$ 10,762,425
Cost of sales	<u>(7,461,065)</u>	<u>(9,525,638)</u>
Gross Profit	810,030	1,236,787
Expenses	(259,295)	(532,327)
Income tax expense	<u>(284,777)</u>	<u>(389,625)</u>
Net income for the period	<u>\$ 265,958</u>	<u>\$ 314,835</u>

### **Sales**

For the 9-month period end July 31, 2012 an 35% reduction in gross profit was recorded compared to the same period the previous year (2011 - \$1,236,787). Net income for the period decreased from \$314,835 for the same period end July 31, 2011 to \$265,958 for the current period.

During the 9-month period the Company was not running a full order book, and it has only been since March 2012 that the Company started its 3-month trial supplying BHP Billiton. The long term contract with BHP Billiton became effective 01 September 2012. Furthermore, the reported reduction in sales was also adversely affected by the difference of exchange rate between the South Africa Rand (ZAR) and the

United States Dollar (USD); the average value of the ZAR lost approximately 16% in comparison to the 9-month period the previous year.

### Expenses

Expenses for the period ended July 31, 2012 decreased by 51% due to the write-down of \$223,639 of accounts payable. Differences in expenses incurred are as follows:

#### *General and administrative expenses*

- Directors and officers of Quantum, a Company's subsidiaries in South Africa billed the Company of \$127,402 (2011-\$158,711) for management services as incentives for their performance as directors and officer of Quantum. Management portion of their time to the Company and portion of their time as and officer and directors of the Company.
- The Company incurred \$41,392 (2011-\$42,142) in consulting fee relating to consulting and management services by the President of the Company. The President works fulltime for the Company.
- Professional fees which include audit, tax, accounting fee and legal of \$109,882 (2011-\$114,571).
- Transfer agent and filing fees of \$13,801 (2011-13,969) consisted of fees paid to regulatory bodies in Canada in connection with routine filings.
- The Company incurred \$51,939 (2011-\$62,487) in travel costs. Travel has increased due to numerous visits by directors and officers to manage the Company's coal processing business in South Africa.

#### *Interest Income*

- The Company's interest income has increased by \$453 for the period in 2012 due to more cash on hand to invest in interest bearing financial assets.

#### *Finance Cost*

- The Company issued debentures totalling \$150,000, which bear interest of 8% per annum, with \$9,128 (2011-\$13,231) of interest expense for the period.
- Interest expenses of \$20,186 (2011-\$25,813) accrued to a company controlled by a director of the Company. The loan is unsecured and bears interest of 6% per annum.
- The Company paid interest of \$6,321 (2011-\$20,071) for a long-term debt. The bank loan bears interest at 8% per annum, matures on July 1, 2014, and is secured by the Company's pilot modular impact crusher acquired in June 2011.

### Accounts Payable

In 2006, the Company recorded liabilities of \$223,639 relating to consulting and management fees from its former officers and directors. After seeking legal and professional advice, these liabilities have been written off during the period.

### Income Taxes

Income tax expenses amounted to \$284,777 (2011-\$389,625). A majority of the future income tax assets originating in Canada include share issuance costs and tax-loss carry forwards for which a valuation allowance has been recorded. The deferred tax liability included in the balance sheet of \$161,349 (October 31, 2011-\$65,758) was recorded to reflect the temporary difference originated on the value assigned to plant and equipment in South Africa.

### Comprehensive Income

The Company is not subject to currency fluctuations in its core activities however the Company is subject to transactions in various currencies and the volatility in international currency markets does have an impact on some costs and translation into the reporting currency of the Company. The current year comprehensive gain on foreign exchange in the amount of \$112,887 (2011-\$Nil) mostly as a result of the translation of foreign-currency denominated balances to the reporting currency and translation of the Company's self-sustaining subsidiary. As at July 31, 2012, the Company has accumulated other comprehensive gain of \$158,628 (October 31, 2011 - \$271,515). The Company does not hedge net asset translation movements, but where necessary and appropriate hedge currency risk for trading items.

### *Three Month Period Ending July 31, 2011*

For the three month ended July 31, 2012, the Company reported an income after tax of \$54,466 (2011-\$277,196).

	<u>July 2012</u>	<u>July 2011</u>
Sales	\$ 3,242,393	\$ 4,299,501
Cost of sales	(2,951,664)	(3,626,950)
Gross Profit	290,729	672,551
Expenses	(157,224)	(209,224)
Income tax expense	(79,039)	(186,131)
Net income for the period	\$ <u>54,446</u>	\$ <u>277,196</u>

### Sales

The 3-month period end July 31, 2012 recorded a reduction in gross profit of 57% compared to the same quarter for the previous year. The significant reduction in sales is not only due to a slight reduction of tonnes sold, but also considerably affected by the fluctuation (and significant differences) of the exchange rate between the operating currency (ZAR) and the reporting currency (USD) between the two periods.

