

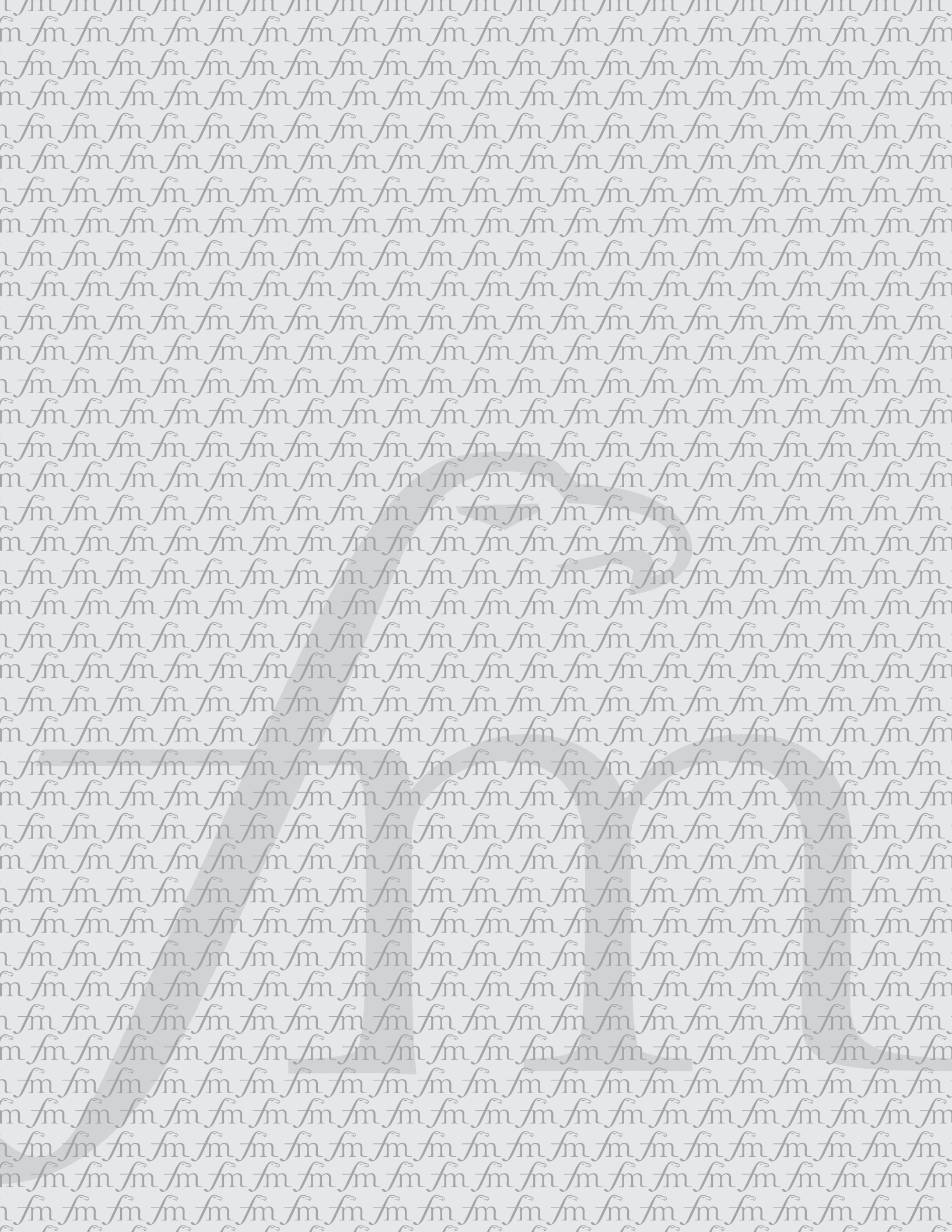
2 0 0 5   A N N U A L   R E P O R T



THERE IS NO  
SUBSTITUTE  
FOR SILVER



FIRST MAJESTIC  
R E S O U R C E   C O R P .



Moving forward to become a mid-tier silver producer.



## HIGHLIGHTS

Silver production initiated at flagship La Parrilla Silver Mine

Acquisition of the La Candelaria Silver Mine

Significant discovery of third ore shoot at the La Parrilla Silver Mine

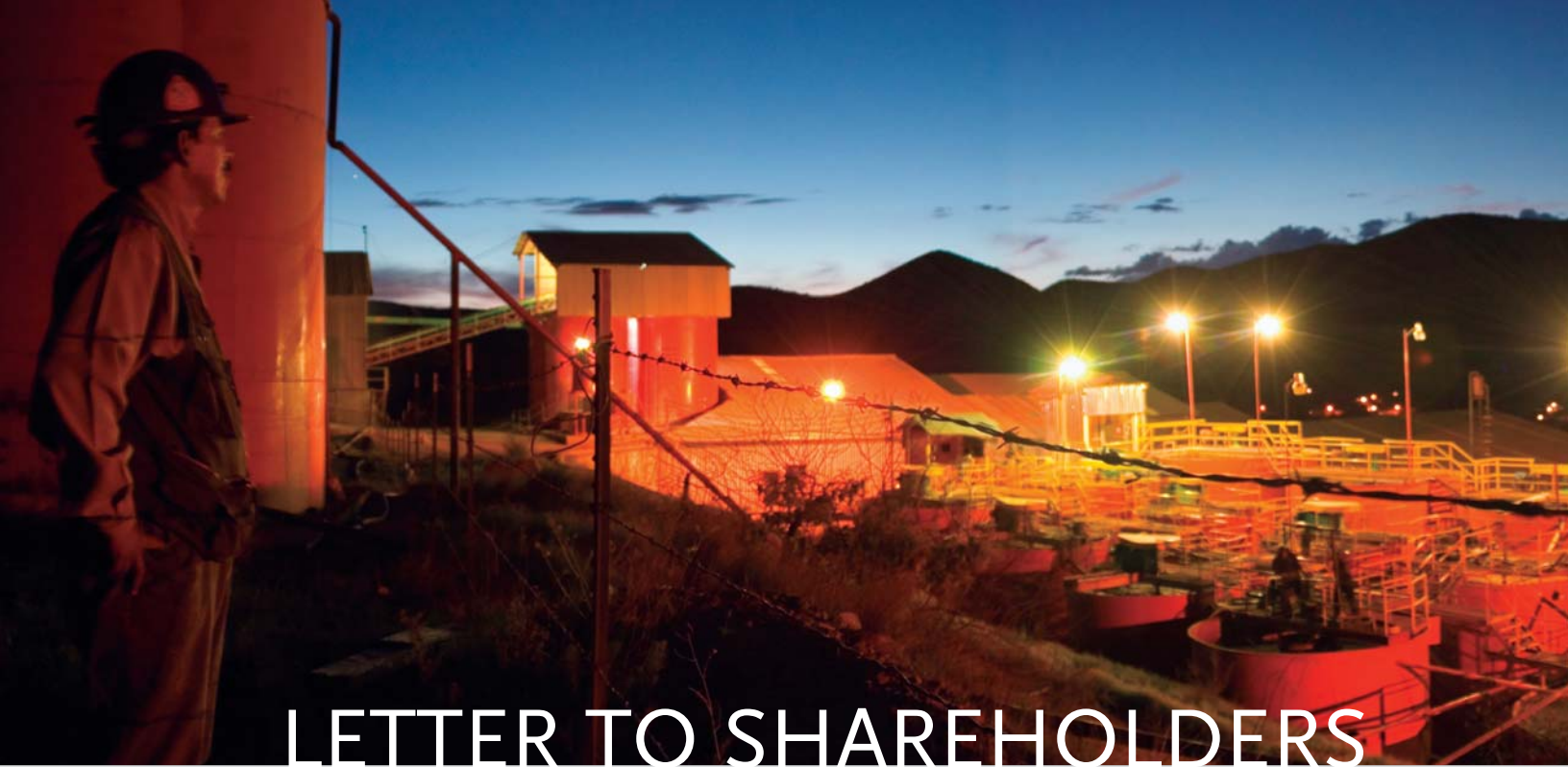
Four large geophysical anomalies discovered at Chalchihuites Group of Properties

Developing five advanced stage silver projects in Mexico

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# LETTER TO SHAREHOLDERS

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This past year has been very exciting and rewarding for both Management and our shareholders as we have grown from an exploration company to a producer of silver.

