

**Uruguay Mineral Exploration Inc.**  
**Consolidated Financial Statements**  
**For the years ended May 31, 2005 and 2004**

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## Management's Responsibility for Financial Reporting

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The consolidated financial statements of Uruguay Minerals Exploration Inc. and the information contained in the annual report have been prepared by and are the responsibility of the Company's management. The consolidated financial statements have been prepared in accordance with generally accepted accounting principles (GAAP) in Canada and, where appropriate, reflect management's best estimates and judgements based on currently available information. Management has developed and is maintaining a system of internal controls to obtain reasonable assurance that the Company's assets are safeguarded, transactions are authorized and financial information is reliable.

The Company's independent auditors, BDO Dunwoody LLP, who are appointed by the Audit Committee, conduct an audit in accordance with Canadian generally accepted auditing standards. Their report outlines the scope of their audit and gives their opinion on the consolidated financial statements.

The Audit Committee of the Company meets periodically with management and the independent auditors to review the scope and results of the annual audit, and to review the consolidated financial statements and related financial reporting matters prior to approval of the consolidated financial statements.

(signed) Chris Clark, President

(signed) David Fowler, CFO

August 29, 2005



Driving growth

BDO Dunwoody LLP  
Chartered Accountants  
and Consultants

1900, 801 – 6 Avenue S.W.  
Calgary, Alberta Canada T2P 3w2  
Telephone: (403) 266-5608  
Fax: (403) 233-7833

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## Auditors' Report

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### To the Shareholders Uruguay Mineral Exploration Inc.

We have audited the consolidated balance sheets of Uruguay Mineral Exploration Inc. as at May 31, 2005 and 2004 and the consolidated statements of income and retained earnings (deficit) and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the consolidated financial statements are free of material misstatement. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at May 31, 2005 and 2004 and the results of its operations and its cash flows for the years then ended, in accordance with Canadian generally accepted accounting principles.

*Signed "BDO Dunwoody LLP"*

### Chartered Accountants

Calgary, Alberta  
August 16, 2005

**Uruguay Mineral Exploration Inc.**  
**Consolidated Balance Sheets**  
Thousands of United States Dollars, except where indicated

**As at May 31** **2005** **2004**

**Assets**

**Current assets**

Cash and cash equivalents	\$ 5,501	\$ 4,971
Accounts receivable (Note 5)	1,785	1,442
Inventories (Note 6)	7,170	4,088
Prepaid expenses and other current assets	722	668
	15,178	11,169

Property, plant and equipment (Note 7)	19,675	5,034
Deferred exploration and development costs (Note 8)	5,088	9,665
Deferred income tax assets (Note 16(c))	1,787	-
Other assets and deferred costs (Note 9)	923	126
<b>Total assets</b>	<b>\$ 42,651</b>	<b>\$ 25,994</b>

**Liabilities and Shareholder's Equity**

**Current liabilities**

Accounts payable and accrued liabilities	\$ 4,945	\$ 3,570
Deferred payment on equipment (Note 10)	4,256	-
Unrealised fair value of derivatives (Note 18(a))	180	-
Deferred payment on acquisition (Note 4 (a))	-	700
	9,381	4,270

Deferred payment on equipment (Note 10)	391	-
Asset retirement obligation (Note 11)	1,558	1,363
<b>Total liabilities</b>	11,330	5,633

Equity instruments (Note 12(b))	29,571	20,817
Contributed surplus (Note 13)	1,577	881
Cumulative translation adjustment	(19)	(19)
Retained earnings (deficit)	192	(1,318)
<b>Total shareholders' equity</b>	31,321	20,361

<b>Total liabilities and shareholders' equity</b>	<b>\$ 42,651</b>	<b>\$ 25,994</b>
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Commitments and contingencies (Note 17)

Approved on behalf of the Board:

*Signed "Christopher Clark"* Director  
Christopher Clark

*Signed "Tony Shearer"* Director  
Tony Shearer

The accompanying notes are an integral part of these consolidated financial statements.

**Uruguay Mineral Exploration Inc.**  
**Consolidated Statements of Income and Retained Earnings (Deficit)**  
Thousands of United States Dollars, except where indicated

<b>For the years ended May 31</b>	<b>2005</b>	<b>2004</b>
Sales	\$ 30,563	\$ 13,989
Net profit interest (Note 4(b))	(253)	-
<b>Net sales</b>	<b>30,310</b>	<b>13,989</b>
<b>Operating expenses</b>	<b>20,588</b>	<b>10,753</b>
<b>Contribution margin</b>	<b>9,722</b>	<b>3,236</b>
<b>Other expenses</b>		
Amortization, depletion and accretion	4,015	647
Compensation expense – stock based	756	821
Fair value adjustment for derivatives	180	-
General and administrative	3,405	957
Interest and financing fees	555	77
	<b>8,911</b>	<b>2,502</b>
<b>Income before other items and taxes</b>	<b>811</b>	<b>734</b>
<b>Other items</b>		
Interest and other income	107	9
Foreign exchange loss	(18)	(190)
	<b>89</b>	<b>(181)</b>
<b>Income before taxes</b>	<b>900</b>	<b>553</b>
<b>Income taxes recovery (Note 16)</b>	<b>610</b>	<b>-</b>
<b>Net income for the year</b>	<b>1,510</b>	<b>553</b>
<b>Deficit, beginning of year</b>	<b>(1,318)</b>	<b>(1,871)</b>
<b>Retained earnings (deficit), end of year</b>	<b>\$ 192</b>	<b>\$ (1,318)</b>
<b>Basic earnings per share</b>	<b>\$ 0.034</b>	<b>\$ 0.014</b>
<b>Diluted earnings per share</b>	<b>\$ 0.031</b>	<b>\$ 0.012</b>
Basic weighted average no. of shares	<b>43,844,434</b>	39,590,211
Diluted weighted average no. of shares	<b>49,014,017</b>	45,990,413

The accompanying notes are an integral part of these consolidated financial statements.

**Uruguay Mineral Exploration Inc.**  
**Consolidated Statements of Cash Flows**  
Thousands of United States Dollars, except where indicated

<b>For the years ended May 31</b>	<b>2005</b>	<b>2004</b>
<b>Operating activities</b>		
Net income for the year	\$ 1,510	\$ 553
Adjustments for:		
Amortization, depletion and accretion	4,015	647
Future income taxes	(1,787)	-
Deferred stripping	(568)	-
Foreign exchange	-	(1)
Fair value adjustment of derivatives	180	-
Compensation expense – stock based	755	821
Finance fees – stock based	188	-
	<u>4,293</u>	<u>2,020</u>
Net change in non-cash working capital balances (Note 18)	<u>(2,169)</u>	<u>(1,325)</u>
	<u>2,124</u>	<u>695</u>
<b>Financing activities</b>		
Proceeds from the issue of share capital, net of issue costs	8,507	9,277
Proceeds from borrowings, net of costs	3,740	-
Repayment of borrowings	(4,000)	-
	<u>8,247</u>	<u>9,277</u>
<b>Investing activities</b>		
Refundable deposits	(16)	34
Purchase of property, plant and equipment	(7,201)	(1,829)
Payments for exploration	(1,974)	(1,655)
Payments on subsidiaries acquired, net of cash acquired	(650)	(3,148)
	<u>(9,841)</u>	<u>(6,598)</u>
Increase in cash and cash equivalents	530	3,374
Cash and cash equivalents, beginning of year	<u>4,971</u>	<u>1,597</u>
<b>Cash and cash equivalents, end of year</b>	<b>\$ 5,501</b>	<b>\$ 4,971</b>
<b>Represented by:</b>		
Cash and cash equivalents (Note 19 (b))	\$ 5,501	\$ 3,471
Cash held in escrow (Note 8 (c))	-	1,500
	<u>\$ 5,501</u>	<u>\$ 4,971</u>

The accompanying notes are an integral part of these consolidated financial statements.

