



**2005 ANNUAL REPORT**

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### AUDITED FINANCIAL STATEMENTS FOR THE FISCAL YEAR ENDED MAY 31, 2005

The Annual Report is designed to present a balanced and understandable view of the group's activities and prospects. The Chairman's statement and the Chief Executive's review provide an assessment of the group's affairs and position.

The Corporation's website ([www.uruguayminerals.com](http://www.uruguayminerals.com)) gives access to the share price of the ordinary shares, and to other information about the group.

# CORPORATE DIRECTORY

## DIRECTORS

Christopher John Clark (President),  
Puntas de Santiago 1604  
Montevideo 11500, Uruguay  
[urumin@adinet.com.uy](mailto:urumin@adinet.com.uy)

Prof. Roger David Morton B.Sc., Ph.D., P.Geol. (Alta)  
(Non-executive)  
Suite 161 Commerce Place, 10155-102 Street  
Edmonton, Alberta, T5J4G8, Canada

Tony Patrick Shearer (Non-executive Chairman)  
15 Addison Crescent  
London W14 8JR, England  
[tony@tonyshearer.com](mailto:tony@tonyshearer.com)

John Christopher Morris (Non-executive)  
25 Bay Road  
Claremont, W. Australia 6010, Australia

Michael Rex Schwabe (Exploration Director)  
Divina Comedia 2041  
Montevideo 11500, Uruguay  
[urumin@adinet.com.uy](mailto:urumin@adinet.com.uy)

## SECRETARY AND GENERAL COUNSEL

Ms. Sara-Lane Sirey  
888, 900-6th Avenue SW  
Calgary, Alberta T2P 3K2, Canada

## REGISTERED OFFICE

Anton, Campion, Macdonald, Phillips, Oyler &  
Buchan (Barristers and Solicitors)  
200, 204 Lambert Street  
Whitehorse, Yukon Territory Y1A 3T2, Canada

## LAWYERS TO THE CORPORATION

Borden Ladner Gervais LLP  
2300 Western Gas Tower  
530, 8th Avenue SW  
Calgary, Alberta T2P 3S8, Canada

## SHARE REGISTRARS

Computershare Trust Company of Canada, 9th  
Floor, 100 University Avenue, Toronto, Ontario M5J  
2Y1, Canada

Carlos V. Coirolo and Associates  
18 de Julio 948 apto. 801  
Montevideo, Uruguay 11.100

## BANKERS

Macquarie Bank Limited, Canada  
Canadian Imperial Bank of Commerce  
ABN Amro, Uruguay

## AUDITORS

BDO Dunwoody LLP  
1900, 801-6th Avenue S.W.  
Calgary, Alberta T2P 3W2, Canada

## OPTIONS AS AT 29 AUGUST 2005

2,685,000 stock options exercisable up to 23rd  
November 2009 at prices between C\$ .40 and C\$  
5.40

## SHARE CAPITAL ISSUED AS AT 15 OCTOBER 2005

46,191,143 shares

## WARRANTS AS AT 29 AUGUST 2005

250,000 warrants exercisable up to 8 August 2006  
at \$C 3.75 per share .

## CHAIRMAN'S REPORT

The last quarter of the financial year was an exceptional quarter in an exceptional year. During that quarter we produced 24,844 ounces of gold, a mere fraction below the target annualised production rate that we have set for 2005/6 of 100,000 ounces. This stronger than expected production generated a profit before tax of \$ 1,934,000 for the quarter, and \$ 900,000 for the year.

Our cash unit costs for the past year (average US\$ 275/oz) continued to fall (to US\$ 229/oz in the last quarter), largely reflecting the rise in head grade, which averaged 2.67 g/t Au for the quarter.

As a result of an intensive infill drilling campaign over the past 12 months, we have now defined our first three-year mining plan for the Arenal orebody. This plan schedules annual production of 100,000 ounces from a head grade of 2.74 g/t Au, which allows us to optimise the utilisation of the Arenal orebody, which is still open to the east and down-dip.

We have been able to achieve this production level from a lower head-grade due to improved operational efficiencies, however this reduction in grade has had the consequence that the projected unit costs will be higher than the previously anticipated US\$150/oz, which was predicated on a head grade of 3.0 g/t Au. This "grade-effect" on unit costs is exacerbated by the rise in energy and consumables costs, which have risen disproportionately over the past year. Having achieved our first three years worth of reserves, the concentration on infill drilling has now eased a little, and we have already begun the lengthy process of exploring the rest of the shaft zone, which runs through the Isla Cristalina for over 110 km. We are confident that the results of this increase in efforts will be extended mine lives.

While the past year was essentially a year of consolidation, it was also a year of "quiet achievement", where all our stated and un-stated goals were achieved. These goals included:

- 1. Keep production from the San Gregorio mine going until the Arenal deposit came into production.**  
Not only did the Company produce 63,600 ounces from within the purchased assets, but we were able to generate sufficient internal cash flow to fund the development of the Arenal mine, and the refurbishment of the mining fleet and the San Gregorio mill without resort to shareholders.
- 2. Evaluate, design and obtain production permission for the new Arenal mine.**  
The production permit for Arenal was received in September 2004, just 6 months after application, and eleven months after we purchased the San Gregorio assets. This reflects great credit on both the Company's engineers, and the Uruguayan authorities.
- 3. Lift the production rate from San Gregorio to a "world-relevant" 100,000 oz/yr.**  
This rate was achieved (sustainably) at the end of the last quarter of 2004/5, some 9 months after the Arenal pit was inaugurated, and three months ahead of schedule.
- 4. Establish sufficient reserves at Arenal and San Gregorio to provide the basis for a sustainable gold mining operation.**  
Concurrent with this report, we are releasing a reserves statement, which provides the detailed engineering basis for the next three years of mine life (Arenal Phase 2). We are now working on extending this to five years (Arenal Phase 3), after which we expect to work on the

ten-year plan, which will probably involve re-development of the San Gregorio/Santa Teresa system.

**5. Develop a management team to support and provide a succession for Chris Clark and Mike Schwabe.**

Several senior appointments have been made on the financial and operational side of the Company, which has not only given Chris great support, but which has also provided a strong platform from which Chris's successor can be groomed. The only position that we are still seeking to fill is that of chief exploration geologist.

**6 List the Company's shares on the AIM market.**

The Company's shares were listed on the London Alternative Investment Market "AIM" in December 2004. The Company has retained its listing on the TSX Venture Exchange in Toronto, Canada.

**Management and staff**

The Company has now assembled a first class team capable of operating the mine and mill at San Gregorio, and running the commercial and financial sides of the company for quite a long time. Each year the Board makes at least one visit to Uruguay, with the most recent visit being in May 2005. We continue to be impressed by the quality and commitment of our people, who now number approximately 275. Apart from 9 expatriates (all of whom live in Uruguay), the entire workforce is Latin American, predominantly Uruguayan. The Company is also an equal opportunity employer, and has recently appointed four female engineers in production roles – a first for Uruguay.

The Company has also put a strong effort into improving the public awareness of the Company's activities in Uruguay, both at the political and local community level. The people of Uruguay overwhelmingly voted in a leftist government for the first time in the country's history in December 2004, and the Company has made a large investment of time and effort to ensure that the new administration is aware of UME'S activities and contribution to the country.

The new administration took power on March 1 2005, and has re-affirmed Uruguay's strategic commitment to mining as a platform for economic growth and diversity. This commitment was underlined by site visits by senior political representatives (including the Vice President) within the first 60 days in power. This commitment was underscored by the granting in April 2005 of National Investment Project status to the Arenal mine, with attendant tax relief on income totalling \$ 9,656,000.

