

**URUGUAY MINERAL EXPLORATION INC.
MEDIA RELEASE**

25th August, 2006

SYMBOLS: UME (TSXV), UGY (AIM)

Results for the quarter and year ended May 31, 2006

- **Gold production target of 100,000 ounces per annum exceeded**
- **Maiden dividend of C3.5 cents per share proposed**

Uruguay Mineral Exploration Inc (“UME” or the “Company”) today announces its financial results for the year and quarter ended May 31, 2006.

Highlights for the year ended May 31, 2006 include:

- Gold production of 101,287 ounces at an average cash cost of US\$210 per ounce, 2006 being the first full year in which the production target of 100,000 ounces from San Gregorio is exceeded (2005: 75,026 ounces at an average cost of US\$275)
- Operating revenues of US\$51,206,000 including gold sales of 100,395 ounces at an average price of US\$486 per ounce (2005: US\$30,563,000 including 69,674 ounces sold at average price of US\$418)
- Net profit after tax of US\$10,583,000 or basic earnings of \$0.23 per share (2005: US\$1,510,000 or basic earnings of US\$0.034 per share)
- Gross operating profit from operations of US\$28,557,000 (2005: US\$9,722,000)
- Cash flow from operations of US\$20,515,000 before non-cash working capital movements (2005: US\$4,647,000)
- Year end cash position of US\$8,931,000 and interest bearing debt of US\$4,225,000 (2005: US\$5,501,000 and US\$4,647,000)
- Maiden dividend of C\$3.5 cents per share proposed to be paid on 27 October 2006 to all shareholders on the register as at 13 October 2006.
- Drill intercepts at Argentinita show a mineralized system of over 700 meters strike and 1-6 meters in width. Infill and extension drilling is in progress to allow a first resource and reserve statement to be completed for this area by January 2007. Importantly this drilling confirms the potential of the Zapucay shear to host gold mineralization over a 3-4 km area where a number of anomalies are still to be tested.
- The Air-FTG[®] gravity and magnetic survey at Lascano was performed by Bell Geospace Inc. The survey significantly improved the quality of information on Lascano and defined 2 to 3 concentric ring shaped gravity and magnetic highs caused by separate sources. Initial interpretation suggest that the gravity high is caused by medium density rocks surrounded by non magnetic lower density rocks. Initial targets identified from this work will be drilled in 2006.
- Appointments of David Fowler as CEO and George Schroer as Vice President Exploration.
- With Chris Clark stepping down as CEO and coming off the Board in October 2006, Julio Porteiro has joined the Board.

Highlights for the last quarter of the financial year include:

- Gold production of 25,350 ounces at an average cash cost of US\$243 per ounce (Q4 2005: 24,844 ounces at US\$229)
- Operating revenues of US\$15,992,000 including the sales of 27,283 ounces of gold at an average price of US\$543 per ounce (Q4 2005: US\$10,284,000 including 22,904 ounces of gold at an average price of US\$422 per ounce)
- Net profit after tax of US\$4,077,000 or US\$0.090 per share (Q4 2005: US\$2,544,000 or US\$0.056)
- Cash flow from operations of US\$6,813,000 before non-cash working capital movements (Q4 2005: US\$1,798,000)

Subsequent to the 2006 year-end, gold exploration on the Isla Crystalina belt has been focused on Laurales, approximately 10 km from Arenal. Approximately 4,956 meters have been drilled to the end of August with the best intercept LAUDDH01 containing 24 metres at 1.83 g/t from 19 metres.

Commenting on the results Chairman Tony Shearer said: "The excellent financial results for the year ended 31st May 2006 show a profit before tax of \$10.6 million and a cash balance at the end of the year of \$9 million. The Board is proposing a dividend of C\$3.5 cents a share costing a total of US\$1.5 million.

"The Board of UME believes that the Company can deliver better returns for shareholders by focusing on expanding our gold production and reserves and resources. Our objective is to have reserves that are greater than five years' production and to target, through successful exploration, an increase in annual production to 250,000 ounces. While exploration success is never guaranteed, it is the Board's belief that the 110 kilometres Isla Crystalina belt is sufficiently promising to deliver these objectives. Our gold exploration efforts on the Florida and Dom Feliciano belts will also be accelerated as there are clearly many prospective areas in these belts.

"Over the past year we have invested significantly on completing an airborne geophysical survey of the very large geophysical anomaly at Lascano in north eastern Uruguay and on the two zinc prospects along the Dom Feliciano mobile belt. To do these and our other base metals projects justice we believe that it is time for us to deliver value to shareholders by investigating the possibility of joint venturing these base metals prospects on which we have been working. We have commenced a process of compiling data to joint venture these projects during 2006/2007.

"David Fowler is proving to be a fine leader and has stepped into the role of Chief Executive with enthusiasm, skill and commitment. In July 2006 we recruited George Schroer as Vice President Exploration, thus filling a key vacancy in the management team."

The information presented in this press release has been reviewed and verified by Mr George Schroer Vice President Exploration and a Certified Professional Geologist. Mr Schroer is the Qualified Person for the purposes of the AIM Guidance Note on Mining, Oil and Gas Companies dated March 2006. Mr Schroer has a Bachelor of Science in Geology from Colorado State University and is a member of SEG and AIPG. He has over 20 years of international experience in exploration.

ENDS

The Management Discussion and Analysis for the period ended May 31, 2006 can be obtained from the following link: www.uruguayminerals.com

The TSX Venture Exchange has not reviewed and does not accept responsibility for the adequacy or accuracy of this news release.

