



# CANACO RESOURCES INC.

## MANAGEMENT DISCUSSION AND ANALYSIS

FOR THE SIX MONTH PERIOD ENDED  
DECEMBER 31, 2009 (RESTATED)

Management's discussion and analysis ("MD&A") provides a review of the performance of Canaco Resources Inc. ("Canaco" or the "Company") operations and has been prepared on the basis of available information up to February 25, 2010 and should be read in conjunction with unaudited interim consolidated financial statements for the six month period ended December 31, 2009, the audited financial statements for the year ended June 30, 2009 and the related notes thereto, which have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"), as well as the Company's June 30, 2009 Annual MD&A. All dollar amounts referred to in this discussion and analysis are expressed in Canadian dollars except where indicated otherwise.

### Restatement

In the previously released unaudited December 31, 2009, consolidated financial statements, the company concluded that the value of the Company's investment in Candente Gold Corp. was equal to the market value on the day the shares were listed for trading on the TSX Exchange. The shares were held in escrow at the time of listing and consequently the Company has determined that the mark to market value of the shares at December 31, 2009, was lower than the quoted market value of the shares. In addition, future income taxes on the mark to market adjustment had not been recorded. The financial results as at and for the three and six month period ended December 31, 2009, have been restated to reflect both of these factors, resulting in the following changes:

|  | As previously<br>reported | As restated  |
|--|---------------------------|--------------|
| <b>Balance Sheet</b>                   |                           |              |
| Investment in Candente Gold Corp       | \$ 3,000,000              | \$ 2,481,828 |
| Accumulated other comprehensive income | 1,699,999                 | 1,004,553    |
| Deficit, end of period                 | (17,119,409)              | (16,942,135) |

|                                | Three Months Ended<br>December 31, 2009 |             | Six Months Ended          |             |
|--------------------------------|---|-------------|---------------------------|-------------|
|                                | As previously<br>reported               | As restated | As previously<br>reported | As restated |
| <b>Statement of Operations</b> |   |             |                           |             |
| Future income tax recovery     | -                                       | 177,274     | -                         | 177,274     |
| Net loss for period            | (414,847)                               | (237,574)   | (993,482)                 | (816,209)   |
| Loss per share                 | (0.00)                                  | (0.00)      | (0.01)                    | (0.01)      |
| Other comprehensive income     | 1,699,999                               | 1,004,553   | 1,699,999                 | 1,004,553   |

## INTRODUCTION

Canaco Resources Inc. (the "Company") was incorporated under the provisions of the Canada Business Corporations Act on January 13, 1987 and changed its name from Canaco Resources Ltd. in November 2003. The Company is in the business of acquiring and exploring gold and diamond projects in Tanzania. The Company is listed on the TSX Venture Exchange (the "Exchange") as a Tier 2 mining issuer under the trading symbol – CAN and the Frankfurt Stock Exchange under the trading symbol – HJ6.

### HANDENI PROJECT

The Handeni Project is 100% owned by Canaco Resources Inc and covers 196 square kilometres. Gold was discovered in the area approximately 6 years ago (2003), spurring a gold rush and intense alluvial, then hard-rock mining until present. A mining village is established at Magambazi, the principal focus of the exploration effort on the Handeni Project.

Gold is hosted in high-grade metamorphosed mafic to felsic volcanic and sedimentary rocks of Archaean or Proterozoic Age. Mineralisation is vein-related structurally-controlled mesothermal gold associated with sulphide including

pyrrhotite and arsenopyrite. The dominant host rocks are garnet-silica altered amphibolite, with lesser gneiss (biotite-kyanite-quartz-feldspar).

On September 8, 2009, the Company announced the initiation of diamond drilling at the Magambazi gold prospect located in the Handeni region of the United Republic of Tanzania and on September 28, 2009 the Company announced the discovery of significant gold mineralization at Magambazi.

During the three month period ended December 31, 2009, the Company continued exploration at the Handeni project, focusing its efforts on the ongoing diamond drilling program at Magambazi, which is described as a broad, intense alteration zone and sulphide mineralization (pyrrhotite, arsenopyrite, pyrite and chalcopyrite) with trace amounts of visible gold and high-grade gold mineralization occurring in two major intervals within the broader alteration envelope.