**May 31, 2005 and 2004**

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## **1. Nature of Operations**

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The Company was incorporated on October 16, 1996, as 713257 Alberta Inc. pursuant to the Alberta Business Corporation Act (Alberta). On January 31, 1997 the Company changed its name to Uruguay Goldfields Inc. On February 13, 1998, the Company amalgamated with Canadian Black River Petroleum Ltd. and thereafter maintained the name of Uruguay Goldfields Inc. On February 8, 2004, 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. The Company's shares are listed on the TSX Venture Exchange in Canada and the Alternative Investment Market in the United Kingdom.

Since inception, the Company's efforts have been devoted to the acquisition and exploration of mineral properties either directly or through joint ventures. Effective October 1, 2004 the Company purchased the San Gregorio mine and processing plant. As a result the Company's gold resources in the Minas de Coralles region close to the mine were developed and commercial production commenced on October 1, 2004. The Company's other exploration projects in Uruguay have not yet reached a stage to determine whether these properties contain ore reserves that are economically recoverable. Accordingly, throughout the period of these consolidated financial statements, the costs related to mineral property exploration, other than those in the area close to the San Gregorio project that contained mineral resources, have been considered as costs related to the pre-operating stage. Once the Company completes preliminary testing of these properties and commences commercial production, these properties will be considered to be in the commercial operations phase.

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## **2. Significant Accounting Policies**

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The consolidated financial statements of the Company have been prepared by management in accordance with Canadian generally accepted accounting principles. The reporting currency used is the United States dollar which is also the Company's functional currency. The preparation of consolidated financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. The consolidated financial statements have, in management's opinion, been properly prepared using careful judgment with reasonable limits of materiality and within the framework of the significant accounting policies summarized below.

(a) Consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries from their respective dates of acquisition. All material inter-company transactions have been eliminated. The reference to "the Company" in these consolidated financial statements includes the parent and all of its subsidiaries.

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**May 31, 2005 and 2004**

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**2. Significant Accounting Policies - continued**

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(b) Foreign currency

Monetary assets and liabilities of integrated operations that are not denominated in United States Dollars are translated at the rate of exchange prevailing at the year end, while revenues and expenses are translated at average rates of exchange during the year. Exchange gains and losses arising on the translation of the accounts are included in consolidated earnings. Non-monetary items are translated at historical exchange rates.

The functional currency of the Company's self sustaining mining operation is the United States Dollar ("the US dollar"). For this operation the company translates foreign currencies into US dollars on the following basis:

- Non-monetary assets and liabilities using historical rates;
- Monetary assets and liabilities using period end rates; and
- Income and expenses are translated at average rates of exchange during the period.

Gains and losses arising from the translation of foreign currency balances into US dollars and from foreign currency transactions are recorded in earnings

(c) Cash and equivalents

Cash and equivalents consist of cash in bank and money market deposits with maturity dates of three months or less and cashable government certificates (Note 18(b)).

(d) Property, plant and equipment

Plant and equipment are recorded at cost less accumulated amortization. Plant and other equipment are amortized on a straight line method over the estimated productive life of the related asset ranging from 2 to 5 years. Productive lives for mobile and other equipment range from 2 to 5 years, but do not exceed the related estimated useful life of the asset.

*Mineral properties*

Mineral properties, including development costs incurred to bring a mining property into production, develop new ore bodies or develop mining areas in advance of production, are capitalized and charged to operations using the units of production method based on the estimated life of mine. Amounts shown as development costs are net of metal recoveries prior to production.

*Property evaluations*

The Company reviews and evaluates the carrying value of its producing mineral properties on a periodic basis. Estimated future net cash flows are calculated for each property using estimated recoverable reserves and/or resources, estimated current commodity price and after deducting estimated production related expenses, capital costs, abandonment and reclamation costs. If the carrying value of the property exceeds the net cash flows, an impairment loss will be determined. The impairment loss is measured as the amount by which the carrying amount of the assets capitalized in a specific ore block or area exceeds their fair value.

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**May 31, 2005 and 2004**

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**2. Significant Accounting Policies - continued**

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(e) Deferred exploration and development costs

The Company is engaged in the acquisition, exploration and development of exploration properties. All acquisition, exploration such as topographical, geochemical and geophysical studies and related direct and indirect overhead expenditures, as appropriate, are deferred and carried at cost until the properties to which they relate are placed into commercial operations, sold or where management has determined there to be a permanent impairment in value. Mineral properties and development costs including acquisition costs, direct mineral exploration costs and capitalized indirect overheads. These costs are capitalized and deferred until the property is in commercial production, when these costs will be depleted as detailed in Note 2(d) above. The costs relating to a property abandoned are written off when the decision to abandon is made, or when there has been a delay in development activities that extend beyond three years, unless there is persuasive evidence to the contrary.

The amount recorded as capitalized indirect overheads under deferred exploration and development costs is based on estimates and breakdown between exploration and development costs versus general and administrative activities. By their nature, these estimates are based on management's judgment and planned course of action. These estimates are subject to measurement uncertainty and the effect on the consolidated financial statements for changes in estimates in future periods could be significant.

The recoverability of amounts shown for deferred exploration and development costs is dependent upon the discovery of economically recoverable reserves, continued confirmation of the Company's interest in the underlying concessions, the ability of the Company to obtain the necessary financing to complete the development and future profitable production or proceeds from disposition or farm-out of existing mining interests. The total amount recorded for deferred exploration and development costs represents expenditures incurred to date and does not reflect nor is it an indicator of present or future values.

(f) Inventories

Expenditures incurred in the mining and processing activities that will result in future gold production are stated at the lower of average production cost and net realizable value. These capitalized costs are classified as ore stockpiles, in process inventories and finished metals.

*Ore stockpiles*

Ore stockpiles are comprised of coarse ore that has been extracted from the mine and is available for processing. Stockpiles are measured by estimating the number of trucks added and removed from the stockpile. Stockpiles are verified by periodic surveys. Costs are added to stockpiles based upon the current mining cost per tonne which comprises of cost of mining the ore and hauling it to the mill and removed at the average cost per tonne. Ore with a marginal cutoff grade is stockpiled for potential future processing but is carried at zero value.

*In process inventories*

In process inventories represent materials that are currently being converted to a saleable product. In process materials are measured based on assays of the material fed to the processing plants and expected recoveries. In process inventories are valued at the lower of average cost of materials fed to the processing plant attributable to source material coming from each mine or stockpile and net realizable value.

**May 31, 2005 and 2004**

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**2. Significant Accounting Policies - continued**

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(f) Inventories (continued)

*Finished metals*

Finished metal inventories, comprising gold and silver dore, are valued at the lower of average production cost and net realizable value. Average production cost represents the average cost of in process inventories prior to the refining process and any relevant refining costs. The cost of gold in process and final products is comprised of mining the ore and hauling it to the mill, costs of processing the ore and an attributable amount of mining and production overheads related to deferred mineral property costs.

*Materials and Supplies*

Materials and supplies are value at the lower of average cost and replacement cost.