Editors note:

Uruguay Mineral Exploration Inc. is a gold producer and exploration company focused on identifying and developing mineral opportunities in Uruguay. UME is a fully integrated mining company, possessing the skills necessary to explore and develop its discoveries. The Company operates the only producing gold mine in the country (San Gregorio), and is also the leading mineral exploration company in Uruguay having assembled an exploration portfolio based on gold, base metals (copper, nickel, lead, zinc) and diamond prospects. In the first half of 2003, the Company discovered the Arenal deposit, currently the largest known gold resource in Uruguay. Uruguay Mineral Exploration Inc. is quoted in Canada (TSXV) and London (AIM) and Collins Stewart Limited is the Company's Nominated Adviser and broker.

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CHAIRMAN'S REPORT

The excellent financial results for the year ended 31st May 2006 show a profit after tax of \$10.6 million, and a cash balance at the year end of \$8.9 million. The Board is proposing that a dividend of C\$ 3.5 cents a share costing approximately of US\$1.5 million is paid to shareholders on 27 October 2006. This policy allows us to return earnings to our shareholders at a level that can be sustained as prices fluctuate, while still maintaining our ability to finance our future growth.

During the year we generated gold sales of US\$48 million by selling 100,395 ounces of gold at an average price of \$482 per ounce after allowing for the sale of 21,400 ounces hedged at \$436 per ounce. The gold market improved late in the year and has continued this trend with the current market price sustaining a level of more than \$600 per ounce. At 31 May 2006 we had 3,589 ounces hedged at 436 per ounce and a further 10,000 ounces hedged at 486 per ounce. These hedges will be finished in the first half of 2006/07.

In his Chief Executive's report, David Fowler sets out our strategy and objectives, and the steps we are taking to achieve those objectives. For the next few years our focus will be on gold production, and expanding our reserves and resources. Our intention is to have reserves that are greater than five years production, and to target through successful exploration an increase in annual production to 250,000 ounces. While exploration success is never guaranteed, it is the Board's belief that the 110 kilometres Isla Crystalina belt is sufficiently promising to deliver these objectives. There are clearly also many high potential gold projects on the Florida and Dom Feliciano belts.

Over the past year we have invested significantly on completing an airborne geophysical survey of the very large geophysical anomaly* at Lascano in north eastern Uruguay and on the two zinc prospects along the Dom Feliciano mobile belt. To do these and our other base metals projects justice we believe that it is time for us to deliver value to shareholders by investigating the possibility of joint venturing these base metals prospects on which we have been working.

Our employees have worked very hard for us during the year under review, and I thank them for all their efforts. David Fowler is proving to be a fine leader, and has stepped in to the role of Chief Executive with enthusiasm, skill and commitment. In July 2006, we recruited George Schroer as Vice President Exploration thus filling a key vacancy in the management team. In August 2006 we also appointed Julio Porteiro, a Uruguayan, as a non Executive Director to provide important input on how the Company develops its business in Uruguay. All shareholders will join me in thanking Chris Clark for his vision in establishing the company, and for all the hard work and skill that he has put into building the company into the production and exploration company that it is today. Chris will be stepping down from the Board and ceasing to be President at the shareholders meeting in London on 12th October 2006. We usually have a very good turnout for the meeting, and I hope to see many of you there this year.

Tony Shearer
August 2006

*= The geophysical anomaly at Lascano is a very large gravity high, and is over 70 kilometres long and up to 40 kilometres wide, with a series of very strong, offset, magnetic highs on the western end. This anomaly, which was discovered in the late 1980's during a search for petroleum, has no surface expression

CEO REPORT

The 2006 financial year saw the results of the hard work and commitment over the past 3 years come to fruition with the first full year's production from San Gregorio at the target rate of 100,000 ounces, the best ever performance.

Financial performance

Net profits after tax increased from \$1.5 million in 2004/05 to \$10.6 million in 2005/06 or basic earnings per share of 23 cents. This increase in earnings came from the increase in production at a higher average grade of ore processed in a market where the price of gold was rising.

The group finished the year with \$8.9 million in cash after spending \$17.7 million on capital expenditure, loan repayments and exploration. Debt at year end was \$4.2 million, including \$2.9 million in convertible notes from the purchase of the net profit interest in Arenal and surrounding tenements. This puts the group in a sound financial position from which it can invest in exploration and development while providing a return to shareholders.

The company generated a gross operating margin from operations of \$29.2 million. The majority of this has been re-invested into the business to deliver the future potential of the company. Table 1 below shows how profits generated have been used.

Table 1 Operating profits generated and what they were used for

	2006
	\$US million
Profits generated from operations	
Sales	51.2
Operating costs	(22.0)
Operating margin	29.2
Operating margin was spent on the following	
Property plant and equipment	(12.0)
Exploration	(5.5)
Corporate costs	(3.5)
Interest	(.3)
Working capital and deferred stripping	(5.7)
Cash income taxes	(.7)
Surplus of cash from operating activities after deducting investing activities	1.5
Financing activities	1.9
Net cash movement for year	3.4

Operations

The Arenal mine has been rapidly developed to provide the majority of the mill feed for the year. This has been a significant achievement in that it has required a flexible phased approach to waste development (rather than opening up the full extent of the pit) and the requirement to limit the pit extent due to the adjacent river. The Arenal deposit is performing to expectation with cumulative tonnes and grade mined to the end of May 31 2006 reconciling closely to the reserve model. The pit wall slip in the last quarter of 2006 and a re-evaluation, by external consultants, of the geotechnical parameters used to model the pit has led to the conclusion that the waste to ore ratio for the defined reserve will change from an original ratio of 4.36:1 to 4.75:1.

The investment and effort that have gone into refurbishing the plant, hiring key staff and implementing a formal maintenance program have allowed average monthly throughput to increase from an average of 83,500 tonnes in 2003/04 (design capacity) to 105,000 tonnes in 2005/06. Considerable work continues to be done in training operators and maintenance staff and developing standard operating procedures to maintain the consistency of plant performance in the coming year.

