Alhambra Resources Ltd.
Management's Discussion and Analysis of Financial Condition and Results of Operations
For the Six Months Ended June 30, 2012 (US Dollars)

This management's discussion and analysis ("MD&A") focuses on key items from the unaudited consolidated financial statements of Alhambra Resources Ltd. (also referred to as "Alhambra" or the "Corporation") for the six months ended June 30, 2012 and the factors reasonably expected to impact future operations and results as prepared on August 27, 2012. This discussion should not be considered all-inclusive, as it excludes changes that may occur in general economic, political and environmental conditions. Additionally, other matters may occur which could affect the Corporation in the future. This discussion should be read in conjunction with the unaudited consolidated financial statements of the Corporation for the six months ended June 30, 2012 and the related notes and the audited consolidated financial statements for the Corporation for the year ended December 31, 2011 and related notes. The financial statements have been prepared in accordance with International Financial Reporting Standards and are reported in US$000's except as otherwise stated.

This MD&A was reviewed and approved by the Corporation's audit committee and board of directors on August 27, 2012. Additional information on the Corporation is available under the Corporation's profile on SEDAR at www.sedar.com.

Forward-Looking Information

Except for the statements of historical fact contained herein, certain statements contained in this MD&A constitute "forward-looking statements" as such term is used in applicable Canadian and US laws. These statements relate to analyses and other information that are based on forecasts of future results, estimates of amounts not yet determinable and assumptions of management. In particular, any statements concerning the Corporation's ability to continue as a going concern as described, statements concerning the strategy of advancing the Uzboy Gold Deposit ("Uzboy") towards pre-feasibility, the formalization of a development plan, converting inferred resources to mineral reserves by conducting additional exploration and other factors and events described in this MD&A should be viewed as forward-looking statements to the extent that they involve estimates thereof. Any statements that express or involve discussions with respect to predictions, expectations, beliefs, plans, projections, objectives, assumptions or future events or performance (often, but not always, using words or phrases such as "expects" or "does not expect", "is expected", "anticipates" or "does not anticipate", "plans", "estimates" or "intends", or stating that certain actions, events or results "may", "could", "would", "might" or "will" be taken, occur or be achieved) are not statements of historical fact and should be viewed as "forward-looking statements". Such forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of the Corporation to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Such risks and other factors include, among others, the Corporation's liquidity and financial capacity, the Corporation's funding sources to meet various obligations, advancing the project towards pre-feasibility, formalizing a development plan, lack of financing in order to convert inferred resources to mineral reserves through additional exploration, costs and timing of exploration and production development, availability of capital to fund exploration and production development or meet working capital requirements; political, social and other risks inherent in carrying on business in a foreign jurisdiction, the effects of a recessionary economy and such other business risks as discussed herein and other publicly filed disclosure documents. Although the Corporation 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 not to be anticipated, estimated or intended. There can be no assurance that such statements will prove to be accurate as actual results and future events could vary or differ materially from those anticipated in such statements. Accordingly, readers should not place undue reliance on forward-looking statements contained in this MD&A.

Forward-looking statements are made based on management's beliefs, estimates and opinions on the date the statements are made and the Corporation undertakes no obligation to update forward-looking statements if these beliefs, estimates and opinions or other circumstances should change, except as required by applicable law.

Measurement Uncertainty

Management makes estimates and assumptions that affect the reported amounts of assets and liabilities as at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those reported. Significant areas requiring the use of management estimates include the determination of impairment of property, plant and equipment and exploration and evaluation costs, provisions, and assumptions used in calculating share-based compensation expense. These estimates are reviewed periodically and, as adjustments become necessary, they are reported in earnings in the periods in which they become known.

Business Overview

The Corporation was incorporated on January 27, 1993 and amalgamated with its wholly-owned subsidiaries, Signature Capital Corp. and Tarco Oil & Gas Ltd., effective January 1, 2002.

On July 31, 2007 the Corporation's shareholders approved a reorganization by way of an arrangement under the *Business Corporations Act* (Alberta) (the "Arrangement") involving the Corporation, its shareholders and a newly incorporated corporation, DOT Resources Ltd. ("DOT").

Under the Arrangement, which became effective on August 29, 2007, the Corporation divided its mineral assets between two separate publicly traded corporations. Except for the period from December 26, 2008 through September 15, 2009, the Corporation continued to hold and operate its gold producing assets situated in Kazakhstan. DOT holds and conducts exploration activities on the Corporation's former Canadian DOT property, situated near Kamloops, British Columbia ("DOT Property").

Pursuant to the Arrangement, the DOT Property was transferred to DOT at its carrying amount of $944,666 in exchange for 30,000,000 common shares. Every shareholder of the Corporation received one (1) new common share and 0.21153 of a DOT common share for every one (1) common share of the Corporation held on the effective date of the Arrangement resulting in 15,000,000 DOT common shares held by Alhambra being distributed to Alhambra shareholders on a pro rata basis. As a result of the Arrangement, Alhambra holds 15,000,001 shares of DOT which represents approximately 27% of the 55,734,333 common shares of DOT currently outstanding. At June 30, 2012, the market trading value of the 15,000,001 DOT shares owned by Alhambra was CDN$600.

On September 26, 2008 a statement of claim ("Kazakhstan Lawsuit") was filed in the Specialized Interdistrict Economical Court of the East-Kazakhstan Oblast ("Lower Court") of the Republic of Kazakhstan ("Kazakhstan") by the Vendors seeking to invalidate Alhambra's ownership of its Kazakhstan Subsidiaries. The basis for the claim was that the Corporation's 100% owned subsidiary, Alhambra Overseas Limited, incorporated to hold Alhambra's interest in the Kazakhstan Subsidiaries, was not incorporated at the time the Agreement was initially entered into, despite the fact that such incorporation was subsequently completed soon thereafter. Alhambra applied to the Lower Court to have the litigation dismissed for the lack of jurisdiction, however, such application was denied as was the appeal to the Civil Cases Review Board of the East-Kazakhstan Oblast Court (the "Review Board"). As a result, hearings in the Lower Court on the merits of the case began on November 17, 2008 and were completed on November 24, 2008. On November 25, 2008 the Lower Court rendered its decision in favor of the Vendors. The Corporation appealed the Lower Court's decision to the Review Board, but on December 26, 2008 the Review Board issued its ruling upholding the Lower Court's decision. The Corporation appealed to the next level of the court system in Kazakhstan which was the Supervisory Chamber of the East-Kazakhstan Oblast Court whose decision, rendered on February 27, 2009, again upheld the decisions of the previous courts. On January 27, 2009 the ownership of the Kazakhstan Subsidiaries was re-registered back in the names of the Vendors giving effect to the court decisions. As a result of the decision, the assets and liabilities related to the Kazakhstan mineral operations were written off as of December 26, 2008 as the Corporation ceased to control the Kazakhstan Subsidiaries.

On April 16, 2009 the Corporation filed an appeal with the Supreme Court of Kazakhstan ("Supreme Court") asking the Supreme Court to overturn the decisions of the lower courts. The Supreme Court hearing was held on August 12, 2009 at which time the Supreme Court reversed the decisions of the Lower Courts and dismissed the Vendors' claim. On September 15, 2009 the ownership of the shares of the Kazakhstan Subsidiaries was re-registered in the name of Alhambra and the Corporation commenced operations on that date.

Selected Annual Operating and Financial Information

	2012	2011
Operating (for the six months ended June 30 except as noted below):		
Mining:		
Waste mined (Tonnes ("T"))	403,952	899,134
Ore stacked (T)	136,220	320,065
Grade of ore mined (Grams/T)	0.57	0.83
Recoverable gold mined (Troy ounces (oz)) (1)	1,620	5,557
Gold sales (ozs)	3,388	3,803
Gold inventory (ozs) (2) (3)	–	615
Gold in work in progress (ozs) (3)	40,071	41,224
Financial (for the six months ended June 30 except as noted below):		
Revenue ($)	5,633	5,543
Average gold price ($/oz)	1,663	1,458
Operations expenses ($)	2,858	3,375
Operations expenses ($/oz)	844	887
Net (loss) ($)	(1,272)	(3,751)
Net (loss) per share:		
Basic and Diluted ($/share)	(0.01)	(0.04)
Capital expenditures ($)	1,040	1,636
Total assets ($) (3)	112,904	112,339
Shareholders' equity ($) (3)	72,261	72,146
Common shares outstanding at year end (3)	104,132,059	104,132,059

Notes:

1. Recoverable gold mined is estimated to be equal to 65% of estimated total gold stacked.
2. Gold inventory at December 31, 2011 represents 615 ounces of gold in transit to the refinery for final processing and sale.
3. Amounts for 2011 are as of December 31, 2011.

