# INTERNATIONAL NORTHAIR MINES LTD.

**(A Development Stage Company)**

**CONSOLIDATED FINANCIAL STATEMENTS**

**28 FEBRUARY 2006 and 2005**

Staley, Okada & Partners
CHARTERED ACCOUNTANTS

Suite 400 - 889 West Pender Street
Vancouver, BC Canada V6C 3B2
**Tel** 604 694-6070
**Fax** 604 585-8377
info@staleyokada.com
www.staleyokada.com

## AUDITORS' REPORT

**To the Shareholders of International Northair Mines Ltd.:**

We have audited the consolidated balance sheets of International Northair Mines Ltd. (the "Company") (A Development Stage Company) as at 28 February 2006 and 2005 and the consolidated statements of loss and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the 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 28 February 2006 and 2005 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

***"Staley, Okada & Partners"***

Vancouver, BC
June 12, 2006

STALEY, OKADA & PARTNERS
CHARTERED ACCOUNTANTS

**International Northair Mines Ltd.** Statement 1

*(A Development Stage Company)*

# Consolidated Balance Sheets

*Canadian Funds*

| ASSETS | | As At 28 February 2006 | | As At 28 February 2005 |
|---|---|---|---|---|
| **Current** | | | | |
| Cash and cash equivalents | **$** | **486,514** | $ | 924,052 |
| Short-term deposits *(Note 11)* | | **195,893** | | 65,817 |
| Accounts receivable | | **30,171** | | 20,694 |
| Due from related parties *(Note 8c)* | | **90,949** | | 187,020 |
| Short-term investments *(Note 4)* | | **196,106** | | 211,262 |
| Prepaid expenses and deposit | | **1,119** | | 14,947 |
| | | **1,000,752** | | 1,423,792 |
| **Property, Plant and Equipment** *(Note 5)* | | **87,585** | | 83,423 |
| **Resource Property Costs** - *Schedule (Note 6)* | | **344,718** | | 384,483 |
| **Reclamation Deposits** | | **-** | | 7,000 |
| | **$** | **1,433,055** | $ | 1,898,698 |
| **LIABILITIES** | | | | |
| **Current** | | | | |
| Accounts payable and accrued liabilities | **$** | **123,004** | $ | 93,597 |
| Due to related parties *(Note 8g)* | | **87,500** | | 13,658 |
| Current portion of capital lease obligation *(Note10b)* | | **8,464** | | 8,407 |
| | | **218,968** | | 115,662 |
| **Capital Lease Obligation** *(Note10b)* | | **8,627** | | 16,814 |
| | | **227,595** | | 132,476 |
| **SHAREHOLDERS' EQUITY** | | | | |
| **Share Capital** *(Note 7a)* | | **21,161,001** | | 21,150,501 |
| **Contributed Surplus** *(Note 7e)* | | **461,897** | | 437,683 |
| **Deficit** - *Statement 2* | | **(20,417,438)** | | (19,821,962) |
| | | **1,205,460** | | 1,766,222 |
| | **$** | **1,433,055** | $ | 1,898,698 |

**Subsequent Events** *(Note 14)*

ON BEHALF OF THE BOARD:

*"F.G. Hewett"*, Director

*"D. Bruce McLeod"*, Director

- See Accompanying Notes -

**International Northair Mines Ltd.** <u>Statement 2</u>

*(A Development Stage Company)*

# Consolidated Statements of Loss and Deficit

*Canadian Funds*

| | Year Ended 28 February 2006 | Year Ended 28 February 2005 |
|---|---|---|
| **General and Administrative Expenses** | | |
| Salaries and benefits | **$ 135,664** | $ 207,122 |
| Office and equipment rental | **122,660** | 104,504 |
| Office and general | **55,709** | 86,995 |
| Shareholder information and investor relations | **82,353** | 90,403 |
| Professional fees | **46,816** | 52,468 |
| Regulatory compliance and transfer agent fees | **25,798** | 30,801 |
| Stock-based compensation | **24,214** | 18,102 |
| Amortization | **27,182** | 17,823 |
| Administrative recoveries *(Note 8a)* | **(116,776)** | (346,137) |
| **Loss Before the Undernoted** | **(403,620)** | (262,081) |
| Write-off of exploration costs | **(359,844)** | (1,198,383) |
| Gain on sale of short-term investments | **118,353** | 31,731 |
| Gain (loss) on foreign exchange | **2,870** | (15,884) |
| Write-down of short-term investments | **(17,491)** | - |
| Gain from property option agreement | **39,046** | - |
| Interest and sundry | **25,210** | 26,610 |
| **Loss for the Year** | **(595,476)** | (1,418,007) |
| Deficit - Beginning of year | **(19,821,962)** | (18,403,955) |
| **Deficit - End of Year** | **$ (20,417,438)** | $ (19,821,962) |
| **Loss per Share - Basic and Diluted** | **$ (0.05)** | $ (0.11) |
| **Weighted Average Number of Shares Outstanding** | **13,054,158** | 13,014,383 |