We have also developed extensive links with the local community, including establishing a two-day "Gold Expo" which attracted an estimated 10,000 people in November 2004. It is planned to make this event an annual celebration of the benefits of mining to the region – employment, technology, opportunity – which otherwise is an economically challenged rural area. It is immeasurably important that we are seen for what we really are - a Uruguay-focussed entity developing and using Uruguayan talent, and working within and for the Uruguayan community.

**Board of Directors**

Chris Clark and Mike Schwabe founded Uruguay Minerals nine years ago. Since then the company has grown and prospered, and we have all got that bit older! Roger Morton has been involved almost

from the start, providing constant advice and support, initially as Chairman (from 1997 to 2002), and latterly as a member of various committees – including the audit committee.

Unfortunately, under corporate governance guidelines we are obliged to have a majority of non-executive directors on the Board. This provides the Company with a major dilemma; if it wishes to develop some of its younger management talent by appointing them to the Board, then, unless some of the existing directors retire, the Board will become unmanageably large for what is still a developing junior company.

Accordingly, it is with enormous gratitude that I can advise that Roger and Mike have offered to step down in October in order to permit the Board to start to rejuvenate itself. Fortunately the Company will not lose the benefit of their experience and advice as Mike will continue to work for the company as Exploration Director, and will remain on the board of the local subsidiaries, and Roger will continue to consult. Shareholders should join me in thanking both Roger and Mike for all they have done in helping develop this exceptional Company.

I am delighted that David Fowler and Bill Lindqvist are being proposed for election to the Board as Finance Director and as a Non-Executive Director respectively. David is 38 years old, and joined us in March 2004 as General Manager - Commercial with responsibility for Finance and Administration. He is a chartered accountant and has previously worked in financial and commercial roles with Eltin Mining in Chile, and Western Metals in Australia.

Bill, who is 63 years old, is a highly respected geologist who, following a successful career in senior management roles at Newcrest and Homestake (now Barrick), is offering to bring his considerable technical and corporate experience to Uruguay Mineral Exploration to assist the Company in the next stage of its evolution as a mid-tier mining company.

I recommend that shareholders support their appointment.

Sara-Lane Sirey has been our corporate secretary and General Counsel since inception. After the shareholders meeting in October she will cease to act for us in these roles as she wishes to concentrate on her other commitments, but she will still be available to give specific advice as required. Sara-Lane has also provided great service to us since inception and I thank her also for all she has done in the formative years of the Group.

## **Conclusion**

The shareholders meeting will be in London at 4:15 pm on 13th October 2005, and I hope that as many as possible of you will attend. In closing I would like to thank our shareholders for their support, and my fellow directors John Morris, Roger Morton, Mike Schwabe and Chris Clark for their immense contributions, as well as all our staff and consultants for their dedication, commitment and talents. This is a company of which we can truly be proud.

Tony Shearer  
Chairman

## **PRESIDENT'S REPORT**

The year 2004/5 was a year where a tremendous effort went into developing the Minas de Corrales Gold Project into a robust low cost gold operation. We entered the year with a very high workload due to the recent acquisition of the San Gregorio mine. One of the effects of this was that we had to deal with a whole range of convergent issues, including, but not limited to:

- finding sufficient ore to maintain production until Arenal was permitted;
- reversing the "closure process", which the mine's previous owners had initiated;
- evaluating the Arenal discovery;
- designing the first stage pit for Arenal;
- applying for a mining permit for Arenal;
- obtaining environmental permitting for Arenal;
- obtaining environmental permitting for a temporary river crossing, so that Arenal ore could be transported to the mill;
- developing a new Resource Statement that included defined Reserves;
- replacing the mining fleet;
- renovating the San Gregorio Treatment Plant, which had been allowed to deteriorate pending closure in 2003;
- funding capital expenditure without further dilution to shareholders; and
- finding competent young professionals to join the Company in technical and managerial roles.

I am pleased to be able to say that during the year we achieved all these goals, and in addition, sought and achieved a listing on the London AIM market. All this was achieved with just the addition of two senior staff – David Fowler and John Sadek.

### **Financial position**

At 31st May 2005 we had cash balances of \$ 5,501,000, and borrowings of \$ 4,647,000. The cash generated from the exercise of 2,630,000 warrants during 2005 provided \$ 8,000,000, which was used to repay the working capital loan from Macquarie Bank.

The Board has decided that the priority use of profits from gold production over the next two years will be payment of the remaining Komatsu debt, the purchase of additional trucks and drill rigs, continuation of the mill upgrade program, and the maintenance of an aggressive exploration program. As stated in the Admission Document for our AIM listing in December 2004, we intend to develop a dividend policy when the financial position is suitable, and I would expect that, in the absence of unforeseen events, we should be in a position to pay a dividend in the 2006/7 year.

### **Operations**

Permission to open the Arenal pit was received in September, 2004, just 6 months after the application was lodged. This approval time-scale was exceptional, and reflects very well on the professionalism of both the Company's engineers and the relevant government authorities.

Once permission was received, the mining team under John Sadek and Jorge Camargo moved very rapidly to open the Phase 1 pit and build the flood contention dyke along the western side of the operational area. This process was assisted by the timely arrival of the new Komatsu mining fleet, which allowed the existing Caterpillar fleet to be dedicated to tailings dam expansion.

Production from Arenal has gradually increased to the point that in April 2005, it became capable of providing all the mill's ore feed requirements.

As a result of moving to full sourcing from Arenal, gold production has risen to targeted levels faster than was planned. The Company produced 75,026 ounces during the year, with the final quarter yielding 24,844 ounces, just 156 ounces short of the targeted 100,000 ounce per annum rate. This production increase resulted from a rise in head-grade to a year-average 2.67 g/t Au. This head-grade is consistent with the grade planned for the next three years – 2.75 g/t Au.

Plant throughput for the year was 1,194,631 tonnes, consistent with the forward planning target of 1.2 million tonnes per annum. This achievement is also highly creditable to Terry Butler and Juan Lacerda, who have been able to maintain production whilst engaging in a major renovation of the processing facilities, which included upgrading the gold room, re-straking the absorption tanks, repairing gearboxes, installing new oil cleaning and lubrication systems on the mills and repairing the scats crushing circuit. These improvements, together with those remaining in our capital plan (and which represent about 50% of the renovation program), are designed to re-equip the plant for another 5-10 years production.

Operating costs have begun to fall, reflecting both the effect of some of the investment in upgraded equipment, as well as the rising head-grade from the mine.

We had originally projected a head-grade of over 3 g/t Au from the mine, which would have resulted in a cash cost of production in the order of US\$150 per ounce, based on 2003 cost parameters. However, our mine planning shows that we will achieve a better financial outcome if we lower the long-run average head-grade to around 2.7 g/t Au. This will allow us to recover more ounces and give us a more balanced production schedule, but it will result in slightly higher unit operating costs.

In addition, many cost parameters – energy, steel, tyres, carbon, reagents – have all escalated (some have almost doubled) over the past twelve months. These effects, together with some remaining operational inefficiencies (such as high cost use of small trucks due to the absence of the permanent river crossing) have resulted in a target unit cost projection closer to US\$200/oz rather than the previously projected US\$150/oz. Nonetheless, achieving the lowest unit cost possible remains our goal.

### **Reserves and Resources**

Concurrent with the release of this report, we are also releasing a Resource Statement that includes Proven and Probable Reserves. We have now defined sufficient Proven Reserves to permit the design of a mine production plan that will produce 100,000 ounces per annum for at least the next three years (our Phase 2 pit). In addition we have sufficient Probable Reserves at Arenal to underpin a minimum of a further two year's production from the mine at the same rate (subject to relocation of the Minas de Corrales River) (the Phase 3 pit).

Under the definitions used (based on JORC), Proven Reserves are those where a full economic feasibility study, including assessment of all technical and commercial factors has been completed with a positive outcome and a deliverable mine plan generated. Probable Reserves are those where the geological information has a high degree of confidence, and where economic viability can be demonstrated on the basis of certain assumptions, but where certain "modifying factors" remain. In

the context of Phase 3 of the Arenal deposit, these “modifying factors” include the fact that engineering studies for the diversion of the Corrales River have not been completed, and neither has permission to move it been sought or received.