(g) Future income taxes

The liability method is used to account for income taxes. Under this method, future tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities, and measured using substantially enacted tax rates and laws that are expected to be in effect when the differences are expected to reverse. On business acquisitions, where differences between assigned values and tax basis of assets acquired and liabilities assumed exist, the Company recognizes the future tax assets and liabilities for the tax effects of such differences. Future income tax assets are recognized when it is more likely than not that the Company will be able to realize the asset recorded.

(h) Asset retirement obligations

The Company recognizes the fair value of a liability for an asset retirement obligation in the period in which it is incurred and records a corresponding increase in the carrying value of the related long-lived asset. The fair value is determined through a review of engineering studies, industry guidelines, and management's estimate on a site by site basis. The liability is subsequently adjusted for the passage of time, and is recognized as an accretion expense in the statement of operations under asset retirement obligations. The liability is also adjusted due to revisions in either the timing or the amount of the original estimated cash flows associated with the liability. The increase in the carrying value of the asset is amortized using the unit of production method based on estimated gross proven reserves as determined by independent engineers. Actual expenditures incurred are charged against the accumulated obligation.

(i) Revenue recognition

Revenue from mining operations is recognized after shipment of gold to third party refineries, when the sales price is fixed, title has passed to the customer and collection of the sale is reasonably assured. Sales include government incentives provided to the Company for the export sales. The incentive is based on the value of exports.

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**May 31, 2005 and 2004**

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**2. Significant Accounting Policies - continued**

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(j) Stock-based compensation plan

Effective June 1, 2004, the Company adopted the recommendations of the CICA Handbook Section 3870 "Stock Based Compensation and Other Stock-Based Payments". This section was amended to require the expensing of all stock based compensation awards for fiscal years beginning after January 1, 2004. The Company has chosen to adopt the recommendation prospectively thereby recording the fair value of the stock options since June 1, 2004 in the statement of operations using the Black-Scholes option-pricing model.

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Corporation's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

(k) Financial instruments

The Company's cash flow and profitability are affected by the market price of gold. The Company uses financial derivatives to mitigate this risk on a proportion of the company's income that will be used to repay debt.

During the year the company entered into spot deferred gold contracts. These spot deferred contracts were then restructured into a longer term price protection program that matches the Company's debt profile using gold put and call options.

Management believes that these contracts were effective and continue to be effective in mitigating the company's downside exposure to the gold price. However under the CICA Accounting Guideline 13 "Hedging relationships" it is unlikely that all transactions completed during the period would meet the requirements necessary for hedge accounting. To maintain a consistent policy in the use of financial derivatives all contracts have been marked to market with the fair value of the derivative instruments recognized as unrealized gains and losses in the statement of operations and deficit.

(l) Earnings Per share amounts

Basic earnings per common share is computed by dividing the net loss by the weighted average number of common shares outstanding for the year. Diluted per share amounts reflect the potential dilution that could occur if securities or other contracts to issue common shares were exercised or converted to common shares. The treasury stock method is used to determine the dilutive instruments.

(m) Joint venture

Certain of the Company's exploration and development activities may be conducted jointly with others. These consolidated financial statements reflect only the Company's proportionate interest in such activities.

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**May 31, 2005 and 2004**

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**2. Significant Accounting Policies - continued**

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(n) Reporting currency

Most of the Company's operations are conducted by its Uruguayan subsidiaries in United States Dollars. Because only limited operations are conducted in Canadian Dollars, in the first quarter of the 2004 fiscal year, the Company adopted the United States Dollar as its functional and reporting currency. Accordingly, the financial statements have been prepared on that basis. All numbers reported in these financial statements are stated in United States Dollars unless otherwise denoted.

(o) Reclassification

Certain comparative figures have been reclassified to conform with the presentation adopted in the current year.

(p) Measurement uncertainty

The value assigned to ore stockpiles, in process inventories and finished metal inventories are based on estimated volumes and grades. These inventories are costed at average costs of mining, processing and production. Volume and grade estimates are made relying on assays and other sampling tests. Costing is based on standard costing principles. By their nature, such estimation methodologies are subject to measurement uncertainties and the effect on consolidated financial statements of changes in estimates in future periods could be significant.

The amounts recorded for amortization and depletion of mineral properties and equipment, deferred stripping, the accretion liability for asset retirement obligations and the amount recorded for future income taxes are based on estimates. The impairment test is based on estimates of proved reserves, production rates, mineral prices, future costs and other relevant assumptions. The deferred stripping calculation is based on the stripping ratio of waste to ore mined over the life of mine and the estimated future waste mining costs. By their nature, these estimates are subject to measurement uncertainty and the effect on the consolidated financial statements of changes in estimates in future periods could be significant.

Title to mineral properties and mining rights involves certain inherent risks due to the difficulties of determining the validity of certain claims as well as the potential for problems arising from the frequently ambiguous conveyancing history characteristic of many mining properties. Although the Company has investigated title to all of its mineral properties for which it holds concessions or other mineral leases or licenses, the Company cannot give an assurance that title to such properties will not be challenged or impugned and cannot be certain that it will have valid title to its mining properties. The Company relies on title opinions by legal counsel who base such opinions on the laws of the country in which the Company operates.

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**May 31, 2005 and 2004**

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### **3. Adoption of Significant New Accounting Policies**

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(a) Hedging

The CICA has issued a new accounting guideline on Hedging Relationships (AcG 13), which is effective for 2004. This guideline, in addition to supplementing and interpreting existing hedging requirements under Canadian GAAP, establishes certain conditions required before hedge accounting may be applied. The Company adopted this accounting guideline in the 2005 financial year, the first year it entered into commodity price derivative contracts.

(b) Deferred Stripping Costs

Effective October 1, 2004 as a result of developing a complete mine plan for the Arenal deposit the company adopted the industry practice of deferring stripping costs. Previously the company had expensed these costs as it could not reasonably estimate the life of mine strip ratio for deposits being mined.

Using the deferred stripping accounting method mining costs associated with waste rock removed in excess of the life of mine average are deferred and charged to operations on the basis of the average strip ratio for the life of the mine. When the cumulative strip ratio is less than the life of mine average a provision for future stripping is made. The life of mine strip ratio at Arenal is estimated at 4.25.

The amount charged to operating costs is therefore subject to Management's ability to estimate the stripping ratio over the life of mine. Any changes to this estimate could have a material affect on the financial statements and will be accounted for on a prospectus basis.

This change in policy had no material impact on the prior year's financial statements as the production related to a mine that had substantially produced all of its reserves.

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### **4. Business Combinations**

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(a) Minera San Gregoria S.A.

The Company effected the purchase of all the shares of Minera San Gregorio S.A., Glendora S.A., Brimol S.A., Bolir S.A., Montemura S.A., Dalvan S.A., hereafter referred to as "MSG", on October 24, 2003 (with an effective date of October 1, 2003) for cash consideration of \$2,000 of which \$1,000 was paid 6 months from the date of close in April, 2003, and \$1,000 was due in October, 2004. To secure the purchase price, the Company issued a pledge agreement and a convertible debenture. The Company also paid a hedge liability of MSG in the amount of \$2,759

The acquisition of MSG at October 1, 2003 has been accounted for using the purchase method and the operations of MSG have been included in the consolidated financial statements from this date forward.

