# Management's Discussion and Analysis

# of the Financial Condition and Results of Operations

# for the year ended June 30, 2013

October 23, 2013

# Caracara Silver Inc.

## Management's Discussion and Analysis
## For the year ended June 30, 2013

*This management discussion and analysis ("MD&A") has been prepared based on information available to Caracara Silver Inc. ("Caracara" or the "Company") as at October 23, 2013. The MD&A of the operating results and financial condition of the Company for the year ended June 30, 2013, should be read in conjunction with the Company's audited annual consolidated financial statements (the "Financial Statements") and the related notes as at and for the years ended June 30, 2013 and 2012. The Financial Statements have been prepared by management in accordance with International Financial Reporting Standards ("IFRS") and all amounts are expressed in Canadian dollars unless otherwise noted. Other information contained in this MD&A has also been prepared by management and is consistent with the data contained in the Financial Statements. Additional information relating to the Company may be found under its profile on SEDAR at www.sedar.com.*

## *MANAGEMENT'S ASSESSMENT OF INTERNAL CONTROL OVER FINANCIAL REPORTING ("ICFR")*

Management is responsible for establishing and maintaining adequate internal control over the Company's financial reporting. The internal control system was designed to provide reasonable assurance to the Company's management regarding the preparation and presentation of the financial statements.

The inherent limitations in all control systems are such that they can provide only reasonable, not absolute, assurance that all control issues and instances of fraud or error, if any have been detected. Therefore, no matter how well designed, ICFR has inherent limitations and can provide only reasonable assurance with respect to financial statement preparation and may not prevent and detect all misstatements.

As the Company is a Venture Issuer (as defined under under National Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings*) ("NI 52-109"), the Company and Management are not required to include representations relating to the establishment and/or maintenance of disclosure controls and procedures and/or ICFR, as defined in NI 52-109. The reader is directed to disclosure of the inherent limitations of ICFR for small to mid-size companies under the ***Risks and uncertainties*** section of this MD&A with regards to segregation of duties.

## *CAUTIONARY NOTE*

This document contains or refers to forward-looking information. Such forward-looking information includes, among other things, statements regarding targets, estimates and/or assumptions in respect of future production, capital costs and future economic, market and other conditions, and is based on current expectations that involve a number of business risks and uncertainties. Factors that could cause actual results to differ materially from any forward-looking statement include, but are not limited to: the grade and recovery of ore which is mined varying from estimates; exploration and development costs varying significantly from estimates; inflation; fluctuations in commodity prices; delays in the development of the any project caused by unavailability of equipment, labour or supplies, climatic conditions or otherwise; termination or revision of any debt financing; failure to raise additional funds required to finance the completion of a project; and other factors. Forward-looking statements are subject to significant risks and uncertainties and other factors that could cause actual results to differ materially from expected results. Readers should not place undue reliance on forward-looking statements. These forward-looking statements are made as of the date hereof and we assume no responsibility to update them or revise them to reflect new events or circumstances, except as required by law. See the section entitled ***Risks and uncertainties***.

## *Corporate*

Caracara Silver Inc. is focused on acquiring, exploring and developing silver, zinc and lead resources to meet the world's growing demand. The Company holds 43 concessions totalling 29,099 hectares in Southern Peru. The Company is the continuing entity of Ansue Capital Corp. ("Ansue"), which was incorporated under the laws of British Columbia on December 3, 2009. Ansue was a capital pool company ("CPC") as defined by the rules of the TSX Venture Exchange ("TSXV") in Policy 2.4 of the TSXV. On July 18, 2011, Ansue announced that at the Annual Meeting of the shareholders of Ansue, all matters regarding a Qualifying Transaction with Southern Andes Energy Inc. ("SAE") were approved including the proposed name change of Ansue to Caracara Silver Inc. On August 19, 2011, the Company closed on a qualifying transaction and completed the Corporate Merger (see note 4 of the Financial Statements). Based on the relative ownership percentages of the combined Company by the shareholders of Southern Andes prior to the transaction, former Ansue shareholders and the composition of the Board of Directors of the newly-combined Company, from an accounting perspective, Solex del Peru S.A.C. ("Solex") (a former Southern Andes subsidiary) is considered to be the accounting acquirer and therefore the Qualifying Transaction has been accounted for as a reverse takeover. For financial reporting purposes, the Company is considered a continuation of Solex, a legal subsidiary, except with regard to authorized and issued share capital, which is that of Ansue, the legal parent.