Measured Resources are those where we have a high degree of geological and engineering confidence that the tonnage and grade can be reliably estimated, and where economic assessment is warranted.

Indicated Resources are those where the degree of geological confidence in the continuity and shape of mineralization is high (but not as high as for the Measured category) and additional infill drilling is required before economic evaluation can proceed.

Inferred Resources are the least reliable category of resources, and are based on reasonable extrapolation of data, or represent an extension of existing data where geological parameters support such an extension.

Our total resource base now stands at 1,293,400 ounces. Mineral Resources as at June 2005 (tonnages, grades and contained ounces rounded to reflect level of accuracy):

Category	Tonnes	Grade (g/t gold)	Contained Ounces
Measured Resources	8,303,000	2.32	619,000
Indicated Resources	4,197,000	1.19	161,400
Inferred Resources	12,975,000	1.23	513,000
TOTAL	25,475,000	1.58	1,293,400

Pit optimization and detailed design work was undertaken in order to determine mineral reserves at Arenal and Santa Teresa. The proven and probable reserves are completely within the Measured Indicated Resource were estimated as follows.

Category	Tonnes	Grade (g/t gold)	Contained Ounces
Proven Reserves	4,300,000	2.72	373,300
Probable Reserves	1,100,000	1.21	43,700
TOTAL	5,400,000	2.41	417,000

The total resource ounces essentially remained constant during the year as we concentrated on improving the confidence level of the Arenal deposit. In essence the growth in total resource ounces effectively replaced ounces mined.

During 2004/5, the Company drilled 25,991 metres of reverse circulation drilling and 9,866 metres of diamond core drilling, of which over 90% was drilled within 5 kilometres of the plant, predominantly at Arenal. Over 95% of this drilling effort went into infill and geotechnical drilling, required for the development of Arenal and the generation of the mine plan.

Limited drilling in and around the old San Gregorio/Santa Teresa workings has shown that it is likely (at today’s gold price) that we will be able to redevelop these old workings once the Arenal mine is mature. The extent to which this will be possible will depend on the results of drilling beneath the old pits, which to date has not been feasible due to equipment needs elsewhere. The Company has recently taken delivery of a modified Ingersoll Rand drill rig capable of reverse circulation drilling to 400 metres. The Company plans to explore the deeper regions of the Arenal and San Gregorio systems with this machine.

## **Exploration**

Now that the production side of the business has been consolidated, emphasis has returned to the exploration program.

The focus of management during the past twelve months on firstly securing sufficient resources to keep the mine open pending the evaluation and permitting of Arenal, and secondly, developing Arenal meant that all our drilling resources (six rigs) were virtually committed within five kilometers of the mill. This meant that progress elsewhere was severely restricted. This phase has now passed.

The Company has invested in new geophysical tools – Induced Polarization and Max-Min (EM) in particular – and is upgrading a VLF system that was acquired with the San Gregorio purchase. The Company has hired a Uruguayan geophysicist to operate the equipment, and has contracted an international geophysical consultant to oversee our programs, as well as to assist in controlling and interpreting the Lascano airborne mag/gravity survey, which is scheduled for October 2005.

The Company has also invested heavily in new drilling machines – our fleet now comprises one Long year 44 diamond drill, one UDR 650 combination diamond/RC drill and one Ingersoll Rand DM 45 reverse circulation drill. In addition, the Company has two buggy rigs (RC) and two Maquesonda diamond drilling machines continuously available for drilling services. This range of machines gives the Company maximum flexibility in drilling and mobilization.

Now that the Company has a good understanding of the mineralization controls that apply at Arenal, it has started to extend a screening exploration program in the area around the mine. This has already identified several new target areas within 30 kilometres of the mill that display attractive characteristics. Work has commenced on these prospects.

In addition, the Company has identified a new area approximately 40 kilometres east of Minas de Corrales, where ultramafic rocks with significant nickel anomalism have been identified. This area, Carpinteria - also contains an extension of the Zapucay shear zone, which is strongly gold-anomalous. Nickel sulphides – in particular pentlandite – have been encountered at Carpinteria.

We have also commenced target screening work on the eastern part of the 110 km-long Isla Cristalina belt, where we believe the exploration potential for gold is also very high.

Progress on the Company's program is covered in detail in the Exploration Report, which follows.

In closing, I would like to thank all the Company's employees for helping us firstly, make the transition from exploration company to producer in record time and secondly, to consolidate the Company's production base so that the exploration side of the Company has the resources available to meet the next challenge – another exploration success.

Finally, I would like to offer the thanks of all at Uruguay Mineral Exploration to the shareholders who have been patient and supportive through the transition time.

Chris Clark  
President

## **EXPLORATION REPORT**

In the past twelve months the Company continued to place the majority of its exploration effort on the Minas de Corrales Gold Project, focusing on upgrading and expanding the resource base at the San Gregorio operation with the main emphasis on the Arenal deposit.

Exploration was also conducted on a number of other projects with varying degrees of emphasis as time and manpower allowed. Active projects included:

- the Minas de Corrales Regional Gold Project, which includes a number of near mine targets,
- the Isla Cristalina Gold Project, which includes a number of target areas remote from the mine operation,
- the Isla Cristalina nickel project,
- the Dom Feliciano Mobile Belt, which includes a number of copper/gold prospects, nickel prospects, lead/zinc prospects and gold prospects,
- the Florida Belt, which includes the Mal Abrigo nickel project as well as a number of gold prospects,
- the Lascano nickel/copper project, and
- the Rivera Diamond project.

### **Minas de Corrales Gold Project**

The primary focus of exploration was the drill evaluation and definition of gold resources close to the San Gregorio Mill. This was a reflection of the fact that the mine had no defined reserves base as a result of the circumstances of the acquisition, and it was critical that the resources identified in 2004 be upgraded to proven and probable reserve category as soon as possible, thus permitting mine planning for the next three to five years. The areas evaluated in this program included Arenal, Santa Teresa, Ombú, and Zapucay.

Arenal received its production permit in September 2004, and mining commenced in October, based on a Phase 1 pit design. Because there had not been sufficient time to fully delineate the deposit, the exploration drill program on the deposit has continued in parallel with production activities. The proximity to production activities necessarily meant that the speed of exploration drilling was slower than would otherwise have been the case.

The Arenal program comprised mainly infill holes, with some step out holes that tested the mineralized structure to a vertical of more than 200 metres. One hundred and fifty reverse circulation drill holes (for 19,062 metres) and forty diamond drill holes (for 7113 metres) were completed during the year at Arenal.

Gold mineralization at Arenal occurs within a major, regional-scale shear zone and is hosted by a rock package comprising altered mylonites, granites and diorites, which dips moderately to the south at 30 to 40 degrees. The mineralized zone is locally up to more than 50 metres thick, and has been traced so far over a strike length of 2,500 metres. The Arenal deposit is still open along strike and down dip.

Drilling to date suggests that the best mineralization sits in lenticular shoots within the main mineralized package. These shoots plunge steeply either to the east or west, depending on local structural controls. At Arenal, the primary plunge is steep and to the east, and because of this, testing

the down-plunge extensions to the main orebody requires a deeper drilling capability than has hitherto been available.

The recent delivery of the DM 45 reverse circulation rig will enable us to test the Arenal main structure to a vertical depth of approximately 400 metres in a rapid and cost-effective manner.

