

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

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**Contents**

<b>Management Report</b>	<b>2</b>
<b>Auditors' Report</b>	<b>3</b>
<b>Consolidated Financial Statements</b>	
<b>Consolidated Balance Sheets</b>	<b>4</b>
<b>Consolidated Statements of Income and Deficit</b>	<b>5</b>
<b>Consolidated Statements of Cash Flows</b>	<b>6</b>
<b>Notes to Consolidated Financial Statements</b>	<b>7 – 25</b>

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## Management's Responsibility for Financial Reporting

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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

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## Auditors' Report

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### 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
	19,350	15,178
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
<b>Total assets</b>	<b>\$ 60,008</b>	<b>\$ 42,651</b>

**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
	9,451	9,381
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
<b>Total liabilities</b>	14,769	11,330
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
<b>Total shareholders' equity</b>	45,239	31,321
<b>Total liabilities and shareholders' equity</b>	<b>\$ 60,008</b>	<b>\$ 42,651</b>

Commitments and contingencies (Note 12)

Approved on behalf of the Board:

*Signed "David Fowler"*  
\_\_\_\_\_  
Director  
David Fowler

*Signed "Tony Shearer"*  
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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 for earnings per share amounts and weighted average number of shares outstanding

<b>For the years ended May 31</b>	<b>2006</b>	<b>2005</b>
Sales	\$ 51,206	\$ 30,563
Net profit interest (Note 5(a))	(635)	(253)
<b>Net sales</b>	<b>50,571</b>	<b>30,310</b>
Operating expenses	22,014	20,588
Amortization, depletion and accretion	8,742	4,015
<b>Operating expenses</b>	<b>30,756</b>	<b>24,603</b>
<b>Operating profit</b>	<b>19,815</b>	<b>5,707</b>
<b>Other expenses</b>		
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
	<b>7,413</b>	<b>4,896</b>
<b>Income before other items and taxes</b>	<b>12,402</b>	<b>811</b>
<b>Other losses (gains)</b>		
Gain on settlement of net profit interest (Note 5(a))	(888)	0
Interest and other income	(64)	(107)
Foreign exchange loss	128	18
	<b>(824)</b>	<b>(89)</b>
<b>Income before taxes</b>	<b>13,226</b>	<b>900</b>
Income taxes (Note 13)	2,643	(610)
<b>Net income for the year</b>	<b>10,583</b>	<b>1,510</b>
<b>Retained earnings (deficit) beginning of year</b>	<b>192</b>	<b>(1,318)</b>
<b>Retained earnings end of year</b>	<b>\$ 10,775</b>	<b>\$ 192</b>
<b>Basic earnings per share (Note 10(e))</b>	<b>\$ 0.23</b>	<b>\$ 0.034</b>
<b>Diluted earnings per share (Note 10(e))</b>	<b>\$ 0.22</b>	<b>\$ 0.031</b>
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

<b>For the years ended May 31</b>	<b>2006</b>	<b>2005</b>
<b>Operating activities</b>		
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>
<b>Financing activities</b>		
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>
<b>Investing activities</b>		
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	-	(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>
<b>Cash and cash equivalents, end of year</b>	<b>8,931</b>	<b>5,501</b>

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

**May 31, 2006 and 2005**

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## **1. Nature of Operations**

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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.

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## **2. Significant Accounting Policies**

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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.

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**May 31, 2006 and 2005**

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**2. Significant Accounting Policies - continued**

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(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.
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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.

**May 31, 2006 and 2005**

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## **2. Significant Accounting Policies - continued**

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(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.

**May 31, 2006 and 2005**

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## **2. Significant Accounting Policies - continued**

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(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.

**May 31, 2006 and 2005**

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**2. Significant Accounting Policies - continued**

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(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.