- See Accompanying Notes -

**International Northair Mines Ltd.** <u>Statement 3</u>

*(A Development Stage Company)*

# Consolidated Statements of Cash Flows

*Canadian Funds*

| Cash Resources Provided By (Used In) | | Year Ended 28 February 2006 | | Year Ended 28 February 2005 |
|---|---|---|---|---|
| **Operating Activities** | | | | |
| Loss for the year | $ | (595,476) | $ | (1,418,007) |
| Items not affecting cash: | | | | |
| Gain on sale of short-term investments | | (118,353) | | (31,731) |
| Write-down of short-term investments | | 17,491 | | - |
| Gain from property option agreement | | (39,046) | | - |
| Stock-based compensation | | 24,214 | | 18,102 |
| Amortization | | 27,182 | | 17,823 |
| Write-off of exploration costs | | 359,844 | | 1,198,383 |
| | | (324,144) | | (215,430) |
| Changes in current assets and liabilities | | 112,512 | | (159,210) |
| | | (211,632) | | (374,640) |
| **Investing Activities** | | | | |
| Acquisition of short-term investments | | (1,585) | | - |
| Proceeds from sale of short-term investments | | 213,353 | | 40,505 |
| Acquisition of property, plant and equipment | | (31,344) | | (23,887) |
| Resource property costs, *net* | | (286,754) | | (819,176) |
| | | (106,330) | | (802,558) |
| **Financing Activities** | | | | |
| Issuance of share capital | | 10,500 | | 143,495 |
| **Net Decrease in Cash and Cash Equivalents** | | (307,462) | | (1,033,703) |
| Cash Position - Beginning of year | | 989,869 | | 2,023,572 |
| **Cash and Cash Equivalents - End of Year** | $ | 682,407 | $ | 989,869 |
| **Consists of:** | | | | |
| Cash and cash equivalents | $ | 486,514 | $ | 924,052 |
| Short-term deposits *(Note 11)* | | 195,893 | | 65,817 |
| Ending balance – cash and cash equivalents | $ | 682,407 | $ | 989,869 |
| **Schedule of Non-Cash Investing and Financing Transactions** | | | | |
| Equipment under capital lease | $ | - | $ | 25,221 |
| Shares received pursuant to a property option agreement | $ | 8,250 | $ | - |
| Stock-based compensation | $ | 24,214 | $ | 18,102 |
| Resource property costs included in accounts payable | $ | 15,866 | $ | 20,337 |

- See Accompanying Notes -

**International Northair Mines Ltd.** Schedule

*(A Development Stage Company)*

# Consolidated Schedules of Resource Property Costs

*Canadian Funds*

| | Acquisition Costs | Exploration Costs | **Total as at 28 February 2006** |
|---|---|---|---|
| **Direct – Mineral** | | | |
| *Mexico* | | | |
| Sierra Rosario | | | |
| Opening balance | $ (18,743) | $ 15,111 | $ **(3,632)** |
| Field work and travel | - | 1,963 | **1,963** |
| Salaries and consulting | - | 6,661 | **6,661** |
| Taxes | 334 | - | **334** |
| Claimstaking and acquisition | 1,682 | - | **1,682** |
| Recoveries | | | |
| - Option payments (cash & shares) | (23,250) | - | **(23,250)** |
| - Cash recoveries | - | (22,804) | **(22,804)** |
| Gain – property option agreement | 39,977 | (931) | **39,046** |
| **Ending balance – Sierra Rosario** | - | - | **-** |
| El Tesoro | | | |
| Opening balance | 13,020 | 331,595 | **344,615** |
| Camp and general | - | 510 | **510** |
| Salaries and consulting | - | 2,101 | **2,101** |
| Taxes | 136 | - | **136** |
| Recoveries | | | |
| - Option payments (cash) | (2,644) | - | **(2,644)** |
| **Ending balance – El Tesoro** | 10,512 | 334,206 | **344,718** |
| Las Moras | | | |
| Opening balance | 24,685 | 10,839 | **35,524** |
| Field work and travel | - | 3,412 | **3,412** |
| Salaries and consulting | - | 6,119 | **6,119** |
| Taxes | 748 | - | **748** |
| Write-offs | (25,433) | (20,370) | **(45,803)** |
| **Ending balance – Las Moras** | - | - | **-** |
| La Joya | | | |
| Opening balance | 4,464 | 3,512 | **7,976** |
| Taxes | 478 | - | **478** |
| Write-offs | (4,942) | (3,512) | **(8,454)** |
| **Ending balance – La Joya** | - | - | **-** |
| General exploration | | | |
| Opening balance | - | - | **-** |
| Assaying, camp and general | - | 19,774 | **19,774** |
| Field work and travel | - | 96,173 | **96,173** |
| Salaries and consulting | - | 182,159 | **182,159** |
| Claimstaking and acquisition | 481 | - | **481** |
| Write-offs | (481) | (298,106) | **(298,587)** |
| **Ending balance – General Exploration** | - | - | **-** |
| **Balance – Resource Property Costs – 28 February 2006** | $ 10,512 | $ 334,206 | $ **344,718** |

