

## **DEFIANCE SILVER CORP.**

### **MANAGEMENT'S DISCUSSION & ANALYSIS For the period ended September 30, 2013**

The following Management Discussion and Analysis ("MD&A") of Defiance Silver Corp. (the "Company") for the three months ended September 30, 2013 has been prepared as of November 27, 2013, and is intended to be read in conjunction with the Company's audited consolidated financial statements for the year ended June 30, 2013, together with the notes thereto, which are available on the SEDAR website: [www.sedar.com](http://www.sedar.com).

The financial statements for the quarter ended September 30, 2013 have been prepared by management using accounting policies consistent with International Financial Reporting Standards ("IFRS"). Management is responsible for the preparation and integrity of the financial statements, including the maintenance of appropriate information systems, procedures and internal controls to ensure that information used internally or disclosed externally, including the MD&A, is complete and reliable.

All the financial information in this MD&A and all dollar amounts in the tables, including comparatives, are expressed in Canadian dollars, unless otherwise noted.

This document contains forward-looking statements. Please refer to "Note Regarding Forward-Looking Statements."

#### **Description of Business**

The Company is a publicly listed company on the TSX Venture Exchange ("TSX-V") trading under the symbol DEF. The Company is an exploration-stage company and engages principally in the acquisition, exploration and development of mineral property interests primarily in Mexico. To date, equity financings have provided the main source of financing.

The recovery of the Company's investment in its mineral rights is dependent upon the discovery of economically recoverable mineral reserves and the ability to raise sufficient capital to finance these operations. The ultimate outcome of these operations cannot presently be determined because they are contingent on future matters.

During the year ended June 30, 2012, the Company's shareholders approved the subdivision of the Company's common shares on the basis of three new shares in exchange for two old shares. All references to number of common shares and per common share amounts have been retroactively restated to reflect this common share split.

#### **Overall Performance**

On September 9, 2011, the Company acquired an option from IMPACT Silver Corp., to purchase the Santa Gabriela (formerly Veta Grande) 200 tpd processing plant and associated surface rights located in the historic Zacatecas Silver District. Also included was the right to acquire a 100% interest in 10 mining concessions and a 27% interest in 3 concessions under a joint venture agreement with an arm's length third party. Subsequently the Company and IMPACT agreed to exclude the 27% interest in the three concessions.

On October 24, 2011, the Company acquired an option to purchase the past producing San Acacio Mine located less than 5 km from the Santa Gabriela mill as part of the Zacatecas Silver District.

On December 2, 2011, the Company completed a share subdivision of its outstanding share capital on the basis of three new common shares for every two existing common shares outstanding.

On February 24, 2012, the Company completed the application for the 29,000 Ha Minerva mining claim in the historic Minerva Mining District in the state of Coahuila, Mexico.

On July 24, 2012, the Company renegotiated the terms for the purchase of the San Acacio Mine that allows for the extension of the option period to September 2015. In April and September 2012, the Company raised a total of \$1,455,550 in two private placements to fund acquisitions, exploration and development programs.

On October 25, 2012 the Company announced a 43-101 compliant resource for the San Acacio Mine as follows.

| Resource Category | Tonnage(mt) | Grade Ag (g/t) | Contained Ag (million oz) |
|-------------------|-------------|----------------|---------------------------|
| Total Indicated   | 1.15        | 95.8           | 3.55                      |
| Total Inferred    | 2.89        | 134.1          | 12.45                     |
| Including         | 0.72        | 236.7          | 5.49                      |

On November 30, 2012 Matthew Kavanagh was appointed as Chief financial Officer.

On December 11, 2012 Ron Sowerby and Brian Robertson were appointed to the Board of Directors.

On March 15, 2013, the Company repriced 397,225 warrants from an exercise price of \$0.65 per share to \$0.30 per share and extended the term of these warrants and 175,025 warrants exercisable at \$0.65 for 1 year with a new expiry date of April 17, 2014.

