

**ALAMOS GOLD INC.**

December 31, 2008 and 2007

(Unaudited - stated in thousands of United States dollars)

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## **MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING**

The consolidated financial statements of Alamos Gold Inc. have been prepared by, and are the responsibility of the Company's management.

The consolidated financial statements are prepared in accordance with accounting principles generally accepted in Canada and reflect management's best estimates and judgments on information currently available. In the opinion of management, the accounting practices utilized are appropriate in the circumstances and the consolidated financial statements fairly reflect the financial position and results of operations of the Company within reasonable limits of materiality.

Management has developed and maintains a system of internal controls to obtain reasonable assurance that the Company's assets are safeguarded, transactions are authorized, and financial information is reliable. All internal control systems have inherent limitations, including the possibility of circumvention and overriding of controls, and therefore, can provide only reasonable assurance as to financial statement reliability and the safeguarding of assets.

The Board of Directors is responsible for ensuring management fulfills its responsibilities. The Audit Committee meets with the Company's management and external auditors to discuss the results of the audit and to review the consolidated financial statements prior to the Audit Committee's submission to the Board of Directors for approval. The Audit Committee also reviews the quarterly financial statements and recommends them for approval to the Board of Directors, reviews with management the Company's systems of internal control, and approves the scope of the external auditors' audit and non-audit work. The Audit Committee is composed entirely of directors not involved in the daily operations of the Company who are thus considered to be free from any relationship that could interfere with their exercise of independent judgment as a Committee member.

The consolidated financial statements have been audited by Ernst & Young LLP, Chartered Accountants and their report outlines the scope of their examination and gives their opinion on the consolidated financial statements.

February 27, 2009

//signed//John A. McCluskey  
John A. McCluskey  
President and Chief Executive Officer

//signed//Jon Morda  
Jon Morda, CA  
Chief Financial Officer

**TO THE SHAREHOLDERS OF ALAMOS GOLD INC.**

We have audited the consolidated balance sheets of Alamos Gold Inc. [the "Company"] as at December 31, 2008 and 2007 and the consolidated statements of operations and comprehensive income, changes in shareholders equity 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 December 31, 2008 and 2007, and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

//signed//Ernst & Young LLP

Chartered Accountants  
Licensed Public Accountants  
Toronto, Canada  
February 27, 2009

**ALAMOS GOLD INC.**  
**CONSOLIDATED BALANCE SHEETS**

(stated in thousands of United States dollars)

	Note Ref.	<u>December 31, 2008</u>	<u>December 31, 2007</u>
<b>A S S E T S</b>			
<b>Current Assets</b>			
Cash and cash equivalents		\$43,779	\$7,757
Amounts receivable	4	4,850	3,040
Advances and prepaid expenses		636	1,520
Available-for-sale securities	5	465	1,195
Inventory	6	26,666	36,222
		<u>76,396</u>	<u>49,734</u>
Mineral property, plant and equipment	7	132,872	126,095
		<u>\$209,268</u>	<u>\$175,829</u>
<b>L I A B I L I T I E S</b>			
<b>Current Liabilities</b>			
Accounts payable and accrued liabilities	8	\$10,919	\$7,907
Income taxes payable	17	2,132	-
Current portion of capital lease obligations	10	-	2,072
Current portion of property acquisition obligations	13	332	562
		<u>13,383</u>	<u>10,541</u>
Capital lease obligations	10	-	6,503
Convertible debenture	11	-	1,297
Future income taxes	17	11,320	11,445
Employee future benefits	9	479	555
Asset retirement obligations	12	3,780	3,460
Property acquisition obligations	13	599	891
<b>Total Liabilities</b>		<u>\$29,561</u>	<u>\$34,692</u>
<b>S H A R E H O L D E R S ' E Q U I T Y</b>			
Share capital	14	\$167,920	\$161,042
Convertible debenture	11	-	293
Contributed surplus	14	10,108	6,810
Accumulated other comprehensive income (loss)		(693)	-
Retained earnings (deficit)		2,372	(27,008)
		<u>179,707</u>	<u>141,137</u>
		<u>\$209,268</u>	<u>\$175,829</u>

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

**On behalf of the Board**

//signed// John A. McCluskey

//signed// Mark Wayne

**ALAMOS GOLD INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME**  
For the years ended December 31

(stated in thousands of United States dollars, except per share amounts)

	<u>2008</u>	<u>2007</u>
<b>OPERATING REVENUES</b>		
Gold sales	\$132,974	\$74,028
<b>OPERATING EXPENSES</b>		
Mining and processing	52,357	42,195
Royalties	6,600	3,776
Amortization	20,723	11,000
Exploration	4,198	2,320
Corporate and administrative	4,550	3,516
Stock-based compensation	4,363	3,425
Accretion expense	324	200
Employee future benefits	166	205
	<u>93,281</u>	<u>66,637</u>
<b>EARNINGS FROM OPERATIONS BEFORE THE FOLLOWING</b>	<b>39,693</b>	<b>7,391</b>
Interest income	395	202
Interest expense	(275)	(1,326)
Accretion of convertible debenture discount	(20)	(69)
Foreign exchange loss	(99)	(48)
Other (loss) gain	(673)	224
	<u>39,021</u>	<u>6,374</u>
<b>Earnings before income taxes</b>	<b>39,021</b>	<b>6,374</b>
Income taxes		
- Current tax expense	(7,461)	(545)
- Future tax expense	(2,180)	(2,895)
	<u>29,380</u>	<u>2,934</u>
<b>Earnings</b>	<b>\$29,380</b>	<b>\$2,934</b>
Other comprehensive income (loss)		
- Unrealized loss on securities	(693)	-
Comprehensive income	<u>\$28,687</u>	<u>\$2,934</u>
Earnings per share		
- basic	\$0.31	\$0.03
- diluted	\$0.30	\$0.03
Weighted average number of common shares outstanding		
- basic	95,428,000	94,065,000
- diluted	97,111,000	96,427,000

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

**ALAMOS GOLD INC.**  
**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**

(stated in thousands of United States dollars)