- See Accompanying Notes -

**International Northair Mines Ltd.** Schedule

*(A Development Stage Company)*

# Consolidated Schedules of Resource Property Costs

*Canadian Funds*

| | Acquisition Costs | Exploration Costs | **Total as at 28 February 2005** |
|---|---|---|---|
| **Direct – Mineral - Mexico** | | | |
| Sierra Rosario | | | |
| Opening balance | $ 574 | $ 7,116 | $ **7,690** |
| Field work and travel | - | 1,471 | **1,471** |
| Salaries and consulting | - | 6,524 | **6,524** |
| Taxes | 683 | - | **683** |
| Recoveries | | | |
| - Option payments (cash) | (20,000) | - | **(20,000)** |
| **Ending balance – Sierra Rosario** | (18,743) | 15,111 | **(3,632)** |
| El Tesoro | | | |
| Opening balance | 105,969 | 604,715 | **710,684** |
| Assays | - | 87,375 | **87,375** |
| Camp and general | - | 35,078 | **35,078** |
| Fieldwork and travel | - | 161,567 | **161,567** |
| Road building | - | 40,779 | **40,779** |
| Salaries and consulting | - | 161,830 | **161,830** |
| Option payments (cash) | 1,296 | - | **1,296** |
| Permits and licenses | - | 245 | **245** |
| Taxes | 7,309 | - | **7,309** |
| Write-offs | (101,554) | (759,994) | **(861,548)** |
| **Ending balance – El Tesoro** | 13,020 | 331,595 | **344,615** |
| Las Moras | | | |
| Opening balance | 9,805 | 4,449 | **14,254** |
| Assays | - | 424 | **424** |
| Fieldwork and travel | - | 901 | **901** |
| Salaries and consulting | - | 5,065 | **5,065** |
| Claimstaking and acquisition | 5,667 | - | **5,667** |
| Option payments (cash) | 7,827 | - | **7,827** |
| Taxes | 1,386 | - | **1,386** |
| **Ending balance – Las Moras** | 24,685 | 10,839 | **35,524** |
| El Tropico | | | |
| Balance carried forward | - | 10,722 | **10,722** |
| Write-offs | - | (10,722) | **(10,722)** |
| **Ending balance – El Tropico** | - | - | **-** |
| La Joya | | | |
| Opening balance | - | - | **-** |
| Assays, camp and general | - | 959 | **959** |
| Salaries and consulting | - | 2,553 | **2,553** |
| Claimstaking and acquisition | 4,464 | - | **4,464** |
| **Ending balance - La Joya** | 4,464 | 3,512 | **7,976** |
| **Balance Carried Forward** | $ 23,426 | $ 361,057 | $ **384,483** |

- See Accompanying Notes -

**International Northair Mines Ltd.**
*(A Development Stage Company)*



# Consolidated Schedules of Resource Property Costs

*Canadian Funds*

| | Acquisition Costs | Exploration Costs | **Total as at 28 February 2005** |
|---|---|---|---|
| **Balance Carried Forward** | $ 23,426 | $ 361,057 | $ **384,483** |
| General exploration - Mexico | | | |
| Opening balance | - | - | **-** |
| Assays, camp and general | - | 46,515 | **46,515** |
| Field work and travel | - | 101,409 | **101,409** |
| Salaries and consulting | - | 173,079 | **173,079** |
| Claimstaking and acquisition | 5,110 | - | **5,110** |
| Write-offs | (5,110) | (321,003) | **(326,113)** |
| **Ending balance – General Exploration Mexico** | - | - | **-** |
| **Balance – Resource Property Costs – 28 February 2005** | $ 23,426 | $ 361,057 | $ **384,483** |

## 1. Nature of Operations

The Company is a development stage company which is engaged principally in the acquisition, exploration and development of mineral properties and in providing administration services to other companies.

