

## ZAZU METALS CORPORATION

(An Exploration Stage Company)

Management's Discussion and Analysis

March 25, 2009

In U.S. dollars

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The following management discussion and analysis of Zazu Metals Corporation ("Zazu" or the "Company") is intended to provide investors with a reasonable basis for assessing the financial performance of the Company as well as certain forward looking statements relating to its potential future performance. The information should be read in conjunction with Zazu's December 31, 2008 audited annual consolidated financial statements, and the related notes for the period then ended which have been prepared in accordance with Canadian generally accepted accounting principles. Zazu's accounting policies are described in note 2 of the December 31, 2008 audited annual consolidated financial statements. All of the financial information presented herein is expressed in US dollars, unless otherwise indicated. This management discussion and analysis is made as at March 25, 2009.

The Company is in the business of exploring for minerals which by its nature involves a high degree of risk and there can be no assurance that current exploration programs will result in profitable mining operations. The recoverability of the carrying value of the mineral properties and the Company's continued existence is dependent upon the preservation of its interest in the underlying properties, the discovery of economically recoverable reserves, the achievement of profitable operations, the ability of the Company to obtain financing or, alternatively, upon the Company's ability to dispose of its interests on an advantageous basis. The Company's mineral properties are located outside of Canada and are subject to the risks normally associated with foreign investment, including increases in taxes and royalties, recognition of contracts and currency exchange fluctuations.

The recent events in the global financial markets have had a profound impact on the global economy. Virtually all industries, including mining for precious and base metals, are impacted by these market conditions, which have included: a sharp contraction in the credit markets resulting in a widening of credit risk spreads and higher costs of funding; a deterioration in the credit ratings of numerous large financial institutions; devaluations and high volatility in global equity, commodity, foreign exchange and metals markets and a corresponding lack of market liquidity; and a slowdown in economic activity that is affecting major global economies. These events could have a significant impact on the Company. The related financial instrument risks to the Company are outlined in note 12 to these consolidated financial statements.

This management discussion and analysis contains "forward-looking information" which may include, but is not limited to, statements with respect to the future financial and operating performance of the Company, its subsidiaries and affiliated companies, its mining project, the future prices of zinc, lead and silver, the estimation of mineral reserves and mineral resources, the realization of mineral reserve and resource estimates, operating and exploration expenditures, costs and timing of the development of new deposits, costs and timing of future exploration, requirements for additional capital, governmental regulation of mining operations and exploration operations, timing and receipt of approvals, consents and permits under applicable mineral legislation, environmental risks, title disputes or claims, limitations of insurance coverage and regulatory matters.

Often, but not always, forward-looking statements can be identified by the use of words such as "plans", "expects", "estimates", "intends", "targets", "anticipates" or "believes" or variations (including negative variations) of such words and phrases, or may be identified by statements to the effect that certain actions, events or results "may", "could", "would", "should", "might" or "will" be taken, occur or be achieved.

Forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of the Company and/or its subsidiaries to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements. Such factors include, among others, future prices of zinc, lead and silver; general business, economic, competitive, political and social uncertainties; the actual results of current exploration activities; conclusions of economic evaluations and studies; fluctuations in the value of the United States dollar relative to the Canadian dollar; changes in project parameters as plans continue to be refined; possible variations of ore grade or projected

recovery rates; accidents, labour disputes and other risks of the mining industry; political instability or insurrection or war; labour force availability and turnover; the availability of suitable road and port facilities; delays in obtaining financing or governmental approvals or in the completion of exploration and development activities; as well as those factors discussed in the section entitled "Risk Factors", all of which are described more fully in the Company's filings with Canadian Securities Administrators posted on [www.sedar.com](http://www.sedar.com).

Although the Company has attempted to identify important factors that could cause actual actions, events or results to differ materially from those described in forward-looking statements, there may be other factors that cause actions, events or results to differ from those anticipated, estimated or intended. Forward-looking statements contained herein are made as of the date of this management discussion and analysis and the Company disclaims any obligation to update any forward-looking statements, whether as a result of new information, future events or results or otherwise.

There can be no assurance that forward-looking statements will prove to be accurate, as actual results and future events could differ materially from those anticipated in such statements. Accordingly, readers should not place undue reliance on forward-looking statements due to the inherent uncertainty therein. Subject to applicable law, the Company assumes no obligation to update or revise any forward-looking statement, whether as a result of new information, future events or any other reason.

Additional information, including a copy of Company's Annual Information Form for the year ended December 31, 2008 is available on SEDAR ([www.sedar.com](http://www.sedar.com)).

## OVERALL PERFORMANCE

Zazu Metals is a Canadian based exploration company formed in November 2006 to acquire an interest in a zinc, lead and silver exploration property, known as the LIK property, located in Alaska. The Company holds a 50% interest in the LIK property (the other 50% interest is held by Teck Cominco Limited) and has the right to earn up to a further 30%. The Company's primary near term objective is to advance the LIK property towards development through the definition of a resource and commencement of a formal feasibility study. The Company also intends to pursue a strategy of evaluating and potentially acquiring interests in other attractive mineral properties that the Company believes will be accretive to its overall growth strategy.

