

ALAMOS GOLD INC.

December 31, 2005 and 2004
(Stated in United States dollars)

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Auditors report

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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 is maintaining a system of internal controls to obtain reasonable assurance that the Company's assets are safeguarded, transactions are authorized, and financial information is reliable. 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 preparation and 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 annual 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 systems of internal control and security, 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 and thus are considered to be free from any relationship that could interfere with the 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.

March 3, 2006

//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 sheet of Alamos Gold Inc. [the “Company”] as at December 31, 2005 and the consolidated statement of earnings, retained earnings and cash flows for the year 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 audit.

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

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

//signed//Ernst & Young LLP

Chartered Accountants
Toronto, Canada
March 3, 2006

ALAMOS GOLD INC.
CONSOLIDATED BALANCE SHEETS
As at December 31
(Stated in United States dollars)

	Note Ref.	<u>2005</u>	<u>2004</u> (Restated – Note 2)
A S S E T S			
Current Assets			
Cash and cash equivalents		\$4,518,590	\$13,127,463
Restricted cash	12	1,219,458	-
Short-term investments	4	-	15,000,000
Fair value of forward contracts	20	966,400	-
Amounts receivable	5	3,861,990	112,117
Advances and prepaid expenses	6	1,934,704	1,733,284
Inventory	7	9,989,355	-
		<u>22,490,497</u>	<u>29,972,864</u>
Deferred financing charges	8	1,183,356	-
Mineral property, plant and equipment	9	101,514,078	43,900,941
Mineral property held for sale	10	1,012,538	1,010,638
		<u>\$126,200,469</u>	<u>\$74,884,443</u>
LIABILITIES			
Current Liabilities			
Accounts payable and accrued liabilities		\$5,323,015	\$ 943,319
Bank loan	12	3,000,000	-
Current portion of capital lease obligations	11	1,190,448	-
		<u>9,513,463</u>	<u>943,319</u>
Capital lease obligations	11	3,615,856	-
Convertible debenture	12	33,325,939	-
Asset retirement obligations	13	2,100,000	50,000
SHAREHOLDERS' EQUITY			
Share capital	14	87,829,646	86,170,028
Warrants	14	265,000	-
Convertible debenture	12	9,983,025	-
Contributed surplus	15	3,170,036	1,877,036
Deficit		<u>(23,602,496)</u>	<u>(14,155,940)</u>
		<u>77,645,211</u>	<u>73,891,124</u>
		<u>\$126,200,469</u>	<u>\$74,884,443</u>

See notes to consolidated financial statements

On behalf of the Board

//signed// John A. McCluskey

//signed// Brian Penny

ALAMOS GOLD INC.
Consolidated Statements of Operations and Deficit
For the years ended December 31
(Stated in United States dollars)

	2005	2004 (Restated – Note 2)
OPERATING REVENUES		
Gold sales	\$2,726,391	\$ -
OPERATING EXPENSES		
Mining and processing	2,269,927	-
Amortization	677,627	90,268
Exploration	1,889,060	994,591
Corporate and administrative	2,791,411	2,415,256
Stock-based compensation	1,142,000	943,965
Accretion of asset retirement obligations	16,000	-
Other loss	93,600	-
	<u>8,879,625</u>	<u>4,444,080</u>
LOSS FROM OPERATIONS	(6,153,234)	(4,444,080)
FINANCIAL REVENUES AND EXPENSES		
Interest income	856,044	234,219
Interest expense on long-term debt (net of capitalized interest of \$253,750, 2004 - \$nil)	(1,823,609)	(288,149)
Financing charges	(342,082)	(390,473)
Accretion of convertible debenture discount (net of capitalized accretion of \$178,980, 2004 - \$nil)	(1,272,125)	-
Foreign exchange (loss) gain	(711,550)	121,668
Loss for the year	(9,446,556)	(4,766,815)
Deficit, beginning of year	(14,155,940)	(9,389,125)
Deficit, end of year	<u>\$(23,602,496)</u>	<u>\$(14,155,940)</u>
Loss per share (note 18)	<u>\$ (0.12)</u>	<u>\$ (0.08)</u>

See notes to consolidated financial statements

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2005

(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. In addition, the Company holds the mineral rights to the Salamandra group of concessions in the state of Sonora, Mexico which includes more than nine known satellite gold occurrences.