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**May 31, 2005 and 2004**

**4. Business Combinations - continued**

The purchase price allocation to the assets acquired and liabilities assumed based on their fair values is set out in the following table:

	<u>Book Value</u>	<u>Fair Value</u>	<u>Discrepancy</u>
Cash	\$ 701	\$ 701	\$ -
Other current assets	3,963	3,963	-
Current liabilities, including hedge liabilities	(5,144)	(5,144)	-
Working capital	(480)	(480)	-
Refundable deposits	125	125	-
Property, plant and equipment	5,705	3,806	1,899
Mine properties	3,931	-	3,931
Environmental and closure provisions	(1,363)	(1,363)	-
Net assets acquired	<u>\$ 7,918</u>	<u>\$ 2,088</u>	<u>\$ 5,830</u>
Purchase price			
-transaction costs	\$ 89	\$ 89	-
-cash and short term obligation	2,000	2,000	-
Cash cost of shares	2,089	2,089	-
-repayment of hedging liability	2,759	2,759	-
Total	<u>\$ 4,848</u>	<u>\$ 4,848</u>	<u>\$ -</u>

During the 2005 year it came to the Company's attention that there was an unrecorded liability, relating to the period prior to the acquisition of MSG by the Company, of \$350. The purchase agreement limited the level of liabilities and provides specific representation and warranties in this regard. The Company signed on December 3 2004 a mutual release with the vendor whereby it agreed with the vendor to reduce the amount due to the vendor by offsetting the undisclosed liability of \$ 350 against the \$1 million due October 24, 2004. As a result a net amount of \$ 650 was paid in 2005.

(b) Loryser S.A. ("Loryser")

On December 6, 2003 the Company finalized the acquisition of 100% of the issued capital of Loryser, and in return, the Company granted a 10% net profit interest from gold obtained from Loryser's areas to an independent third party. The Company had previously managed Loryser as part of the Minas de Corrales Joint Venture. The Company's Arenal gold deposit is situated on the Loryser ground.

**5. Accounts Receivable**

(a) Accounts receivable are comprised of:

	<u>2005</u>	<u>2004</u>
Trade receivables	-	\$ 702
Tax receivables <sup>(1)</sup>	<b>\$ 1,785</b>	701
Employee loan (Note 14)	-	39
	<u><b>\$ 1,785</b></u>	<u>\$ 1,442</u>

<sup>(1)</sup> Tax receivables comprises of VAT and other export tax incentives.

**Uruguay Mineral Exploration Inc.**  
**Notes to Consolidated Financial Statements**  
Thousands of United States Dollars, except where indicated

**May 31, 2005 and 2004**

**6. Inventories**

	<u>2005</u>	<u>2004</u>
Finished metals	807	\$ 274
Ore in stockpiles	1,131	257
Gold in circuit	561	402
Materials and supplies	4,671	3,155
	<u>7,170</u>	<u>\$ 4,088</u>

**7. Property, Plant and Equipment**

	<u>Cost</u>	<u>2005 Accumulated Amortization and Depletion</u>	<u>Net Book Value</u>
Land and lease rights	\$ 671	\$ -	\$ 671
Plant and equipment	14,234	2,780	11,454
Mineral properties	8,995	1,445	7,550
	<u>\$ 23,900</u>	<u>\$ 4,225</u>	<u>\$ 19,675</u>
	May 31 2004		
	<u>Cost</u>	<u>Accumulated Amortization and Depletion</u>	<u>Net Book Value</u>
Land and lease rights	\$ 671	\$ -	\$ 671
Plant and equipment	4,226	672	3,554
Mineral properties	809	-	809
	<u>\$ 5,706</u>	<u>\$ 672</u>	<u>\$ 5,034</u>

The Arenal project reached commercial production on October 1, 2004. Accumulated deferred exploration and development costs of \$ 6,551 relating to the Minas de Corrales project were capitalized and amortized on units of production basis.

The plant is located on leased land. The lease expires in 2026. No further payments are due on the lease. Included in plant and equipment is \$ 288 (2004 - \$298) of spare parts that are amortized over 5 years. Included in mineral properties is \$ 982 (2004 - \$809) of mine development costs that have not yet been amortized as these are pre-stripping and development costs for deposits from which production has not commenced.

The Company applied an impairment test to capitalized costs at May 31, 2005 to determine whether such costs may be recovered in future. Capitalized costs were compared to estimated future cash flows from production of proven reserves plus the cost (net of impairment) of unproved properties, discounted at 10%. No impairment loss was determined as a result of the impairment test.

**May 31, 2005 and 2004**

**8. Deferred Exploration and Development Costs**

	<u>2005</u>	<u>2004</u>
Acquisition costs and option payments	\$ 775	\$ 1,537
Exploration, development and other property costs	2,972	4,990
Capitalized indirect overheads	1,341	3,138
	<u>\$ 5,088</u>	<u>\$ 9,665</u>

(a) The Company has the right to purchase shares of a Uruguayan company, Davinco S.A (Presidente Terra project) pursuant to an agreement dated May 14, 1997. The terms of this purchase are as follows:

- i) 80% of DAVINCO SA issued shares for the amount of \$750, payable in installments. \$475 has been paid up to November 30, 2001. The balance of installments is due as follows:

<u>Installment</u>	<u>Due date</u>
\$ 275	Within 5 days after the issue of a feasibility study on mineral properties held by DAVINCO SA.

- ii) 20% of DAVINCO SA total shares, once the 80% has been acquired and provided a decision has been made to continue mineral exploration, at a variable price depending on the productive potential.

At May 31, 2005, no projects were abandoned in the current period.

(b) Included in 2004 deferred exploration and development costs of \$5,088 is \$ 745 (2004 - \$1,827) paid as fees, of which \$33 (2004 - \$203) was incurred in 2004. These fees represent geological consulting, administrative services and other salary costs incurred by the Company. The outlays made by the Company include payments for services rendered by certain directors and employees for technical assistance and geological services rendered with respect to the Company's exploration and development activities in Uruguay.

(c) The Uruguay Mining legislation requires all mining titles to be supported by guarantees for any environmental rehabilitation requirements resulting from exploration or mining activities. These guarantees are required to be posted by non-title holders. As a result, certain of the Company's employees, officers and directors have provided personal assets as guarantees. The Company intends to compensate these individuals in the event that the guarantee is called. The Company has also agreed to pay a guarantee fee to the individuals at rates advantageous to the Company. This fee is based on the amount of the guarantee and is negotiated on a case-by-case basis. The total guarantees provided at May 31, 2005 were approximately \$ 974 (2004 - \$ 824). These relate to potential site restoration responsibilities associated with exploration activities. In addition, as a consequence of the acquisition of the San Gregorio mine, the Company has assumed full responsibility for the rehabilitation of the mining site. This obligation is supported by a rehabilitation guarantee of US\$1,500. During the period the sum of US\$1,500 held in escrow to support this guarantee was released and replaced by a letter of credit provided by Macquarie Bank.

The Company's current site restoration liability in respect of its exploration activities is not material.

**May 31, 2005 and 2004**

**9. Other Assets and Deferred Costs**

	2005		2004
Refundable deposits	\$ 140	\$	126
Capitalized debt issue costs	215		-
Deferred stripping (Note 3(b))	568		-
	<u>\$ 923</u>	\$	<u>126</u>

Costs and fees relating to the secured financing facility have been capitalized and will be amortized over the life of the facilities, commencing December 1, 2004. Warrants with a value of \$ 188 given as compensation for the interim working capital facility have been expensed.