The head office, principal address and registered and records office of the Company is located at 120 Adelaide Street West, Suite 2400, Toronto, Ontario, M5H 1T1.

The Financial Statements were approved for issuance by the Board of Directors on October 21, 2013.

## *Option agreement*

On May 3, 2013, the Company announced that it had signed an option agreement with Inversiones Collodi SAC ("IC") with respect to Caracara's Peruvian exploration properties. IC is a private Peruvian mineral exploration and development company based in Lima. Under the terms of the agreement, IC would have the right to earn a 65% interest in the Company's concessions by making exploration expenditures totalling US$12.5 million over a four-year period. In addition, IC would make cash payments to the Company's wholly-owned affiliate company in Peru, totalling $1.85 million. The Company has received the first $242,370 payment owing.

The following were highlights of the transaction:

- $12.5 million of exploration expenditures over a four-year period
- $2 million exploration budget in year one
- $1.85 million in cash payments to the Company over the four year option period
- IC could earn a 65% interest and an additional 5% by financing and completing a prefeasibility study on any of the projects in the Company's portfolio
- Key Caracara exploration staff would manage the field exploration programs with IC staff under the guidance of a technical committee

However, on October 4, 2013, the Company reported that it had received notice from IC terminating its option agreement with Caracara. During the four month period of the agreement, IC carried out a limited 2,400-m drilling program on the Princesa silver-zinc-lead project and did not conduct any drilling on Caracara's principal Pilunani zinc-lead project or the Parcuyo project, as was originally contemplated.

The Company did benefit from a $242,370 option payment and the payment of all concession land fees which will allow the Company to maintain its large 29,000-hectare land position in Peru to May, 2015. As

a result of the termination of the option agreement, Caracara retains a 100% interest in these highly prospective concessions.

### *Projects update*

Caracara controls 30 (2012 – 30) mineral claims along the Princesa-Pilunani mineralized trend located 1,000 kilometers southeast of Lima, the capital of Peru or 210 kilometres north of Juliaca, within the administrative department of Puno, in southern Peru. The Company holds another 3 (2012 – 13) claims within the administrative department of Cuzco. As of June 30, 2013, all of the 33 mineral claims were in good legal standing and were being held by Solex, a wholly-owned Peruvian subsidiary of the Company.

The Company controls two groups of claims located in the southeast part of Peru. The first group is the Princesa-Pilunani project which consists of 30 claims totaling 20,699 hectares located within the Puno Department at approximately 1,000 kilometers from Lima, the capital of Peru. The lead-zinc-silver project has been the focus of most of the exploration work carried out by the Company since the Ansue merger. The second group is the Cullquimayo project which originally consisted of 13 claims covering 8,400 hectares located within the Cusco Department. In May 2013, 10 claims totaling 6,000 hectares were dropped following a small reconnaissance survey. As of June 30, 2013, all of these clams were in good standing and were being held by Solex, a wholly-owned Peruvian subsidiary of the Company.

The Princesa-Pilunani project is divided into three sub-groups named Princesa, Pilunani and Potoni, all located within a 45 kilometres long metallogenic belt underlined by several lead-zinc+/-silver showings and old mines which are associated with cross cutting structures and diatreme breccia. Twenty of these base metals occurrences are located within the Company's claims including the Princesa mineralized zone which hosts a NI 43-101 inferred resources of 4.6 million tonnes grading 90.88 g/t Ag, 1.69% Zn and 1.66% Pb.