2. CHANGE IN ACCOUNTING POLICY

In 2005 the Company changed its accounting policy with respect to mineral property, plant and equipment. Prior to 2005, the Company was in the development stage and applied an accounting policy whereby costs associated with unproven or undeveloped mineral properties that did not have commercially proven economic mineral reserves were deferred until such time as the related property was placed into production, sold or abandoned.

The Company is adopting a new accounting policy for mineral property, plant and equipment under which exploration costs that do not have the characteristics of mine development costs are expensed as incurred and mine development costs are capitalized as incurred.

This accounting change has been applied retroactively with restatement of prior periods. The Company has determined that the costs incurred with respect to the Escondida, Mulatos and El Salto properties qualify as mine development costs and are now classified as such within mineral property, plant and equipment. Accordingly, the exploration costs in 2005 related to the Escondida property of \$1,403,177, the El Salto property of \$198,176 and the Mulatos property of \$1,172,608 have been capitalized. All other exploration costs incurred in 2005 of \$1,889,060 have been expensed. The financial statements for the 2004 year were restated to effect this change with the recognition of \$994,591 of exploration costs and a corresponding reduction to mineral property, plant and equipment. There was no cumulative effect of this accounting change on the deficit as at January 1, 2004.

3. SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation

These consolidated financial statements have been prepared by management in accordance with generally accepted accounting principles ("GAAP") in Canada and presented in United States dollars. 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. Canadian GAAP may differ materially from GAAP in the United States. A reconciliation of significant differences between Canadian and United States GAAP is presented in note 21.

Principles of consolidation

The consolidated financial statements include the financial statements of the Company and its subsidiaries. All significant intercompany 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, accrued liabilities, future 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. Costs incurred or premium income received on forward sales or option contracts are recognized in revenue when the contracts expire or production is delivered. Changes in the fair value of the related asset or liability are recognized in earnings.

Inventory

Inventory which includes gold-in-process, dore, 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 a dore bar.

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. If it is determined that the capitalized costs related to a property are not recoverable over its productive life, those costs will be written down to fair value as a charge to operations in the period such determination is made.

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 for current 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 are 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.

Mineral property held for sale

Mineral property held for sale is recognized at the lower of its carrying amount or fair value less cost to sell.

Foreign currency translation

The United States dollar is the functional currency of the Company and its subsidiaries. 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 net income.

Cash and cash equivalents

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

Short-term investments

Short-term investments include notes with an original maturity of one year or less. Short-term investments are recorded at cost which approximates fair value. The Company invests with financial institutions with high credit quality.

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 enters from time to time into foreign exchange forward contracts to manage the Company's exposure to fluctuations in the Canadian and United States dollar foreign exchange rates. The Company also enters into spot deferred gold sales (forward 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. Such an allowance applies fully to all potential net income tax assets of the Company.

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 environmental regulations are continually changing and generally becoming more restrictive. The Company has made, and intends to make in the future, expenditures to comply with such laws and regulations. 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 units-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. Fair value estimations are, however, subject to change based on negotiations with regulatory authorities, and changes in laws and regulations. Refer to note 13.

Loss per share

Loss per share is calculated based on the weighted average number of common shares outstanding during the year. The diluted loss 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, warrants and convertible debentures 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. Diluted loss per share has not been disclosed since the exercise of options and warrants and conversion of the convertible debenture would be anti-dilutive.

Reclassification

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

4. SHORT-TERM INVESTMENTS

At December 31, 2004, the Company's short-term investments consisted of a \$15,000,000, 28-day term note which matured January 12, 2005, with an annualized yield of 2.278%, guaranteed by a Canadian chartered bank.

