Consolidated Financial Statements of

MKANGO RESOURCES LTD

For the years ended December 31, 2012 and 2011

Management's Responsibility

To the Shareholders of Mkango Resources Ltd.:

Management is responsible for the preparation and presentation of the accompanying consolidated financial statements, including responsibility for significant accounting judgments and estimates in accordance with International Financial Reporting Standards. This responsibility includes selecting appropriate accounting principles and methods, and making decisions affecting the measurement of transactions in which objective judgment is required.

In discharging its responsibilities for the integrity and fairness of the consolidated financial statements, management designs and maintains the necessary accounting systems and related internal controls to provide reasonable assurance that transactions are authorized, assets are safeguarded and financial records are properly maintained to provide reliable information for the preparation of consolidated financial statements.

The Board of Directors has appointed an Audit Committee, consisting primarily of directors who are neither management nor employees of the Company. The Audit Committee is responsible for overseeing management in the performance of its financial reporting responsibilities, and for approving the financial information included in the annual report. The Audit Committee has the responsibility of meeting with management, and the external auditors to discuss the internal controls over the financial reporting process, auditing matters and financial reporting issues. The Audit Committee is also responsible for recommending the appointment of the Company's external auditors.

MNP LLP, an independent firm of Chartered Accountants, is appointed by the Shareholders to audit the consolidated financial statements and report directly to them; their report follows. The external auditors have full and free access to, and meet periodically and separately with, both the Audit Committee and management to discuss their audit findings.

Signed "Alex Lemon"
Alex Lemon, President

Signed "Sandra Beaulieu"
Sandra Beaulieu, CFO

April 29, 2013

Independent Auditors' Report

To the Shareholders of Mkango Resources Ltd.:

We have audited the accompanying consolidated financial statements of Mkango Resources Ltd. and its subsidiaries, which comprise the consolidated statement of financial position as at December 31, 2012 and 2011, and the consolidated statements of comprehensive loss, cash flows and changes in equity for the years then ended, and notes comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for Consolidated Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Mkango Resources Ltd. and its subsidiaries as at December 31, 2012 and 2011, and their financial performance and their cash flows for the years then ended, in accordance with International Financial Reporting Standards.

Emphasis of Matter

Without qualifying our opinion, we draw attention to Note 2 in the consolidated financial statements which indicates the existence of a material uncertainty that may cast significant doubt on Mkango Resources Ltd.'s ability to continue as a going concern.

Without qualifying our opinion, we draw attention to Note 14 in the consolidated financial statements which explains that certain comparative information for the year ended December 31, 2011 has been restated.

MNP LLP

April 29, 2013
Calgary, Alberta

Chartered Accountants

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MKANGO RESOURCES LTD

Consolidated Statement of Financial Position

Reported in US dollars

As at	Notes	December 31, 2012	December 31, 2011 (*Restated – Note 14*)
ASSETS			
Current			
Cash and cash equivalents		**$ 320,766**	$ 3,739,420
Restricted cash	5	**4,018**	-
Accounts receivable	10	**5,964**	7,101
Prepaid and deposit		**110,466**	207,864
Total currents assets		**441,214**	3,954,385
Property and equipment	6	**6,313**	8,775
Total assets		**447,527**	3,963,160
LIABILITIES			
Current			
Accounts payable and accrued liabilities	10	**142,807**	132,850
Due to related party	7	**-**	15,343
Warrants - derivative financial instruments	8(b)	**-**	843,051
Total current liabilities		**142,807**	991,244
EQUITY			
Share capital	8(a)	**5,632,076**	5,632,076
Contributed surplus		**1,928,324**	1,736,877
Accumulated deficit		**(7,255,680)**	(4,397,037)
Total equity		**304,720**	2,971,916
Total liabilities and equity		**$ 447,527**	$ 3,963,160
Going concern	2		
Commitments	11		
Subsequent events	13		

Refer to accompanying notes to the consolidated financial statements.

Approved on behalf of the Board:

(signed) "*William Dawes*"

William Dawes, Director

(signed) "*David Berg*"

David Berg, Director

MKANGO RESOURCES LTD
Consolidated Statement of Comprehensive Loss
Reported in US dollars

For the year ended	Notes	**December 31, 2012**	December 31, 2011 *(Restated - Note 14)*
Expenses			
General and administrative		**$ 1,309,607**	$ 825,997
Mineral exploration expenditures		**2,248,336**	2,071,961
Depreciation	6	**2,462**	1,245
Share based payments	8(c)	**191,447**	1,279,376
		3,751,852	4,178,579
Interest income		**(2,373)**	(14,151)
Gain on forgiveness of amount due to related party	7	**(15,343)**	-
Gain on revaluation of warrants	8(b)	**(823,459)**	(737,851)
Foreign exchange gain		**(52,034)**	(19,238)
Net loss and comprehensive loss attributable to common shareholders		**$ (2,858,643)**	(3,407,339)
Net loss per share - basic and diluted		**$ (0.08)**	$ (0.09)
Weighted average shares outstanding basic and diluted		**37,442,855**	37,398,471

Refer to accompanying notes to the consolidated financial statements.