	Number of Shares outstanding	Share capital	Convertible debenture	Contributed surplus	Accumulated other comprehensive income (loss)	Retained earnings (deficit)	Total Shareholders' Equity
<b>Balance at December 31, 2006</b>	<b>93,710,515</b>	<b>\$158,971</b>	<b>\$297</b>	<b>\$3,740</b>	<b>\$-</b>	<b>\$(29,942)</b>	<b>\$133,066</b>
Stock-based compensation				3,425			3,425
Shares issued on exercise of options	801,000	2,050		(355)			1,695
Shares issued on conversion of convertible debenture	4,716	21	(4)				17
Earnings						2,934	2,934
<b>Balance at December 31, 2007</b>	<b>94,516,231</b>	<b>\$161,042</b>	<b>\$293</b>	<b>\$6,810</b>	<b>\$ -</b>	<b>\$(27,008)</b>	<b>\$141,137</b>
Stock-based compensation				4,363			4,363
Shares issued on exercise of options	1,752,500	5,403		(1,065)			4,338
Shares issued on conversion of convertible debenture	258,677	1,475	(293)				1,182
Earnings						29,380	29,380
Other comprehensive income (loss)					(693)		(693)
<b>Balance at December 31, 2008</b>	<b>96,527,408</b>	<b>\$167,920</b>	<b>\$ -</b>	<b>\$10,108</b>	<b>\$(693)</b>	<b>\$2,372</b>	<b>\$179,707</b>

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

**ALAMOS GOLD INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
For the years ended December 31

(stated in thousands of United States dollars)

	<u>2008</u>	<u>2007</u>
<b>Cash provided by (used for):</b>		
<b>Operating Activities</b>		
Earnings	\$29,380	\$2,934
Adjustments for items not involving cash:		
Amortization	20,723	11,000
Accretion expense	344	269
Employee future benefits	166	205
Unrealized foreign exchange (gain) loss	(2,629)	51
Future income taxes	2,180	2,895
Realized gain on sale of securities	(22)	(113)
Stock-based compensation	4,363	3,425
Changes in non-cash working capital:		
Fair value of forward contracts	406	-
Amounts receivable	(5,470)	3,328
Inventory	7,392	(5,065)
Prepaid expenses	884	(206)
Accounts payable, taxes payable, advances and accrued liabilities	7,622	2,136
	<u>65,339</u>	<u>20,859</u>
<b>Investing Activities</b>		
Sale of securities	59	239
Mineral property, plant and equipment	(25,039)	(14,934)
	<u>(24,980)</u>	<u>(14,695)</u>
<b>Financing Activities</b>		
Common shares issued	4,338	1,695
Bank loan	-	(3,000)
Capital lease repayments	(8,575)	(2,024)
Convertible debenture settled	(100)	-
Restricted cash	-	44
	<u>(4,337)</u>	<u>(3,285)</u>
Net increase in cash and cash equivalents	36,022	2,879
Cash and cash equivalents - beginning of year	7,757	4,878
<b>Cash and cash equivalents - end of year</b>	<b><u>\$43,779</u></b>	<b><u>\$7,757</u></b>
Supplemental information:		
Interest paid	\$341	\$1,078
Income taxes paid	\$1,850	\$-

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

## **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(stated in United States dollars)**

### **1. NATURE OF OPERATIONS**

Alamos Gold Inc. and its wholly-owned subsidiaries (“the Company”) are engaged in the acquisition, exploration, development and extraction of precious metals in Mexico. The Company owns and operates the Mulatos mine (“the Mine”). In addition, the Company holds the mineral rights to the Salamandra group of concessions in the state of Sonora, Mexico, which includes several known satellite gold occurrences.

### **2. SIGNIFICANT ACCOUNTING POLICIES AND BASIS OF PRESENTATION**

#### **Basis of presentation**

These consolidated financial statements have been prepared by management in accordance with generally accepted accounting principles (“GAAP”) in Canada. The United States dollar is both the functional and reporting currency of the Company. Summarized below are those policies considered particularly significant to the Company. References to the Company included herein are inclusive of the Canadian parent company and its consolidated subsidiaries.

#### **Principles of consolidation**

The consolidated financial statements include the financial statements of the Company and its subsidiaries. All inter-company balances and transactions have been eliminated on consolidation.

#### **Use of estimates**

The preparation of financial statements in conformity with GAAP requires that management make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenues earned and expenses incurred during the reporting period. Accounts which require management to make material estimates and significant assumptions in determining amounts recorded include amortization, mineral property, plant and equipment, inventory, asset retirement obligations, property acquisition obligations, employee future benefits, accrued liabilities, income taxes and contingencies. Actual results could differ from those estimates.

#### **Revenue recognition**

Revenue is earned primarily from the sale of gold and is recognized when refined metal is delivered to a purchaser pursuant to a purchase agreement that fixes the quantity and price of the metal for each delivery. Costs incurred or premium income related to forward sales or option contracts are recognized in revenue when the contract is settled. Changes in the fair value of outstanding forward sales or option contracts are recognized in earnings.

#### **Inventory**

Inventory which includes gold-in-process, dore and parts and supplies is stated at the lower of cost or net realizable value.

- (i) Dore represents a bar containing predominantly gold by value which must be refined off-site to return saleable metals. Dore inventory is valued at the lower of average cost to produce the dore and net realizable value.
- (ii) In-process inventory represents costs that are incurred in the process of converting mineralized ores into partially refined precious metals, or dore, consisting primarily of gold by value. In-process inventories are composed of ore in stockpiles and ore on leach pads. Ore in stockpiles represents mined ore which requires crushing or screening before being placed on the leach pads. Leach pad ore represents mined ore which has been stacked on an impermeable pad and permeated with chemical solutions to dissolve precious metals and channel the resulting gold-bearing solutions to a plant for recovery of gold in the form of dore bars.

Cost of in-process inventory includes operating costs incurred to that stage of the process plus amortization of mineral property, plant and equipment allocable to that stage of the process. Operating costs at each stage of the process are recognized when incurred. Amortization of mineral property, plant and equipment associated with each stage of the process is added periodically. When physical quantities are transferred from one stage of the process to another, associated accumulated costs are also transferred based on average cost per recoverable ounce of gold contained in that inventory at the time of transfer. The amount of recoverable gold contained in in-process inventory is estimated based on the tonnes and grade of ore placed on the pad and metallurgical recoveries based on testing and ongoing monitoring of the rate of gold recoveries. Variations between actual and estimated quantities may result in a write-down of inventory if necessary to maintain a lower of average cost or net realizable value basis or a prospective adjustment to the basis of transferring in-process costs of production to dore.