The development and retention of key employees are critical to the future growth potential of the company. A Human Resources Manager has been appointed to focus on this issue in the coming year with emphasis on development and training. The Company is looking to appoint a Safety Manager to bring the same level of focus to improving safety performance that continues to be below the required level.

Cash operating costs were \$210 per ounce for the full year, 5% higher than targeted in our prior year outlook. Approximately \$3 per ounce relates to repairs as a result of the pit wall slip with the balance due to other cost increases.

While quarterly gold production will vary due to the pit constraints discussed above the yearly target for 2007 is 100,000 ounces. We have made all of the necessary studies, and submissions to the Government for the expansion of the Arenal pit and the diversion of the Corrales River. We expect to get this critical approval by the end of 2006.

Development

While progress has been made during the year reserves and resources, net of production, are largely unchanged from the prior year. With the appointment of a new Vice President of Exploration reserves and resources will be reviewed and updated concurrently with the publication of the Company's half year report in January 2007. The focus of near mine drilling during the year has been Arenal, San Gregorio and Argentinita.

Our target at the beginning of the year for Arenal was to define additional open pit reserves to the south east and to test depth extensions. We invested approximately 14,500 meters in these targets. This drilling showed that the mineralised zones to the south east widen but become more defuse and therefore lower grade. A conceptual expansion of the Arenal pit at depth to the south east as shown in the above figure would potentially provide an additional 2,000,000 tonnes of material at a grade of 1.46 g/t. However, at this stage, the higher strip ratio means that this mineralization is only potentially economic with open pit mining at a gold price of \$ 600 per ounce. Within the broader zone of mineralization there are however higher grade lenses and there is additional open extension of mineralization at depth to the south east. Studies have begun to evaluate the economics and practicality of underground mining at depth. This work is planned to be completed during the 2006/07 financial year.

During the year 9,000 meters was drilled in the area of the old San Gregorio pits. This drilling was focused on testing depth extensions of the San Gregorio East pit, the potential to define additional mineralization at Rieles to merge the East Pit and main pit and depth extensions of the main pit. Drilling is continuing on this and on the western end of the San Gregorio pit. Modelling of these resources has started with phase 1 results to be available to be release concurrently with the half year results in January 2007.

Argentinita is a new deposit 3 km South South West along the same major regional structure that is adjacent to the Zapucay deposit mined in the prior year. Drilling to date has defined mineralization along strike for 700 meters with an average width of 1 to 6 meters. The average grade of the intercepts above .5 g/t is 1.3 g/t. Significant additional drilling needs to be done to infill and extend mineralization however we confident that a low grade deposit will be defined. Reserves and resources will be released in January 2007.

Exploration

The Company recruited George Schroer as Vice President of Exploration during July 2006. George is an experienced geologist with the ability to meet the challenge of turning our exploration potential into reserves. With this appointment, and after many years of valuable service, Mike Schwabe steps down as Exploration Director. Mike will continue in the geology team as a consultant.

During the year we spent \$6 million on exploration of which \$2 million was invested in airborne gravity and magnetic surveys for 7 project areas including Lascano. The Lascano survey has been successful in resolving the gravity and magnetic characteristics of the underlying rocks and drill targets have been identified for drilling before December 2006. .

The acquisition of the new DM45 drill rig and additional geologists during 2006 allowed us to expand our exploration efforts on the Isla Crystalina belt in the second half of the year. Positive results have been achieved at the Argentinita gold prospect where we have likely identified our next gold deposit.

As we go forward our strategy will be to ensure that we have sufficient resources to pursue both regional and near mine projects concurrently. At May 31, 2005 the company had 12 geologists dedicated to exploration. Within 6 months the company plans to have 24 geologists with strength being added at all levels of experience. A new diamond drill rig, capable of drilling to 1,000 meters will arrive in August 2006 and a second DM45 RC rig capable of drilling to 400 meters will be available by December 2006. A Drilling Superintendent has been added to focus on productivity and cost and train new employees. A Geophysics Supervisor has also been employed to co-ordinate data collection, processing and interpretation of geophysical data. Importantly the addition of these two people frees our geologists to focus on geology.

Our exploration program continues to be viewed as the priority for the future growth and wealth creation of the company. We were successful in discovering Arenal and are focused on repeating this success.

Strategy

Since inception nearly 10 years ago, UME has followed a strategy of exploring for gold, base metals and diamonds in Uruguay. This strategy has led to the acquisition and development of a significant number of prospects and information and the development of an operating gold mine. Strategically it makes sense for us to grow our gold business, and to focus the majority of our resources on this objective.

We have spent considerable time and effort developing our base metals and diamonds assets to their current point and we want to realize their potential. We have therefore decided to look for partners who are prepared to work with us in joint ventures, or spin these businesses off as separate public companies. Data on all key base metals projects will be prepared by September 2006 and will be available for due diligence by third parties from September 2006. Our intention is to sign agreements with interested parties during the 2006/2007 financial year and for them to commence work on the ground immediately. We will continue to invest in these projects until we have suitably attractive investment propositions.

Outlook

Our key objectives for 2006/2007 are to:

- Produce 100,000 ounces of gold at a cost of less than \$US 250 per ounce
- Obtain permission to divert the Corrales river to allow ongoing development of the Arenal pit
- Define additional reserves at San Gregorio, Argentinita and Arenal
- Prepare scoping studies on underground mining, incremental plant expansion options, and heap leach processing.
- Identify and drill exploration targets that can convert into gold reserves within 2 years
- Find partners to work with us to advance our base metals prospects
- Work towards an IPO of our diamond assets.

I would like to thank all of those who have and continue to commit to the success of UME. Our employees and consultants, shareholders, the local communities in which we operate and the Uruguayan Government have all supported the company over the last year and we look forward to building on this in the coming year.