MKANGO RESOURCES LTD
Consolidated Statement of Cash Flows
Reported in US dollars

For the year ended	Notes	**December 31, 2012**	December 31, 2011 *(Restated – Note 14)*
Cash flow used by operating activities			
Net loss and comprehensive loss for the year		**$ (2,858,643)**	$ (3,407,339)
Adjustments			
Share based payments	8(d)	**191,447**	1,279,376
Gain on revaluation of warrants	8(b)	**(823,459)**	(737,851)
Depreciation	6	**2,462**	1,245
Gain on forgiveness of amount due to related party	7	**(15,343)**	-
Foreign exchange gain		**(52,034)**	(19,238)
Change in non-cash operating capital			
Accounts receivable		**1,137**	14,087
Prepaid and deposit		**97,398**	(207,864)
Accounts payable and accrued liabilities		**9,957**	(668,595)
Cash used by operating activities		**(3,447,078)**	(3,746,179)
Cash flow used by investing activities			
Acquisition of property and equipment		**-**	(9,732)
Cash flow used by financing activities			
Repayments to related party		**-**	(390,106)
Options exercised		**-**	24,583
Refunded share issue costs		**-**	1,476
Cash used by financing activities		**-**	(364,047)
Effect of exchange rate changes on cash		**32,442**	19,238
Change in cash and cash equivalents		**(3,414,636)**	(4,100,720)
Cash and cash equivalents at the beginning of the period		**3,739,420**	7,840,140
Cash and cash equivalents reclassified to restricted cash		**(4,018)**	-
Cash and cash equivalents at the end of the period		**$ 320,766**	$ 3,739,420

Refer to accompanying notes to the consolidated financial statements.

MKANGO RESOURCES LTD

Consolidated Statement of Changes in Equity
Reported in US dollars

	Share capital	Contributed Surplus	Deficit *(Restated – Note 14)*	Total *(Restated – Note 14)*
Balance at December 31, 2010	$ 5,606,017	$ 457,501	$ (989,698)	$ 5,073,820
Share based payments	-	1,279,376	-	1,279,376
Stock options exercised	24,582	-	-	24,582
Share issue costs	1,477	-	-	1,477
Net loss and comprehensive loss for the period	-	-	(3,407,339)	(3,407,339)
Balance at December 31, 2011	$ 5,632,076	$ 1,736,877	$ (4,397,037)	$ 2,971,916
Share based payments	-	191,447	-	191,447
Net loss and comprehensive loss for the period	-	-	(2,858,643)	(2,858,643)
Balance at December 31, 2012	$ 5,632,076	$ 1,928,324	$ (7,255,680)	$ 304,720

Refer to accompanying notes to the consolidated financial statements.

1. GENERAL INFORMATION

The principal business of Mkango Resources Ltd. (the "Company" or "Mkango") is rare earth element and associated minerals exploration and development in the Republic of Malawi, Africa.

The Company was incorporated under the name Alloy Capital Corp. ("Alloy") on November 13, 2007 under the laws of the Province of Alberta, Canada. On December 20, 2010, Alloy was acquired through a "reverse takeover" by Lancaster Exploration ("Lancaster"). The articles of the Company were amended to change the name of the Company from Alloy Capital Corp. to Mkango Resources Ltd. Mkango's head office is located at 1400, 700 – 2nd Street SW, Calgary, Alberta Canada, T2P 4V5.

Lancaster was incorporated August 3, 2007 by Memorandum and Articles of Association issued pursuant to the provisions of the BVI Companies Act. Lancaster's registered office is located at 56 Administration Drive, Wickhams Cay 1, Road Town, Tortola, British Virgin Islands. Lancaster is a wholly owned subsidiary of Mkango.

On May 19, 2011, Lancaster Exploration Limited was incorporated under the laws of Blantyre, Malawi. Lancaster Exploration Limited is a wholly owned subsidiary of Lancaster.

The consolidated financial statements were authorized for issuance by the Board of Directors of the Company on April 29, 2013.

2. GOING CONCERN

These consolidated financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the payment of liabilities in the ordinary course of business. The Company incurred a net loss of $2,858,643 for the year ended December 31, 2012 (2011 - $3,407,339) and has an accumulated deficit of $7,255,680 (2011 - $4,397,037). The Company is in the process of acquiring, exploring and developing its mineral interests. The ability of the Company to continue as a going concern is dependent upon the existence of an economically recoverable mineral resource, obtaining necessary financing to complete the development of such mineral resources, and upon future profitable production. These factors indicate the existence of a material uncertainty that cast significant doubt on the Company's ability to continue as a going concern.

The operations of the Company for the next 12 months will be funded by a non-brokered private placement ("Financing") which closed in two tranches. The first tranche closed on March 1, 2013 and the second tranche closed on April 11, 2013 (Note 13).

Should the Company be unable to continue as a going concern, it may be unable to realize the carrying value of its assets and to settle its liabilities as they become due. These consolidated financial statements do not reflect the adjustments or reclassification of assets and liabilities which would be necessary if the Company were unable to continue its operations.

3. BASIS OF PRESENTATION

(a) Statement of Compliance

These consolidated financial statements for the year ended December 31, 2012 have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

(b) Basis of presentation and measurement

These consolidated financial statements have been prepared on an accrual basis, except for cash flow information, using the historical cost convention, except for certain financial instruments measured at fair value through profit and loss ("FVTPL").