The Corporation continues to mine substantially all its ore from the east zone of Uzboy. During the six months ended June 30, 2012, the Corporation sold a total of 3,388 ounces ("ozs") of gold for total proceeds of $5.6 million. This compares to sales of 3,803 ozs and $5.6 million of sales during the six months ended June 30, 2011. At December 31, 2010, an estimated 41,224 ozs of gold had been stacked and was in various stages of processing for sale ("work in progress") and the Corporation had 615 ozs of gold inventory in transit. During the six months ended June 30, 2012 an additional estimated 1,620 ozs of gold was stacked which, after selling 3,388 ozs, resulted in an estimated balance of 40,071 ozs in work in progress at June 30, 2012.

During the six months ended June 30, 2012, the Corporation mined a total of 403,952 T of waste and stacked 136,220 T of ore at an average gold grade of 0.57 grams/T ("g/t"). This compares to 899,134 T of waste mined and 320,065 T of ore stacked at an average gold grade of 0.83 g/t during the six months ended June 30, 2011.

Financial Review

Segmented information

The Corporation and its subsidiaries operate in one reportable segment, the exploration for and development of mineral properties in Kazakhstan and therefore presentation geographically is the most appropriate. Identifiable assets, revenues and net income (loss) in each of its geographic are as disclosed in note 18 (*'Operating segments'*) to the June 30, 2012 unaudited consolidated financial statements.

Sales revenue

Revenue is recognized from the sale of gold when the price is determinable, the product has been delivered and title has been transferred to the customer and collection of the sales price is reasonably assured. The Corporation ships cathodic sediment to a refinery in Italy where the final refining process takes place and the gold is sold. The Corporation sells all of its gold to one supplier.

During the six months ended June 30, 2012 the Corporation recognized $5,633 in revenue from the sale of 3,388 ozs of gold at an average price of $1,663/oz. During the six months ended June 30, 2011 the Corporation recognized $5,543 in revenue from the sale of 3,803 ozs of gold at an average price of $1,458/oz.

During the three months ended June 30, 2012 the Corporation recognized $2,506 in revenue from the sale of 1,542 ozs of gold at an average price of $1,625/oz. During the three months ended June 30, 2011 the Corporation recognized $3,077 in revenue from the sale of 2,033 ozs of gold at an average price of $1,514/oz.

The increase in revenue for the six months ended June 30, 2012 over the comparable six month period in 2011 was a result of a 14% increase in average gold prices which offset an 11% decrease in sales volumes. While average gold prices in the three months ended June 30, 2012 increased 7% over comparable average gold prices in 2011, the price increases were not sufficient to offset the 24% decline in gold sales volumes. The decrease in sales volumes was the result of lower quantities of new ore at lower grades being stacked. Early in 2012 mechanical issues with the Corporation's mining contractor's equipment resulted in less new ore being stacked on the heap. In addition, as of June 15, 2012, due to financial issues, stacking of new ore on the heap has been suspended. As a result gold sales are currently being generated from the inventory of ore on the heaps. Alhambra anticipates that stacking of fresh ore will resume in the fourth quarter.

Net smelter royalty

The net smelter royalty ranges from 2.5 to 3.0% (dependent on the price of gold) of gross revenue. During the six months ended June 30, 2012, the Corporation recognized $169 in net smelter royalty expenses as compared to $166 for the six months ended June 30, 2011, which is 3% (2011 – 3%) of the revenue recognized in the period. During the three months ended June 30, 2012, the Corporation recognized $75 in net smelter royalty expenses as compared to $92 for the three months ended June 30, 2011, which is 3% (2011 – 3%) of the revenue recognized in the period.

Cost of sales

Operating expenses consist of all costs associated with the production of gold, (including direct costs incurred in the mining, leaching and resin stripping processes ("Process Operating Costs"), Mineral Extraction Tax ("MET")), transportation and refining of the cathodic sediment. All process operating costs are charged to work in progress and are expensed on the basis of the quantity of gold sold as a percentage of total recoverable gold mined.

Operating costs for the six months ended June 30, 2012 were $2,858 or $844/oz of gold sold as compared to $3,375 or $887/oz of gold sold for the six months ended June 30, 2011. Operating costs for the three months ended June 30, 2012 were $1,217 or $789/oz of gold sold as compared to $1,873 or $921/oz of gold sold for the three months ended June 30, 2011.

Included in the operating cost amount for the six months ended June 30, 2012 is $244 or $72/oz related to the amortization of the bump-up to fair value from the estimated cost of work in progress on re-valuation in 2009. Cash operating costs were therefore $772/oz. In the six months ended June 30, 2011, $507 or $133/oz of similar costs were included in operating costs resulting in the cash cost of gold sold for this period of $754/oz.

For the three months ended June 30, 2012, $132 or $86/oz (three months ended June 30, 2011 - $261 or $129/oz) related to the amortization of the bump-up to fair value from the estimated costs of work in progress resulting $703/oz and $792/oz of cash costs, respectively.

Administrative expenses

For the six months ended June 30,		2012		2011
Canada				
Share-based compensation	$	329	$	2,109
Cash based corporate overhead costs		726		1,182
Total Canada		1,055		3,291
Kazakhstan		582		1,439
	$	1,637	$	4,730

For the three months ended June 30,		2012		2011
Canada				
Share-based compensation	$	132	$	754
Cash based corporate overhead costs		353		474
Total Canada		485		1,228
Kazakhstan		410		983
	$	895	$	2,211

Administrative expenses for the six months ended June 30, 2012 were $1,637, a decrease of $3,093 from the $4,730 recorded in the six months ended June 30, 2011. Of the totals, $582 related to the Saga Creek operations for the six months ended June 30, 2012 as compared to $1,439 for the comparable six month period in 2011.

Administrative expenses for the three months ended June 30, 2012 were $895, a decrease of $1,316 from the $2,211 recorded in the three months ended June 30, 2011. Of the totals, $410 related to Saga Creek's operations for the three months ended June 30, 2012 as compared to $983 for the comparable month period in 2011.

Included in the $582 recorded in the six months ended June 30, 2012 was a recovery of $158 of penalties that had been accrued in prior periods related to the assessment by the tax authorities in Kazakhstan disallowing certain income tax deductions (see note 21 (*'Legal challenge of tax assessment'*) to the June 30, 2012 unaudited consolidated financial statements and the Legal challenge of tax assessment section of the MD&A). Included in the $1,439 recorded in the six months ended June 30, 2011 was $397 of potential penalties related to the assessment by tax authorities in Kazakhstan of Historical Costs (see note 21 (*'Legal challenge of tax assessment'*) to the June 30, 2012 unaudited consolidated financial statements and the Legal challenge of tax assessment section of the MD&A). When the effects of these two tax related items are removed from the Saga Creek administration costs, the remaining administrative cost amounts for Saga Creek were $740 and $1,042 for the six months ended June 30, 2012 and 2011, respectively.

The remainder of administrative expenses relates to corporate activities and is comprised of share-based compensation and cash based corporate overhead. Share-based compensation totaled $329 and $132 for the six and three months ended June 30, 2012 as compared to $2,109 and $754 for the six and three months ended June 30, 2011. Due primarily to the high volatility of the Corporation's stock price, this calculation results in the value assigned to stock options approaching the actual option grant price. As a result, the higher the option price, the higher the value assigned to the options for purposes of share-based compensation expense. Both amounts relate primarily to the amortization of the value calculated for the 3,050,000 options granted in January of 2011 at a price of $1.05 per share however by June 30, 2012, these options were almost entirely vested resulting in the significant decrease in share-based compensation expense.