5. AMOUNTS RECEIVABLE

	2005	2004
	\$	\$
Accounts receivable	405,520	112,117
Mexican value added tax recoverable	3,456,470	-
	<u>3,861,990</u>	<u>112,117</u>

6. ADVANCES AND PREPAID EXPENSES

	2005	2004
	\$	\$
Advances to contractors	1,639,708	1,666,895
Prepaid expenses	294,996	66,389
	<u>1,934,704</u>	<u>1,733,284</u>

7. INVENTORY

	2005	2004
	\$	\$
Precious metals dore	793,494	-
In-process precious metals	7,817,926	-
Parts and supplies	1,377,935	-
	<u>9,989,355</u>	<u>-</u>

8. DEFERRED FINANCING CHARGES

Costs incurred and allocated to the debt portion of the convertible debenture financing (note 12) are amortized over the five-year term of the debt. Costs incurred to establish the Company's bank loan facility (note 12) are amortized over the one-year term.

	2005	2004
	\$	\$
Convertible debenture	1,221,871	-
Bank loan	316,602	-
Less: accumulated amortization	(355,117)	-
	<u>1,183,356</u>	<u>-</u>

9. 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 21,300 hectares, in consideration for the payment of CDN\$11,154,011 in acquisition costs and assigned expenses. Production from the acquired properties is subject to a sliding scale net smelter royalty on the first 2,000,000 ounces of gold production from certain concessions. The royalty commences at 1% when the price of gold is less than \$300 per ounce, rising to 5% when the price of gold exceeds \$400 per ounce.

Included within the Salamandra group of concessions is the Mulatos mine. In June 2004, the Company completed a feasibility study on a portion of the Mulatos property known as the Estrella Pit Development. The Mulatos mine began operations in 2005.

	December 31, 2005			December 31, 2004		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
	\$	\$	\$	\$	\$	\$
Mineral property and mine development	42,589,727	507,160	42,082,567	33,458,361	-	33,458,361
Mining plant and equipment	55,091,745	1,533,276	53,558,469	10,599,879	247,839	10,352,040
Assets under capital lease (note 11)	5,731,480	41,026	5,690,454	-	-	-
Office and computer equipment	243,093	60,505	182,588	114,262	23,722	90,540
	<u>103,656,045</u>	<u>2,141,967</u>	<u>101,514,078</u>	<u>44,172,502</u>	<u>271,561</u>	<u>43,900,941</u>

10. MINERAL PROPERTY HELD FOR SALE

The Company owns a 100% interest in the La Fortuna property ("La Fortuna"). La Fortuna is comprised of two mineral concessions, covering approximately 606 hectares, in Durango, Mexico. In 2000, La Fortuna was written-down to its estimated recoverable amount of \$1 million.

Effective November 1, 2005 the Company entered into a letter agreement with Morgain Minerals Inc. ("Morgain") to sell its La Fortuna property for consideration of five million common shares of Morgain. Closing of the transaction is subject to completion of due diligence and the signing of a definitive agreement expected in the first quarter of 2006. As at March 3, 2006, the fair value of the share consideration to be received is approximately \$2,000,000, based on the quoted price.

11. CAPITAL LEASE OBLIGATIONS

During 2005, the Company entered into five leases with a financing company for mining equipment. The maximum term of each lease is five years, with payments totaling \$99,204 per month over the term of the leases. The obligations under capital lease bear interest at LIBOR plus 4.1%. Minimum payments are \$1,190,448 per annum for 2006 through 2010. The amount of interest expense related to the obligations under capital lease included in the determination of the loss for the year ended December 31, 2005 is \$16,523 (2004 - nil). The Company has the right to re-pay the outstanding balance of the leases at any time.

12. DEBT

Convertible Debenture

Effective February 2, 2005, the Company issued a CDN\$50 million aggregate principal amount of 5.5% convertible unsecured subordinated debenture maturing on February 15, 2010. A 3.5% underwriters' fee was paid. The debenture bears interest at an annual rate of 5.5%, payable semi-annually in arrears on February 15 and August 15 of each year. The debenture is convertible into common shares at a rate of 188.6792 common shares for each CDN\$1,000 principal amount of debenture. In certain circumstances, the debenture may be redeemed in whole or in part at the option of the Company after February 15, 2008.

The debenture is classified as a liability, with the exception of the portion relating to the conversion features, which is classified as an equity component, resulting in the carrying value of the debenture being less than its face value. The discount is being accreted over the term of the debenture, utilizing the effective interest rate method and the 12.6% interest rate implicit in the debenture.