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles with the assumption that the Company will be able to realize its assets and discharge its liabilities in the normal course of business, rather than through a process of forced liquidation.

The Company's continuing operations are dependent upon its ability to either secure additional equity capital or generate cash flow from operations in the future. These consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded assets and liabilities that might be necessary, should the Company be unable to continue as a going concern.

## 2. Significant Accounting Policies

### a) Basis of Consolidation

These consolidated financial statements include the accounts of the Company and its wholly owned Mexican subsidiary, Grupo Northair de Mexico, S.A. de C.V., which is accounted for using the purchase method of accounting.

The Company accounts for investments, in which it has a 20% or greater interest or where the Company has a significant influence, on the equity basis, whereby the investment is initially recorded at cost and increased or decreased to reflect the Company's share of any earnings or losses of the investee.

### b) Cash and Cash Equivalents

For purposes of reporting cash flows, the Company considers cash and cash equivalents to include amounts held in banks and highly liquid debt investments with maturities at point of purchase of three months or less. The Company places its cash and cash investments with institutions of high credit worthiness. At times, such investments may be in excess of federal insurance limits.

### c) Short-term Investments

Investments in which the Company has less than a 20% interest and does not have significant influence are recorded at cost, and are written-down to the lower of cost and market if the decline in market value is deemed to be other than a temporary decline.

### d) Amortization

The Company provides for amortization on the following basis:

- Office furniture and equipment - 10% to 30% declining balance
- Equipment under capital lease - over the lease term using the straight-line method

One-half of the above rate is applied in the year of acquisition.

## 2. Significant Accounting Policies - *Continued*

e) **Mineral Exploration and Development Costs**

The Company is in the process of exploring its mineral properties and has not yet determined whether these properties contain ore reserves that are economically recoverable.

Mineral exploration and development costs are capitalized on an individual prospect basis until such time as an economic ore body is defined or the prospect is abandoned. Costs for a producing prospect are amortized on a unit-of-production method based on the estimated life of the ore reserves, while those costs for the prospects abandoned are written off.

The recoverability of the amounts capitalized for the undeveloped mineral properties is dependent upon the determination of economically recoverable ore reserves, confirmation of the Company's interest in the underlying mineral claims, the ability to obtain the necessary financing to complete their development, and future profitable production or proceeds from the disposition thereof.

Title to mineral properties involves certain inherent risks due to the difficulties of determining the validity of certain claims as well as the potential for problems arising from the frequently ambiguous conveyancing history characteristic of many mineral properties. The Company has investigated title to all of its mineral properties and, to the best of its knowledge, title to all of its properties are in good standing.

f) **Obligations Under Capital Leases**

Leases are classified as either capital or operating. Leases that transfer substantially all of the benefits and risks of ownership of property to the Company are accounted for as capital leases. At the time a capital lease is entered into, an asset is recorded with its obligation. Payments made under operating leases are expensed as incurred.

g) **Share Capital**

*i)* The proceeds from the exercise of stock options and warrants are recorded as share capital for the amount for which the option or warrant enabled the holder to purchase a share in the Company.

*ii)* Share capital issued for non-monetary consideration is recorded at an amount based on fair market value.

h) **Loss per Share**

Basic earnings (loss) per share is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding during the year. The computation of diluted earnings (loss) per share assumes the conversion, exercise or contingent issuance of securities only when such conversion, exercise or issuance would have a dilutive effect on earnings per share. The dilutive effect of convertible securities is reflected in diluted earnings per share by application of the "if converted" method. The dilutive effect of outstanding options and warrants and their equivalents is reflected in diluted earnings per share by application of the treasury stock method.

## 2. Significant Accounting Policies - *Continued*

### i) Income Taxes

The asset and liability method is used for determining future income taxes. Under the asset and liability method, the change in the net future tax asset or liability is included in income. The income tax effects of temporary differences in the time when income and expenses are recognized in accordance with Company accounting practices and the time they are recognized for income tax purposes are reflected as future income tax assets or liabilities. Future income tax assets and liabilities are measured using statutory rates that are expected to apply to taxable income in the years in which temporary differences are expected to be recovered or settled.

### j) Foreign Currency Translation

The accounts of the Company's foreign operations have been translated into Canadian dollars as follows:

- i) Monetary assets and liabilities at year-end rates;
- ii) All other assets and liabilities at historical rates; and
- iii) Revenue and expense and exploration and development items at the average rate of exchange prevailing during the year.

Exchange gains and losses arising from these transactions are reflected in income or expense in the year that they occur.

### k) Management's Estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reported periods. Actual results could differ from those estimates.