David Fowler
Chief Executive Officer

Uruguay Mineral Exploration Inc.
Consolidated Financial Statements
For the years ended May 31, 2006 and 2005

Management's Responsibility for Financial Reporting

The consolidated financial statements of Uruguay Mineral 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 judgments 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, PricewaterhouseCoopers 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" Chief Executive Officer

August 23, 2006

Auditors' Report

Auditors' Report**To the Shareholders of
Uruguay Mineral Exploration Inc.**

We have audited the consolidated balance sheet of Uruguay Mineral Exploration Inc. as at May 31, 2006 and the consolidated statements of income and retained earnings and cash flows for the year 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 audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. 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, 2006 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

The consolidated financial statements as at May 31, 2005 and for the year then ended were audited by other auditors who expressed an opinion without reservation on those statements in their report dated August 16, 2005.

Signed "PricewaterhouseCoopers LLP"

Chartered Accountants
Toronto, Ontario, Canada
August 23, 2006

Uruguay Mineral Exploration Inc.
Consolidated Balance Sheets

Thousands of United States Dollars, except where indicated

As at May 31	2006	2005
Assets		
Current assets		
Cash and cash equivalents	\$ 8,931	\$ 5,501
Accounts receivable (Note 3)	1,699	1,785
Inventories (Note 4)	8,108	7,170
Prepaid expenses	612	722
	<u>19,350</u>	<u>15,178</u>
Property, plant and equipment (Note 5)	22,896	19,675
Deferred exploration and development costs (Note 6)	11,184	5,088
Future income tax assets (Note 13)	1,855	1,787
Other assets and deferred costs (Note 7)	4,723	923
Total assets	\$ 60,008	\$ 42,651
Liabilities and Shareholder's Equity		
Current liabilities		
Accounts payable and accrued liabilities	\$ 5,076	\$ 4,945
Current portion of long term debt (Note 8)	2,058	4,256
Unrealized fair value of derivatives (Note 15)	2,317	180
	<u>9,451</u>	<u>9,381</u>
Future income tax liabilities (Note 13(d))	1,486	-
Long term debt (Note 8)	2,167	391
Asset retirement obligation (Note 9)	1,665	1,558
Total liabilities	<u>14,769</u>	<u>11,330</u>
Equity instruments (Note 10)	32,858	29,571
Contributed surplus (Note 11)	1,625	1,577
Cumulative translation adjustment	(19)	(19)
Retained earnings	10,775	192
Total shareholders' equity	<u>45,239</u>	<u>31,321</u>
Total liabilities and shareholders' equity	\$ 60,008	\$ 42,651

Commitments and contingencies (Note 12)

Approved on behalf of the Board:

<i>Signed "David Fowler"</i>	<i>Signed "Tony Shearer"</i>
_____ David Fowler	_____ Tony Shearer
Director	Director

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 for earnings per share amounts and weighted average number of shares outstanding

For the years ended May 31	2006	2005
Sales	\$ 51,206	\$ 30,563
Net profit interest (Note 5(a))	(635)	(253)
Net sales	50,571	30,310
Operating expenses	22,014	20,588
Amortization, depletion and accretion	8,742	4,015
Operating expenses	30,756	24,603
Operating profit	19,815	5,707
Other expenses		
Compensation expense – stock based	1,453	756
Fair value adjustment for derivatives	2,138	180
General and administrative	3,483	3,405
Interest and financing fees	339	555
	7,413	4,896
Income before other items and taxes	12,402	811
Other losses (gains)		
Gain on settlement of net profit interest (Note 5(a))	(888)	-
Interest and other income	(64)	(107)
Foreign exchange loss	128	18
	(824)	(89)
Income before taxes	13,226	900
Income taxes (Note 13)	2,643	(610)
Net income for the year	10,583	1,510
Retained earnings (deficit) beginning of year	192	(1,318)
Retained earnings end of year	\$ 10,775	\$ 192
Basic earnings per share (Note 10(e))	\$ 0.23	\$ 0.034
Diluted earnings per share (Note 10(e))	\$ 0.22	\$ 0.031
Basic weighted average number of shares	46,661,234	43,844,434
Diluted weighted average number of shares	48,548,859	49,014,017

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

For the years ended May 31	2006	2005
Operating activities		
Net income for the year	\$ 10,583	\$ 1,510
Adjustments for:		
Amortization, depletion and accretion	8,742	4,015
Future income taxes	(68)	(1,787)
Deferred stripping	(3,870)	(568)
Non-cash tax deferred payment (Note 13(d))	1,486	0
Fair value adjustment of derivatives	2,137	180
Compensation expense – stock based	1,453	755
Other non cash transactions	52	188
	<u>20,515</u>	<u>4,293</u>
Net change in non-cash working capital balances (Note 16)	<u>(2,129)</u>	<u>(2,169)</u>
	<u>18,386</u>	<u>2,124</u>
Financing activities		
Proceeds from the issue of share capital, net of issue costs	1,473	8,507
Proceeds from borrowings, net of costs	457	3,740
Repayment of borrowings	-	(4,000)
	<u>1,930</u>	<u>8,247</u>
Investing activities		
Refundable deposits	-	(16)
Purchase of property, plant and equipment	(12,058)	(7,201)
Sales of capital assets	650	-
Payments for exploration	(5,478)	(1,974)
Payments on subsidiaries acquired, net of cash acquired	0	(650)
	<u>(16,886)</u>	<u>(9,841)</u>
Increase in cash and cash equivalents	3,430	530
Cash and cash equivalents, beginning of year	<u>5,501</u>	<u>4,971</u>
Cash and cash equivalents, end of year	8,931	5,501

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

1. Nature of Operations

Uruguay Mineral Exploration Inc (“the Company”) is 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 Corrales region 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.

2. Significant Accounting Policies

Consolidated financial statements of the Company have been prepared by management in accordance with Canadian generally accepted accounting principles. 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 controlled subsidiaries from their respective dates of acquisition. All inter-company transactions have been eliminated. The reference to “the Company” in these consolidated financial statements includes the parent and all of its subsidiaries.