At December 31, 2005, in accordance with the terms of the trust indenture, a trust account held CDN\$1,375,000 plus accumulated interest (total \$1,219,458) for payment of interest to debenture holders from August 16, 2005 to February 15, 2006. Subsequent to December 31, 2005, the Company made an additional payment to fund the trust account for interest payable for the period from February 16, 2006 to February 15, 2007 in the amount of CDN\$2,750,000.

Bank loan

On July 21, 2005, the Company obtained a bank line of credit consisting of a \$10 million unsecured one year extendible revolving facility and a non-margin hedging line. Interest is payable at a rate of 2.75% above applicable LIBOR on the drawn portion of the facility, and 0.75% on the un-drawn portion. The initial term is for one year, and may be extended at the discretion of the lender for two additional one-year terms. As at December 31, 2005, the Company was advanced \$3 million related to this facility. On January 12, 2006 the Company was advanced an additional \$3 million. On February 7, 2006, the bank agreed to increase the amount available to the Company under the line of credit to \$16 million over the life of the facility.

13. 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.

Continuity of asset retirement obligations for the twelve-month period ended December 31, 2005:

	<u>2005</u>
	\$
Obligations at January 1, 2005	50,000
Liabilities incurred	2,034,000
Accretion of discounted cash flows	<u>16,000</u>
Obligations at December 31, 2005	<u>\$2,100,000</u>

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

Estimated cost	\$4,264,255
End of mine life	2015
Discount rate	7.25%

14. SHARE CAPITAL

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

	<u>Number of Shares</u>	<u>Amount \$</u>
Outstanding at January 1, 2004	50,164,705	34,369,682
Placement of shares (less issue costs of \$1,454,167)	10,000,000	21,120,895
Placement of shares (less issue costs of \$1,404,585)	10,000,000	23,047,275
Exercise of stock options	752,398	554,176
Exercise of warrants	<u>5,860,815</u>	<u>7,078,000</u>
Outstanding at January 1, 2005	76,777,918	86,170,028
Exercise of stock options	192,500	237,315
Exercise of warrants	<u>495,700</u>	<u>1,422,303</u>
Outstanding at December 31, 2005	<u>77,466,118</u>	<u>87,829,646</u>

b) Stock options outstanding at December 31, 2005

Number	Expiry Date	Exercise Price CDN \$
210,000	December 23, 2010	6.35
980,000	June 2, 2010	3.73
375,000	December 16, 2009	3.50
850,000	June 25, 2009	2.25
90,000	February 12, 2009	2.75
410,000	December 23, 2008	6.35
883,500	December 9, 2008	2.50
557,483	July 23, 2008	1.13
320,000	June 2, 2008	3.73
50,000	January 30, 2008	0.76
150,000	July 22, 2007	1.00
330,000	June 25, 2007	2.25
150,000	June 3, 2007	1.16
5,355,983	Weighted average exercise price	3.03

Summary of stock option activity:

	Stock options	Weighted Average Exercise Price CDN \$
Outstanding at January 1, 2004	2,650,881	1.50
Granted	1,725,000	2.55
Exercised	(752,398)	0.96
Expired	(20,000)	2.50
Outstanding at January 1, 2005	3,603,483	2.11
Granted	1,945,000	4.57
Exercised	(192,500)	1.48
Balance at December 31, 2005	5,355,983	3.03

Subsequent to December 31, 2005, 663,000 stock options were exercised at a weighted average exercise price of CDN\$2.96.

c) Warrants outstanding at December 31, 2005 :

Number	Expiry Date	Exercise Price CDN \$
350,000	July 21, 2007	5.80
4,404,300	April 8, 2006	3.50
4,754,300		3.67

Summary of warrant activity:

	Shares	Weighted Average Exercise Price
		CDN \$
Balance at January 1, 2004	5,775,699	1.50
Issued	5,000,000	3.50
Exercised	(5,875,699)	1.57
Balance at January 1, 2005	4,900,000	3.50
Issued	350,000	5.80
Exercised	(495,700)	3.50
Balance at December 31, 2005	<u>4,754,300</u>	<u>3.67</u>

Subsequent to December 31, 2005, 2,134,300 warrants were exercised at a weighted average exercise price of CDN\$3.50.