Better drill intersections from the definition drilling conducted during the past year include:

Hole No.	Co-ordinates	Intercept
ALRC 154	530332847E;6505522769N	18m @ 3.85g/t from 10m
ALRC 155	530334662E;6505516368N	22m @ 6.25g/t from 14m
ALRC 156	530352769E;6505540037N	13m @ 6.90g/t from 6m
ALRC 166	530320000E;6505490000N	42m @ 2.29g/t from 39m
ALRC 179	530441989E;6505415883N	38m @ 3.74g/t from 70m
ALRC 180	530432096E;6505399117N	46m @ 3.72g/t from 70m
ALRC 218	530724080E;6505251010N	30m @ 2.50g/t from 154m

During the past year, a number of holes were drilled on the Santa Teresa (western) section of the Arenal/San Gregorio shear. This resulted in the definition of a mining reserve of 738,580 tonnes grading 1.15g/t Au, for a contained 27,308 ounces. This work was conducted to confirm whether waste material necessary for the next tailings dam lift could be sourced from Santa Teresa to the company's overall economic advantage, rather than from the waste dumps.

As a result of this work, the resource statement announced in March 2004, has now been updated to incorporate the additional information from Arenal, and Santa Teresa.

Drilling is continuing at Arenal, Ombú and Rieles.

The updated reserves and resources (independently reviewed by RSG) are as follows:

Mineral Resources as at June 2005 (tonnages, grades and contained ounces rounded to reflect level of accuracy)

Category	Tonnes	Grade (g/t gold)	Contained Ounces
Measured Resources	8,303,000	2.32	619,000
Indicated Resources	4,197,000	1.19	161,400
Inferred Resources	12,975,000	1.23	513,000
TOTAL	25,475,000	1.58	1,293,400

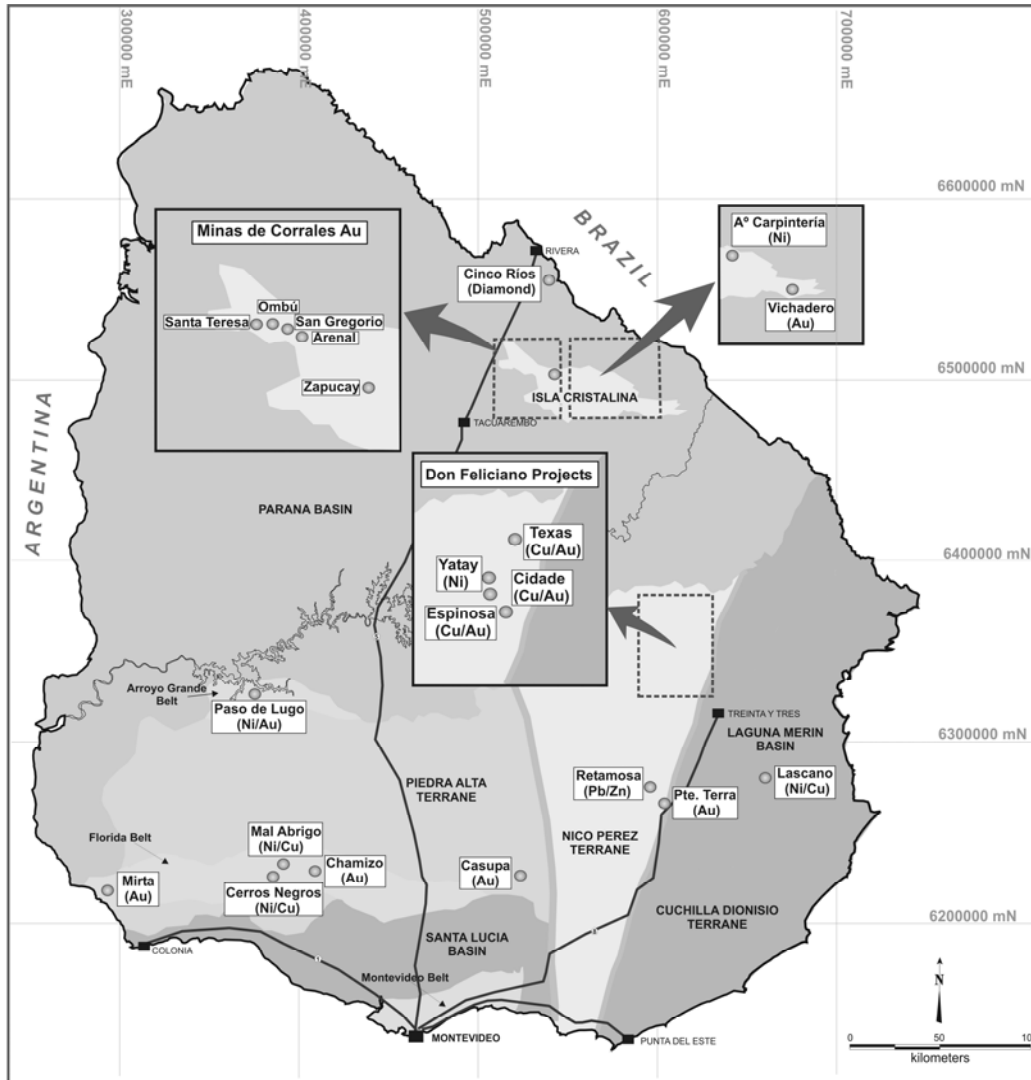
Pit optimization and detailed design work was undertaken in order to determine mineral reserves at Arenal and Santa Teresa. The proven and probable reserves were calculated as follows.

Category	Tonnes	Grade (g/t gold)	Contained Ounces
Proven Reserves	4,300,000	2.72	373,300
Probable Reserves	1,100,000	1.21	43,700
TOTAL	5,400,000	2.41	417,000

Exploration emphasis in the Minas de Corrales district will now be directed towards identification and testing of new targets, particularly along the Arenal/San Gregorio shear zone ("ASZ") and the Zapucay shear zone together with parallel or splay shear zones.

## Other Gold Projects

The Company has a number of other gold projects and targets, mainly at the grass roots level, located on the Isla Cristalina Belt, the Florida Greenstone Belt and the Dom Feliciano Mobile Belt. Work on these projects during the past year consisted mainly of mapping and soil sampling.



## Nickel/PGM Projects

### General

The Company's geologists believe that Uruguay's Archean/Lower Proterozoic rocks are prospective for nickel and platinum group metals (PGMs). During the year under review, a regional, country-wide evaluation of known ultramafic/mafic rock units with the potential to host nickel and/or PGMs was completed. This work identified several nickel-anomalous areas, including the Carpentaria prospect. In addition, work continued on the Mal Abrigo and Yatay prospects.

### Mal Abrigo

This project, which is located in the Florida Greenstone belt, comprises a large gabbro/hornite complex, where disseminated nickel/copper mineralization has been noted in outcrops at several localities. Reconnaissance prospecting also located disseminated sulphides in the nearby Cerro Negro complex, which may be part of the same intrusive event. An application for a prospecting license at Cerro Negro was lodged as a result. At Mal Abrigo, ground surveys including further soil sampling and Max-Min geophysical surveys were undertaken to identify zones that may have developed sulphide accumulations. Earlier drilling had disclosed a number of zones up to 20 metres thick with disseminated sulphides. The sulphides comprised pyrrhotite with ex-solution of pentlandite and minor chalcopyrite. This project is awaiting drill availability prior to testing the Max-Min generated targets.

### Yatay

The Yatay nickel prospect, which is in the Dom Feliciano Mobile Belt, is characterized by outcrops of massive sulphides (mainly pyrrhotite with minor pentlandite). These outcrops, which lie within a well-defined shear zone within sedimentary rocks adjacent to an assemblage of ultramafic rock units, has been on hold pending availability of drill rigs to test the shear zone. The project has now been reactivated and a Max-Min geophysical survey is in progress with the objective of defining drill targets associated within the sulphide-rich shear package and the ultramafic rock package.