(b) Reporting currency

Most of the Company’s operations are conducted by its Uruguayan subsidiaries in United States Dollars. The Company has adopted the United States Dollar as its functional and reporting currency.

(c) Foreign currency translation

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.

2. Significant Accounting Policies - continued

(c) Foreign currency translation - cont

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 related to integrated operations are recorded in earnings

(d) Cash and equivalents

Cash and equivalents consist of cash in bank and money market deposits with maturity dates of three months or less.

(e) Property, plant and equipment

Plant and equipment is recorded at cost less accumulated amortization. Plant and other equipment are amortized on a straight line method over the estimated productive life of the asset. 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.

The Company reviews plant and equipment for impairment whenever events of change in circumstances indicate that the carrying amount of an asset may not be recoverable based on future undiscounted cashflows. When asset values are determined to be impaired recorded assets are revised to their fair value and an impairment loss is recorded in the statement of income.

Mineral properties

Mineral properties include 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 commercial production.

Proceeds from disposition of mineral properties are normally credited to the capitalized costs with no gain or loss being recognized unless the sale is significant to the capitalized property costs. For such significant dispositions, a gain or loss would be recognized. Expenditures attributed to abandoned projects are written off in the year that the project is abandoned.

Property evaluations

The Company reviews and evaluates the carrying value of its producing mineral properties on a periodic basis. Estimated future undiscounted net cash flows are calculated for each property using estimated recoverable reserves and/or resources, estimated future commodity price and after deducting estimated production related expenses, capital abandonment and reclamation costs. If the carrying value of the property exceeds the undiscounted 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 exceeds its fair value.

2. Significant Accounting Policies - continued

(f) 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 include 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 amortized as detailed in Note 3(d) above.

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.

When an area of interest is abandoned the costs relating to the abandoned property are written down, when a decision to abandon is made or when there has been pause in development activities that exceeds three years, unless there is persuasive evidence to the contrary.

(g) 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 for the remaining ore mined from the Arenal reserve for 2006 was 7.11:1 (2005 4.86:1). The life of Mine strip ratio to May 31 2006 was 4.34:1.

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.

The waste to ore ratio and the remaining life of the mine are both regularly assessed by management to ensure the carrying value and rates of depletion are appropriate.

(h) Inventories

Ore stockpiles

Ore stockpiles are comprised of coarse ore that has been extracted from the mine and is available for processing. Stockpiles are physically measured or estimated and valued at the lower of average cost or net realizable value. Ore with a marginal cutoff grade is stockpiled for potential future processing but is carried at zero value.

2. Significant Accounting Policies - continued

(h) Inventories

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 and net realizable value.

Materials and Supplies

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

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.

(i) 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.

(j) 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 income 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.

(k) Revenue recognition

Revenue from mining operations is recognized after shipment of gold to third party refineries, when the sales price is determinable, 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.

(l) Stock-based compensation plan

The Company recognizes the fair value of stock options granted as an expense against income over the applicable stock option vesting period and the corresponding value is recorded in contributed surplus. Stock options issued to persons other than employees are accounted for at fair value and deferred and amortized over the relevant service period. The Black Scholes option pricing model is used to determine fair value. The consideration received and the exercise of stock options is credited to share capital at the time of exercise.

2. Significant Accounting Policies - continued

m) Financial instruments

Financial derivatives are marked to market with the fair value of the derivative instruments recognized as unrealized gains and losses in the statement of income.

(n) Earnings per share amounts

Basic earnings per common share are computed by dividing the net profit by the weighted average number of common shares outstanding during the year. Diluted per share amounts reflect the potential dilution effect of "in the money" 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.

(o) 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.

(p) Reclassification

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

(q) Use of estimates

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.

The amounts recorded for amortization and depletion, deferred stripping, and accretion of mineral properties and equipment, the 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.

3. Accounts Receivable

	<u>2006</u>	<u>2005</u>
Receivables	\$ 59	\$ -
Other Tax receivables	1,640	1,785
	<u>\$ 1,699</u>	<u>\$ 1,785</u>

4. Inventories

	2006	2005
Finished metals	\$ 906	\$ 807
Ore in stockpiles	709	1,131
Gold in circuit	1,331	561
Materials and supplies	5,162	4,671
	\$ 8,108	\$ 7,170

5. Property, Plant and Equipment

	Cost	2006 Accumulated Amortization and Depletion	Net Book Value
Land and lease rights	\$ 1,895	\$ -	\$ 1,895
Plant and equipment	20,362	7,474	12,888
Mineral Properties	13,218	5,105	8,113
	\$ 35,475	\$ 12,579	\$ 22,896
		2005	
	Cost	Accumulated Amortization and Depletion	Net Book Value
Land and lease rights	\$ 671	\$ -	\$ 671
Plant and equipment	14,234	2,780	11,454
Mineral Properties	8,995	1,445	7,550
	\$ 23,900	\$ 4,225	\$ 19,675

- (a) During October 2005, the Company acquired the 10% net profit interest over key tenements within the Minas de Corrales project, including the tenement on which Arenal deposit is located. This agreement terminates UME's obligation to pay the NPI holder 10% of the net profits derived from gold produced from the NPI area as part of the acquisition of the tenements. An amount of \$ 3,500 is shown under mineral properties and is amortized using the unit of production method based on the estimated life of mine. Another \$ 383 is included under Deferred Exploration and is not being amortized as they are related to key tenements in exploration areas with no determined resources. The net profit interest accrued remained unpaid, and the accumulated accrual for \$ 888 (2006 - \$ 253, 2005 - \$ 635) was reversed during the year
- (b) 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 a unit of production basis.
- (c) 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 \$ 782 (2005 - \$288) of spare parts that are amortized over 5 years. Included in mineral properties is \$ 1,355 (2005 - \$982) 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.