In conjunction with the closing of a line of credit on July 21, 2005, the Company issued 350,000 two-year warrants to the lender at an exercise price of CDN\$5.80 per share. The warrants were valued using the Black Scholes option pricing model, a stock price on the date of issue of CDN\$4.45, an exercise price of CDN\$5.80, an expected life of 2 years, a risk-free interest rate of 3.75%, an expected volatility of 50% and an expected dividend yield of 0%. The value of the warrants was capitalized to deferred financing charges and is amortized over the initial one-year term of the credit facility.

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 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.

During the twelve-month period ended December 31, 2005 the Company granted incentive stock options to its directors, officers and employees to purchase up to a total of 1,945,000 common shares in the capital of the Company at a weighted average exercise price of CDN\$4.57 per share. The options granted to directors and officers are exercisable for a five-year period, and options granted to employees are exercisable for a three-year period. Vesting terms for each option grant are authorized at the discretion of the Board. Of the 1,945,000 stock options granted during 2005, 1,325,000 vested immediately on grant, 160,000 vest over a nine-month period and 460,000 vest over a two-year period.

The Company has determined the fair value of stock-based compensation and allocated it as follows, depending on the nature of the grant:

December 31	2005	2004
	\$	\$
Mineral property, plant and equipment	151,000	225,388
Stock-based compensation expense	<u>1,142,000</u>	<u>943,965</u>
Total	<u>1,293,000</u>	<u>1,169,353</u>

No cash is transferred upon the granting of stock options. The Company credits its contributed surplus account for the value of the grant.

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

December 31	2005	2004
Risk-free rate	3.75%	3.5%
Expected dividend yield	nil	nil
Expected stock price volatility	50%	55%
Expected option life, based on term of the grant (months)	24	18 – 30

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.

16. RELATED PARTY TRANSACTIONS

A director of the Company was paid \$69,440 during the year ended December 31, 2005 for management and administrative services pursuant to a monthly services contract. In 2004, \$475,723 was paid (including a bonus of \$249,000) to two directors and officers of the Company through consulting or employment arrangements for management, investor relations and administrative services. These transactions have occurred in the normal course of operations and are measured at their fair value as determined by management.

17. 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.

December 31	2005	2004
	\$	\$
Assets, by geographic segment (at amortized cost)		
Mexico	119,952,652	47,781,884
Canada	6,247,817	27,102,559
	126,200,469	74,884,443

Year ended December 31	2005		
	Mexico	Canada	Total
	\$	\$	\$
Revenues	2,726,391	-	2,726,391
Loss	2,135,478	7,311,078	9,446,556

Year ended December 31	2004		
	Mexico	Canada	Total
	\$	\$	\$
Revenues	-	-	-
Loss	1,495,849	3,270,966	4,766,815

18. LOSS PER SHARE

Loss per share has been calculated using the weighted-average number of shares outstanding during the year of 77,179,619 (2004 – 62,202,713). Diluted loss per share has not been disclosed as it is anti-dilutive.

19. INCOME TAXES

The reconciliation of the expected tax recovery at statutory rate and provision for income tax recovery is:

December 31	2005	2004 (restated)
	\$	\$
Loss before income taxes	9,446,556	4,766,815
Expected tax recovery at statutory income tax rate	3,400,000	1,650,000
Increase (decrease) resulting from:		
Difference in foreign tax rates	200,000	(30,000)
Financing charges	-	150,000
Non-deductible accretion expense	(500,000)	-
Non-deductible stock based compensation expense	(400,000)	(340,000)
Foreign exchange net taxable gains	(1,600,000)	-
Inflation net taxable gains	(700,000)	-
Other	(100,000)	60,000
Valuation allowance	(300,000)	(1,490,000)
Income tax recovery	-	-