Cash based corporate overhead expenses for the six and three months ended June 30, 2012 totaled $726 and $353 as compared to $1,182 and $474 for the six and three months ended June 30, 2011. Reductions in professional costs and public company expenses accounted for the biggest portion of the decrease in cash based corporate overhead expenses for both the six month and three month periods ending June 30, 2012 as compared to the corresponding periods in 2011. In the six months ended June 30, 2011 professional costs associated with the conversion to International Financial Reporting Standards ("IFRS") and the 2010 year end audit greatly exceeded the Corporation's estimate and accrual in 2010 with the difference being expensed in 2011. As part of the audit, work was done to remove the audit qualification that Alhambra received on its 2008 annual financial statements because of the loss of the Kazakhstan subsidiaries. With the re-acquisition on September 15, 2009 it was then possible to clear up that qualification which was required in order for the Corporation to pursue a dual listing on an Asian exchange. As the Corporation maintains a small professional accounting staff, it was necessary to contract professional help to assist with the conversion, particularly considering that a significant amount of time of Alhambra's employees was being devoted to the work necessary to pursue the dual listing. In addition, in the first quarter of 2011 the Corporation incurred professional costs associated with a review of the Corporation's resources as part of a plan to complete a National Instrument 43-101 report. The investor relations component of public company costs accounted for the decrease in that component of corporate overhead costs as restrictions on the Corporation's available cash in 2012 has caused the Corporation to reduce that activity.

Depletion and depreciation

Depletion and depreciation expense for the six and three months ended June 30, 2012 was $967 and $551 as compared to $1,017 and $572 for the six and three months ended June 30, 2011. Substantially all the amounts for both years relate to the Kazakhstan operation.

Depletion and depreciation charged on the fair value assigned to mineral properties as a result of the re-acquisition at September 15, 2009 is charged to work in progress on the basis of the volume of gold produced as a percentage of total estimated gold resources. It is then expensed on the basis of the quantity of gold sold as a percentage of the quantity of gold estimated to be in work in progress. For the six months ended June 30, 2012, $1,144 (six months ended June 30, 2011 - $2,736) of depletion and depreciation was charged to work in progress. Depletion and depreciation charged to work in progress for the three months ended June 30, 2012 was $768 (three months ended June 30, 2011 - $1,553). The major component of this cost is the depletion of the revaluation amount assigned to the carrying cost of mineral assets. The lower production volumes in 2012 as compared to 2011 were the cause of the reduced depletion and depreciation charged to work in progress. However actual depletion and depreciation expensed for the six and three months ended June 30, 2012 was only slightly lower than in the corresponding periods in 2011 as gold sales volumes did not negatively vary to the same extent as production volumes.

Finance costs

	Three months ended June 30,				Six months ended June 30			
		2012		2011		2012		2011
Interest on overdue taxes	$	29	$	208	$	63	$	375
Reversal of accrued interest on successful tax appeal		(7)		–		(132)		–
Extension of warrants		–		–		1,394		–
Unwinding of the discount on provisions		–		89		2		178
Interest on trade payables		20		–		42		–
Foreign exchange loss (gain)		366		125		283		(99)
Total finance costs	$	408	$	422	$	1,652	$	454

During the six months ended June 30, 2012 the Corporation recorded total net finance costs of $1,652 as compared to $454 for the six months ended June 30, 2011. For the three months ended June 30, 2012 net finance costs were $408 as compared to 422 for the corresponding three month period in 2011

Interest accrued on overdue taxes relates to the taxes being assessed by the government of Kazakhstan that the Corporation has been appealing. For the six months ended June 30, 2012 the $63 reported relates to interest on the Commercial Discovery Bonus assessed late in 2011 (see note 23 (*'Commercial Discovery Bonus'*) to the June 30, 2012 unaudited consolidated financial statements and the Commercial Discovery Bonus section of this MD&A). For the six months ended June 30, 2011 interest on overdue taxes related to Historical costs of $264, the 2009 MET of $80 and disallowance of deductions related to corporate income tax of $31. During the six months ended June 30, 2012, $132 of interest that had been accrued on the disallowance of deductions related to corporate income tax was reversed as a result of the positive decision reached by the tax court (see 21 *'Legal challenge of tax assessment'* to the June 30, 2012 unaudited consolidated financial statements and the Legal challenge of tax assessment section of this MD&A).

During the six months ended June 30, 2012 the Corporation charged $1,394 to financing costs representing the value attributed to the extension of the expiry dates of 2,500,450 warrants which expiry date had already been extended to February 8, 2012, 5,388,690 warrants originally scheduled to expire on February 19, 2012 and 3,913,635 warrants originally scheduled to expire on August 28, 2012 (see note 15(d) (*'Warrants'*) to the unaudited consolidated financial statements and the Share data section of this MD&A).

The foreign exchange losses reported for the six months ended June 30, 2012 and 2011 relate primarily to Saga Creek's outstanding debt to Alhambra which is denominated in US dollars. The Kazakhstan Tenge has fallen in value against the US$ which has resulted in an increase in the Tenge value of the loan on the books of Saga Creek thus creating an unrealized loss.

Income tax expense

Income tax expense recorded relates entirely to Saga Creek. As Saga Creek is a profitable entity, it pays income tax under Kazakhstan law. For the six months ended June 30, 2012, the Corporation recorded an income tax recovery of $382 as compared to a similar recovery of $457 for the six months ended June 30, 2011. The recovery recorded for the six months ended June 30, 2012 was comprised of a current tax recovery of $278 (six months ended June 30, 2011 – expense of $83) and a deferred tax recovery of $104 (six months ended June 30, 2011 – deferred tax recovery of $540).

The current income tax recovery of $278 recorded in the six months ended June 30, 2012 is comprised primarily of a reversal of accrued income taxes of $334 related to the assessment by the tax authorities in Kazakhstan on the disallowance of deductions (see note 21 *'Legal challenge of tax assessment'* to the June 30, 2012 unaudited consolidated financial statements and the Legal challenge of tax assessment section of this MD&A).

At September 15, 2009 Saga Creek recorded a large future income tax liability associated primarily with the fair value assigned to Saga Creek's assets and liabilities. The Corporation is recording future income tax recoveries related to these assets as they are amortized to depletion and depreciation. As a result, Saga Creek recognized a recovery of deferred income tax liabilities previously recorded of $104 during the six months ended June 30, 2012 as compared to a recovery of $540 for the six months ended June 30, 2011.

Effective January 1, 2009 the corporate tax rate in Kazakhstan was reduced to 20% from the previous rate of 30%. Also effective January 1, 2009 the Government of Kazakhstan introduced an excess profits tax. This tax is a progressive tax in that as profits increase, the rate of tax on the increment in excess profits, as defined, also increases. The Corporation has not yet been subject to any excess profits tax.

Net loss

The Corporation recorded a net loss of $1,272 for the six months ended June 30, 2012 compared to a net loss recorded in the six months ended June 30, 2011 of $3,751. The net loss for the six months ended was comprised of net earnings of $1,273 (2011 – net loss of $546) from mining operations and a net loss of $2,545 (2011 - $3,205) from corporate activities.

For the three months ended June 30, 2012 the Corporation recorded a net loss of $1,112 as compared to a net loss of $2,065 for the comparable three month period ended June 30, 2011. The net loss for the three months ended was comprised of a net loss of $543 (2011 – net loss of $966) from mining operations and a net loss of $569 (2011 - $1,099) from corporate activities.

Kazakhstan mining operations for the six months ended June 30, 2012 reported net earnings of $1,273 as compared to a net loss totaling $546 for the six months ended June 30, 2011. The $1,819 improvement in net earnings from mining operations is primarily the result of higher gold prices, lower operating costs based on lower production volumes and penalties and interest recorded in 2011 related to the tax assessments that were subsequently reversed because of the positive court rulings.

For the six months ended June 30, 2012, Canadian corporate losses totaled $2,545, a decrease of $660 over the $3,205 recorded in the six months ended June 30, 2011. Lower share-based compensation expenses, partially offset by the recording of financing costs related to the extension of the expiry dates of outstanding warrants, accounted for the improvement.

Based on a weighted average number of common shares of 104,132,059 for the six months ended June 30, 2012 and 2011, the Corporation's basic and diluted net loss per common share was $0.01 for 2012 and $0.04 for 2011.