As a key component of this transformation, a team of mining professionals lead by the Company's Chief Operating Officer, Ramon Davila, was successfully assembled, positioning the Company for sustained growth and development well into the future. Moreover, our corporate strategy of growing through aggressive development and acquisition was again realized by the successful addition, to our already established asset base, of three more advanced silver projects that could individually be company builders in themselves.

The La Parrilla Silver Mine, our core asset and our producing silver mine, was acquired as a stepping-stone into the Mexican mining scene. Since this acquisition, the mine has proven to be much larger than originally anticipated. We have spent this year improving the operations through a variety of mechanical improvements and modernizations. Production since October has been relatively stable, though the recoveries have been low due to mining

of the oxide cap. This was expected and viewed as a cost of doing business, as we were training our mining staff and improving the overall operations in anticipation of reaching the lower levels of the mine where the sulphides would bring higher recoveries and thus greater return.

After the year end the lower levels of the mine were reached and recoveries improved dramatically as expected. With the improvements made during the year at the mill, combined with the mining of better ores, we can now expect incremental increases in production levels over the following year.

As investors in mining companies, we are all experiencing a very exciting and promising time. The continued bull market in the resource sector is anticipated to continue for several years. The lack of investment in mineral resources in the past twenty years combined with increasing demand is having a positive impact on metals prices and thus will continue to have a positive impact on investors.



Management will continue to aggressively develop the Company's assets and pursue other advanced silver project opportunities for potential acquisition.

The primary goal and objective of Management is to advance First Majestic to reach its objective of becoming a mid-tier silver producer focusing its efforts in Mexico.

Management remains extremely optimistic and is very excited about the future of the Company and the present market conditions in the resource sector. The time is right for shareholders to begin to prosper again and Management will do everything it can to bring continued value to the Company's shares.



**Keith Neumeyer**  
President & CEO, Director

**Ramon Davila**  
Chief Operating Officer, Director

# LA PARRILLA SILVER MINE

DURANGO, MEXICO



6 First Majestic is expanding production at its La Parrilla Silver Mine and further developing resources with its drill program.

The La Parrilla Silver Mine, located between the cities of Zacatecas and Durango in west central Mexico began operations in October 2004. First Majestic acquired the mine in May 2004, and after a few months of preparations, operations began. Our primary focus was to bring the mine into production in order to begin to produce silver, while at the same time allowing our mining staff the time to define and develop additional ore to expand production at a rate that would yield at least 2 million ounces of silver per year.

Underground development in 2004 and 2005 combined with a drilling program that commenced in June 2005 are proving that the total potential at La Parrilla is much larger than originally anticipated.

The mine lies within the 800 kilometre northwest trending Mexican silver belt (Faja de Plata) which is defined by Mexico's greatest silver deposits. La Parrilla lies at the north end and contains mineralization styles of the San Martin/Sabinas Mines, the Colorada Mine and the Fresnillo Mine; these four mines are producing a combined production of more than 40 million ounces of silver per year.

First Majestic's goal for the year was to initiate operations at the mine and mill, while simultaneously

developing the oxide ore and gaining access to the lower sulphide ores in preparation for increasing production this year. In the mine, over 1183 metres of underground drifting was completed during the year and recoveries at the mill improved dramatically from around 50% to over 70% as fine tuning at the mill began to take hold. Now that the sulphide zones are reached, further improvements in recoveries are expected.

As a result of underground drifting, a significant new zone of mineralization was discovered to the east of the old mine. This area has been named Ore Shoot No. 3 and contains mineralization in an extension of approximately 250 meters with grades averaging 350 gpt of silver. Most of the Company's recent silver production has been mined from this new zone. The discovery, which is 50 meters east of Ore Shoots No. 1 and No. 2, is part of a recently identified regional mineralized structure which is 4 kilometres in length and will have a significant impact on the total mineral resource.

This ongoing development, which began in December 2004, and continues today, has been successfully supplying fresh ore to the mill for silver production and creating new improved accesses to the lower levels in the mine.

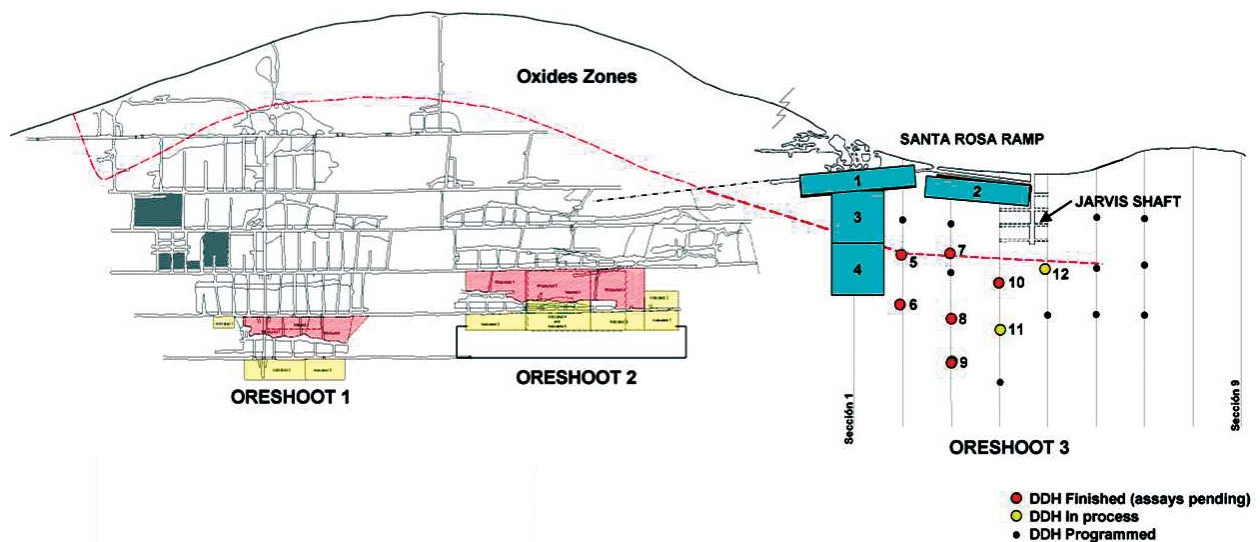


In September 2005, subsequent to year end, level 3 of Ore Shoot No. 2 was reached. This accomplishment was a major milestone as it joined the old mine to the new mine and this new ramp will act as the primary access to the lower levels of the mine as mining activity increases.

The focus for this coming fiscal year is two fold. Firstly, the long anticipated increase in production can now happen as a result of the work completed to date. Incremental increases in silver production are planned over the coming year with the first increases expected to occur this fall. Secondly, a 25,000 meter drill program commenced in June of this year and will continue for at least the next 12 months. The drill program is following

the 4 kilometre strike length of the structure and testing it to depth. The purpose of this program is to define a large mineable resource and to report, on an ongoing basis, a NI 43-101 resource/reserve calculation.

In addition to the improvements that have been seen at the mine this year, First Majestic maintains an excellent relationship within the communities in Mexico that it is active in. As an example, the Company created a Community Relations Department in the town of La Parrilla which has created ongoing programs for the youth and with local schools and the local Church. First Majestic takes pride in making a contribution to these communities.



# LA CANDELARIA SILVER MINE

## JALISCO, MEXICO



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Increasing silver production at the La Candelaria Silver Mine will be a top priority in the coming year.

