

**2008**  
**Third Quarter Report**



**CALEDONIA**  
**Mining Corporation**

**Management's Discussion and Analysis**

This discussion and analysis of the consolidated operating results and financial condition of Caledonia Mining Corporation ("the Corporation") for the nine months ended September 30, 2008, September 30, 2007 and September 30, 2006 should be read in conjunction with the unaudited Consolidated Financial Statements as at September 30, 2008 and the Annual Report for the year ended December 31, 2007, all of which are available from the System for Electronic Data Analysis and Retrieval at [www.sedar.com](http://www.sedar.com) or from the Corporation's website at [www.caledoniamining.com](http://www.caledoniamining.com). The Unaudited Consolidated Financial Statements and related notes have been prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP").

**Note that all currency references in this document are to Canadian dollars, except where specifically stated.**

**Listings**

The Corporation is listed on the Toronto Stock Exchange as "CAL", on NASDAQ-OTCBB as "CALVF", and on London's AIM as "CMCL".

**FORWARD LOOKING STATEMENTS**

This Management Discussion and Analysis contains certain forward-looking statements relating but not limited to the Corporation's expectations, intentions, plans and beliefs. Forward-looking information can often be identified by forward-looking words such as "anticipate", "believe", "expect", "goal", "plan", "intend", "estimate", "could", "should", "may" and "will" or similar words suggesting future outcomes, or other expectations, beliefs, plans, objectives, assumptions, intentions or statements about future events or performance. Forward-looking information may include reserve and resource estimates, estimates of future production, unit costs, costs of capital projects and timing of commencement of operations, and is based on current expectations that involve a number of business risks and uncertainties. Factors that could cause actual results to differ materially from any forward-looking statement include, but are not limited to, failure to establish estimated resources and reserves, the grade and recovery of ore which is mined varying from estimates, capital and operating costs varying significantly from estimates, delays in obtaining or failures to obtain required governmental, environmental or other project approvals, inflation, changes in exchange rates, fluctuations in commodity prices, delays in the development of projects and other factors. Forward-looking statements are subject to risks, uncertainties and other factors that could cause actual results to differ materially from expected results.

Potential shareholders and prospective investors should be aware that these statements are subject to known and unknown risks, uncertainties and other factors that could cause actual results to differ materially from those suggested by the forward-looking statements. Shareholders are cautioned not to place undue reliance on forward-looking information. By its nature, forward-looking information involves numerous assumptions, inherent risks and uncertainties, both general and specific, that contribute to the possibility that the predictions, forecasts, projections and various future events will not occur. The Corporation undertakes no obligation to update publicly or otherwise revise any forward-looking information whether as a result of new information, future events or other such factors which affect this information, except as required by law.

**1. OPERATIONAL REVIEW AND RESULTS OF OPERATIONS****1.1 GOLD PRODUCTION****Blanket Mine (1983) (Private) Limited – Zimbabwe ("Blanket")**

In view of the fact that the Reserve Bank of Zimbabwe ("RBZ") has not paid the mine the foreign exchange for gold purchased by it since May 2008, Blanket was unable to purchase essential imported consumables and has had no alternative but to suspend production, as announced in the press release on October 23, 2008, until revenue is forthcoming. The mine staff continues to keep the operations in a good state of repair and all staff have been retained, although their efforts have been redirected to maintenance projects.

**Safety, Health and Environment**

- The mine continued its good safety performance and recorded no lost time injuries during the quarter and the number of restricted work accident cases (reportable accidents) declined by 66% relative to the previous quarter. However, 8 medical aid and first aid incidents were recorded which is consistent with the previous quarter.
- During the quarter 487 employees were trained in Hazard Identification and Risk Assessment (HIRA) while supervisors were trained in Planned Job Observations and Supervisory Skills.
- The mine retired 8 employees on medical grounds. No occupational health illnesses were detected during the quarter. 27 employees and their dependents voluntarily underwent HIV tests during the

quarter, of which only 1 person tested positive. HIV/AIDS education continues but confidentiality restricts management's ability to identify suspected cases.

There were no adverse environmental issues during the quarter, and results from groundwater testing continue to show that the tailings dams are not affecting the quality of the groundwater. Used oil, scrap metal and spent batteries are sold to reputable dealers as a means of disposing of such potentially hazardous waste.

The economic situation in Zimbabwe has deteriorated significantly and the number of dismissals due to desertion remains high - 43 employees were dismissed during the quarter for being absent without permission. Under the current deteriorating economic conditions, formal employment is shunned in favor of work in the informal sector. As a result, the mine has had to intensify recruitment efforts in order to maintain critical staffing levels and has had to maintain a vigorous training program to prepare these replacement employees.

#### **Capital Projects - Number 4 Shaft Expansion Project**

Due to the ongoing critical shortage of foreign currency, no further work took place on the No 4 shaft project and the anticipated future expenditure is estimated at US\$2,200,000. This expenditure, once made will enable production to be increased to 1,000 tonnes per day from which an annual gold production of 40,000 ounces is forecast.

#### **Operations**

During the past quarter the operation continued to be hampered by the following:

- Labour shortages caused by the rapidly deteriorating socio-economic situation in Zimbabwe. The overall manpower numbers are currently at approximately 50% of the normal requirement.
- The critical shortage of foreign currency receipts has curtailed the ability of the mine to replenish stocks of a wide range of consumable items which are essential for safety, mining and production. Consequently, mining activities were suspended.

The factors above have contributed directly to the current drop in production from the 25,000 ounce per annum level at the start of the No 4 shaft expansion project.

<b>Production results</b>		<b>3<sup>rd</sup> Quarter 2008</b>	<b>3<sup>rd</sup> Quarter 2007</b>	<b>Nine months to Sept 2008</b>	<b>Nine months to Sept 2007</b>
Ore milled	Tonnes	<b>22,884</b>	14,042	<b>81,688</b>	60,559
Sands processed	Tonnes	-	81,081	-	125,137
Ore Gold Grade milled	Grams/tonne	<b>3.09</b>	1.90	<b>3.33</b>	3,05
Recovery % - Ore	Per cent	<b>88%</b>	75%	<b>88%</b>	83%
Gold produced - Total	Ounces	<b>2,028</b>	2,672	<b>7,687</b>	8,784
Gold Sold	Ounces	<b>2,466</b>	2,262	<b>8,364</b>	9,471

The difference between gold produced and gold sold is the carry over gold work in progress from the previous period. In the first quarter of 2007, underground production was interrupted by the closure of the No. 4 shaft for expansion work and during this period sands from nearby dumps were used to supplement production, resulting in an overall decline in grade. The tonnage of ore milled in Q3 was 30% lower than in Q2 and the gold production decreased by 32% over the period. The reduced gold production is a function of the low tonnage of 22,884 milled and the lower head grade of 3.09 grams per tonne. The reduction in the number of underground production crews and the forced depletion of critical consumables were the main factors contributing to the lower gold production.

#### **Outlook**

Since the two 2008 Zimbabwe elections and the inconclusive power sharing negotiations that followed, the economic future of the country continues to remain uncertain. Foreign currency remains in extremely short supply at government level and therefore it is likely to be some time before the mine receives payment for its gold sales. Dependant on the availability of foreign and local funds, management remains committed to:

- Completing the #4 shaft project;
- Returning Blanket to the 25,000 oz per annum production level, and as soon as possible thereafter increasing production to the planned 40,000 oz per annum level;
- Re-commencing the down dip diamond drilling program to evaluate the main ore zones which are known to extend to depth below the 750 m level;

- Re-commencing development work at Blanket's various exploration projects close to the mine;

Production operations at Blanket will remain in forced suspension until such time as the mine is paid for its gold sales. Efforts to look after the workforce in terms of basic foods and well being will continue during the period of suspended operations provided that Blanket is able to access the required tranches of funds from the RBZ.

## **1.2 EXPLORATION AND PROJECT DEVELOPMENT**

### **1.2.1 COBALT AND BASE METALS**

#### **Nama Cobalt Project – Zambia**

Early in Q4 2008 Caledonia was granted four Large Scale Mining Licences in respect of the Nama cobalt project by the Mines Development Department of the Zambian Ministry of Mines and Minerals Development. In addition, Caledonia received a 10 year Investment Licence from the Zambia Development Agency in respect of the Nama Cobalt Project.

The 2008 drilling campaign commenced during the second quarter of this year. The primary objectives of the program were to improve the definition of Resource Body D as well as the Co/Cu mineralised zone discovered at Konkola West. Recently received results of research work carried out by two laboratories in South Africa and one in Canada has resulted in a flowsheet involving both hydrometallurgical and pyrometallurgical processes. In order to justify the implementation of a pyrometallurgical process, the resource base would have to be substantial increased and it is for this reason that current drilling efforts are focused on other very large D type iron-rich bodies about 10 kilometres to the west of the D area

#### **Resource Body D**

Diamond drilling of the D body was undertaken primarily in order to upgrade the resources defined by the 2007 reverse circulation drilling program. This program is providing additional information on the shape, mineralogical characteristics, depth variations, engineering characteristics and internal dilution of the resource body.

During the quarter 24 diamond drilled bore holes were drilled in the area, totalling 2,058 meters. All potentially mineralised sections of the core were split using a diamond saw, and half core samples submitted for assay for Co, Cu, Ni, Zn and Fe. A total of 969 samples were submitted for assay, of which about 70% of the results have been received to date. While provisional modelling of the resource is already under way, final computation of the revised resource statistics can only be completed once all the results have been received.

Exploration is currently focused on the drilling of the additional "D-Type" bodies identified earlier this year as well as other possible sources of large iron rich bodies that can supplement the D resource.

#### **Konkola West**

Both Co and Cu enrichment was encountered in a trench excavated on a geochemical anomaly in the Konkola West area. The occurrence is situated close to a position where both Copperbelt and iron rich mineralization styles can be expected. Twelve holes were completed in this target area during the quarter amounting to 1,588 meters of drilling and 804 drill core samples were submitted for assay. The drilling of this target was completed early in the 4<sup>th</sup> quarter but the computation of the resource is dependent on the final analytical results which are outstanding.

Further field work is currently being done in the area in order to define other targets to be drilled later in the season.

#### **Further Developments**

China Nerin (Nanchang Engineering and Research Institute for Nonferrous Metals) Engineering Co Limited, a well established and experienced engineering company, has been requested to delay completion of their work on the Chinese Feasibility Study (CFS) pending finalisation of the revised and additional resource data, finalization of the metallurgical process and clarification of the Zambian taxation that will apply to the Nama project.

Finalization of the CFS is expected during the first half of 2009 and will be dependent on the definition of an increased Indicated Resource sufficient to support at least 5 years of production at design capacity, and finalization of the metallurgical research required to define an economic process route to treat the high-iron "D-Type" mineralisation, and clarification of the Zambian tax environment under which Nama would operate.

Any further unanticipated permitting, metallurgical, mining or funding delays will result in the construction commencement date being delayed.

An Environmental Impact Statement for the planned mining and metallurgical plant operations covering resource bodies A and D has been submitted to the Environmental Council of Zambia for approval. It is anticipated that the document will require certain updates to reflect recent changes in the metallurgical and tailings facilities of the project.