### Expenses

Expenses for the period ended July 31, 2012 decreased due to the write-down of \$223,639 of accounts payable. Differences in expenses incurred are as follows:

#### *General and administrative expenses*

- Directors and officers of Quantum, a Company's subsidiaries in South Africa billed the Company of \$25,976 (2011-\$56,510) for management services as incentives for their performance as directors and officer of Quantum.
- The Company incurred \$15,804 (2011-\$14,809) in consulting fee relating to consulting and management services by a President of the Company.

- Professional fees which include audit, tax, accounting fee and legal of \$33,631 (2011-\$32,851).
- Transfer agent and filing fees of \$4,321 (2011-\$4,318) consisted of fees paid to regulatory bodies in Canada in connection with routine filings.
- The Company incurred \$15,838 (2011-\$39,401) in travel costs.

#### *Finance Cost*

- Debentures totalling \$150,000, which bears interest of 8% per annum, with \$3,085 (2011- \$2,992) of interest expense for the period.
- Interest expenses of \$4,336 (2011-\$4,348) accrued to a company controlled by a director of the Company. The loan is unsecured and bears interest of 6% per annum.
- The Company paid interest of \$1,856 (2011-\$20,071) for a long-term debt which matures on July 1, 2014 and is secured by the Company's crushing and screening plant.

#### Income Taxes

Income tax expenses amounted to \$79,039 (2011-\$186,131). A majority of the future income tax assets originating in Canada include share issuance costs and tax-loss carry forwards for which a valuation allowance has been recorded.

### SUMMARY OF QUARTERLY REPORTS

Results for the most recent quarters ending with the last quarter for the period ended July 31, 2012:

	Three Months Ended			
	July 31, 2012 \$	April 30, 2012 \$	January 31, 2012 \$	October 31, 2011 \$
Sales	3,242,393	2,627,388	2,401,314	2,574,300
Gross Profit	290,729	191,936	327,365	429,569
Net Income (Loss)	54,466	104,009	107,483	259,931
Basic and diluted (loss) per share	0.00	0.00	0.00	0.00

	Three Months Ended			
	July 31, 2011 \$	April 30, 2011 \$	January 31, 2011 \$	October 31, 2010 <sup>(1)</sup> \$
Sales	4,299,501	3,709,335	2,753,589	2,983,161
Gross (Profit	672,551	383,521	180,715	276,427
Net (Loss) Income	277,196	85,868	(48,229)	(327,497)
Basic and diluted loss per share	0.01	0.00	(0.00)	(0.01)

<sup>1</sup>Financial data for periods before January 31, 2011 are presented in accordance with Canadian GAAP.

The above table includes adjustments to net income (loss) totals and per share values after implementation of IFRS adjustments. The table below reconciles net income (loss) and per share income (loss) for the four quarters ended July 31, 2011. No adjustments were made to fiscal 2010 figures.

	As original Reported \$	IFRS adjustment \$	Balance under IFRS \$	Per share Under IFRS
October 31, 2011	259,931	-	259,931	0.00
July 31, 2011	277,196	-	277,196	0.01
April 30, 2011	85,868	-	85,868	0.00
January 31, 2011	(48,229)	-	(48,229)	(0.00)

## LIQUIDITY AND CAPITAL RESOURCES

At July 31, 2012, the Company had cash and cash equivalents of \$1,489,884 and working capital of \$1,047,925. All cash and cash equivalents are deposit with a Standard Bank and are interest accruing accounts.

	As At July 30, 2012 \$	As At October 31, 2011 \$
Current assets	3,312,547	3,255,999
Property	132,001	-
Plant and Equipment	585,934	448,897
Intangible Assets	1	1
Total Assets	4,030,483	3,704,897
Current Liabilities	2,264,622	2,379,641
Deferred Tax Liability	161,349	65,758
Debentures	150,000	150,000
Long Term Debt	44,706	78,537
Total Liabilities	2,620,677	2,673,936
Stockholder's Equity	1,409,806	1,030,961
Working Capital	1,047,925	876,358

Significant working capital components include cash in current or interest bearing accounts, trade and other receivable, sales tax receivable, inventories, prepaid expenses and deposits, due to related parties, trade and other payable and accrued liabilities, income tax payable and current portion of long-term debt.