On April 12, 2013, the Company repriced 937,500 warrants from an exercise price of \$0.21 per share to \$0.25 per share and extended the term of these warrants for 1 year with a new expiry date of April 15, 2014.

On July 9, 2013 the Company renegotiated terms of the option agreement with IMPACT Silver Corp. The term of the option was extended to September 9, 2015 with interim payments of \$10,000 or 150,000 common shares of the Company on September 9, 2013 (paid 150,000 common shares of the company) and \$ 25,000 or 350,000 common shares of the company on September 9, 2014. The form of the interim payments is at the discretion of DEF.

On July 19, 2013 the Company completed a private placement totalling \$215,000. Terms of the private placement were the sale of 2,150,000 units with each Unit comprised of one common share and one-half of one transferable share purchase warrant ("Warrant"), each whole Warrant entitling the holders to acquire one additional common share for a period of 24 months at an exercise price of \$0.15 per share if exercised during the first year and thereafter at a price of \$0.20 per share.

On July 25, 2013 the Company renegotiated payment terms for the US\$150,000 payment due on September 27, 2013 under the San Acacio option agreement. The revised payment terms call for four quarterly payments of US\$37,500 commencing on September 27, 2013.

On September 27, 2013, the Company made the initial quarterly payment of US\$37,500 due under the option to purchase agreement for the San Acacio mine.

### **Mineral Property Review**

*This review has been prepared by the Company's geologic staff under the supervision of Bruce Winfield, P.Ge., President, CEO and Director of the Company, and a Qualified Person ("QP") as defined by National Instrument 43-101 (Standards of Disclosure for Mineral Projects).*

The Company currently owns, or has the right to acquire an interest in two properties and has applied for a third property, all of which are located in Mexico (the Santa Gabriela, San Acacio Mine, and the Minerva Properties).

### **Santa Gabriela Processing Plant**

The Company entered into an option agreement with IMPACT Silver Corp. for the acquisition of the Santa Gabriela processing plant in the historic Zacatecas Silver District, Mexico. The Santa Gabriela processing plant consists of the Santa Gabriela (formerly Veta Grande) processing plant and associated surface rights, as well as a 100% interest in 10 mining.

In accordance with terms of the option agreement, the Company issued 2,680,500 common shares on February 28, 2012 to IMPACT Silver Corp. and is obligated to pay IMPACT Silver Corp \$1,955,200 on the earlier of (i) two years from the execution date of the agreement and (ii) the date the Company begins the commercial processing of ore at the Mill, before title is passed to Defiance Silver Corp. The first day of commercial processing of ore at the Mill is defined as the first day after the Mill has achieved production averaging 160 tonnes per day over a 30 day period. On July 9, 2013 the Company renegotiated terms of the option agreement with IMPACT Silver Corp. The term of the option was extended to September 9, 2015 with interim payments of \$10,000 or 150,000 common shares of the Company on September 9, 2013 (paid 150,000 common shares of the company) and \$25,000 or 350,000 common shares of the company on September 9, 2014. The form of payment is at the discretion of DEF.

The Santa Gabriela flotation plant which first started in the mid 1990's, custom treated mineral from various mines in the district, including the San Acacio mine, until 2010 when it was shut down. The mill is located approximately 5 kilometers north of the city of Zacatecas. Services are excellent in the area with access via paved roads to the property boundary and power from the state electrical grid. The mill is located on a property with 16 hectares of surface rights that provides ample room for the current facilities as well room for future expansion.

The 10 mining concessions host old workings from various historic mining operations which principally exploited epithermal vein structures mainly for silver with minor base metals and gold. The Company plans to investigate both the exploration potential of the concessions as well as the numerous mine dumps from the historic operations as a possible source of feed for the Santa Gabriela mill.

Plans for the immediate future include continuing permitting for the refurbishment of the Santa Gabriela plant and bringing it back into production. The company currently has the Impacto Ambiental (Environmental Study) and the Cambio de Uso de Suelos (rezoning) permits. The Company has applied for the water use and construction in a Federal Zone permits from Conagua and anticipates that they will be granted in the near future.