As announced earlier in Q3, the recently introduced taxation legislation in Zambia, whilst not rendering the project uneconomic, imposes an unreasonably heavy burden on investors. Caledonia has had constructive discussions with the Zambian authorities and has made detailed proposals to the requisite Ministries and Departments for a more appropriate taxation structure for the Nama project. The ability of the Zambian authorities to respond to our proposals was impaired by the unforeseen Presidential elections in Zambia that resulted from the untimely death of President Mwanawasa. Caledonia expects to be able to progress the discussions with the Zambian authorities when normal government resumes after the post-election period.

Market conditions for raising debt and equity are currently extremely difficult. However the prospective debt providers with whom Caledonia had entered preliminary discussions regarding debt funding have confirmed that they retain their interest in the Nama Cobalt Project and their capacity to participate in debt funding. Caledonia considers it prudent to defer any discussions with prospective equity providers until the technical and taxation aspects of the Nama Project have been clearly defined and the general equity market conditions improve.

## **1.2.2 ROOIPOORT AND MAPOCHSGRONDE PGE/Ni/Cu PROJECTS – SOUTH AFRICA**

### **Property**

#### **Rooipoort and Mapochsgronde**

The prospecting rights granted to the company to prospect for PGMs on the major portions of the Mapochsgronde tribal trust land are currently in the process of registration. A further application has been made for an adjoining property to the north of the current rights.

The Rooipoort platinum rights, previously held by Caledonia's subsidiary, Eersteling Gold Mine, are currently being registered under Maid O' the Mist, also a wholly owned subsidiary of Caledonia. Maid O' the Mist is the vehicle that will be used to manage the Joint Venture with Mitsubishi Corporation in the Rooipoort area. Once registered and all other due diligence matters are complete, funds are expected to be released by Mitsubishi Corporation to proceed with the exploration of this area.

It was announced during the quarter that Caledonia and Mitsubishi Corporation of Japan signed a Heads of Agreement relating to potential Joint Ventures (JV) between the companies on both the above platinum properties. The JV's will come into effect as soon as certain due diligence conditions of the agreement have been completed to Mitsubishi's satisfaction. In terms of the agreement, Mitsubishi will fund 100% of all further exploration on each of the above two properties up to a bankable feasibility stage, or to the value of \$40 million for the 2 JV's, whichever comes first, to earn a 50% interest in the JV's. The JV management team is planning a rapid escalation in exploration activity as soon as the registration of the prospecting rights is completed and the Shareholder Agreements are signed between Caledonia and Mitsubishi Corporation.

## **1.2.3 GOLD**

### **Zimbabwe Exploration – Gold**

Due to the lack of foreign currency no exploration work took place during the quarter.

## **1.2.4 DIAMONDS**

### **Mulonga Plain – Zambia**

An application for a Retention Licence has been lodged with the Zambian authorities. The Zambian Government department responsible for the issuing of prospecting licences has been reorganised and this has temporarily delayed the process of awarding permits. No response had been received from the Zambian authorities by the date of this report.

### **Kashiji Plain - Zambia**

No further field work was carried out on the Kashiji or Lukulu licenses in this quarter. This license expired in June 2008, at which time the Corporation had already applied for retention licenses covering these areas.

### Goedgevonden - South Africa

The Corporation holds prospecting rights over the Goedgevonden diamond bearing kimberlite pipe and surrounding area. This property is located approximately 20 km north of the now defunct Stilfontein gold mine in the Klerksdorp district of the North West Province in South Africa and 200 km south west of Johannesburg.

Although the New Order Prospecting Rights have been granted, the signature of the documentation is awaiting certain suspensive conditions. Discussions are in progress with other parties with a view to realizing value by either joint venture or disposal of the properties constituting the Goedgevonden Diamond Project. No further work was carried out on this property during the quarter.

### 1.2.5 GENERAL OUTLOOK

Exploration by its nature is speculative with a high degree of risk accompanied by the potential for high returns. The Corporation manages this risk by using well-qualified exploration professionals, senior mining company joint venture partners and by exploring in areas which are considered as having a better than average potential for discovery.

### 1.3 QUALIFIED PERSONS

Dr Trevor Pearton, BSc Eng (Mining Geology), PhD (Geology), FGSSA, VP Exploration is a qualified person as defined by NI 43-101. Dr. Pearton is responsible for the technical information provided in this MD&A except where otherwise stated. He was assisted where appropriate by outside consultants and/or qualified persons for joint-ventured projects. Mr. David Grant is the Independent Qualified Person for the NI 43-101 compliant reports on the resources of the Nama Property, prepared by Applied Geology and Mining (Proprietary)Limited, whose Managing Director is Mr. Grant .

## 2. SUMMARY OF QUARTERLY RESULTS - (C\$ 000's - except per share amounts.)

The following information is provided for each of the 8 most recently completed quarters of the Corporation - ending on the dates specified - in thousands of Canadian dollars. The figures are extracted from underlying financial statements that have been prepared according to Canadian GAAP.

	Sept 30/08	June 30/08	Mar 31/08	Dec 31/07	Sept 30/07	June 30/07	Mar 30/07	Dec 31/06
Sales before discontinued operations	2,280	2,883	2,504	3,231	1,950	1,539	3,319	9,044
Income/(loss) before discontinued operations	(2,749)	(261)	791	494	(855)	364	(3,909)	3,841
- per share undiluted	(0.0055)	(0.0005)	0.0016	0.0010	(0.0019)	0.0007	(0.0085)	0.0084
- per share Diluted	(0.0055)	(0.0005)	0.0016	0.0010	(0.0019)	0.0007	(0.0085)	0.0084
Discontinued operations (loss)	(30)	(24)	(70)	(249)	(80)	(126)	(254)	(1,283)
Net Income/(loss) after discontinued operations	(2,779)	(285)	721	245	(935)	238	(4,163)	2,558
- per share undiluted	(0.0056)	(0.0006)	0.0015	0.0005	(0.0019)	0.0005	(0.0074)	0.0056
- per share Diluted	(0.0056)	(0.0006)	0.0015	0.0005	(0.0019)	0.0005	(0.0074)	0.0056
No of shares basic '000	500,169	500,169	493,199	487,869	487,869	487,869	457,981	457,981

The discontinued operations in the quarter ended September 2008 relate to Eersteling Mines, Barbrook was included up to March 31, 2008. All foreign exchange gains or losses are reported in the results before discontinued operations. The gold sales at Blanket were 2,466 ounces in Q3 (3,089 ounces in Q2, 2,809 ounces in Q1, 4,352 ounces in Q1 2007, 2,922 ounces in Q2 2007, 2,262 ounces in Q3 2007 and 4,512 ounces Q4 2007). Included in the loss for the quarter, before discontinued operations, is the unrealized foreign exchange gain/ (loss) of (\$992,000); (loss of (\$860,000) in Q2, \$100,000 gain in Q1 of 2008, and in 2007 \$456,000 in Q4, (\$1,016,000) in Q3, (\$707,000) in Q2 and \$255,000 in Q1). The huge collapse in the value of the Zimbabwe dollar resulted in an unrealized foreign exchange loss of \$856,000 at Blanket. As a result of the sale of Barbrook Mines shares and loan claims a loss of \$203,000 has been realized due to foreign exchange fluctuations.

The gross profit of \$302,000 (\$1,526,000 in Q2 and \$1,245,000 in Q1 2008) for the third quarter has been achieved despite inflationary factors in Zimbabwe (493 million % per month in October 2008) and is evidenced by the fact that the Reserve Bank of Zimbabwe (“RBZ”) owed Blanket US\$3,098,000 for gold sales at the end of the quarter compared to US\$2,685,000 at the end of Q2 and US\$2,680,000 at the end of Q1. During the quarter RBZ made no direct payments to Blanket but paid certain suppliers on the Mine’s behalf to the amount of roughly US\$270,000.

The results of Blanket have been translated into Canadian dollars using the inter-bank rate that was introduced by the RBZ in May 2008. This rate of exchange (“ROE”) is established by the market on a “willing buyer - willing seller” basis. The table below illustrates the rates of exchange used per financial statement category; all rates of exchange before Q2 2008 were derived from the gold support price quoted by RBZ. Due to the introduction of the inter-bank rate the effective discount on gold sold in Zimbabwe dollars initially decreased from 90% to roughly 15% but as the inter-bank rate has not been allowed to move freely in the market the discount has widened again to about 90%. Blanket sold 719 ounces of gold during the quarter solely for Zimbabwe dollars at a discount of above 90% to the US\$ based market price. This was necessary as Blanket had no Zimbabwe dollars to pay the work force. When introduced the inter-bank rate was set at Z\$190 million per US\$1 and is currently trading at about Z\$600 (new currency 10 zeros removed).

	2008	2008	2008	2007	2007
Z\$'s per C\$1	Q3 ROE	Q2 ROE	Q1 ROE	Q4 ROE	Q3 ROE
Sales revenue	48	337,140,498	5,161,433	275,926	156,590
Other income statement items	53	3,736,329,101	10,019,210	260,870	150,507
Monetary assets and liabilities	122	10,631,984,967	22,960,635	378,644	168,645
All other assets and liabilities	101.19	101.19	101.19	101.19	101.19

On July 30, 2008 the RBZ announced a new monetary policy. Part of the announcement dealt with the devaluation of the Zimbabwe dollar and 10 zeros were removed from the value of the currency i.e. Z\$100,000,000,000 became Z\$10. Due to the rampant inflation all 10 zeros have returned to the devalued currency as of early November 2008.

### 3. INVESTING

During the third quarter 2008 the Corporation invested \$993,000 in capital assets and mineral properties (\$959,000 in 2007 and \$1,566,000 in 2006). Of the amount invested in 2008, \$755,000 was spent at Nama on drilling exploration and \$223,000 at Rooipoort acquiring the Falconbridge prospecting rights. Due to a lack of foreign currency there was negligible capital expenditure at Blanket.

### 4. FINANCING

In February 2008 \$1,119,000 (nil – 2007 and \$1,475,000 – 2006) was raised from private placements (net of expenses). In all 12,300,000 shares, priced at \$0.10 were issued in the private placement along with an equal number of warrants priced at \$0.15, valid for 1 year. The funds were used to finance exploration activity on the Corporation’s most prospective projects and working capital requirements. No further capital raising took place in the third quarter.

On May 31, 2008 the sale of Barbrook Mine to Eastern Goldfields was concluded. The full purchase price of \$9,213,000 was paid in cash. These funds are being used to finance exploration activities at Nama and other corporate expenses.

## **5. LIQUIDITY AND CAPITAL RESOURCES**

As of September 30, 2008, the Corporation had a working capital of \$9,105,000 (surplus of \$65,000 at December 31, 2007). The increase in working capital is due to the proceeds received for Barbrook Mine and the transfer of Barbrook liabilities to Eastern Goldfields. Due to the state of the Zimbabwean economy, Blanket is operating on a virtual cash basis as suppliers do not grant credit in the hyper-inflationary environment. During the quarter the US dollar amount owed by the RBZ has increased to US\$3,098,000 from US\$2,685,000 at June 30, 2008. Blanket has received no direct payments from RBZ during the quarter and as a result gold production has been temporarily suspended. Blanket will retain all staff as long as it can convert US dollars owed to it by RBZ at a favourable exchange rate to pay salaries and purchase food requirements. Blanket has managed to conclude two transactions with RBZ on this basis since production was suspended. RBZ has also paid certain of Blanket suppliers directly from the US dollars owed by RBZ namely for electricity and fuel supplies.