Accounts receivable and accounts payable are expected to increase or decrease as sales volumes change.

<u>For the 6-month period end April 30,</u>	2012 \$	2011 \$
Cash used in operating activities	1,827,005	771,628
Cash used in investing activities	(625,092)	(262,224)
Cash provided by financing activities	(33,831)	135,843
Change in cash	1,168,082	645,247

During the nine month period ended July 31, 2012, operations used \$1,827,005 in cash compared to \$771,628 during the nine month period ended July 31, 2011. The increase in cash used from operations in 2012 as compared to 2011 is mainly due to a fluctuation in accounts receivable and accounts payable due to the purchase of equipment and inventories in our subsidiaries in South Africa.

During the nine month period ended July 31, 2012, there was a net cash decrease from financing activities for a long-term debt totalling \$84,741.

Except as described above, the Company's management is not aware of any other trends or other expected fluctuations in its liquidity that would create any deficiencies. The Company's management believes that its cash balances will be sufficient to meet the Company's short-term and long-term requirements for ongoing operations and planned growth.

### ECONOMIC DEPENDENCE

Sales from the Company's South African coal processing business are substantially derived from two customers (ArcelorMittal and BHP Billiton), and as a result, the Company is economically dependent on these customers. The Company's exposure to credit risk is limited to the carrying value of its accounts receivable. As at July 31, 2011, accounts receivable included \$1,193,051 due from these customers which were subsequently collected.

### REVENUE RECOGNITION

Revenue from the sale of calcined anthracite is recognized upon transfer of title which is completed when the physical product is delivered to customers and collection is reasonably assured. Interest and other income are recognized when earned and collection is reasonably assured.

### CONTRACTUAL OBLIGATIONS

#### *Long-Term Debt*

Bank loan	\$ 84,741
Less: Current Portion	<u>40,035</u>
	<u>\$ 44,706</u>

The bank loan bears interest at 8% per annum, matures on July 1, 2014, and is secured by the Company's crushing and screening plant, acquired in June 2011. During the period ended July 31, 2012, the Company incurred interest expense totalling \$6,321 (2011 - \$20,071).

#### *Debentures*

<u>For the 9-month period end July 31,</u>	2012	2011
	\$	\$
Debenture-outstanding	170,186	175,813
Less: interest paid	<u>(20,186)</u>	<u>(25,813)</u>
Total	<u>150,000</u>	<u>150,000</u>

In January 2009, the Company issued debentures totalling \$150,000, which included \$50,000 subscribed by a related company controlled by the Chairman of the Company. The debentures bear interest at 8% per annum compounded annually, effective May 1, 2011, and are secured by a first floating charge on all property and assets of the Company. The maturity of the debentures has been extended to May 1, 2013, at which date the debentures may be converted to common shares of the Company at \$0.25 per common share. The Company plans to pay off the debentures in full during April 2013 using the Company's working capital.

## **TRANSACTIONS WITH RELATED PARTIES**

All of the undernoted fees are in respect to the current period ended July 31, 2012, unless otherwise indicated.

- a) Consulting fee of \$41,392 (2011-\$48,295) was paid to a director of the Company, in consideration of management consulting services. This director was owed \$Nil at April 30, 2012.
- b) Directors' management fees of \$127,402 (2011 - \$158,711) were paid to directors and officers of the Company for management compensation in the normal course of operation of the Company's subsidiaries in South Africa.
- c) Administrative and accounting fees of \$39,871 (2011 - \$40,921) were paid to a director of the Company for secretarial, general administrative and accounting services and overseeing regulatory filings and requirements. As at July 31, 2012, an amount of \$461 (2011-\$Nil) was due from this director. The balance is unsecured, non-interest bearing and has no specified terms of repayment.
- d) The amount due to a company controlled by a director (also an officer) for advances made is unsecured, bears interest at 6% per annum effective November 1, 2010, and has no specific terms of repayment. As at July 31, 2012, the outstanding amount of \$280,084 (2011-\$597,866) included accrued interest of \$20,186 (2011 - \$25,813).

## **OFF-BALANCE SHEET ARRANGEMENTS**

The Company has no off-balance sheet arrangements

## **COMMITMENTS**

On January 1, 2011 the Company entered into an agreement, for its own security, to lease premises for its anthracite coal processing plant in South Africa, ("Quantum"), for a term of five years expiring on January 1, 2016. The agreement offers the lessee, Quantum, in lieu of rent, feedstock coal to be delivered to its adjacent premises, which it purchases at market related prices.