- (iii) Parts and supplies inventory is valued at the lower of average cost and replacement cost.

### **Mineral property, plant and equipment**

#### **a) Mineral property acquisition and mine development costs:**

The Company may hold interests in mineral properties in various forms, including prospecting licenses, exploration and exploitation concessions, mineral leases and surface rights. The costs of acquiring these interests are capitalized as mineral property acquisition costs.

Property acquisition and mine development costs are recorded at cost and amortized by the unit-of-production method based on estimated recoverable reserves. Pre-production expenditures are capitalized until the commencement of production. Mine development costs incurred to expand operating capacity, develop new orebodies or develop mine areas in advance of current production are deferred and then amortized on a unit-of-production basis. Mine development costs related to current period production are charged to operations as incurred.

Interest and amortization of deferred financing charges on financing attributable to mine development is capitalized to mine development costs while construction and development activities at the property are in progress. When the property is placed into production, those capitalized costs are included in the calculation of the amortization of mine development costs.

Exploration expenditures on properties not advanced enough to identify their development potential are charged to operations as incurred. Expenditures incurred on non-producing properties identified as having development potential, as evidenced by a positive economic analysis of the project, are capitalized.

b) Plant and equipment:

Plant and equipment is stated at cost less accumulated amortization. Plant and equipment is amortized on a unit-of-production basis over estimated recoverable reserves or on a straight-line basis over the estimated useful life of the asset, whichever period is lower.

c) Impairment

The carrying values of mineral property, plant and equipment are reviewed periodically, when impairment factors exist, for possible impairment, based on the future undiscounted net cash flows of the related mine or development property. If it is determined that the estimated net recoverable amount is less than the carrying value, then a write down to the estimated fair value amount is made with a charge to operations. Estimated future cash flows of a mine or development property include estimates of recoverable ounces of gold based on proven and probable reserves. To the extent that economic value exists beyond the proven and probable reserves of a mine or development property, this value is included as part of the estimated future cash flows. Estimated future cash flows also involve estimates regarding gold prices, production levels, capital, reclamation costs and income taxes. Cash flows are subject to risks and uncertainties and changes in the estimates of the cash flows could affect the recoverability of long-lived assets.

### **Foreign currency translation**

Monetary assets and liabilities of the Company which are denominated in foreign currencies are translated into United States dollars at the exchange rate prevailing at the consolidated balance sheet dates. Non-monetary assets and liabilities are translated at historical exchange rates prevailing at each transaction date. Revenues and expenses are translated at rates of exchange prevailing in the transaction period, with the exception of amortization which is translated at historical exchange rates. All exchange gains and losses are included in the determination of earnings.

### **Cash and cash equivalents**

Cash and cash equivalents, which include cash and highly liquid investments with remaining maturities of three months or less at acquisition, are recorded at cost, which approximates fair value.

### **Financial instruments and financial risk**

The Company's financial instruments consist primarily of monetary assets and liabilities, the fair value of which approximate their carrying value due to the short-term nature of these instruments. The Company may enter into foreign exchange forward contracts to manage the Company's exposure to fluctuations in the Canadian and United States dollar and Mexican peso foreign exchange rates. The Company may also enter into forward gold sale transactions. These forward contracts are marked-to-market and recognized in the financial statements at their fair value.

### **Income taxes**

The Company accounts for future tax assets and liabilities using the liability method based on the temporary differences between the consolidated financial statement carrying amounts

of existing assets and liabilities and their tax bases. Future tax assets and liabilities are measured using tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the date of the change. When the future realization of income tax assets does not meet the test of being more likely than not to occur, a valuation allowance in the amount of the potential future benefit is taken and no net asset is recognized.

### **Stock-based compensation**

The Company has a stock-based compensation plan as described in Note 15. The Company accounts for stock options using the fair value method. Under this method, compensation expense is measured at fair value on the date of grant using the Black-Scholes option pricing model, and is charged as an expense or capitalized, depending on the nature of the grant, in the period the options are vested.

### **Asset retirement obligations**

The Company's mining and exploration activities are subject to various government laws and regulations relating to the protection of the environment. These laws and regulations are continually changing and are generally becoming more restrictive. The Company has made, and will continue to make expenditures to comply with such laws and regulations. Site closure and reclamation costs expected to be incurred in the future are estimated by the Company's management based on the information available to them. Actual site closure and reclamation costs could be materially different from the current estimates. Any change in cost estimates should additional information become available would be accounted for on a prospective basis. The fair value of the future liability for an asset retirement obligation is recognized in the period in which it is incurred with an offsetting amount being recognized as an increase in the carrying amount of the corresponding asset. This asset is amortized on a unit-of-production basis over the estimated life of the mine while the corresponding liability accretes to its future value by the end of the mine's life. Refer to Note 12.

### **Employee future benefits**

The Company is subject to Mexican statutory laws and regulations governing employee termination benefits. Employee future benefits include statutorily mandated accrued benefits payable to employees in the event of termination in certain circumstances. Termination benefits are recognized as an expense and associated liability when the amount can be reasonably estimated at the discounted value of the expected future payments. Refer to Note 9.

### **Earnings per share**

Earnings per share is calculated based on the weighted average number of common shares outstanding during the year. The diluted earnings per share is calculated based on the weighted average number of common shares outstanding during the year, plus the effects of the dilutive common share equivalents. This method requires that the dilutive effect of outstanding options and warrants issued be calculated using the treasury stock method. This method assumes that all common share equivalents have been exercised at the beginning of the period (or at the time of issuance, if later), and that the funds obtained thereby were used to purchase common shares of the Company at the average trading price of common shares during the period.

### **3. CHANGES IN ACCOUNTING POLICIES AND PRESENTATION**

#### **a) Capital Disclosures**

Effective January 1, 2008, the Company adopted the new Canadian Institute of Chartered Accountants ("CICA") Handbook Section 1535: Capital Disclosures. This standard requires disclosure of information that enables users of the Company's financial statements to evaluate the entity's objectives, policies and processes for managing capital. The disclosures required by adoption of this section are presented in Note 18.