Subsequent to December 31, 2009, diamond drilling operations were established to evaluate geochemical targets at Magambazi North, 800 metres north of the Magambazi South Main Zone on the 100% owned “Kilindi” Prospecting License.

The Magambazi North prospect is part of a 1.4 kilometre long trend of gold mineralization defined by bedrock gold occurrences, artisanal mine workings and soil geochemical anomalies. This 1.4 kilometre trend includes the Magambazi, Magambazi Central and Magambazi North targets (collectively known as the “Magambazi prospects”) and represents the southernmost segment of the 11 kilometre Handeni Gold Trend contained within the Company’s Handeni property.

On February 17, 2010, the Company provided an update on the drilling at Magambazi North and announced the results of drilling to date at Magambazi North. The results from drilling of the Magambazi North to date are listed below:

**TABLE 1 – Magambazi North Drill Results To February 17, 2010<sup>(1)</sup>**

| Drill Hole<br>(3) |           | From<br>(metres) | To<br>(metres) | Interval<br>(1)<br>(metres) | Au Grade <sup>(2)</sup><br>(grams/tonne) | Dip/Azimuth |
|-------------------|-----------|------------------|----------------|-----------------------------|--|-------------|
| MGZD018           |           | 21.0             | 24.7           | 3.7                         | 2.25                                     | -50° / 340° |
| MGZD019           |           | 70.0             | 88.0           | <b>18.0</b>                 | <b>3.3</b>                               | -50° / 237° |
|                   | Including | 70.0             | 78.0           | 8.0                         | 5.68                                     |             |
|                   | And       | 100.0            | 103.0          | 3.0                         | 3.04                                     |             |
| MGZD020           |           | 63.0             | 63.7           | 0.7                         | 4  | -90° / 0°   |
| MGZD023           |           | 22.0             | 27.4           | 5.4                         | 1.44                                     | -55° / 237° |
|                   |           | 54.7             | 85.0           | <b>30.3</b>                 | <b>3.46</b>                              |             |
|                   | Including | 70.0             | 76.3           | 6.3                         | 5.57                                     |             |
| MGZD024           |           | 64.4             | 72.4           | <b>8.0</b>                  | <b>3.25</b>                              | -55° / 237° |
| MGZD025           |           | 41.4             | 52.6           | 11.2                        | 1.33                                     | -55° / 237° |
|                   |           | 74.0             | 87.0           | <b>13.0</b>                 | <b>2.65</b>                              |             |
| MGZD026           |           | 87.7             | 95.7           | 8.0                         | 1.73                                     | -55° / 237° |
| MGZD027           |           | 99.0             | 126.7          | <b>27.7</b>                 | <b>2.18</b>                              | -55° / 237° |
|                   | including | 99.0             | 106.4          | 7.4                         | 4.05                                     |             |

1. Drill intercept lengths are down-hole lengths reflecting apparent widths of mineralization with true widths ranging between 60% - 100% of the reported down-hole lengths.

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2. The calculation of drill intercept employs a 0.3 gAu/t cut-off and no cutting grade for high gold values
  3. A drill collar location map can be found on the company's website, [www.canaco.ca](http://www.canaco.ca)

#### THE HARVEST COPPER, GOLD, ZINC PROSPECT, ETHIOPIA

Subsequent to the December 31, 2009, the Company entered into a letter of intent with Beijing Donia Resources Co. Ltd. to acquire 70 per cent of the outstanding shares of Harvest Mining PLC, a private Ethiopian exploration company. Harvest owns a 100-per-cent interest in 605 square kilometres of exploration concessions in the Tigray state of Ethiopia. These concessions host several identified gold-enriched, polymetallic volcanogenic massive sulphide (VMS) prospects.

Harvest's exploration assets (the Nefasit, Hamlo, Terakimti, Adi Nebrid, Igub and Medri Felasi concession, respectively) are located in the SW extension of the Neo-Proterozoic Asmara VMS type copper-zinc-gold-silver metallogenic belt where several deposits have been previously discovered in central Eritrea. These discoveries include the Bisha deposit (27 million tonnes grading 2.08 grams per tonne gold and 1.8 per cent copper per tonne) and the Emba Derho deposit (38 million tonnes grading 1.08 per cent copper, 0.18 gram per tonne gold and 9.31 grams per tonne silver).