6. Deferred Exploration and Development Costs

	2006	2005
Acquisition costs and option payments	\$ 775	\$ 775
Exploration, development and other property costs	8,853	2,972
Capitalized indirect overheads, net of exchange gains	1,556	1,341
	\$ 11,184	\$ 5,088

(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.

(b) Included in 2006 deferred exploration and development costs of \$ 9,424 is \$ nil (2005 - \$ 745) paid as fees. 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, 2006 were approximately \$ 1,390 (2005 - \$ 974). 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 letter of credit provided by Macquarie Bank of \$1,500.

7. Other Assets and Deferred Costs

	2006	2005
Refundable deposits	\$ 140	\$ 140
Capitalized debt issue costs	145	215
Deferred stripping (Note 2(g))	4,438	568
	<u>\$ 4,723</u>	<u>\$ 923</u>

8. Long Term Debt

	2006	2005
Drawn debt facilities		
Deferred payment on equipment (b)(c)	\$ 863	\$ 4,647
Deferred payment on acquisition of Net Profit Interest (e)	2,905	-
Finance lease (f)	457	-
	<u>4,225</u>	<u>4,647</u>
Less current portion	<u>(2,058)</u>	<u>(4,256)</u>
	<u>\$ 2,167</u>	<u>\$ 391</u>
Available debt facilities		
Working capital facility (a)	\$ 2,000	\$ 2,150
Deferred payment on equipment (b)(c)	-	4,647
Finance lease (f)	43	-
	<u>\$ 2,043</u>	<u>\$ 6,797</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 September 2006 and the environmental bond facility in December 2006.

(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. 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%. As at May 31, 2006 this obligation has been settled.

(d) 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

8. Long Term Debt - continued

- (e) 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.
- (f) On November 30, 2005 a subsidiary of the Company issued three unsecured convertible notes with a face value of \$ 1,050 pursuant to the acquisition detailed at note (5a). The three convertible notes are payable on or before July 30, 2006, July 30, 2007 and July 30, 2008 respectively. Each convertible note can be converted into 250,000 ordinary shares during a 30 day period prior to the final payment date for each installment. No interest accrues on the notes. The convertible notes have been recorded at their net present value using an 8.5% discount rate.
- (g) On May 31, 2006 a subsidiary of the Company signed a financial lease facility agreement of \$ 500 with ABN AMRO N.V. Sucursal Montevideo for the purchase of light vehicles. The facility is payable in equal monthly installments over a three year period at 180 days LIBOR plus 2.5% rate of interest. As at 31 May 2006, \$ 457 has been drawn under this facility.
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9. 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 weighed average cost of capital of 8.5% (6% in 2005) and an inflation factor of 3%.

The following table summarizes the movements in the asset retirement obligation activities for the years ended May 31, 2006 and 2005.

	2006	2005
Balance at beginning of year	\$ 1,558	\$ 1,363
Changes in cash flow estimates	208	132
Accretion expense	(101)	63
Balance at end of year	\$ 1,665	\$ 1,558

Changes in cashflow estimates arise from a re-assessment of cyanine effluents treatment, sealing of the tailings dam and re-vegetation of waste piles. The liability for retirement on an undiscounted basis before inflation factor of 3% is estimated to be approximately \$ 2,070 within five years.

10. Equity Instruments

(a) Authorized
Unlimited number of Common Shares of no par value

(b) Issued

Common shares	2006		2005	
	Number (000's)	Amount	Number (000's)	Amount
Issued and outstanding, beginning of year	46,107	\$ 30,308	42,865	\$ 21,194
Issued for stock options exercised	1,077	1,951	612	600
Issued for Net Profit Interest acquisition (Note 5(a) – 8(e))	290	1,096	-	-
Issued for mine properties acquisition	51	240	-	-
Issued for exercise of warrants for cash			2,630	8,514
Issued and outstanding	47,525	\$ 33,595	46,107	\$ 30,308
Less: cumulative share issue costs ⁽¹⁾		(925)		(925)
Balance, end of year	47,525	\$ 32,670	46,107	\$ 29,383
Weighted average number of shares	46,661		43,844	

(1) These costs have been recorded gross of any related tax effect, as the ultimate utilization of any related tax benefit is currently uncertain.

(b) Issued - continued

Warrants and convertible notes	2006		2005	
	Number (000's)	Amount \$	Number (000's)	Amount \$
Issued and outstanding, beginning of year	250	\$ 188	2,630	\$ 548
Issued as fee for financing facilities (Note 11c)	-	-	250	188
Issued for acquisition of Net Profit Interest (Note 11c)	750	-	-	-
Exercised	-	-	(2,630)	(548)
Issued and outstanding, end of year	1,000	\$ 188	250	\$ 188
Total equity instruments		\$ 32,858		\$ 29,571

10. Equity Instruments - continued

(c) Warrants and convertible notes

On November 30, 2005, the Company acquired the net profit interest in tenements at the Minas de Corrales Gold Project as described at Note 5(a) and 8(e). Pursuant to this agreement the Company issued three convertible notes that provided the holder with the option to convert the note, with a face value of \$ 1,050 into 250,000 ordinary shares. The note may be converted during a 30 day period prior to the expiry date. The fair value of the option to convert the notes into ordinary shares was calculated as the difference between the nominal and fair value of the notes.

The convertible notes expire as follows:

Ordinary shares to be issued on conversion of promissory note	Option price \$	Expiry date
250,000	4.20	July 30, 2006
250,000	4.20	July 30, 2007
250,000	4.20	July 30, 2008

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 8(a). The fair value of these options were estimated using the Black and 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 \$ 188 was attributed to these warrants.