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

December 31, 2005	Canada	Mexico	Total
	\$	\$	\$
Future tax assets			
Non-capital losses	5,148,000	10,904,000	16,052,000
Financing charges	1,332,000	-	1,332,000
Valuation allowance	(4,468,000)	(119,000)	(4,587,000)
	2,012,000	10,785,000	12,797,000

Future tax liabilities			
Inventory	-	(2,432,000)	(2,432,000)
Mineral property, plant and equipment	(2,012,000)	(8,353,000)	(10,365,000)
	<u>(2,012,000)</u>	<u>(10,785,000)</u>	<u>(12,797,000)</u>
Net future tax liabilities			

December 31, 2004 (restated)	Canada	Mexico	Total
	\$	\$	\$
Future tax assets			
Non-capital losses	3,450,000	2,940,000	6,390,000
Financing charges	1,080,000	-	1,080,000
Valuation allowance	(4,070,000)	(1,670,000)	(5,740,000)
	<u>460,000</u>	<u>1,270,000</u>	<u>1,730,000</u>
Future tax liabilities			
Mineral property, plant and equipment	(460,000)	(1,270,000)	(1,730,000)
	<u>-</u>	<u>-</u>	<u>-</u>
Net future tax liabilities			

Non-capital losses available in Canada to be utilized in subsequent years are \$14 million expiring between 2006 and 2015. Losses in Mexico amount to approximately \$38 million and expire over a 10-year period.

20. COMMITMENTS AND CONTINGENCIES

During 2005, the Company entered into capital leases as fully described in note 11. As at December 31, 2005, the future minimum lease payments under capital lease were:

Year	Capital lease payments
	\$
2006	1,190,448
2007	1,190,448
2008	1,190,448
2009	1,190,448
2010	1,190,448
	<u>5,952,240</u>
Less: Imputed interest	<u>(1,145,936)</u>
	<u>4,806,304</u>

At December 31, 2005 the Company had contracts to acquire \$16 million Canadian dollars in May 2007, and \$10 million Canadian dollars in the first quarter of 2006. The marked to market value of these foreign exchange forward contracts was a gain of \$1,060,000 at December 31, 2005.

The Company had outstanding gold forward contracts to sell 2,000 ounces of gold in January 2006. These contracts were not designated as hedges at inception. The marked to market value of these contracts was a loss of \$93,600 at December 31, 2005.

Production royalties, on a sliding scale to the price of gold, at 5% of gold revenue with gold above \$400 per ounce, are a contractual obligation once commercial production (as defined in the agreement) is attained, but cannot reasonably be estimated as they are a function of the price of gold and production rate, neither of which can be ascertained with any certainty.

21. DIFFERENCES BETWEEN CANADIAN AND UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP)

These consolidated financial statements have been prepared in accordance with Canadian GAAP. Material variations in the accounting principles, practices and methods used in preparing these consolidated financial statements from principles, practices and methods accepted by United States GAAP ("U.S. GAAP") are described and quantified below.

Mineral property, plant and equipment

U.S. GAAP requires that exploration and development costs on mineral properties prior to the completion of a definitive feasibility study, which establishes proven and probable reserves, be expensed as incurred. Under Canadian GAAP, these costs may be deferred when certain criteria are met. In 2005, the Company changed its accounting policy under Canadian GAAP such that exploration expenditures on properties not advanced enough to identify their development potential are charged to operations as incurred. The Company completed its feasibility study on the Mulatos project in June 2004. All exploration and development expenditures related to the Mulatos project incurred prior to June 2004 of \$22,879,785 have been expensed for U.S. GAAP purposes. Since the mineral property, plant and equipment subject to units of production amortization under U.S. GAAP is lower than under Canadian GAAP, the application of U.S. GAAP results in lower amortization expense and lower amortization capitalized to inventory.

Convertible debentures

Under Canadian GAAP, the liability and equity components of the convertible debenture are determined and separately classified on the consolidated balance sheet. The liability component represents the present value of the interest and principal payments on the debenture and the equity component represents the fair value of the holder's conversion feature. The stated interest payments and accretion expense from adjusting the time value of the principal of the debenture over time are presented separately in the consolidated statements of operations. Deferred financing charges are separately classified between liability and equity on the same basis.