#### **b) Financial Instruments – Disclosure and Presentation**

Effective January 1, 2008, the Company adopted CICA Handbook Section 3862: Financial Instruments – Disclosure ("Section 3862") and Handbook Section 3863: Financial Instruments – Presentation ("Section 3863"). The objective of Section 3862 is to provide financial statement disclosure to enable financial statement users to evaluate the significance of financial instruments on the Company's financial position and performance and the nature and extent of risks arising from financial instruments that the Company is exposed to during the reporting period and at the balance sheet date, and how the Company is managing those risks. The purpose of Section 3863 is to enhance the financial statement user's understanding of the significance of financial instruments to the Company's financial position, performance and cash flows. The disclosures required by adoption of these sections are presented in Note 5.

#### **c) Inventories**

Effective January 1, 2008, the Company adopted CICA Handbook Section 3031: Inventories. This section requires that inventory be recorded at the lower of cost or net realizable value. This section also clarifies that the allocation of fixed production overhead requires the consistent use of either first-in, first-out or the weighted average method to measure inventory, and requires that any previous write-downs be reversed when the value of the inventory increases. The amount of the reversal is limited to the amount of the original write-down. The disclosures required by adoption of this section are presented in Note 6.

#### **d) Recent Accounting Pronouncements**

##### **International Financial Reporting Standards**

In February 2008, the Canadian Accounting Standards Board confirmed that public companies will be required to adopt IFRS for fiscal years beginning on or after January 1, 2011. The adoption of IFRS will require the Company to change certain accounting policies, accounting systems, internal controls over financial reporting and disclosure controls. The Company is in the process of completing its initial IFRS diagnostic to identify the high-level impact of adopting IFRS on its financial statements and will continue to invest in training and necessary resources to complete the conversion.

##### **Goodwill and Intangible Assets**

The CICA has issued a new accounting standard, Section 3064: Goodwill and Intangible Assets, which clarifies that costs can be deferred only when they relate to an item that meets the definition of an asset, and as a result, startup costs must be expensed as incurred. The new and amended standards are effective for the Company beginning January 1, 2009. At this time, the Company does not believe adoption of this standard will have a material impact on its consolidated financial statements.

## Business Combinations, Consolidations, Non-Controlling Interests

In January 2009, the AcSB issued the following new Handbook sections: 1582 – Business Combinations, 1601 – Consolidations, and 1602 – Non-Controlling Interests. These standards are effective January 1, 2011. The Company has not yet determined the impact of the adoption of these standards on its consolidated financial statements.

## EIC-173 Credit Risk and the Fair Value of Financial Assets and Liabilities

In January 2009 the Emerging Issues Committee (“EIC”) issued EIC-173. In this EIC the Committee reached a consensus that in determining the fair value of financial assets and financial liabilities an entity should take into account the credit risk of the entity and the counterparty. While the EIC is effective for periods ending after the issuance date, the Company has adopted the EIC for its results ending as of December 31, 2008. Adoption had no impact on the classification or valuation of the Company’s consolidated financial statements.

### 4. AMOUNTS RECEIVABLE

	<b>December 31, 2008</b>	<b>December 31, 2007</b>
	(\$000)	(\$000)
Accounts receivable	432	107
Mexican value-added tax	4,418	2,933
	<b>\$4,850</b>	<b>\$3,040</b>

### 5. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

#### a) Categories of Financial Assets and Liabilities

Financial instruments are classified into one of the following five categories under Canadian GAAP: held-for-trading, held-to-maturity investments, loans and receivables, available-for-sale financial assets and other financial liabilities. The carrying value of the Company’s financial instruments are classified into the following categories:

	<b>December 31, 2008</b>	<b>December 31, 2007</b>
	(\$000)	(\$000)
Held for trading <sup>(1)</sup>	43,779	7,757
Gold forward contracts designated as held-for-trading <sup>(2)</sup>	(406)	-
Available-for-sale <sup>(3)</sup>	465	1,195
Loans and receivables <sup>(4)</sup>	4,850	3,040
Other financial liabilities <sup>(5)</sup>	(11,444)	10,657

<sup>(1)</sup> Includes cash and cash equivalents.

<sup>(2)</sup> Includes the Company’s gold forward sales contracts which are not considered to be effective hedges for accounting purposes. Classified within accounts payable and accrued liabilities in the consolidated balance sheet.

<sup>(3)</sup> Includes the Company’s investment in the common shares of Castle Gold Corporation (“Castle”, formerly Morgain Minerals Inc.).

<sup>(4)</sup> Includes amounts receivable.

<sup>(5)</sup> Includes accounts payable and accrued liabilities, property acquisition obligations and the debt component of the convertible debenture liability.

The Company has determined the estimated fair values of its financial instruments based on appropriate valuation methodologies; however, considerable judgment is required to develop these estimates. The fair values of the Company's financial instruments are not materially different from their carrying values.

In 2006, the Company sold its La Fortuna property to Castle for consideration of 2.5 million common shares of Castle and a 1% net smelter royalty on future production from the La Fortuna property. In the year ended December 31, 2008, the Company sold 242,000 common shares of Castle. At December 31, 2008, the Company held 2,153,500 shares of Castle with a fair value of \$430,000 as determined based on published closing price quotations. In addition to its investment in the common shares of Castle, the Company holds other securities valued at \$35,000 at December 31, 2008.

## **b) Derivative Financial Instruments**

The Company may utilize financial instruments to manage the risks associated with fluctuations in the market price of gold and foreign exchange rates. At December 31, 2008, the Company had outstanding contracts to deliver up to 6,911 ounces of gold (nil at December 31, 2007) in 2009 at prices below the period-end market price resulting in a mark-to-market loss of approximately \$406,000. At December 31, 2008, the Company also had outstanding United States dollar denominated 30-day term deposits totaling \$5,000,000, which are redeemed in Mexican pesos if certain predetermined market exchange rates are realized on contract settlement. If these contracts are settled in Mexican pesos, the Company uses these funds in the normal course of its operations. The mark-to-market loss associated with the contracts outstanding at December 31, 2008 was \$36,000 and is classified within other loss. The Company did not have any other foreign exchange forward contracts outstanding at December 31, 2008 or at December 31, 2007.

## **c) Risk Management**

The Company's activities expose it to a variety of financial risks: market risk (including commodity price, foreign exchange and interest rate risk), credit risk and liquidity risk. The Company's risk management program focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the Company's financial performance. The Company may use derivative financial instruments to hedge certain risk exposures. The Company does not purchase derivative financial instruments for speculative investment purposes.