### **San Acacio Silver Mine**

On October 24, 2011, the Company optioned from a private Mexican company, the right to acquire a 100% interest in the San Acacio silver mine located in the historic Zacatecas Silver District, Mexico. The past producing San Acacio mine consisting of 10 mining concessions totaling 7.46 km<sup>2</sup>, hosts the southeastern portion of the Veta Grande vein system.

On signing the option agreement October 24, 2011, the Company paid US\$25,000 for an initial 90 day period for evaluation and due diligence. This period was extended for a further 90 days on payment of US\$50,000. The option to purchase was for a period of 9 months with a purchase price of US\$5.5 million. On July 24, 2012, the Company renegotiated the terms for the purchase of the San Acacio Mine extending the option period to September 2015 with interim payments of US\$150,000 and US\$225,000 on September 27, 2013 and September 27, 2014 respectively. On July 25, 2013 the Company renegotiated payment terms for the US\$150,000 payment due on September 27, 2013 under the San Acacio option agreement. The revised payment terms call for four quarterly payments of US\$37,500 commencing on September 27, 2013. On September 27, 2013 the initial quarterly payment was made. The purchase agreement also provides for a 2.5% net smelter return royalty payable to the vendor on production from the property. The Company will have the right to purchase the royalty at any time. For five years from the date of the agreement, the purchase price is US\$2.5 million. Thereafter the purchase price will escalate with the official Mexican Inflation Index. Following the first anniversary of the purchase of the assets, the Company must make minimum annual royalty payments of US\$125,000. The minimum royalty commitment terminates in the event that the minimum royalty paid is equal to or higher than the equivalent to US\$125,000 during 6 consecutive months.

Under terms of the purchase agreement, the Company can also purchase: surface rights covering 12 ha controlling the adit access to the underground workings for US\$5,000; and surface rights covering 12.0246 ha on which are located approximately 300,000 tonnes of tailings from the former San Acacio mine. The tailings can be purchased for a price of US\$1.50 per tonne with the tonnage determined by future work programs.

The San Acacio Mine controls approximately 5.6 kilometers of the 8.5 kilometer long Veta Grande vein system, one of the three major vein systems within the Zacatecas Silver District that has produced over 700 million ounces of silver since 1546. Veta Grande is a classic epithermal silver rich vein system with accessory gold and base metal credits. The San Acacio Mine has been exploited over a strike length of 1.0 kilometers to an average depth of 210 meters. Three shallow exploration shafts were also made prior to 1900 along the vein for an additional 600 meters along strike to the southeast. The structure, which is believed to exist over a further four kilometers of strike length to the southeast, has not had any modern exploration.

San Acacio has a 43-101 compliant resource as follows (refer to news release dated October 25, 2011):

| Resource Category | Tonnage(mt) | Grade Ag (g/t) | Contained Ag (million oz) |
|-------------------|-------------|----------------|---------------------------|
| Total Indicated   | 1.15        | 95.8           | 3.55                      |
| Total Inferred    | 2.89        | 134.1          | 12.45                     |
| Including         | 0.72        | 236.7          | 5.49                      |

The Company has been carrying out compilation and reinterpretation of the existing data. A new 43-101 resource will be calculated based on the results and assuming an underground mining scenario. An exploration program has been designed to explore potential for the vein structure to host additional mineral both down dip below the historic workings as well as along strike. Surface sampling is also planned for metallurgical testing of the various mineralogical zones within the historically mined areas. Mineral from the San Acacio mine is planned to be feed stock for the Santa Gabriela processing plant.

