

# **Khan Resources Inc.**

Management Discussion and Analysis

December 31, 2014

---

## KHAN RESOURCES INC.

### RESULTS FOR THE THREE MONTHS ENDED DECEMBER 31, 2014

This Management Discussion and Analysis ("MD&A") has been approved in accordance with a resolution of the Board of Directors dated February 25, 2014. It should be read in conjunction with the unaudited interim condensed consolidated financial statements of the Company as at December 31, 2014.

#### Highlights

*International arbitration action against the Government of Mongolia* – All submissions and hearings have now been completed in respect of the international arbitration action against the Government of Mongolia for the illegal expropriation in 2009 of the Company's mining and exploration licenses for the Dornod uranium project in northeastern Mongolia. The hearing on merits and quantum was completed between November 11 and November 15, 2013 and two post-hearing briefs were subsequently submitted; the first on February 5, 2014 followed by a final brief on April 11, 2014. The Tribunal is continuing to formulate their decision which the Company believes should be forthcoming. The amount of damages sought by Khan currently exceeds \$350 million.

*Cash* – Substantial cash outflows for legal expenses related to the international arbitration came to an end by March 31, 2014. Management is now conserving its cash resources pending the judgment of the Tribunal. The Company's rate of cash expenditures has declined significantly since April 1, 2014. Cash balances are being supplemented by the exercise of outstanding options and by the sale of investments.

*Investments* – At December 31, 2014, the Company held 14.4 million common shares of Macusani Yellowcake Inc. ("Macusani") with a fair value of \$650,000, a decrease of \$289,000 from its value at September 30, 2014. There were no disposals of Macusani shares during the latest quarter. The Company's holdings represent 5.5% of the 259.7 million Macusani outstanding common shares.

*Corporate matters* – The Mongolian subsidiaries were closed on September 30, 2013 and all Mongolian tangible assets were retired. The office in Ulaanbaatar was closed on June 30, 2014. Due to circumstances in Mongolia impeding the legal dissolution of these subsidiaries, the Company determined that it did not have substantive control over these entities; accordingly the assets and liabilities of the Mongolian subsidiaries were derecognized at December 31, 2014.

The following table summarizes financial results of the Company for the first fiscal quarters ended December 31, 2014 and 2013.

In thousands of dollars

	2014	2013	Change %
Net loss from continuing operations Three months ended December 31	(446)	(1,086)	58.9%
Net income (loss) from discontinued operations Three months ended December 31	(8)	30	126.7%
Basic and diluted earnings per share (\$) Three months ended December 31	(0.01)	(0.01)	0.0%
Cash flow Three months ended December 31	(168)	(728)	76.9%
Cash and cash equivalents As at December 31	184	1,503	-87.8%
Working Capital As at December 31	806	2,157	-62.6%

## **Overall Performance**

### **International Arbitration**

The international arbitration action, initiated in January 2011 against the Government of Mongolia and its state-owned uranium company, MonAtom LLC, for the Government of Mongolia's failure to reissue the Company's mining and exploration licenses for the Dornod uranium project in northeastern Mongolia is nearing an award. The damages sought by Khan now exceed US\$350 million. The merits and damages phase of the arbitration commenced in August 2012 following the ruling by the Tribunal hearing the action that they had jurisdiction over the action and had dismissed all of Mongolia's objections to the continuance of the suit.

Khan (the "Claimants" in this action) filed its initial submission on the merits and damages of the case in December 2012. Included in the submission was documentation of an increase in Khan's claim for damages from US\$200 million to US\$326 million including interest to that point in time. The amount claimed now exceeds US\$350 million as interest continues to accrue on any damages awarded. The Respondents filed their Statement of Defense and Counterclaim to the Company's submission in April 2013. These Statements were followed by a Company rejoinder submitted on June 28, 2013, and a Respondent's rejoinder submitted on October 4, 2013. The formal hearing by the Tribunal on the merits and damages for the case was completed as scheduled from November 11 through November 15, 2013. At the completion of the hearing, the Tribunal asked for the submission of two post-hearing briefs before rendering their decision. The first post-hearing brief was submitted on February 5, 2014 and the second and final post-hearing brief was submitted on April 11. The Tribunal is continuing their decision making process and it has been indicated that a decision can be expected shortly.