During the year ended June 30, 2013, the Company carried out several exploration programs until May 2013 when the option agreement with IC was signed. , The Company has since initiated an aggressive exploration program with its partners at the Princesa-Pilunani project. In 2012, drilling activities were performed at Marcia (2 diamond drill holes ("ddh's") for a total of 303.90 metres) and at Princesa (2 ddh's for a total of 344.60 metres). In 2013, under the work agreement with Inversiones Collodi, 16 ddh's totaling 3,048.90 metres have been completed from May 21, 2013 to August 12, 2013.

Exploration works and more particularly drilling, requires permitting from the Peruvian authorities which has become more constrained for the mining sector since the introduction of a new law named "Consulta Previa" affecting the local native inhabitants. Permitting from the local communities is mandatory and must be obtained legitimately in order to acquire access rights and use of the lands to conduct any field program. The Company's community relations team treats these communities in a professional and harmonious manner and makes every effort to participate in economical, educational and social development by encouraging local community involvement. The team has been successful in negotiating new agreements with several communities including Cullco Belen for the drilling program at the Princesa property, Picotani for the exploration program contemplated at the Pilunani property and Fundo Pichuchuane for the work to be completed at the Parcuyo property. The Company has strict corporate policies enforcing the mandate respecting the inhabited land, the residents and the environment.

The following paragraphs describe summarily the exploration program and results obtained during the last fiscal year and the latest developments from the ongoing program with Inversiones Collodi.

***Pilunani project: Drilling at the Nilda and Marcia property***

A surface drilling program comprised of 9 ddh's totaling 1498.90 metres that lasted from May 14, 2012 to July 09, 2012 has been completed. The program aimed at testing some existing and new lead-zinc showings and some Induced Polarization anomalies. The most significant results were:

Nilda property: Hole NIL12-04: 18 metres grading 2.4 g/t Ag, 0.60% Zn and 0.17% Pb
Marcia property: Hole MAR12-05: 89 metres grading nil Ag, 0.39% Zn and 0.10% Pb

The properties were put in care and maintenance and the Environmental Closure Plan was completed prior to year end to comply with the Peruvian regulations regarding the end of the exploration activities.

***Princesa project***

The surface drilling program was initiated on August 16, 2012 and halted on August 26 in order for the Company to comply with the new Peruvian environmental regulations for exploration activities. This new regulation requires for a Consulta Previa to be realized by the Peruvian government authorities with inhabitants of the property area. Following several months of discussion with the authorities, it was concluded that the people living within the boundaries of the property were not declared native which were conditions for mandatory application of the law. On December 11, 2012, the Company received the "Favorable Technical Report" from the Peruvian Ministry of Energy and Mines ("MEM") and was authorized to resume its drilling operations. The Company however opted to postpone the drilling operations until March 2013 due to the rainy season.

Two ddh's totaling 344.6 metres were completed to test the vertical continuity of the known mineralization between holes PRIN-61 and 62 drilled in 2007 and, to test its down dip extension. Mineralization cut in ddh PRIN12-01 and 02 consisted in fine disseminations and hairline veinlets of pyrite-galena-sphalerite, locally as semi massive blebs, which is associated with a deformed zone within sediments. That mineralization is geochemically characterized by an enrichment of barium and manganese. The best results of these two holes:

Hole PRIN12-01: 9.2 metres grading 47.4 g/t Ag, 1.10% Zn and 1.47% Pb
Hole PRIN12-02: 33.7 metres grading 9.2 g/t Ag, 0.38% Zn and 0.34% Pb

Following the signing of the option agreement with IC, a drilling program started on May 22, 2013 and was completed on August 12, 2013. Sixteen ddh's totaling tested the westernmost and the down dip extensions of the Princesa Structure (13 ddh's) and some IP anomalies (3 ddh's). The program was halted in order to evaluate the results obtained so far. Among these results, the most significant are:

Hole PRIN13-04: 17.9 metres grading 14.7 g/t Ag, 0.86% Zn and 0.84% Pb
Hole PRIN13-07: 15.2 metres grading 86.1 g/t Ag, 0.77% Zn and 2.56% Pb
Hole PRIN13-08: 19.4 metres grading 64.4 g/t Ag, 1.56% Zn and 0.75% Pb
Hole PRIN13-10: 31.3 metres grading 25.6 g/t Ag, 1.48% Zn and 0.79% Pb

Meanwhile at Pilunani, a semi detailed environmental study has been completed and presented to the Peruvian authorities while a team of geologists are conducting some detailed geological mapping on key areas of the property in order to upgrade the overall geological interpretation and to pin point the best drilling targets.