(c) Functional and presentation currency

The consolidated financial statements are presented in US dollars, which is the functional currency of the Company and its subsidiaries.

(d) Principles of consolidation

The accompanying consolidated financial statements of the Company include the accounts of the Company and its wholly owned subsidiaries. All intercompany balances and transactions are eliminated upon consolidation.

3. BASIS OF PRESENTATION (continued)

(e) Use of estimates and judgments

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

In preparing these consolidated financial statements, the significant judgments made by management applying the Company's accounting policies and the key sources of estimation uncertainty are outlined in:

(i) Exploration and Evaluation expenditures (Note 4a)

Costs incurred in respect of properties that have been determined to have proved reserves are classified as development and production assets. In such circumstances, technical feasibility and commercial viability are considered to be established. Costs incurred in respect of new prospects with no established development past or present and no proved or probable reserves assigned are classified as exploration and evaluation expenses.

(ii) Functional currency

The functional currency of the Company and its subsidiaries is the currency of the primary economic environment in which each entity operates. The Company has determined the functional currency of each consolidated entity as the US dollar. Determination of functional currency may involve certain judgments to determine the primary economic environment and the Company reconsiders the functional currency of each entity if there is a change in events and conditions which determine the primary economic environment.

(iii) Measurement of share based payments (Note 8c)

The Company uses an option pricing model to determine the fair value of share-based payments. Inputs to the model are subject to various estimates about volatility, interest rates, dividend yields, forfeiture rates and expected life of the units issued. Fair value inputs are subject to market factors as well as internal estimates. The Company considers historic trends together with any new information to determine the best estimate of fair value at the date of grant.

(iv) Income taxes (Note 9)

The Company follows the liability method for calculating deferred taxes. Differences between the amounts reported in the consolidated financial statements of the Company and their respective tax bases are applied to tax rates in effect to calculate the deferred tax asset or liability. In addition, the Company recognizes the future tax benefit related to deferred tax assets to the extent that it is probable that the deductible temporary differences will reverse in the foreseeable future. Assessing the recoverability of deferred tax assets requires the Company to make significant estimates related to the expectations of future cash flows from operations and the application of existing tax laws in each jurisdiction. 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) Determination of fair values (Note 10)

The estimated fair value of financial assets and liabilities, by their very nature, are subject to measurement uncertainty.

3. BASIS OF PRESENTATION (continued)

(f) New standards and interpretations not yet adopted

Amendments to IFRS 7, Financial Instruments: Disclosures and IAS 32, Financial Instruments: Presentation, were issued in 2011 to clarify the current offsetting model and develop common disclosure requirements to enhance the understanding of the potential effects of offsetting arrangements. Amendments to IFRS 7 are effective for the Company on January 1, 2013 with required retrospective application. Amendments to IAS 32 are effective for the Company on January 1, 2014 with required retrospective application and early adoption permitted.

IFRS 9 was issued in November 2009 and subsequently amended as part of an ongoing project to replace IAS 39 Financial instruments: Recognition and measurement. The standard requires classification of financial assets into two measurement categories based on the entity's business model for managing its financial instruments and the contractual cash flow characteristics of the instrument. The categories are those measured at fair value and those measured at amortized cost. The classification and measurement of financial liabilities is primary unchanged from IAS 39, other than the fair value measurement option which now addresses an entity's own credit risk. Additional amendments are expected with respect to de-recognition of financial instruments, impairment and hedge accounting. This new standard will also impact disclosures provided under IFRS 7 Financial instrument: disclosures. IFRS 9 is effective for annual periods beginning on or after January 1, 2015.

IFRS 10, 'Consolidated Financial Statements' was issued in May 2011 and will supersede the consolidation requirements in SIC-12 'Consolidation – Special Purpose Entities' and IAS 27 'Consolidated and Separate Financial Statements' effective for annual periods beginning on or after January 1, 2013. IFRS 10 builds on existing principles by identifying the concept of control as the determining factor in whether an entity should be included within the consolidated financial statements of the parent company. The standard also provides additional guidance to assist in the determination of control where this is difficult to assess.

IFRS 11, 'Joint Arrangements' was issued in May 2011 and will supersede existing IAS 31, 'Joint Ventures' effective for annual period beginning on or after January 1, 2013. IFRS 11 provides for the accounting of joint arrangements by focusing on the rights and obligations of the arrangement, rather than its legal form (as is currently the case). The standard also eliminates the option to account for jointly controlled entities using the proportionate consolidation method.

IFRS 12, 'Disclosure of Interests in Other Entities' was issued in May 2011 and is a new and comprehensive standard on disclosure requirements for all forms of interests in other entities, including subsidiaries, joint arrangements, associates and unconsolidated structured entities. IFRS 12 is effective for annual periods beginning on or after January 1, 2013.

IFRS 13, 'Fair Value Measurement' was issued in May 2011 and is effective prospectively for annual periods beginning on or after January 1, 2013. IFRS 13 replaces fair value measurement guidance contained in individual IFRSs, providing a single source of fair value measurement guidance. The standard provides a framework for measuring fair value and establishes new disclosure requirements to enable readers to assess the methods and inputs used to develop fair value measurements and for recurring valuations that are subject to measurement uncertainty and the effect of those measurements on the financial statements.