**10. Debt and Deferred Payment of Equipment**

	2005		2004
<b>Drawn debt facilities</b>			
Working capital facility (a)	\$ -	\$	-
Deferred payment on equipment (b)(c)	4,647		-
	<u>4,647</u>		<u>-</u>
Less current portion	4,256		-
	<u>\$ 391</u>	\$	<u>-</u>
<b>Available debt facilities</b>			
Working capital facility (a)	\$ 2,150	\$	-
Deferred payment on equipment (b)(c)	4,647		-
	<u>\$ 6,797</u>	\$	<u>-</u>

(a) On August 8, 2004, the Company entered into a secured \$2,000 interim working capital facility with Macquarie Bank Limited. On October 26, 2004 this interim facility was increased to \$3,000. On December 8, 2004 the Company signed documentation for a secured financing facility of \$6,500 replacing the interim working capital facility with Macquarie Bank Limited. This facility will provide \$1,500 for environmental bonds and \$5,000 for working capital needs. The facility will bear interest at a rate of Libor plus 2%, and is secured by a general floating charge over all of the Company's assets. The working capital facility is due to expire in February 2006 and the environmental bond facility in December 2006.

**May 31, 2005 and 2004**

**10. Debt and Deferred Payment of Equipment - continued**

(b) On August 5, 2004, a subsidiary of the Company signed a sale and purchase agreement for the purchase of \$6,349 in mine equipment from Komatsu Latin America Corporation. The equipment is being purchased on deferred payment terms with an initial payment of 25%, twelve monthly installments equal to 15% and a final balloon payment of 60% 12 months from the date that equipment is assembled and ready to work. Interest on all balances outstanding accrues at the 90 day Libor rates plus 4% and is secured by a pledge over the assets financed. The net book value of the equipment under the agreement at May 31, 2005 is \$ 5,491.

On 15 June 2005 a subsidiary of the Company signed an amendment to the August 5, 2004 sale and purchase agreement to purchase an additional \$1,352 in mine equipment from Komatsu Latin America Corporation. This equipment is being purchased on deferred payment terms with an initial payment of 25%, twelve monthly installments equal to 15% and a final balloon payment of 60% 12 months from the date that equipment is assembled and ready to work. Interest on all balances outstanding accrues at the 90 day Libor rates plus 4%. Additional amounts relating to assembly and freight included in deferred payments on equipment will be paid following the final commissioning of the equipment.

**11. Asset Retirement Obligations**

The Company's asset retirement obligations relate to the retirement and remediation of the San Gregorio Operation.

The asset retirement obligations have been recorded as a liability at estimated fair value, assuming a credit adjusted risk free discount rate of 6%, weighted average term of 4 years and an inflation factor of 3%.

The following table summarises the movements in the asset retirement obligation activities for the years ended May 31, 2005 and 2004.

	<b>2005</b>	<b>2004</b>
<b>At 1 June</b>	<b>\$ 1,363</b>	<b>\$ 1,363</b>
Changes in cash flow estimates	<b>132</b>	-
Accretion expense	<b>63</b>	-
	<b>\$ 1,558</b>	<b>\$ 1,363</b>

Changes in cashflow estimates arise from a re-assessment of dismantle costs for the plant and the commercialization of Arenal, including new waste dumps. The undiscounted amount of expected cashflows required to settle the asset retirement obligations are estimated to be \$ 1,995 (2005 \$ 1,815) in 5 years.

**May 31, 2005 and 2004**

**12. Equity Instruments**

(a) Authorized

Unlimited number of Common Shares of no par value

(b) Issued

**Common shares**

	May 31, 2005		May 31, 2004	
	Number (000's)	Amount \$	Number (000's)	Amount \$
Issued and outstanding, beginning of year	42,865	\$ 21,194	36,297	\$ 12,278
Issued for stock options exercised	612	600	150	45
Issued for cash (Note 12(c))	-	-	2,400	4,629
Issued for exercise of warrants for cash	2,630	8,514	4,018	4,242
Issued and outstanding	46,107	\$ 30,308	42,865	\$ 21,194
Less: cumulative share issue costs <sup>(1)</sup>		(925)		(925)
Balance, end of year	46,107	\$ 29,383	42,865	\$ 20,269
Weighted average number of shares	43,844		39,590	

**Warrants**

	May 31, 2005		May 31, 2004	
	Number (000's)	Amount \$	Number (000's)	Amount \$
Issued and outstanding, beginning of year	2,630	\$ 548	4,008	\$ 140
Issued for private placement (Note 12(c))	-	-	2,400	500
Issued as a commission for private placement (Note 12(c))	-	-	240	50
Issued as fee for financing facilities (Note 12(c))	250	188	-	-
Exercised	(2,630)	(548)	(4,018)	(142)
Issued and outstanding, end of year	250	\$ 188	2,630	\$ 548
<b>Total equity instruments</b>		<b>\$ 29,571</b>		<b>\$ 20,817</b>

(1) These costs have been recorded gross of any related tax effect, as the ultimate utilization of any related tax benefit in Canada continues to remain uncertain.

During August 2004, the Company issued 250,000 warrants at an exercise price of \$3.75 per share in satisfaction of a financing fee on the facilities detailed at Note 10(a). The fair value of these options were estimated using the Black Scholes option pricing model with the following assumptions: Dividend yield (nil), Expected volatility (.4), risk free rate (3%) and a weighed average life of 2 years. As such a value of \$US188 was attributed to these warrants.

**May 31, 2005 and 2004**

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**12. Equity Instruments - continued**

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(c) Private placements

During October 2003, the Company completed a private placement of 2,400,000 units at a price of \$2.14 (CDN \$2.85) per unit for gross proceeds of \$5,129 (CDN \$6,840). Each unit comprised one common share and one warrant, with each whole warrant entitling the holder to acquire one additional common share upon the payment of \$2.78 (CDN \$3.75) per share on or before 18 months from the date of issuance. This private placement was partially non arms' length as a non executive director of the Company subscribed for 40,000 units. The acting agent also received a commission of 240,000 share purchase warrants exercisable at \$2.78 (CDN \$3.75) per share expiring 18 months from the closing date.

The fair value of all warrants issued in 2004 was estimated using the Black Scholes option pricing model with the following assumptions: Dividend yield (Nil), Expected volatility (0.35), risk-free interest rate (5.0%), and weighted average life of 1.5 years. As such, a value of \$550 was attributed to these warrants of which \$50 was attributed to the 240,000 warrants for the agent commission. As a result, \$4,628 of the \$5,128 value has been attributed to the common shares issued and \$500 to the 2,400,000 warrants attached to these common shares.

(d) Warrants

At May 31, 2005 the Company had 250,000 (2004 – 2,630,000) warrants outstanding. During 2005, the Company issued 250,000 (2004 – 2,640,000) warrants as a financing fee (2004 warrants were for a private placement). The outstanding warrants are exercisable as follows:

Number of Warrants	Warrant Price \$CDN	Expiry Date
250,000	3.75	August 8, 2006

(e) Options

Effective June 1, 2004 the Company adopted the recommendations of the CICA Handbook with respect to stock-based compensation and commenced to expense stock options granted from June 1, 2004 using the fair value method. Previously, no value was assigned to stock options or warrants issued in exchange for employee, directors and officers services.

The Company has an option Plan for its officers, directors and employees of the Company. Options under the plan are typically granted in such numbers as reflects the responsibility of the particular optionee and his or her contribution to the business and activities of the Company. The Company can issue a maximum of 6,000,000 stock options under this plan. Options granted under the plan have a term of up to 5 years. Except in specified circumstances, options are not assignable and terminate on the optionee ceasing to be employed by or associated with the Company. The terms of the plan further provide that the price at which shares may be issued under the Plan cannot be less than the market price (net of permissible discounts) of the shares when the relevant options were granted.