On December 19, 2007, the Company completed its Initial Public Offering ("IPO") and its common shares and common share purchase warrants began trading on The Toronto Stock Exchange under the symbols "ZAZ" and "ZAZ.WT", respectively. The Company is a reporting issuer in Ontario, British Columbia, Alberta, Saskatchewan, Manitoba, New Brunswick, Nova Scotia, Prince Edward Island, and Newfoundland.

## SELECTED ANNUAL INFORMATION

The following information is for the years ended December 31, 2008 and December 31, 2007 and the period from incorporation (November 29, 2006) to December 31, 2006:

|                                       | 2008        | 2007       | 2006       |
|---------------------------------------|-------------|------------|------------|
| Interest income                       | \$ 221,962  | \$ 432,513 | \$ 12,937  |
| Net loss for the period               | (4,054,344) | (717,279)  | (157,446)  |
| Basic and diluted loss per share      | (0.13)      | (0.12)     | (0.08)     |
| Total assets                          | 30,629,278  | 32,487,601 | 10,571,579 |
| Total long-term financial liabilities | Nil         | Nil        | Nil        |
| Cash dividends declared               | Nil         | Nil        | Nil        |

## RESULTS OF OPERATIONS

The net loss of the Company primarily reflects the overhead costs incurred by the Company as it oversees exploration and development of its LIK property. The exploration and development costs incurred at the LIK property have been capitalized to mineral property interests. If the property proceeds to development, these costs become part of pre-production and development costs of the mine. If a property is abandoned or continued exploration is deemed not appropriate in the foreseeable future, the related deferred expenditures are written off.

### 2008 vs. 2007

The Company's net loss for the year ended December 31, 2008 was \$4,054,344 or \$0.13 per share compared to a net loss of \$717,279 or \$0.12 per share for the year ended December 31, 2007.

The overall increase in expenses in 2008 compared to 2007 corresponds to the increased level of activity by the Company. Activities in 2007 were focused on acquiring an interest in the LIK project and identifying sources of funding to finance this acquisition with only one month of drilling activity at the LIK project. Activities in 2008 were fully focussed on exploration and development at the LIK project.

The net loss for the year ended December 31, 2008 included salaries and consulting fees as well as additional costs for audit and accounting fees, directors' fees, regulatory fees and transfer agent expenses, legal fees, insurance, office costs and travel. The most significant portion of the loss was stock-based compensation, a non-cash item. Interest income helped offset some of the expenses.

During 2008 the Company recognized \$2,685,000 of stock based compensation (2007 – \$234,900) of which \$330,300 was capitalized as a deferred exploration cost and \$2,354,700 was expensed as stock based compensation. Stock based compensation is recognized over the vesting period of the underlying options. The Company granted 2,775,000 options to staff, directors and consultants in December 2007 and an additional 150,000 options in March 2008. Stock based compensation in 2007 was limited to a vesting period of only one month, while in 2008, the options continued to vest through November. In November 2008, all of the holders of the Company's stock options agreed to the cancellation of their stock options. No compensation was paid to the option holders for the cancellation of the stock options. During 2008, but prior to the cancellation of the stock options in November 2008, the Company recognized \$2,329,500 of stock based compensation of which \$287,500 was capitalized as a deferred exploration cost and \$2,042,000 was expensed as stock based compensation. Upon cancellation of all the outstanding stock options in November 2008, the unrecognized compensation cost of the unvested options of \$355,500 was immediately recognized of which \$42,800 was capitalized as a deferred exploration cost and \$312,700 was expensed as stock based compensation.

Audit and accounting costs were \$111,581 (2007 – \$104,144) for the year ended December 31, 2008. During the first quarter of 2008 and for part of the second quarter, the Company utilized outside contractors to meet its financial reporting needs and these costs, together with corporate tax reporting and interim review fees, comprise audit and accounting costs. Audit and accounting costs are higher in 2008 than in 2007 due to the increased level of activity by the Company in 2008.

Consulting fees were \$503,000 (2007 – \$233,750) for the year ended December 31, 2008. The Company employed a larger number of consultants in 2008 as compared to 2007 and realized an increase in consulting fees. Consulting fees for 2008 include \$58,000 (2007 – nil) of one-time bonuses. Consulting fees paid to consultants involved directly in exploration at the LIK property are included in deferred exploration expenditures.

Under the Company's policy for director remuneration, each director receives a base fee of CDN\$12,000 per year. In addition, all directors are entitled to be reimbursed for reasonable expenses (including travel) incurred in connection with the attendance of committee or directors' meetings. Directors (other than the Chairman) who chair a committee are entitled to additional compensation of between CDN\$5,000 and CDN\$10,000. The directors who are also employees of the Company (or any of its subsidiaries) do not receive any compensation for serving as directors. During 2008, the Company incurred \$48,319 (2007 – \$34,875) for directors' fees.