The Corporation anticipates that the funds held by the RBZ (US\$3,098,000) will only be available, in the immediate future, for use at Blanket in Zimbabwe. However, the Corporation's Board has decided that it is not necessary to, at this date, conclude that the amount is not going to be ultimately collectible – and the full amount is still showing in its quarter-end Balance Sheet as a current asset.

Gold sales in Zimbabwe continued on the basis of a minimum of 75% of the proceeds being paid in US dollar and the balance paid in Zimbabwe dollars using the inter-bank rate. The 75% US dollar retention was increased from 55% in the latest Monetary Policy announcement and an extra 150% of the inter-bank rate was also added to the sales formula for the Zimbabwe dollar portion.

Blanket continues to be self funding. Little or no money is currently being spent on capital development due to a lack of foreign and local currency.

Anticipated cash inflows in 2008 will be used mainly by the Corporation on its exploration, development and production activities.

Future gold production at Blanket is totally dependent on the RBZ paying the outstanding US dollars owed to Blanket, so essential imported consumables can be acquired and the No 4 shaft expansion - at an estimated cost of \$750,000 to regain the 600 tpd ore delivery to the plant and a further amount of \$1,500,000 to reach the expanded rate of 1,000 tpd ore delivery and plant expansion needs, will be completed.

Areas of focus outside Zimbabwe are as follows:

- the defined activities at the Corporation's Nama Cobalt/Copper Project at an estimated cost of \$ 4,000,000
- the Rooipoort and Mapochsgronde South African PGE & Ni properties which will be funded by Mitsubishi in terms of the JV agreements.
- corporate working capital.

The prime area of focus will be the Nama Cobalt Project in Zambia. Notwithstanding the estimated expenditure amounts for each of the programs described above, the Corporation cannot predict the actual amounts that will be spent on those programs. Decisions will be made to go ahead on the programs from time to time by Management as they, at that time, determine appropriate, based on results achieved in previous programs and funding availability.

The Corporation does not have any significant long-term contractual obligations or commercial commitments other than the payment of its current liabilities and its five cobalt sales agreements. It has two joint venture agreements with Ashton Mining of Canada Inc. and Motapa Diamonds Inc. In each case these partners were responsible for all property expenditures until a feasibility study had been completed. The Corporation has minor obligations in respect of licence fees for its exploration and mining properties some of which are paid in full by the Corporation's joint venture partners. Now that Motapa wishes to withdraw from its JV on Mulonga Plain, the Corporation will be responsible for maintaining the Licences. As of September 30, 2008 the Corporation had potential/contingent liabilities to do rehabilitation work on Blanket and Eersteling Mines - if and when those Mines are permanently closed - at an estimated cost of \$1,033,000. With the completion of the sale of the Barbrook the rehabilitation liability of \$93,000 has passed onto the new owners.

## **6. OFF-BALANCE SHEET ARRANGEMENTS**

There are no off balance sheet arrangements.

## 7. RELATED PARTY TRANSACTIONS

The Corporation had the following related party transactions in the normal course of business:

\$ 000s	Year to date September		
	2008		
	2008	2007	2006
	\$	\$	\$
Management fees, allowances and Director fees paid or accrued to a company which provides the services of the Corporation's President	423	388	356
Rent paid to a Company owned by members of the President's family	32	33	34
Directors fees, travel expenses, consulting fees and salaries paid to the Chairman and Directors of the Board (note1)	801	204	157

Note 1: Since 2005 Caledonia has had limited cash resources to compensate the Chairman and other non-executive Directors for consulting work and related director responsibilities. The Chairman along with the other non-executive Directors agreed to defer their claims for time spent on Caledonia business until it had the cash resources to pay the claims. As Caledonia has now sold Barbrook, Caledonia has paid and accrued amounts to compensate the Chairman and non-executive directors for unbilled time spent on Caledonia business since 2005. An amount of \$406,000 relates to fees for the periods 2005, 2006 and 2007.

## 8. CRITICAL ACCOUNTING POLICIES

There are two major areas where accounting estimates are made, asset impairment and asset retirement obligation. As significant impairment provisions have already been made against the assets and there is a reasonable level of certainty around the estimate it is considered unlikely that any change in estimate would result in a material impact on the results of the Corporation. Based on indicative purchase offer previously made for Eersteling Mine no further asset impairment has been made against these assets. The asset retirement obligation is also considered to be estimated with a reasonable degree of certainty, although the original estimation was calculated some years ago. The estimation is accreted annually at 5% and thus any change in circumstances is considered unlikely to have a material impact on the results of the Corporation or its operations.

The following accounting policy changes have been adopted as of January 1, 2008 and are more fully described in the Interim Consolidated Financial Statements.

### a. Inventories:

Effective January 1, 2008, the Corporation adopted the new recommendations of the Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3031, Inventories. This standard provides guidance on the determination of cost and its subsequent recognition as an expense, including any write-downs to net realizable value. It also provides guidance on the cost formulas that are used to assign costs to inventories and requires the reversal of write downs, if applicable, on inventory. There were no changes to the Corporation's accounting policies required on implementation of this standard.

### b. Financial Instruments – Disclosures

Effective January 1, 2008, the Corporation adopted the new recommendations of CICA Handbook Section 3862, Financial Instruments - Disclosures; Section 3863, Financial Instruments – Presentation.

Section 3862 on financial instrument disclosures, provides guidance on disclosures in the financial statements to enable users of the financial statements to evaluate the significance of financial instruments to the Corporation's financial position and performance and about risks associated with both recognized and unrecognized financial instruments and how these risks are managed. The new Section requires qualitative and quantitative information relating to concentrations of risk, credit risk, liquidity risk and price risk currently found in Section 3861.

Section 3863 carries forward unchanged the presentation requirements of Section 3861. This Section establishes standards for presentation of financial instruments and non-financial derivatives. It deals with the classification of financial instruments, from the perspective of the issuer, between liabilities and equity, the classification of related interest, dividends, losses and gains, and the circumstances in which financial assets and financial liabilities are offset.

### c. Capital Disclosures

Effective January 1, 2008, the Corporation adopted the new recommendations of CICA Handbook Section 1535-Capital Disclosures. Section 1535 requires the disclosure of an entity's objectives, policies and processes for managing capital as well as quantitative data about what the entity regards as capital. Disclosure of externally imposed capital requirements is also required and whether the entity has complied with these and, if not, the consequences.

The Corporation has included disclosures recommended by the new section in Note 14 to these unaudited interim consolidated financial statements

### d. Financial Statements Presentation

Effective January 1, 2008, the Corporation adopted the new recommendations of CICA amended Handbook Section 1400-General Standards of Financial Statements Presentation. The section provides revised guidance related to management's responsibility to assess and disclose the ability of an entity to continue as a going concern.

## 9. FINANCIAL RISK EXPOSURE AND RISK MANAGEMENT

The Corporation is exposed in varying degrees to a variety of financial instrument related risks by virtue of its activities. The overall financial risk management program focuses on preservation of capital, and protecting current and future Corporation assets and cash flows by reducing exposure to risks posed by the uncertainties and volatilities of financial markets.

The Board of Directors has responsibility to ensure that an adequate financial risk management policy is established and to approve the policy. The Corporation's Audit Committee oversees management's compliance with the Corporation's financial risk management policy.

The types of risk exposure and the way in which such exposures are managed are as follows:

### a) Currency Risk

As the Corporation operates in an international environment, some of the Corporation's financial instruments and transactions are denominated in currencies other than the Canadian Dollar. The results of the Corporation's operations are subject to currency transaction risk and currency translation risk. The operating results and financial position of the Corporation are reported in Canadian dollars in the Corporation's consolidated financial statements.

The fluctuation of the Canadian dollar in relation to other currencies will consequently have an impact upon the profitability of the Corporation and may also affect the value of the Corporation's assets and the amount of shareholders' equity.

A significant portion of the Corporation's assets and liabilities are denominated in South African rand and Zimbabwe dollars. Management do not consider that the fluctuation of the value of the South African Rand to the Canadian Dollar could have a significant impact on the results of operations. Blanket operation is subject to a hyperinflationary environment in Zimbabwe, foreign creditors are denominated in Rands and local costs increase with inflation. As the official exchange rate is not free floating and the effective buying power of the Zimbabwe Dollar decreases accordingly there could be a significant impact on the results of the operations. The shareholder loan account in Zimbabwe is denominated in US Dollars and will generate foreign exchange losses for Blanket in Zimbabwe Dollar terms but the effect on the consolidated financial statements in Canadian Dollars is unlikely to be significant. The fair values of these financial instruments approximate their carrying values, unless otherwise noted. The Corporation does not use any derivative instruments to reduce its foreign currency risks.

The summary below details the cash or near cash items denominated in a currency other than the Canadian dollar that would be affected by changes in exchanges rates relative to the Canadian dollar. All values are in thousands.

'000	US Dollars	Zimbabwe Dollars	SA Rand
Cash	1	(64)	600
Accounts Receivable	3,106	8,033	1,813
Accounts Payable	77	17,223	1,057

The table below illustrates by how much a 1% change in the rate of exchange between the Canadian dollar and the currencies above will affect net income.

'000	US Dollars	Zimbabwe Dollars	SA Rand
Cash	-	-	1
Accounts Receivable	30	1	2
Accounts Payable	1	1	1

#### **b) Interest Rate Risk**

Interest rate risk is the risk borne by an interest-bearing asset or liability as a result of fluctuations in interest rates.

Unless otherwise noted, it is the opinion of management that the Corporation is not exposed to significant interest rate risk as it is debt free and only utilizes overdraft facilities for short periods if necessary. The Corporation's cash and cash equivalents include highly liquid investments that earn interest at market rates. The Corporation manages its interest rate risk by endeavoring to maximize the interest income earned on excess funds while maintaining the liquidity necessary to conduct operations on a day-to-day basis. The Corporation's policy focuses on preservation of capital and limits the investing of excess funds to liquid term deposits in "A" grade financial institutions.

Fluctuations in market interest rates have not had a significant impact on the Corporation's results of operations due to the short-term to maturity of the investments held.

#### **c) Concentration of Credit Risk**

Credit risk is the risk of a financial loss to the Corporation if a gold sales customer fails to meet its contractual obligation. Credit risk arises principally from the Corporation's receivables from the Reserve Bank of Zimbabwe ("RBZ") who is the sole buyer of gold produced.

At December 31, 2007 the RBZ owed Blanket US\$1,780,000 (one million seven hundred and eighty thousand dollars) and at September 30, 2008 this had increased to US\$3,098,000 despite having received US\$1,450,000 in direct payments and a further US\$606,000 in payments to suppliers made directly by RBZ. The lack of foreign currency in Zimbabwe affects all business sectors and management maintains close relations with RBZ to ensure payments are made whenever necessary, within the capabilities of the RBZ.

In the Monetary Policy Statement announced by RBZ on April 30, 2008 an exporter who is owed foreign currency by RBZ is now allowed to sell the currency to a willing buyer through the commercial bank system at a negotiated rate. This enables Blanket to access Zimbabwe dollars required for the operation at rates more favourable than the official exchange rate. This has been proven possible on two occasions. No provision has been made against the trade receivable due by the RBZ.