The Company continues to believe it has a very strong case against the Government of Mongolia for their illegal expropriation of the Dornod asset without appropriate compensation.

### **Closure of Mongolian subsidiaries**

The Mongolian subsidiaries were closed on September 30, 2013 and all Mongolian tangible assets were retired. The office in Ulaanbaatar was closed on June 30, 2014. The Company no longer has any employees in Mongolia.

The Company has determined that it does not have the power to govern the financial and operating policies of the Mongolian subsidiaries due to circumstances in Mongolia that are impeding the legal dissolution of these entities. Accordingly the Company derecognized related assets, liabilities and non-controlling interests at December 31, 2014. The Company did not receive any consideration in the deconsolidation of these two subsidiaries.

The assets and liabilities of the Mongolian subsidiaries are not significant to the Company's consolidated financial statements.

In conjunction with the closure plan, the Company recognized in the September 30, 2013, financial statements a provision of \$38,000 for restructuring costs consisting of employee termination benefits along with estimated accounting and legal costs for closure. During the year ended September 30, 2014, \$29,000 was incurred and charged against the provision. During three months ended December 31, 2014 additional \$4,000 was charged against the provision for the cost associated with tax and legal advice. The results of Mongolian operations are reported as discontinued operations on the face of the Company's audited consolidated statement of loss for the three months ended December 31, 2014 with comparative results for the three months ended December 31, 2013.

## Selected Quarterly Information

In thousands of dollars

	Dec. 31 2014	Dec. 31 2013	Dec. 31 2012
Revenue	1	4	11
Loss from operations	(237)	(1,056)	(1,203)
Available-for-sale financial assets, change in fair value	(217)	-	-
Net loss	(454)	(1,056)	(1,203)
Total assets	936	2,950	6,393
Total non-current liabilities	-	-	-
Basic and diluted earnings per share (in Canadian dollars)	(0.01)	(0.01)	(0.02)

The Company incurred significant legal costs associated with its international arbitration case in 2012 and 2013. No legal costs related to international arbitration were incurred during three months ended December 31, 2014 resulting in a lower net loss than in comparable periods of 2013 and 2012. The reduction in total assets as at December 31, 2014 is due to the reduction in cash balances, net decrease in fair value of the investment in Macusani and non-cash impairment losses recognized for the year ended September 31, 2012, reducing all assets related to the Dornod Uranium Project to zero.

## Results of Operations

### Revenue

In thousands of dollars

Notes	Three months ended	
	Dec. 31, 2014	Dec. 31, 2013
<b>Revenue</b>		
Finance income from continued operations	1	4
Finance income from discontinued operations	-	-
<b>Total revenue</b>	<b>1</b>	<b>4</b>

Finance income declined by \$3,000 in the quarter as a result of lower cash balances on hand compared to the prior year.

### Legal Expenses

During the first quarter of 2014, legal expenses, primarily related to the international arbitration proceedings, were \$863,000. There were no legal expenses related to the international arbitration case during the first quarter of fiscal 2015; the only legal costs incurred by the Company were \$9,000 for corporate secretarial services.

At December 31, 2014, a contingent liability amounting to \$3,757,535 (September 30, 2014 - \$3,627,652) existed in respect of a completion fee arranged with legal counsel handling the international arbitration. The fee is based on the actual cost of the legal work completed and is conditional upon the recovery (in whole or significant part) by the Company of a settlement or award of the international arbitration case. As a present obligation does not exist due to the conditional nature of the fee, the amount is uncertain and cannot be measured reliably. Therefore management has not recognized a provision in the consolidated financial statements as at the date of their approval.

### **General Corporate Expenses**

In thousands of dollars

	Three months ended	
	Dec. 31, 2014	Dec. 31, 2013
Accounting and audit	7	9
Investor relations	3	-
Insurance	13	16
Management remuneration	124	141
Office and travel	66	62
<b>Total general corporate expenses</b>	<b>213</b>	<b>228</b>

Expenses have been reduced through staff reductions and reduced operating activity.

### **Amortization and impairment loss**

There was no amortization expense and impairment loss for the first quarter of 2015 (2014 –\$1,000) because all the Company's tangible assets were fully amortized or impaired before October 1, 2014.