Insurance costs of \$78,935 (2007 – \$25,918) for the year ended December 31, 2008 represent premiums on the Company's comprehensive general liability and Directors and Officers policies. The comprehensive general liability policy was put in place in April 2007, while the Directors and Officers coverage did not take effect until July 2007. An increase in amounts covered in 2008 resulted in greater insurance costs for 2008.

Investor and shareholder relations expenses of \$25,388 (2007 – \$45,002) for the year ended December 31, 2008 consist primarily of the costs of marketing trips and other costs such as attending industry conferences. These expenses are lower for 2008 than 2007 due to decreased marketing activity in 2008.

Legal fees represent fees over and above those incurred in connection with the Company's financings. Legal fees specifically paid in connection with any of the Company's financings are normally included in the issue costs of those financings and recorded as an offset to proceeds received from those financings.

Office, rent and communications costs were \$127,580 (2007 – \$44,579) for the year ended December 31, 2008. The Company increased its office space and staffing levels in late 2007 resulting in the large increase in office, rent and communication costs in 2008.

Regulatory and transfer agent costs were \$33,348 (2007 – \$135,236) for the year ended December 31, 2008. These costs are lower in 2008 as the Company is no longer subject to the non-recurring fees associated with the Company's initial listing of its shares and warrants in December 2007. These costs in 2008 represent those filing and listing fees normally associated with public companies.

Salaries and benefits costs were \$427,369 (2007 – \$172,308) for the year ended December 31, 2008. The Company increased staffing levels in late 2007 which resulted in the increase in salaries and benefits costs. Salaries for 2008 include \$26,000 (2007 – nil) of one-time bonuses. Salary and bonus amounts are determined by the compensation committee of the board of directors. Wages and benefits paid to staff involved directly in exploration at the LIK property are included in deferred exploration expenditures.

Travel costs were \$72,279 (2007 – \$47,414) for the year ended December 31, 2008. Travel costs increased in 2008 due to increased travel by the Company's officers. Several of the Company's officers reside in the United States and travel to the administrative office in Vancouver to attend management meetings.

Interest income was \$221,962 (2007 – \$432,513) for the year ended December 31, 2008. Interest income was lower in 2008 due to decreasing yields from the Company's usual type of investments and lower cash balances. Yields for these investments decreased as interest rates fell in both the US and Canada. Funds not required for the Company's immediate operations are invested in highly liquid investments which are readily convertible into cash with maturities of three months or less when purchased.

Historically, the Company has raised cash in private financings denominated in US dollars. Although the majority of the Company's expenditures are made in US dollars, as a Canadian company, it is necessary to also make payments in Canadian dollars. As a result, the Company maintains a portion of its cash in Canadian dollars and this balance is subject to foreign exchange gains or losses. The Company's initial public offering in December 2007 was denominated in Canadian dollars resulting in the Company holding a larger than usual amount of Canadian dollars. During 2008, the Canadian dollar weakened versus the US dollar, resulting in a foreign exchange loss of \$475,652 for the year. The weakening trend of the Canadian dollar began in the fourth quarter of 2007 and the Company recognized a foreign exchange loss of \$810 for 2007.

The future income tax recovery was \$36,800 (2007 – nil) for the year ended December 31, 2008. The Company recorded a future income tax liability which relates to the excess of book value of mineral properties and deferred exploration expenditures over tax values. The future income tax recovery is that portion of the future income tax liability which has been offset by applying the Company's available income tax losses.

### **LIK Property, Alaska**

Unless otherwise stated, the technical information in this section in respect of the LIK property is based upon the "Amended Technical Report on the LIK Deposit, Northern Alaska, U.S.A." dated August 20, 2007 as amended

October 29, 2007 (the "Technical Report") prepared by Scott Wilson Roscoe Postle Associates Inc. ("Scott Wilson RPA"). The author of the Technical Report is a "qualified person" for purposes of NI 43-101. Scott Wilson RPA is independent of the Company, within the meaning of NI 43-101, as is the author of the Technical Report. The Technical Report is available on the Company's website ([www.zazumetals.com](http://www.zazumetals.com)) and on SEDAR ([www.sedar.com](http://www.sedar.com)).

The Company retained Scott Wilson RPA to prepare a current mineral resource estimate and an accompanying NI 43-101 technical report. Scott Wilson RPA will incorporate results from the Company's 2007 and 2008 diamond drill programs with the historical drilling of 135 drill holes comprising 26,200 metres (86,000 feet) in order to prepare a current resource estimate. Scott Wilson RPA's technical report will also include information based on different cut-off grades, assumed operating costs, metal recoveries, smelter and transportation costs, and long-term metal price assumptions. The Company expects to receive this report in early to mid 2009.