For both six month periods ended June 30, 2012 and 2011, options and warrants representing all the options and warrants outstanding were excluded from the dilutive earnings per share calculation as they would be considered anti-dilutive.

Summarized Cash Flows

For the six months ended June 30,		2012		2011
Net cash (used in) operating activities	$	(650)	$	(957)
Net cash provided from financing activities		491		31
Net cash (used in) investing activities		(597)		(1,595)

Operating cash flow

For the six months ended June 30, 2012 and 2011, net cash flows used in operating activities were $650 and $957, respectively which were primarily attributed to positive cash flow from mining operations offset primarily by the increase in work in progress inventories.

Financing cash flow

The Corporation is currently restricted from raising capital through the issue of common share equity because of the Government of Kazakhstan's pre-emptive right (see note 22 (*'Government of Kazakhstan pre-emptive right'*) to the unaudited consolidated financial statements and the Government of Kazakhstan pre-emptive right section of this MD&A). The Company did raise CDN$500 from the issue of a 14% unsecured promissory note with principle and interest thereon due and payable on or before March 31, 2013.

Investing cash flow

For the six months ended June 30, 2012, net cash flow used in investing activities was $597, primarily as a result of the acquisition of property, plant and equipment of $1,040 partially offset by an increase in accounts payable related to investing activities.

For the six months ended June 30, 2011, net cash flow used in investing activities was $1,595, primarily as a result of the acquisition of property, plant and equipment of $1,636 partially offset by an increase in accounts payable related to investing activities.

Selected Balance Sheet Items

Trade and other receivables

Trade and other receivables primarily represent refundable Value Added Tax ("VAT") and amounts receivable from the sale of gold. VAT is paid by the Corporation on goods and services purchased in Kazakhstan and utilized in its operations. At June 30, 2012 the balance outstanding on account of VAT was $979 (December 31, 2011 - $624). The Corporation applies for a refund of VAT in the first quarter following the end year for which the VAT had been paid. The refund claim is subject to audit by the tax authorities in Kazakhstan with the refund due around the end of the second quarter. Historically, the Corporation has been successful in collecting all amounts due.

Amounts outstanding for the sale of gold totaled $976 at June 30, 2012 (December 31, 2011 - $nil). The Corporation recognizes revenue from the sale of gold when the price is determinable, the product has been delivered and title has been transferred to the customer and the collection of the sale proceeds is reasonably assured. Accounts receivables typically arise when a gold sale is made near a month end but payment is not made until the following month. Normally, the time between shipment and the receipt of cash is approximately two weeks.

Deposits and prepaid expenses

At June 30, 2012 the Corporation had $2,468 in deposits and prepaid expenses as compared to $2,471 at December 31, 2011. Of these amounts, $2,207 (December 31, 2011 - $2,130) has been incurred by the Corporation in its advancement of a potential listing on an Asian stock exchange. Once the Corporation completes the financing associated with the listing, these costs will be charged to share capital. If the listing is abandoned, these costs will be charged to administrative expense. Prepaid expenses arise in Kazakhstan as the Corporation is often required to place a deposit down upon signing of a contract for the purchase of goods and services.

Inventories

The Corporation's inventory comprises mostly work in progress in which all costs associated with the production of gold, including Process Operating Costs and MET, as well as a portion of depreciation of equipment used in each process, and depletion on mineral assets, are charged to work in progress inventory and expensed based on the quantity of gold sold as a percentage of gold mined. At June 30, 2012 the Corporation estimated that there was approximately 40,071 ozs of gold in work in progress (December 31, 2011 – 41,224 ozs) at a carrying cost of $32,156 (December 31, 2011 - $30,910). The Corporation reclassifies the portion of this inventory that it does not expect to sell in the next year as non-current. At June 30, 2012, the Corporation classified 30,071 ozs ($22,245) (December 31, 2011 – 31,224 ozs and $17,704) as non-current.

At June 30, 2012, the Corporation also had $1,113 (December 31, 2011 - $1,074) of raw materials and supplies inventory which is used in its operations and $nil (December 31, 2011 - $654) which represents the cost of nil ozs (December 31, 2011 - 615 ozs) of gold that was in transit to the refinery for final processing and sale at June 30, 2012 (December 31, 2011).

Trade and other payables

At June 30, 2012 the Corporation had outstanding $7,786 in trade and other payables (December 31, 2011 - $7,520). The credit terms that govern the Corporation's relationship with its suppliers are such that the majority of all amounts outstanding are due within one month.

Deferred tax liabilities

At June 30, 2012 the Corporation has $32,065 (December 31, 2011 – $32,390) in deferred tax liabilities that relate primarily to the fair value assigned to Uzboy on the re-acquisition of control of Saga Creek.

Discussion on Expenditures

2012 Capital Expenditures

During the three months ended June 30, 2012 the Corporation recorded capital expenditures of $303 which relates to the Corporation's 2012 exploration program which is detailed below.

During the three months ended June 30, 2012, Alhambra completed the exploration core drilling on one of its advanced exploration projects at Shirotnaia which was initiated in the first quarter of 2012. In addition, soil sampling programs were initiated and completed at the early stage exploration areas of Vasilkovskoe East and Zhusaly.

In April, the interpretation of Alhambra's 1,360 square kilometres ("km^2") (Phase 1) ground gravity and magnetic surveys over the Dombraly-Shirotnaia gold trend was concluded which resulted in the identification of 18 new exploration targets, of which five were deemed as being high priority see News Release dated April 10, 2012). In addition, the Corporation received and SEDAR filed the final technical report related to the initial independent National Instrument ("NI") 43-101 gold resource estimate (the "Shirotnaia Estimate") for Shirotnaia (see News Release dated April 16, 2012). The resources identified in the Shirotnaia Estimate were 645,000 ozs of Inferred mineral resources contained in 34.6 million tonnes grading 0.58 grams per tonne gold ("g/t Au") and an additional 71,000 ozs of Indicated mineral resources contained in 2.9 million tonnes grading 0.76 g/t Au were identified using natural cut-off grades of 0.1 g/t Au for oxide gold mineralization and 0.2 g/t Au for transitional and primary gold mineralization respectively.

Also in April, the Dombraly 2011 core drilling program assay results were released. The program resulted in the discovery of two new zones of higher grade gold mineralization and extended the known areas of gold mineralization both north and south, and at least five known zones of gold mineralization were significantly extended or the mineralization in these zones had been upgraded in terms of both grade and width, the best mineralized intervals being 17.29 g/t Au over 3.9 m, 4.40 g/t Au over 14.1 m and 3.57 g/t Au over 14.7 m (see News Release dated April 24, 2012).

Since the beginning of 2012, two batches of core drill samples (totaling 5,146, 2,160 and 2,986 samples respectively) from Shirotnaia and Zhanatobe have been sent to the Kyrgyzstan Stewart Group laboratory for assaying.

As of the end of the second quarter of 2012, the assay results pending from the Stewart Kyrgyzstan laboratory were as follows:

- Shirotnaia – 3,691 core and 7 QA/QC core re-sampling,
- Zhanatobe – 1,448 core.

In addition, as of the end of the second quarter of 2012, 1,417 soil samples were being prepared for export as follows:

- Vasilkovskoe East – 844,
- Zhusaly – 573.

Additional updates were made to the planned 2012 drilling program in this quarter.

Shirotnaia

During the second quarter of 2012, the first stage of the Shirotnaia exploration core drilling program, which was initiated in the first quarter of 2012, was completed. Two holes (337 meters) were drilled in April. All core was logged, cut and sampled. The entire core drilling program completed in the first and second quarters of 2012 amounted to 18 holes (3,691 m). A total of 3,691 samples were taken and shipped to the Kyrgyzstan Stewart Group laboratory (of which 1,538 samples had been shipped prior to the end of the first quarter). Assay results are pending. The objective of this drill program was to define the orientation of the gold mineralization and to follow the mineralized zones along strike and at depth.

All drill holes encountered intervals of strong chlorite sericite alteration and sulphide mineralization as well as intervals of carbonate-quartz veins and veinlets.