#### **d) Liquidity Risk**

Liquidity risk is the risk that the Corporation will not be able to meet its financial obligations as they fall due.

The Corporation manages its liquidity by ensuring that there is sufficient capital to meet short and long term business requirements, after taking into account cash flows from operations and the Corporation's holdings of cash and cash equivalents. The Corporation believes that these sources will be sufficient to cover the likely short and long term cash requirements. Senior management is also actively involved in the review and approval of planned expenditures by regularly monitoring cash flows from operations and anticipated investing and financing activities.

Blanket in Zimbabwe continues to be self funding even whilst production is suspended.

#### **e) Commodity Price Risk**

The value of the Corporation's mineral resource properties is related to the price and outlook of targeted precious metals, base metals and diamonds. In addition, adverse changes in the price of certain raw materials can significantly impair the Corporation's cash flows.

Gold prices historically have fluctuated widely and are affected by numerous factors outside of the Corporation's control, including, but not limited to, industrial and retail demand, central bank lending, forward sales by producers and speculators, levels of worldwide production, short-term changes in supply and demand because of speculative hedging activities, and macro-economic variables, and certain other factors related specifically to gold.

The major factor influencing commodity price risk is that RBZ does not pay Blanket market value for 100% of the gold produced.

During the quarter the RBZ bought gold for USD at a discount to the market price of approximately 25% or for Zimbabwe dollars at a controlled price not representative of the market price.

The profitability of Blanket is highly correlated to the controlled price paid by RBZ and the hyperinflationary conditions experienced in Zimbabwe, currently 493 million % per month as at October 31. To the extent that the price of gold increases over time, asset value increases and cash flows improve; conversely, declines in the price of gold directly impacts value and cash flows. A protracted period of unadjusted gold prices by RBZ could impair the Corporation's operations and development opportunities, and significantly erode shareholder value.

## 10. SECURITIES OUTSTANDING

As at September 30, 2008 the following securities were outstanding:

- (a) 500,169,280 common shares;
- (b) Options and warrants as follows:

Number	Description	Exercise Price	Validity
34,080,000	Common share purchase options	Average \$0.1740	Various until May 11, 2016
12,300,000	Common share purchase warrants	\$0.15	Until January 11, 2009

As the Corporation's Option Plan allows the granting of options on a number of shares equal to 10% of the issued shares, the Corporation could grant options on 50,016,928 shares. This figure includes the current unexercised options. On April 30, 2008 2,370,000 share purchase options were issued at \$0.155 per share and a further 13,950,000 share purchase options were issued at \$0.155 per share during September 2008.

## 11. CONTROLS

### Evaluation of disclosure controls and procedures.

The Company's Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") have evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures, and assessed the design of the Company's internal control over financial reporting as of December 31, 2007, pursuant to the certification requirements of Canadian Multilateral Instrument 52-109 and the requirements of the SEC. The CEO and CFO concluded that, despite the deficiencies noted below, the Company's disclosure controls and procedures were effective as of December 31, 2007.

Based on that evaluation the CEO and CFO have determined that the Company had insufficient personnel to ensure appropriate segregation of duties within the Financial Reporting and Review Process. Specifically, the responsibilities assigned to the Company's CFO include substantially all financial statement and note creation functions. No additional personnel in the Company, apart from the members of the Audit Committee, perform functions at a level of precision and involvement that would adequately prevent or detect immaterial misstatements on a timely basis. As an additional result of the insufficient personnel the Company did not maintain formal policies and procedures regarding end-user computing control over the access to, completeness, accuracy, validity, and review of, certain spreadsheet information that supports the financial reporting process. In 2008 the Company experienced and discovered an operational deficiency that caused the 2007 Form 20-F Annual Report to be filed prior to it being approved by the Disclosure Committee.

Management has concluded that, despite the lack of segregation of duties and computing controls, a material misstatement in financial reporting is not a "reasonable possibility" (as defined in applicable SEC guidance). Blanket (which is operated by the Company's wholly owned subsidiary Blanket Mine (1983) (Private) Limited is

the Company's only operating mine and preparation of its operating results are performed by the CFO of the subsidiary and an accounting team in Zimbabwe. These results are reviewed by Company management and then incorporated into the consolidated financial statements of the Company.

The Company has a Disclosure Committee consisting of four Directors and has disclosure controls and procedures which it follows in an attempt to ensure that it complies with all required disclosures on an adequate and timely basis. The Company's Directors and Management, and the Disclosure Committee, are making all reasonable efforts to ensure that the Company's disclosures are made in full compliance with the applicable rules and requirements. All reasonable efforts are also being made to ensure that the Company's disclosure controls and procedures provide reasonable assurance that the material information relating to the Company, including its consolidated subsidiaries, is made known to the Company's Certifying Officers by others within those entities and to allow timely decisions regarding required disclosures.

## **12. IFRS CHANGEOVER PLAN**

Caledonia is in the preliminary stages of developing a changeover plan with emphasis on the following critical areas:

- the production of IFRS compliant financial statements from the first quarter 2011
  - identification of applicable accounting policies
  - description of the decision making process
  - quantification of the impact of the adoption of IFRS on the financial statements
- internal expertise required to implement IFRS
- the affect on business activities
- the affect on control activities

Caledonia will have to enlist the assistance of consultants or the auditors, where independence issues allow, to assist with the formulation of a detailed plan due to limited internal resources.

A more detailed changeover plan will be discussed in the annual MD&A at the end of 2008.

## **13. BOARD AND SENIOR MANAGEMENT CHANGES**

Dr. Trevor Pearton was appointed VP Exploration on February 15, 2008.

Mark Learmonth, previously of Macquarie First South, was appointed as VP Development and Investor Relations on July 10, 2008.

Mr Leigh A. Wilson who was appointed as a non-executive Director of the Corporation and a member of the Audit Committee on March 28, 2008 and a member of the Disclosure Committee on May 26, 2008 resigned on October 31, 2008.

Mr Robert W. Babensee was appointed as a non-executive Director of the Corporation and a member of the Audit Committee on October 31, 2008 to replace Mr Wilson.

Mr Steve Curtis, VP Finance and Chief Financial Officer of Caledonia was appointed to the Board on June 1, 2008.

At the present time there is a worldwide shortage of senior mining industry professionals and the Corporation is one of many companies looking for suitable staff. With the anticipated sale of the South African gold mines and the planned expansion of the Zambian exploration, mining and metallurgical pilot plant programs the Corporation is re-evaluating its requirements for additional senior staff.

## **Management's Responsibility for Financial Reporting**

### ***To the Shareholders of Caledonia Mining Corporation:***

The accompanying unaudited consolidated financial statements as at September 30, 2008 were prepared by management in accordance with accounting principles generally accepted in Canada, consistently applied and within the framework of the summary of significant accounting policies in these consolidated financial statements. Management is responsible for all information in the quarterly report. All financial and operating data in the quarterly report is consistent, where appropriate, with that contained in the consolidated financial statements.

The Board of Directors discharges its responsibilities for the consolidated financial statements primarily through the activities of its Audit Committee composed of three directors, all of whom are not members of management. This Committee meets with management to assure that it is performing its responsibility to maintain financial controls and systems and to approve the quarterly consolidated financial statements of Caledonia.

The consolidated financial statements have not been reviewed by Caledonia's auditors.

**S. E. Hayden**  
President and  
Chief Executive Officer

**S.R. Curtis**  
Vice-President Finance  
and Chief Financial Officer

<b>Unaudited</b>	<b>Caledonia Mining Corporation Consolidated Balance Sheets (in thousands of Canadian dollars)</b>	
	<b>September 30 2008</b>	<b>December 31 2007</b>
<b>Assets</b>	<b>\$</b>	<b>\$</b>
Current		
Cash and cash equivalents	5,499	76
Accounts receivable	3,424	2,064
Inventories	860	2,085
Prepaid expenses	25	17
Assets held for sale	98	166
	<b>9,906</b>	<b>4,408</b>
<b>Capital Assets and Mineral properties held for sale</b>	<b>701</b>	<b>11,424</b>
<b>Investments</b> (Note 1)	<b>24</b>	<b>22</b>
<b>Capital assets</b> (Note 2)	<b>190</b>	<b>213</b>
<b>Mineral properties</b> (Note 3)	<b>14,570</b>	<b>13,425</b>
	<b>15,485</b>	<b>25,084</b>
	<b>25,391</b>	<b>29,492</b>
<b>Liabilities and Shareholders' Equity</b>		
Current		
Bank overdraft	-	13
Accounts payable	777	2,743
Liabilities held for sale	24	1,587
	<b>801</b>	<b>4,343</b>
<b>Long term liability</b> (Note 11)	<b>-</b>	<b>11</b>
<b>Asset retirement obligation</b> (Note 4)	<b>852</b>	<b>732</b>
<b>Asset retirement obligation - held for sale</b> (Note 4)	<b>181</b>	<b>311</b>
	<b>1,834</b>	<b>5,397</b>
<b>Shareholders' Equity</b>		
Share capital (Note 5)	196,125	195,006
Contributed surplus	1,724	1,040
Accumulated other comprehensive income/(loss)	(55)	(57)
Deficit	(174,237)	(171,894)
	<b>23,557</b>	<b>24,095</b>
	<b>25,391</b>	<b>29,492</b>

On behalf of the Board:

“ S E Hayden”                      Director

“G R Pardoe”                      Director

The accompanying summary of significant accounting policies and notes are an integral part of these consolidated financial statements.

**Caledonia Mining Corporation**  
**Consolidated Statements of Changes in Shareholders' Equity**  
**(in thousands of Canadian dollars)**

**Unaudited**

**For the periods ended September 30, 2008, December 31, 2007 and 2006**

	Share Capital	Contributed Surplus	Accumulated other comprehensive income	Deficit	Total
	\$	\$	\$	\$	\$
Balance at December 31, 2005	180,053	923		(161,604)	19,372
Shares issued	10,573				10,573
Stock options expense		81			81
Options forfeited		(15)			(15)
Net Loss for the year				(5,675)	(5,675)
Balance at December 31, 2006	190,626	989		(167,279)	24,336
Warrants exercised note 5(b)(iv)	4,380				4,380
Adjustment to opening					
Balance, change in accounting					
Policy			31		31
Stock options expense note		61			61
Options forfeited		(10)			(10)
Investments revaluation					
To fair value			(88)		(88)
Net Loss for the year				(4,615)	(4,615)
Balance at December 31, 2007	195,006	1,040	(57)	(171,894)	24,095
Shares issued	1,119				1,119
Stock options expense note 5(c)		684			684
Investments revaluation					
To fair value			2		2
Net Profit for the period				(2,343)	(2,343)
Balance at September 30, 2008	196,125	1,724	(55)	(174,237)	23,557

The accompanying summary of significant accounting policies and notes are an integral part of these consolidated financial statements.