During 2008, the Company incurred \$3,900,357 (2007 – \$1,257,563) in exploration expenditures at the LIK property. Total deferred property expenditures, including acquisition and an allowance for future income taxes, were \$25,664,514 at December 31, 2008. During 2008 the Company has also purchased a second drill rig and other mobile and camp equipment.

The Company completed its 2008 field season in September. In total 58 drill holes were completed for a total of 6,900 metres (22,400 feet).

The Company primary near-term objective is to upgrade and expand the historic resource to a fully compliant NI 43-101 mineral resource for the Lik South deposit. The data from the 2008 drilling will be incorporated into an NI 43-101 resource to be developed by Scott Wilson Roscoe Postle Associates Inc. Scott Wilson RPA will then combine all work to date and commence preparation of a comprehensive scoping study, and ultimately, a feasibility study.

The Company also completed geophysical programs to identify potential extensions to the resource, especially in the Lik North area and new targets were identified for future drilling.

Early stage metallurgical testing was done with positive results. Recoveries for zinc were 87% into a concentrate grading 52% and lead recoveries reached as high as 81% into a concentrate grading 57%. However, test results indicate that lower lead recoveries of approximately 70% would yield a concentrate grade of 70%, which would be more marketable to smelters. The ultimate decision on grade and recovery will be determined through a marketing analysis at the feasibility stage. These results are the first metallurgical tests conducted by the Company which plans to continue working on improving the metallurgical results through optimization of the processing methods.

Plans for 2009 include working with consultants to assess any environmental issues as well as continue our permitting process. The Company also plans to commission a report to study the costs and requirements of any potential routes for the road from the Lik property to the public port facilities and will work with an engineering firm to analyse the port facility to determine if any modification are required to accommodate future concentrate production from the Lik property. No drilling is planned for 2009.

Management, along with other industry participants, believes the longer term outlook for zinc prices is bullish with prices expected to rise as global supply decreases due to declines in existing mines' grades as well as shutdowns of soon to be exhausted mines. At present, there is little new mine capacity scheduled to replace this decline in production. Additional support for the price of zinc is expected in the medium and long term as a result of the increased consumption of zinc by the various infrastructure projects contained in many of the stimulus plans proposed by the world's major economies.

Management believes that the work done to date by the Company has produced results as good as, or in some cases, better than expected and justifies further work. Although it has decided to curtail exploration work at the Lik property until such time as capital markets improve, management has concluded that there has been no impairment of the Company's long-lived assets as at December 31, 2008.

## SUMMARY OF QUARTERLY RESULTS

For the quarters ended:

|   | 12/31/08    | 9/30/08   | 6/30/08   | 03/31/08    | 12/31/07  | 9/30/07  | 6/30/07  | 03/31/07 |
|---|-------------|-----------|-----------|-------------|-----------|----------|----------|----------|
|   | \$          | \$        | \$        | \$          | \$        | \$       | \$       | \$       |
| Interest income                             | 26,375      | 44,738    | 57,861    | 92,988      | 85,834    | 101,567  | 125,428  | 119,684  |
| Net income (loss)                           | (1,157,127) | (765,172) | (673,690) | (1,458,355) | (621,721) | (77,563) | (24,275) | 6,280    |
| Income (loss) per share - basic and diluted | (0.04)      | (0.02)    | (0.02)    | (0.05)      | (0.07)    | (0.01)   | (0.00)   | 0.00     |

The large fluctuations in the Company's quarterly results are primarily due to the timing of stock option grants and the translation of foreign currency denominated financial items. Excluding stock-based compensation expense and foreign exchange gains and losses, the Company's net losses would amount to \$318,067 for the fourth quarter of 2008, \$281,562 for the third quarter of 2008, \$316,737 for the second quarter of 2008, \$307,626 for first quarter of 2008 and \$354,089 for the fourth quarter of 2007. These amounts reflect normal overheads expected by the Company given its current stage of operations.

## LIQUIDITY AND CAPITAL RESOURCES

Historically the Company's primary source of funding has been the sale of equity securities for cash. The Company is not in commercial production on the LIK property and, accordingly, it does not generate cash from operations.

At December 31, 2008, the Company had cash and cash equivalents totalling \$4,453,279 as compared to \$10,538,533 at December 31, 2007. The Company has no significant financial or other instruments except that its cash balances are primarily invested in easily liquidated bankers' acceptances. The Company does not have any exposure to Asset-Backed Commercial Paper.

At December 31, 2008, the Company's aggregate commitments for operating leases for its office in Vancouver totalled CDN\$65,032. In March 2008, the Company entered into a lease for its head office in Vancouver. This lease calls for monthly payments of CDN\$5,275 for the period May 2008 through October 2009.