### Carpintaria

This new nickel project was generated from the regional screening survey, which followed up anomalous nickel results in the Company's stream geochemistry database. Exploration here is at an early stage, with mapping, soil and rock sampling and geophysical surveys underway. The rock package comprises a complex sequence of structurally deformed granitic rocks, serpentinised ultramafics, mafic units and graphitic and sulphidic black shales. Soil sampling has returned elevated nickel values associated with the ultramafic units, with the highest value to date being 0.48% nickel. Work is continuing and it is anticipated that drill targets will be defined in the near future.

### **Diamond Project**

Stream sediment sampling continued in the drainage catchments where previous surveys had detected indicator mineral assemblages or micro diamonds. The samples comprised 100 kilograms of stream sediment collected from suitable trap sites, which is then concentrated to a 10 kilogram sample prior to sending for analysis for diamonds and indicator minerals. 119 samples were collected in this survey and 58 of these contained kimberlite indicator minerals. These results have enabled a target area to be defined, and it is proposed to fly this area with airborne gravity and magnetics in conjunction with the Lascano survey in September/October 2005.

### **Dom Feliciano Mobile Belt (Isla Patrulla Copper/Gold Project)**

The survey area (previously referred to as the Isla Patrulla copper/gold project) has been extended to include a belt of favorable lithologies up to 70 km long by 20 km wide. This expanded project area, now reported as the Dom Feliciano Mobile Belt, contains an extensive package of rocks exhibiting strong copper and gold anomalism.

Following target definition derived from a combination of airborne geophysics and stream sediment geochemistry, a ground follow up program was undertaken which has identified fourteen target areas for follow up exploration. These target areas - Texas, Puntas del Yermal, La Calera, Canada de la

Yerba, Yatay, Yatay South, Quebrada Sur, Cidades, Espinosa, IP Town, La Tapera, La Patrulla, El Bragado, and Portera Negra – have been under progressive review for the past two years with the objective of defining targets capable of hosting world-class base metals deposits. This review is ongoing. Studies conducted during 2004/5 include mapping, soil and rock chip sampling, gridding and RAB and diamond drilling.

At Cidades, a coincident copper/gold anomaly of 800m x 100m previously defined by soil sampling was tested by five RAB holes (total depth 120m). The results showed that the Cidades system has very high background gold values, with the best result being hole CDB 5, which returned 15.3m @ 104ppb in altered leuco-granites adjacent to a mafic contact. Elsewhere at Cidades, rock chip sampling near the soil anomaly has encountered quartz veining containing values up to 6 g/t Au.

Infill soil sampling at Yatay Sur defined a low-grade gold anomaly of more than 1000m by 100m. The anomaly is associated with prominent siliceous zones within mafic and ultramafic rock units.

At Espinosa, soil sampling identified a robust gold anomaly (to 800ppb Au) over an area of 1000m by 200m. Mapping and rock chip sampling delineated a gossanous outcrop adjacent to a structural boundary between a carbonate-rich sequence and a shale sequence. Systematic rock chip sampling of this gossanous zone returned anomalous gold values with the highest value being 7.9g/t Au. Twenty four RAB holes (523 metres) returned best intersections of 12 metres of 2.4 g/t gold and 12 metres of 1.5 g/t gold. Follow-up diamond drilling, however failed to support the RAB data and the prospect is now being re-evaluated within the regional framework.

Regional mapping and stream sampling is continuing on the Dom Feliciano Mobile Belt Project.

### **Lascano**

The Lascano project, located in north-east Uruguay, covers a very large gravity anomaly with a strong magnetic signature. A contract has been let with Bell Geo-Space to conduct a detailed airborne gravity and magnetic survey with the objective of better defining the anomaly. This improved definition is expected to enable the identification of appropriate drill targets, which can then be drill-tested. The survey is scheduled to commence in October 2005, and data acquisition and processing will take approximately 6 month before a follow –up action plan can be generated.

Mike Schwabe  
Technical Director

## OPERATIONS REPORT

The year commenced with ore being sourced from three main production centre – the Zapucay mine, which is 28 kilometers east of the San Gregorio mill, the Ombú pit and the low grade stockpiles.

At Zapucay, mining has occurred in three phases in total yielding approximately 300,000 tonnes at around 2 g/t Au. Phase 3 was introduced in January 2005, and this last phase of the pit produced 66,000 tonnes at 1.8g/t prior to mining ceasing in May 2005. Zapucay ore was fed into the blend at a proportion of up to 20%. Zapucay has been returned to exploration now that Arenal is in production.

The Ombú pit, which is the west extension of the San Gregorio orebody, was opened in early 2004, and yielded 27,000 tonnes at a grade of 1.3g/t Au prior to cessation of mining in September 2004. The deposit is only partially drilled (upper regions only) and has been returned to exploration now that Arenal is in production.

Approximately 250,000 tonnes at an average grade of 0.89g/t Au was processed from the medium and low grade stockpiles during the early part of the year.

Permission to open the Arenal pit was received in September, 2004, and the first ore was produced in October 2004. Access to Arenal is restricted to the west by the presence of the Corrales river, necessitating the construction of a flood contention barrier, which was completed in April 2005.

With this barrier completed, mining at Arenal moved into full swing and a total of 770,000 tonnes at a grade of 2.3g/t Au had been mined by year-end. Overall Arenal has a strip ratio (Phase 1) of 4.1 to 1, but in the early stages of pit development, the strip ratio is higher. At year-end, 3.7M tonnes of waste had been mined from the Arenal pit.

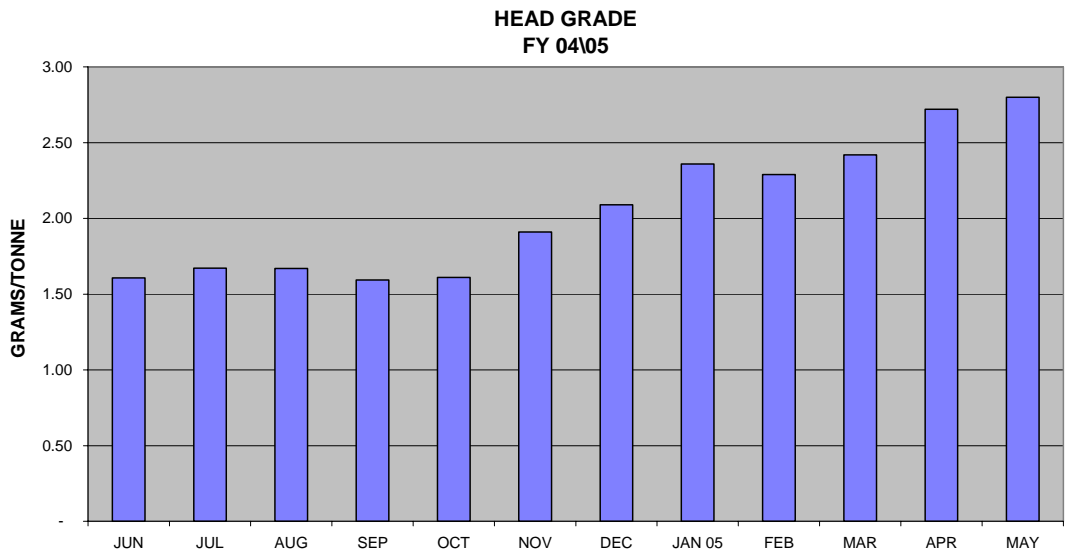
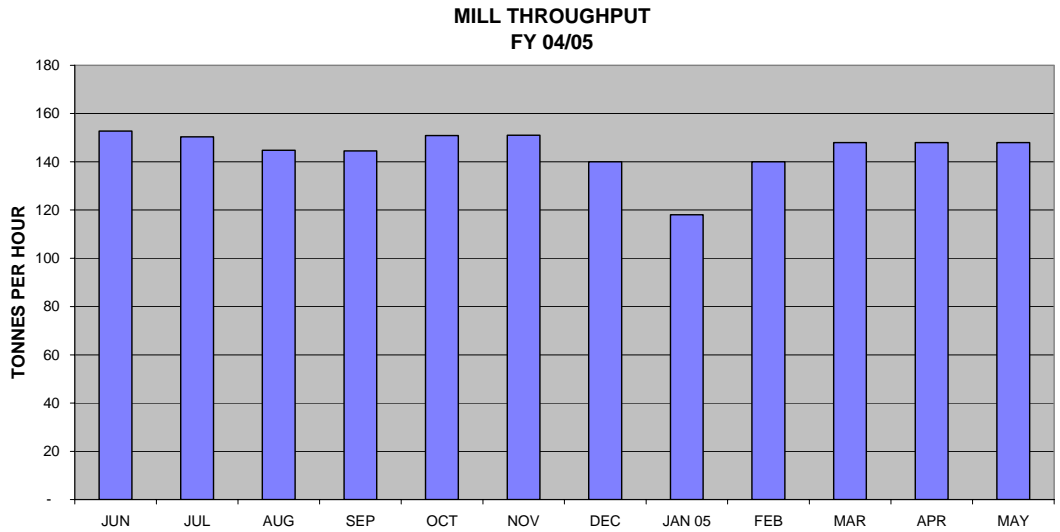
In November 2004, the first of the new Komatsu 55 tonne haul trucks was received and the new fleet became fully operational during December 2004. The effect of replacing the mining fleet (trucks, excavator, loaders, graders, dozers etc) is expected to lower unit mining costs and increase production capacity.