IAS 27 replaced the existing IAS 27 'Consolidated and Separate Financial Statements'. IAS 27 contains accounting and disclosure requirements for investments in subsidiaries, joint ventures and associates when an entity prepares separate financial statements. IAS 27 requires an entity preparing separate financial statements to account for those investments at cost or in accordance with IFRS 9 Financial Instruments. IAS 27 is effective for annual periods beginning on or after January 1, 2013.

IAS 28 was amended in 2011 which prescribes the accounting for investments in associates and sets out the requirements for the application of the equity method when accounting for investments in associates and joint ventures. IAS 28 is effective for annual periods beginning on or after January 1, 2013.

The application of these standards, amendments and interpretations are not anticipated to have a material impact on the results or financial position of the Company.

4. SIGNIFICANT ACCOUNTING POLICIES

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the Company's consolidated financial statements.

(a) Intangible Exploration and Property and Equipment Assets

(i) Recognition and measurement

Exploration and evaluation ("E&E") expenditures

Exploration and evaluation costs typically include pre-licensing, preliminary property evaluation, drilling and directly attributable general and administrative costs. These costs are recognized in the statement of comprehensive loss as mineral exploration expenditures, including the costs of acquiring licenses pending determination of technical feasibility and commercial viability.

The technical feasibility and commercial viability of extracting a resource is considered to be determinable based on several factors including the assignment of proven reserves. Upon determination of technical feasibility and commercial viability, the costs incurred prospectively are capitalized to a separate category within property and equipment referred to as mineral interests.

Property and equipment ("P&E") expenditures

Items of property and equipment, which include mineral interests, are measured at cost less accumulated depletion and depreciation and accumulated impairment losses. Development and production assets are grouped into cash generating units ("CGU") for impairment testing and categorized within property and equipment as mineral interests. Property and equipment is comprised of drilling and mining servicing assets, and other corporate assets. When significant components of property and equipment, including mineral interests, have different useful lives, they are accounted for as separate items (major components).

Property and equipment assets, categorized as mineral interests, are assessed for impairment if facts and circumstances suggest that the carrying amount exceeds the recoverable amount.

Gains and losses on disposal of property and equipment, including mineral interests, are determined by comparing the proceeds from disposal with the carrying amount of property and equipment and are recognized within the consolidated statement of comprehensive loss.

(ii) Subsequent costs

Costs incurred subsequent to the determination of technical feasibility and commercial viability and the costs of replacing parts of property and equipment are capitalized only when they increase the future economic benefits embodied in the specific asset to which they relate. All other expenditures are recognized in the consolidated statement of comprehensive loss, as incurred.

Such capitalized costs represent costs incurred in developing proved and/or probable mineral reserves and bringing in or enhancing production from such mineral reserves, and is accumulated on a property by property basis. The carrying amount of any replaced or sold component is derecognized. The costs of the day-to-day servicing of property and equipment are recognized in the consolidated statement of comprehensive loss, as incurred.

(iii) Depletion and depreciation

The net carrying value of development or production assets will be depleted using the unit of production method by reference to the ratio of production in the year to the related proven and probable mineral reserves, taking into account estimated future development costs necessary to bring those mineral reserves into production. Future development costs are estimated taking into account the level of development required to produce the reserves.

Corporate assets including vehicles are recorded at cost and are depreciated over the estimated useful life of the asset using the declining balance based on a 20% rate. Depreciation methods, useful lives and residual values are reviewed at each reporting date.

4. SIGNIFICANT ACCOUNTING POLICIES (continued)

(b) Impairment

(i) Financial assets

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

An impairment loss in respect of a financial asset measured at amortized cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate. Individually significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk characteristics.

All impairment losses are recognized in the consolidated statement of comprehensive loss.

An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognized. For financial assets measured at amortized cost the reversal is recognized in the consolidated statement of comprehensive loss.

(ii) Non-financial assets

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

For the purpose of impairment testing, assets are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the "cash-generating unit" or "CGU"). The recoverable amount of an asset or a CGU is the greater of its value in use and its fair value less costs to sell.

In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Value in use is generally computed by reference to the present value of the future cash flows expected to be derived from production of proven and probable reserves.

An impairment loss is recognized if the carrying amount of an asset or its CGU exceeds its estimated recoverable amount. Impairment losses are recognized in the consolidated statement of comprehensive loss. Impairment losses recognized in respect of CGU's are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amounts of the other assets in the unit (group of units) on a pro rata basis.

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

(c) Decommissioning obligation

The Company's activities may give rise to dismantling, decommissioning and site disturbance re-mediation activities. A provision is made for the estimated cost of site restoration and capitalized in the relevant asset category.

Decommissioning obligations are measured at the present value of management's best estimate of expenditures required to settle the present obligation at the reporting date. Subsequent to the initial measurement, the obligation is adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation. The increase in the provision due to the passage of time is recognized as finance costs whereas increases/decreases due to changes in the estimated future cash flows are capitalized. Actual costs incurred upon settlement of the decommissioning obligations are charged against the provision to the extent the provision was established.