At Parcuyo, geological mapping and sampling is programmed before preparing a drilling permit.

## *Results of operations*

**Years ended June 30, 2013 and 2012**

During the year ended June 30, 2013, the Company incurred net losses of $1,779,903 compared to a net loss for the year ended June 30, 2012, of $5,186,014. The decrease in net losses for the year ended June 30, 2013, is due to reduced corporate and exploration activities following the completion of the Qualifying Transaction in 2011. Details of the expenditures follow:

**Consulting and professional fees $57,780 (2012 - $185,717)**

Decreased costs of $127,937 are mainly the result of legal fees regarding the Qualifying Transaction incurred in 2012.

**General and administrative costs $218,873 (2012 - $183,656)**

General and Administrative Costs increased $35,216 due to increased cost in Peru's administrative expenses including legal and audit expenditures following the signing of the Option Agreement. In May 2013, the Company restructured the subsidiary offices in Peru and replaced the Country Manager which should result in lower administrative expenditures in the future.

**Investor relations costs $28,551 (2012 - $85,535)**

Investor relations costs decreased $56,984 due to decreased investor relations activities in 2013.

**Listing costs $nil (2012 - $751,984)**

For the year ended June 30, 2013, the Company incurred no listing costs (2012 - $751,984). Costs incurred in 2012 were related to the Company's Qualifying Transaction and the effective listing of its shares on the TSXV through the corporate merger.

**Management fees and salaries $523,765 (2012 – $472,301)**

Increased expenses of $51,464 are due to the following reasons: Increase of $36,850 RG Mining Investment Inc management fee due to 12 months fees in 2013 versus 11 months in 2012. (see related-party disclosure in this MD&A); Increase of directors' fees of $9,924 and other miscellaneous items of $4,690.

**Share-based compensation $162,329 (2012 - $761,874)**

For the year ended June 30, 2013, the Company incurred share-based compensation of $162,329 regarding the vesting costs of previously issued options. The Company did not issue any new options during the year ended June 30, 2013.

**Shareholder and public company costs $21,529 (2012 - $111,681)**

Decreased costs of $90,422 are mainly the result of costs incurred in 2012 in regards to the Company's Qualifying Transaction, regulatory fees and shareholder reporting during this process.

### *Exploration and evaluation expenditures*

The evaluation and exploration expenses for the Company are broken down as follows:

| | **Year ended June 30, 2013** | Year ended June 30, 2012 | Cumulative from May 31, 2011 to June 30, 2013 |
|---|---|---|---|
| | **$** | $ | $ |
| **Acquisition costs** | **352,190** | 1,117,247 | 1,963,104 |
| | | | |
| **Exploration costs:** | | | |
| Drilling | **129,576** | 296,609 | 426,185 |
| Environmental and community relations | **11,376** | 137,988 | 233,416 |
| Assaying and sampling | **18,795** | 36,759 | 111,665 |
| Field and camp supplies | **117,561** | 393,924 | 567,215 |
| Consulting and professional fees | **57,195** | 300,757 | 583,689 |
| General exploration expenditures | **332,032** | 429,523 | 1,613,760 |
| | **666,535** | 1,595,560 | 3,535,930 |
| **Total exploration and evaluation expenditures** | **1,018,725** | 2,712,807 | 5,499,034 |