Unaudited	Caledonia Mining Corporation					
	Consolidated Statements of Operations and Comprehensive Income/ (Loss)					
	(in thousands of Canadian dollars except share and per share amounts)					
	For the three months ended September 30			For the nine months ended September 30		
	2008	2007	2006	2008	2007	2006
	\$	\$	\$	\$	\$	\$
<b>Revenue and operating costs</b>						
Revenue from sales	2,280	1,950	4,540	7,668	6,808	4,540
Operating costs	1,978	1,176	2,163	4,595	7,534	2,710
<b>Gross profit (loss)</b>	<b>302</b>	<b>774</b>	<b>2,377</b>	<b>3,073</b>	<b>(726)</b>	<b>1,830</b>
<b>Costs and expenses</b>						
General and administrative	2,016	542	986	3,174	1,584	1,719
Interest expense/(income)	(106)	65	(3)	(133)	120	1
Amortization	101	4	79	302	510	99
Unrealised Foreign exchange loss/(gain)	992	1,017	(1,054)	1,752	1,468	1,432
Other expense (income) (Note 7)	48	-	4	198	(11)	(3)
	3,051	1,628	12	5,293	3,671	3,248
<b>Income (loss) before discontinued operations</b>	<b>(2,749)</b>	<b>(854)</b>	<b>2,365</b>	<b>(2,220)</b>	<b>(4,397)</b>	<b>(1,418)</b>
<b>Current Income Tax</b>	<b>-</b>	<b>(1)</b>	<b>(106)</b>	<b>-</b>	<b>(3)</b>	<b>(107)</b>
<b>Net income(loss) before discontinued operations</b>	<b>(2,749)</b>	<b>(855)</b>	<b>2,259</b>	<b>(2,220)</b>	<b>(4,400)</b>	<b>(1,525)</b>
<b>Discontinued operations (loss)</b>	<b>(30)</b>	<b>(80)</b>	<b>(5,333)</b>	<b>(123)</b>	<b>(460)</b>	<b>(6,708)</b>
<b>Net Income/(loss) after discontinued operations</b>	<b>(2,779)</b>	<b>(935)</b>	<b>(3,074)</b>	<b>(2,343)</b>	<b>(4,860)</b>	<b>(8,233)</b>
<b>Revaluation of Investments to fair value (Note 1)</b>	<b>(6)</b>	<b>(76)</b>	<b>-</b>	<b>2</b>	<b>(76)</b>	<b>-</b>
<b>Comprehensive Income/(Loss)</b>	<b>(2,785)</b>	<b>(1,011)</b>	<b>(3,074)</b>	<b>(2,341)</b>	<b>(4,936)</b>	<b>(8,233)</b>
Income/(loss) per share (Note 6)						
Basic and diluted from continuing operations	(\$0.005)	(\$0.002)	\$0.006	(\$0.004)	(\$0.009)	(\$0.004)
Basic and diluted from discontinued operations	-	-	(\$0.013)	-	(\$0.001)	(\$0.017)
Basic and diluted for the year	(\$0.005)	(\$0.002)	(\$0.007)	(\$0.004)	(\$0.010)	(\$0.021)

The accompanying summary of significant accounting policies and notes are an integral part of these consolidated financial statements.

**Caledonia Mining Corporation**  
**Consolidated Statement of Cash Flows**  
(in thousands of Canadian dollars)

**Unaudited**

	For the three months ended			For the Nine months ended		
	2008	2007	2006	2008	2007	2006
	September 30	September 30	September 30	September 30	September 30	September 30
	\$	\$	\$	\$	\$	\$
<b>Cash provided by (used in)</b>						
<b>Operating activities</b>						
Income(loss) before discontinued operations	(2,749)	(855)	(2,259)	(2,220)	(4,400)	(1,525)
Adjustments to reconcile net cash from operations (Note 8)	835	3	297	1,073	415	356
Changes in non-cash working capital balances (Note 8)	(73)	396	3,357	(2,142)	1,766	669
	<b>(1,987)</b>	<b>(456)</b>	<b>5,913</b>	<b>(3,289)</b>	<b>(2,219)</b>	<b>(500)</b>
<b>Investing activities</b>						
Expenditures on capital assets and mineral properties	(993)	(904)	(1,304)	(1,493)	(2,284)	(1,436)
Investment in Blanket net of cash received	-	-	(859)	-	-	(859)
Sale of Barbrook Mine	(19)	-	-	9,213	-	-
	<b>(1,012)</b>	<b>(904)</b>	<b>(2,163)</b>	<b>7,720</b>	<b>(2,284)</b>	<b>(2,295)</b>
<b>Financing activities</b>						
Bank overdraft	-	-	-	(13)	-	(197)
Shares held in Escrow	-	-	(3,014)	-	-	-
Issue of share capital net of issue costs	-	-	2,160	1,119	4,380	7,559
	-	-	(854)	1,106	4,380	7,362
Cash flow from discontinued operations						
Operating activities	(29)	(80)	(5,333)	(123)	(460)	(6,708)
Amortization	1	5	1,767	9	21	2,893
Financing activities	-	-	-	-	-	-
Investing activities	-	(55)	262	-	(55)	(922)
	<b>(28)</b>	<b>(130)</b>	<b>(3,304)</b>	<b>(114)</b>	<b>(494)</b>	<b>(4,737)</b>
<b>Increase (decrease) in cash for the period</b>	<b>(3,027)</b>	<b>(1,490)</b>	<b>(408)</b>	<b>5,423</b>	<b>(617)</b>	<b>(170)</b>
<b>Cash and cash equivalents, beginning of the period</b>	<b>8,526</b>	<b>2,171</b>	<b>1,314</b>	<b>76</b>	<b>1,298</b>	<b>1,076</b>
<b>Cash and cash equivalents, end of the period</b>	<b>5,499</b>	<b>681</b>	<b>906</b>	<b>5,499</b>	<b>681</b>	<b>906</b>
<b>Cash and cash equivalents at end of the period relate to:</b>						
<b>Continuing operations</b>	<b>5,500</b>	<b>691</b>	<b>863</b>	<b>5,500</b>	<b>691</b>	<b>863</b>
<b>Discontinued operations</b>	<b>(1)</b>	<b>(10)</b>	<b>43</b>	<b>(1)</b>	<b>(10)</b>	<b>43</b>
	<b>5,499</b>	<b>681</b>	<b>906</b>	<b>5,499</b>	<b>681</b>	<b>906</b>

The accompanying summary of significant accounting policies and notes are an integral part of these consolidated financial statements.

### **Nature of Business**

The Corporation is engaged in the acquisition, exploration and development of mineral properties for the exploitation of base and precious metals. The ability of the Corporation to recover the amounts shown for its capital assets and mineral properties is dependent upon the existence of economically recoverable reserves; the ability of the Corporation to obtain the necessary financing to complete exploration and development; and future profitable production or proceeds from the disposition of such capital assets and mineral properties.

The Corporation operates in a number of operating segments but its assets located in Zimbabwe, including its interests in gold properties, are subject to a hyperinflationary environment and may be subject to sovereign risks, including political and economic instability, government regulations relating to mining, currency fluctuations and inflation, all or any of which may impede the Corporation's activities in this country or may result in the impairment or loss of part or all of the Corporation's interest in the properties.

### **Basis of Presentation and Going Concern**

These unaudited interim consolidated financial statements of Caledonia Mining Corporation ("Caledonia" or the "Corporation") have been prepared by management in accordance with accounting principles generally accepted in Canada ("Canadian GAAP") for interim financial statements. Certain information and note disclosures normally included in the annual consolidated financial statements prepared in accordance with Canadian GAAP have been condensed or excluded. As a result, these unaudited interim consolidated financial statements do not contain all disclosures required to be included in the annual consolidated financial statements and should be read in conjunction with the most recent audited annual consolidated financial statements and notes thereto for the year ended December 31, 2007.

These unaudited consolidated financial statements have been prepared on the basis of a going concern, which contemplates that the Corporation will be able to realize assets and discharge liabilities in the normal course of business. The Corporation's ability to continue as a going concern is dependent upon attaining profitable operations, realising proceeds from the disposal of mineral properties and obtaining sufficient financing to meet its liabilities, its obligations with respect to operating expenditures and expenditures required on its mineral properties.

### **Significant Accounting Policies:**

These unaudited interim consolidated financial statements are prepared with the following accounting policies consistent with the Corporation's audited annual consolidated financial statements and notes thereto for the year ended December 31, 2007, except for the following changes in accounting policies:

### **Adoption of New Accounting Standards**

#### **a. Inventories:**

Effective January 1, 2008, the Corporation adopted the new recommendations of the Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3031, Inventories. This standard provides guidance on the determination of cost and its subsequent recognition as an expense, including any write-downs to net realizable

value. It also provides guidance on the cost formulas that are used to assign costs to inventories and requires the reversal of write downs, if applicable, on inventory. There were no changes to the Corporation's accounting policies required on implementation of this standard.

**b. Financial Instruments – Disclosures**

Effective January 1, 2008, the Corporation adopted the new recommendations of CICA Handbook Section 3862, Financial Instruments - Disclosures; Section 3863, Financial Instruments – Presentation.

Section 3862 on financial instrument disclosures, provides guidance on disclosures in the financial statements to enable users of the financial statements to evaluate the significance of financial instruments to the Corporation's financial position and performance and about risks associated with both recognized and unrecognized financial instruments and how these risks are managed. The new Section requires qualitative and quantitative information relating to concentrations of risk, credit risk, liquidity risk and price risk currently found in Section 3861.

Section 3863 carries forward unchanged the presentation requirements of Section 3861. This Section establishes standards for presentation of financial instruments and non-financial derivatives. It deals with the classification of financial instruments, from the perspective of the issuer, between liabilities and equity, the classification of related interest, dividends, losses and gains, and the circumstances in which financial assets and financial liabilities are offset.

The Corporation has included disclosures recommended by these sections in Notes 12 and 13 to these unaudited interim consolidated financial statements.

**c. Capital Disclosures**

Effective January 1, 2008, the Corporation adopted the new recommendations of CICA Handbook Section 1535- Capital Disclosures. Section 1535 requires the disclosure of an entity's objectives, policies and processes for managing capital as well as quantitative data about what the entity regards as capital. Disclosure of externally imposed capital requirements is also required and whether the entity has complied with these and, if not, the consequences.

The Corporation has included disclosures recommended by the new section in Note 14 to these unaudited interim consolidated financial statements

**d. Financial Statements Presentation**

Effective January 1, 2008, the Corporation adopted the new recommendations of CICA amended Handbook Section 1400-General Standards of Financial Statements Presentation. The section provides revised guidance related to management's responsibility to assess and disclose the ability of an entity to continue as a going concern.

**Recently issued accounting pronouncements issued and not yet effective**

In February 2008, the Canadian Institute of Chartered Accountants ("CICA") issued Section 3064 Goodwill and intangible assets, replacing Section 3062, Goodwill and other intangible assets. The new Section will be applicable to financial statements relating to fiscal years beginning on or after October 1, 2008. Accordingly, the Corporation will adopt the new standards for its fiscal year beginning 1 January 2009. It establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill are unchanged from the standards included in the previous Section 3062. The Corporation is currently evaluating the impact of the adoption of this new Section on its consolidated financial statements.

**International Financial Reporting Standards ("IFRS")**

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

**Other Existing Accounting Policies**

**Inventories**

These include gold in circuit (WIP) and bulk consumable stores. WIP is valued at the lower of the cost of production, on an average basis, at the various stages of production or net realisable value if the cost of production exceeds the current gold price. Bulk consumable stores are valued at the lower of cost or net realisable value on an average basis.