Initial exploration results indicate there is significant potential for the discovery of similar deposits on Harvest's concessions. Since 2007, extensive exploration activities have been completed including remote sensing, geological mapping, geochemical soil sampling, geophysical ground magnetic surveys, induced polarization surveys, and extensive trenching and drilling on selected targets.

#### FINANCIAL POSITION

As at December 31, 2009, the Company had current assets of \$5,009,884 and current liabilities of \$698,289 compared to current assets of \$2,024,344 and current liabilities of \$1,487,486 as at June 30, 2009. As a result, Canaco has working capital of \$4,311,595 at December 31, 2009 compared to working capital of \$536,858 as at June 30, 2009.

As at December 31, 2009, the Company recognized as other comprehensive income an unrealized gain of \$1,004,553 on the shares it holds in Candente Gold Corp. that are classified as an available for sale financial asset; and as such, the securities are marked to market at the end of each reporting period.

Share capital and warrants as at December 31, 2009 totalled \$24,679,171 compared to \$18,394,080 as at June 30, 2009. During the six month period ended December 31, 2009, the Company raised additional capital of \$5,367,320 from the issue of 15,335,199 shares and 7,667,601 warrants. In addition, 4,283,244 warrants were converted for proceeds of \$1,054,721 and 315,000 stock options were converted for proceeds of \$31,500. The Company as well issued 500,000 shares in settlement of a debt obligation, 270,000 shares as commissions for the private placement completed the current financial year and 125,000 shares in satisfaction of a condition included in an Amending Agreement for a property the Company previously held under option.

**RESULTS OF OPERATIONS**

|  | Three month period ended<br>December 31, |              | Six month period ended<br>December 31, |              |
|--|--|--------------|--|--------------|
|  | 2009                                     | 2008         | 2009                                   | 2008         |
| <b>Expenses</b>  |  |              |  |              |
| Amortization   | \$ 940                                   | \$ 586       | 1,337                                  | \$ 1,171     |
| Audit fees   | 1,275                                    | 1,775        | 1,275                                  | 1,935        |
| Consulting & corporate development fees                            | 127,601                                  | 35,925       | 225,351                                | 99,872       |
| Corporate financial services fees                                  | 22,500                                   | 30,000       | 45,000                                 | 30,000       |
| Directors & advisory board fees                                    | 13,722                                   | 17,250       | 30,972                                 | 34,500       |
| General & administrative   | 28,278                                   | 19,541       | 52,219                                 | 43,940       |
| Investor/shareholder relations                                     | 80,833                                   | 23,063       | 102,954                                | 75,014       |
| Legal fees   | 48,215                                   | 4,282        | 55,513                                 | 7,408        |
| Rent & occupancy costs   | 4,621                                    | 2,250        | 9,121                                  | 4,500        |
| Stock-based compensation   | -  | -            | 383,772                                | -            |
| Transfer agent & filing fees                                       | 8,006                                    | 9,266        | 10,495                                 | 12,648       |
| Travel   | 55,865                                   | 1,423        | 89,390                                 | 15,902       |
|  | 391,856                                  | 145,361      | 1,007,399                              | 326,890      |
| Loss before under noted items                                      | (391,856)                                | (145,361)    | (1,007,399)                            | (326,890)    |
| Foreign exchange gain  | (14,110)                                 | (1,728)      | 42,631                                 | 51,255       |
| Interest income  | -  | 78           | -                                      | 1,087        |
| Interest on term loan  | (8,882)                                  | -            | (28,715)                               | -            |
| Loss before future income tax recovery                             | (414,848)                                | (147,012)    | (993,483)                              | (274,548)    |
| Future income tax recovery   | 177,274                                  | -            | 177,274                                | -            |
| Net loss for period  | \$ (237,574)                             | \$ (147,012) | \$ (816,209)                           | \$ (274,548) |
| Loss per share - basic & diluted                                   | \$ (0.00)                                | \$ (0.00)    | \$ (0.01)                              | \$ (0.01)    |
| Weighted average number of shares<br>outstanding - basic & diluted | 93,398,300                               | 42,997,071   | 92,578,801                             | 42,997,071   |

**NET LOSS**

The net loss for the three month period ended December 31, 2009 amounted to \$237,574 compared to a net loss for three month period ended December 31, 2008 of \$147,011. Included in the results for the three month period ended December 31, 2009 is a foreign exchange loss of \$14,110 and interest of \$8,882. The net loss for the six month period ended December 31, 2009 amounted to \$816,209 compared to a net loss for six month period ended December 31, 2008 of \$274,548. Included in the results for the six month period ended December 31, 2009 is a foreign exchange gain of \$42,631 and interest charged on the \$350,000 term loan amounting to \$28,715 that was paid out in November 2009.