Should the Company decide to purchase feedstock materials from an alternative supplier, that the lessor is able to provide, then a rent of approximately \$25,000 is payable on a month-to-month basis. To date, the Company has not been required to pay any rent for the premises as it has continued to purchase feedstock coal from the lessor, Springlake Colliery.

## **RECENT ACCOUNT ANNOUNCEMENTS**

IFRS 9 Financial Instruments, as issued in November 2009 and revised in October 2010 is required to be adopted by 2013, subject to confirmation by the International Accounting Standards Board. The standard addresses classification and measurement of financial assets and replaces the multiple category and measurement models in IAS 39 and divides all financial assets that are currently in the scope of IAS 39 into two classifications; amortized cost and those measured at fair value.

IFRS 10 - Consolidated Financial Statements builds on existing principles and standards and identifies the concept of control as the determining factor in whether an entity should be included within the consolidated financial statements of the parent Company.

IFRS 11 - Joint Arrangements establishes the principles for financial reporting by entities when they have an interest in arrangements that are jointly controlled.

IFRS 12 Disclosure of Interest in Other Entities provides the disclosure requirements for interests held in other entities including joint arrangements, associates, special purpose entities and other off balance sheet entities.

IFRS 13 - Fair Value Measurement defines fair value, requires disclosure about fair value measurements and provides a framework for measuring fair value when it is required or permitted within the IFRS standards.

IAS 28 - Investments in Associate and Joint Ventures revised the existing standard and prescribes the accounting for investments and sets out the requirements for the application of the equity method when accounting for investments in associates and joint ventures.

The Corporation has not completed its evaluation of the effect of adopting these standards on its consolidated financial statements.

### **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

The details of Canaf's accounting policies are presented in Note 3 of the condensed consolidated interim financial statements ended July 31, 2012. These policies are considered by management to be essential to understanding the processes and reasoning that go into the preparation of the Company's financial statements and the uncertainties that could have a bearing on its financial results.

### **MANAGEMENT FINANCIAL RISKS**

The fair value of the Company's financial assets and liabilities approximates the carrying amount.

Financial instruments measured at fair value are classified into one of three levels in the fair value hierarchy according to the relative reliability of the inputs used to estimate the fair values. The three levels of the fair value hierarchy are:

- a. Level 1 - unadjusted quoted prices in active markets for identical assets or liabilities
- b. Level 2 - inputs other than quoted prices that are observable for the asset or liability either directly or indirectly; and
- c. Level 3 - inputs that are not based on observable market data.

	Financial assets at fair value			July 31, 2012
	Level 1	Level 2	Level 3	
Held-for-trading financial asset				
Cash and cash equivalents	1,489,884			1,489,884
<b>Total financial assets at fair value</b>	<b>1,489,884</b>			<b>1,489,884</b>

	Financial assets at fair value			July 31, 2011
	Level 1	Level 2	Level 3	
Held-for-trading financial asset				
Cash and cash equivalents	1,631,346			1,631,346
<b>Total financial assets at fair value</b>	<b>1,631,346</b>			<b>1,631,346</b>

The Company is exposed to varying degrees to a variety of financial instrument related risks. The Board approves and monitors the risk management processes, inclusive of counterparty limits, controlling and reporting structures.

The type of risk exposure and the way in which such exposure is managed is provided as follows:

#### *Fair Values*

The carrying values of cash, accounts receivable, accounts payable and accrued liabilities, long-term debt, debentures, and amounts due from and to related parties approximate their fair value as at the balance sheet date.

#### *Liquidity Risk*

Liquidity risk is the risk that the Company will encounter difficulty in meeting obligations associated with financial liabilities. The Company is dependent upon on the availability of credit from its supplier and its ability to generate sufficient fund from equity financing or from third parties to meet current and future obligations. There can be no assurances that such financing will be available on terms acceptable to the Company.

#### *Credit Risk*

Credit risk on financial instruments arises from the potential for counterparties to default on their obligations to the Company. Current credit exposure is on the loss that would be incurred if the Company's counterparties were to default at the same time.

The Company has a credit risk exposure related to its economic dependence on two customers for its calcine sales. The Company has assessed its exposure to credit risk and has determined that no significant risks exist from these concentrations of credit.

#### *Interest Rate Risk*

Interest on the Company's long-term debt, debentures and amount due to a related party is based on fixed rates. The Company has not entered into any derivative agreements to mitigate the interest rate risk.