### l) Stock-based Compensation

All stock-based awards made to employees and non-employees are measured and recognized using a fair value based method. For employees, the fair value of the options at the date of the grant is accrued and charged to operations, with the offsetting credit to contributed surplus, on a straight-line basis over the vesting period. If and when the stock options are ultimately exercised, the applicable amounts of contributed surplus are transferred to share capital. For non-employees, the fair value of the options is measured on the earlier of the date at which the counterparty performance is complete or the date the performance commitment is reached or the date at which the equity instruments are granted if they are fully vested and non-forfeitable.

### m) Asset Retirement Obligations

The Company follows the recommendations of CICA Handbook Section 3110, Asset Retirement Obligations. This section requires recognition of a legal liability for obligations relating to retirement of property, plant and equipment or the reclamation of mineral exploration or development activities, and arising from the normal operation of those assets. Such asset retirement costs must be recognized at fair value, when a reasonable estimate of fair value can be estimated, in the period in which it is incurred, added to the carrying value of the assets, and amortized into income on a systematic basis over the asset's expected life.

## 2. Significant Accounting Policies - *Continued*

### n) Variable Interest Entities – Change in Accounting Policy

Accounting Guideline 15 defines Variable Interest Entities ("VIE") as entities that have insufficient equity to fund their activities without additional financing or where their investors lack one or more specified essential characteristics of a controlling financial interest. The standard provides guidance for determining when an entity is a VIE and who, if anyone, should consolidate the VIE. The Guideline applies to all annual and interim periods beginning on or after 15 March 2005. During the year, the Company completed its evaluation and concluded that it has no VIEs.

### o) Impairment of Long-Lived Assets

The Company follows CICA Handbook Section 3063, "Impairment of Long-Lived Assets". Section 3063 requires the Company to assess the impairment of long-lived assets, which consists primarily of property and equipment, whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying value of the asset to its fair value. If such assets are considered to be impaired, the amount of the impairment is measured by the amount by which the carrying amount of the asset exceeds its fair value. The amount of the impairment is charged to income in the period when the impairment is determined.

## 3. Fair Value of Financial Instruments

The Company's financial instruments consist of cash and cash equivalents, short-term deposits, accounts receivable, amounts due from related parties, short-term investments, accounts payable and amounts due to related parties. Unless otherwise noted, it is management's opinion that the Company is not exposed to significant interest, currency or credit risks arising from the financial instruments. The fair value of these financial instruments approximates their carrying value due to their short-term maturity or capacity of prompt liquidation.

## 4. Short-term Investments

The Company's short-term investments consist of common shares in several Canadian listed companies. All short-term investments held by the Company are recorded at the lower-of-cost or market value and represent less than a 5% interest in the respective companies.

| | **2006 Net Book Value** | **2006 Market Value** | 2005 Net Book Value | 2005 Market Value |
|---|---|---|---|---|
| Holdings in companies related by virtue of common directors/officers *(Note 8e)* | **$ 188,506** | **$ 642,828** | $ 209,662 | $ 886,716 |
| Holdings in unrelated companies | **7,600** | **20,050** | 1,600 | 3,700 |
| | **$ 196,106** | **$ 662,878** | $ 211,262 | $ 890,416 |

### 5. Property, Plant and Equipment

Details are as follows:

| | As at 28 February 2006 | | | As at 28 February 2005 | | |
|---|---|---|---|---|---|---|
| | **Cost** | **Accumulated Amortization** | **Net Book Value** | Cost | Accumulated Amortization | Net Book Value |
| Office furniture and equipment | **$ 137,596** | **$ 70,188** | **$ 67,408** | $ 106,252 | $ 48,050 | $ 58,202 |
| Equipment under capital lease | **25,221** | **5,044** | **20,177** | 25,221 | - | 25,221 |
| | **$ 162,817** | **$ 75,232** | **$ 87,585** | $ 131,473 | $ 48,050 | $ 83,423 |

### 6. Resource Property Costs

a) The write-off of exploration costs consisted of:

| | For the Year Ending 28 February **2006** | 2005 |
|---|---|---|
| Mexico – General exploration and property examinations | **$ 298,587** | $ 326,113 |
| El Tesoro, Mexico | **-** | 861,548 |
| El Tropico, Mexico | **-** | 10,722 |
| La Joya, Mexico | **8,454** | - |
| Las Moras, Mexico | **45,803** | - |
| Reclamation bonds, British Columbia | **7,000** | - |
| | **$ 359,844** | $ 1,198,383 |

b) **Sierra Rosario, Mexico**

The Company acquired, by staking, a concession in the state of Sinaloa Mexico, known as Sierra Rosario ("Rosario"). By letter of intent dated 11 March 2004, the Company granted Sparton Resources Inc. ("Sparton") the option to acquire a 51% interest in the property by completing the following:

| | Cash | Shares | Exploration Expenditures | |
|---|---|---|---|---|
| Upon signing the agreement (received) | $ 20,000 | - | $ - | |
| On or before 11 March 2005 (received) | 15,000 | 75,000 | - | |
| On or before 31 August 2005 (completed) | - | - | 150,000 | |
| On or before 11 March 2006* | 20,000 | 100,000 | 150,000 | * |
| On or before 11 March 2007 | 25,000 | 100,000 | 200,000 | |
| On or before 11 March 2008 | 50,000 | - | 300,000 | |
| | $ 130,000 | 275,000 | $ 800,000 | |

* Pursuant to a letter dated 4 May 2006, the date to complete the required expenditures was extended to 31 August 2006. Subsequent to the year-end, in May 2006 the Company received 100,000 common shares of Sparton and $20,000 pursuant to the terms of the option agreement.

## 6. Resource Property Costs - *Continued*

### c) El Tesoro, Mexico

The Company acquired a large property position located in the State of Durango, Mexico, consisting of four concessions by staking and an additional four concessions by option agreements.

In March 2005, the Company terminated the option agreements relating to the Guadalupe, Dos Hermanos, Santo Niño and La Esperanza mineral concessions. In anticipation of this decision, the Company wrote-off related exploration and acquisition costs of $861,548 during the year ended 28 February 2005.

The Company continues to maintain its interest in four mineral concessions known as La Lajita, Tesoro 1, Tesoro 2 and Tesoro 3, all of which were acquired by staking. These mineral concessions are located in Pueblo Nuevo Municipality, State of Durango, Mexico.

In September 2005, the Company's wholly-owned subsidiary, Grupo Northair de Mexico, S.A. de C.V. ("Grupo Northair") entered into a Letter of Intent with Compania Minera San Valentin, S.A. de C.V. ("San Valentin") whereby San Valentin may lease Grupo Northair's El Tesoro concessions for up to 15 years by paying Grupo Northair US$2,000 per month to explore and mine the G Zone and an additional US$3,000 per month for the rights to the rest of the concessions. San Valentin has the option to purchase the G Zone for US$200,000 and the remainder of the concessions for a further US$300,000. Should San Valentin exercise the purchase option, Grupo Northair will retain a 49% back-in right for the G Zone. Pursuant to a letter of amendment dated 27 April 2006, the option agreement for the period between May and September 2006 was changed so that San Valentin will make lease payments totalling US$15,000 over the five-month period and no mining will take place on the G Zone until September 2006, at which time the original terms of the agreement will take effect.

### d) El Tropico

During the year ended 28 February 2005, the Company abandoned the El Tropico property located in the State of Sinaloa, Mexico and wrote-off all capitalized acquisition and exploration costs.

### e) Las Moras, Mexico

By letter of intent dated 16 October 2003, the Company had an option to earn a 100% interest in certain mineral concessions known as Las Moras located in the State of Durango, Mexico. During the year ended 28 February 2006, the Company wrote-off accumulated acquisition and exploration costs of $45,803 in anticipation that the option agreement would be terminated subsequent to the year-end.

### f) La Joya, Mexico

During the year ended 28 February 2005, the Company acquired, by staking, a concession in the state of Durango, Mexico, known as the La Joya Project. During the year ended 28 February 2006, the Company wrote-off accumulated acquisition and exploration costs of $8,454 in anticipation that the concession would be terminated subsequent to the year-end.

## 7. Share Capital

a) Details are as follows:

| | Shares | | Amount |
|---|---|---|---|
| Authorized: | | | |
| Unlimited common shares without par value | | | |
| Issued and outstanding: | | | |
| Balance - 29 February 2004 | 12,831,347 | $ | 20,997,506 |
| Exercise of options | 30,000 | | 18,500 |
| Exercise of warrants | 165,825 | | 124,995 |
| Fair value of stock options exercised *(Note 7d)* | - | | 9,500 |
| Balance - 28 February 2005 | 13,027,172 | | 21,150,501 |
| Exercise of options | 50,000 | | 10,500 |
| Balance - 28 February 2006 | 13,077,172 | $ | 21,161,001 |

b) **Stock Options**

The Company has established a share purchase option plan whereby the board of directors may, from time to time, grant up to a total of 1,705,992 options to directors, officers, employees or consultants. Options granted must be exercised no later than ten years from date of grant or such lesser period as determined by the Company's board of directors. The exercise price of an option is not less than the closing price on the TSX Venture Exchange on the last trading day preceding the grant date. Options typically vest on the grant date.