Vasilkovskoe East

In the second quarter of 2012, a soil sampling program on the Vasilkovskoe East early stage project was commenced and completed. This project includes three areas where soil sampling was planned – Western, Alexandrovsky and Vasilkovskoe Northeast. In the Western area as a result of the 2011 exploration program, several gold anomalies in soil were established. More detail sampling around these anomalies was completed with 189 samples taken along 6 lines. In the Alexandrovsky area, 3 lines were sampled (183 samples taken) and completed. More detailed sampling was also carried out in this area (229 samples along 4 lines). Sampling in the Vasilkovskoe Northeast area targeted to check the ASTER anomalies established there. 226 soil samples were collected along 9 separate lines. In total, 844 soil samples were taken from the Vasilkovskoe East project. The soil samples were dried, screened to -80#, and were ready for export to Kyrgyzstan.

Zhusaly

In the second quarter of 2012, soil sampling on the Zhusaly early stage project commenced and was almost completed. As a result of the 2011 exploration program, two gold anomalies in soil were established there. For the 2012 field season more detailed sampling around the southeastern anomaly was planned as well as a NE extension of the regional soil grid targeting to cover the main part of the negative magnetic anomaly. In June, 573 soil samples were taken along 11 lines. They will be now dried and screened to -80#.

Remote Sensing and Gravity and Magnetic Survey

The interpretation of the 1,360 km^2 (Phase one) ground gravity and magnetic surveys over the Dombraly-Shirotnaia gold trend was completed and resulted in the identification of 18 new primary exploration targets which were correlated with the results of an ASTER satellite imagery analysis.

These 18 new primary targets were prioritized, with five of them deemed as being high priority. It is anticipated that a soil sampling program followed by a reverse circulation drilling program will be implemented in 2012 to further test the gold potential of the first four high priority targets.

Resources By Deposit

Alhambra's current total corporate NI 43-101 gold resources are as noted below:

Project	Measured (M)			Indicated (I)			M + I			Inferred		
	Tonnes	Grade (g/t)	Ounces	Tonnes	Grade (g/t)	Ounces	Tonnes	Grade (g/t)	Ounces	Tonnes	Grade (g/t)	Ounces
Uzboy (1)	14,317,200	1.52	700,000	7,009,500	1.22	275,500	21,326,700	1.42	975,500	11,258,200	1.17	421,700
Dombraly (2)	-		-	559,000	1.22	22,000	559,000	1.22	22,000	9,317,000	1.01	301,000
Shirotnaia (3)	-		-	2,900,000	0.76	71,000	2,900,000	0.76	71,000	34,577,000	0.58	645,000
TOTAL	14,317,200	1.52	700,000	10,468,500	1.09	368,500	24,785,700	1.34	1,068,500	55,152,200	0.77	1,367,700

(1) Effective as of Dec 31/07 as per ACA Howe per news release dated Apr 8/08 at a 0.40 g/t cut-off.
(2) Effective as of Nov 27/11 as per ACA Howe per news release dated Feb 7/12 using natural cut-off grades of 0.13 g/t, 0.1 g/t and 0.2 g/t for the low grade stockpile, pit infill and in-situ mineralized zones respectively.
(3) Effective as of Jan 9/12 as per ACA Howe per news release dated Feb 28/12 using cut-off grades of 0.1 g/t for oxide gold mineralization and 0.2 g/t for transitional and primary gold mineralization respectively.

Capital Expenditure Activity Subsequent to June 30, 2012

Shirotnaia

A reverse circulation ("RC") drilling program was initiated in Shirotnaia in July. The objective of this drilling program is to check for possible extensions of gold mineralization to the north where it is marked on the surface by anomalous soil and trench samples taken earlier. This area has significant potential according to the recently prepared structural model. A total of 26 (2,600 m) RC holes are planned to be drilled. As of the end of July 2012, 7 holes totaling 616 m were drilled and 638 samples had been taken which were being prepared for export.

Uzboy

Alhambra's independent consultants (Micromine and ACA Howe International) continued to work on updating the Uzboy NI 43-101 resource estimate and Preliminary Economic Assessment. Both of these updates, which were anticipated to have been completed by mid-year 2012, have been delayed. Micromine has advised Alhambra that it has been experiencing difficulties in modeling the updated designed pit to the actual existing pit surface. Upon completion of these studies, the Corporation will press release the study results.

Administrative expenditures

For the six months ended June 30, 2012, administrative expenses totaled $1,637, a decrease of $3,093 from the total for the six months ended June 30, 2011 of $4,730. Included in these amounts are $582 and $1,439 of administrative expenses related to Saga Creek operations for the six months ended June 30, 2012 and 2011, respectively. As noted above, after the effects of the penalties related to Saga Creek's tax assessment are accounted for, Saga Creek's administration expenses for the comparative six month periods ended June 30, 2012 and 2011 are $740 and $1,042, respectively.

The remaining $1,055 of administrative expenses for the six months ended June 30, 2012 relates to corporate overhead costs which was a decrease of $2,236 from the corporate overhead costs for the six months ended June 30, 2011 of $3,291. Included in these amounts were share-based compensation expenses of $329 and $2,109 for the six months ended June 30, 2012 and 2011, respectively. The remaining $726 and $1,182 for the six months ended June 30, 2012 and 2011, respectively relate to corporate cash overhead expenses as detailed below.

Employee costs accounted for $438 (60%) of the total corporate administrative costs for the six months ended June 30, 2012 as compared to $536 (45%) for the six months ended June 30, 2011. The decrease was the result of additional consulting costs in 2011 in connection with the Corporation's early adoption of IFRS required as a result of the Corporation's investigation into a dual listing on an Asian stock exchange in 2011 offset in part by increased salaries for staff effective January 1, 2012.

Corporate professional costs, which include legal, auditing and outside consulting fees, totaled $95 (13%) for the six months ended June 30, 2012 as compared to $331 (28%) for the six months ended June 30, 2011. Professional costs were higher in 2011 as the Corporation's costs associated with the conversion to IFRS and the Corporation's audit were significantly higher than originally contemplated and accrued for during the 2010 year. As part of the audit, work was done to remove the audit qualification that Alhambra received on its 2008 annual financial statements because of the loss of the Kazakhstan subsidiaries. With the re-acquisition on September 15, 2009 it was then possible to clear up that qualification which is required in order for the Corporation to pursue the Asian public listing. As the Corporation maintains a small professional accounting staff, it was necessary to contract professional assistance to help with the conversion, particularly considering that a significant amount of time of Alhambra's employees was devoted to the work necessary to pursue the listing on an Asian stock exchange. In addition, in the six months ended June 30, 2011, the Corporation incurred professional costs associated with a review of the Corporation's resources as part of a plan at that time to complete a NI 43-101 report.

Costs related to the maintenance of Alhambra as a public Corporation including investor relations, stock exchange and corporate trust services and annual and quarterly report costs accounted for $102 (14%) of total corporate administrative expenses for the six months ended June 30, 2012 as compared to $224 (19%) for the six months ended June 30, 2011. During 2011, the Corporation carried out a more active investor relations program that has been curtailed in 2012 to conserve cash.

Office expenses for the six months ended June 30, 2012 totaled $91 (13%) as compared to $91 (8%) for the six months ended June 30, 2011.

Liquidity and capital resources

Alhambra operates in a capital intensive industry in which the demands for capital to finance exploration and development of its properties as well as its corporate overheads occur far in advance of projects being put on production and generating cash flow. While the Corporation generates cash flow from the production and sale of gold mined from the oxide zone of the Uzboy gold deposit, additional funds are required to enable Alhambra to add shareholder value through exploration and development and fund some of its working capital requirements. As a result, the Corporation depends on the capital markets to fund these activities. If the Corporation is unable to raise additional funds through these capital markets, the Corporation's ability to continue as a going concern is extremely doubtful. However, in order for the Corporation to raise funds through the issue of common shares, it must first get approval from the government of Kazakhstan to issue common shares. The Corporation has filed an application with the Kazakhstan Ministry of Industry and New Technology ("MINT") to obtain approval to proceed at its discretion with the issue of common shares (see note 22 ('Government of Kazakhstan pre-emptive right') to the June 30, 2012 unaudited consolidated financial statements and the Government of Kazakhstan pre-emptive right section of this MD&A).