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**EXPENSES**

Expenses for the three month period ended December 31, 2009 totalled \$391,855 compared to \$145,361 for the three month period ended December 31, 2008 representing an increase of \$246,494 or 170%. For the six month period ended December 31, 2009 total expenses were \$1,007,397 compared to \$326,890 for the six month period ended December 31, 2008 representing an increase of \$680,507. After adjustment for stock-based compensation expensed in the current period of \$383,772 (2008 – \$Nil), expenses totalled \$623,625 compared to the prior expenses of \$326,890 for the six month period ended December 31, 2008 representing an increase of \$296,735 or 91%. Significant variances for the three month and six month period December 31, 2009 compared to the three month and six month period December 31, 2008 are discussed below.

**Consulting & corporate development fees**

Consulting fees of \$127,601 in the three month period ended December 31, 2009 compared to \$35,925 reported in the corresponding comparative period. Consulting fees were \$225,351 reported in the six month period ended December 31, 2009 compared to \$99,872 in the same period of 2008. Fees charged to this account represent fees paid to external consultants, officers and directors for services rendered. The increase in the fees for the current year is a direct result of increased corporate activities.

**Corporate financial services fees**

During the three month period ended December 31, 2009, the company paid a fee of \$22,500 to an external consultant to source additional leads to fund the Company's projects.

**General & administrative**

General and administrative charges were \$28,278 for the three month period ended December 31, 2009 compared to \$19,541 for the three month period ended December 31, 2008. General and administration expenses were \$52,219 in the six month period ended December 31, 2009 compared to \$43,940 in the same period of 2008. Included in this category are bank fees, communications lines (telephone, facsimile and internet), delivery, interest, office supplies, printing and reproduction.

**Investor relations/shareholders relations**

Investor relations' charges were \$80,833 for the three month period ended December 31, 2009 compared to \$23,063 for the three month period ended December 31, 2008. Investor relation charges were \$102,954 for the six month period ended December 31, 2009 compared to \$75,014 for the six month period ended December 31, 2008. In the previous year, investor relations' activities were curtailed due to poor financial market conditions and limited financial resources.

**Travel**

Travel charges were \$55,865 for the three month period ended December 31, 2009 compared to \$1,423 for the three month period ended December 31, 2008. Travel charges were \$89,390 for the current six month period ended December 31, 2009 compared to \$15,902 reported in the corresponding comparative period. Travel in the prior year was cutback due to poor financial market conditions and limited financial resources.

**Future income tax recovery**

Future income taxes related to the increase in mark to market value of the Companies investment in Candente Gold Corp. totalled \$177,274 in the three month period ended December 31, 2009 and \$177,274 in the six month period ended December 31, 2009.

**CAPITAL EXPENDITURES**

During the six month period ended December 31, 2009, the Company spent \$1,813,478 (2008 - \$620,231) on its capital spending program. Capital expenditures by project and category are summarized as follows:

|   | Six month period ended |            |
|---|------------------------|------------|
|   | 2009                   | 2008       |
| Acquisition                                   |                        |            |
| El Oro, Mexico                                | \$ -                   | \$ 47,942  |
| Ethiopia                                      | 2,011                  | -          |
| Handeni Property, Tanzania                    | -                      | 38         |
| Total acquisition costs for the periods       | 2,011                  | 47,980     |
| Exploration expenditure*                      |                        |            |
| El Oro, Mexico                                | -                      | 60,834     |
| Handeni Property, Tanzania                    | 1,811,467              | 511,417    |
| Total exploration expenditure for the periods | 1,811,467              | 572,251    |
|   | \$ 1,813,478           | \$ 620,231 |

\* - excludes advances totalling \$1,031 (2008-\$1,304), equipment \$Nil (2008 -\$383) and stock-based compensation of \$54,527 (2008 - \$Nil)