**Capital Assets**

***Producing Assets***

Producing assets are recorded at cost less grants, accumulated amortization and write-downs. Producing plant and equipment assets are amortized using the unit-of-production method on the ratio of tonnes of ore mined or processed to the estimated proven and probable mineral reserves as defined by the Canadian Institute of Mining, Metallurgy and Petroleum.

Other producing assets are amortized using the straight line method basis on the estimated useful lives of the assets. The estimated life of the producing assets ranges up to 10 years. Repairs and maintenance expenditures are charged to operations; major improvements and replacements which extend the useful life of an asset are capitalized and amortized over the remaining useful life of that asset. Eersteling Gold Mine has been put up for sale and is thus presented as assets for sale in these consolidated financial statements.

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**Caledonia Mining Corporation**  
**Summary of Significant Accounting Policies (continued)**  
(in thousands of Canadian Dollars)

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***Non-Producing Assets***

Non-producing assets are recorded at cost less write downs. At the time of commercial production, the assets are reclassified as producing. During non-producing periods, no amortization is recorded on plant and equipment but vehicles and computer equipment continue to be amortized.

***Assets held for sale and discontinued operations***

The sale of Barbrook Mine was concluded on May 31, 2008 and is thus no longer shown as an asset for sale.

The components shown as held for sale in the Balance Sheet are as follows:

	Eersteling Gold Mine	
	September 30	December 31
	2008	2007
	\$	\$
Capital Assets and mineral properties	<b>701</b>	645
Current Assets	<b>98</b>	78
Current Liabilities	<b>(24)</b>	(38)
Asset Retirement obligation	<b>(181)</b>	(204)

As a consequence of this Eersteling Mine's results for 2008 are disclosed as discontinued operations and the comparative results include Barbrook and Eersteling. Revenue from discontinued operations for the nine months ended September is nil (\$61 in 2007 and \$2,818 in 2006). There is no tax applicable to discontinued operations.

**Mineral Properties**

***Producing Properties***

When and if properties are placed in production, the applicable capitalized costs are amortized using the unit-of-production method as described above. Blanket Mine (1983) (Private) Limited ("Blanket") was acquired during 2006 and has been consolidated into these results from July 1, 2006 and, as such, has been presented as a producing asset in these consolidated financial statements.

***Non-Producing Properties***

Costs relating to the acquisition, exploration and development of non-producing resource properties which are held by the Corporation or through its participation in joint ventures are capitalized until such time as either economically recoverable reserves are established or the properties are sold or abandoned.

A decision to abandon, reduce or expand activity on a specific project is based upon many factors including general and specific assessments of mineral reserves, anticipated future mineral prices, anticipated costs of developing and operating a producing mine, the expiration date of mineral property leases, and the general likelihood that the Corporation will continue exploration on the project. However, based on the results at the conclusion of each phase of an exploration program, properties that are not suitable as prospects are re-evaluated to determine if future exploration is warranted and that carrying values are appropriate.

The ultimate recovery of these costs depends on the discovery and development of economic ore reserves or the sale of the properties or the mineral rights. The amounts shown for non-producing resource properties do not necessarily reflect present or future values.

**Foreign Currency Translation**

Balances of the Corporation denominated in foreign currencies and the accounts of its foreign subsidiaries are translated into Canadian dollars as follows:

- (i) monetary assets and liabilities at period end rates;
- (ii) all other assets and liabilities at historical rates, and
- (iii) revenue and expense transactions at the average rate of exchange prevailing during the period.

Exchange gains or losses arising on these translations are reflected in income in the year incurred.

Blanket is a self-sustaining operation and operates in Zimbabwe in a hyper inflationary economy. Accordingly the results of these operations have been translated into Canadian Dollars using the temporal method. Included in the statement of operations is an exchange loss for the nine month period of \$2,203 (Loss \$1,048 – 2007) relating to the translation of Blanket. See note 16.

**Caledonia Mining Corporation**  
**Notes to the Consolidated Financial Statements**

(in thousands of Canadian Dollars unless otherwise indicated and except for share and per share amounts)

**1. Investments**

On May 9, 2002, the Corporation participated in a private placement of the purchase of shares of Motapa Diamonds Inc. ("Motapa") at a cost of \$79. The shares of Motapa are listed on the TSX Venture Exchange in Canada.

The adoption of CICA Handbook Sections 3855 and 1530, retrospectively from January 1, 2007, determines that the Corporation records its investments in Motapa Diamonds Inc. and in Old Mutual Plc as financial instruments "available for sale" and they are thus recorded at fair value.

The fair value of the investment, at September 30 in Motapa Diamonds Inc is \$20 (\$19 -2007) and the fair value of the shares held in Old Mutual Plc is \$4 (\$8 - 2007).

**2. Capital Assets**

	September 30, 2008		
	<u>Cost</u> <sup>(1)</sup>	<u>Accumulated</u> <u>Amortization</u>	<u>Net</u> <u>Book Value</u>
	\$	\$	\$
Land – plant sites	12	-	12
Plant and equipment			
- producing <sup>(2)</sup>	24	3	21
- non-producing <sup>(3)</sup>	229	229	-
Office equipment	908	851	57
Vehicles	387	287	100
	1,560	1,370	190
	December 31, 2007		
	<u>Cost</u> <sup>(1)</sup>	<u>Accumulated</u> <u>Amortization</u>	<u>Net</u> <u>Book Value</u>
	\$	\$	\$
Land - plant sites	12	-	12
Plant and equipment			
- producing <sup>(2)</sup>	24	1	23
- non-producing <sup>(3)</sup>	229	229	-
Office equipment	887	838	49
Vehicles	387	258	129
	1,539	1,326	213

<sup>(1)</sup> Cost is comprised of the original cost of the asset, less write-downs, removal of cost for disposals and government grants.

<sup>(2)</sup> The producing plant and equipment relates to the Blanket operation.

<sup>(3)</sup> The net book value of non-producing plant and equipment represents Zambian operations.



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**4. Asset Retirement Obligation**

	<u>September 30</u> <u>2008</u>	<u>December 31</u> <u>2007</u>
	\$	\$
Continuing operation- balance at December 31, 2007	732	811
Accretion expense	33	35
Unrealised foreign exchange loss (gain)	87	(114)
<b>Closing balance at September 30, 2008</b>	<b>852</b>	<b>732</b>
Held for sale operations- balance at December 31, 2007	311	364
Sale of Barbrook Mine	(106)	-
Unrealised foreign exchange loss (gain)	(24)	(53)
<b>Closing balance – at September 30, 2008.</b>	<b>181</b>	<b>311</b>

The asset retirement obligations relate to Blanket \$852 (\$732 – 2007) and Eersteling Gold Mine \$181 (\$311 – 2007) and are estimates of costs of rehabilitation at the end of the mine life, increased annually for accretion expense at a rate of 5%. As Eersteling Gold Mine is on care and maintenance no accretion was made in 2008.

**5. Share Capital**

- (a) Authorized
  - An unlimited number of common shares
  - An unlimited number of preference shares.
- (b) Issued

	<u>Number of Shares</u>	<u>Amount</u> \$
Common shares		
Balance, December 31, 2005	370,715,136	180,053
Issued pursuant to private placement (i)	15,437,626	1,475
Issued pursuant to a private placement (ii)	34,828,259	3,924
Issued pursuant to acquisition (Note 14)	20,000,000	3,014
Issued pursuant to a private placement (iii)	17,000,000	2,160
Balance - December 31 , 2006	457,981,021	190,626
Warrants exercised (iv)	29,888,259	4,380
Balance - December 31 , 2007	487,869,280	195,006
<b>Issued pursuant to a private placement (v)</b>	<b>12,300,000</b>	<b>1,119</b>
<b>Balance – September 30 , 2008</b>	<b>500,169,280</b>	<b>196,125</b>

**Caledonia Mining Corporation**  
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(in thousands of Canadian Dollars unless otherwise indicated and except for share and per share amounts)

- (b) (i) During December 2005, the Corporation commenced a private placement to raise \$3,496. As at December 31, 2005, the first closing raised gross proceeds of \$1,875 comprising 17,850,000 units. The balance of the offering was received by February 2006 upon completion of the second to fourth closings (see Note 14 below). A total of 33,287,626 units priced at \$0.105 were subscribed for all closings. Each unit consisted of one common share and one common share purchase warrant. The common share purchase warrants are exercisable for one common share at \$0.20 per whole warrant for a period of 24 months from the date of issuance.

The private placement agents were paid a commission of 9% of the gross proceeds raised. Cash commissions paid on the first closing amounted to \$168 and has been charged to share capital in 2005.

- (ii) In April 2006 the Corporation commenced a private placement to raise additional funds. This placement raised \$3,924 after expenses from the sale of 34,828,259 units. Each unit consists of one common share and one share purchase warrant.
- (iii) In July 2006 the Corporation completed a private placement to raise additional funds. This placement of 17,000,000 units, each consisting of one common share and one share purchase warrant, was completed in July 2006 and raised \$2,160 after expenses.
- (iv) In April and May 2007 shareholders holding 29,888,259 warrants at \$0.15 each exercised the warrants raising \$4,380 after expenses.
- (v) In February 2008 the Corporation completed a private placement to raise additional funds. This placement raised \$1,119 after expenses from the sale of 12,300,000 units. Each unit consists of one common share and one common share purchase warrant.

(c) Stock Option Plans and Stock-Based Compensation

The Corporation has established incentive stock option plans (the "Plans") for employees, officers, directors, consultants and other service providers. Under the Plans, as at September 30, 2008, the Corporation has the following options outstanding:

<u>Number of Options</u>	<u>Exercise Price</u>	<u>Expiry Date</u>
	\$	
10,000,000	0.235	April 24, 2012
150,000	0.345	June 2, 2012
610,000	0.260	April 29, 2014
200,000	0.260	August 15, 2014
4,000,000	0.110	February 15, 2015
1,000,000	0.140	July 10, 2010
300,000	0.125	May 11, 2016
200,000	0.110	January 23, 2017
1,100,000	0.1125	May 31, 2012
200,000	0.1125	May 31, 2012
16,320,000	0.155	Mar 18, 2013
<u>34,080,000</u>	<u>0.1740</u>	

**Caledonia Mining Corporation**  
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The continuity of the options granted, exercised, cancelled and expired under the Plans during 2008, 2007 and 2006 are as follows:

	<u>Number of Options</u>	<u>Weighted Avg. Exercise Price</u> \$
Options outstanding at December 31, 2005	16,898,000	0.21
Granted	450,000	0.13
Forfeited or expired	(110,000)	(0.27)
Options outstanding at December 31, 2006	17,238,000	0.21
Forfeited or expired	(150,000)	(0.115)
Granted	200,000	0.11
Granted	1,300,000	0.1125
Options outstanding at December 31, 2007	18,588,000	0.198
Forfeited or expired	(828,000)	(0.33)
Granted	16,320,000	0.155
<b>Options outstanding at September 30, 2008</b>	<b>34,080,000</b>	<b>0.174</b>

The options to purchase common shares noted above, have been granted to directors, officers, employees and service providers at exercise prices determined by reference to the market value of the common shares on the date of grant. The vesting of options is made at the discretion of the board of directors at the time the options are granted. A stock option expense of \$684 (\$40 – 2007) has arisen from the granting of 2,370,000 options during April, 2008 and a further 13,950,000 options during September 2008.