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**May 31, 2005 and 2004**

**12. Equity Instruments - continued**

The following table summarizes information regarding the Company's outstanding options as at May 31, 2005:

	Number of Shares (000's)	Option Price per Share Range CDN \$	Weighted Average Exercise Price CDN \$
Options outstanding, May 31, 2004	2,705	\$0.30 - \$4.00	\$0.75
<b>Options – granted</b>	<b>676</b>	<b>\$3.00 - \$5.40</b>	<b>\$3.74</b>
<b>Options – exercised</b>	<b>(612)</b>	<b>\$0.30 - \$3.00</b>	<b>\$1.02</b>
<b>Options outstanding, May 31, 2005</b>	<b>2,769</b>		<b>\$1.97</b>

The following table summarizes information about the stock options outstanding to the officers, directors and staff at May 31, 2005:

Options Outstanding	Option price CDN \$	Weighted Average Exercise Price CDN \$	Remaining Contractual Life
562,500	\$ 0.40	\$ 0.40	1.7 years
235,000	\$ 0.75	\$ 0.75	2.8 years
150,000	\$ 1.00	\$ 1.00	2.3 years
915,000	\$ 1.50	\$ 1.50	3.3 years
346,500	\$ 3.00	\$ 3.00	4.0 years
60,000	\$ 3.40	\$ 3.40	4.1 years
300,000	\$ 4.00	\$ 4.00	3.9 years
200,000	\$ 5.40	\$ 5.40	4.5 years
<b>2,769,000</b>			

The following table summarizes information about the stock options outstanding at May 31, 2004:

Options Outstanding	Option price CDN \$	Weighted Average Exercise Price CDN \$	Remaining Contractual Life
50,000	\$0.30	\$0.30	0.2 years
785,000	\$0.40	\$0.40	2.7 years
150,000	\$1.00	\$1.00	3.3 years
300,000	\$0.75	\$0.75	3.8 years
1,120,000	\$1.50	\$1.50	4.3 years
300,000	\$4.00	\$4.00	4.9 years
<b>2,705,000</b>			

All of the options detailed above are fully exercisable. The weighted average exercise price of the options outstanding at May 31, 2005 is \$1.97 (2004 - \$0.75).

During the year, \$755 (2004 – \$821) of compensation expense was recorded. For the purposes of stock based compensation, the fair value of each option was determined on the date of granting using the Black Scholes option pricing model with the following assumptions: Dividend yield Nil (2004 - Nil), expected volatility (range of 0.40 to 0.50) (2004 - 0.38), risk-free interest rate 3.0% (2004 – 5%), and weighted average life of 4.0 years (2004 – 4.0 years). The options have a weighted average fair value of \$1.12 per option.

**May 31, 2005 and 2004**

**13. Contributed Surplus**

The following table summarises the movements in contributed surplus for the years ended May 31, 2005 and 2004.

	2005	2004
<b>At 1 June</b>	<b>\$ 881</b>	<b>\$ 60</b>
Expense for the year	756	821
Transfer on exercise of options	(60)	-
	<b>\$ 1,577</b>	<b>\$ 881</b>

**14. Related Party Transactions**

Except as disclosed elsewhere in these consolidated financial statements, the Company had the following related party transactions:

- (a) Included in accounts receivable is \$nil (2004 - \$39) in employee loans (Note 5). The employee loans have been used for the benefit of the Company to provide certain guarantees as required by the Uruguayan Government in relation to prospecting and exploration activities. The entire balance of \$39 was repaid during the year.
- (b) During 2005, the Company has paid approximately \$ 32 (2004 - \$32) in directors fees.
- (c) In 2004, a non-executive director of the Company subscribed for 40,000 units pursuant to the private placements detailed in Note 12(c).

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

**Uruguay Mineral Exploration Inc.**  
**Notes to Consolidated Financial Statements**  
Thousands of United States Dollars, except where indicated

**May 31, 2005 and 2004**

**15. Segmented Information**

The Company has three reportable segments: Gold, exploration and corporate. The corporate segment is responsible for corporate financing and other business development activities for the Company. The Gold segment operates the San Gregorio gold mine and the exploration segment is devoted to the acquisition and exploration of mineral properties. The gold and exploration segments operate solely in Uruguay. Precious metals are refined and sold in Europe through one refinery.

	2005			
	Gold	Exploration	Corporate	Total
Sales	\$ 30,310	\$ -	\$ -	\$ 30,310
Net income (loss)	\$ 4,406	\$ (1,127)	\$ (1,769)	\$ 1,510
Property, plant and equipment	\$ 19,508	\$ 156	\$ 11	\$ 19,675
Deferred exploration and development	\$ 411	\$ 4,677	\$ -	\$ 5,088

  

	2004			
	Gold	Exploration	Corporate	Total
Sales, net of royalties	\$ 13,989	\$ -	\$ -	\$ 13,989
Net income (loss)	\$ 2,250	\$ (1)	\$ (1,696)	\$ 553
Property, plant and equipment	\$ 3,803	\$ 1,222	\$ 9	\$ 5,034
Deferred exploration and development	\$ -	\$ 9,665	\$ -	\$ 9,665

The accounting policies of the segments are the same as those described in the summary of significant accounting policies. Deferred exploration and development expenditure and equipment were transferred from the Exploration segment to the Gold segment with the commencement of Arenal operations.

**May 31, 2005 and 2004**

**16. Income Taxes**

- (a) The reconciliation between taxes shown in the consolidated statements of income and retained earnings/(deficit) differ from the amounts obtained by applying statutory rates of taxes to earnings before provision for income taxes due to the following.

	<u>2005</u>	<u>2004</u>
Income before taxes	\$ 900	\$ 553
Income tax rate	35%	35%
Expected income taxes expense	<u>315</u>	<u>193</u>
Tax effect of:		
Amortization, credit on consolidation	1,164	(1,693)
Inflation adjustments for losses and net assets	(980)	(847)
Foreign exchange gains/(losses)	1,657	-
Investment incentives (Note 16(d))	(803)	-
Rate difference due to investment incentives	1,200	-
Difference in tax rates	340	-
Tax losses recouped - Uruguay	(3,978)	-
Other differences	399	121
Tax losses not recognized – Canada and International	<u>76</u>	<u>2,226</u>
Income tax expense/benefit	<u>\$ (610)</u>	<u>\$ -</u>
	<u>2005</u>	<u>2004</u>
Comprising		
Current income taxes	\$ 1,177	\$ -
Future income taxes - recovery	<u>(1,787)</u>	<u>-</u>
	<u>\$ (610)</u>	<u>\$ -</u>

- (b) Un-recognized tax benefits

The Company has non capital loss carry forwards of \$ 11,076 (2004 - \$ 7,227) that may be available for tax purposes. The losses at gross value are in the following jurisdictions and expire as follows:

	<u>Canada</u>	<u>Uruguay</u>	<u>Barbados</u>
Year to 31 May 2006	\$ 757	\$ 1,011	\$ -
Year to 31 May 2007	509	2,681	117
Year to 31 May 2008	489	-	-
Year to 31 May 2009	465	-	-
Year to 31 May 2010	-	-	-
Year to 31 May 2011	127	-	131
Year to 31 May 2012	-	-	1,025
Year to 31 May 2013	-	-	905
Year to 31 May 2014	-	-	1,571
Year to 31 May 2015	1,288	-	-
	<u>\$ 3,635</u>	<u>\$ 3,692</u>	<u>\$ 3,749</u>

**May 31, 2005 and 2004**

**16. Income Taxes (continued)**

In Uruguay the Company has deferred costs which result in available tax pools of \$ 1,955 (2004 – \$5,654) in acquisition, exploration and development expenditures, which may be deductible against future production income from the related properties. The deductibility of these expenditures will be based on the life of the reserves brought into production. In addition, the Company can seek tax relief for certain projects under existing Uruguayan legislation. Such relief may be granted on a project-by-project basis. It is the Company's intention to make application for such relief for projects as they near production.