**SUMMARY OF QUARTERLY RESULTS - UNAUDITED**

| Quarter ended   | Net revenues | Net loss (1) | Net loss per share - basic | Net loss per share - diluted |
|---|--------------|--------------|----------------------------|------------------------------|
|   | \$           | \$           | \$                         | \$                           |
| 31-Dec-09   | Nil          | (237,574)    | (0.00)                     | (0.00)                       |
| 30-Sep-09   | Nil          | (578,635)    | (0.01)                     | (0.01)                       |
| 30-Jun-09   | Nil          | (1,943,293)  | (0.04)                     | (0.04)                       |
| 31-Mar-09   | Nil          | (195,623)    | (0.00)                     | (0.00)                       |
| 31-Dec-08   | Nil          | (147,011)    | (0.00)                     | (0.00)                       |
| 30-Sep-08   | Nil          | (127,537)    | (0.00)                     | (0.00)                       |
| 30-Jun-08   | Nil          | (1,721,111)  | (0.04)                     | (0.04)                       |
| 31-Mar-08   | Nil          | (268,788)    | (0.01)                     | (0.01)                       |
| (1) Values may not add to reported amount for the years then ended due to rounding. |              |              |                            |                              |

There are no other meaningful trends evident from analysis of the summary of quarterly financial information over the last eight quarters other than those discussed through the MD&A with respect to the annual results.

**LIQUIDITY**

At December 31, 2009, the Company had cash of \$4,958,434 and working capital of \$4,311,595.

Cash on hand at December 31, 2009 is not considered adequate to meet requirements for fiscal 2010 based on the proposed acquisition of Harvest Mining PLC, exploration programs planned on the Handeni Property and budgeted general and administrative expenses. To meet working capital requirements, the Company will have to access financial resources through equity placements in the junior resource market, procure industry partners for its primary exploration projects and/or sell its projects in exchange for equity/cash.

**CAPITAL RESOURCES AND GOING CONCERN**

Canaco has been successful in meeting its exploration capital requirements through the completion of equity placements. Although the Company has been successful in obtaining the necessary financing to continue operations in the past, there can be no assurance that it will be able to continue to do so in the future. Management is of the opinion that the basis upon which the financial statements have been prepared is appropriate in the circumstances. Notwithstanding management's expectations, there is a level of uncertainty that the Company will be able to continue as a going concern and therefore whether they will be able to realize assets and discharge liabilities in the normal course of business.

Canaco may be impacted by any potential downward trend in market conditions. Trends effecting Canaco's liquidity are dictated by the demands on financial resources created by the advancing nature of the Company's current exploration assets and the pursuit of a growth strategy that targets property acquisition, with their attendant exploration commitments and the Company's ability to access the financial resources required to meet these demands. As the exploration properties advance through exploration, they typically require more capital-intensive programs that apply pressure to the Company's financial resources. Additional planned exploration programs on the non-producing leaseholds will result in a steady drain to the Company's liquidity.

In acquiring the required capital to pursue the Company's business plan, capital will be generated from a combination of accessing junior equity markets, procuring industry partners for its primary exploration assets or sale of exploration assets for equity positions or cash.

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Trends that affect the market generally, and the perception of Canaco within the marketplace, can affect the Company's ability to access capital in both a positive and negative way. Trends in this general market are defined by fluctuations in the global economy and the demand for metals and commodity prices. Trends in the perception of Canaco in the junior resource marketplace will be affected by general trends in the junior resource equity markets, the Company's performance in creating shareholder value and in demonstrating the ability to manage the Company's affairs and achieve mandated objectives.

The Company has historically financed its exploration programs through the issuance of equity capital, while at the same time trying to reduce shareholder dilution by securing joint venture partners where appropriate. Recent malaise in the Canadian equity capital markets in particular for junior exploration companies could make securing additional financing difficult in the short term. The Company's management intends to continue to seek out the best opportunities to maximize shareholder value by further exploration programs on its projects and by generating new discoveries. However, failure to secure additional financing at reasonable terms may significantly impact the Company's ability to continue as a going concern.

Uncertainty is a prevalent element in exploration and therefore can, on occasion, impede the Company's ability to meet its financial requirements and result in an inability to advance exploration assets and meet objectives in a timely manner.

## CONTRACTUAL OBLIGATIONS

Canaco does not have any contractual obligations with respect to its mineral properties. The Company has the right to acquire a 100% interest in Magambazi gold primary mining licences by making a cash payment of US\$1,800,000 on or before July 26, 2010 to Magambazi Mines Company Ltd. subject to a 2% net smelter return royalty, which is exercisable at the Company's discretion.