The Arenal ore has a higher work index of 20+ than the San Gregorio ore ( 16-18) meaning that a fully integrated approach to comminution is required from blast fragmentation through to process plant milling. The Company is working closely with technical experts from its explosives supplier to improve blasting efficiency and control.

Mining costs are also still being negatively impacted by the need to use a temporary river crossing over the Corrales River. Having to cross the river via a Bailey Bridge means that apart from having to use less efficient small road trucks to move the ore to the mill, double handling costs are incurred. In addition there is a loss of close grade control in mill blending, as two intermediate stockpiles are involved. Permission for a permanent causeway crossing is expected imminently.

During the past year, most of the Company's focus was on renovating the plant to a standard capable of sustaining a further "eight year" production campaign. Understandably, maintenance on the plant had been minimal in recent years, and refurbishing and restoring the plant to its original specifications is still only half complete. Work undertaken included upgrading the gold room and installing new security measures, re-lining the absorption tanks, repairing mill gearboxes, installing new oil cleaning and lubrication systems on the mills and repairing the scats crushing circuit.

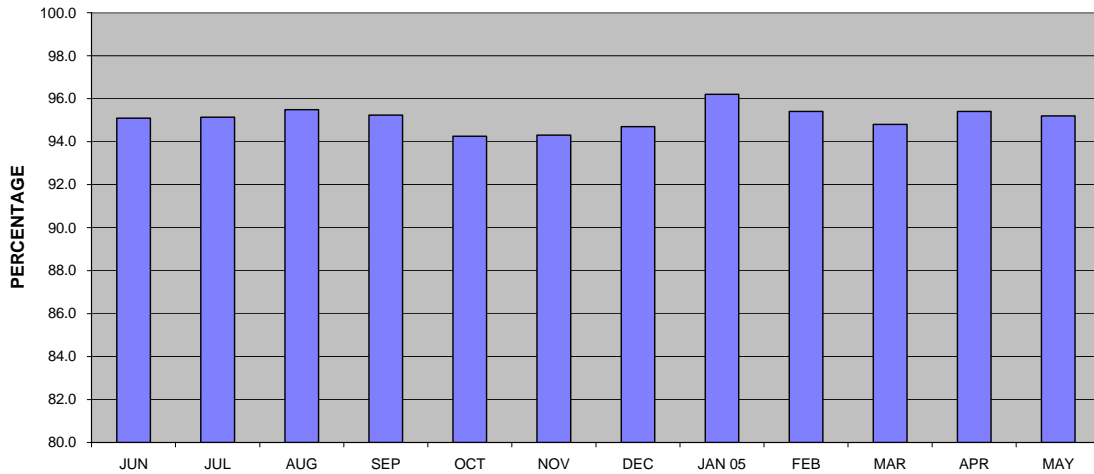
There was also a strong focus placed on optimizing the plant metallurgic performance. As a result, even though there were a number of extended shutdowns while major equipment overhauls were undertaken, throughput was progressively increased through the year, to the point where the targeted throughput of 100,000 tonnes per month is now reliably achieved.



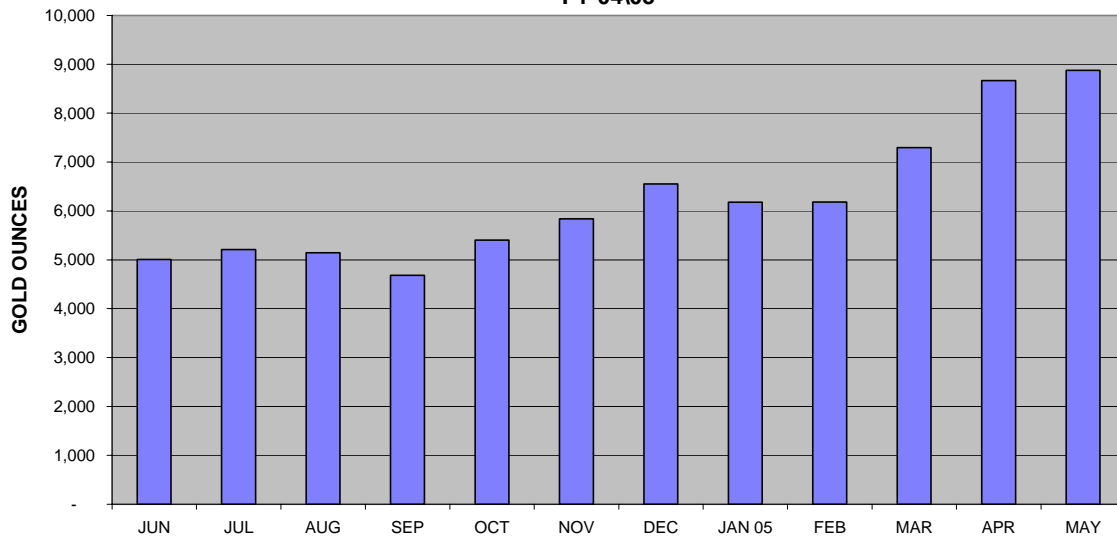
Emphasis on operational control was also increased, and target recovery of 95% is regularly achieved or exceeded. Plant throughput for the year was 1.19M tonnes, consistent with the Company's forward planning target of 1.2 million tonnes per annum treating a harder feed.

As a result, gold production rose progressively through the year, and the target level of 8,300 ounces per month was first achieved in April 2004, fortunately 3 months ahead of schedule.

**RECOVERY  
FY 0405**



**GOLD PRODUCTION  
FY 0405**



A new lift (3 metres) was completed on the tailings storage facility, which is sufficient for a further eighteen months production, and work commenced on rehabilitating the water treatment plant which handles any discharge from the site (if needed).

Due to the increased silver content of the Arenal ore, the gold/silver ratio of doré produced by the Company has fallen from 60:40 to 40:60, with attendant increases in processing, transport and gold refining costs.

As a result of the increased hardness of the Arenal ore, the higher silver content and high maintenance burden, the monthly milling unit cost rose by approximately 25% compared to the average of the previous year, but this is already being recovered and is falling in line with expectations as productivity benefits from various initiatives currently underway and planned for next year take effect.

The timely approval of environmental permits for Arenal reflects well on the Company's ability to meet or exceed its environmental obligations. The company is working with the Uruguayan environmental authorities to present a 5 year development plan for the San Gregorio operation to fully explain the company's plans and reduce time pressures for future environmental approvals.