### **Share-based compensation**

There was no share-based compensation for the quarter ended December 31, 2014 (2013 - \$15,000) because all options granted in prior periods were fully vested before October 1, 2014.

### **Available-for-sale investments (Macusani)**

The value of the Company's investment in Macusani as at December 31, 2014 was \$650,000 (September 30, 2014 - \$939,000). The decrease of \$289,000 resulted from a decrease in the fair value of the Macusani common shares. \$72,000 of the decrease in fair value before income tax of \$10,000 was recognized in other comprehensive loss ("OCI") reducing the OCI that existed on October 1, 2014 to zero and the remaining portion of \$217,000 was recognized in the consolidated statement of loss. There were no sales of Macusani shares during the first fiscal quarter.

During the first quarter of 2014, the value of Macusani investment increased by \$155,000 and was recognized in OCI.

### **Discontinued operations**

Discontinued operations comprise the Mongolian subsidiaries that were closed on September 30, 2013. The loss from discontinued operations was \$8,000 (2013 – gain of \$30,000). Certain transactions incurred in 2013 did not repeat in 2014. During the three months ended December 31, 2013, the Company sold the remaining Mongolian assets for a gain of \$47,000 and reversed the over-estimated restoration provision for an additional gain of \$22,000. During the three months ended December 31, 2014, other operating expenses were \$31,000 less than the comparative period as salaried employees left the business. Future costs related to these discontinued operations are expected to be minimal.

### **Income Tax**

During the three months ended December 31, 2014, the Company recognized an income tax expense of \$10,000 (2013 – reversal of deferred income tax expense of \$21,000) on the consolidated statement of loss for the purpose of offsetting the reversal of deferred tax expense in the same amount recognized in the consolidated statement of comprehensive loss. The deferred tax expense is recognized on the consolidated statement of loss because it originated in operations. The net result of these two amounts is zero.

## Summary of Quarterly Results

In thousands of dollars

	Dec. 31 2014	Sep 30 2014	Jun 30 2014	Mar. 31 2014	Dec. 31 2013	Sep. 30 2013	Jun 30 2013	Mar 31 2013	Dec 31 2012
Revenue	1	-	1	2	4	3	4	7	11
Expenses	(455)	(177)	(417)	(797)	(1,060)	(1,968)	(1,151)	(971)	(1,214)
Net loss	(454)	(177)	(416)	(795)	(1,056)	(1,965)	(1,147)	(964)	(1,203)
Basic and diluted earnings per share (\$)	(0.01)	(0.00)	(0.01)	(0.01)	(0.01)	(0.03)	(0.02)	(0.01)	(0.02)

## Financial and Capital Management

### Outstanding share data

Common shares outstanding

	Number of shares
Outstanding, October 1, 2014	76,416,482
Shares issued under share option plan	400,000
Outstanding, December 31, 2014	76,816,482

Share options outstanding

	Number of shares	Weighted average exercise price (\$)
Outstanding, October 1, 2014	6,925,000	0.31
Granted	-	-
Exercised	(400,000)	(0.20)
Forfeited	-	-
Outstanding, December 31, 2014 (a)	6,525,000	0.32

(a) All options were vested and exercisable at December 31, 2014.

Common shares outstanding - diluted

	Number of shares
Outstanding, December 31, 2014	83,341,482

At February 25, 2015, 77,666,482 common shares and 5,675,000 share options were outstanding. Diluted common shares outstanding were 83,341,482.

### Cash Flows

For the first quarter of fiscal 2015 operating cash outflow was \$246,000, an improvement of \$531,000 from the prior year. This can be attributed primarily to \$855,000 less legal expenses than in the prior year, offset by higher cash balances used to reduce accounts payable and accrued liabilities balances at the beginning of fiscal 2014. Most of these unpaid balances at October 1, 2013 were also connected with the international arbitration case.

During the first quarter of fiscal 2015, investment cash outflow was \$5,000 due to the deconsolidation of a Mongolian subsidiary. Investing cash inflow in the prior year of \$46,000 was generated primarily from the sale of assets at the Dornod site.

During the first quarter of fiscal 2015, the exercise of stock options provided cash of \$80,000. In the first quarter of 2014, the exercise of stock options provided cash of \$4,000.