### *Selected Annual Information*

Following is selected annual information for each of the three most recently completed financial years:

| | **Year ended June 30, 2013** | **Year ended June 30, 2012** | **Year ended June 30, 2011** |
|---|---|---|---|
| | $ | $ | $ |
| Total revenues | - | - | - |
| Net gain (loss) | (1,779,903) | (5,265,555) | 5,148 |
| | | | |
| Basic and diluted net loss per common share | (0.03) | (0.12) | 0.52 |
| Total assets | 1,309,656 | 1,335,077 | 2,976,493 |
| Long-term debt | - | - | - |
| Retained earnings (deficit) | (7,465,693) | (7,323,678) | (1,771,476) |
| Cash dividends declared per common share | - | - | - |

### *Summary of quarterly results*

| | Quarter ended June 30, 2013 | Quarter ended Mar. 31, 2013 | Quarter ended Dec. 31, 2012 | Quarter ended Sept. 30, 2012 |
|---|---|---|---|---|
| | $ | $ | $ | $ |
| Total revenues | – | – | – | – |
| Net Income/(Loss) | 19,061 | (257,908) | (762,616) | (778,440) |
| Basic and diluted net loss per share | - | (0.005) | (0.01) | (0.02) |
| Total assets | 1,309,656 | 1,335,077 | 1,577,756 | 2,280,024 |
| Long-term debt | – | – | – | – |
| Deficit | (7,465,693) | (9,122,642) | (8,864,733) | (8,102,118) |
| Cash dividends declared per common share | – | – | – | – |

| | Quarter ended Jun. 30, 2012 | Quarter ended Mar. 31, 2012 | Quarter ended Dec. 31, 2011 | Quarter ended Sept. 30, 2011 |
|---|---|---|---|---|
| | $ | $ | $ | $ |
| | | *(Restated)* | *(Restated)* | *(Restated)* |
| Total revenues | -- | – | – | – |
| Net loss | (1,083,210) | (775,785) | (1,566,765) | (1,760,253) |
| Basic and diluted net loss per share | (0.03) | (0.02) | (0.03) | (0.94) |
| Total assets | 2,976,493 | 3,931,058 | 4,670,866 | 5,138,702 |
| Long-term debt | – | – | – | – |
| Deficit | (7,323,678) | (5,874,279) | (5,098,494) | (3,531,729) |
| Cash dividends declared per common share | – | – | – | – |

The Company's operations are not generally subject to seasonal variations. The timing of exploration activities is influenced primarily by the availability of funds and the identification of suitable exploration targets, however, due to either their location or nature the exploration of some properties may be restricted during certain times of the year due to climatic conditions.

During the quarter ended June 30, 2013, the company had a net income of $19,061 versus a net loss of $257,908 during the previous quarter ended March 31, 2013. The Company did not conduct any drilling operations during that quarter and benefited from option payment received from IC totalling US$200,000.

### *Liquidity and capital resources*

As at June 30, 2013, the Company had cash and cash equivalents of $1,278,565 and working capital of $1,231,597 compared to cash and cash equivalents of $2,929,525 and working capital of $2,776,071 at June 30, 2012. The positive cash and working capital position are attributed to the completion of the Corporate Merger in 2011, which included a financing completed by Ansue that garnered net proceeds (after issuance costs) of $5,971,897. The Company has not participated in any financing activities since.

Working capital decreased in the current year by $1,544,474 primarily due to the Company's operating activities of $1,650,960 offset by increases in accounts receivable of $15,878 and decreases in accounts payable of $122,363.

The Company is a junior mining company and does not issue debt to finance its operations. It relies entirely on equity financings.

Following the termination of the option agreement by IC in October 2013, the Company will be required to provide more cash for its operations. During the year ended June 30, 2013, the Company received $242,370 in option payments and was expected to receive US$300,000 during the year ending June 30, 2014. As this payment will no longer be received by the Company from IC, it will continue to monitor its cash resources against expenditure forecasts associated with the recent developments to assess its financing requirements.

### *Adoption of new and revised standards and interpretations*

The IASB issued a number of new and revised International Accounting Standards, IFRS, and amendments that are effective for the Company's financial year beginning on July 1, 2013, except as indicated.