(d) Warrants

The Corporation has issued the following common share purchase warrants pursuant to private placements which are outstanding as of September 30, 2008:

<u>Number of Warrants</u>	<u>Shares for Warrants</u>	<u>Exercise Price</u>	<u>Expiry Date</u>
12,300,000	1 for 1	\$0.15	February 21, 2009

The continuity of warrants issued and outstanding is as follows:

	<u>Number of Warrants</u>
Outstanding December 31, 2005	17,850,000
Issued pursuant to private placements	67,265,885
Outstanding December 31, 2006	85,115,885
Exercised	(29,888,259)
Expired	(39,790,000)
Outstanding December 31, 2007	15,437,626
Expired	(15,437,626)
Issued pursuant to private placements	12,300,000
<b>Outstanding September 30, 2008</b>	<b>12,300,000</b>

**Caledonia Mining Corporation**  
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**6. Net Income/ (Loss) Per Share**

The net income/ (loss) per share figures have been calculated using the weighted average number of common shares outstanding during the respective quarter which amounted to 500,169,280 (2007 – 487,869,280; 2006 – 455,209,281). Fully diluted income/ (loss) per share have not been calculated as it would be anti-dilutive.

**7. Other Expense (Income) before discontinued operations**

Other expense (income) is comprised of the following:

	<u>Three months ended September 30</u>			<u>Nine months ended September 30</u>		
	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>
	\$	\$	\$	\$	\$	\$
Realised foreign exchange loss on sale of Barbrook Mine	53	-	-	203	-	-
Other	(5)	-	4	(5)	(11)	(3)
	<b>48</b>	<b>-</b>	<b>4</b>	<b>198</b>	<b>(11)</b>	<b>(3)</b>

**8. Statement of Cash Flows**

Items not involving cash are as follows:

	<u>Three months ended September 30</u>			<u>Nine months ended September 30</u>		
	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>
	\$	\$	\$	\$	\$	\$
Amortization	101	4	79	302	15	99
Rehabilitation accretion	11	(52)	-	33	(146)	-
Blanket long term liability	-	-	-	(11)	-	-
Share option expenses	616	40	-	684	40	-
Write down of mineral property	-	-	293	-	495	293
Other	107	11	(75)	65	11	(36)
	<b>835</b>	<b>3</b>	<b>297</b>	<b>1,073</b>	<b>415</b>	<b>356</b>

The net changes in non-cash working capital balances for operations are as follows:

	<u>Three months ended September 30</u>			<u>Nine months ended September 30</u>		
	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>
	\$	\$	\$	\$	\$	\$
Accounts payable	(36)	163	232	(1,979)	(3,426)	314
Accounts receivable	(537)	(147)	(368)	(1,359)	608	93
Inventories	613	377	411	1,225	4,445	169
Prepaid expenses	(11)	(12)	3,082	(9)	33	93
Assets held for sale	(102)	15	-	(20)	106	-
	<b>(73)</b>	<b>396</b>	<b>3,357</b>	<b>(2,142)</b>	<b>1,766</b>	<b>669</b>

**Caledonia Mining Corporation**  
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Supplemental cash flow Information:

	Three months ended September 30			Nine months ended September 30		
	2008	2007	2006	2008	2007	2006
	\$	\$	\$	\$	\$	\$
Interest paid	56	65	-	100	120	4
Interest (received)	(162)	-	(3)	(233)	-	(3)
Tax paid	-	1	107	-	3	107

**9. Segmental Information**

For the nine months ended September 30,

2008

	Corporate	Zimbabwe	South Africa	Zambia	Total
	\$	\$	\$	\$	\$
Revenue from sales	4	7,664	-	-	7,668
Operating costs	-	(4,184)	(411)	-	(4,595)
General and administrative	(2,864)	(49)	(260)	-	(3,173)
Interest	226	(100)	7	-	133
Amortization	-	(292)	(10)	-	(302)
Foreign exchange gains/(loss)	238	(1,878)	(9)	(103)	(1,752)
Other income (expense)	-	-	(198)	-	(198)
Income (loss) for continuing operations	(2,396)	1,160	(881)	(103)	(2,220)
Discontinued operations (loss)	-	-	(123)	-	(123)
Income tax expense	-	-	-	-	-
Net income (loss) for the year	(2,396)	1,160	(1,004)	(103)	(2,343)
Identifiable assets	5,473	8,775	5,032	5,312	24,592
Expenditure on capital assets and mineral properties	-	45	264	1,184	1,493

For the nine months ended September 30,

2007

	Corporate	Zimbabwe	South Africa	Zambia	Total
	\$	\$	\$	\$	\$
Revenue from sales	4	6,804	-	-	6,808
Operating costs	-	(5,975)	(1,559)	-	(7,534)
General and administrative	(1,290)	(1)	(293)	-	(1,584)
Interest	-	(119)	(1)	-	(120)
Amortization	(495)	(3)	(12)	-	(510)
Foreign exchange gains/(loss)	(3)	(2,373)	873	35	(1,468)
Other income (expense)	-	11	-	-	11
Income (loss) for continuing operations	(1,784)	(1,656)	(992)	35	(4,397)
Discontinued operations (loss)	-	-	(460)	-	(460)
Income tax expense	-	(3)	-	-	(3)
Net income (loss) for the year	(1,784)	(1,659)	(1,452)	35	(4,860)
Identifiable Assets	777	7,317	3,886	3,312	15,292
Expenditure on capital assets and mineral properties	-	616	11	1,657	2,284

**10. Contingent Liability**

In the Share Sale Agreement dated May 12, 2006 pursuant to which the Corporation purchased 100% of the shares of Blanket, the Corporation agreed that it would, as soon as reasonably practicable after the Closing of the Agreement, cause Blanket to implement a share incentive scheme considered by the Directors to be in the best interests of Blanket, pursuant to which a percentage of the shares of Blanket will be deposited in a Trust for the benefit of the management and employees of Blanket. As at December 31, 2007 no scheme had been established, nor were any shares of Blanket deposited in a Trust for the purposes of such a scheme. The Corporation and the Board of Directors of Blanket have delayed the establishment of the required scheme pending clarification of the anticipated Zimbabwe laws relating to the indigenization of the mining industry, as it is recognized that the Zimbabwean laws will likely have a material impact on the structure of the proposed scheme and the percentage of the issued shares of Blanket required to be put into trust for the purposes of the scheme.

**11. Long Term Liability**

The long term liability refers to a provision for the Service Bonus Fund relating to employees at Blanket in Zimbabwe. The fund was established earlier to provide a gratuity to permanent employees of Blanket on cessation of employment at Blanket for any reason apart from dismissal or resignation. The provision is built up by providing 15% of an employee's basic salary per year up to a maximum of Z\$5,000,000 (old currency). The maximum payout to any employee is Z\$5,000,000 (five million Zimbabwe Dollars – old currency) in terms of the current rules. See note 16.

This fund represents a defined contribution future employee benefit fund for which the funds have not been segregated by the Corporation.

Due to the hyper-inflationary environment in Zimbabwe this liability is shown as Nil in the balance sheet due to the translation of the Zimbabwe dollar value into Canadian dollars.

**12. Fair Value of Financial Instruments**

The Corporation has various financial instruments comprising of cash and cash equivalents, trade receivables, investments, accounts payable, bank overdrafts, accrued liabilities and long-term debts.

The various assets and liabilities were classified as follows on adoption:

- (a) Cash and cash equivalents are classified as "assets held for trading". They are stated at fair value and any gains/losses arising on revaluation at the end of each period are included in the statement of operations. We have no derivative financial instruments that would have been classified on a similar basis.
- (b) Investments are classified as "assets available for sale". They are presented at fair value and the gains/losses arising from their revaluation at the end of each quarter will be included in other comprehensive income. When a decline in fair value is other than temporary, the accumulated loss that had been recognized directly in other comprehensive income is removed from accumulated other comprehensive income and recognized in net income even though the financial asset has not been derecognized.
- (c) Accounts receivables are classified under "loans and receivables". They are recorded at their original cost which is deemed their fair value at that time. Subsequent measurement will be at amortized cost using the effective interest rate method.

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**Caledonia Mining Corporation**  
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- (d) Bank overdraft is classified as a “financial liability held for trading” as there is a contractual obligation to deliver cash. It is measured at fair value which is book value plus accrued interest. It is stated at fair value and any gains/losses arising on revaluation at the end of each period are included in the statement of operations.
- (e) Accounts payable and accrued liabilities and long term debt are classified under “other financial liabilities”. They are recorded at their fair value at that time. Subsequent measurement will be at amortized cost using the effective interest rate method.

### **13. Financial Risk Exposure and Risk Management**

The Corporation is exposed in varying degrees to a variety of financial instrument related risks by virtue of its activities. The overall financial risk management program focuses on preservation of capital, and protecting current and future Corporation assets and cash flows by reducing exposure to risks posed by the uncertainties and volatilities of financial markets.

The Board of Directors has responsibility to ensure that an adequate financial risk management policy is established and to approve the policy. The Corporation’s Audit Committee oversees management’s compliance with the Corporation’s financial risk management policy.

The types of risk exposure and the way in which such exposures are managed are as follows:

#### **(a) Currency Risk**

As the Corporation operates in an international environment, some of the Corporation’s financial instruments and transactions are denominated in currencies other than the Canadian Dollar. The results of the Corporation’s operations are subject to currency transaction risk and currency translation risk. The operating results and financial position of the Corporation are reported in Canadian dollars in the Corporation’s consolidated financial statements.

The fluctuation of the Canadian dollar in relation to other currencies will consequently have an impact upon the profitability of the Corporation and may also affect the value of the Corporation’s assets and the amount of shareholders’ equity.

A significant portion of the Corporation’s assets and liabilities are denominated in South African rand and Zimbabwe dollars. Management do not consider that the fluctuation of the value of the South African Rand to the Canadian Dollar could have a significant impact on the results of operations. Blanket operation is subject to a hyperinflationary environment in Zimbabwe, foreign creditors are denominated in Rands and local costs increase with inflation. As the official exchange rate is fixed and the effective buying power of the Zimbabwe Dollar decreases accordingly there could be a significant impact on the results of the operations. The shareholder loan account in Zimbabwe is denominated in US Dollars and will generate foreign exchange losses for Blanket in Zimbabwe Dollar terms but the effect on the consolidated financial statements in Canadian Dollars is unlikely to be significant. The fair values of these financial instruments approximate their carrying values, unless otherwise noted. The Corporation does not use any derivative instruments to reduce its foreign currency risks.

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Below is a summary of the cash or near cash items denominated in a currency other than the Canadian dollar that would be affected by changes in exchange rates relative to the Canadian dollar. All values are in thousands. See note 16.

As at September 30, 2008			
'000	US Dollars	Zimbabwe Dollars	SA Rand
Cash	1	(64)	600
Accounts Receivable	3,106	8,033	1,813
Accounts Payable	77	17,223	1,057

The table below illustrates by how much a 1% change in the rate of exchange between the Canadian dollar and the currencies above will affect net income.

'000	US Dollars	Zimbabwe Dollars	SA Rand
Cash	-	-	1
Accounts Receivable	30	1	2
Accounts Payable	1	1	1

**(b) Interest Rate Risk**

Interest rate risk is the risk borne by an interest-bearing asset or liability as a result of fluctuations in interest rates.