### **Financial Instruments and Financial Risks**

The Company's primary financial instruments consist of cash and its current and non-current financial assets, including its investment in Macusani Yellowcake Inc. The Company no longer has a significant financial risk associated with its Mongolian subsidiaries due to their closure on September 30, 2013.

Bank accounts are held with major banks in Canada and the Netherlands through one of the Company's subsidiary holding companies. As a Canadian bank holds the majority of the Company's cash and the same Canadian bank also holds the guaranteed investment certificate, there is a concentration of credit risk with one bank in Canada. This risk is managed by using a major bank that is a high credit quality financial institution as determined by rating agencies. Interest rate risk is minimal at this time.

The Company is exposed to equity price risk through its holdings of marketable equity securities that will fluctuate in value as a result of trading on Canadian financial markets. As the Company's investments are in uranium exploration companies, the value will also fluctuate based on commodity prices and exploration success.

### **Liquidity**

With cash on hand of \$184,000 and an available-for-sale investment in Macusani with a fair market value of \$650,000 as at December 31, 2014, the Company believes that it has sufficient liquidity to cover its obligations. In addition, subsequent to the first quarter, all outstanding options with expiry on February 16, 2015 were exercised along with some options with expiry on August 2015. The exercise of options contributed \$192,500 to the treasury during the second fiscal quarter. During the last fiscal year, the Company paid all remaining legal and court costs related to the formal hearing by the Tribunal on the merits and damages for the case that was completed in November 2013. The Company does not expect any further consequential legal expenses related to the merits and damages phase of the international arbitration case. Management is now conserving its cash resources pending the judgment of the Tribunal.

The Company has positive working capital and does not have any contractual obligations, including those in the nature of long-term debt, capital lease obligations, operating leases, purchase obligations or other long-term obligations.

In respect of the Company's International Arbitration action, management believes in the merits of its case and expects a significant award to be rendered to the Company. In the event that no international arbitration award is rendered to the Company, this material uncertainty may cast significant doubt as to the Company's ability to continue as a going concern given its financial position as at December 31, 2014. See also Critical Accounting Estimates set out below.

### **Off-Balance Sheet Arrangements**

The Company does not have any off-balance sheet arrangements.

### **Transactions with Related Parties**

An officer of the Company is a partner in a firm that provides some legal services to the Company. The Company paid an aggregate of \$9,000 for the three months ended December 31, 2014 (2013 - \$7,000). At December 31, 2014, the balance outstanding was nil (2013 - nil).

During the first quarter of fiscal 2015, certain directors, officers and employees of the Company exercised stock options, acquiring 400,000 shares for total proceeds of \$80,000. During the first quarter of fiscal 2014, 20,000 options were exercised for cash proceeds of \$4,000.

### **Proposed Transactions**

The Company does not have any proposed asset or business acquisitions or dispositions that are awaiting the approval of the Board of Directors at the date of this MD&A.

## Critical Accounting Estimates

The preparation of the Company's consolidated financial statements in conformity with IFRS requires management to make judgments, estimates and assumptions that affect the reported amounts of assets, liabilities and contingent liabilities at the date of the consolidated financial statements and reported amounts of revenues and expenses during the reporting period. Estimates and assumptions are continuously evaluated and are based on management's experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. However, actual outcomes can differ from these estimates.

In particular, information about significant areas of estimation uncertainty considered by management in preparing the consolidated financial statements is described below.

### *Estimates*

**i. Impairment of assets**

At each reporting date, the Company assesses whether there is objective evidence that an asset is impaired. Where an indicator of impairment exists, an estimate of the recoverable amount is made in accordance with IFRS standards. IFRS standards require a reversal of an impairment loss where there has been a change in estimates used to determine the recoverable amount. These assessments require the use of estimates and assumptions to project the future cash inflows related to an individual asset or a Cash Generating Unit.

**ii. Restoration provision**

The provision at the balance sheet date represents management's best estimate of the cost of removal of residual materials and remediation of disturbed areas. The cost estimates are updated at regular intervals to reflect known developments. Reclamation and closure costs are estimated based on the Company's interpretation of current regulatory requirements and constructive obligations and are measured at fair value. At December 31, 2014, management believes that all obligations to remove residual materials and remediate disturbed areas at the Dornod property have been fulfilled.