Under the contract with its drilling contractor, the Company agreed to complete a minimum of 30,000 feet of drilling. A total of 4,564 feet was drilled during the 2007 work season, and 22,406 feet were drilled during the 2008 work season. The Company has committed to spending \$150,000 for the preparation of the scoping study for the Lik property.

The Company also had commitments of \$3,007,583 for amounts due under various consulting and employment contracts.

The following is a summary of the Company's contractual obligations and commitments as at December 31, 2008:

|                                       | Total      | 2009       | 2010 – 2012 | 2013 - 2014 | 2015 and beyond |
|---------------------------------------|------------|------------|-------------|-------------|-----------------|
| Exploration services agreement – US\$ | \$ 270,265 | \$ 270,265 | \$ -        | \$ -        | \$ -            |
| Office operation leases – CDN\$       | 65,032     | 58,014     | 7,018       | -           | -               |
| Consulting agreements – US\$          | 1,846,750  | 579,000    | 1,267,750   | -           | -               |
| Employment agreements – US\$          | 1,160,833  | 310,000    | 850,833     | -           | -               |

The Company has entered into consulting and employment agreements with senior officers for terms ranging from three to five years and for an aggregate of \$889,000 per year. The Company may terminate these agreements at any time, subject to the payment of fees ranging from a lump sum payment amounting to three months of the contract fee, to a lump sum amounting to the balance of the contract fee for the duration of the entire contract, plus a cancellation and termination penalty equal to 40% of that amount.

As the Company has in the past been dependent on the sale of equity securities in order to raise cash, it has scaled back its planned work programs at Lik until such time that capital markets improve and the prospects for a successful financing, on less dilutive terms to the Company, is more likely. The Company believes its current capital resources will be sufficient to finance its revised business objectives for 2009, 2010 and part of 2011.

## **OFF-BALANCE SHEET ARRANGEMENTS**

During the year ended 2008 and up to the date of this report, the Company had no off-balance sheet transactions.

## **TRANSACTIONS WITH RELATED PARTIES**

During 2008, the Company paid \$22,946 for legal costs to a legal firm whose partner is a director of the Company. In 2007, the Company paid \$277,700 for legal, incorporation and share issuance costs to this legal firm.

Under the Company's policy for director remuneration, each director receives a base fee of CDN\$12,000 per year. In addition, all directors are entitled to be reimbursed for reasonable expenses (including travel) incurred in connection with the attendance of committee or directors' meetings. Directors (other than the Chairman) who chair a committee are entitled to additional compensation as follows: (i) CDN\$10,000 to chair the Audit Committee; (ii) CDN\$5,000 to chair the Corporate Governance Committee; and (iii) CDN\$5,000 to chair the Compensation and Nomination Committee. The directors who are also employees of the Company (or any of its subsidiaries) do not receive any compensation for serving as directors. Directors' fees for the year ended December 31, 2008 totalled \$48,319 (2007 – \$34,875).

The total amount payable to related parties at December 31, 2008 was \$10,712 (2007 – \$34,875). The amounts due to related parties are interest free with no specific terms of repayment.

## **FOURTH QUARTER**

During the fourth quarter of 2008, the Company spent \$660,066 on deferred exploration costs, \$1,216 for equipment and \$2,262 for costs relating to its initial public offering in December 2007.

During the fourth quarter of 2008, all of the holders of the Company's stock options agreed to the cancellation of their stock options. No compensation was paid to the option holders for the cancellation of the stock options. During the fourth quarter of 2008, but prior to the cancellation of the stock options in November 2008, the Company recognized \$240,300 (2007 – \$234,900) of stock based compensation of which \$29,600 (2007 – nil) was capitalized as a deferred exploration cost and \$210,700 (2007 – \$234,900) was expensed as stock based compensation. Upon cancellation of all the outstanding stock options in November 2008, the unrecognized compensation cost of the unvested options of \$355,500 was immediately recognized and \$42,800 was capitalized as a deferred exploration cost and \$312,700 was expensed as stock based compensation.

During the fourth quarter of 2008, the Canadian dollar continued to weaken versus the US dollar, resulting in a foreign exchange loss of \$315,660 (2007 – \$32,732) recognized in the fourth quarter. The Company maintains a portion of its cash in Canadian dollars in order to fund its administrative office costs.

The broker warrants issued in connection with the 2007 private placement offering expired unexercised on December 28, 2008.

## **OUTSTANDING SHARE DATA**

The Company is authorized to issue an unlimited number of Common Shares and an unlimited number of special voting shares, issuable in series. At March 25, 2009, the Company had 30,663,771 Common Shares issued and outstanding as well as warrants to purchase an additional 1,268,150 common shares. There were also 3,065,000 stock options outstanding, though since they were only granted on March 2, 2009 none of these were vested, and thus not exercisable, at March 25, 2009.

If fully exercised, the warrants, broker warrants and stock options would bring a further CDN\$3,772,800 to the Company's treasury.