At June 30, 2012 the Corporation had $124 in cash and $7,390 in positive working capital. Included in other working capital is $11,024 in work in progress related to 10,000 ozs of gold that the Corporation is estimating it will sell during the next twelve months.

Related party transactions

Balances and transactions between the Corporation and its subsidiaries have been eliminated on consolidation and are not disclosed in this section. Details of the transactions between the Corporation and other related parties are disclosed below.

(a) Compensation of key management personnel:

The remuneration of directors and other members of key management personnel during the six months ended June 30, 2012 and 2011 were as follows:

For the six months ended June 30,		2012		2011
Short-term employee benefits	$	388	$	387
Share-based payments		230		1,556
Director fees		–		–
	$	618	$	1,993

In addition to their salaries, executive officers also participate in the Group's share option program.

(b) Other transaction:

On August 29, 2007, the Corporation and DOT entered into an Administrative and Corporate Services Contract (the "Contract") whereby DOT agreed to engage the Corporation to provide management, administration and corporate services to DOT. The Contract provides for a monthly remuneration of CDN$20 plus all reasonable out of pocket expenses and is for an indefinite term but may be terminated by either party upon providing 30 days prior written notice. Effective January 1, 2011, the Corporation suspended billing DOT the monthly remuneration therefore during the six months ended June 30, 2012 and 2011, the Corporation billed DOT CDN$nil under the Contract. The amount uncollected as of June 30, 2012 was CDN$359 (2011 - CDN$359). In addition, as of June 30, 2012 the Corporation has advanced DOT CDN$402 to enable DOT to meet working capital requirements while DOT is investigating options regarding financing. Currently the Corporation is not charging DOT any interest. The Corporation determined that there was a high probability that the amount owing from DOT was non-collectable and as such expensed $767 owing from DOT during the fourth quarter of 2011 as part of corporate maintenance costs within administrative expenses.

Financial instruments

The fair values of cash and cash equivalents, trade and other receivables, trade and other payables are approximated by their carrying amounts because of their short-term nature or because they bear interest at market rates.

Commitments

Under its foreign investment contract which details the Corporation's rights and obligations associated with its licenses, the Corporation is obligated to spend a minimum of $300 per year on exploration activities within its license territory. The contract also provides that any amounts spent in excess of the yearly minimum shall be credited against future requirements. To date the Corporation has exceeded the minimum amount required under the contract.

Contingent on the availability of financing, availability of drill rigs, and favourable weather conditions, Alhambra continues to anticipate a $3 million exploration program for 2012.

The Corporation has contractual obligations for various expenditures such as royalties, exploration and the cost of goods and services supplied to the Corporation. Such expenditures are predominantly related to the earning of revenue and in the ordinary course of business.

The Corporation has no other off balance sheet financing arrangements.

Share data

The Corporation is authorized to issue an unlimited number of common shares of which 104,132,059 were outstanding as of June 30, 2012. The following table shows the detailed number of shares, options and warrants outstanding as of June 30, 2012 and changes that have occurred up to the date of this MD&A.

	As of June 30, 2012	Change in 2012	Issued in 2012	As of August 28, 2012
Common shares issued and outstanding	104,132,059	–	–	104,132,059
Common shares issuable upon exercise of stock options	8,518,500	–	–	8,518,500
Common shares issuable upon exercise of warrants	11,802,775	–	–	11,802,775
Common shares fully diluted	124,453,334	–	–	124,453,334

Pursuant to a private placement competed in 2010, the Corporation issued 18,604,650 units at a purchase price of $0.43 per unit for total gross proceeds of $8,000. Each unit was comprised of one (1) common share and one-half (1/2) of a common share purchase warrant resulting in the issue of 18,604,650 common shares and 9,302,325 warrants. Each whole warrant entitled the holder thereof to purchase one common share of the Corporation at a purchase price of $0.72 per common share on or before February 19, 2012 for 5,388,690 warrants and March 28, 2012 for 3,913,635 warrants. The Corporation sought and obtained approval from the TSX Venture Exchange ("TSX-V") to extend the expiry date of the warrants to the earlier of February 19, 2013 for 5,388,690 warrants and March 28, 2013 for 3,913,635 warrants and a date which is sixty (60) days after receipt of a waiver of right of first refusal from the Government of Kazakhstan and the receipt of consent of MINT in respect of the issuance of common shares upon exercise of these warrants. The Corporation calculated the fair value of the extension of these warrants to be $1,041.

During 2011 the Corporation had outstanding 2,500,450 warrants which were exercisable into common shares of the Corporation at a price of CDN$0.45 per common share and were originally set to expire on August 11, 2011 however the Corporation sought and obtained approval from the TSX-V to extend the expiry date first to December 9, 2011 and then to February 8, 2012. The Corporation calculated the fair value of the two extensions obtained in 2011 to be $146. During the six months ended June 30, 2012, the Corporation sought and obtained approval from the TSX-V to further extend the expiry date of these warrants to the earlier of February 11, 2013 and a date which is sixty (60) days after receipt of a waiver of right of first refusal from the Government of Kazakhstan and the receipt of consent of the MINT in respect of the issuance of common shares upon exercise of these warrants. The Corporation calculated the fair value of the extension received in the 2012 to be $353.

Legal challenge of tax assessment

In 2010 Saga Creek was assessed amounts that tax authorities in Kazakhstan believed were owed by Saga Creek for Historical Costs, Mineral Extraction Tax ("MET") as well as for their disallowance of certain corporate income tax deductions for the 2006 to 2009 taxation years ("CIT"). The original amount of the assessments including penalties and interest was approximately $4.3 million. The Corporation believed that the assessments were not consistent with Kazakhstan legislation as well as the provisions of Saga Creek's foreign investment contract which governs the Saga Creek's licenses. As a result, Saga Creek filed a claim in the District Economical Court ("Economical Court") seeking to have the assessment of the tax authorities, together with the applicable interest and penalties reversed. On May 13, 2011 the judge in charge of the case largely, but not wholly, rejected Saga Creek's claim, upholding the assessments. On June 2, 2011, Saga Creek appealed this decision to the Appellate Chamber of Akmola Oblast Court ("Appellate Chamber"). On August 5, 2011 the Appellate Chamber upheld the Economical Court's decision, again rejecting all Saga Creek's arguments. Saga Creek filed a further appeal to the Cassation Chamber on August 22, 2011 which is the final court of appeal prior to the Supreme Court. On September 27, 2011 the Cassation Chamber ruled on Saga Creek's appeal. Both Saga Creek and the tax authorities have one year to appeal all or part of the decision. The summary of decision of the Cassation Chamber including any recent updates is as follows:

(a) The 2009 assessment for Historical Costs amounting to approximately $1.6 million was cancelled. While the assessment was only for the 2009 year, the legislation as enacted had provided that the total obligation for Historical Costs of $15.8 million be paid in equal quarterly installments over ten (10) years beginning January 1, 2009. As a result the Corporation reversed the full provision of $13.8 million and an accrual of approximately $2.5 million in interest and penalties to June 30, 2011, all of which were reversed in the third quarter of 2011.

(b) The assessment for CIT amounting to approximately $0.4 million was cancelled and sent back to the Specialized Inter-district Economic Court of the Akmola Oblast ("Akmola Court") for review and re-consideration by a new panel of judges. On May 11, 2012 the Akmola Court rendered its decision and reversed a substantial portion of the assessment. As at December 31, 2011 the Corporation had accrued a total of $0.6 million related to the CIT assessment including interest and penalties. The decision by the court reduced that amount to approximately $0.04 million. As a result the Corporation has recorded a recovery of approximately $0.6 million of which $0.3 has been recorded as a recovery of current income taxes, $0.1 has been recorded as a reduction in finance costs and $0.2 as a reduction in administrative expenses.

(c) The assessment for the 2009 MET in the amount of approximately US$1.0 million was upheld. A total of approximately $1.6 million related to the MET, interest and penalty has been paid by Saga Creek of which approximately $0.7 million related to interest and penalties. The Corporation has decided to appeal the decision of the Cassation Chamber to the Supreme Court. The appeal was filed on May 14, 2012. The Supreme Court has refused to hear the case, indicating that they believe the decisions of the lower courts were valid. Saga Creek has appealed to the Prosecutor General's office to convince the Prosecutor General to lobby the Supreme Court to actually hear the case. Saga Creek has not yet received a response from the Prosecutor General's office.