**iii. Restructuring provision**

The provision at the balance sheet date represents management's best estimate of the cost of winding up the Mongolian operation. The provision mainly comprises an estimate for costs for the ultimate wind-up of a Mongolian subsidiary and is measured at fair value.

**iv. Recovery of deferred tax assets**

Judgment is required in determining whether deferred tax assets are recognized on the balance sheet. Deferred tax assets, including those arising from un-utilized tax losses require management to assess the likelihood that the Company will generate taxable earnings in future periods, in order to utilize recognized deferred tax assets. Estimates of future taxable income are based on forecast cash flows from operations and the application of existing tax laws in each jurisdiction. To the extent that future cash flows and taxable income differ significantly from estimates, the ability of the Company to realize the net deferred tax assets recorded at the reporting date could be impacted. Additionally, future changes in tax laws in the jurisdictions in which the Company operates could limit the ability of the Company to obtain tax deductions in future periods.

**v. Fair value of financial assets and liabilities**

Where the fair value of financial assets and financial liabilities recorded in the balance sheet cannot be derived from active markets, their fair value is determined using valuation techniques including discounted cash flow models. The Company's current financial assets and financial liabilities are derived from active markets so there is no need to use valuation techniques.

### *Judgments*

**i. Going concern assumption**

The going concern assumption is a fundamental principle in the preparation of financial statements. Under the going concern assumption, an entity is ordinarily viewed as continuing in business for the foreseeable future with neither the intention nor the necessity of liquidation, ceasing trading or

seeking protection from creditors pursuant to laws or regulations. Accordingly, unless the going concern assumption is inappropriate in the circumstances of the entity, assets and liabilities are recorded on the basis that the entity will be able to realize its assets, discharge its liabilities, and obtain refinancing (if necessary) in the normal course of business. The assessment of an entity's ability to continue as a going concern is the responsibility of the entity's management.

The consolidated financial statements have been prepared on a going concern basis however, the Company has disclosed in the consolidated financial statements, the existence of a material uncertainty with respect to the going concern assumption. While management of the Company believes in the merits of its case and expects a significant award will be rendered to the Company, in the event that no international arbitration award is rendered to the Company, this material uncertainty may cast significant doubt as to the Company's ability to continue as a going concern given its financial position as at December 31, 2014.

## **Risks and Uncertainties**

Khan's success depends upon a number of factors, many of which are beyond its control. Typical risk factors include, among others, litigation risk, political risk, financing risk, title risks, exploration and development risks, joint venture risks, commodity price, and currency exchange rate risks, operating and environmental hazards encountered in the mining business and changing laws and public policies.

## **Additional Information**

Additional information is available by accessing SEDAR at [www.sedar.com](http://www.sedar.com) or the Company's website at [www.khanresources.com](http://www.khanresources.com).

## **Forward-Looking Statements**

Certain statements included or incorporated by reference in this MD&A, including information as to the future financial or operating performance of the Company, its subsidiaries and its projects, constitute forward-looking statements. The words "believe", "expect", "anticipate", "contemplate", "target", "plan", "intends", "continue", "budget", "estimate", "may", "schedule" and similar expressions identify forward-looking statements. This MD&A includes, but is not limited to, forward-looking statements regarding: the Company's ability to meet its working capital needs for the twelve-month period ending September 30, 2014 and statements regarding the Company's critical accounting estimates. Forward-looking statements are necessarily based upon a number of estimates and assumptions that, while considered reasonable by the Company, are inherently subject to significant business, economic, competitive, political and social uncertainties and contingencies. Many factors could cause the Company's actual results to differ materially from those expressed or implied in any forward-looking statements made by, or on behalf of, the Company. Such factors include, among others, risks relating to additional funding requirements, political and foreign risk, uninsurable risks, competition, environmental regulation and liability, government regulation, currency fluctuations, recent losses and write-downs and dependence on key employees. See "Risk and Uncertainties" section of this MD&A. Due to risks and uncertainties, including the risks and uncertainties identified above, actual events may differ materially from current expectations. Investors are cautioned that forward-looking statements are not guarantees of future performance and, accordingly, investors are cautioned not to put undue reliance on forward-looking statements due to the inherent uncertainty therein. Forward-looking statements are made as of the date of this MD&A and the Company disclaims any intent or obligation to update publicly such forward-looking statements, whether as a result of new information, future events or results or otherwise.