Risk management is the responsibility of the corporate finance function. The Company's corporate finance function identifies, evaluates and where appropriate, hedges financial risks. Material risks are monitored and are regularly discussed with the Audit Committee of the Board of Directors.

### *i. Commodity Price Risk*

The Company is exposed to commodity price risk associated with the volatility in the market price of gold. Gold prices are affected by factors beyond the Company's control, including central bank sales, producer hedging activities, the relative exchange rate of the United States dollar with other major currencies, global and regional demand and political and economic conditions. Worldwide gold production levels also affect gold prices, and the price of gold can be subject to high levels of short-term volatility due to speculative activities. The Company may enter into derivative financial instruments to manage the Company's exposure to commodity price risk. However at this time, the Company has elected not to

actively manage its long-term exposure to commodity price risk through the use of derivative financial instruments.

#### *ii. Foreign Exchange Risk*

Certain of the Company's financial assets and liabilities are denominated in Canadian dollars or Mexican pesos. In addition, the Company incurs certain operating costs denominated in both the Canadian dollar and the Mexican peso. Accordingly, the Company is exposed to financial gain or loss as a result of foreign exchange movements against the United States dollar, and the Company's operating costs are affected by changes in foreign exchange rates in those currencies.

The Company has elected not to hedge its exposure to fluctuations in the Canadian dollar by buying fixed rate forward contracts in Canadian dollars. Corporate and administrative costs associated with the Company's head office in Toronto are denominated in Canadian dollars. A 10% increase in the value of the Canadian dollar compared to the United States dollar could increase the Company's reported corporate and administrative costs by approximately \$0.5 million annually.

The Company has exposure to monetary assets and liabilities denominated in Mexican pesos. Significant cash balances, outstanding amounts receivable, accounts payable or tax liabilities denominated in Mexican pesos could expose the Company to a foreign exchange gain or loss. Recently, the value of the Mexican peso compared to the United States dollar has weakened significantly. The Company has hedged the majority of its balance sheet exposure to changes in the Mexican peso/United States dollar exchange rate by maintaining additional cash balances in Mexican pesos to offset its future tax liabilities and taxes payable balances denominated in pesos. As the Mexican peso weakens against the United States dollar, the Company's operating costs (as reported in equivalent United States dollars) decrease. A 10% decline in the value of the Mexican peso compared to the United States dollar could reduce the Company's reported mining and processing costs and increase reported earnings before income taxes by approximately \$2.5 million annually.

#### *iii. Interest Rate Risk*

The Company's interest rate risk related to interest-bearing debt obligations is not material as the Company has no outstanding debt. As a result of the Company's minimal exposure to fluctuations in market interest rates, the Company has elected not to enter into interest rate swaps or other active interest rate management programs at this time.

#### *iv. Credit Risk*

Credit risk arises from cash and cash equivalents held with banks and financial institutions, derivative financial instruments (including forward gold sales contracts) and amounts receivable. The maximum exposure to credit risk is equal to the carrying value of the financial assets.

The objective of managing counter-party credit risk is to prevent losses in financial assets. The Company assesses the quality of its counter-parties, taking into account their creditworthiness and reputation, past experience and other factors. The Company only enters into forward gold sales contracts with large reputable financial institutions.

The carrying value of amounts receivable are reduced through the use of an allowance account (when applicable) and the amount of any allowance is recognized as a loss and included in operating expenses. When a receivable balance is considered uncollectible, it is written off against the allowance for amounts receivable. The majority of the Company's receivable balances consist of Mexican value-added tax recoverable claims. The Company

is exposed to credit risk in the case that the tax department of the Mexican government is unable to pay the amounts receivable. As at December 31, 2008, the Company was owed \$4,418,000 from the Mexican government.

*v. Liquidity Risk*

Liquidity risk arises through the excess of financial obligations due over available financial assets at any point in time. The Company's objective in managing liquidity risk is to maintain sufficient readily available cash reserves and credit in order to meet its liquidity requirements at any point in time. The Company currently achieves this by maintaining sufficient cash and cash equivalents. As at December 31, 2008 the Company had cash and cash equivalents of \$43,779,000. Subsequent to year-end, the Company completed a financing for net proceeds of \$62,500,000. Accordingly, the Company expects that construction of the mill and other ongoing construction projects at its current operations will be financed from existing cash balances. The total cost and planned timing of acquisitions and/or other development or construction projects is not currently determinable and it is not currently known whether the Company will require external financing in future periods.

**6. INVENTORY**

	<b>December 31, 2008</b>	<b>December 31, 2007</b>
	(\$000)	(\$000)
Precious metals dore and refined precious metals	3,596	4,760
In-process precious metals	14,617	22,693
Parts and supplies	8,453	8,769
	<u>\$26,666</u>	<u>\$36,222</u>

The carrying value of inventory is calculated using weighted average cost. The amount of inventory charged to operations as mining and processing costs during the year ended December 31, 2008 was \$52,249,000 (year ended December 31, 2007 - \$41,027,000). The amount of inventory charged to operations as amortization in the year ended December 31, 2008 was \$14,907,000 (year ended December 31, 2007 - \$10,465,000).

**7. MINERAL PROPERTY, PLANT AND EQUIPMENT**

In 2003, the Company acquired a 100% interest in certain properties within the Salamandra group of concessions which currently comprises approximately 28,500 hectares, in consideration for the payment of CDN\$11,154,000. Certain concessions within the acquired properties are subject to a sliding scale net smelter royalty on the first 2,000,000 ounces of gold production. The royalty rate is 5% when the market price of gold exceeds \$400 per ounce. Included within the Salamandra group of concessions is the Mulatos mine which began operations in 2005.