In March 2009, the Company granted 3,065,000 stock options to directors, officers and employees. These stock options were granted pursuant to the Company's Stock Option Plan with a term of five years and an exercise price of CDN\$0.30 per share.

## **PROPOSED TRANSACTIONS**

As is typical of the mineral exploration and development industry, the Company is continually reviewing potential merger, acquisition, investment and joint venture transactions and opportunities that could enhance shareholder value. At present there are no transactions being contemplated by management or the board that would affect the financial condition, results of operations and cash flows of any asset of the Corporation.

## **CRITICAL ACCOUNTING ESTIMATES**

The preparation of its consolidated financial statements requires the Company to use estimates and assumptions that affect the reported amounts of assets, liabilities and expenses. The Company's accounting policies are described in Note 2 to the December 2008 audited consolidated financial statements.

The Company is capitalizing all direct acquisition, land holding and exploration expenditures related to its properties until commercial production commences or the investment is abandoned, at which time the costs will either be amortized on a unit-of-production basis or fully charged to operations.

In addition, generally accepted accounting principles require the Company to consider at the end of each accounting period whether or not there has been any change in circumstances which would indicate impairment of the capitalized mineral property, plant and equipment. For non-producing properties, this assessment is based on whether factors that may indicate the need for a write-down are present. If the Company determines there has been an impairment because the Company has determined that the deferred costs of non-producing properties may not be recovered based on current economics or permitting considerations, the Company would be required to write-down the recorded value of its mineral property, plant and equipment to its estimated fair value, which would reduce the Company's earnings and net assets.

## **CHANGES IN ACCOUNTING POLICIES INCLUDING INITIAL ADOPTION**

In February 2007, the CICA issued Handbook Section 1535, Capital Disclosures which is effective for fiscal years beginning on or after October 1, 2007. This standard requires disclosure of information that enables users of the Company's financial statements to evaluate the entity's objectives, policies and processes for managing capital. The Company adopted this standard effective January 1, 2008.

In February 2007, the CICA issued Handbook Section 3862, Financial Instruments – Disclosure ("Section 3862") and Handbook Section 3863, Financial Instruments – Presentation ("Section 3863"), which are effective for fiscal years

beginning on or after October 1, 2007. The Company adopted these standards effective January 1, 2008. The objective of Section 3862 is to provide financial statement disclosure to enable financial statement users to evaluate the significance of financial instruments on the Company's financial position and performance and the nature and extent of risks arising from financial instruments that the Company is exposed to during the reporting period and at the balance sheet date, and how the Company is managing those risks. The purpose of Section 3863 is to enhance the financial statement user's understanding of the significance of financial instruments to the Company's financial position, performance and cash flows. The Company has designated its cash and cash equivalents as held for trading which are recorded at fair value. Receivables are designated as loans and receivables, which are recorded at amortized cost. Accounts payable and accrued liabilities are designated as other financial liabilities, which are recorded at amortized cost. The carrying value of cash and cash equivalents, accounts receivable and accounts payable approximate their fair values due to their immediate or short term nature.

In May 2007, the CICA issued amended Handbook Section 1400, General Standards of Financial Statement Presentation. The section provides revised guidance related to management's responsibility to assess and disclose the ability of an entity to continue as a going concern. This amended standard applies to annual financial statements for fiscal years beginning on or after January 1, 2008. The Company has included this disclosure in its consolidated financial statements.

In June 2007, the CICA issued Handbook Section 3031, Inventories which became effective on January 1, 2008. This section requires that inventory be recorded at the lower of cost or net realizable value. This section also clarifies that the allocation of fixed production overhead requires the consistent use of either first-in, first-out or the weighted average method to measure inventory, and requires that any previous write-downs be reversed when the value of the inventory increases. The amount of the reversal is limited to the amount of the original write-down. The Company adopted this standard effective January 1, 2008 with no effect on the Company's financial statements.

In November 2007, the CICA approved new Section 3064, Goodwill and Intangible Assets, replacing Sections 3062, Goodwill and Other Intangible Assets, and 3450, Research and Development Costs. New Section 3064 establishes revised standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets and becomes effective for fiscal years beginning on or after October 1, 2008, with earlier adoption permitted. The adoption of this standard is not expected to have any effect on the Company's financial statements.

In 2006, the Canadian Accounting Standards Board ("AcSB") published a new strategic plan that will significantly affect financial reporting requirements for Canadian companies. The AcSB strategic plan outlines the convergence of Canadian GAAP with international financial reporting standards ("IFRS") over an expected five year transitional period. In February 2008 the AcSB announced that 2011 is the changeover date for publicly-listed companies to use IFRS, replacing Canada's own GAAP. The date is for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The transition date of January 1, 2011 will require the restatement for comparative purposes of amounts reported by the Company for the year ended December 31, 2010. While the Company has begun assessing the adoption of IFRS for 2011, the financial reporting impact of the transition to IFRS cannot be reasonably estimated at this time.