## TRANSACTIONS WITH RELATED PARTIES

In the normal course of business, Canaco has had transactions with individuals and Companies considered related parties. Related party transactions involve normal commercial compensation for services rendered by senior management, officers, directors or insiders of the Company by companies with which they are associated as owners, contractors or employees.

**Dr. Jingbin Wang, Chairman and Director:** provides services to the Company in his capacity as a director. During the six month period ended December 31, 2009, \$403 in aggregate has been recorded as a payable to Dr. Wang to compensate him for time to fulfill his duties and obligations to the Company in his capacity as a director.

**Andrew Lee Smith, President, CEO and Director:** provides contracted consulting services to the Company through Iron Mask Explorations Ltd., a company in which Mr. Smith is the sole proprietor. As a Director, Mr. Smith did not receive any compensation during the six month period ended December 31, 2009.

**David Smalley, Corporate Secretary** provides legal services to the Company through the firm of Fraser & Company, a firm in which he is a Partner. During the six month period ended December 31, 2009, \$1,000 in aggregate has been recorded as payable to Mr. Smalley for corporate secretarial services.

**Jacqueline Tucker, CFO:** provides contracted consulting services to the Company through J.M. Tucker Inc., a company in which Ms. Tucker is the sole proprietor.

**Mr Chaoxian Zhou, Deputy General Manager:** provides services to the Company as an Officer.

**Miss Lingling Yang, Director of Corporate Communications:** provides services to the Company as an Officer.

**Mr. Shuixing Fu, Director:** provides services to the Company in his capacity as a director. During the six month period ended December 31, 2009, \$764 in aggregate has been recorded as a payable to Mr Fu to compensate him for time to fulfill his duties and obligations to the Company in his capacity as a director.

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**Brian Lock, Director:** provides services to the Company in his capacity as a director. During the six month period ended December 31, 2009, \$8,500 in aggregate has been recorded as payable to Mr. Lock to compensate him for time to fulfill his duties and obligations to the Company in his capacity as a director.

**David S. Parsons, Chairman Audit Committee and Director:** provides services to the Company in his capacity as a director and chairman of the audit committee. During the six month period ended December 31, 2009, \$14,000 in aggregate has been recorded as payable to Mr. Parsons to compensate him for time to fulfill his duties and obligations to the Company in his capacity as a director.

**Randy Smallwood, Chairman Acquisition Committee and Director:** provides services to the Company in his capacity as a director and chairman of the acquisition committee. During the six month period ended December 31, 2009, \$7,500 in aggregate has been recorded as payable to Mr. Smallwood to compensate him for time to fulfill his duties and obligations to the Company in his capacity as a director.

During the six month period ended December 31, 2009, the Company was charged \$240,245 by officers and directors for consulting and corporate development fees. During the six month period ended December 31, 2009, Fraser & Company, a firm in which David Smalley, an officer of the Company, is a partner charged fees of \$47,525 for legal services. As at December 30, 2009, directors and officers were owed \$125,163 in respect of services and expense reimbursements.

Transactions with related parties are measured at the exchange rate, which is the amount established and agreed to by the related parties and which are similar to those negotiable with third parties.

## PROPOSED TRANSACTIONS

As of December 31, 2009, the Company has no material proposed transactions.

## FINANCIAL INSTRUMENTS

Financial instruments consist of cash, accounts receivable, promissory note receivable, accounts payable and accrued liabilities and loan payable. At December 31, 2009 and June 30, 2009 there were no significant differences between the carrying amounts of the financial instruments reported on the balance sheet and their estimated fair values due primarily to the short-term maturity of the financial instruments.

## CRITICAL ACCOUNTING ESTIMATES

The significant accounting policies used by Canaco are disclosed in note 2 to the annual consolidated financial statements. Certain accounting policies require that management make appropriate decisions with respect to the formulation of estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Management reviews its estimates on a regular basis. The emergence of new information and changed circumstances may result in actual results or changes to estimated amounts that differ materially from current estimates. The following discussion helps to assess the critical accounting policies and practises of the Company and the likelihood of materially different results being reported.