	<b>December 31, 2008</b>		
	Cost	Accumulated Amortization	Net Book Value
	(\$000)	(\$000)	(\$000)
Mineral property and mine development	66,127	(14,075)	52,052
Mining plant and equipment	110,828	(30,274)	80,554
Office and computer equipment	634	(368)	266
	<b>\$177,589</b>	<b>\$(44,717)</b>	<b>\$132,872</b>

	<b>December 31, 2007</b>		
	Cost	Accumulated Amortization	Net Book Value
	(\$000)	(\$000)	(\$000)
Mineral property and mine development	59,150	(8,713)	50,437
Mining plant and equipment	92,833	(17,411)	75,422
Office and computer equipment	483	(247)	236
	<b>\$152,466</b>	<b>\$(26,371)</b>	<b>\$126,095</b>

## 8. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

	<b>December 31, 2008</b>	<b>December 31, 2007</b>
	(\$000)	(\$000)
Trade accounts payable	4,674	5,673
Customer advances	2,926	-
Royalties payable	1,605	1,076
Other accrued liabilities	1,714	1,158
	<b>\$10,919</b>	<b>\$7,907</b>

## 9. EMPLOYEE FUTURE BENEFITS

The Company accrues employee future benefits for all contract workers paid through its subsidiary employment services company. These benefits consist of a one-time payment equivalent to twelve days' wages for each year of service (at the employee's most recent salary, but not to exceed twice the legal minimum wage), payable to all employees with fifteen or more years of service, as well as to certain employees terminated involuntarily prior to the vesting of their seniority premium benefit. Under Mexican Labour Law, the Company also provides statutorily mandated severance benefits to its employees terminated under certain circumstances. Such benefits consist of a one-time payment of three months' wages plus twenty days' wages for each year of service payable upon involuntary termination without just cause.

The liability associated with the seniority and termination benefits is calculated as the present

value of expected future payments. In determining the expected future payments, assumptions regarding employee turnover rates, inflation, minimum wage increases and expected salary levels are required and are subject to review and change.

The assumptions used in the determination of employee future benefits are as follows as at:

	<b>December 31, 2008</b>	<b>December 31, 2007</b>
Inflation adjusted interest rate	8.37%	8.26%
Salary increase rate	5.77%	4.64%
Minimum wage increase rate	3.70%	3.60%

## **10. CAPITAL LEASE OBLIGATIONS**

In the second quarter of 2008, the Company prepaid its capital lease obligations. The amount of interest expense related to the obligations under capital lease included in the determination of earnings for the year ended December 31, 2008 was \$234,000 (year ended December 31, 2007 - \$818,000).

## **11. DEBT**

### **a) Convertible Debenture**

Effective February 2, 2005, the Company issued a CDN\$50 million aggregate principal amount 5.5% convertible unsecured subordinated debenture maturing on February 15, 2010. Interest on the convertible debenture is payable semi-annually in arrears on February 15 and August 15 of each year at an annual rate of 5.5%. Under the terms of the trust indenture, the debenture is convertible into common shares at a rate of 18.86792 common shares for each CDN\$100 principal amount of debenture on maturity.

In 2006, the Company announced an incentive conversion period to allow for early conversion at incentive conversion ratios. Debentures representing CDN\$48,444,000 or approximately 97% of the outstanding balance were converted into common shares at incentive conversion ratios ranging from 20.3824 to 20.5907 common shares for each CDN\$100 principal of debenture, resulting in the issuance of 9,966,982 common shares. In addition, accrued interest related to the converted debentures was settled through the issuance of common shares at 18.86792 common shares per CDN\$100 of accrued interest, resulting in the issuance of 174,520 common shares. Convertible debentures representing CDN\$25,000 were converted during 2007. The face value of the outstanding convertible debentures at December 31, 2007 was CDN\$1,471,000.

On March 24, 2008, in accordance with the terms of the trust indenture, the Company announced that it had issued a notice of redemption to debenture holders. The notice of redemption indicated that any outstanding debentures on April 28, 2008 would be redeemed for cash. Debentures representing CDN\$1,371,000 were converted into common shares prior to the redemption date, resulting in the issuance of 258,677 common shares. The outstanding principal amount of debentures of CDN\$100,000 plus accrued interest at the redemption date was redeemed for cash. Accordingly, the convertible debenture balance at December 31, 2008 is nil.

## b) Bank Loan

On July 21, 2005, the Company obtained a bank line of credit consisting of a \$10 million unsecured revolving facility and a non-margin hedging line. The initial term was for one-year, and was extended at the discretion of the lender to July 21, 2008. On August 25, 2007, the bank agreed to increase the amount available to the Company to \$15 million. Interest was payable at a rate of 2.25% above applicable LIBOR on the drawn portion of the facility, and 0.75% on the undrawn portion. On April 30, 2008, the Company requested that the bank line of credit be cancelled as the Company had no intention of drawing funds prior to the end of its term in July 2008.

## 12. ASSET RETIREMENT OBLIGATIONS

The fair value of a liability for an asset retirement obligation is recognized in the period in which it is incurred, on a discounted cash flow basis, if a reasonable estimate can be made. The liability accretes to its full value over time through charges to operations. In addition, the fair value is added to the carrying amount of the Company's mineral property, plant and equipment, and is amortized on a units-of-production basis over the life of the Mine.

A continuity of asset retirement obligations is as follows:

	Year ended December 31, 2008	Year ended December 31, 2007
	(\$000)	(\$000)
Obligations at start of year	3,460	2,640
Revisions in estimated cash flows and changes in assumptions	(177)	604
Liabilities incurred	263	33
Accretion of discounted cash flows	234	183
Obligations at end of year	\$3,780	\$3,460

The assumptions used in the determination of the asset retirement obligations are as follows as at:

	December 31, 2008	December 31, 2007
Estimated cost (\$000)	5,681	5,374
End of mine life	2014	2014
Discount rate	6.48% - 7.30%	6.48% - 6.70%

## 13. PROPERTY ACQUISITION OBLIGATIONS

The Company is in the process of acquiring property adjacent to its present and prospective mining operations, including property comprising the town of Mulatos. Property owners and possessors are being offered a comprehensive benefits package including compensation for their property and/or relocation benefits. In certain cases, relocation benefits include deferred monthly payments over periods varying from three to five years. Obligations are recognized when a legal contract is signed by both parties and are measured at the discounted value of expected future payments. At December 31, 2008, the Company has applied a discount rate of approximately 7% to expected future payments.

## 14. SHARE CAPITAL

a) Authorized share capital of the Company consists of unlimited common shares without par value.