#### *Foreign Currency Risk*

Foreign exchange risk arises because of fluctuations in exchange rates. The Company conducts a significant portion of its business activities in foreign currencies. The Company's subsidiaries, principally located in South Africa, routinely transact in the local currency, exposing the Company to potential foreign exchange risk in its financial position and cash flows.

The assets, liabilities, revenue and expenses that are denominated in foreign currencies will be affected by changes in the exchange rate between the United States dollar and these foreign currencies. The Company has outstanding debt obligations that are payable in Canadian dollars and has issued securities convertible or exercisable into common shares at values expressed in Canadian dollars.

The Company does not currently use financial instruments to mitigate this risk

#### *Commodity Price Risk*

The Company's revenues, earnings and cash flows are directly related to the volume and price of calcined anthracite sold and are sensitive to changes in market prices over which it has little or no control. The Company has the ability to address its price-related exposures through the use of sales contracts.

## **CAPITAL RISK MANAGEMENT**

The Company's objectives in managing its capital are to ensure adequate resources are available to fund its coal processing business in South Africa, to seek out and acquire new projects of merit, and to safeguard its ability to continue as a going concern. The Company manages its share capital as capital, which at July 31, 2012 totalled \$8,079,463 (October 31, 2011 and November 1, 2011- \$8,079,463).

The Company manages its capital structure in a manner that provides sufficient funding for operational and capital expenditure activities. Funds are secured through the sale of calcined anthracite in South Africa and, when necessary, through debt funding or equity capital raised by means of private placements. There can be no assurances that the Company will be able to obtain debt or equity capital in the case of operating cash deficits.

The Company may, from time to time, invest capital that is surplus to immediate operational needs in short-term, liquid, and highly rated financial instruments held with major financial institutions, or in marketable securities. The Company may also, from time to time, enter into forward foreign exchange and commodity price contracts to hedge a portion of its exposure to movements in foreign exchange and commodity prices.

The Company has no externally imposed capital requirements, and has not paid or declared any dividends since the date of incorporation, nor are any contemplated in the foreseeable future. There were no changes in the Company's approach to capital management during the period ended July 31, 2012.

## **MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

In connection with National Instrument ("NI") 52-109 (Certification of Disclosure in Issuer's Annual and Interim Filings) adopted in December 2008 by each of the securities commissions across Canada, the Chief Executive Officer and Chief Financial Officer of the Company will file a Venture Issuer Basic Certificate with respect to the financial information contained in the unaudited interim financial statements and the audited annual financial statements and respective accompanying Management's Discussion and Analysis.

The Venture Issuer Basic Certification does not include representations relating to the establishment and maintenance of disclosure controls and procedures and internal control over financial reporting, as defined in NI 52-109.

## **RISKS AND UNCERTAINTIES**

The Company is subject to a number of risk factors due to the nature of the mining business in which it is engaged, including movements in commodity prices, which are difficult to forecast. The Company seeks to counter these risks as far as possible by selecting exploration areas on the basis of their recognized geological potential to host economic deposits.

The Company's assets are of indeterminate value. For further particulars see the financial statements filed on [www.sedar.com](http://www.sedar.com).

### *Exploration and Development*

The Company is not currently engaged in any exploration or development projects.

### *Operating Hazards and Risks*

Operations in which the Company has a direct or indirect interest will be subject to all the hazards and risks normally incidental to exploration, development and production of resources, any of which could result in work stoppages, damage to persons or property and possible environmental damage. Although

the Company has or will obtain liability insurance in an amount which it considers adequate, the nature of these risks is such that liabilities might exceed policy limits, the liabilities and hazards might not be insurable, or the Company might not elect to insure itself against such liabilities due to high premium costs or other reasons, in which event the Company could incur significant costs that could have a material adverse effect upon its financial condition.

#### *Metal and Mineral Prices*

Factors beyond the control of the Company affect the price and marketability of gold and other metals and minerals. Metal and mineral prices have fluctuated widely, particularly in recent years and are affected by numerous factors including international, economic and political trends, expectations of inflation, currency exchange fluctuations, interest rates, global or regional consumption patterns, speculative activities and worldwide production levels. The effect of these factors on the Company's future prospects cannot accurately be predicted.

#### *Political Risk*

Quantum is located in South Africa and consequently the Company will be subject to certain risks, including currency fluctuations, electricity outages and possible political or economic instability, and exploration and production activities may be affected in varying degrees by political stability and government regulations relating to the industry. Any changes in regulations or shifts in political attitudes are beyond the control of the Company and may adversely affect its business. Exploration may be affected in varying degrees by government regulations with respect to restrictions on future exploitation and production, price controls, export controls, foreign exchange controls, income taxes, expropriation of property, environmental legislation and site safety.