(c) The following table sets out changes in the future income tax asset:

	<u>2005</u>	<u>2004</u>
Opening income tax asset	\$ -	\$ -
Recognized future income tax asset	<u>1,787</u>	-
	<u>\$ 1,787</u>	<u>\$ -</u>

The significant components of the company's future income tax asset is as follows

	<u>2005</u>	<u>2004</u>
Operating loss carryforwards	\$ 1,478	\$ 5,720
Closure provisions	388	-
Inventory	306	-
Excess of tax values over carrying values (carrying values over tax values)	<u>981</u>	<u>(376)</u>
	<u>3,153</u>	5,344
Valuation allowance	<u>(1,366)</u>	<u>(5,344)</u>
Net future income tax asset	<u>\$ 1,787</u>	<u>\$ -</u>

(d) As a result of the Arenal project being granted national interest status under Uruguayan Investment Law tax benefits have been granted on capital investments of up to \$US19.3 million over the 3 year period commencing 1 June 2004. These benefits include:

- relief from Corporate Tax on a total of up to \$US 9,656 of taxable income has been granted for the 2006, 2007 and 2008 financial years. At the current tax rate of 30% this equates to a potential reduction of tax payable of \$US 2,897.
- in addition, up to a further \$US 9,656 in taxable income from the 2005, 2006, 2007 and 2008 financial years may be deferred to 2010. At the current tax rate of 30% this is equivalent to deferral of potential tax payments of up to a further \$US 2,897.

These benefits are indicative maximum benefits. The actual benefit will depend on the timing of investment and profitability of operations in any specific tax year. To receive the benefit, the taxable income to which the benefit applies needs to be retained in the business for a period of 5 years before it can be distributed as dividends. The company has not recognized any future benefit on the unused portion of the benefit.

**May 31, 2005 and 2004**

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**17. Commitments and Contingencies**

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In addition, to the commitments detailed in Note 8 on exploration of mineral properties, the Company has the following commitments:

- (a) The Company is committed to monthly rental payments on their premises of \$96 in 2006 and \$56 in 2007.
  - (b) Minas De Corrales Project – on acquisition of 100% of the issued capital of Loryser S.A the Company granted a 10% net profits interest from gold obtained from Loryser's areas. The Company had previously managed Loryser as part of the Minas de Corrales Joint Venture. The Company's Arenal gold deposit is situated on the Loryser ground.
  - (c) The company has committed to approximately \$ 1,352 (2004 \$nil) in capital expenditure at 31 May 31, 2005 (2004 – nil).
  - (d) The Texas and Mal Abrigo interests acquired by the Company are subject to a 2% net profits interest and a 1% net smelter return respectively, payable to the vendor.
  - (e) In the ordinary course of business, the Company and its subsidiaries enter into contracts which contain indemnification provisions, such as loan agreements, purchase contracts, service agreements, licensing agreements, asset purchase and sale agreements, joint venture agreements, operating agreements, leasing agreements, land use agreements, etc. In such contracts, the Company may indemnify counterparties to the contracts if certain events occur. These indemnification provisions vary on an agreement by agreement basis. In some cases, there are no pre-determined amounts or limits included in the indemnification provisions and the occurrence of contingent events that will trigger payment under them is difficult to predict. Therefore, the maximum potential future amount that the Company could be required to pay cannot be estimated.
  - (f) Under the terms of the by-laws of the Company, the Company indemnifies individuals who have acted at the Company's request to be a director and/or officer of the Company (and/or one or more of its direct and indirect subsidiaries), to the extent permitted by law, against any and all damages, liabilities, costs, charges or expenses suffered by or incurred by the individuals as a result of their service. The claims covered by such indemnifications are subject to statutory and other legal limitation periods. The nature of the indemnification agreements prevents the Company from making a reasonable estimate of the maximum potential amount it could be required to pay to beneficiaries of such indemnification agreements. The Company has purchased various insurance policies to reduce the risks associated with such indemnifications.
  - (g) The Company has entered into employment agreements with certain officers ("officers") of the Company. The employment agreements specify that officers are entitled to a lump sum payment ranging from three to twenty four months salary in the event they are terminated without cause.
-

**May 31, 2005 and 2004**

**18. Financial Instruments**

The Company holds various forms of financial instruments. The nature of these instruments and the Company's operations expose the Company to commodity price risk, currency risk, credit risk, and fair value risk. The Company manages its exposure to these risks by operating in a manner that minimizes its exposure to the extent practical.

(a) Commodity Price Risk

The Company uses financial derivatives to mitigate the effect of certain risks that are inherent in its business. As at May 31, 2005 the Company had entered into a number of financial derivatives to reduce its exposure to fluctuations in the gold price. These instruments consist of gold option contracts. The company intends to deliver into these contracts.

For these contracts the fair value was calculated using the spot price at period end, expected future prices and volatilities. The nature and level of these contracts are such that they offer a degree of downside protection while allowing the company to participate in price appreciation. The fair value of these contracts is noted below. The net value of these contracts have been recorded as a liability.

Asset/(liability)	2005	2004
Gold put options	\$ 165	\$ -
Gold call options	(345)	-
	\$ (180)	\$ -

The Company has entered into put option contracts on 32,500 ounces at a forward price of \$US 400 per ounce. To cover the cost of the put option contracts the company has sold 32,500 call options at a forward price of \$US 436 per ounce. The put and call options are matched in timing and will be delivered into on a monthly basis at a rate of 2,500 ounces per month.

(b) Currency risk

The Company's cash balances are held principally in US dollars in a Canadian bank, while its expenses are incurred in Uruguay pesos as well as US dollars and other currencies. The Company currently reports its results in United States dollars. There would be an adverse impact on the reported results if the following situations arise:

- (i) The Uruguay inflationary impact on the peso expenses increases at more than the depreciation of the Uruguay peso against the United States dollar. This would result in an increase of the peso-based expenses.
- (ii) The United States dollar depreciates against the Uruguay peso. This would reduce the available cash resources and increase the related expense.

A significant portion of the Company's operations are located in Uruguay, and are subject to fluctuations in exchange rates. The Company manages its currency rate risk by denominating its contracts and commitments, where possible, in US dollars.

**May 31, 2005 and 2004**

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**18. Financial Instruments**

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(c) Credit risk

The Company enters into financial agreements (financial instruments) with major international banks and other international financial institutions in order to manage underlying revenue and future cash flow exposures arising from commodity prices. Financial instruments, which subject the Company to concentrations of credit risk, consist primarily of cash, accounts receivable and securities. The Company has sales to one customer.

(d) Fair value risk

The carrying amount of cash, accounts receivable and current liabilities approximate their fair value due to the short-term maturities of these instruments. The fair value of the Company's debt is approximated by its carrying value due to its floating interest rate.