### **Minerva Property**

Defiance has applied for the Minerva property located in northern Mexico. The property comprises approximately 29,000 ha covering a district with a series of old artisanal mine workings from the 1980's with very limited production from a small stamp mill. Access is good via a series of paved and dirt roads. However, only limited modern exploration has been carried out. Silver-lead-zinc mineralization occurs as carbonate replacement and skarn bodies within a well developed limestone-siltstone sequence and is related to a series of granite to diorite igneous intrusions. The deposit model for the area is the La Encantada deposit being mined by First Majestic Corp (previously mined by Penoles). La Encantada currently has a total reserve and resource of the following:

| Resource Category    | Tonnage (mt) | Grade Ag (g/t) | Contained Ag (million oz) |
|----------------------|--------------|----------------|---------------------------|
| Proven + Probable    | 7.8          | 156            | 39                        |
| Measured + Indicated | 5.9          | 181            | 34.5                      |
| Inferred             | 2.9          | 233            | 21.6                      |

Ref: First Majestic Silver Corp website October 2013

Management plans to initially carry out a regional satellite imagery alteration study and prospecting to define areas for more follow up of mapping, sampling and possibly ground geophysics.

## **Results of Operations**

### **Summary of Quarterly Results**

The following tables summarize information derived from the Company's financial statements for each of the eight most recently completed quarters:

|                    | <b>2014Q1</b> | <b>2013Q4</b> | <b>2013Q3</b> | <b>2013Q2</b> |
|--------------------|---------------|---------------|---------------|---------------|
| Net loss           | \$ 141,377    | \$ 243,262    | \$ 176,670    | \$ 326,735    |
| Net loss per share | \$ 0.01       | \$ 0.01       | \$ 0.01       | \$ 0.01       |

  

|                    | <b>2013Q1</b> | <b>2012Q4</b> | <b>2012Q3</b> | <b>2012Q2</b> |
|--------------------|---------------|---------------|---------------|---------------|
| Net loss           | \$ 143,987    | \$ 693,078    | \$ 205,866    | \$ 140,923    |
| Net loss per share | \$ 0.01       | \$ 0.04       | \$ 0.01       | \$ 0.01       |

### **Quarter ended September 30, 2013**

For the quarter ended September 30, 2013, the Company incurred a net loss of \$141,377 (2012 - \$143,987) or \$0.01 (2012 - \$0.01) per share. The net loss primarily relates to expenses incurred for management, legal and audit, general corporate and regulatory fees, and travel costs. The Company paid or accrued \$76,613 in management fees during the quarter ended September 30, 2013 compared to \$79,242 during the quarter ended September 30, 2012. Legal and audit fees were \$2,745 during the current quarter compared to \$10,799 during the comparative quarter.

The Company spent \$197,152 cash on operating activities during the quarter ended September 30, 2013 as compared to \$249,295 during the quarter ended September 30, 2012.

The Company's cash decreased \$28,881 from \$81,712 as at June 30, 2013 to \$52,831 as at September 30, 2013. Cash resources used in operations during the quarter ended September 30, 2013 totaled \$158,559 and cash resources used in investing activities during the quarter was \$70,507 for expenditures on mineral property interests. Financing activities provided \$200,185 cash resources from equity financings.

### **Liquidity**

The Company is in the acquisition and early exploration stage and therefore has no cash flow from operations. At September 30, 2013, the Company had cash of \$52,831 (June 30, 2013 - \$81,712) and a working capital deficiency of \$133,347 (June 30, 2013 - \$159,187).

At present, the Company's operations do not generate cash flows and its financial success is dependent on management's ability to discover economically viable mineral deposits. The mineral exploration process can take many years and is subject to factors that are beyond the Company's control.

## Capital Resources

The Company will continue to seek capital through public markets by issuing common shares pursuant to private placements. The Company manages its capital structure to maximize its financial flexibility making adjustments to it in response to changes in economic conditions and the risk characteristics of the underlying assets and business opportunities. The Company does not presently utilize any quantitative measures to monitor its capital and is not subject to externally imposed capital requirements.