	<b>Number of Shares</b>	<b>Amount</b>
		(\$000)
Outstanding at January 1, 2007	93,710,515	158,971
Exercise of stock options	801,000	1,695
Conversion of convertible debenture	4,716	21
Transfer of contributed surplus to share capital for exercised stock options	-	355
Outstanding at December 31, 2007	94,516,231	161,042
Exercise of stock options	1,752,500	4,338
Conversion of convertible debenture	258,677	1,475
Transfer of contributed surplus to share capital for exercised stock options	-	1,065
Outstanding at December 31, 2008	96,527,408	\$167,920

b) Stock options outstanding and exercisable as at December 31, 2008:

<b>Range of exercise prices (\$CDN)</b>	<b>Outstanding</b>			<b>Exercisable</b>	
	<b>Number of options</b>	<b>Weighted average exercise price (\$CDN)</b>	<b>Weighted average remaining contractual life (years)</b>	<b>Number of options</b>	<b>Weighted average exercise price (\$CDN)</b>
\$2.01 - \$3.00	505,000	\$2.28	0.46	505,000	\$2.28
\$3.01 - \$4.00	670,000	\$3.73	1.42	670,000	\$3.73
\$6.01 - \$7.00	2,112,000	\$6.30	3.64	1,003,000	\$6.30
\$7.01 - \$8.00	1,825,000	\$7.29	2.74	1,481,400	\$7.29
\$8.01 - \$9.00	874,500	\$8.90	2.04	874,500	\$8.90
	<u>5,986,500</u>	<u>\$6.36</u>	<u>2.61</u>	<u>4,533,900</u>	<u>\$6.30</u>

c) Summary of stock option activity:

	<b>Number</b>	<b>Weighted average exercise price (\$CDN)</b>
Outstanding at January 1, 2007	5,185,500	\$4.32
Granted	2,472,000	7.22
Exercised	(801,000)	2.16
Forfeited	(302,000)	7.86

Outstanding at December 31, 2007	6,554,500	\$5.52
Granted	1,545,000	\$6.12
Exercised	(1,752,500)	\$2.69
Forfeited	(360,500)	\$7.90
Outstanding at December 31, 2008	5,986,500	\$6.36

## 15. STOCK-BASED COMPENSATION

The Company has a stock option plan, originally approved by the Board of Directors (the "Board") on April 17, 2003, to allow the Company to grant incentive stock options to its directors, officers, employees and consultants. At the Company's annual general meeting held on May 24, 2005, the shareholders of the Company approved an amendment, as amended and ratified on May 25, 2007 and May 15, 2008, to the Company's stock option plan. Under the amended stock option plan, the number of shares reserved for issuance cannot exceed 10% of the total number of shares which are outstanding on the date of grant. The exercise price, term (not to exceed ten years) and vesting provisions are authorized by the Board at the time of the grant.

Stock options granted to directors, officers and certain consultants are exercisable for a five-year period, and options granted to employees are generally exercisable for a three-year period. All incentive stock options granted vest 20% on the date of grant, and 20% at each six-month interval following the date of grant.

In 2008, the Company granted incentive stock options to certain of its directors, officers and employees to purchase up to 1,545,000 common shares in the capital of the Company at exercise prices ranging from CDN\$6.00 to CDN\$6.76 per share. In 2007, the Company granted 2,472,000 stock options at an exercise prices ranging from CDN\$6.81 to CDN\$7.29 per share.

The fair value of stock options granted were estimated using the Black-Scholes option pricing model with the following assumptions:

For options granted in the year ended	December 31, 2008	December 31, 2007
Risk-free rate	2.75%	4.00%
Expected dividend yield	nil	nil
Expected stock price volatility	50%	50%
Expected option life, based on terms of the grants (months)	27-40	27-40
Weighted average per share fair value of options granted	\$2.26	\$2.45

Option pricing models require the input of highly subjective assumptions, particularly as to the expected price volatility of the stock. Changes in these assumptions can materially affect the fair value estimate, and therefore it is management's view that the existing models may not provide a single reliable measure of the fair value of the Company's stock option grants.

As at December 31, 2008, 4,533,900 stock options were exercisable. The remaining 1,452,600 stock options vest over the following 2.6 years. Subsequent to December 31, 2008, 74,000 stock options were exercised at an average exercise price of CDN\$4.95. In addition, on February 19, 2009, 470,000 stock options were granted at an exercise price of CDN\$7.84.

## 16. SEGMENTED REPORTING

The Company operates in one business segment (the exploration, mine development and extraction of precious metals, primarily gold) in two geographic areas: Canada and Mexico.

	<b>December 31, 2008</b>	<b>December 31, 2007</b>
	(\$000)	(\$000)
Assets, by geographic segment		
- Mexico	177,868	173,890
- Canada	31,400	1,939
	<u>209,268</u>	<u>175,829</u>

Year ended	<b>December 31, 2008</b>			<b>December 31, 2007</b>		
	Mexico (\$000)	Canada (\$000)	Total (\$000)	Mexico (\$000)	Canada (\$000)	Total (\$000)
Revenues	132,974	-	132,974	74,028	-	74,028
Earnings	40,801	(11,421)	29,380	9,438	(6,504)	2,934

## 17. INCOME TAXES

### a) Single Rate Tax Law

Effective January 1, 2008, the Company became subject to a new Single Rate Tax Law enacted by the Mexican government on September 28, 2007. Under the new Single Rate Tax Law, the Company's Mexican operating subsidiaries are subject to a tax equivalent to 17.5% (with lower transitional rates in 2008 of 16.5% and 2009 of 17%) of the Company's revenues less certain allowable deductions (as determined on a cash basis). The single rate tax is payable each year to the extent that it exceeds income tax otherwise payable pursuant to the pre-existing Mexican income tax laws. Any excess single rate tax paid cannot be credited against income taxes payable in future periods. In the year ended December 31, 2008, the application of the new single rate tax did not impact the Company's tax expense.