Unless otherwise noted, it is the opinion of management that the Corporation is not exposed to significant interest rate risk as it is debt free and only utilizes overdraft facilities for short periods if necessary. The Corporation's cash and cash equivalents include highly liquid investments that earn interest at market rates. The Corporation manages its interest rate risk by endeavoring to maximize the interest income earned on excess funds while maintaining the liquidity necessary to conduct operations on a day-to-day basis. The Corporation's policy focuses on preservation of capital and limits the investing of excess funds to liquid term deposits in "A" grade financial institutions.

Fluctuations in market interest rates have not had a significant impact on the Corporation's results of operations due to the short-term to maturity of the investments held.

**(c) Concentration of Credit Risk**

Credit risk is the risk of a financial loss to the Corporation if a gold sales customer fails to meet its contractual obligation. Credit risk arises principally from the Corporation's receivables from the Reserve Bank of Zimbabwe ("RBZ") which is the sole buyer of gold produced in Zimbabwe, in terms of legislation.

At December 31, 2007 the RBZ owed Blanket US\$1,780,000 (one million seven hundred and eighty thousand US dollars) and at September 30, 2008 this had increased to US\$3,098,000 despite having received two payments of US\$325,000 and US\$1,125,000 and having paid roughly US\$606,000 to various suppliers in Zimbabwe from the amounts due by RBZ. The lack of foreign currency in Zimbabwe affects all business sectors and management maintains close relations with RBZ to ensure payments are made whenever necessary, to sustain operations, within the capabilities of the RBZ.

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In the Monetary Policy Statement announced by RBZ on April 30, 2008 an exporter who is owed foreign currency by RBZ is now allowed to sell the currency to a willing buyer through the commercial bank system at a negotiated rate.

In light of the recent Monetary Policy Statement, which includes new methods to recover funds owed by the RBZ, no provision has been made against the trade receivable due by the RBZ.

**(d) Liquidity Risk**

Liquidity risk is the risk that the Corporation will not be able to meet its financial obligations as they fall due.

The Corporation manages its liquidity by ensuring that there is sufficient capital to meet its likely cash requirements, after taking into account cash flows from operations and the Corporation's holdings of cash and cash equivalents. The Corporation believes that these sources will be sufficient to cover the likely short and long term cash requirements. Senior management is also actively involved in the review and approval of planned expenditures by regularly monitoring cash flows from operations and anticipated investing and financing activities.

Blanket in Zimbabwe continues to be self funding.

**(e) Commodity Price Risk**

The value of the Corporation's mineral resource properties is related to the price of gold, platinum and cobalt, and the outlook for these minerals. In addition, adverse changes in the price of certain raw materials can significantly impair the Corporation's cash flows.

Gold prices historically have fluctuated widely and are affected by numerous factors outside of the Corporation's control, including, but not limited to, industrial and retail demand, central bank lending, forward sales by producers and speculators, levels of worldwide production, short-term changes in supply and demand because of speculative hedging activities, and macro-economic variables, and certain other factors related specifically to gold.

The major factor influencing commodity price risk is that RBZ does not pay Blanket market value for gold produced.

During the quarter the RBZ bought gold for USD at a discount to the market price of approximately 25% or if sold for Zimbabwe dollars at a price determined by the inter-bank exchange rate.

The profitability of the Blanket is highly correlated to the controlled price paid by RBZ and the hyperinflationary conditions experienced in Zimbabwe, currently 493 million % per month as at October 31, 2008. To the extent that the price of gold increases over time, asset value increases and cash flows improve; conversely, declines in the price of gold directly impact value and cash flows.

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**Caledonia Mining Corporation**  
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**14. Capital Management**

The Corporation's objectives when managing capital are to safeguard its ability to continue as a going concern in order to pursue the mining operations and exploration potential of the mineral properties.

The Corporation's capital includes short-term debt, long-term debt and equity, comprising issued common shares, contributed surplus and accumulated deficit.

The Corporation's primary objective with respect to its capital management is to ensure that it has sufficient cash resources to maintain its ongoing operations, to provide returns for shareholders and benefits for other stakeholders and to pursue growth opportunities. To secure additional capital to pursue these plans, the Corporation may attempt to raise additional funds through borrowing and/or the issuance of equity, debt or by securing strategic partners.

In order to maximize ongoing exploration efforts, the Corporation does not pay dividends.

As at September 30, 2008, the Corporation is not subject to externally imposed capital requirements and there has been no change with respect to the overall capital risk management strategy.

Shareholders' Equity	As at September 30, 2008	As at December 31, 2007
Issued common shares	196,125	195,006
Contributed surplus	1,724	1,040
Other comprehensive income	(55)	(57)
Deficit	(174,237)	(171,894)
Total	23,557	24,095

**15. Comparative Figures**

The prior period figures have been reclassified to conform to the current presentation.

**16. Subsequent Events**

The President of the Republic of Zimbabwe brought the Indigenisation and Economic Empowerment Act into law through decree during March 2008. The law seeks to ensure that a majority stake (at least 51%) in all companies is held by indigenous Zimbabweans. The acquisition of the 51% would be on a "willing buyer willing seller" basis. The statutory instrument enacting the above bill was passed on April 17, 2008. No further action has been taken in this regard.

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**Caledonia Mining Corporation**  
**Notes to the Consolidated Financial Statements**

(in thousands of Canadian Dollars unless otherwise indicated and except for share and per share amounts)

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In the Monetary Policy Statement announced by the Governor of the RBZ on July 30, 2008 the Zimbabwe dollar has been devalued by scrapping 10 zeros from the Zimbabwe dollar. The retention percentage of export proceeds was also decreased from 65% to 55% but has subsequently been adjusted to 75% i.e. Blanket will be allowed to retain 75% of proceeds from gold sales in US dollars. The balance of 25% will be converted into Zimbabwe dollars at the interbank rate.

On October 23, 2008 it was announced that gold production at the Blanket had been temporarily suspended due to the continuing non-payment of foreign exchange by the Reserve Bank of Zimbabwe (“RBZ”) for the sale of gold delivered to Fidelity Printers and Refiners (“Fidelity”), a subsidiary of the RBZ. Zimbabwean law requires 100% of gold produced in the country be sold and delivered to Fidelity regardless of whether previous sales have been paid for or not.

The lack of payment depleted stocks of essential consumable stores, which once exhausted forced Blanket to suspend production.

Blanket requires regular monthly access to foreign exchange in order to purchase the wide range of consumables and spares that are essential to the mining and metallurgical production requirements, and vital for the safety of its workforce.

Since gold production was suspended Blanket has managed to convert two tranches of US Dollars owed by RBZ to enable management to pay and feed its workforce. We anticipate that this facility will continue.

On July 31, 2008 Caledonia was advised by Orectech Resources Inc. (“Orectech”) that it was unable to raise the funds required to close the Sale of Shares Agreement for the purchase of Eersteling Gold Mine Limited. In terms of the agreement Caledonia has issued Orectech a notice of default which required Orectech to conclude the transaction within 14 days or Caledonia could cancel the agreement or exercise other legal remedies. Despite the notice of default Orectech failed to close the transaction, Caledonia has not cancelled the agreement as of November 10, 2008.

**BOARD OF DIRECTORS**

G.R. Pardoe (1) (2) (3) (4) (5)  
*Chairman of the Board,*  
*Johannesburg, South Africa*

S. E. Hayden (3) (5)  
*President and Chief Executive Officer*  
*Johannesburg, South Africa*

J. Johnstone  
*Retired Mining Engineer*  
*Gibsons, British Columbia, Canada*

F C. Harvey  
*Retired Executive*  
*Oakville, Ontario, Canada*

C. R. Jonsson (2) (3) (5)  
*Principal of Tupper Jonsson & Yeadon*  
*Barristers & Solicitors*  
*Vancouver, British Columbia,*  
*Canada*

R. Liverant (1)  
*Chartered Accountant -Retired*  
*Vancouver, British Columbia, Canada*

R.W. Babensee (1)  
*Chartered Accountant -Retired*  
*Toronto, Ontario, Canada*

S. R. Curtis (5)  
*Vice-President Finance and Chief Financial officer*  
*Johannesburg, South Africa*

**OFFICERS**

S. E. Hayden (3) (5)  
*President and Chief Executive Officer*  
*Johannesburg, South Africa*

S. R. Curtis (5)  
*Vice-President Finance and Chief Financial officer*  
*Johannesburg, South Africa*

Dr. T. Pearton  
*Vice President Exploration*  
*Johannesburg, South Africa*

C. R. Jonsson (2) (3) (5)  
*Corporation Secretary*  
*Vancouver BC*

**BOARD COMMITTEE MEMBERS**

- (1) Audit Committee
- (2) Compensation Committee
- (3) Corporate Governance Committee
- (4) Nominating Committee
- (5) Disclosure Committee

**Corporate Directory**  
**CORPORATE OFFICES**

**Canada - Head Office**

**Caledonia Mining Corporation**  
Suite 1201, 67 Yonge Street  
Toronto, Ontario M5E 1J8 Canada  
Tel:(1)(416) 369-9835 Fax:(1)(416) 369-0449  
[info@caledoniamining.com](mailto:info@caledoniamining.com)

**South Africa – África Office**

**Greenstone Management Services (Pty) Ltd.**

P.O. Box 834  
Saxonwold 2132  
South Africa  
Tel: (27)(11) 447-2499 Fax: (27)(11) 447-2554

**Zambia**

**Caledonia Mining (Zambia) Limited**

P.O. Box 36604  
Lusaka, Zambia  
Tel:(260)(1) 29-1574 Fax(260)(1) 29-2154

**Zimbabwe**

**Caledonia Holdings Zimbabwe (Limited)**  
P.O. Box CY1277  
Causeway, Harare  
Zimbabwe  
Tel:(263)(4) 701 151/4 Fax:(263)(4) 702 248

**CAPITALIZATION** at October 31, 2008

Authorised: Unlimited

**Shares, Warrants and Options Issued:**

Common Shares:	500,169,280
Warrants:	12,300,000
Options:	34,080,000

**SOLICITORS**

**Borden Ladner Gervais LLP**

Suite 4100, Scotia Plaza  
40 King Street West  
Toronto, Ontario M5H 3Y4 Canada

**Tupper, Jonsson & Yeadon**

1710-1177 West Hastings St, Vancouver,  
British Columbia V6E 2L3 Canada

**AUDITORS**

**BDO Dunwoody LLP**

**Chartered Accountants**

Suite 3300, 200 Bay Street  
Royal Bank Plaza, South Tower  
Toronto, Ontario M5J 2J8 Canada

**REGISTRAR & TRANSFER AGENT**

**Equity Transfer Services Inc.**

Suite 400 200 University Ave  
Toronto, Ontario M5H 4H1 Canada  
Tel: (416) 361-0152 Fax:(416) 361-0470

**BANKERS**

**Canadian Imperial Bank of Commerce**

6266 Dixie Road  
Mississauga, Ontario L5T 1A7 Canada

**NOMAD AND BROKER (AIM)**

**RBC Capital Markets**

71 Queen Victoria Street  
London EC4V 4DE  
Tel: +44 20 7653 4000

**SHARES LISTED**

Toronto Stock Exchange Symbol "CAL"  
NASDAQ OTC BB Symbol "CALVF"  
London "AIM" Market Symbol "CMCL"

**Web Site:** <http://www.caledoniamining.com>