### Mineral Properties and Related Deferred Costs

The Company follows the method of accounting for its interests in mineral properties whereby all costs related to acquisition, exploration and development are capitalized by area of interest. These expenditures are carried forward where rights to tenure of the areas of interest are current and it is expected the expenditure will be recovered through successful development and exploitation of the area of interest or alternatively by its sale. Expenditures are also carried forward where activities are continuing in the area of interest but have not yet reached a stage of development which permits reasonable assessments of the existence or otherwise of economically recoverable reserves. Expenditures that no longer satisfy the above criteria are written off.

On a periodic basis, management reviews the carrying value of each of the Company's interests in mineral properties to assess whether there has been any impairment in value. If it is determined that future cash flows are less than the

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carrying values a write down to the estimated fair value of such deferred mineral property costs will be charged to operations.

From time to time, the Company acquires and disposes of properties pursuant to the terms of option agreements. Options are exercisable entirely at the discretion of the optionee, and accordingly, are recorded as mineral property costs (recoveries) when payments are made or received.

Although the Company has taken steps to verify title to mineral properties in which it has an interest according to the usual industry standards, these procedures do not guarantee the Company's title. Such properties may be subject to prior agreements or transfers and title may be affected by undetected defects

#### Reclamation Costs

The amounts recorded for reclamation costs are estimates based on engineering studies and management's assessment of the work that is anticipated to remediate the Handeni site based on the current state of ground disturbance. The provision for reclamation is determined on an annual basis.

#### Stock-Based Compensation and Warrants

Compensation expense for options and warrants granted is determined based on estimated fair values of the options and warrants at the time of grant, the cost of which is recognized over the vesting period of the respective options and warrants. The key parameters impacting the calculation of fair value of options and warrants are the share volatility and the expected life.

### ACCOUNTING POLICIES

The Company has established accounting policies generally accepted in Canada and applicable to development stage enterprises in the resource sector, which are applied on a consistent basis.

### CHANGES IN ACCOUNTING POLICIES

Effective July 1, 2009, the Company has adopted the guidelines governed by the following Sections of the Canadian Institute of Chartered Accountants ("CICA") Handbook:

#### GOODWILL AND INTANGIBLE ASSETS

The CICA issued the new Handbook Section 3064, "Goodwill and Intangible Assets", which will replace Section 3062, "Goodwill and Other Intangible Assets". The new standard establishes revised standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. The new standard also provides guidance for the treatment of preproduction and start-up costs and requires that these costs be expensed as incurred. The new standard applies to annual and interim financial statements relating to fiscal years beginning on or after October 1, 2008. The adoption of this standard has had no impact on the Company's financial statements.

#### NEW ACCOUNTING STANDARDS

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

The Canadian Accounting Standards Board ("AcSB") recently confirmed that International Financial Reporting Standards ("IFRS") will replace Canadian standards and interpretations on January 1, 2011. The process of changing from current Canadian GAAP to IFRS will be a significant undertaking that may materially affect reported financial position and results of operations and also affect certain business functions.

The Company has not yet completed a full evaluation of the adoption of IFRS and its impact on its financial position and results of operations. The full evaluation and an implementation plan will be completed before June 30, 2010. The evaluation and implementation plan addresses the impact of IFRS on:

- Accounting policies, including choices among policies permitted under IFRS and implementation decisions such as whether changes will be applied on a retrospective or prospective basis;

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- Information technology and data systems;
  - Internal control over financial reporting;
  - Disclosure controls and procedures, including investor relations and external communications plans;
  - Financial reporting expertise, training requirements and the need for assistance from outside expertise; and,
  - Post implementation monitoring to access any future developments of IFRS.

The Company is in its final stages of completing a review of its accounting policies and of Canadian GAAP relevant to its financial reporting requirements to ascertain the key differences and options with respectable accounting standards under IFRS. Following completion of this review, the Company will determine the impact of the transition to IFRS on its financial statements and systems, if any. This phase is expected to be completed in the first half of calendar 2010. The third and final, implementation transition phase to IFRS is currently planned for fiscal 2011 in order to meet the expected adoption date. Training of the personal started in 2008 and is ongoing.