Under U.S. GAAP, convertible debt instruments are classified as debt until such time as they are converted to equity. Accordingly, for U.S. GAAP purposes, the convertible debenture is presented on the consolidated balance sheet as a liability. No accretion expense is recognized and no deferred financing charges are allocated to equity.

The following items (a) to (e) are inclusive of the impact on line items in these consolidated financial statements that would result substantially from the application of U.S. GAAP to the convertible debenture, mineral property, plant and equipment and deferred financing charges.

December 31	2005	2004 (restated)
	\$	\$
a) Consolidated Balance sheet		
Assets		
<u>Deferred financing charges</u>		
Deferred financing charges under Canadian GAAP	1,183,356	-
Add: Unamortized portion of deferred financing charges capitalized under U.S. GAAP	338,933	-
Deferred financing charges under U.S. GAAP	1,522,289	-
<u>Mineral property, plant and equipment</u>		
Mineral property, plant and equipment under Canadian GAAP (note 9)	101,514,078	43,900,941
Less: Mineral property, plant and equipment expensed under U.S. GAAP	(22,879,785)	(22,879,785)
Add: Accumulated amortization not recorded under U.S. GAAP	508,541	-
Less: Convertible debenture accretion capitalized under Canadian GAAP	(178,980)	-
Mineral property, plant and equipment under U.S. GAAP	78,963,854	21,021,156
<u>Mineral property held for sale</u>		
Mineral property held for sale under Canadian GAAP	1,012,538	1,010,638
Less: Mineral property held for sale expensed under U.S. GAAP	(1,012,538)	(1,010,638)
Mineral property held for sale under U.S. GAAP	-	-
Liabilities		
<u>Convertible debenture</u>		
Convertible debenture under Canadian GAAP	33,325,939	-
Add: Equity component of convertible debenture under Canadian GAAP	9,983,025	-
Add: Deferred financing charges related to equity component under Canadian GAAP	416,000	-
Add: Foreign exchange on convertible debenture under U.S. GAAP	2,578,701	-
Less: Accretion expense and capitalized accretion under Canadian GAAP	(1,451,105)	-
Less: Foreign exchange on convertible debenture under Canadian GAAP	(1,967,560)	-
Convertible debenture under U.S. GAAP	42,885,000	-

b) Operations

Loss under Canadian GAAP	(9,446,556)	(4,766,815)
Mineral property, plant and equipment expensed under U.S. GAAP	-	(5,428,555)
Mineral property held for sale expensed under U.S. GAAP	(1,900)	
Amortization expense lower under U.S. GAAP	148,245	-
Accretion expense on convertible debenture under Canadian GAAP	1,272,125	-
Additional deferred financing charges under U.S. GAAP	(77,067)	-
Additional foreign exchange loss on convertible debenture under U.S. GAAP	(611,141)	-
Loss under U.S. GAAP	(8,716,294)	(10,195,370)
Loss per share under U.S. GAAP	(0.11)	(0.16)

c) Deficit

Closing deficit under Canadian GAAP	(23,602,496)	(14,155,940)
Adjustment to deficit for mineral property, plant and equipment costs expensed under U.S. GAAP	(22,731,540)	(22,879,785)
Adjustment to deficit for mineral property held for sale expensed under U.S. GAAP	(1,012,538)	(1,010,638)
Adjustment to deficit for difference in accounting for convertible debenture under U.S. GAAP	583,917	-
Closing deficit under U.S. GAAP	(46,762,657)	(38,046,363)

d) Cash Flows - Operating Activities

Cash used for operations under Canadian GAAP	(12,675,226)	(3,251,092)
Mineral property, plant and equipment expensed under U.S. GAAP	-	(5,428,555)
Non-cash deferred expenditures expensed under U.S. GAAP	-	225,388
Cash used for operations under U.S. GAAP	(12,675,226)	(8,454,259)

e) Cash Flows - Investing Activities

Cash applied to investments under Canadian GAAP	(42,919,405)	(42,721,921)
Add: Mineral property, plant and equipment expensed under U.S. GAAP	-	5,203,168
Cash applied to investments under U.S. GAAP	(42,919,405)	(37,518,753)