At May 31, 2006, the Company has 250,000 (May 31, 2005 -250,000) warrants outstanding. During the period, the Company issued nil (2005 – 250,000) warrants. The outstanding warrants are exercisable as follows:

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

(d) Employee stock options

The Company has an option Plan for its officers, directors, employees and consultants of the Company and its subsidiaries. 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. 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.

For the purposes of stock based compensation, the fair value of each option was determined on the date of granting using the Black-Sholes option pricing model with the following assumptions: Dividend yield (Nil) (2004 - Nil), expected volatility (60%) (2005 - range of 40% to 50%), risk-free interest rate range of .35% to 4.25% (2005 – 3%), and weighted average life of 3.0 years (2005 – 4.0 years).

10. Equity Instruments - continued

The following table summarizes information regarding the Company's outstanding options as at May 31, 2006:

	Number of Shares (000's)	Option Price per Share Range CDN \$	Weighted Average Exercise Price CDN \$
Balance at beginning of year	2,769	\$0.30 - \$4.00	\$1.97
Options – granted	890	\$4.50 - \$5.50	\$4.58
Options – exercised or cancelled	<u>(1,092)</u>	\$0.40 - \$4.00	\$1.58
Balance at end of year	<u>2,567</u>	\$0.40 - \$5.50	\$3.03

The following table summarizes information about the stock options outstanding at May 31, 2006:

Outstanding				Exercisable	
Options 000s	Option price CDN \$	Weighted average Exercise Price CDN \$	Remaining Life Years	Options 000s	Weighted average Exercise Price CDN \$
270	\$ 0.40	\$ 0.40	0.7	270	\$ 0.40
95	\$ 0.75	\$ 0.75	1.8	95	\$ 0.75
748	\$ 1.50	\$ 1.50	2.3	748	\$ 1.50
104	\$ 3.00	\$ 3.00	3.0	104	\$ 3.00
60	\$ 3.40	\$ 3.40	3.1	60	\$ 3.40
200	\$ 4.00	\$ 4.00	2.9	200	\$ 4.00
763	\$ 4.50	\$ 4.50	3.9	-	\$ 4.50
68	\$ 4.62	\$ 4.62	4.3	-	\$ 4.62
200	\$ 5.40	\$ 5.40	3.5	200	\$ 5.40
59	\$ 5.50	\$ 5.50	4.8	-	\$ 5.50
<u>2,567</u>				<u>1,677</u>	

The following table summarizes information about the stock options outstanding at May 31, 2005:

Outstanding				Exercisable	
Options 000s	Option price CDN \$	Weighted average Exercise Price CDN \$	Remaining Life Years	Options 000s	Weighted average Exercise Price CDN \$
563	\$0.40	\$0.40	1.7	563	\$0.40
235	\$0.75	\$0.75	2.8	235	\$0.75
150	\$1.00	\$1.00	2.3	150	\$1.00
915	\$1.50	\$1.50	3.3	915	\$1.50
346	\$3.00	\$3.00	4.0	346	\$3.00
60	\$3.40	\$3.40	4.1	60	\$3.40
300	\$4.00	\$4.00	3.9	300	\$4.00
200	\$5.40	\$5.40	4.5	200	\$5.40
<u>2,769</u>				<u>2,769</u>	

Of the 2,567,333 options outstanding 1,677,333 are exercisable. The weighted average exercise price of the options outstanding at May 31, 2006 is CDN\$ 3.03 (2005 - \$CDN 1.97)

10. Equity Instruments - continued

During the year \$ 1,453 (2005 - \$ 756) 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 Black Scholes option pricing model with the following assumptions: Dividend yield nil (2005 – Nil), expected volatility 60% (2005 –range of 40% to 50%), risk free interest rate 4.3% (2005 – 3.0%), and weighted average life of 3.0 years (2005 -4.0 years). At May 31, 2006 the aggregate unamortized fair value of unvested stock options granted amounted to \$ 722 (2005 - nil).

(e) Earnings per share

The reconciliation of basic and diluted earnings per share where relevant are as follows:

	<u>2006</u>	<u>2005</u>
Basic earnings per share		
Numerator		
Net earnings available to shareholders	\$ 10,583	\$ 1,510
Denominator		
Weighted average earnings per share	46,661,234	43,844,434
Basic earnings per share(cents per share)	0.23	0.034

(e) Earnings per share - continued

	<u>2006</u>	<u>2005</u>
Diluted earnings per share		
Numerator		
Net earnings available to shareholders	\$ 10,583	\$ 1,510
Denominator		
Weighted average shares outstanding	46,661,234	43,844,434
Potential net incremental issue of shares from warrants	250,000	2,550,250
Potential net incremental issue of shares from stock options	1,262,625	2,619,333
Potential net incremental issue of shares from convertible notes	375,000	-
Shares outstanding plus assumed conversions	48,548,859	49,014,017
Diluted earnings per share (cents per share)	0.22	0.031

11. Contributed Surplus

The following table summarizes the movements in contributed surplus for the years ended May 31, 2006 and 2005.

	<u>2006</u>	<u>2005</u>
Balance at beginning of the year	\$ 1,577	\$ 881
Stock based compensation	536	756
Transfer on exercise of options	(488)	(60)
Balance at end of year	<u>\$ 1,625</u>	<u>\$ 1,577</u>

12. Commitments and contingencies

- (a) In addition, to the commitments detailed in Note 6 on exploration of mineral properties, the Company has the following commitments for the Texas and Mal Abrigo projects: interests acquired by the Company are subject to a 2% net profits interest and a 1% net smelter return respectively, payable to the vendor.
- (c) The Company has a granted letter of credit facility with ABN AMRO N.V. Sucursal Montevideo for \$ 600. As at 31 May, 2006, \$ 11 was drawn for international imports of supplies.
- (d) As a part of the agreement for the purchase of the net profit interest, as explained in Note 5(a) and 8(c) of the financial statements, an additional \$ 1,050 is also payable after the third anniversary date, if the average monthly price of gold for the previous 36 months exceeds \$ 400 per ounce.
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13. Income Taxes