#### *Environmental Factors*

All phases of the Company's operations will be subject to environmental regulation in South Africa.

Environmental legislation is evolving in a manner which will require stricter standards and enforcement, increased fines and penalties for non-compliance, more stringent environmental assessments of proposed projects and a heightened degree of responsibility for companies and their officers, directors and employees. In addition, certain types of operations require the submission and approval of environmental impact assessments. Environmental assessments of proposed projects carry a heightened degree of responsibility for companies and directors, officers and employees. The cost of compliance with changes in governmental regulations has a potential to reduce the profitability of operations. The exploration, development and production activities of the Company will require certain permits and licenses from various governmental authorities and such operations are and will be governed by laws and regulations governing exploration, development and production, labour standards, occupational health, waste disposal, toxic substances, land use, environmental protection, safety and other matters. Companies engaged in exploration activities generally experience increased costs and delays as a result of the need to comply with applicable laws, regulations and permits. There can be no assurance that all licenses and permits which the Company may require to carry out exploration and development of its projects will be obtainable on reasonable terms or on a timely basis, or that such laws and regulations would not have an adverse effect on any project that the Company may undertake.

#### *Cash Flows and Additional Funding Requirements*

Although since the acquisition of Quantum, the Company has significant revenues from operations, the majority of sources of funds currently available to the Company for any future acquisition and development projects will in large portion be derived from the issuance of equity or project finance debt. Although the Company presently has sufficient financial resources and has been successful in the past in obtaining equity and debt financing to undertake its currently planned exploration and development

programs, there is no assurance that it will be able to obtain adequate financing in the future or that such financing will be on terms advantageous to the Company.

#### *Title to Assets*

Although the Company has or will receive title options for any concessions in which it has or will acquire a material interest, there is no guarantee that title to such concessions will be not challenged or impugned. In some countries, the system for recording title to the rights to explore, develop and mine natural resources is such that a title opinion provides only minimal comfort that the holder has title. Also, in many countries, claims have been made and new claims are being made by aboriginal peoples that call into question the rights granted by the governments of those countries.

#### *Enforcement of Civil Liabilities*

Substantially all of the assets of the Company will be located outside of Canada and certain of the directors and officers of the Company will be resident outside of Canada. As a result, it may be difficult or impossible to enforce judgments granted by a court in Canada against the assets of the Company or the directors and officers of the Company residing outside of Canada.

#### *Management*

The Company is dependent on a relatively small number of key employees, the loss of any of whom could have an adverse effect on the Company.

### **ADOPTION OF ACCOUNTING STANDARDS AND PRONOUNCEMENTS UNDER IFRS**

The Canadian Accounting Standards Board (“AcSB”) confirmed in February 2008 that IFRS will replace Canadian generally accepted accounting principles (“GAAP”) for publicly accountable enterprises for financial periods beginning on or after January 1, 2011, with earlier application permitted.

These condensed interim financial statements have been prepared in accordance with International Accounting Standard 34, Interim Financial Reporting (“IAS 34”) using accounting policies consistent with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”) and interpretations of the International Financial Reporting Interpretations Committee (“IFRIC”).

These are the Company’s first IFRS condensed interim financial statements for part of the period covered by the first IFRS consolidated annual financial statements to be presented in accordance with IFRS for the year ending October 31, 2012. Previously, the Company prepared its annual and interim financial statements in accordance with GAAP.

#### *Transition to IFRS*

The accounting policies in Note 4 of the condensed financial statements have been applied as follows:

- in preparing the condensed interim financial statements for the three and nine months ended July 31, 2012;
- the comparative information for the three and nine months ended July 31, 2011;
- the statement of financial position as at October 31, 2011; and
- the preparation of an opening IFRS statement of financial position on the Transition Date, November 1, 2010.

In preparing the opening IFRS statement of financial position, comparative information for the three and nine months ended July 21, 2011 and the financial statements for the year ended October 31, 2011, the

Company has adjusted amounts reported previously in financial statements prepared in accordance with Canadian GAAP ("CAGAAP").

### **First-Time Adoption of International Financial Reporting Standards ("IFRS")**

The condensed consolidated interim financial statements for the period ended July 31, 2012 are the Company's first financial statements prepared in accordance with IFRS. The Company adopted IFRS in accordance with IFRS 1 "First Time Adoption of International Financial Reporting Standards" which requires that comparative financial information be provided. As a result the first date at which the Company has applied IFRS was November 1, 2010 (the "Transition Date").