2005 was also year when the Company worked hard to improve an unsatisfactory historical safety performance for the operation. An independent safety audit was commissioned, additional safety supervisory staff were employed and key policies and procedures were implemented. These measures are expected to improve the safety culture of the operation and reduce the Company's lost time injury rate from 25 towards a target of zero.

The Company employs approximately 275 people. The majority of these employees live in communities close to the mine and the Company has developed partnerships with representative bodies to participate in community support programs. The first Expo Oro, an open day and trade fair where the public is invited to visit the mine, attracted approximately 10,000 people. As mining is a relatively new industry in Uruguay, informing the Government ministries with whom the Company works is an important measure in demonstrating the potential of the mining industry to contribute to the development of Uruguay. During the year the President of Uruguay visited the mine in May 2004 and the Vice-President in May 2005.

John A. Sadek  
G.M. Operations

# BACKGROUND TO THE EVOLUTION OF THE CORPORATION, AND LISTING DETAILS

Uruguay Mineral Exploration Inc. (UME) was incorporated on October 16, 1996 as 713257 Alberta Inc. pursuant to the Business Corporations Act (Alberta). On January 31, 1997, the Corporation changed its name to Uruguay Goldfields Inc (“UGI”). On February 13, 1998, the Corporation amalgamated with Canadian Black River Petroleum Ltd., continuing as UGI. This amalgamation enabled the Corporation to list on the Canadian Dealing (over-the counter) Network in Toronto, Ontario.

On March 29, 2000, the common shares of UME were admitted for listing on the Canadian Venture Exchange (CDNX).

On February 8, 2002, the Corporation changed its name to Uruguay Mineral Exploration Inc., and continued from the Province of Alberta to the Yukon Territory to be governed by the corporate laws of the Yukon Territory.

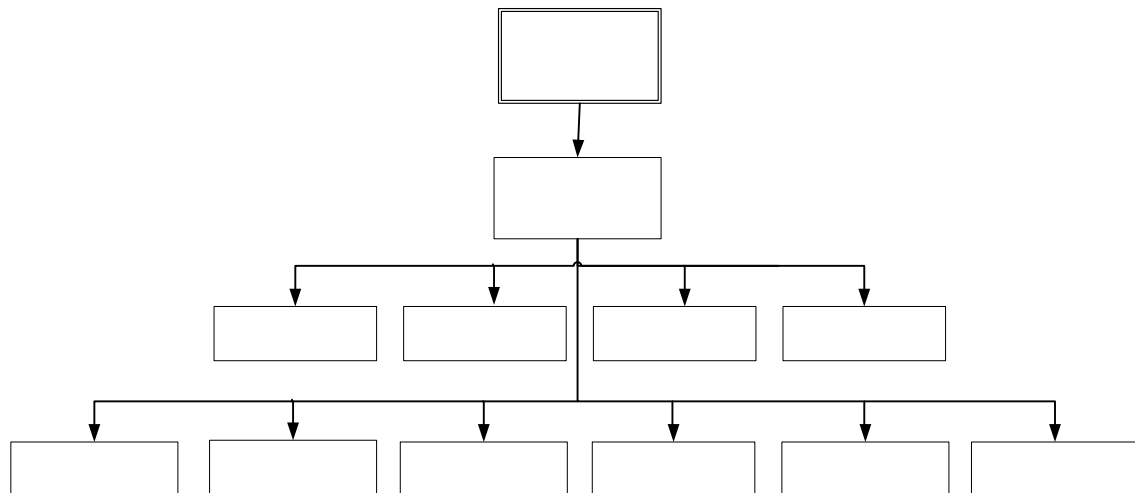
During June 2002, the CDNX was acquired by The Toronto Stock Exchange as a wholly owned subsidiary. Accordingly the name of the CDNX was changed to the TSX Venture Exchange, where the Corporation’s common shares trade under the symbol UME.

Effective October 1 2004 UME acquired the Uruguayan subsidiaries of Crystallex International Inc including Minera San Gregorio S.A. that owned and operated the San Gregorio Gold Project in northern Uruguay.

On 18 December 2004 the Corporation listed it’s common shares on the London AIM market.

## Corporate structure

The Corporation’s corporate structure is shown in figure 1 below. All entities are 100% owned.



## **Commercial structure**

UME controls (or has the rights to control) 100% of the interests in all the projects in which it is involved, except as set out in Notes 13 (Commitments) to the Financial Statements for the year ended 31st May 2004.

## **Shareholder's Timetable**

Year end:	31st May
Annual report circulated to shareholders	by 13th September 2005
Shareholders meetings in London, England	13th October 2005
Circulation of the report for the quarter ending	
31st August 2005	by 30th October 2005
30th November 2005	by 29th January 2006
28th February 2006	by 29th April 2006

## **DIRECTORS' REPORT**

### **Officers**

Chris Clark (aged 61, President and Chief Executive, appointed 1996)

Chris is a mining industry professional with over 25 years experience in the international mining industry. He had fifteen years experience with Rio Tinto group in Australia, New Guinea and Europe, principally in both technical and corporate management aspects of the copper, iron ore and gold industries. He was Operations Director of Ramsgate Resources Ltd, a listed Australian medium scale gold producer with exploration activities in Papua New Guinea and Argentina, and is one of the two joint founders of UME. Chris has been President of UME since its inception in 1996, and his previous directorships include a number of public and private companies including Uruguay Gold NL, Ramsgate Resources NL, Mt Monger Gold Project Pty Ltd, Hamersley Iron (Japan) Pty Ltd, Hamersley Iron (Europe) Pty Ltd, Hamersley Exploration Pty Ltd, and Pilbara Harbour Services Limited.

John Morris (61, Non-executive Director, appointed May 2002; A, CG, R)

John has over 30 years experience in exploration, mining and the management of public companies. John has held various directorships with Australian public companies, including the Forsyth group of companies, which he grew to be the seventh largest gold producer in Australia, and Ramsgate Resources NL, which developed the Mount Monger Gold Project. He is a Director of Chaco Resources PLC.

Prof. Roger Morton (69, Non-executive Director, appointed 1998; A, CG, R)

Roger was professor of Economic Geology at the University of Alberta from 1967 until 1995. He is now Professor Emeritus at the University of Alberta and serves as the President of Polar Star Diamonds Ltd. and of Diamori Ltd. Dr. Morton currently serves as the Chairman of Mindoro Resources Inc. In addition, he serves as a director of Jaguar Resources Corp., Brazilian Diamonds Limited, Sola resource Corp., Leeward Capital Corp., True North Gems Ltd., and acts as a private consultant to mining companies.

Mike Schwabe (61, Exploration Director, appointed 1996)

Mike is a professional exploration geologist with a background in gold, nickel, base metals and uranium. Mike has extensive experience in exploration and mine development throughout the United States, Australia, Canada and South America. Together with Chris Clark, Mike is a Joint founder of UME. His previous executive positions include Managing Director of Anglo Australian Resources Ltd, Vice-President Exploration of American Resource Corp, and Vice-President of Exploration for Bond Gold Corporation.

Tony Shearer (aged 56, Non-executive chairman, appointed February 2002; A, CG, R)

Tony spent over 20 years with Deloitte Haskins & Sells, chartered accountants, in London, Johannesburg, and Edinburgh, qualifying as a chartered accountant in 1971 and becoming a partner in 1980. In 1988 Tony joined M&G Group (the leading UK listed mutual funds group) as their finance director and became Chief Operating Officer. He has worked within the City of London since then, as

Deputy Chief Executive of Old Mutual International, and Chief Executive of two other financial services companies. Currently Tony is an Chief Executive of Singer & Friedlander Group PLC..