As at 28 February 2006, the Company had 1,295,000 incentive stock options outstanding as follows:

| Opening Balance | Granted | Exercised/ Cancelled | Ending Balance | Exercise Price | Expiry |
|---|---|---|---|---|---|
| 50,000 | - | (50,000) | - | $0.21 | 15 August 2005 |
| 75,000 | - | - | 75,000 | $0.15 | 17 October 2006 |
| 325,000 | - | - | 325,000 | $0.25 | 17 July 2007 |
| 5,000 | - | - | 5,000 | $0.40 | 5 June 2008 |
| 660,000 | - | (25,000) | 635,000 | $0.69 | 21 October 2008 |
| 20,000 | - | - | 20,000 | $1.20 | 8 January 2009 |
| 65,000 | - | - | 65,000 | $0.40 | 17 June 2009 |
| - | 50,000 | - | 50,000 | $0.35 | 15 March 2010 |
| - | 120,000 | - | 120,000 | $0.23 | 14 September 2010 |
| 1,200,000 | 170,000 | (75,000) | 1,295,000 | | |

As at 28 February 2006, all of the 1,295,000 stock options outstanding have vested.

c) **Stock-based Compensation**

During the year ended 28 February 2006, the Company granted options to purchase up to 170,000 (2005 - 80,000 @ $0.40) shares of the Company's stock to employees and non-employees of the Company at exercise prices between $0.23 and $0.35. A fair value of the options of $24,214 (2005 - $18,102) *(Note 7c)* has been recorded in the Company accounts.

## 7. Share Capital - *Continued*

### c) Stock-based Compensation - *Continued*

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions:

| | Year ended 28 February 2006 | Year ended 28 February 2005 |
|---|---:|---:|
| Expected dividend yield | 0.00% | 0.00% |
| Expected stock price volatility | 58.4% ~ 60.1% | 62.5% |
| Risk free interest rate | 3.6% ~ 3.8% | 4.27% |
| Expected life of options | 5 years | 5 years |

Option pricing models require the input of highly subjective assumptions including the estimate of the share price volatility. Changes in the subjective input assumptions can materially affect the fair value estimate, and therefore the existing models do not necessarily provide a reliable single measure of the fair value of the company's stock options.

### d) Warrants

As at 28 February 2006, the Company had Nil (2005 - 1,493,931 warrants) warrants outstanding. During the year, a total of 1,493,931 warrants exercisable at $0.80 per share expired without exercise.

### e) Contributed Surplus

| | **2006** | 2005 |
|---|---:|---:|
| Balance - Beginning of the year | **$ 437,683** | $ 429,081 |
| Fair value of stock-based compensation *(Note 7b)* | **24,214** | 18,102 |
| Fair value of stock options exercised – transferred to share capital | **-** | (9,500) |
| Balance - End of the year | **$ 461,897** | $ 437,683 |

## 8. Related Party Transactions

Except as disclosed elsewhere in the financial statements, related party transactions are as follows:

a) Administrative recoveries of $116,776 (2005 - $346,137) are primarily recovered from various companies with certain directors in common.

b) Total salaries of $276,000 (2005 - $258,000) were paid to two directors of the Company. The Company recovered $197,945 (2005 - $197,879) based on time spent, from companies with certain directors in common.

c) The amounts due from (to) related parties are for expense reimbursements and are receivable from (payable to) various companies with directors in common. The amounts are non-interest bearing and are receivable (payable) within the following year, and therefore, have been classified as current.

## 8. Related Party Transactions - *Continued*

d) Gain on the sale of securities of $118,353 (2005 - $31,731) resulted from the sale of shares of companies with certain directors in common.

e) Troon Ventures Ltd., Tenajon Resources Ltd., Stornoway Diamond Corp., Sherwood Copper Corporation (formerly Sherwood Mining Corporation) and New Dimension Resources Ltd. (formerly NDT Ventures Ltd.) have certain directors and officers in common with the Company.

f) During the year, directors and officers acquired 50,000 (2005 – Nil) shares of the Company for proceeds to the Company of $10,500 (2005 – $Nil).

g) The amount of $87,500 (2005 – Nil) is due to a company with a director and officer in common for the exercise of a stock option.

These transactions are in the normal course of operations and are measured at the exchange amount of consideration established and agreed to by all the related parties.