#### **BUSINESS COMBINATIONS/CONSOLIDATED FINANCIAL STATEMENTS/NON-CONTROLLING INTEREST**

In January 2009, the Canadian Institute of Chartered Accountants (“CICA”) adopted Handbook sections 1582, “Business Combinations”, 1601, “Consolidated Financial Statements” and 1602, Non-Controlling Interest”, which superseded current sections 1581, “Business Combinations” and 1600, “Consolidated Financial Statements”. These sections will be applied prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011. Earlier adoption is permitted. If an entity applies these sections before January 1, 2011, it is required to disclose that fact and apply each of the new sections concurrently. These new sections are the Canadian equivalent to IFRS.

#### **OTHER MD&A REQUIREMENTS**

##### **ADDITIONAL DISCLOSURE FOR VENTURE ISSUERS WITHOUT SIGNIFICANT REVENUE**

Refer to financial statements for capitalized or expensed exploration and development costs, general and administration expenses and other material costs.

##### **OUTSTANDING SHARE (DATA)**

As at December 31, 2009, Canaco had 111,748,179 common shares, 34,621,114 warrants and 7,322,035 options issued and outstanding.

As at February 25, 2010, Canaco had 115,575,182 common shares, 30,954,111 warrants and 10,037,035 options issued and outstanding.

#### **RISK FACTORS**

Mineral exploration and development involves a high degree of risk and few properties that are explored are ultimately developed into producing mines. There is no assurance that the Company's mineral exploration activities will result in any discoveries of new bodies of commercial deposits. There is also no assurance that if a commercial deposit is discovered that the ore body would be economical for commercial production. Discovery of mineral deposits is dependent upon a number of factors and significantly influenced by the technical skill of the exploration personnel involved. The commercial viability of a mineral deposit is also dependent upon a number of factors, which are beyond the Company's control. Some of these factors are the attributes of the deposit, market, government policies and regulation and environmental protection.

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**CAUTION ON FORWARD-LOOKING STATEMENTS**

*The MD&A contains certain forward-looking statements concerning anticipated development in Canaco's operation in future periods. Forward-looking statements are frequently, but not always identified by words such as "expects", "anticipates", "believes", "intends", "estimates", "potential", "possible" and similar expressions, or statements that events, conditions or results "will", "may", "could" or "should" occur or be achieved. The forward-looking statements are set forth principally under the heading "Outlook" in the MD&A and may include statements regarding exploration results and budgets, mineral resource estimates, work programs, capital expenditures, timelines, strategic plans, market price of commodities or other statements that are not statement of fact. Forward-looking statements are statements about the future and are inherently uncertain, and actual achievements of Canaco may differ materially from those reflected in forward-looking statements due to a variety of risks, uncertainties and other factors. Canaco's forward-looking statements are based on the beliefs, expectations and opinions of management on the date the statements are made, and Canaco does not assume any obligation to update forward-looking statements if circumstances or management's beliefs, expectations or opinions should change except as required by law. For the reasons set forth above, investors should not place undue reliance on forward-looking statements. Important factors that the could cause actual results to differ materially from Canaco's expectations include uncertainties involved in disputes and litigation, fluctuations in commodity prices and currency exchange rates; uncertainties relating to interpretation of drill results and the geology, continuity and grade of deposits; uncertainty of estimates of capital and operating costs, recovery rates, production estimates and economic return; the need for cooperation of government agencies and native groups in the exploration and development of properties and the issuance of required permits; the need to obtain additional financing to develop properties and uncertainty as to the availability and terms of future financing; the possibility of delay in exploration or development programs or in construction projects and uncertainty in meeting anticipated program milestones; uncertainty as to timely availability of permits and other government approvals and other risks and uncertainties disclosed in other information released by Canaco from time to time and filed with the appropriate regulatory agencies.*

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Canaco Resources Inc.

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**P R O F I L E**

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| Contact Name: Andrew Lee Smith  | POP System Issuer: No   |
| Telephone Number: 604 488-0822  | Reporting Jurisdictions: British Columbia, Alberta, Quebec  |
| Fax Number: 604 899-1240  | Stock Exchange: TSX Venture   |
| Date of Formation: Jan 3 1987   | Stock Symbol: CAN   |
| Governing Jurisdiction: Canada  | Auditor: PricewaterhouseCoopers LLP, Chartered Accountants  |
| Industry Classification: junior natural resource - mining                                       | Transfer Agent: Computershare Investor Services Inc   |
| CUSIP Number: 134804  | Size of Issuer (Assets): Under \$15,000,000   |
| Financial Year-End: June 30   |   |