Sara-Lane Sirey (37, Corporate Secretary and General Counsel, appointed 1998)

Sara-Lane provides advice on corporate law, securities, contracts and strategic alliances. Sara-Lane graduated LLB from the University of Saskatchewan in 1992. Until 2001 she was a partner of Armstrong Perkins Hudson LLP (previously Ogilvie and Company) in Calgary, Alberta, specializing in corporate and securities law. Sara-Lane is an officer of a number of public companies operating in Canada, U.K. and South America.

\* = Member of the following Committees of the Board:

A = Audit Committee

CG = Corporate Governance Committee

R = Remuneration Committee

### **Principal Activities**

Since inception, the principal activity of the entities within the consolidated entity has been the acquisition and exploration of mineral properties, either directly or through joint ventures, in Uruguay. Effective October 1, 2003 the company acquired the San Gregorio Gold Project in Uruguay and the scope of it's operations now cover the mining and processing of precious metals as well as exploration.

### **Dividends**

UME has not paid any dividends to date.

### **Likely Developments and Expected Results**

In the opinion of the Directors there are no matters that would affect the future operations and expected results of the consolidated entity that have not been referred to in this Annual Report.

### **Deeds of Indemnity and Officers' Insurances**

The Corporation does not currently hold any Directors and Officers insurance.

### **Corporate Governance Statement**

The Board of Directors currently comprises a Non-Executive chairman, two other Non-Executive directors, and two Executive directors. The chairman is responsible for the running of the Board. The Board is responsible to the shareholders for the overall direction and control of the Company and its subsidiaries (collectively the "Group"), as well as for the corporate governance of the consolidated entity. It guides and monitors the business and affairs of the Corporation on behalf of the shareholders by whom the directors are elected, and to whom they are accountable.

To ensure that the Board is well equipped to discharge its responsibilities it has established guidelines for the operation of the Board. It has delegated to the President the management, operation and

administration of the consolidated entity within parameters set by the Board, and has delegated certain matters to Committees of the Board. The Board ensures that the executive management is appropriately qualified and experienced to discharge their responsibilities, and regularly monitors the performance of the executive team. In addition the Board reserves to itself the setting of the strategy including any change in the nature of the Group's business, all decisions relating to the issue of shares, options and warrants, dividend policy, any decisions in respect of the acquisition or disposal of fixed assets, companies, businesses, properties and titles, any partnerships, joint ventures or "farm-in" arrangements, the approval of the Corporation's financial statements, and the approval of all circulars and listing particulars required by the authorities.

At each scheduled meeting, directors are apprised of the group's current performance, financial position, and any significant strategic issues. The Corporate Secretary is responsible for ensuring that Board procedures are followed, and all directors have access to her advice and services. The Board is satisfied that it is provided with information in an appropriate form and quality to enable it to discharge its duties. Directors may, in the furtherance of their duties, seek independent professional advice, at the Corporation's expense if considered appropriate.

All directors are required to submit themselves for election at each annual general shareholders' meeting. Any appointment is until the next meeting (which must be held within 15 months of the prior annual general shareholders meeting). The composition of the Board is reviewed on a regular basis to ensure that its make up and the diversity of skills and experience are appropriate for the Corporation. The directors bring to the Board a wide range of experience and skills, and participate fully in decisions on key issues facing the group. The directors hold regular meetings with shareholders and their representatives to discuss the Corporation's strategy and financial performance. These discussions could encompass strategy, performance management and corporate governance issues.

The Board meets at least quarterly, in person or by phone, and has regular contact between the directors during the year. Between 1st June 2004 and 31st May 2005 the Board met by phone or by written resolution on 19 occasions.

The Audit Committee comprises three Non-Executive Directors and is chaired by Tony Shearer. It is responsible for nominating the external auditors, for ensuring that there are appropriate internal controls, and for reviewing the adequacy and scope of the annual statutory audit, and the annual and quarterly financial statements. The Committee meets throughout the year to review a wide range of issues including the Corporation's published financial statements, internal control issues, regulatory compliance, and the oversight of the objectivity and effectiveness of the auditors.

The Board of Directors, although retaining ultimate responsibility for their operation, has delegated the review of the effectiveness of the system of internal controls to the Audit Committee. However, such a system is designed to manage rather than eliminate the risk of failure to achieve business objectives, and can only provide reasonable, and not absolute, assurance against material misstatement or loss, including the safeguarding of assets, the maintenance of proper accounting records, the reliability of financial information, compliance with appropriate legislation, regulation and best practice, and the identification and management of business risk. The Board has delegated detailed implementation of the system of internal financial control throughout the group to executive management. These controls include financial controls that assist the Board in meeting its responsibilities for the integrity and accuracy of the group's accounting records. The Group's financial statements, prepared from these records, comply with accounting principles generally accepted in Canada.

Between 1st June 2004 and 31st May 2005 the Committee met by phone or by written resolution on 6 occasions, and all the Members were present at each meeting.

The Corporate Governance Committee comprises three Non-Executive Directors (chaired by Tony Shearer). It is responsible for the Corporation's approach to, and reporting in respect of, corporate governance, for ensuring that all members of the Board understand their duties and responsibilities, and for the mandate given to the President. Between 1 June 2004 and 31 May 2005, the Committee met on 2 occasions, and all members were present.

The Remuneration Committee, comprises the Non-Executive Directors (chaired by Tony Shearer). It is responsible for reviewing the remuneration policy, for determining and reviewing compensation arrangements of the executive directors and officers, and for ensuring compliance with all requirements relating to executive remuneration (including the annual report on it). The Committee meets as required to consider all aspects of remuneration paid to executive directors, and to make recommendations to the Board on the remuneration framework and strategy for the senior employees. The remuneration packages, and the benefits paid to each director, are subject to continual monitoring, and are reviewed by the Committee. The Board is responsible for determining the level of fees paid to Non-Executive directors following consideration of recommendations from the executive directors. Between 1 June 2004 and 31 May 2005, the Committee met by phone on 2 occasions, and all members were present at each meeting.

### **Directors' Responsibilities**

The directors are required to prepare financial statements for each financial period, or year, which present fairly the financial position of the Corporation and the group and of the results for the period. In preparing those financial statements, the directors are required to select suitable accounting policies and apply them consistently, and make judgments and estimates that are reasonable and prudent. They are also required to follow applicable accounting standards, disclosing and explaining any material departure there from. The accounts are required to be prepared on a going concern basis, so long as that remains appropriate. The directors are responsible for ensuring that proper accounting records are kept, which disclose with reasonable accuracy at any time the financial position of the Corporation, and enable them to ensure that the accounts comply with relevant legislation. The directors also have a general responsibility to safeguard the assets of the group, and to prevent and detect fraud and other irregularities.

### **Going Concern**

After making appropriate enquiries, the directors have a reasonable expectation that the group has adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the accounts.

## **REPORT OF THE REMUNERATION COMMITTEE**

### Remuneration Policy

The Corporation's executive remuneration program is administered by the Remuneration Committee.

The Corporation's overall policy regarding compensation of the Corporation's executive officers is structured to provide a competitive compensation package that supports both the short-term and long-term goals of the Corporation, attracts and retains suitable and qualified executive management, and establishes a compensation framework which is industry competitive.

The executive compensation program comprises two elements, namely a base salary, and participation in the Corporation's incentive stock option plan.

Executive base salaries are determined having reference to the salary levels in the industry in which the Corporation operates. Criteria included in the determination of salary levels includes the scope, skills, responsibilities, working conditions, and complexity of the position held, and salaries being paid for similar positions in other companies of similar size and business.

The share scheme has been established for directors, executive officers, contractors and employees of the Corporation and its subsidiaries. The Board of Directors is responsible for the administration of any share schemes, and determines the number of Common share under option, the date each option is to be effective, the exercise price of Common Shares issuable under each option and any and all terms and conditions of each particular option.

The Remuneration Committee considers the annual participation in the Corporation's share schemes, and considers it to be the primary ingredient in relating the total executive compensation to the Corporation's performance.

Further details are provided in the Management's 2005 Information Circular.