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**19. Statement of Cash Flows**

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(a) The net change in non-cash working capital items is as follows:

	<u>2005</u>	<u>2004</u>
Accounts receivable	\$ (408)	\$ (666)
Prepaid expenses	(54)	(403)
Inventories	(3,082)	(1,079)
Accounts payable and accrued liabilities	1,375	823
	<u>\$ (2,169)</u>	<u>\$ (1,325)</u>

(b) Included in cash and cash equivalents is nil (2004 - \$425) of negotiable certificates issued by the Uruguayan Government that can be used to pay taxes or be converted to cash. The certificates are denominated in Uruguayan pesos and hence are subject to currency risk (Note 17(b)).

(c) Interest paid

	<u>2005</u>	<u>2004</u>
Interest paid	\$ 555	\$ 77

(d) During the year, the Company entered into a sale purchase agreement to purchase \$6,349 of mine equipment (Note 10(b)).

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**May 31, 2005 and 2004**

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**20. International Accounting Standards GAAP reconciliation**

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The Company's financial statements have been prepared in accordance with Canadian generally accepted accounting principles (Canadian GAAP).

The Company's shares are listed on the Toronto Venture Stock Exchange and the AIM. The Company's Annual Information filing on the Alternative Investment Market (AIM) of the London Stock Exchange requires that the Company prepare a reconciliation of Canadian GAAP to International GAAP if material difference exist between the preparation of these financial statements under Canadian GAAP and International GAAP. As the preparation of these financial statements under International Accounting Standards does not differ in any material respect to Canadian GAAP no reconciliation is provided.

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**21. Subsequent Events**

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- (a) Subsequent to year end, on June 15, 2005, a subsidiary of the Company. signed a sale and purchase agreement for the purchase of \$1,352 in mine equipment with Komatsu Latin America Corporation. The equipment is being purchased on deferred payment terms with an initial payment of 25%, twelve monthly installments equal to 15% and a final balloon payment of 60% 12 months from the date that equipment is assembled and ready to work. The Company will also be responsible for all assembly and mobilization costs. Interest on all balances outstanding accrues at the 90 day libor rates plus 4%. Commencing the date that the machinery is assembled and ready for use.
  - (b) Subsequent to year end, the Company had 84,000 options exercised for \$C 219.
  - (c) Subsequent to the end of the financial year the Company has signed a letter of commitment with Bell Geospace for an aerial survey to be performed during October 2005. The survey has a value of \$ 1,200 and is subject to final contractual agreement.
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**Uruguay Mineral Exploration Inc.**  
**Schedule of Deferred Costs**  
**United States Dollars**

**May 31, 2005 and 2004**

	May 31, 2004	Expenditures	Transfers	May 31, 2005
Minas de Corrales Gold Project (1)				
Acquisition	\$ 900	\$ 125	\$ (900)	\$ 125
Exploration	2,877	1,040	(3,665)	252
Deferred administration	1,915	105	(1,986)	34
	<u>5,692</u>	<u>1,270</u>	<u>(6,551)</u>	<u>411</u>
Base Metals Projects (2)				
Acquisition	105	-	-	105
Exploration and overhead	1,269	537	-	1,806
Deferred administration	849	74	-	923
	<u>2,223</u>	<u>611</u>	<u>-</u>	<u>2,834</u>
Other Gold Projects (3)				
Acquisition	480	-	-	480
Exploration and overhead	515	16	-	531
Deferred administration	354	2	-	356
	<u>1,349</u>	<u>18</u>	<u>-</u>	<u>1,367</u>
Diamonds Projects (4)				
Acquisition	65	-	-	65
Exploration and overhead	30	66	-	96
Deferred administration	19	9	-	28
	<u>114</u>	<u>75</u>	<u>-</u>	<u>189</u>
Regional Exploration (5)				
Exploration and overhead	287	-	-	287
	<u>\$ 9,665</u>	<u>\$ 1,974</u>	<u>\$ (6,551)</u>	<u>\$ 5,088</u>

No amounts directly related to these projects were expensed. During the period ended May 31, 2005, total expenditures for deferred exploration and mineral properties were \$1,974 (2004 - \$1,659).

May 31, 2005 and 2004

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- (1) **Minas de Corrales Gold Project (MCGP):** The MCGP is situated approximately 450 kilometers north of Montevideo and features Uruguay's only operating gold mine. The Corporation controls 100% of this historic gold field, which is characterized by widespread gold mineralization. The two largest deposits discovered to-date are the San Gregorio deposit, which has produced over 500,000 ounces since it was discovered in the mid 1880's, and the Arenal deposit, which was discovered in 2004. Arenal, which is now in production, contains an inferred resource of over 750,000 ounces, and is still open in all directions. Other known, unmined deposits in the area include Sobre Saliente and Castrillón, where indicated resources of approximately 200,000 and 20,000 ounces of gold respectively have been delineated. The company has an aggressive exploration effort underway in the area targeting further "Arenal-style" deposits within a 50 km radius of the MCGP.
- (2) **Base Metals Projects:** These include the *Isla Patrulla/Texas* copper/gold project where a substantial zone of copper and gold anomalism has been identified approximately 300 km north-east of Montevideo. A number of targets have been identified using a combination of stream geochemistry and airborne geophysics, and these targets are being progressively tested. Previous drilling at the Texas prospect intersected high-grade, but narrow width copper/gold/lead/silver mineralization, and the object of the current search is for locations where this mineralization will have accumulated in greater thicknesses. At *Mal Abrigo*, located approximately 140 km WNW of Montevideo, a large, layered mafic/ultramafic complex is the subject of study for nickel/copper/platinoids. Disseminated copper and nickel sulphides are visible at the surface in a number of places and work is underway to identify zones where massive sulphides may have accumulated. At *Lascano*, located approximately 250 kilometers north-east of Montevideo, a very strong gravity high approximately 70 kilometers long by up to 40 kilometers wide is considered to be a capable of hosting Norilsk-style nickel mineralisation. A detailed airborne airmag/gravity survey is scheduled for September/October 2005, with the expectation of generating drill targets for 2006. At *Carpinteria*, which is situated approximately 500 km north of Montevideo, an extensive sequence of komatiitic basalts and ultramafic flows with strong nickel anomalism is currently being evaluated.
- (3) **Other Gold Projects.** These include *Presidente Terra*, which is located approximately 240 kilometers north east of Montevideo, where work conducted during 2000 and 2001 identified high-grade mineralized float over a 12 km strike length of a large gold-mineralized shear system. This project has been on hold due to competing priorities. *Mirta*, which is located near Colonia in the south-west of Uruguay, is a complex, shear-hosted gold deposit and the company has been assessing the mineralisation controls in order to define further drill targets. The deposit is characterized (so far) by a series of short, plunging, high-grade ore zones contained within a broader, low-grade mineralisation envelope. At *Chamizo*, which is located approximately 120 km ENE of Montevideo, a gold-bearing metamorphosed acid tuff is being investigated.
- (4) **Diamonds including Cinco Rios Project.** This project is located in the North of Uruguay and includes the Minas de Corrales area as well as the properties obtained with the acquisitions of Cinco Rios SA. Systematic drainage sampling has identified an area where positive kimberlite indicator minerals are clustered, and a close-space airborne gravity survey is scheduled for October 2005. The company has previously recovered several macro-and micro-diamonds, together with G9 and G10 garnets from this area.
- (5) **Regional Exploration.** The company has an ongoing program of identifying and field-checking geochemical anomalies obtained from reviewing data held within the company's proprietary data-base. Where appropriate successful prospects are designated and allocated to the major project groupings shown above.