In October 2005, subsequent to year end, First Majestic announced that it signed an agreement for the purchase of a 100% interest in a presently operating silver mine known as the La Candelaria Silver Mine. Included in this purchase was an operating flotation mill with a present capacity of 100 tpd and surrounding property consisting of over 1,384 hectares. This large land package is located in Hostotipaquillo, a very prolific and historic silver district in Mexico and includes other old mines such as, El Orito, and La Fortuna silver mines and others yet to be reviewed.

A four month due-diligence program has been entered into for the purpose of carrying out an exploration/confirmation program which will include: surface geology, mapping, and underground and surface sampling. The objective is to define the available ore resources and to make the appropriate additional development and exploration plans. A NI 43-101 report will be filed at the end of this program. The terms of this purchase can be seen on the Company's website and closing should take place in early 2006.

First Majestic will help to manage and continue to operate the mine during this initial four month period. The

Company is anxious to complete this transaction as it will immediately result in First Majestic owning and operating two producing silver mines in Mexico.

The Candelaria Silver Mine is located in the Hostotipaquillo silver mining district in the Jalisco State in Mexico. The property hosts a very large and prolific network of veins and brachiated ore bodies within the 1,384 hectares land package. Production will continue from the open pit area. Average ore grades being fed to the mill are 350 gpt of silver and 2 gpt of gold. Milling rates are presently at an approximate 50 tpd, forecasted to expand to 100 tpd within a few months with potential incremental increases in production.

Management has been reviewing several mines for the purpose of acquisition this year and is pleased that we were successful in signing this agreement. The Candelaria is accessible by paved road from Guadalajara making the economics even more attractive. The mine is showing great grades despite the old mining techniques presently being used and the large land package is anticipated to add substantial long term upside.



# DIOS PADRE SILVER MINE

## SONORA, MEXICO



Preliminary indications at Dios Padre support potential for development of a high-grade silver deposit.

In November 2004, the Company signed an agreement for the purchase of the Dios Padre Silver Mine located in the Eastern Sierra Madre Mountain range about midway between Hermosillo and Chihuahua in east central Sonora Mexico. The deposit is somewhat isolated and the surrounding area has little infrastructure. The purchase includes all properties, assets and equipment and all mining concessions consisting of 285 hectares. During the third quarter the rehabilitation of the access roads to the area and to the mine was completed in order to give access to a crew of geologists. This was part of the initial due diligence and resulted in the preparation of a NI 43-101 report which outlined a budget to further define this asset.

The Dios Padre Silver Mine has a long but poorly recorded history of mining. The available documentation is largely in the form of a variety of visiting consultants' reports and a limited drilling evaluation report.

Based on the available underground sampling data, high grade mineralization is apparent. This mineralization is largely in the form of argentiferous galena near surface and as freibergite (a silver bearing variety of tetrahedrite) some 50 meters to 60 meters below surface.

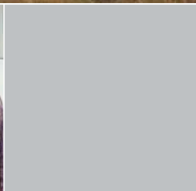
Various interpretations of the intensity of the mineralization and total tonnages have resulted in a wide variation in resource estimates in the Dios Padre Silver Mine. The most modern studies available have been unable to confirm any resource estimate at the mine because of caving and inaccessibility of the old workings. The lack of historic mine and surface geological studies and lack of documentation of mining plans and sections will require a complete upgrade of the old data using modern techniques never before used in this area.

The most recent study known, dated December 2002, estimated a resource in the accessible upper levels of the mine of 3,500,000 tonnes grading 465 gpt containing 57,211,000 ounces of silver. This estimate is not NI 43-101 compliant and requires the Company to complete a budgeted expense program to determine whether this resource estimate can be relied on.

Follow up work anticipated to commence within the next few months, will consist of; reopening the mine, surveying, mapping, and sampling. Upon completion, a drill program designed to test the most recent resource estimates and evaluate much older estimates will commence.

# CANDAMENA MINING DISTRICT

## CHIHUAHUA, MEXICO



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Large land package and high-grade results from limited and sporadic production holds much promise for future development.

In December 2004, the Company signed two agreements covering the purchase of the Candamena Mining District, located in the Eastern Sierra Madre Mountain range about midway between Hermosillo and Chihuahua in east central Sonora Mexico. The purchase includes all properties, assets and equipment and all mining concessions consisting of 5,215 hectares.

The Candamena Mining District hosts several highly mineralized areas within this large land package; the Nuevo Dolores, the La Blanca, the La Verde and the La Prieta.

The Nuevo Dolores deposit, also known as the Candamena Deposit, has a number of old shafts and diggings, which are believed to date back two centuries. Previous exploration programs executed in 1996-97, included mapping, rock chip sampling and 11,500 meters in 60 diamond drill holes, which tested only a small part of the property. The resource estimate at that time was an inferred resource of 6,100,000 tonnes grading 0.905 grams of gold per tonne. Also reported was a potential for resources in this deposit of 1,000,000 ounces of gold and 20,000,000 ounces of silver. These estimates are not NI 43-101 compliant and will require the Company to execute a substantial exploration program duplicating much of the earlier work before a new mineral resource estimate can be made.

In review of the old data, the mineralized structure remains open at depth and to the south and was known to extend off the past property boundaries of which the Company has now acquired rights to the entire district. Furthermore, it appears the resource may be amenable to open pit mining and it also appears that the minerals respond well to conventional milling and flotation.

In summary, the Nuevo Dolores deposit represents a non-compliant drilled resource still in an early stage of exploration and should be treated with high priority. Presently the Company is re-evaluating and digitizing all available data.

The La Blanca represents an area of immediate and high interest. This area has never been explored by modern methods but is clearly similar to the Nuevo Dolores deposit. It appears to be an important area for future development and extension of the main mineralized area.

The old La Verde mine has historic underground mined resources grading 466 gpt of silver, 0.13 gpt of gold, 4.33% lead and 3% zinc and the La Prieta mine is reported as containing similar grades. Further studies of La Verde and La Prieta are required to confirm these grades. It should be kept in mind that no modern exploration has ever been carried out on this structure.

The Candamena Mining District is clearly similar to a number of other economically important gold-silver mines in the district. The northern part of the Sierra Madre Occidental in Chihuahua and Sonora, host some of the largest volcanic-hosted, epithermal, precious metals mines in Mexico. They all occur at the same general geological horizon, and are all very similar, genetically, geologically, and mineralogically.

During the fourth quarter a NI 43-101 report was filed outlining a budget and exploration program which will be followed during the coming year.

# CHALCHIHUITES GROUP OF PROPERTIES

## CHALCHIHUITES, MEXICO



Phase III exploration will test the depth extensions of the Perseverancia Silver Mines chimneys and the extent of mineralization of the Las Cotorras and Verdiosa Mines and the San Jaun vein structures.

The Chalchihuites Group of Properties is comprised of 487 hectares of mining claims covering four old mines, namely the Perseverancia Silver Mine, San Juan Silver Mine, the Magistral Mine and La Esmeralda Mine, which all have a history of high grade silver and base metal production. Mineralization is present in veins, manto and chimney type ore bodies.

During this year a first phase exploration program was executed, consisting of a systematic collection of several rock samples from underground at the Perseverancia Silver Mine and from other drifts within the property boundaries. Based on encouraging results, the second phase program consisted of additional geological mapping, geochemistry and a geophysical program. The geochemistry and geophysical survey was conducted during the Second and Third Quarters and consisted of over 13 line kilometres on 7 lines spaced 150 meters apart with 50 meter sample intervals.

The geochemistry program identified four very well defined anomalies outlining and coinciding with the Perseverancia Silver Mine, the San Juan Silver Mine, La Esmeralda Mine and Las Cotorras Mine.

Coincidentally, Natural Source Audio-Frequency Magneto-Telluric (NSAMT) geophysical anomalies confirm the geochemical anomalies at the Perseverancia, San Juan and Esmeralda. In particular, the survey traces out the possible extension of two known chimneys at the Perseverancia mine, beyond the current 200 meters to a depth of at least 500 meters, which was the extent of this survey.