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**3. Accounts Receivable**

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

**May 31, 2006 and 2005**

**4. Inventories**

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

**5. Property, Plant and Equipment**

	<b>Cost</b>	<b>2006 Accumulated Amortization and Depletion</b>	<b>Net Book Value</b>
<b>Land and lease rights</b>	<b>\$ 1,895</b>	<b>\$ -</b>	<b>\$ 1,895</b>
<b>Plant and equipment</b>	<b>20,362</b>	<b>7,474</b>	<b>12,888</b>
<b>Mineral Properties</b>	<b>13,218</b>	<b>5,105</b>	<b>8,113</b>
	<b>\$ 35,475</b>	<b>\$ 12,579</b>	<b>\$ 22,896</b>
		<b>2005</b>	
	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
	<b>\$ 23,900</b>	<b>\$ 4,225</b>	<b>\$ 19,675</b>

- (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 (2005 - \$ 253, 2006 - \$ 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.

**May 31, 2006 and 2005**

**5. Property, Plant and Equipment - continued**

- (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.

**May 31, 2006 and 2005**

**6. Deferred Exploration and Development Costs - continued**

(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
<b>Drawn debt facilities</b>		
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>
<b>Available debt facilities</b>		
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>

**May 31, 2006 and 2005**

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## **8. Long Term Debt - continued**

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- (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 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.
- (e) 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.
- (f) 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**

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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%.

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**May 31, 2006 and 2005**

**9. Asset Retirement Obligations - continued**

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	<u>\$ 1,665</u>	<u>\$ 1,558</u>

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 <sup>(1)</sup>		(925)		(925)
Balance, end of year	<u>47,525</u>	<u>\$ 32,670</u>	<u>46,107</u>	<u>\$ 29,383</u>
Weighted average number of shares	<u>46,661</u>		<u>43,844</u>	

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

**May 31, 2006 and 2005**

**10. Equity Instruments - continued**

(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	<u>1,000</u>	<u>\$ 188</u>	<u>250</u>	<u>\$ 188</u>
<b>Total equity instruments</b>		<b>\$ 32,858</b>		<b>\$ 29,571</b>

(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

**May 31, 2006 and 2005**

**10. Equity Instruments -continued**

(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).

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:

<b>Outstanding</b>				<b>Exercisable</b>	
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>	

**May 31, 2006 and 2005**

**10. Equity Instruments - continued**

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

<b>Outstanding</b>				<b>Exercisable</b>	
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)

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>
<b>Basic earnings per share</b>		
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

**May 31, 2006 and 2005**

**10. Equity Instruments - continued**

(e) Earnings per share - continued

	<b>2006</b>	2005
<b>Diluted earnings per share</b>		
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.

	<b>2006</b>	2005
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	\$ 1,625	\$ 1,577

**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.

**May 31, 2006 and 2005**

**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.

	<u>2006</u>	<u>2005</u>
Income before taxes	\$ 13,226	\$ 900
Income tax rate	35%	35%
Expected income taxes expense	<u>4,629</u>	<u>315</u>
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	<u>(30)</u>	<u>          </u>
Other differences	<u>189</u>	<u>399</u>
Income tax expense/benefit	<u>\$ 2,643</u>	<u>\$ (610)</u>
Comprising		
Current income taxes	2,711	1,177
Future income taxes - recovery	(68)	(1,787)
Total	<u>\$ 2,643</u>	<u>\$ (610)</u>

- (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>

**May 31, 2006 and 2005**

**13. Income Taxes - continued**

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

	2006	2005
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	2,340	981
Sub-total	6,425	6,174
Valuation allowance	(4,570)	(4,367)
Net future income tax asset	\$ 1,855	\$ 1,787

(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:

	Canada	Uruguay	Barbados
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	-	-
	\$ 3,734	\$ 3,194	\$ 4,415

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.

**May 31, 2006 and 2005**

**13. Income Taxes - continued**

(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			Total
	Gold	Exploration	Corporate	
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

**May 31, 2006 and 2005**

**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)
	\$ (2,317)	\$ (180)

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.

**May 31, 2006 and 2005**

**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:

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

(b) Supplementary cash flow information:

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