IFRS requires the Company to retrospectively apply all effective IFRS standards effective as of the Company's first IFRS annual reporting date as of October 31, 2012. IFRS are applied retrospectively at the Transition Date with all adjustments to assets and liabilities as stated under Canadian GAAP taken to retained earnings, unless certain optional exemptions and mandatory exceptions are applied.

#### **a) First-time Adoption Exemptions Applied**

IFRS 1 permits certain exemptions from full retrospective application upon transition. The Company has applied the following optional exemptions to its opening consolidated statement of financial position at November 1, 2010:

##### **i) Business Combinations**

The Company has elected not to retrospectively apply IFRS 3 "Business Combinations" to business combinations that occurred before the Transition Date.

##### **ii) Share-Based Payment Transactions**

The Company has elected not to apply IFRS 2 "Share-Based Payment" to equity instruments that vested prior to the Transition Date.

##### **iii) Compound Financial Instruments**

The Company has elected not to retrospectively separate the liability and equity components of compound instruments under IAS 32 "Financial Instruments - Presentation" if the liability component is no longer outstanding at the Transition Date.

##### **iv) Cumulative Translation Differences**

The Company has elected not to apply IAS 21 "The Effects of Changes in Foreign Exchange Rates" for cumulative translation differences that existed on the Transition Date. Accordingly, the Company has deemed the cumulative translation differences for all foreign operations to be zero at November 1, 2010, and adjusted retained earnings by the same amount. The gain or loss on a subsequent disposal of a foreign operation shall exclude translation differences that arose before November 1, 2010.

#### **b) First-time Adoption Exception Applied**

IFRS 1 also prohibits retrospective application of some aspects of other IFRSs. The Company has applied the following mandatory exception to its opening statement of financial position at November 1, 2010:

i) Estimates

An entity's estimates under IFRS at the Transition Date to IFRS must be consistent with estimates made for the same date under Canadian GAAP, unless there is objective evidence that those estimates were in error. The Company's IFRS estimates as of November 1, 2010 are consistent with its Canadian GAAP estimates for the same date.

c) Notes to the Reconciliation of Canadian GAAP to IFRS

IFRS employs a conceptual framework that is similar to Canadian GAAP. While the adoption of IFRS has not changed the actual cash flows of the Company, the adoption has resulted in changes to the Company's reported financial position and results of operations. Presented in Note 27(d), (e) and (f) of the condensed consolidated financial statements dated January 31, 2012 are reconciliations to IFRS of the Company's assets, liabilities, equity, comprehensive income, and cash flows from those reported under Canadian GAAP, with the resulting adjustments explained below.

i) Reserves in Equity

*Under Canadian GAAP* - A balance within contributed surplus existed to record the issuance of stock options and broker's warrants. Such amounts remained in contributed surplus upon expiry of the equity instruments.

*Under IFRS* - The components of contributed surplus are presented separately and reclassified into "reserve for stock options" and "reserve for broker's warrants". Such amounts are transferred to retained earnings upon expiry of the equity instruments. On the Transition Date, the Company transferred the value of expired equity instruments in the amount of \$618,600 from reserves to retained earnings.

ii) Deferred Tax Asset and Liability

*Under Canadian GAAP* - Deferred tax assets and liabilities (previously referred to as future income tax assets and liabilities) were classified as current or non-current based on the classification of the underlying assets and liabilities to which they relate.

*Under IFRS* - All deferred tax assets and liabilities must be classified as non-current.

iii) Cumulative Translation Differences

The Company has deemed the cumulative translation difference of \$130,095 that existed on the Transition Date to be zero and adjusted retained earnings by the same amount as elected under IFRS 1 (Note 27(a)(iv)) of the condensed consolidated financial statements dated January 31, 2012.

iv) Property and Equipment

IFRS 1 provides a choice between measuring property, plant and equipment at its fair value at the Transition Date and using those amounts as the deemed cost or using the historical cost valuation under Canadian GAAP. The Company has chosen to continue applying the cost model and has not restated its property and equipment under IFRS.

v) Presentation of Expenses

*Under Canadian GAAP* – Costs on the statement of comprehensive loss have been classified by nature.

*Under IFRS* – Costs on the statement of comprehensive loss have been classified by function in accordance with IAS 1. These costs have been reclassified to general and administrative expenses under IFRS from individual presentation by nature under Canadian GAAP.

The adoption of IFRS has not had an impact on the Company's operations, strategic decisions, or cash flows. Further information on the IFRS impacts is provided in Note 4 "Summary of Significant Accounting Policies" of the Company's unaudited condensed consolidated interim financial statements for the nine months ended July 31, 2012.