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

	2006	2005
Income before taxes	\$ 13,226	\$ 900
Income tax rate	35%	35%
Expected income taxes expense	4,629	315
Tax effect of:		
Amortization, credit on consolidation	(809)	1,164
Stock compensation expense	435	0
Inflation adjustment	64	(980)
Foreign exchange gains/(losses)	(65)	1,657
Investment incentives (Note 16(d))	(1,768)	(803)
Rate difference due to investment incentives	-	1,200
Difference in tax rates	(696)	340
Tax losses recouped	(2)	(3,978)
Tax losses not recognized	696	76
Over provision for prior financial year	(30)	
Other differences	189	399
Income tax expense/benefit	\$ 2,643	\$ (610)
Comprising		
Current income taxes	2,711	1,177
Future income taxes - recovery	(68)	(1,787)
Total	\$ 2,643	\$ (610)

13. Income Taxes - continued

(b) The following table sets out changes in the future income tax asset for the current year

	<u>2006</u>	<u>2005</u>
Balance beginning of year	\$ 1,787	\$ -
Recognized future income tax expense	<u>68</u>	<u>1,787</u>
Balance end of year	<u>\$ 1,855</u>	<u>\$ 1,787</u>

The significant components of the Company's future income tax asset are as follows

	<u>2006</u>	<u>2005</u>
Operating loss carry forwards	\$ 3,970	\$ 4,499
Closure provisions	399	388
Hedge liability	695	-
Inventory	196	306
Deferred stripping	(1,175)	-
Property plant and equipment and mine properties	<u>2,340</u>	<u>981</u>
Sub-total	6,425	6,174
Valuation allowance	<u>(4,570)</u>	<u>(4,367)</u>
Net future income tax asset	<u>\$ 1,855</u>	<u>\$ 1,787</u>

(c) Un-recognized tax benefits

The Company has non capital loss carry forwards of \$ 11,343 (2005 - \$ 8,630) 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 2007	\$ 864	\$ 1,452	\$ -
Year to 31 May 2008	581	867	-
Year to 31 May 2009	580	875	59
Year to 31 May 2010	549	-	-
Year to 31 May 2011	-	-	65
Year to 31 May 2012	-	-	1,025
Year to 31 May 2013	-	-	905
Year to 31 May 2014	149	-	1,391
Year to 31 May 2015	453	-	970
Year to 31 May 2016	558	-	-
	<u>\$ 3,734</u>	<u>\$ 3,194</u>	<u>\$ 4,415</u>

13. Income Taxes - continued

In Uruguay the Company has deferred costs which result in available tax pools of \$ 4,890 (2005 – \$1,955) 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.

(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 \$ 19,300 over the 3 year period commencing 1 June 2004. These benefits include:

- relief from Corporate Tax on a total of up to \$ 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 \$ 2,897. For financial year 2005-2006, the company applied for a relief of \$ 1,486 remaining the difference to be applied during 2007.
- in addition, up to a further \$ 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 \$ 2,897. For financial year 2005-2006, the utilization of the benefit determined a deferred tax payment of \$1,486 to be accomplished in 2010. Liability is shown as non current under the denomination "Future Income Tax Liability".
- During financial year 2005-2006 other tax benefits applicable to investments in Uruguay were utilized determining a reduction of taxable income for \$ 937 and thus, a tax saving of \$ 281 (30%).

The use of the remaining available benefits 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 future tax implications for these available benefits.

14. 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.

	2006			
	Gold	Exploration	Corporate	Total
Net Sales	\$ 50,571	\$ -	\$ -	\$ 50,571
Amortization and depletion	\$ 8,742	\$ -	\$ -	\$ 8,742
Net income (loss)	\$ 13,543	\$ (1,456)	\$ (1,504)	\$ 10,583
Property, plant and equipment	\$ 21,384	\$ 277	\$ 1,235	\$ 22,896
Deferred exploration and development	\$ 1,677	\$ 9,507	\$ -	\$ 11,184
Capital expenditure including exploration	\$ 10,239	\$ 6,096	\$ 1,228	\$ 17,563

14. Segmented Information - continued

	2005			Total
	Gold	Exploration	Corporate	
Net Sales	\$ 30,310	\$ -	\$ -	\$ 30,310
Amortization and depletion	\$ 4,015	\$ -	\$ -	\$ 4,015
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
Capital expenditure including exploration	\$ 7,201	\$ 1,974	\$ -	\$ 9,175

The accounting policies of the segments are the same as those described in the summary of significant accounting policies.

15. 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, 2006 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 values of these contracts have been recorded as a liability.

Asset/(liability)	2006	2005
Spot deferred	\$ (220)	\$ -
Gold put options	-	165
Gold call options	(2,097)	(345)
	<u>\$ (2,317)</u>	<u>\$ (180)</u>

The Company has entered into put option contracts on 2,500 ounces at a forward price of \$ 400 per ounce and a further 10,000 ounces at a forward price of \$ 430 per ounce. To cover the cost of the put option contracts the Company has sold call options contracts on 10,000 ounces at a forward price of \$ 436 per ounce and a further 10,000 ounces at a forward price of \$ 486.5 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. The lower value put and call options are delivered first.

15. Financial Instruments - continued

(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 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.

(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.

(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.

16. Statement of Cash Flows

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

	<u>2006</u>	<u>2005</u>
Accounts receivable	\$ 86	\$ (408)
Prepaid expenses	110	(54)
Inventories	(1,588)	(3,082)
Accounts payable and accrued liabilities	(737)	1,375
	<u>\$ (2,129)</u>	<u>\$ (2,169)</u>

(b) Supplementary cash flow information:

	<u>2006</u>	<u>2005</u>
Income tax paid	\$ 663	-
Interest paid	\$ 272	\$ 555