- **IFRS 9 *Financial Instruments: Classification and Measurement*** – introduces new requirements for the classification and measurement of financial instruments, effective on July 1, 2015 with early adoption permitted.

- **IFRS 10 *Consolidated Financial Statements*** – establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities.

- **IFRS 11 *Joint Arrangements*** – provides for a more realistic reflection of joint arrangements by focusing on the rights and obligations of the arrangement, rather than its legal form.

- **IFRS 12 *Disclosure of Interests in Other Entities*** – requires the disclosure of information that enables users of financial statements to evaluate the nature of, and risks associated with its interests in other entities and the effects of those interests on its financial position, financial performance and cash flows.

- **IFRS 13 *Fair Value Measurement*** – provides the guidance on the measurement of fair value and related disclosures through a fair value hierarchy.

The Company has not early adopted these standards, amendments and interpretations; however, the Company is currently assessing what impact the application of these standards or amendments will have on the financial statements.

## *Significant accounting policies*

### Continuance of operations

The Financial Statements have been prepared on the going concern basis, which assumes that the Company will be able to realize its assets and discharge its liabilities in the normal course of business. As at June 30, 2013, the Company has not generated any revenues from operations and used $1,650,960 (2012 - $3,169,610) for operating activities for the year. The continued operations of the Company are dependent on its ability to generate future cash flows or obtain additional financing. Management is of the opinion that it has sufficient working capital to meet the Company's liabilities and commitments as they become due, although there is a risk that additional financing may be required but will not be available on a timely basis or on terms acceptable to the Company. The Financial Statements do not reflect any adjustments that may be necessary if the Company is unable to continue as a going concern.

### Management estimates

The preparation of the Financial Statements requires management to make judgements and estimates and form assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. On an ongoing basis, management evaluates its judgements and estimates in relation to assets, liabilities, revenue and expenses. Management uses historical experience and various other factors it believes to be reasonable under the given circumstances as the basis for its judgements and estimates. Actual outcomes may differ from these estimates under different assumptions and conditions. The most significant estimates, when applicable, relate to asset retirement obligations; property, plant and equipment, recoverability of accounts receivable, valuation of deferred income tax amounts, impairment testing and the calculation of share-based payments. The most significant judgements, when applicable, relate to recognition of deferred tax assets and liabilities, determination of the commencement of commercial production and the determination of the economic viability of a project.

The Financial Statements contain management's judgement and estimates regarding the recoverability of its accounts receivable and the calculation of share-based payments.

### Mineral properties

All acquisition and exploration costs, net of incidental revenues, are charged to operations in the period incurred until such time as it has been determined that a property has economically recoverable reserves, in which case subsequent exploration costs and the costs incurred to develop a property are capitalized into Property, plant and equipment ("PPE"). On the commencement of commercial production, depletion of each mining property will be provided on a unit-of-production basis using estimated resources as the depletion base.

### Share-based payment transactions

Employees (including directors and senior executives) of the Company receive a portion of their remuneration in the form of share-based payment transactions, whereby employees render services as consideration for equity instruments ("equity-settled transactions"). Where equity instruments are granted to employees or others providing similar services, they are recorded at the fair value of the equity instrument granted at the grant date. The grant date fair value is recognized in profit or loss over the vesting period, described as the period during which all the vesting conditions are to be satisfied.

In situations where equity instruments are issued to non-employees, they are recorded at the fair value of the goods or services received or at the fair value of the equity instruments issued (if it is determined the fair value of goods or services cannot be reliably measured), and are recorded at the date the goods or services are received.

**Equity-settled transactions**

The costs of equity-settled transactions with employees are measured by reference to the fair value at the date on which they are granted.