### b) Rate Reconciliation

The reconciliation of the expected tax expense at a combined statutory rate of 33.5% and provision for income tax expense is:

<b>December 31</b>	<b>2008</b>	<b>2007</b>
	(\$000)	(\$000)
Earnings before income taxes	<u>39,021</u>	<u>6,374</u>
Expected tax expense at statutory income tax rate	13,070	2,295
(Decrease)/increase resulting from:		
Difference in foreign tax rates	(1,780)	(930)

Non-deductible accretion expense	-	25
Non-deductible stock-based compensation expense	1,460	1,230
Non-taxable gain	(170)	(125)
Change in foreign exchange rates	(4,160)	(3,570)
Inflation net taxable gains	1,150	1,040
Withholding tax	600	545
Reduction in Canadian future income tax rates	-	2,560
Valuation allowance	(529)	370
Income tax expense	9,641	3,440

c) **Future tax reconciliation**

The following information summarizes the principal temporary differences and the related future tax effect:

<b>December 31, 2008</b>	<b>Canada</b>	<b>Mexico</b>	<b>Total</b>
	(\$000)	(\$000)	(\$000)
<b>Future tax assets</b>			
Non-capital losses	6,300	-	6,300
Capital losses	1,400	-	1,400
Financing costs	300	-	300
Asset retirement obligations	-	1,040	1,040
Other short-term	-	330	330
Valuation allowance	(8,000)	-	(8,000)
	-	1,370	1,370
<b>Future tax liabilities</b>			
Inventory	-	(1,170)	(1,170)
Mineral property, plant and equipment	-	(11,520)	(11,520)
	-	(12,690)	(12,690)
<b>Net future tax liabilities</b>	-	<b>(11,320)</b>	<b>(11,320)</b>

<b>December 31, 2007</b>	<b>Canada</b>	<b>Mexico</b>	<b>Total</b>
	(\$000)	(\$000)	(\$000)
<b>Future tax assets</b>			
Non-capital losses	7,340	1,480	8,820
Capital losses	3,960	-	3,960
Financing costs	600	-	600
Asset retirement obligations	-	960	960
Valuation allowance	(11,900)	-	(11,900)
	-	2,440	2,440
<b>Future tax liabilities</b>			
Inventory	-	(1,642)	(1,642)

Mineral property, plant and equipment	-	(12,243)	(12,243)
	-	(13,885)	(13,885)
<b>Net future tax liabilities</b>	-	<b>(11,445)</b>	<b>(11,445)</b>

#### d) Loss Carry-forwards

Non-capital losses available in Canada to be utilized in subsequent years are approximately \$20 million expiring between 2009 and 2027.

### 18. MANAGEMENT OF CAPITAL

The Company defines capital that it manages as its shareholders equity. The Company's objectives when managing capital are to safeguard the entity's ability to continue as a going concern so that it can continue to provide returns for shareholders and benefits for other stakeholders. As at December 31, 2008, total managed capital was \$179,707,000 (December 31, 2007 - \$141,137,000).

The Company's capital structure reflects the requirements of a company focused on sustaining strong cash flows from its current mining operations and financing both internal and external growth opportunities and development projects. The Company faces lengthy development lead times as well as risks associated with increasing capital costs and project completion timing due to the availability of resources, permits and other factors beyond the Company's control. The Company's operations are also significantly affected by the volatility of the market price of gold.

The Company continually assesses its capital structure and makes adjustments to it with reference to changes in economic conditions and risk characteristics associated with its underlying assets. In order to maintain or adjust the capital structure, the Company may issue new shares, pay dividends, sell assets or enter into new debt arrangements.

The Company manages its capital structure by performing the following:

- Maintaining a liquidity cushion in order to address any potential operational disruptions or industry downturns
- Preparing detailed budgets and cash flow forecasts for each of mining operations, exploration, development projects and corporate activities that are approved by the Board of Directors
- Regular internal reporting and Board of Directors meetings to review actual versus budgeted spending and cash flows
- Detailed project financial analysis to assess or determine new funding requirements

### 19. COMMITMENTS AND CONTINGENCIES

#### a) Royalty

Production from the Mine is subject to a sliding scale production royalty, which at current gold prices above \$400 per ounce is set at a rate of 5% of the value of gold and silver produced, less certain allowed refining and transportation costs. Valuations are based on daily average London PM Fix gold prices, not actual prices realized by the Company.

#### b) Mulatos Town Relocation

The Company commenced the planned relocation of the town of Mulatos in 2007. Relocation contracts have been signed with in excess of half of the families residing in Mulatos at the start of the relocation program. Property owners and possessors are being offered a comprehensive benefits package including compensation for their property at a premium to independent third-party valuations and/or relocation benefits. In certain cases, relocation benefits include deferred monthly payments. Since the start of the relocation effort in 2007, the Company has capitalized approximately \$5,200,000 in property acquisition, relocation benefits, legal and related costs. The Company has also recognized a liability of \$931,000 representing the discounted value of expected future payments for relocation benefits to property owners and possessors that had signed contracts with the Company as at December 31, 2008. The discounted value of the liability was capitalized to mineral property, plant and equipment.

During the second quarter of 2008, the Company entered into a land purchase agreement with certain landowners. Pursuant to the land purchase agreement, the Company made a payment of \$1,250,000 in order to secure temporary occupation rights to specified land. An additional payment of approximately \$1,000,000 (based on current foreign exchange rates) is payable once the land has been vacated and is transferred to the Company. The probability and timing of this additional payment is currently unknown to the Company and has not been accrued in the consolidated balance sheet.

Additional future property acquisition, relocation benefits, legal and related costs may be material. The Company cannot currently determine the expected timing, outcome of negotiations or costs associated with the relocation of the remaining property owners and possessors and potential land acquisitions.

#### **c) Mining Equipment Dispute**

In 2005, the Company acquired certain used mobile mining equipment from a United States construction company. In 2006, a court judgment was issued in the United States allowing a finance company to repossess the equipment from the construction company which had failed to make required loan payments on the equipment. In April 2008, the Company was notified that the finance company would seek compensation in the amount of \$840,000 from the Company for the unpaid balance. No court judgment has been issued in Mexico or elsewhere against the Company. The Company is currently obtaining legal advice from counsel in the United States and Mexico, and cannot currently determine the outcome of this dispute.

## **20. SUBSEQUENT EVENTS**

Subsequent to year-end on February 17, 2009, the Company completed a financing whereby the Company issued a total of 10,410,000 common shares at a price of CDN\$8.00 for gross proceeds of CDN\$83,280,000. In conjunction with the financing, the underwriters received a cash commission of 5%. Net proceeds of the financing after underwriters commissions and legal costs amounted to CDN\$78,990,000 or approximately \$62,500,000.

## **21. RECLASSIFICATION**

Certain comparative figures have been reclassified to conform to the current period presentation.