(d) Foreign currency translation

Foreign currency denominated assets and liabilities are translated at the exchange rate prevailing at the date of the consolidated statement of financial position for monetary items. Non-monetary assets and liabilities are translated at the rates prevailing at the transaction date. Revenues and expenses are translated using exchange rates prevailing at the dates of the transaction. Any exchange gain or loss that arises on translation is included in the consolidated statement of income and comprehensive income for the period.

4. SIGNIFICANT ACCOUNTING POLICIES (continued)

(e) Taxation

Income tax expense comprises current and deferred tax. Income tax expense is recognized in profit or loss except to the extent that it relates to items recognized directly in equity, in which case it is recognized in equity.

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

Deferred tax is recognized using the liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized on the initial recognition of assets or liabilities in a transaction that is not a business combination. In addition, deferred tax is not recognized for taxable temporary differences arising on the initial recognition of goodwill. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

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

(f) Loss per share

Basic loss per share is calculated by dividing the loss attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period. Diluted earnings per share is determined by adjusting the weighted average number of common shares outstanding for the effects of dilutive instruments. All instruments that could have a dilutive effect are considered anti-dilutive when the Company is in a loss position.

(g) Share based payments

The Company may issue options to directors, officers, employees and non-employees to purchase common shares. The fair value of options determined using the Black-Scholes option pricing model on the date they are granted to employees is recognized as compensation expense with a corresponding increase in contributed surplus over the vesting period. Options to non-employees are measured at the fair value of the goods or services received, unless the fair value of the options are more reliably determinable, and are recognized each reporting date as compensation expense with a corresponding increase in contributed surplus over the vesting period. A forfeiture rate is estimated on the grant date and is adjusted to reflect the actual number of options that vest.

(h) Provisions

The Company makes a distinction between:

- Provisions: present obligations, either legal or constructive, arising from past events, the settlement of which is expected to give rise to an outflow of resources the amount and timing of which are uncertain; and,
- Contingent liabilities: possible obligations that arise from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more future events not wholly within the control of the Company, or present obligations arising from past events the amount of which cannot be estimated reliably or whose settlement is not likely to give rise to an outflow of resources.

Provisions are recognized when the liability or obligation giving rise to the indemnity or payment arises, to the extent that its amount can be reliably estimated and it is probable that the commitment will have to be settled. Contingent liabilities are not recognized in the consolidated financial statements, but rather are disclosed.

4. SIGNIFICANT ACCOUNTING POLICIES (continued)

(i) Cash and cash equivalents

Cash and cash equivalents comprise of cash on hand and term deposits held with banks.

(j) Financial instruments

(i) Non-derivative financial instruments

Non-derivative financial instruments comprise cash and cash equivalents, restricted cash, accounts receivable, accounts payable and accrued liabilities and due to related party. Non-derivative financial instruments are recognized initially at fair value plus, for instruments not at fair value through profit or loss, any directly attributable transaction costs. Subsequent to initial recognition, non-derivative financial instruments are measured as described below:

Financial assets at fair value through profit or loss ("FVTPL")

An instrument is classified at fair value through profit or loss if it is held for trading or is designated as such upon initial recognition. Financial instruments are designated at fair value through profit or loss if the Company manages such investments and makes purchase and sale decisions based on their fair value in accordance with the Company's risk management or investment strategy. Upon initial recognition, attributable transaction costs are recognized in profit or loss when incurred. Financial instruments at fair value through profit or loss are measured at fair value, and changes therein are recognized in profit or loss. The Company has classified cash and cash equivalents and restricted cash as fair value through profit or loss.

Loans and receivables

Other non-derivative financial instruments, such as accounts receivable are measured at amortized cost using the effective interest method, less any impairment losses.

Other financial liabilities

Other non-derivative financial instruments, such as accounts payable and accrued liabilities and due to related party are measured at amortized cost using the effective interest method, less any impairment losses.

(ii) Derivative financial instruments

Warrants denominated in a currency other than the Company's functional currency are derivative financial instruments designated as FVTPL and are measured at fair value with changes in fair value recognized in the consolidated statement of comprehensive loss.

(iii) Share capital

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

5. RESTRICTED CASH

The Malawi Revenue Authority, customs and excise division ("MRA"), required a $4,018 bank guarantee from the Company in order to allow equipment to be imported into the country for its Stage 2 drilling program. Historically the Company's importer was the guarantor, but as a result of changes made by the MRA, this role is now limited to banks and insurance companies.

6. PROPERTY AND EQUIPMENT

	Cost	Accumulated Depreciation	Net Book Value
Balance at December 31, 2010	$ 288	-	$ 288
Additions	9,732	-	9,732
Less Depreciation	-	(1,245)	(1,245)
Balance at December 31, 2011	10,020	(1,245)	8,775
Less Depreciation	-	(2,462)	(2,462)
Balance at December 31, 2012	$ 10,020	$ (3,707)	$ 6,313

7. RELATED PARTY TRANSACTIONS

a) The Company is related to Leo Mining and Exploration Ltd. ("Leo Mining") by virtue of common directors and officers who have an ownership in and exercise significant influence over both companies. All expenses of Lancaster from incorporation to December 20, 2010, were paid by Leo Mining on behalf of Lancaster in an effort to help fund operations prior to the Company going public. As of December 31, 2012 Lancaster has a payable to Leo Mining in the amount of $nil (2011 – $15,343). The amount was unsecured and due on demand. During the year ended December 31, 2012, the remaining balance of $15,343 was forgiven by Leo Mining.