The costs of equity-settled transactions are recognized, together with a corresponding increase in equity, over the period in which the performance and/or service conditions are fulfilled, ending on the date on which the relevant employees become fully entitled to the award ("the vesting date"). The cumulative expense is recognized for equity-settled transactions at each reporting date until the vesting date reflects the Company's best estimate of the number of equity instruments that will ultimately vest. The profit or loss charge or credit for a period represents the movement in cumulative expense recognized as at the beginning and end of that period and the corresponding amount is represented in share option reserve.

No expense is recognized for awards that do not ultimately vest, except for awards where vesting is conditional upon a market condition, which are treated as vesting irrespective of whether or not the market condition is satisfied provided that all other performance and/or service conditions are satisfied.

Where the terms of an equity-settled award are modified, the minimum expense recognized is the expense as if the terms had not been modified. An additional expense is recognized for any modification which increases the total fair value of the share-based payment arrangement, or is otherwise beneficial to the employee as measured at the date of modification.

The dilutive effect of outstanding options is reflected as additional dilution in the computation of earnings per share.

**Financial assets**

All financial assets are initially recorded at fair value and designated upon inception into one of the following four categories: held-to-maturity, available-for-sale, loans-and-receivables or at fair value through profit or loss ("FVTPL").

Financial assets classified as FVTPL are measured at fair value with unrealized gains and losses recognized through earnings. The Company's cash and cash equivalents is classified as FVTPL.

Financial assets classified as loans-and-receivables and held-to-maturity are measured at amortized cost. The Company's trade and other receivables are classified as loans-and-receivables and its related-party loan receivable is classified as held-to-maturity.

Financial assets classified as available-for-sale are measured at fair value with unrealized gains and losses recognized in other comprehensive income (loss) except for losses in value that are considered other than temporary.

Purchases or sales of financial assets that require delivery of assets within a time frame established by regulation or convention in the marketplace (regular way trades) are recognized on the settlement date.

Transactions costs associated with FVTPL financial assets are expensed as incurred, while transaction costs associated with all other financial assets are included in the initial carrying amount of the asset.

**Financial liabilities**

All financial liabilities are initially recorded at fair value and designated upon inception as FVTPL or other-financial-liabilities.

Financial liabilities classified as other-financial-liabilities are initially recognized at fair value less directly attributable transaction costs. After initial recognition, other-financial-liabilities are subsequently measured at amortized cost using the effective interest method. The effective interest method is a method of calculating the amortized cost of a financial liability and of allocating interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments through the expected life of the financial liability, or, where appropriate, a shorter period. The Company's trade and other payables are classified as other-financial-liabilities.

Financial liabilities classified as FVTPL include financial liabilities held for trading and financial liabilities designated upon initial recognition as FVTPL. Derivatives, including separated embedded derivatives are also classified as held for trading unless they are designated as effective hedging instruments. Fair value changes on financial liabilities classified as FVTPL are recognized through the statement of comprehensive income. As at June 30, 2013, the Company has not classified any financial liabilities as FVTPL.

**Impairment of financial assets**

The Company assesses at each date of the statement of financial position whether a financial asset is impaired.

**Assets carried at amortized cost**

If there is objective evidence that an impairment loss on assets carried at amortized cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original effective interest rate. The carrying amount of the asset is then reduced by the amount of the impairment. The amount of the loss is recognized in profit or loss.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed to the extent that the carrying value of the asset does not exceed what the amortized cost would have been had the impairment not been recognized. Any subsequent reversal of an impairment loss is recognized in profit or loss.

In relation to trade receivables, a provision for impairment is made and an impairment loss is recognized in profit and loss when there is objective evidence (such as the probability of insolvency or significant financial difficulties of the debtor) that the Company will not be able to collect all of the amounts due under the original terms of the invoice. The carrying amount of the receivable is reduced through use of an allowance account. Impaired debts are written off against the allowance account when they are assessed as uncollectible.

**Available-for-sale**

If an available-for-sale asset is impaired, an amount comprising the difference between its cost and its current fair value, less any impairment loss previously recognized in profit or loss, is transferred from equity to profit or loss. Reversals in respect of equity instruments classified as available-for-sale are not recognized in profit or loss.