As a result of the May 14, 2012 decision of the courts related to the CIT assessment, the lien previously registered against certain assets of Saga Creek has been removed.

As a result of the decision by the Cassation Chamber that no Historical Costs are payable, the Corporation has, as indicated, reversed the original provision and all related penalties and interest that had previously been recorded. As indicated, the tax authorities and the public prosecutor have until September 27, 2012 to appeal the decision of the Cassation Chamber to the Supreme Court. While the Corporation understands that it is standard practice in Kazakhstan for the tax authorities to appeal unfavorable court rulings, there is no guarantee that they will in fact appeal. Even if they do appeal the decision, there is no guarantee that the Supreme Court will in fact choose to hear the appeal and if it agrees to hear the appeal there is no guarantee that it will reverse the decision of the Cassation Chamber. If however the final result is that the Supreme Court hears the appeal and decides in favor of the tax authorities, the effect on the Corporation's Consolidated Statement of Financial Position as at June 30, 2012 would be to increase intangible assets by $13.6 million, to increase trade and other payables by $4.4 million, to increase provisions by $14.1 million, and to increase loss by $4.9 million. The increase in loss would result from a charge to administration expenses for penalties of $2.6 million and a charge to finance costs of $2.3 million for interest and unwinding of the discount on the Historical Cost provision. The Corporation is not aware of any legal arguments that would support overturning the decision of the Cassation Chamber.

Similarly, the tax authorities and the public prosecutor have until May 11, 2013 to appeal the decision of the Akmola Court related to the CIT assessment. Again there is no guarantee that the tax authorities will in fact appeal or that the appeal will heard and if it heard, there is no guarantee that it will reverse the decision of the Akmola Court. If however the final result is the appeal is heard and decided in favor of the tax authorities, the effect on the Corporation's Consolidated Statement of Financial Position as at June 30, 2012 would be to increase trade and other payables by $0.6 million and to increase loss by $0.6 million as detailed above.

Government of Kazakhstan pre-emptive right

The Subsoil and Subsoil Use Act (the "Act") in Kazakhstan grants the Government of Kazakhstan the first right of refusal to purchase any direct or indirect interest in any subsoil license or legal entity holding that license or the legal entity controlling the holder of the subsoil use license at market prices should the license or shares or instruments convertible or giving rights to shares (joint, the "Subsoil Use Assets") come up for sale. As a result, before a company can accept an offer to sell its Subsoil Use Assets, it must first get approval from relevant Kazakhstan authorities. The Act extends this obligation to require a company whose main business is connected with subsoil use in Kazakhstan to get approval should it desire to issue any common shares or issue any derivative instruments that are convertible into common shares. On April 21, 2011, the Corporation completed and filed an application with the relevant Kazakhstan agency to have pre-approved, any shares that may be issued upon conversion of outstanding warrants and options as well as requested that the Government of Kazakhstan pre-approve a private placement that the Corporation would contemplate doing in the near future to finance its exploration and development activities. This application was amended on August 16 and October 25, 2011 which included responses to certain questions received from the Kazakhstan agency.

Alhambra has been advised that its application has been reviewed, a recommendation has been made and forwarded to the Government of Kazakhstan's Interdepartmental Commission, and that a decision on whether or not the Government of Kazakhstan will waive its pre-emptive right to participate in the financing has been made. Alhambra has been further advised that the Corporation's Application has been forwarded to MINT's Expert Commission, who is responsible for formalizing the government's final decision regarding its waiver. The Corporation has yet to receive a formal decision from MINT. The Corporation is not aware of any such applications that have been rejected by the Government of Kazakhstan.

Commercial discovery bonus

On February 22, 2012 Saga Creek was given notice by Kazakhstan tax authorities that it was required to pay a Commercial Discovery Bonus (the "Bonus") based on the approved commercial reserves for Uzboy. According to the notification, Saga Creek is required by law to pay an amount equal to 0.1% of the commercial value of the 14,455.8 kg of gold and 48,100 kg of silver of reserves approved under Kazakhstan legislation for Uzboy. In addition, Saga Creek will be required to pay a 50% penalty plus interest at the prescribed rate which is approximately 17.5%. Payment of the Bonus was due on May 24, 2011. Saga Creek has filed a notice of objection with the tax authorities on the basis that Clause 6.2 (b) of its Subsoil use contract explicitly defines that Saga Creek *"pays a commercial discovery bonus at a zero rate"* which in effect means that Saga Creek is not obliged to pay this bonus at all.

The tax authorities have rejected Saga Creek's notice of objection. Saga Creek intends to appeal that decision to the Kazakhstan courts. The Corporation also anticipates that the lower courts in Kazakhstan will uphold the tax authorities' assessment which will necessitate Saga Creek filing its appeal to the Supreme Court of Kazakhstan. As the Corporation is uncertain at this time how the Kazakhstan courts will ultimately decide on Saga's obligation regarding the Bonus, the Corporation has recorded the Bonus and related interest and penalties up to June 30, 2012. Saga Creek has estimated the amount of the Bonus to be $0.7 million and has charged this amount to intangible assets. In the six months ended June 30, 2012 the Saga Creek accrued $0.06 million in interest related to the unpaid Bonus bringing the total interest and penalties accrued to June 30, 2012 to approximately $0.5 million.

Business Risks

The following describes the types of risks that the Corporation is exposed to in its operations and how it manages those risks.

World Economic Uncertainty

While certain economies and business sectors are recovering from the recent economic slowdown, there still remains stock market uncertainty and an international credit crisis that could adversely impact the Corporation's ability to raise sufficient working capital to sustain operations. The Corporation can neither predict the impact how this uncertainty will have on future results.

Exploration and development

The mining industry in general is inherently risky in nature. Mineral properties are often non-productive for reasons that cannot be anticipated in advance and a company may be subject to risks from operations, mining law, environmental regulations, permits and licenses and financing.

Focusing exploration efforts in areas in which a company has existing knowledge and expertise helps in its efforts to find reserves. Exploration activities rely on the exploration results collected at that time and on the professional judgment of people involved in the exploration business. There is no assurance that exploration programs will result in a discovery being made. In the event that a discovery is made, no assurance can be given that the discovery will result in either resources or reserves being established on the property. If reserves are established, it may take a number of years and substantial expenditures until production is achieved, during which time the economic feasibility of the project may change.

The long-term profitability of a company's operation will, in part, be directly related to the success of its exploration programs in finding additional reserves, which may be affected by a number of factors that are beyond the control of the company.

Operations risk

Operational risk relates to the ability to recover metal from an established mineral reserve. Using skilled and experienced professional staff helps to reduce this risk. Using the latest technologies and controlling costs to maximize profitability also assist in minimization of this risk. Other possible risks include changes in metal prices, unstable ground conditions, procurement of reagents, supplies and fuels and qualified operating personnel as well as severe weather conditions. Maintaining insurance can help to mitigate some of the operational risks.

Kazakhstan Country risk

When operating in a country such as Kazakhstan, a company is subject to economic, political and social risks inherent in doing business in that country. These risks include matters arising out of the policies of the government, economic conditions, imposition of, or changes to, taxes and regulations, foreign currency exchange fluctuations and the enforceability of contract rights.

The unaudited consolidated financial statements and MD&A reflect management's assessment of the impact of the Kazakhstan business environment on the operations and the financial position of the Corporation. The future business environment may differ from management's assessment.

Regulations and mining law

Mining operations and exploration activities are subject to the laws and regulations of a country in which a company does business. There is no assurance that these laws will not change in the future.

Environmental factors

All phases of a company's operations are subject to environmental regulations in the country in which it operates. Environmental legislation may continue to evolve in a manner which requires 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. While a company may take the steps necessary to protect the environment around its operations, there is no assurance that future changes in environmental regulation, if any, will not adversely affect a company's operations or result in substantial costs and liabilities in the future.

Permits and licenses

The operation of a company requires permits from the government of the country in which the company operates. There can be no assurance that a company will be able to obtain all necessary permits that may be required to carry out its operations in the future.