b) For the year ended December 31, 2012, the Company recorded $351,923 (2011 - $74,180) for directors fees, legal fees and key management fees and related costs. Included in accounts payable and accrued liabilities at December 31, 2012, was $3,870 (2011 - $39,107) due to directors and officers. The amounts owed are unsecured, due on demand and non-interest bearing.

c) Key management remuneration to directors and executives

	2012	2011
Salary	$ 353,158	$ 320,622
Share based payments	132,238	721,172
Total compensation	$ 485,396	$ 1,041,794

8. SHARE CAPITAL

a) Common Shares

The Company is authorized to issue an unlimited number of common and preferred shares without nominal or par value. The Company has not issued any preferred shares to date. The holders of common shares are entitled to one vote for each share on all matters submitted to a shareholder vote and are entitled to share in all dividends that the Company's board of directors, in its discretion, declares from available funds.

	Ref	Number	USD
Balance at December 31, 2010		37,376,188	$ 5,606,017
Stock options exercised	(i)	66,667	24,583
Share issue costs refunded		-	1,476
Balance at December 31, 2011 and 2012		37,442,855	$ 5,632,076

(i) On October 31, 2011, 66,667 stock options were exercised at US$0.369 for a cash payment of US$24,583.

b) Warrants

As the exercise price of the share purchase warrants is fixed in Canadian dollars and the functional currency of the Company is the US dollar, the warrants are considered a derivative, as a variable amount of cash in the Company's functional currency will be received on exercise. Warrants issued do not include warrants issued to brokers and agents since they fall into the scope of IFRS 2.

	Exercise Price	Years	Number of Warrants	Fair Value
Balance at December 31, 2010	$0.75	1.2	7,760,750	$ 1,580,902
Change in fair value				
Warrants issued - Non-Brokered Offering	$0.75	1.0	5,348,250	(508,483)
Warrants issued - Brokered Offering	$0.75	1.0	2,412,500	(229,368)
Balance at December 31, 2011	$0.75	1.0	7,760,750	$843,051
Change in fair value				
Foreign exchange impact	$0.75	-	-	(19,592)
Warrant expiry	$0.75	-	(7,760,750)	(823,459)
Balance at December 31, 2012			-	$ -

The warrants expired on December 20, 2012 therefore, as of December 31, 2012 the fair value was $nil (2011 - $843,051).

8. SHARE CAPITAL (continued)

c) Share based payments

The Company has a rolling stock option plan established to recognize contributions made by key personnel, to provide incentive to qualified parties to increase their proprietary interest in the Company and thereby encourage their continued association with the Company. The number of options granted under the plan is limited to 10% in the aggregate of the number of issued and outstanding common shares of the Company at the date of the grant of the options.

The compensation expense relating to stock options that has been recognized in the consolidated statement of comprehensive loss for the year ended December, 2012 and 2011 is $191,447 and $1,279,376 respectively. The corresponding amount has been recognized in contributed surplus. The options vest over a variety of terms ranging from 12 to 18 months.

The following table provides a summary of the status of the Company's stock option plan and changes during the periods ended:

	Options Outstanding	Weighted Average Exercise Price	Options Exercisable	Weighted Average Contractual Life Remaining (years)
Balance at December 31, 2010	200,000	$0.38	200,000	0.9
Granted - January 17, 2011	2,350,000	0.50	2,350,000	8.1
Granted - June 16, 2011	62,500	0.65	62,500	1.5
Granted - June 2011	330,000	0.55	330,000	8.5
Options exercised - August 2011	(66,667)	0.38	(66,667)	-
Balance at December 31, 2011	2,875,833	0.50	1,457,708	8.6
Granted - December 10, 2012	200,000	0.50	-	3.0
Balance at December 31, 2012	3,075,833	$0.50	2,875,833	7.4

On December 10, 2012, the Company granted 200,000 stock options to a consultant. The options are exercisable at $0.50 per share until December 10, 2015 and fully vest by December 10, 2013.

The fair value of each option granted is estimated as of the grant date using the Black-Scholes option pricing model. The following assumptions were used in arriving at the fair value for the options:

Issued,	December 31, 2012	December 31, 2011
Risk free interest rate	1.13%	3.25%
Expected life	3 years	10 years
Expected volatility	118%	95%
Forfeiture rate	5%	5%

d) Escrowed shares

There are no common shares held in escrow at December 31, 2012 (2011 – 10,586,449). The final release occurred on June 5, 2012.