## 9. Segmented Information

The Company's business consists of mineral exploration and development. Details on geographic segments are as follows:

| | Canada | | Mexico | | Total | |
|---|---|---|---|---|---|---|
| | **2006** | 2005 | **2006** | 2005 | **2006** | 2005 |
| Loss for the year | **$ 301,513** | $ 1,275,066 | **$ 293,963** | $ 142,941 | **$ 595,476** | $ 1,418,007 |
| Identifiable assets | **$ 1,079,335** | $ 1,512,163 | **$ 353,720** | $ 386,535 | **$ 1,433,055** | $ 1,898,698 |
| Administrative expenses | **$ 381,213** | $ 241,772 | **$ 22,407** | $ 20,309 | **$ 403,620** | $ 262,081 |

## 10. Lease Obligations

a) The Company has a lease agreement for its office space. The minimum annual commitments for rental expenses are as follows:

| | |
|---|---|
| 2007 | $ 131,365 |
| 2008 | 132,973 |
| 2009 | 142,851 |
| 2010 | 135,044 |
| 2011 | 135,044 |
| Total | $ 677,277 |

In addition to the basic monthly rent, the Company must also pay a proportionate share of the building's operating costs and property taxes. The Company has a sub-lease agreement with Strongbow Exploration Inc., a company with an officer in common. The Company may recover approximately two-thirds of the minimum annual rent commitment pursuant to this sub-lease agreement.

## 10. Lease Obligations - *Continued*

b) The Company has certain equipment classified as a capital lease and the applicable cost is included in property, plant and equipment *(Note 5)*. Future minimum lease payments with remaining terms in excess of one year are as follows:

| | | |
|---|---|---|
| 2007 | $ | 8,464 |
| 2008 | | 8,627 |
| Total minimum lease payments | | 17,091 |
| Less: Current portion | | (8,464) |
| Long-term portion | $ | 8,627 |

## 11. Short-term Deposits

Included in short-term deposits of $195,893 (2005 - $65,817) is $5,000 held for reclamation costs (2005 - $5,000) and $65,893 (2005 - $60,817) held as collateral for the corporate credit cards.

## 12. Income Taxes

a) Reconciliation of accounting and taxable income

| | | **For the Year Ended 28 February 2006** | | For the Year Ended 28 February 2005 |
|---|---|---|---|---|
| Net Income (Loss) for the year | **$** | **(595,476)** | $ | (1,418,007) |
| Add: | | | | |
| Write-off of resource property costs | | **359,844** | | 1,198,383 |
| Amortization | | **27,182** | | 17,823 |
| Stock-based compensation | | **24,214** | | 18,103 |
| Write down of investments | | **17,491** | | - |
| Other | | **51,093** | | 98,742 |
| Deduct: | | | | |
| Gain on disposal of assets | | **(118,353)** | | (31,731) |
| Share issuance costs | | **(45,918)** | | (40,584) |
| Gain on property option agreement | | **(39,046)** | | - |
| | **$** | **(318,969)** | $ | (157,271) |

b) The Company has non-capital losses which may be applied to reduce future years' taxable income. At 28 February 2006, these losses expire as follows:

| | | |
|---|---|---|
| 2011 | $ | 34,000 |
| 2015 | | 157,000 |
| 2016 | | 319,000 |
| | $ | 510,000 |

## 12. Income Taxes *-Continued*

c) The Company has Canadian and Foreign Development and Exploration Expenditures of $5,793,851 (2005 - $5,834,488) available to offset future taxable income. The tax benefits of these expenditures carry forward indefinitely.

d) The components of the future income tax asset balances are as follows:

| | **28 February 2006** | 28 February 2005 |
|---|---|---|
| Future income tax asset | | |
| Non-capital loss carry-forwards | **$ 510,000** | $ 191,000 |
| Exploration tax credits in excess of the accounting tax basis | **6,387,000** | 6,246,000 |
| Capital loss carry-forward | **451,000** | 489,000 |
| Other | **99,000** | 118,000 |
| | **7,447,000** | 7,044,000 |
| Effective income tax rate | **31.0%** | 31.9% |
| Future income tax asset | **2,309,000** | 2,247,000 |
| Allowance for future income tax | **(2,309,000)** | (2,247,000) |
| Future income tax asset | **$ -** | $ - |

Future income tax assets and liabilities are measured using statutory rates that are expected to apply to taxable income in the years in which temporary differences are expected to be recovered or settled.

Future income tax assets are recorded when it is more likely then not, that they will be recovered in future periods.

## 13. Comparative Figures

Certain of the comparative figures have been reclassified to conform to the current year's presentation.

## 14. Subsequent Events

a) In April 2006, the Company acquired the El Reventon project in Durango, Mexico by staking a 100% interest in certain claims and by concluding an option agreement for an additional concession. Under the terms of the option agreement, the Company may earn a 100% interest in the optioned concession by making payments totalling US$150,000 over a four year period.

b) In May 2006, the Company issued 35,000 common shares at $0.23 per share pursuant to a stock option exercise.