Additionally, the geophysics details a skarn/intrusive contact, hosting the Perseverancia, Las Cotorras and Verdiosa mines over a strike length in excess of 1 km. At the San Juan mine, geophysics imply both strike and depth extensions of the mapped and sampled vein structures.

The Company intends to commence a third stage exploration program this fall. The program will include 5,000 meters of diamond drilling which will initially focus on testing the depth extensions of the Perseverancia Silver Mine chimneys, targets along the 1 km strike length of the Las Cotorras and Verdiosa mines and the San Juan vein structures along strike and at depth.



## MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The consolidated financial statements of First Majestic Resource Corp. 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 judgment based on information currently available.

Management has developed and maintains a system of internal controls to ensure that the Company's assets are safeguarded, transactions are authorized and properly recorded and financial information is reliable.

The Board of Directors is responsible for ensuring management fulfills its responsibilities. The Audit Committee reviews the results of the audit and the annual consolidated financial statements prior to their submission to the Board of Directors for approval.

The consolidated financial statements have been audited by Deloitte & Touche LLP and their report outlines the scope of their examination and gives their opinion on the financial statements.

Keith Neumeyer  
President

October 7, 2005

# AUDITORS' REPORT



## DELOITTE & TOUCHE LLP

2800 - 1055 DUNSMUIR STREET, 4 BENTALL CENTRE, P.O. BOX 49279, VANCOUVER BC V7X 1P4 CANADA  
TEL: (604) 669-4466 | FAX: (604) 685-0395 | WWW.DELOITTE.CA

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To the Shareholders of  
First Majestic Resource Corp.

We have audited the consolidated balance sheet of First Majestic Resource Corp. as at June 30, 2005 and the consolidated statements of operations and deficit 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 June 30, 2005 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

The financial statements as at June 30, 2004 and for the year then ended were audited by another auditor who expressed an opinion without reservation on those statements in his report dated October 25, 2004.

Chartered Accountants  
Vancouver, British Columbia  
October 7, 2005



## CONSOLIDATED BALANCE SHEETS

AS AT JUNE 30

	<b>2005</b>	<b>2004</b>
	\$	\$ (Note 15)
<b>ASSETS</b>		
<b>CURRENT</b>		
Cash and cash equivalents	3,404,723	9,729,084
Accounts receivable and advances	705,818	614,087
Inventory (Note 3)	154,966	—
	<u>4,265,507</u>	<u>10,343,171</u>
<b>MINERAL PROPERTY INTERESTS</b> (Note 4)	5,982,970	4,213,261
<b>PROPERTY, PLANT AND EQUIPMENT</b> (Note 5)	<u>2,207,268</u>	<u>2,078,397</u>
	<u>12,455,745</u>	<u>16,634,829</u>
<b>LIABILITIES</b>		
<b>CURRENT</b>		
Accounts payable and accrued liabilities	356,192	3,140,363
<b>ASSET RETIREMENT OBLIGATION</b> (Note 14)	<u>1,125,842</u>	<u>1,119,994</u>
	<u>1,482,034</u>	<u>4,260,357</u>
<b>SHAREHOLDER'S EQUITY</b>		
<b>SHARE CAPITAL</b> (Note 6)	23,404,473	21,568,806
<b>SHARE OPTION EXERCISES RECEIVED</b> (Note 6)	84,000	—
<b>CONTRIBUTED SURPLUS</b> (Note 7)	1,333,137	933,037
<b>WARRANT EXERCISES RECEIVED</b>	—	12,500
<b>DEFICIT</b>	<u>(13,847,899)</u>	<u>(10,139,871)</u>
	<u>10,973,711</u>	<u>12,374,472</u>
	<u>12,455,745</u>	<u>16,634,829</u>
CONTINUING OPERATIONS (Note 1)		
CONTINGENT LIABILITIES (Note 13)		

APPROVED ON BEHALF OF THE BOARD

Director "Keith Neumeyer"

Director "Paul Matysek"

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

# CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT

FOR THE YEARS ENDED JUNE 30



	<b>2005</b>	2004
	\$	\$
		(Note 15)
<b>REVENUE</b>		
Mineral sales	914,000	-
Cost of Sales	1,240,527	-
<b>GROSS PROFIT (LOSS)</b>	<u>(326,527)</u>	<u>-</u>
<b>EXPENSES</b>		
Accounting and administrative services	69,657	23,205
Accretion of reclamation obligation	87,321	46,835
Audit	23,000	11,500
Corporate development	592,037	261,881
Depletion	161,571	-
Depreciation	137,328	1,155
Property investigation	9,130	-
Investor relations	64,250	25,575
Legal	124,970	97,278
Management fees	149,967	90,376
Office	74,182	22,493
Printing and stationery	77,898	37,522
Professional fees	230,257	34,141
Regulatory	15,352	18,335
Rent	113,423	9,040
Salaries and benefits	109,566	-
Shareholder costs	2,356	13,036
Stock-based compensation	476,600	932,400
Transfer agent fees	15,286	10,821
Travel	123,345	38,752
Website	3,561	3,412
	<u>2,661,057</u>	<u>1,677,757</u>
<b>LOSS BEFORE OTHER ITEMS</b>	<u>(2,987,584)</u>	<u>(1,677,757)</u>
<b>OTHER ITEMS</b>		
Interest income	129,296	32,297
Foreign exchange	169,862	28,594
Write-down of mineral property interests (Note 4(e), (f))	(1,019,602)	-
	<u>(720,444)</u>	<u>60,891</u>
<b>NET LOSS FOR THE YEAR</b>	<u>(3,708,028)</u>	<u>(1,616,866)</u>
<b>DEFICIT - BEGINNING OF YEAR</b>	<u>(10,139,871)</u>	<u>(8,523,005)</u>
<b>DEFICIT - END OF YEAR</b>	<u>(13,847,899)</u>	<u>(10,139,871)</u>
<b>BASIC AND DILUTED LOSS PER COMMON SHARE</b>	<u>(0.17)</u>	<u>(0.15)</u>
<b>WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING</b>	<u>22,261,433</u>	<u>10,832,314</u>



## CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED JUNE 30

	<b>2005</b>	<b>2004</b>
	\$	\$ (Note 15)
<b>CASH PROVIDED FROM (USED FOR) OPERATING ACTIVITIES</b>		
Net loss for the year	(3,708,028)	(1,616,866)
Adjustment for items not affecting cash		
Depletion	161,571	-
Depreciation	137,328	1,155
Stock-based compensation	476,600	932,400
Accretion of reclamation obligation	87,321	46,835
Write-down of mineral property interests	1,019,602	-
Foreign exchange	(81,473)	45,855
	<u>(1,907,079)</u>	<u>(590,621)</u>
Net change in non-cash working capital items		
Accounts receivable and advances	(7,731)	(587,975)
Inventory	(154,966)	-
Accounts payable and accrued liabilities	(2,784,171)	321,516
	<u>(4,853,947)</u>	<u>(857,080)</u>
<b>INVESTING ACTIVITIES</b>		
Additions to plant and equipment	(266,199)	(2,079,552)
Expenditures on mineral property interests	(2,950,882)	(378,157)
Proceeds from government grant on mineral property expenditures	-	28,133
	<u>(3,217,081)</u>	<u>(2,429,576)</u>
<b>FINANCING ACTIVITIES</b>		
Issuance of common shares	1,746,667	13,322,600
Share issue costs	-	(316,271)
	<u>1,746,667</u>	<u>13,006,329</u>
<b>(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS</b>	<u>(6,324,361)</u>	<u>9,719,673</u>
<b>CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR</b>	<u>9,729,084</u>	<u>9,411</u>
<b>CASH AND CASH EQUIVALENTS - END OF YEAR</b>	<u>3,404,723</u>	<u>9,729,084</u>
<b>CASH AND CASH EQUIVALENTS IS COMPRISED OF:</b>		
Cash	281,723	3,729,084
Term deposits	3,123,000	6,000,000
	<u>3,404,723</u>	<u>9,729,084</u>

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



# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2005



## 1. CONTINUING OPERATIONS

First Majestic Resource Corp. (the "Company") is in the business of acquisition, production, development and exploration of mineral properties in Mexico. During the year, the Company commenced commercial production at the La Parrilla Silver Mine ("La Parrilla").