9. INCOME TAX

The differences between the income tax provisions calculated using the statutory rates and the reported income tax provision are as follows:

	December 31, 2012	**December 31, 2011** *(Restated – Note 14)*
Loss for the year before taxes	$ (2,858,643)	$ (3,407,339)
Statutory tax rate	25.0%	26.5%
Expected income tax reduction	(714,661)	(902,945)
Increase resulting from:		
Revaluation of warrants	(205,865)	(195,531)
Share based payments	46,689	339,034
Change in estimates, tax rates and other	(7,665)	(104,832)
Tax rate differential between Canada and foreign jurisdiction	(169,471)	79,848
Change in deferred tax assets not recognized	1,050,973	784,426
Income tax expense	$ -	$ -

No deferred tax assets have been recognized as it is not probable that future taxable profit will allow the deferred tax asset to be recovered. The major components of the deferred tax assets are as follows:

	December 31, 2012	**December 31, 2011**
Deferred tax assets:		
Property and equipment	$ 1,112	$ 374
Evaluation and exploration costs	1,133,975	459,474
Loss carry forwards	752,889	328,611
Share issue costs	98,413	146,957
Deferred tax asset	1,986,389	935,416
Less: Deferred tax assets not recognized	(1,986,389)	(935,416)
	$ -	$ -

As at December 31, 2012, the Company had $896,393 (2011 - $678,597) in non-capital losses available to claim against future taxable income in Canada. These non-capital losses expire as follows:

2027	$ 77,764
2028	32,305
2029	30,680
2030	28,611
2031	524,240
2032	315,768
	$ 1,009,368

As at December 31, 2012, the Company had $1,668,489 (2011 - $516,853) in non-capital losses available to claim against future taxable income in Malawi. The non-capital losses have an indefinite life.

10. FINANCIAL INSTRUMENTS

Determination of fair values

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

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

Cash and cash equivalents and restricted cash are measured at level 1; warrant derivative liability is measured at level 2.

The carrying value of cash and cash equivalents, restricted cash, accounts receivable, accounts payable and accrued liabilities and amount due to related party approximate their fair value due to their short term nature and maturity. Warrants with an exercise price in a currency other than the functional currency are recorded as a derivative liability and carried at fair value, see Note 8(b).

Financial risk management

The Company's Board of Directors monitors and manages the financial risks relating to the operations of the Company. These include foreign currency, interest rate, liquidity and credit risks.

Foreign currency rate risk

The functional and presentation currency of the Company is the United States dollar. The Company enters into transactions denominated in the Canadian Dollar, the United States dollar and the UK Pound Sterling. The Company raised equity in the Canadian dollar in 2010 and purchased sufficient working capital to fund 12 months of expenditures denominated in the United States dollar and the UK Pound Sterling during 2011 when exchange rates were favorable. These currencies represent 90% of the Company's expenditures. The Company also incurs 10% of its expenditures in the Malawi Kwacha. The Kwacha is subject to currency fluctuations which may adversely affect the Company's financial position. In order to mitigate this risk, the Company holds the minimum funds required to fund its monthly obligations, in the Malawi Kwacha.

As at December 31, 2012 and 2011, the following balances were held by the Company:

	As at December 31,	
	2012	2011
Canadian dollar	$ 71,783	$ 1,113,645
United States dollar	185,892	2,147,702
UK Pound Sterling	61,243	478,073
Malawi Kwacha	5,866	-
	$ 324,784	$ 3,739,420

A 5% change in the exchange rate of the foreign currencies above would not have a material effect on the Company's net loss for the year.

Interest rate risk

The Company's exposure to interest rate risk relates primarily to its cash and cash equivalents at banks. However, the interest rate risk is expected to be minimal. The Company does not presently hedge against interest rate movements.

Liquidity risk

Liquidity risk includes the risk that, as a result of the Company's operational liquidity requirements:

a) The Company will not have sufficient funds to settle a transaction on the due date;
b) The Company will be forced to sell financial assets at a value which is less than the fair value; or
c) The Company may be unable to settle or recover a financial asset at all. The Company's operating cash requirements including amounts projected to complete the Company's existing capital expenditure program are continuously monitored and adjusted as input variables change. As these variables change, liquidity risks may necessitate the Company to conduct equity issues or obtain project debt financing.

10. FINANCIAL INSTRUMENTS (continued)

Liquidity risk (continued)

The Company manages its liquidity risk by maintaining adequate cash and cash equivalents. The Company is actively seeking additional funding to improve its exposure to liquidity risk. The Company continually monitors its actual and forecast cash flows to ensure that there are adequate reserves to meet the maturing profiles of its financial assets and liabilities.

The following table outlines the maturities of the Company's liabilities:

	Contractual Cash Flows	Less than 1 Year
Accounts payable and accrued liabilities	$ 142,807	$ 142,807

Credit risk

The Company's principal financial assets are cash and cash equivalents. The credit risk on cash and cash equivalents is limited because the majority are deposited with banks with high credit ratings assigned by international credit-rating agencies. Accounts receivable consists of GST and interest on investments with a credible financial institution.

11. COMMITMENTS

The Company was granted the Phalombe Licence for the Songwe property on January 21, 2010. The licence was issued by the Malawi Government on a three year rolling basis. The license was renewed effective January 20, 2013 for an additional two years (Note 13). As at December 31, 2012 the future spending commitments for exploration with the Government of Malawi based on the year end foreign exchange rate for the local currency to US dollars are as follows:

Exploration commitments	$ 134,259
Ground rent	39,599
Total commitment	$ 173,858

On September 10, 2010, the Company was granted an additional exploration licence by the Malawi Minister of Natural Resources, Energy and Environment in respect of an area of 468 km2 in Thambani, Mwanza District, Malawi. The license was issued by the Malawi Government on a three year basis originally, and as of September 2013 will be up for renewal on a two year rolling basis thereafter. The Company has not undertaken any activity on such licence area to date. As at December 31, 2012 the future spending commitments for exploration expenses with the Government of Malawi are as follows:

Exploration commitments	$ 153,391
Ground rent	14,445
Total commitment	$ 167,836

The Company expects to use the funds received from private placement equity financings to meet these commitments.