Income and other taxes

As in many emerging markets, the taxation system in Kazakhstan is relatively new and is characterized by numerous taxes and frequent changes in legislation, official pronouncements and court decisions, which are often unclear, contradictory and subject to varying interpretation by different tax authorities. Taxes are subject to review and investigation by a number of authorities, which have the authority to impose severe fines, penalties and interest charges. A tax year generally remains open for review by the tax authorities for five subsequent calendar years; however, under certain circumstances a tax year may remain open longer.

These circumstances may create tax risks that are more significant than in other countries. Management believes that it has provided adequately for tax liabilities based on its interpretations of applicable tax legislation, official pronouncements and court decisions. However the interpretations of relevant authorities could differ and the effect the on financial results, if the authorities are successful in enforcing their interpretations, could be significant.

Going Concern Risk

The re-gaining of control of the Kazakhstan Subsidiaries effective September 15, 2009 combined with the financing done in 2010 and the conversion to share capital of the secured debentures significantly reduced Alhambra's going concern risk. These funds however, are not sufficient to enable the Corporation to meet all its obligations and carry out significant exploration and development programs. During the six months ended June 30, 2012, the Corporation incurred a net loss of $1,272 and the Corporation is not generating a sufficient amount of cash flow from operations to cover its commitments. To continue as a going concern, as well as implement exploration and development plans to sustain the Corporation and promote growth, significant additional capital will be required. The Corporation is currently attempting to raise additional funds, however, there is no assurance that it will be able to do so. However, in order for the Corporation to raise funds through the issue of common shares, it must first get approval from the government of Kazakhstan to issue common shares (see note 22 *'Government of Kazakhstan pre-emptive right'* to the unaudited consolidated financial statements and the Government of Kazakhstan pre-emptive right in this MD&A).

Significant Accounting Policies

The significant accounting policies used by the Corporation are disclosed in the notes to the Corporation's audited consolidated financial statements. Certain accounting policies require that management make appropriate decisions with respect to the formulation of estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. The following discussion outlines such accounting policies and is included in this MD&A to aid the reader in assessing the significant accounting policies and practices of the Corporation and likelihood of materially different results being reported. The Corporation's management reviews its estimates regularly.

The following significant accounting policies outline the major policies involving critical estimates.

Work in progress

Work in progress is determined by estimating the quantity of recoverable gold at the various stages of the production process. While the Corporation performs tests to estimate the recoverability of gold as well as uses various sampling techniques to measure the daily quantity of gold either stacked on or recovered from the heaps in each process, the actual quantity of recoverable gold can only be determined with certainty after the reserves have been completely mined and the project abandoned. Work in progress was written off at December 26, 2008 as a result of the loss of control of the Kazakhstan Subsidiaries. Upon re-gaining control the Corporation was required to record the work in progress at fair market value.

Mineral resources and reserves

A mineral resource is defined by the Canadian Institute of Mining, Metallurgy and Petroleum as a concentration or occurrence of natural, solid, inorganic or fossilized organic material in or on the earth's crust in such form and quantity and of such a grade or quality that it has reasonable prospect for economic extraction. Mineral reserves are those parts of mineral resources which, after the application of all mining factors, estimated gold recovery and operating costs, are the estimated tonnage and grade which is the basis of an economically viable project. Proven and Probable mineral reserves differ by the degree of certainty of such reserves. By their nature, reserves are at best estimates and can only be determined once the reserves have been completely mined and the project abandoned. Changes in Proven and Probable mineral reserves impact the calculation of depletion and the evaluation for impairment as discussed in note 2 of the consolidated financial statements.

Upon re-acquisition, the Corporation was required to record mineral properties at fair market value. In determining the fair market value of the Kazakhstan Subsidiaries' assets, the Corporation made assumptions about reserves, recovery rates, prices, operating, general and administration costs and capital costs and deferred income tax rates as well as made assumptions in determining the Corporation's weighted average cost of capital used to discount the estimated annualized cash flows that were derived from the modeling work done.

Provisions

Provisions are recorded when a present legal or constructive obligation exists as a result of past events where it probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

Provisions are determined by discounting the expected future cash flows and therefore require an estimate to be made of the future liability plus the discount rate applicable.

Share-based payments

Compensation costs attributable to stock options granted by the Corporation are charged to earnings over the vesting periods of the options. The fair value calculation method adopted by the Corporation is the Black-Scholes model, which requires management to estimate interest rates, the expected life of the options and the expected volatility of the Corporation's share price over the life of the options. These estimates may be different than the actual interest rates, life and volatility.

Income tax accounting

The determination of the Corporation's income tax assets and liabilities requires interpretation of complex laws and regulations. All tax filings are subject to audit and potential reassessment after the lapse of considerable time. Accordingly, the actual income tax assets and liabilities may differ significantly from that estimated and recorded by management. This is further complicated by the fact that the taxation system in Kazakhstan is relatively new and characterized by frequent changes in legislation, official pronouncements and court decisions.

Selected Quarterly Data

	Q2 2012	Q1 2012	Q4 2011	Q3 2011
Gold sales (ozs)	1,542	1,846	1,526	3,858
Average gold price ($/oz)	$ 1,625	$ 1,694	$ 1,773	$ 1,817
Revenue ($000's)	$ 2,506	$ 3,127	$ 2,705	$ 7,012
Net profit (loss) ($000's)	$ (1,112)	$ (160)	$ (2,578)	$ 2,065
Basic earnings (loss) per share	$ (0.01)	$ (0.00)	$ (0.03)	$ 0.02
Diluted earnings (loss) per share	$ (0.01)	$ (0.00)	$ (0.03)	$ 0.02

	Q2 2011	Q1 2011	Q4 2010	Q3 2010
Gold sales (ozs)	2,033	1,770	2,870	4,378
Average gold price ($/oz)	$ 1,514	$ 1,392	$ 1,404	$ 1,277
Revenue ($000's)	$ 3,077	$ 2,466	$ 4,030	$ 5,590
Net profit (loss) ($000's)	$ (2,065)	$ (1,686)	$ (4,005)	$ (289)
Basic earnings (loss) per share	$ (0.02)	$ (0.02)	$ (0.05)	$ (0.00)
Diluted earnings (loss) per share	$ (0.02)	$ (0.02)	$ (0.05)	$ (0.00)

The net profit recorded in the third quarter of 2011 is primarily the result of the reversal of interest and penalties accrued in the fourth quarter of 2010 related to the assessment by the Kazakhstan tax authorities for Historical Costs. The loss recorded in the fourth quarter of 2010 is due to lower gold sales revenue plus penalties and interest accrued as a result of the assessment by the tax authorities in Kazakhstan (see note 21 (*"Legal challenge of tax assessment"*) to the June 30, 2012 unaudited consolidated financial statements and the Legal challenge of tax assessment of this MD&A).

Operations at Saga Creek are seasonal such that given no other major operational issues, it is expected that the gold sales during the cold weather months will be less than other months. As a result, monthly sales of gold during the months of December through May will be less than during other months of the year. The Corporation does heat the leaching solution to help offset some of the effects of the cold winters.

2012 Objectives

Alhambra plans to continue implementing its 2012 exploration program during the remainder of 2012 which will include completion of the Dombraly East soil sampling programs as well as RC drilling at Shirotnaia, Kerbay, Kontactovy, Stepnyak and Vasilkovskoe East. Core drilling at its advanced "resource definition" exploration projects of Uzboy, Dombraly and Shirotnaia is also planned. In addition the Corporation plans to initiate the Pre-Feasibility Study for the Uzboy primary gold (sulphide gold) production development project.

Contingent on the availability of financing, availability of drill rigs, and favourable weather conditions, Alhambra continues to anticipate a $3 million exploration program for 2012.

The pursuit of a dual listing of Alhambra's common shares on an Asian Exchange was halted in 2011 due to the delays incurred in receiving a formal reply from MINT on its pre-emptive right application, delays in generating and analyzing drill results, and delays in generating the new and updated NI 43-101 resource report and Preliminary Economic Assessment (Scoping Study) for Uzboy. Alhambra will continue to work on the dual listing once these issues have been resolved.