## **FINANCIAL AND OTHER INSTRUMENTS**

The Company's financial assets and liabilities consist of cash and cash equivalents, receivables, accounts payable and accrued liabilities and the amount due to related parties, some of which are denominated in Canadian dollars. These accounts are recorded at cost in US dollars, which approximates fair value. The Company is exposed to financial gain or loss as a result of foreign exchange movements by the Canadian dollar against the US dollar.

The Company's cash and cash equivalents are primarily invested in easily liquidated bankers' acceptances issued by Canadian chartered banks. The Company does not have any exposure to Asset-Backed Commercial Paper.

In addition to costs denominated in US dollars, the Company also incurs general and administrative costs denominated in Canadian dollars. Accordingly, the Company's general and administrative costs are affected by

changes in the foreign exchange rate of the Canadian dollar. Canadian dollar denominated costs represent approximately 18% of the Company's total budgeted general and administrative costs for 2009. A 10% increase in the value of the Canadian dollar against the US dollar could increase the Company's reported general and administrative costs by approximately \$28,000 annually. The Company has elected not to hedge its exposure to fluctuations in the Canadian dollar by buying fixed rate forward contracts in Canadian dollars.

## **INTERNAL CONTROLS OVER FINANCIAL REPORTING**

Management is responsible for the design of internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the financial statements in accordance with accounting principles generally accepted in Canada. Based on regular reviews of its internal control procedures during and at the end of the period covered by this MD&A, management believes its internal controls and procedures are effective in providing reasonable assurance that financial information is recorded, processed, summarized and reported in a timely manner.

## **CHANGES TO INTERNAL CONTROL OVER FINANCIAL REPORTING**

There have been no significant changes to the Company's internal control over financial reporting that occurred during the year ended December 31, 2008 that have materially affected, or are reasonably likely to materially affect the Company's internal control over financial reporting.

## **DISCLOSURE CONTROLS**

Management is also responsible for the design and effectiveness of disclosure controls and procedures to provide reasonable assurance that material information related to the Company, including its consolidated subsidiary, is made known to the Company's certifying officers. The Company's Chief Executive Officer and Chief Financial Officer have each evaluated the effectiveness of the Company's disclosure controls and procedures as of December 31, 2008 and have concluded that these controls and procedures are effective in providing reasonable assurance that material information relating to the Company is made known to them by others within the Company.

## **OUTLOOK**

The Company begins 2009 with \$4.5 million in cash. As the Company has in the past been dependent on the sale of equity securities in order to raise cash, and in response to the recent downturn in the worldwide capital markets, the Company has scaled back its planned work programs at Lik until such time that capital markets improve and the prospect for a successful financing, on less dilutive terms to the Company, is more likely. The Company believes its current capital resources will be sufficient to finance its planned business objectives for 2009, 2010 and part of 2011. In order to fund further exploration work and advance the LIK property, the Company may be required to raise additional financing through the issuance of its securities.

The Company is not planning any drilling in 2009. The Company has retained an independent engineering firm to prepare a current mineral resource estimate and an accompanying NI 43-101 Technical Report. This scoping study will incorporate results from the Company's 2007 and 2008 drill programs with the historical drilling of 135 drill holes comprising 86,000 feet (26,200 metres) in order to prepare the current resource estimate and will also include information based on different cut-off grades, assumed operating costs, metal recoveries, smelter and transportation costs, and long-term metal price assumptions.

The Company also plans to continue environmental work, including an environmental impact study, in order to obtain all necessary land use and operating permits for the LIK property.

The Company also plans to commission a report to study the costs and requirements of any potential routes for the road from the Lik property to the public port facilities and will work with an engineering firm to analyse the port facility to determine if any modification are required to accommodate future concentrate production from the Lik property.

## **RISK FACTORS**

The financing, exploration, development and mining of any of the Company's properties is subject to a number of factors including the price of zinc, lead and silver, laws and regulations, political conditions, currency fluctuations, environmental regulations, hiring qualified people and obtaining necessary services in jurisdictions where the Company operates. The current trends relating to these factors are favorable but could change at any time and negatively affect the Company's operations and business.

The following is a brief discussion of those distinctive or special characteristics of the Company's operations and industry which may have a material impact on, or constitute risk factors in respect of the Company's future financial performance.

### *Exploration Risk*

Mineral exploration and development involve a high degree of risk and few projects are ultimately developed into producing mines. There is no assurance that the Company's future exploration and development activities will result in the definition of a body of commercial ore. Whether an ore body will be commercially viable depends on a number of factors including the particular attributes of the deposit such as size, grade and proximity to infrastructure, as well as mineral prices and government regulations, including environmental regulations.

### *Financial Capability and Additional Financing*

If the Company's exploration programs are successful, additional funds will be required in order to complete the development of its properties. The only sources of future funds presently available to the Company are the sale of additional equity capital or the entering into of joint venture arrangements or other strategic alliances in which the funding sources could become entitled to an interest in the properties or the projects. The Company's capital resources are largely determined by the strength of the junior resource market and by the status of the Company's projects in relation to these markets, and its ability to compete for investor support of its projects.