12. CAPITAL MANAGEMENT

The Company's total capital resources as at December 31, 2012 is $304,720 which consists of total equity. The Company closed an equity issue on December 20, 2010 which has provided liquidity through 2011 and 2012. The Company raised additional funds through an equity issue, which closed in two tranches, on March 1, 2013 and April 11, 2013 (Note 13). It is anticipated that these additional funds will meet working capital requirements through 2013. The Company's objective when managing its capital is to have sufficient capital to maintain its ongoing operations, pursue its strategic opportunities and maintain a flexible capital structure which optimizes the cost of capital at an acceptable risk. The Company manages its capital structure and makes adjustments to it based on the funds available to the Company. The Company does not presently utilize any quantitative measures to monitor its capital. The Company has no externally imposed capital requirements.

13. SUBSEQUENT EVENTS

a) Financing

On February 25, 2013, the Company announced a Financing of up to 11,430,000 units ("Unit") at a price of C$0.175 per Unit for gross cash proceeds of up to $2,000,250 Canadian dollars.

On March 1, 2012, 4,285,715 Units were issued to Leo Mining and Exploration Limited at a price of C$0.175 per Unit for gross cash proceeds of C$750,000. On April 11, 2013, 8,836,033 Units of the Company were issued at a price of C$0.175 per Unit for gross cash proceeds of C$1,546,306. In total, 13,121,748 Units were issued in connection with the private placement for gross cash proceeds of C$2,296,306.

Each Unit consists of one common share and one-half common share purchase warrant ("Warrant"). Each whole Warrant entitles the holder to acquire one common Share for C$0.35 for a period of 12 months following the closing date of the Financing. Where the closing price of the common shares on the TSX Venture Exchange equals or exceeds C$0.40 for 20 consecutive trading days following the date that is four months and one day after the date of issuance of the Warrants, the Company shall have the right to require conversion of the Warrants at the exercise price upon 30 days' notice.

The Company paid cash finders' fees totalling C$75,471.37 and issued 431,266 finders' warrants in connection with the Financing. Each finders' warrant entitles the holder to acquire one Unit for C$0.175 for a period of 12 months following the closing date of the financing. Where the closing price of the common shares of the Company on the TSX Venture Exchange equals or exceeds C$0.40 for 20 consecutive trading days following the date that is four months and one day after the date of issuance of the finders' warrants, the Company shall have the right to require conversion of the finders' warrants at the exercise price upon 30 days' notice.

The securities issued under the private placement have a hold period of four months and one day from the closing date.

The funds raised through the Financings will be used for general corporate purposes and to conduct further metallurgical test work, mine planning, environmental studies as well as other aspects required to move the project through the pre-feasibility stage.

b) License renewal

On January 20, 2013 the Phalombe Licence for the Songwe property was renewed. The licence was issued by the Malawi Government and will be up for renewal on a two year rolling basis, henceforth. The future spending commitments for exploration with the Government of Malawi have changed to:

Exploration commitments	$ 430,500
Ground rent	36,825
Total commitment	$ 467,325

14. RESTATEMENTS FOR THE YEAR ENDED DECEMBER 31, 2011

The Company has restated its consolidated financial statements as at and for the year ended December 31, 2011 due to the Company recording a deposit paid to a customer as mineral exploration expenditures in 2011. The impact of the amounts restated were to increase prepaid and deposit by $196,660, decrease mineral exploration expenditures by $209,680, increase general and administrative expenses by $920, decrease foreign exchange gain by $12,100 and decrease the accumulated deficit in 2011 by $196,660.

Consolidated Statement of Financial Position as at December 31, 2011	Previously Reported	Adjustment	Restated
Prepaid and deposit	11,204	196,660	207,864
Accumulated deficit	$ (4,593,697)	$ 196,660	$ (4,397,037)

Consolidated Statement of Comprehensive Loss for the year ended December 31, 2011	Previously Reported	Adjustment	Restated
General and administrative	825,077	920	825,997
Mineral exploration expenditures	2,281,641	(209,680)	2,071,961
Foreign exchange gain	(31,338)	12,100	(19,238)
Net loss and comprehensive loss attributable to common shareholders	$ (3,603,999)	$ 196,660	$ (3,407,339)

Consolidated Statement of Changes in Equity for the year ended December 31, 2011	Previously Reported	Adjustment	Restated
Total comprehensive loss for the year	$ (3,603,999)	$ 196,660	$ (3,407,339)
Accumulated deficit	$ (4,593,697)	$ 196,660	$ (4,397,037)

Consolidated Statement of Cash Flows for the year ended December 31, 2011	Previously Reported	Adjustment	Restated
Net loss and comprehensive loss for the year	$ (3,603,999)	$ 196,660	$ (3,407,339)
Foreign exchange gain	(31,338)	12,100	(19,238)
Change in non-cash operating capital:			
Prepaid and deposit	(11,204)	(196,660)	(207,864)