## Outstanding Share Data

As at the date of this report, the Company had 24,097,750 common shares issued and outstanding. The following incentive stock options and warrants are outstanding at the date of this report:

|               | <u>Number</u> | <u>Exercise Price</u> | <u>Expiry Date</u> |
|---------------|---------------|-----------------------|--------------------|
| Stock Options | 405,000       | \$ 0.13               | August 6, 2014     |
|               | 675,000       | 0.33                  | June 6, 2016       |
|               | 120,000       | 0.60                  | December 19, 2016  |
|               | 680,000       | 0.265                 | November 22, 2017  |
|               | 250,000       | 0.265                 | December 10, 2017  |
| Warrants      | 937,500       | 0.25                  | April 15, 2014     |
|               | 397,225       | 0.30                  | April 17, 2014     |
|               | 175,025       | 0.65                  | April 17, 2014     |
|               | 1,075,000     | 0.15                  | July 22, 2015      |

## Off-Balance Sheet Arrangements

The Company does not have any off-balance sheet arrangements as at September 30, 2013 or as of the date of this report.

## Related Party Transactions

As at September 30, 2013, accounts payable and accrued liabilities include \$171,940 (June 30, 2013 - \$133,366) payable to directors, officers and companies controlled by directors and/or officers. Amounts payable to related parties have no specific terms of repayment, are unsecured and do not bear interest.

During the quarter ended September 30, 2013, the Company:

- (a) paid or accrued management fees of \$26,250 (2012 – \$33,750) to a company controlled by the CEO, President and director of the Company.
- (b) paid or accrued management fees of \$15,763 (2012 – \$14,992) to an officer of the Company.

- (c) paid or accrued management fees of \$8,100 (2012-\$10,500) to a company controlled by a director of the Company
- (d) paid or accrued management fees of \$7,500 (2012 - \$2,000) to an officer of the Company.
- (e) paid or accrued \$6,000 (2012-\$6,000) in rent expense, included in office and administration, to a company related by common directors.

### **Proposed Transactions**

At the present time, there are no proposed transactions that should be disclosed.

### **Risks and Uncertainties**

#### *No Source of Revenue*

The Company has no source of revenue other than interest income earned on cash held in investment accounts. All of the Company's short to medium-term operating and project expenses must be derived from its existing cash position or from external financing.

#### *Unproven Mineral Right Interests*

The Company has not been able to identify a known body of commercial grade ore on its mineral property interests. The ability of the Company to realize the costs it has incurred to date on these mineral property interests is dependent upon the Company being able to lever its property interests and cash, by way of exploration activities and option/joint ventures, into assets of greater value.

### **Financial Instruments**

The Company's financial instruments consist of cash, receivables and accounts payable and accrued liabilities. Unless otherwise noted, it is management's opinion that the Company is not exposed to significant interest, currency or credit risks arising from the financial instruments. The fair value of the financial instruments approximates their carrying value due to their short-term maturity or capacity of prompt liquidation.

Foreign exchange risk is the risk arising from changes in foreign currency fluctuations. The Company does not use any derivative instruments to reduce its exposure to fluctuations in foreign currency rates. It is the opinion of management, however, that the foreign exchange risk to which the Company is exposed is minimal.

### **Critical Accounting Policies and Estimates**

The Company's significant accounting policies are described in Note 2 of the consolidated financial statements for the year ended June 30, 2013. Management considers the following policies to be critical in understanding the judgments that are involved in the preparation of the financial statements and the uncertainties that could impact the results of operations, financial condition and cash flows:

#### Use of estimates

The preparation of consolidated financial statements in accordance with accounting policies consistent with IFRS requires management to make estimates and assumptions that affect the



reported amount of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the year. Actual results could differ from these estimates. Significant accounts that require estimates relate to the impairment of mineral property interests, valuation allowance applied against future income tax assets and share-based compensation.

### Mineral property interests

The Company defers all costs related to investments in mineral properties on a property-by-property basis. Such costs include mineral property acquisition costs and exploration expenditures, net of any recoveries. Costs are deferred until such time as the extent of mineralization has been determined and mineral properties are either developed or the Company's mineral rights are allowed to lapse.