In order to exercise the option to increase its ownership of the Lik property to 80%, the Company must spend the Required Expenditure Amount prior to 2018. The Required Expenditure Amount is currently estimated to be approximately \$39.8 million (after adjustment for inflation indexing and escalations) of which \$11.2 million has been incurred. Accordingly, the exact amount the Company is required to spend is uncertain and the longer the duration of time over which such expenditures are made, the greater the potential variability in this spending obligation.

There is no assurance that the Company will be successful in raising sufficient funds to meet its obligations or to complete all of the currently proposed exploration programs. If the Company does not raise the necessary capital to meet its obligations under current contractual obligations, the Company may have to forfeit its interest in properties or prospects earned or assumed under such contracts. In addition, if the Company does not raise the funds to complete the currently proposed exploration programs, the viability of the Company could be jeopardized.

### *Permits and Government Regulation*

Although the Company believes it has all of the necessary permits to carry out the proposed exploration programs, the operations of the Company may require licenses and permits from time to time from various governmental authorities to carry out exploration and development at its projects. Obtaining permits can be a complex, time-consuming process. There can be no assurance that the Company or its joint venture partner will be able to obtain

the necessary licences and permits on acceptable terms, in a timely manner or at all. The costs and delays associated with obtaining permits and complying with these permits and applicable laws and regulations could stop or materially delay or restrict the Company or its joint venture partner from continuing or proceeding with existing or future operations or projects. Any failure to comply with permits and applicable laws and regulations, even if inadvertent, could result in the interruption or closure of operations or material fines, penalties or other liabilities. In addition, the requirements applicable to sustain existing permits and licenses may change or become more stringent over time and there is no assurance that the Company or its joint venture partner will have the resources or expertise to meet its obligations under such licenses and permits.

The mineral exploration activities of the Company are subject to various laws governing prospecting, development, production, taxes, labour standards, occupational health, mine safety, waste disposal, toxic substances and other matters. Mining and exploration activities are also subject to various laws and regulations relating to the protection of the environment, historical and archaeological sites and endangered and protected species of plants and animals. Although the exploration activities of the Company are currently carried out in material compliance with all applicable rules and regulations, no assurance can be given that new rules and regulations will not be enacted or that existing rules and regulations will not be applied in a manner which could limit or curtail exploration or development. New rules and regulations may be enacted or existing rules and regulations may be applied to the operations and activities of the Company and could have a substantial adverse impact on the Company.

In the United States, Congress has considered a number of proposed amendments to the General Mining Law of 1872. If adopted, such amendments could, among other things, substantially increase the cost of holding unpatented mining claims, impair the ability of companies to develop mineral resources on unpatented mining claims and impose royalties on production from unpatented mining claims. The effects, if any, of any such amendments on the Company and its operations cannot be determined at this time.

#### *Fluctuating Prices*

The profitability of the Company's operations will be dependent upon the market price of mineral commodities. Mineral prices fluctuate widely and are affected by numerous factors beyond the control of the Company. The level of interest rates, rate of inflation, world supply of mineral commodities, consumption patterns, sales of zinc, lead and silver, forward sales by producers, production, industrial and consumer demand, speculative activities and stability of exchange rates can all cause significant fluctuations in prices. Such external economic factors are in turn influenced by changes in international investment patterns, monetary systems and political developments. The prices of mineral commodities have fluctuated widely in recent years. Current and future price declines could cause commercial production to be impracticable. The prices of commodities are affected by numerous factors beyond the Company's control.

#### *Environmental Regulation*

The Company's activities are subject to environmental laws and regulations which may materially adversely affect its future operations. These laws and regulations control the exploration and development of the LIK property and their effects on the environment, including air and water quality, mine reclamation, waste handling and disposal, the protection of different species of plant and animal life, and the preservation of lands. These laws and regulations will require the Company to acquire permits and other authorizations for certain activities. There can be no assurance that the Company will be able to acquire such necessary permits or authorizations on a timely basis, if at all.

Further, environmental legislation is evolving in a manner which will require stricter standards and enforcement, increased fines and penalties for non-compliance, more stringent environmental assessments of proposed projects and a heightened degree of responsibility for companies and their officers, directors and employees. There is no assurance that future changes in environmental regulation, if any, will not adversely affect the Company's operations.

The Company is not currently insured against most environmental risks. Without such insurance, and if the Company becomes subject to environmental liabilities, the payment of such liabilities would reduce or eliminate its available funds or could exceed the funds the Company has to pay such liabilities and result in bankruptcy.

*More information*

For a further discussion of risk factors, please see “Risk Factors” in the Investors section of our website ([www.zazumetals.com](http://www.zazumetals.com)).