These consolidated financial statements have been prepared on a going concern basis, which assumes the realization of assets and satisfaction of liabilities in the normal course of business. During the year ended June 30, 2005, the Company recorded a loss of \$3,708,028 (2004 - \$1,616,866) and current cash reserves at June 30, 2005 are insufficient to satisfy the required option and other payments necessary to retain the Company's interest in all of its mineral properties. On October 7, 2005, the Company announced a private placement equity financing for proceeds of \$5,691,292 as described in Note 16.

The Company believes it has adequate funds to meet its obligations as they come due for the year ended June 30, 2006. The Company's ability to continue as a going concern in the longer term is dependent on the Company's ability to raise equity or other financing as required and ultimately its ability to achieve profitable operations. These financial statements do not include any adjustments to the amount and classification of recorded assets and liabilities that might be necessary, should the Company be unable to continue as a going concern.

## 2. SIGNIFICANT ACCOUNTING POLICIES

### ***Basis of Presentation***

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, First Majestic Resources Mexico, S.A. de C.V. which was incorporated on February 9, 2004 to pursue its Mexican mineral development and exploration activities. Inter-company balances and transactions are eliminated on consolidation.

### ***Use of Estimates***

The preparation of consolidated financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reported period. Significant estimates used in the preparation of these consolidated financial statements include, among others, the expected economic lives and the future operating results and net cash flows expected to result from exploitation of resource properties and related assets, the amount of proven and probable mineral reserves and the amount of future site reclamation costs and asset retirement obligations. Actual results could differ from those estimates.



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2005

### **2. SIGNIFICANT ACCOUNTING POLICIES** (continued)

#### ***Cash and Cash Equivalents***

Cash and cash equivalents consist of cash and money market instruments with terms to maturity not exceeding 90 days at date of issue.

#### ***Inventories***

Ore in process is valued at the lower of production cost to produce saleable metal and net realizable value. Materials and supplies are valued at the lower of cost and replacement cost.

#### ***Mineral Property Interests***

Mineral property costs and exploration, development and field support costs directly relating to mineral properties are deferred until the property to which they directly relate is placed into production, sold, abandoned or subject to a condition of impairment. The deferred costs will be amortized over the useful life of the orebody following commencement of production or written off if the property is sold or abandoned. Administration costs and other exploration costs that do not relate to any specific property are expensed as incurred.

On a periodic basis, management reviews the carrying values of deferred mineral property acquisition and exploration expenditures with a view to assessing whether there has been any impairment in value. When the carrying value of a property exceeds its net recoverable amount that may be estimated by quantifiable evidence of an economic geological resource or reserve, or the Company's assessment of its ability to sell the property for an amount less than the deferred costs, provision is made for the impairment in value.

Although the Company has taken steps to verify title to mineral properties in which it has an interest, according to the usual industry standards for the stage of exploration of such properties, these procedures do not guarantee the Company's title. Such properties may be subject to prior agreements or transfers and title may be affected by undetected defects.

From time to time, the Company acquires or disposes of properties pursuant to the terms of options agreements. Options are exercisable entirely at the discretion of the optionee and accordingly, are recorded as mineral property costs or recoveries when the payments are made or received.

#### ***Asset Retirement Obligations and Reclamation costs***

Future costs to retire an asset including dismantling, remediation and ongoing treatment and monitoring of the site are recognized and recorded as a liability at fair value at the date the liability is incurred. The liability is

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2005



## 2. SIGNIFICANT ACCOUNTING POLICIES (continued)

accrued over time to the estimated amount ultimately payable through periodic charges to earnings. In addition, future site restoration costs are capitalized as part of the carrying value of the related mineral property at its initial discounted value and amortized over the mineral property's useful life based on a units-of-production method.

### ***Translation of Foreign Currencies***

The Company considers its subsidiaries to be operationally integrated with the parent company and, therefore, it uses the temporal method to translate the accounts of its subsidiaries. Under this method, monetary items are translated at the rate of exchange in effect at the balance sheet date. Non-monetary items are translated at average rates in effect during the period in which they were earned or incurred. Gains and losses resulting from the fluctuation of foreign exchange rates have been included in the determination of income.

### ***Income Taxes***

The Company uses the asset and liability method of accounting for income taxes. Under this method, income tax liabilities and assets are recognized for the estimated tax consequences attributable to differences between the amounts reported in the financial statements and their respective tax bases (temporary differences), using substantially enacted income tax rates. The effect of a change in income tax rates on future income tax liabilities and assets is recognized in income in the period that the change occurs. Future income tax assets are recognized to the extent that they are considered more likely than not to be realized.

### ***Property, Plant and Equipment***

Property, plant and equipment are recorded at cost less accumulated depreciation applied from the commencement of operations, calculated using the following methods and annual rates:

Automobile	20%	straight-line
Buildings	5%	straight-line
Mill machinery	10%	straight-line
Mine equipment	10%	straight-line
Computer equipment	20%	straight-line
Office equipment	20%	straight-line

### ***Revenue Recognition***

Estimated mineral revenue, based upon prevailing metal prices, is recorded in the financial statements when title to the ore transfers to the customer, which generally occurs on date of shipment. Revenue is recorded in



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2005

### **2. SIGNIFICANT ACCOUNTING POLICIES** (continued)

the statement of operations net of treatment and refining costs paid to counter parties under terms of the off take arrangements. Revenue from the sale of ore is subject to adjustment upon final settlement of estimated metal prices, weights and assays. Adjustments to revenue for metal prices are recorded monthly and any other adjustments are recorded on final settlement.

#### ***Impairment of Long-Lived Assets***

Long-lived assets are assessed for impairment when events and circumstances warrant. The carrying value of a long-lived asset is impaired when the carrying amount exceeds the estimated undiscounted net cash flow from use and fair value. In that event, the amount by which the carrying value of an impaired long-lived asset exceeds its fair value is charged to earnings.

#### ***Loss Per Share***

Basic earnings per share is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding during the period. The computation of diluted earnings per share assumes the conversion, exercise or contingent issuance of securities only when such conversion, exercise or issuance would have a dilutive effect on earnings per share. The dilutive effect of convertible securities is reflected in diluted earnings per share by application of the "if converted" method. The dilutive effect of outstanding options and warrants and their equivalents is reflected in diluted earnings per share by application of the treasury stock method. The effects of potential issuances of shares under options and warrants would be anti-dilutive, and therefore basic and diluted losses per share are the same.

#### ***Stock Based Compensation***

The Company uses the fair value method for recording compensation for all awards made to directors, employees and non-employees including stock appreciation rights, direct awards of stock and awards that call for settlement in cash or other assets. The compensation expense is determined as the fair value of the option at the date of grant calculated using an option pricing model.

#### ***Comparative Figures***

Certain of the comparative figures of prior years have been reclassified to conform with the presentation as at and for the year ended June 30, 2005.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2005



### 3. INVENTORIES

Inventories consist of the following:

	<b>2005</b>	2004
	\$	\$
Ore in process	71,941	-
Materials and supplies	83,025	-
	<u>154,966</u>	<u>-</u>

### 4. MINERAL PROPERTY INTERESTS

Expenditures incurred on mineral property interests are as follows:

	<b>2005</b>			2004		
	Acquisition Costs \$	Deferred Exploration Costs \$	Total Costs \$	Acquisition Costs \$	Deferred Exploration Costs \$	Total Costs \$
<b>MEXICO</b>						
La Parrilla	3,432,470	589,860	4,022,330	3,403,647	127,371	3,531,018
Chalchihuites	727,687	158,826	886,513	155,522	17,829	173,351
Dios Padre	524,421	51,752	576,173	-	-	-
Candamena	466,331	31,623	497,954	-	-	-
Niko	-	-	-	85,935	266,208	352,143
<b>ARGENTINA</b>						
Platino	-	-	-	76,000	80,749	156,749
	<u>5,150,909</u>	<u>832,061</u>	<u>5,982,970</u>	<u>3,721,104</u>	<u>492,157</u>	<u>4,213,261</u>

Details of expenditures by nature and property are summarized in Schedule A - "Consolidated Summary of Mineral Property Interests" to these financial statements.