**Impairment of non-financial assets**

At each date of the statement of financial position, the Company reviews the carrying amounts of its tangible and intangible assets to determine whether there is an indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). Where it is not possible to estimate the recoverable amount of an individual asset, the Company estimates the recoverable amount of the cash-generating unit to which the assets belong.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognized immediately in the statement of comprehensive income, unless the relevant asset is carried at a re-valued amount, in which case the impairment loss is treated as a revaluation decrease.

Where an impairment loss subsequently reverses, the carrying amount of the asset (cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset (or cash-generating unit) in prior years.

## *Transactions with related parties*

During the year ended June 30, 2013, RG Mining Investments Inc. ("RGMI") charged the Company $442,200 (2012 - $405,350) for management and administrative fees and $nil (2012 - $7,500) for investor relations and Company web-based set-up costs. RGMI provides management and administrative services to the Company and provides the services of the Company's personnel. The agreement providing the services has a term of 1 year and expires May 31, 2013. It is automatically renewed for successive 12-month periods unless terminated upon 60 days prior notice by either party or upon the criminal conviction, death, disability, incapacity, bankruptcy, insolvency, gross negligence, gross dereliction of duty or gross misconduct, of RGMI or the personnel it provides to the Company. The Company's CEO and CFO beneficially own RGMI.

During the year ended June 30, 2013, the Company incurred board of directors' fees of $70,000 (2012 – $60,076)

During the year ended June 30, 2013, the fair value of vested stock options issued to directors, officers and employees of the Company amounted to $162,329 (2012 - $761,874).

These transactions are in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

## *Risks and uncertainties*

### Operational

The operations of the Company are speculative due to the high-risk nature of its business, which is the acquisition, financing, exploration and development of mining properties. The risks below are not the only ones facing the Company. Additional risks not currently known to the Company, or that the Company currently deems immaterial, may also impair the Company's operations. If any of the following risks actually occur, the Company's business, financial condition and operating results could be adversely affected.

### Exploration and development risk

Caracara's business of exploring mineral resources involves a variety of operational, financial and regulatory risks that are typical in the mining industry. The Company attempts to mitigate these risks and minimize their effect on its financial performance, but there is no guarantee that the Company will be profitable in the future, and Caracara's common shares should be considered speculative.

### Financing risk

There can be no assurance that any funding required by the Company will become available, and, if so, that it will be offered on reasonable terms or that the Company will be able to secure such funding through third party financing or cost sharing arrangements. Furthermore, there is no assurance that the Company will be able to secure new mineral properties or projects or that they can be secured on competitive terms

### Political and demographic risk

Some operations of the Company are conducted in Peru. As a result, the Company and it's wholly-owned subsidiary, Solex, will be subject to political instability and changes in government policies, laws and regulations in Peru. Any changes in regulations or shifts in political conditions are beyond the Company's control and may adversely affect the Company's and/or Solex's business, including, income taxes, expropriation of property, employment, land use, water use, environmental legislation and exploration safety.

### Segregation of duties

Segregation of duties is a basic, key internal control and one of the most difficult to achieve in a small company. It is used to ensure that errors or irregularities are prevented or detected on a timely basis by employees in the normal course of business. Due to the Company's small size and limited resources, a complete segregation of duties within the Company's accounting group cannot be fully achieved. The result is that the Company is highly reliant on the performance of mitigating procedures during the process of closing its financial statements in order to ensure the financial statements are presented fairly in all material respects. Management will identify and hire additional accounting resources where cost effective and when required. Where it is not cost effective to obtain additional accounting resources, management will review existing mitigating controls and, if appropriate, implement changes to its internal control processes whereby more effective mitigating controls will be adopted.

### *Outstanding Share Data*

As at October 23, 2013, the Company had 51,895,835 common shares outstanding, 2,933,333 options outstanding and zero warrants outstanding.

### *General*

The Company also discloses information related to its activities on SEDAR at www.sedar.com and on its website www.caracarasilver.com.