### **CAUTIONARY STATEMENTS ON FORWARD-LOOKING INFORMATION**

This MD&A together with the Company's unaudited condensed consolidated interim financial statements for the period ended July 31, 2012 contain certain statements that may be deemed "forward-looking statements". All statements in this MD&A, other than statements of historical fact, that address exploration drilling, exploitation activities and events or developments that the Company expects to occur, are forward looking statements. Forward looking statements in this document are statements that are not historical facts and are generally, but not always, identified by the words "expects", "plans", "anticipates", "believes", "intends", "estimates", "projects", "potential" and similar expressions, or that events or conditions "will", "would", "may", "could" or "should" occur. Information inferred from the interpretation of drilling results and information concerning resource estimates may also be deemed to be forward looking statements, as it constitutes a prediction of what might be found to be present when and if a project is actually developed. Although the Company believes the expectations expressed in such forward-looking statements are based on reasonable assumptions, such statements are not guarantees of future performance and actual results may differ materially from those in the forward-looking statements.

Inherent in forward-looking statements are risks and uncertainties beyond the Company's ability to predict or control, including risks that may affect the Company's operating or capital plans, including risks generally encountered in the exploration and development of natural resource properties, such as unusual or unexpected geological formations, unanticipated metallurgical difficulties, ground control problems, process upsets and equipment malfunctions; risks associated with labour and unavailability of skilled labour; fluctuations in the market prices of the Company's principal products, which are cyclical and subject to substantial price fluctuations; risks created through competition for natural resource properties; risks associated with lack of access to markets; risks associated with mineral and resource estimates, including the risk of errors in assumptions or methodologies; risks posed by fluctuations in exchange rates and interest rates, as well as general economic conditions; risks associated with environmental compliance and permitting, including those created by changes in environmental legislation and regulation; risks associated with the Company's dependence on third parties in the provision of transportation and other critical services; risks associated with aboriginal title claims and other title risks; social and political risks associated with operations in foreign countries; and risks associated with legal proceedings.

Actual results and developments are likely to differ, and may differ materially, from those expressed or implied by the forward-looking statements contained in this MD&A. Such statements are based on a number of assumptions which may prove to be incorrect, including, but not limited to, the following assumptions: that there is no material deterioration in general business and economic conditions; that there is no unanticipated fluctuation of interest rates and foreign exchange rates; that the supply and demand for, deliveries of, and the level and volatility of commodity prices develop as expected; that the Company receives regulatory and governmental approvals as are necessary on a timely basis; that the Company is able to obtain financing as necessary on reasonable terms; that there is no unforeseen

deterioration in the Company's activity costs; that the Company is able to continue to secure adequate transportation as necessary for its exploration activities; that the Company is able to procure equipment and supplies, as necessary, in sufficient quantities and on a timely basis; that exploration activity timetables and capital costs for the Company's planned projects are not incorrectly estimated or affected by unforeseen circumstances; that costs of closure of various operations are accurately estimated; that there are no unanticipated changes to market competition; that the Company's estimates in relation to its natural resource interests are within reasonable bounds of accuracy (including with respect to size, grade and recoverability of mineral projects) and that the geological, operational and price assumptions on which these are based are reasonable; that no environmental and other proceedings or disputes arise; and that the Company maintains its ongoing relations with its employees, consultants and advisors.

Readers are cautioned that the foregoing list of important factors and assumptions is not exhaustive. Forward-looking statements are not guarantees of future performance. Events or circumstances could cause the Company's actual results to differ materially from those estimated or projected and expressed in, or implied by, these forward-looking statements. The Company undertakes no obligation to update publicly or otherwise revise any forward-looking statements or the foregoing list of factors, whether as a result of new information or future events or otherwise, except as may be required under applicable laws.

### **OUTSTANDING SHARES**

Authorized:	Unlimited number of common and preferred shares without par value.
Common shares outstanding:	47,426,195
Warrants:	nil
Options:	nil
Fully Diluted:	47,426,195

### **OTHER REQUIREMENTS**

Additional disclosure of the Company's technical reports, material change reports, news release and other information can be obtained on SEDAR at [www.sedar.com](http://www.sedar.com) and the Company's website, [www.canafgroup.com](http://www.canafgroup.com).

On Behalf of the Board,

#### **Canaf Group Inc.**

"Christopher Way"

Christopher Way  
*Chief Executive Officer*

"Zeny Manalo"

Zeny Manalo  
*Chief Financial Officer*