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2005

### 4. MINERAL PROPERTY INTERESTS (continued)

#### a) La Parrilla Silver Mine, Durango, Mexico

On January 9, 2004, the Company entered into a purchase agreement, with parties who are at arms length to the Company, to acquire the La Parrilla Silver Mine, located approximately 65 kilometres south-east of the city of Durango, Mexico. The acquisition cost of US\$3,000,000 includes all mining properties, assets and equipment, including a processing mill, and mining concessions covering an area of 280 hectares. A finder's fee of US\$182,500 was paid to a director of the Company. Subsequent to acquisition, the Company completed its assessment of the environmental liabilities assumed in connection with the acquisition of the La Parrilla mine and as a result, recorded a provision for reclamation liabilities of \$1,027,304 as described in Note 14.

#### b) Chalchihuites Group of Properties, Zacatecas, Mexico

On June 8, 2004, the Company entered into an option agreement to purchase five mining concessions and one mining exploration concession located in Chalchihuites, Zacatecas, Mexico in consideration of cash payments in the aggregate of US \$4,000,000 payable over a three year period to June 8, 2007 and incurring a total of US \$500,000 of expenditures on the property over the same three year period, of which US \$150,000 is to be spent within six months of the date of the agreement.

In March, 2004, the Company entered into seven option agreements for the acquisition of additional mining concessions comprising approximately 195 hectares in the Chalchihuites area for a total purchase price of US\$1,500,000 payable over a three year period and incurring a combined US\$500,000 of expenditures on the properties over a three year period.

On July 7, 2004, the Company entered into an option agreement to acquire ten additional concessions comprising of 204 hectares adjoining the north-west boundary of the land package. The purchase consideration is US\$1,650,000 payable over a three year period.

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2005



## 4. MINERAL PROPERTY INTERESTS (continued)

### b) Chalchihuites Group of Properties, Zacatecas, Mexico (continued)

The above amounts are payable as follows:

US\$ 12,500	March 26, 2004 (paid)
100,000	June 8, 2004 (paid)
10,000	July 7, 2004 (paid)
15,000	September 26, 2004 (paid)
100,000	December 8, 2004 (paid)
20,000	January 7, 2005 (paid)
22,500	March 26, 2005 (paid)
300,000	June 8, 2005 (paid)
220,000	July 7, 2005 (paid subsequently)
250,000	September 26, 2005 (paid subsequently)
500,000	December 8, 2005
250,000	January 26, 2006
450,000	March 26, 2006
500,000	June 8, 2006
500,000	July 7, 2006
250,000	September 26, 2006
500,000	December 8, 2006
500,000	January 7, 2007
500,000	March 26, 2007
2,000,000	June 8, 2007
150,000	July 7, 2007
<u>US\$ 7,150,000</u>	

A finder's fee in the aggregate of US\$303,750 is payable to a director of the Company, in the event that all of the options are exercised. The finder's fee will be recorded in the event that the options are exercised.

### c) Dios Padre Silver Mine, Sonora, Mexico

On November 18, 2004, the Company entered into a purchase agreement, as amended on December 17, 2004 and June 13, 2005, with parties who are at arm's length to the Company to acquire the Dios Padre Silver Mine ("Dios Padre"), located in the eastern Sierra Madre Mountain Range and midway between Hermosillo and Chihuahua in east central Sonora Mexico. The acquisition includes all properties, assets and equipment and all mining concessions consisting of 285 hectares. The purchase price of US\$6,500,000 is payable over a period of four years.



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2005

### 4. MINERAL PROPERTY INTERESTS (continued)

#### c) Dios Padre Silver Mine, Sonora, Mexico (continued)

The above amounts are payable as follows:

US\$ 80,000	November 8, 2004 (paid)
220,000	November 18, 2004 (paid)
30,000	June 27, 2005 (paid)
120,000	July 4, 2005 (paid subsequently)
150,000	December 13, 2005
250,000	June 13, 2006
300,000	December 13, 2006
500,000	June 13, 2007
700,000	December 13, 2007
1,000,000	June 13, 2008
1,400,000	December 3, 2008
1,750,000	June 13, 2009
<u>US\$ 6,500,000</u>	

In addition, the Company is required to issue a total of 500,000 common shares upon completion of specific phases of the exploration program. The purchase of the Dios Padre is subject to completion of satisfactory due diligence, receipt of any necessary regulatory approvals and formal purchase documentation. Also, a 1% Net Smelter Royalty is payable for a period of seven years from the commencement of commercial production of the Dios Padre.

#### d) Candamena Mining District, Chihuahua, Mexico

In December 2004, the Company signed two letter agreements with Mr. Miguel Perez Chavez and Mr. Angel Chaparro Ortiz for the purchase of the Candamena Mining District ("Candamena"), located in the Eastern Sierra Madre Mountain range about midway between Hermosillo and Chihuahua in east central Sonora Mexico. The purchase includes all properties, assets and equipment and all mining concessions consisting of 5,215 hectares.

The Company agreed to pay Mr. Miguel Perez Chavez US\$7,000,000 over a four year period for the purchase of 4,602 hectares including the Nuevo Dolores, La Blanca and La Verde areas, all the assets and the flotation mill located on the property. In addition, a 1% Net Smelter Royalty is payable up to a maximum of US\$4,000,000.

The Company has agreed to pay Mr. Angel Chaparro Ortiz US\$600,000 over a four year period for the purchase of 613 hectares including the La Prieta mine.



# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2005



## 4. MINERAL PROPERTY INTERESTS (continued)

### d) Candamena Mining District, Chihuahua, Mexico (continued)

The above amounts are payable as follows:

US\$ 150,000	November 22, 2004 (paid)
50,000	February 22, 2005 (paid)
150,000	May 22, 2005 (paid)
175,000	November 22, 2005
250,000	May 22, 2006
250,000	November 22, 2006
350,000	May 22, 2007
1,275,000	November 22, 2007
1,575,000	May 22, 2008
3,375,000	November 22, 2008
<u>US\$ 7,600,000</u>	

The Candamena Mining District hosts several highly mineralized areas. The Nuevo Dolores is a volcanic-hosted epithermal gold-silver deposit; the La Blanca is a similar highly prospective area and has two old high-grade silver-lead-zinc mines called the La Verde and the La Prieta, which have an old flotation mill and other equipment.

### e) Niko Silver Project, Mexico

During the year, the Company terminated the agreement to acquire the Niko Silver Project. The Company wrote off the acquisition and related exploration costs of \$862,853.

### f) Platino Porphyry Project, Argentina

During the year, the Company terminated the agreement to acquire the Platino Porphyry Project. The Company wrote off the acquisition and related exploration costs of \$156,749.