All deferred mineral property expenditures are reviewed each reporting period, on a property-by-property basis, to consider whether there are any conditions that may indicate impairment. When the carrying value of a property exceeds its net recoverable amount that may be estimated by quantifiable evidence of an economic geological resource or reserve, joint venture expenditure commitments or the Company's assessment of its ability to sell the property for an amount exceeding the deferred costs, provision is made for the impairment in value.

From time to time, the Company may acquire or dispose of a mineral property pursuant to the terms of an option agreement. As the options are exercisable entirely at the discretion of the optionee the amounts payable or receivable are not recorded. Option payments are recorded as property costs or recoveries when the payments are made or received.

### Income taxes

Income tax on the profit or loss for the periods presented comprises current and deferred tax. Income tax is recognized in profit or loss except to the extent that it relates to items recognized directly in equity, in which case it is recognized in equity. Current tax expense is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at period end, adjusted for amendments to tax payable with regards to previous years.

Deferred tax is recognized in respect of temporary differences, between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The following temporary differences are not provided for: goodwill not deductible for tax purposes; the initial recognition of assets or liabilities which affect neither accounting nor taxable loss as well as differences relating to investments in subsidiaries to the extent that they will probably not reverse in the foreseeable future. The amount of deferred tax provided is based on the expected manner of realization or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the consolidated statement of financial position date.

A deferred tax asset is recognized only to the extent that it is probable that future taxable profits will be available against which the asset can be utilized.

Additional income taxes that arise from the distribution of dividends are recognized at the same time as the liability to pay the related dividend. Deferred tax assets and liabilities are

offset when there is a legally enforceable right to set off current tax assets against current tax liabilities and when they relate to income taxes levied by the same taxation authority and the Company intends to settle its current tax assets and liabilities on a net basis.

### Share-based compensation

The Company accounts for stock-based compensation using a fair value based method with respect to all stock-based payments to directors, employees and non-employees. For directors and employees, the fair value of the options is measured at the date of grant. For non-employees, the fair value of the options is measured on the earlier of the date at which the counterparty performance is completed or the date the performance commitment is reached or the date at which the equity instruments are granted if they are fully vested and non-forfeitable. The fair value of the options is accrued with the offset credit to contributed surplus. For directors and employees the fair value is recognized over the vesting period and for non-employees the fair value is recognized over the related service period. If and when the stock options are ultimately exercised, the applicable amounts of contributed surplus are transferred to share capital.

The Company grants stock options to acquire common shares of the Company to directors, officers, employees and consultants. An individual is classified as an employee when the individual is an employee for legal or tax purposes, or provides services similar to those performed by an employee.

The fair value of stock options is measured on the date of grant, using the Black-Scholes option pricing model, and is recognized over the vesting period. Consideration paid for the shares on the exercise of stock options is credited to share capital.

In situations where equity instruments are issued to non-employees and some or all of the goods or services received by the entity as consideration cannot be specifically identified, they are measured at fair value of the share-based payment. Otherwise, share-based payments are measured at the fair value of goods or services received.

### **Note Regarding Forward-Looking Statements**

Except for historical information, this MD&A may contain forward-looking statements. The statements involve known and unknown risks, uncertainties, and other factors that may cause the Company's actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievement expressed or implied by these forward-looking statements.

The factors that could cause actual results to differ materially include, but are not limited to, the following: general economic conditions; changes in financial markets; the impact of exchange rates; political conditions and developments in countries in which the Company operates; changes in the supply, demand and pricing of the metal commodities which the Company hopes to find and successfully mine; changes in regulatory requirements impacting the Company's

operations; the sufficiency of current working capital and the estimated cost and availability of funding for the continued exploration and development of the Company's exploration properties.

This list is not exhaustive and these and other factors should be considered carefully, and readers should not place undue reliance on the Company's forward-looking statements. As a result of the foregoing and other factors, no assurance can be given as to any such future results, levels of activity or achievements and neither the Company nor any other person assumes responsibility for the accuracy and completeness of these forward-looking statements (except as required by applicable law).

Additional information relating to the Company can be found on SEDAR at [www.sedar.com](http://www.sedar.com).