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2005

### 5. PROPERTY, PLANT AND EQUIPMENT

	2005			2004		
	Costs	Accumulated Amortization	Net Book Value	Costs	Accumulated Amortization	Net Book Value
	\$	\$	\$	\$	\$	\$
Land	6,732	-	6,732	6,732	-	6,732
Automobile	17,630	3,702	13,928	-	-	-
Buildings	566,090	19,445	546,645	566,090	-	566,090
Mill Machinery	1,574,012	96,489	1,477,523	1,364,912	-	1,364,912
Mine equipment	137,673	9,511	128,162	129,318	-	129,318
Computer equipment	3,948	248	3,700	945	-	945
Office equipment	39,666	9,088	30,578	11,555	1,155	10,400
	<u>2,345,751</u>	<u>138,483</u>	<u>2,207,268</u>	<u>2,079,552</u>	<u>1,155</u>	<u>2,078,397</u>

### 6. SHARE CAPITAL

Authorized - unlimited common shares without par value

Issued -	2005		2004	
	Shares	\$	Shares	\$
Balance- beginning of year	21,381,235	21,568,806	5,781,735	8,435,477
Issued during the year				
For cash:				
Private placements	-	-	11,000,000	12,200,000
Exercise of options	220,000	239,500	135,000	47,250
Exercise of warrants	1,803,482	1,519,667	4,034,500	1,075,350
For mineral properties	-	-	300,000	127,000
For finder's fee	-	-	130,000	-
Transfer of contributed surplus for stock options exercised	-	76,500	-	-
Less share issue costs	2,023,482	1,835,667	15,599,500	13,449,600
	-	-	-	(316,271)
Balance - end of year	<u>2,023,482</u>	<u>1,835,667</u>	<u>15,599,500</u>	<u>13,133,329</u>
	<u>23,404,717</u>	<u>23,404,473</u>	<u>21,381,235</u>	<u>21,568,806</u>

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2005



## 6. SHARE CAPITAL (continued)

a) A summary of the changes of the Company's stock options for the year ended June 30, 2005 and 2004, is as follows:

	2005		2004	
	Number of Shares	Weighted Average Exercise Price \$	Number of Shares	Weighted Average Exercise Price \$
Outstanding - beginning of year	1,750,000	1.28	475,000	0.35
Granted	775,000	2.00	1,410,000	1.50
Exercised	(460,000)	0.70	(135,000)	0.35
Outstanding - end of year	2,065,000	1.68	1,750,000	1.28

Of the options exercised, 240,000 options were exercised prior to June 30, 2005 but the shares had not been issued and are recorded as share option exercises received. Included in accounts receivable and advances at June 30, 2005 is a total of \$84,000 for the proceeds from the exercise of these options, which will be deposited upon issuance of the shares.

The following table summarizes the stock options outstanding and exercisable at June 30, 2005:

Exercise Price \$	Options Outstanding	Expiry Date
0.76	190,000	November 24, 2005
2.25	100,000	April 1, 2006
1.80	110,000	June 21, 2006
0.60	180,000	October 23, 2006
2.05	175,000	December 3, 2006
1.42	250,000	February 10, 2007
2.25	150,000	April 1, 2007
2.39	50,000	April 18, 2007
1.80	360,000	June 21, 2007
1.85	200,000	December 14, 2007
1.79	200,000	January 12, 2008
2.41	100,000	March 22, 2008
	<u>2,065,000</u>	



# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2005

## 6. SHARE CAPITAL (continued)

b) As at June 30, 2005, the Company had outstanding warrants issued pursuant to private placements and agents warrants which may be exercised to purchase up to 4,062,018 shares.

A summary of changes to the Company's outstanding warrants for the year ended June 30, 2005 is as follows:

	Number of Shares	
	2005	2004
Balance, beginning of year	5,815,500	2,750,000
Issued pursuant to a private placement	-	7,150,000
Exercised	(1,753,482)	(4,084,500)
Balance, end of year	<u>4,062,018</u>	<u>5,815,500</u>

The following table summarizes the outstanding warrants and expiry dates at June 30, 2005:

Exercise Price \$	Warrants Outstanding	Expiry Date
0.30	695,000	October 15, 2005
2.05	<u>3,367,018</u>	May 6, 2006
	<u>4,062,018</u>	

During the year ended June 30, 2004, 50,000 warrants were exercised prior to June 30, 2004, but the shares were not issued until subsequent to year end. The proceeds from the exercise of the warrants of \$12,500 was included in accounts receivable and advances at June 30, 2004 and were deposited subsequent to year end.

## 7. STOCK-BASED COMPENSATION

During the year ended June 30, 2005, the Company granted stock options to directors and consultants to purchase 775,000 shares of the Company.

Pursuant to the Company's policy for accounting for stock-based compensation (note 2), the fair value of stock options granted, in the amount of \$476,600, has been recorded as an expense in the year.

The fair value of stock options granted is estimated using the Black-Scholes Option Pricing Model with the following assumptions:

	2005	2004
Risk-free interest rate	3.02%	1.18% - 5.75%
Estimated volatility	52% - 77%	108% - 121%
Expected life	1.0 - 1.5 years	1.0 - 1.5 years
Expected dividend yield	0%	0%

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2005



## 7. STOCK-BASED COMPENSATION (continued)

The weighted average fair value of the options granted during the year ended June 30, 2005, was \$0.62 (2004 - \$0.66) per share.

The components of contributed surplus are as follows:

	<b>2005</b>	2004
	\$	\$
Balance, beginning of year	933,037	637
Stock options issued during the year	476,600	932,400
Fair value of options exercised during the year	(76,500)	—
	<u>1,333,137</u>	<u>933,037</u>

Option-pricing models require the use of estimates and assumptions including the expected volatility. Changes in the underlying assumptions can materially affect the fair value estimates and, therefore, existing models do not necessarily provide a reliable measure of the fair value of the Company's stock options.

## 8. RELATED PARTY TRANSACTIONS

- a) During the year ended June 30, 2005, the Company incurred \$149,967 (2004 - \$90,376) for management services provided by the President and/or a company controlled by the President of the Company.
- b) During the year ended June 30, 2005, the Company incurred \$22,600 (2004 - \$NIL) for geological and technical services provided by a director and/or a company controlled by a director of the Company.
- c) During the year ended June 30, 2005, the Company paid \$150,470 (2004 - \$NIL) to a director for management services related to the mining operations of the Company in Mexico.
- d) During the year ended June 30, 2005, the Company incurred exploration expenditures of \$510,710 with a company related by way of a director in common.



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2005

### 9. SEGMENTED INFORMATION

a) Operating segment

The Company's operations are primarily directed towards the exploration and development of mineral properties in Mexico. The Company's mining activities represent a single reportable segment.

b) Geographic segments

The Company's mineral properties are located in Mexico and its corporate assets are located in Canada. All of its operating revenue is earned in Mexico.

	2005			2004 (Note 15)			
	Canada \$	Mexico \$	Total \$	Canada \$	Mexico \$	Argentina \$	Total \$
Sales	-	914,000	914,000	-	-	-	-
Current assets	3,527,954	737,553	4,265,507	9,669,826	673,345	-	10,343,171
Mineral property interest	-	5,982,970	5,982,970	-	4,056,512	156,749	4,213,261
Property, plant and equipment	30,578	2,176,690	2,207,268	10,400	2,067,997	-	2,078,397
	<u>3,558,532</u>	<u>8,897,213</u>	<u>12,455,745</u>	<u>9,680,226</u>	<u>6,797,854</u>	<u>156,749</u>	<u>16,634,829</u>

# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2005



## 10. SUPPLEMENTAL CASH FLOW INFORMATION

Non-cash financing and investing activities were conducted by the Company as follows:

	2005 \$	2004 \$
Financing activities		
Issuance of common shares for mineral property interests	-	127,000
Investing activities		
Expenditures on mineral property interests	-	(127,000)

## 11. INCOME TAXES

As at June 30, 2005, the Company has approximately \$2,843,000 of non-capital losses and \$125,000 of capital losses carried forward and cumulative unclaimed resource deductions and capital cost pools of approximately \$5,380,000 available, in certain circumstances, to offset future taxable income in Canada. The non-capital losses expire commencing 2006 through 2012. The net capital loss can be utilized to reduce taxes on future capital gains and may be carried forward indefinitely. The cumulative resource deductions and capital cost pools may be carried forward indefinitely.

In addition, subject to certain restrictions, the Company has tax pools of approximately \$5,138,000 available to offset future taxable income in Mexico.

Future income tax benefits which may arise as a result of these losses have not been recognized in the financial statements as their realization is unlikely.

The reconciliation of income tax provision computed at statutory rates to the reported income tax provision is as follows:

	2005 \$	2004 \$
Combined federal and provincial income tax rate	35.62%	35.62%
Income tax benefit computed at Canadian statutory rates	1,320,800	590,656
Foreign tax rates different from statutory rates	(26,200)	(1,396)
Non-deductible expenses	(636,400)	(384,475)
Unrecognized benefit of income tax losses	(658,100)	(204,785)
	-	-



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2005

### 11. INCOME TAXES (continued)

Significant components of the Company's future tax assets and liabilities, after applying enacted corporate income tax rates, are as follows:

	2005 \$	2004 \$
Future income tax assets		
Net tax losses carried forward	2,451,000	611,992
Temporary differences on assets	569,000	1,481,831
Share issue costs	71,000	95,681
Valuation allowance for future income tax assets	(3,091,000)	(2,189,504)
Net future income tax assets	-	-
Future income tax liabilities	-	-
Future income tax assets, net	-	-

### 12. FINANCIAL INSTRUMENTS, CREDIT AND OTHER RISKS

The carrying amounts reported in the balance sheet for accounts receivable and advances and accounts payable approximate fair values due to the short term to maturity of the instruments.

The Company's Mexican mineral revenues are dependent on selling concentrate to one smelter. However, as this customer is well capitalized, credit risk is not considered to be significant.

The Company is exposed to fluctuations in commodity prices and exchange rates. To date, the Company has not used derivative instruments to hedge these risks.

### 13. CONTINGENT LIABILITIES

In February, 2004, an action was commenced against the Company by the optionors of the Wekusko Property whereby the optionors are seeking an amount of \$43,500, 30,000 common shares of the Company and an entitlement to exercise an option to purchase 100,000 shares of the Company at \$0.35 per share. The Company believes it has substantial defences to the claim; however, the outcome of this litigation is not presently determinable.



# NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2005



## 14. ASSET RETIREMENT OBLIGATION

	<b>2005</b>	2004
	\$	\$
Balance, beginning of year	1,119,994	-
Liabilities assumed on acquisition of La Parrilla	-	1,027,304
Interest accretion	87,321	46,835
Effect of translation of foreign currencies	(81,473)	45,855
	<u>1,125,842</u>	<u>1,119,994</u>

The total undiscounted amount of estimated cash flows required to settle the Company's estimated obligations is US\$1,943,000 which has been discounted using a credit adjusted risk free rate of 8.5%. The reclamation obligation relates to the La Parrilla mine and is expected to be paid in 2014. The present value of the reclamation liabilities may be subject to change based on management's current estimates, changes in remediation technology or changes to the applicable laws and regulations. Such changes will be recorded in the accounts of the Company as they occur.

## 15. CHANGE IN ACCOUNTING POLICY

Effective July 1, 2004, the Company adopted the new accounting standard for asset retirement obligations, a standard that applies to future site reclamation costs for the Company's mineral properties. Under this standard, future costs to retire an asset including dismantling, remediation and ongoing treatment and monitoring of the site are recognized and recorded as a liability at fair value at the date the liability is incurred. The liability is accreted over time to the estimated amount ultimately payable through periodic charges to earnings. In addition, future site reclamation costs are capitalized as part of the carrying value of the related mineral property at its initial discounted value and amortized over the mineral property's useful life based on a units-of-production method. The estimated costs for reclamation of non-producing mineral properties are accrued as liabilities when the costs of site clean-up and reclamation can be reasonably estimated. This change in accounting policy has been adopted retroactively, with the effect that the net loss for the year ended June 30, 2004 was decreased by \$41,350 from \$1,658,216 to \$1,616,866. The change also resulted in an increase in the provision for reclamation liabilities of \$893,264 at the date of acquisition of the La Parrilla mine (Note 4(a)) and \$985,954 at June 30, 2004. The carrying value of the related asset at the date of acquisition of the La Parrilla mine was also increased by \$1,027,304.



## NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2005

### 16. SUBSEQUENT EVENTS

Subsequent to June 30, 2005:

- a) the Company announced a non-brokered private placement offering for gross proceeds of \$5,691,292 consisting of 3,076,374 units of the Company at a price of \$1.85 per unit. Each unit will consist of one common share and one-half of one common share purchase warrant with each full warrant entitling the holder to purchase one additional common share of the Company at an exercise price of \$2.25 per share for a period of two years after the closing of the offering. Finder's fees ranging from 1% to 7% are payable on portions of this private placement.
- b) the Company entered into an agreement with Oremex Resources Inc. to acquire a 100% interest in mineral claims known as the La Encarnacion and San Ignacio Dos mining claims at La Parrilla, Durango, Mexico. As consideration, the Company paid \$40,000 and is required to issue 200,000 common shares in the Company. The acquisition agreement is subject to regulatory approval.

# SCHEDULE A - CONSOLIDATED SUMMARY OF MINERAL PROPERTY INTERESTS

YEARS ENDED JUNE 30



	2005						2004
	La Parrilla Project \$	Chalchi- huites \$	Mexico		Niko \$	Argentina	Total
			Dios Padre \$	Candamena \$		Platino \$	\$
<b>BALANCE - BEGINNING OF YEAR,</b>							
as previously reported	2,503,714	173,351	-	-	352,143	156,749	3,185,957
Asset retirement obligation	1,027,304	-	-	-	-	-	1,027,304
<b>BALANCE - BEGINNING OF YEAR, restated (Note 15)</b>	<b>3,531,018</b>	<b>173,351</b>	<b>-</b>	<b>-</b>	<b>352,143</b>	<b>156,749</b>	<b>4,213,261</b>
<b>EXPENDITURES DURING THE YEAR</b>							
Assaying	8,955	977	-	-	25,750	-	35,682
Consulting	19,829	80,287	10,026	15,607	14,438	-	140,187
Drafting	-	-	-	-	9,603	-	9,603
Drilling	-	43,738	21,790	-	370,899	-	436,427
Environmental	-	-	-	-	-	-	-
Field office	924	33	1,225	-	4,137	-	6,319
Field supplies	-	10,116	-	-	9,757	-	19,873
Filing Fees	7,600	5,600	11,164	14,066	-	-	38,430
Geological and geophysics	-	-	-	-	9,082	-	9,082
Laboratory	-	245	-	-	-	-	245
Lease payments	-	-	-	-	9,480	-	9,480
Management fees	-	-	-	-	46,846	-	46,846
Maps	-	-	-	-	-	-	-
Mine Development Costs	441,143	-	-	-	-	-	441,143
Pre-production costs	145,608	-	-	-	-	-	145,608
Surface rights	-	-	-	-	2,484	-	2,484
Travel	-	-	7,547	1,950	1,769	-	11,266
Vehicles	-	-	-	-	6,465	-	6,465
	624,059	140,996	51,752	31,623	510,710	-	1,359,140
Less: grants received	-	-	-	-	-	-	-
	624,059	140,996	51,752	31,623	510,710	-	1,359,140
<b>ACQUISITION COSTS DURING THE YEAR</b>	<b>28,824</b>	<b>572,166</b>	<b>524,421</b>	<b>466,331</b>	<b>-</b>	<b>-</b>	<b>1,591,742</b>
	652,883	713,162	576,173	497,954	510,710	-	2,950,882
Less: Write-off of mineral properties	-	-	-	-	(862,853)	(156,749)	(1,019,602)
Depletion	(161,571)	-	-	-	-	-	(161,571)
	(161,571)	-	-	-	(862,853)	(156,749)	(1,181,173)
<b>BALANCE - END OF YEAR</b>	<b>4,022,330</b>	<b>886,513</b>	<b>576,173</b>	<b>497,954</b>	<b>-</b>	<b>-</b>	<b>5,982,970</b>
	4,022,330	886,513	576,173	497,954	-	-	5,982,970



## MANAGEMENT DISCUSSION AND ANALYSIS

FOR THE YEAR ENDED JUNE 30, 2005

This Management Discussion and Analysis of FIRST MAJESTIC RESOURCE CORP. (the "Company") provides analysis of the Company's financial results for the year ended June 30, 2005. The following information should be read in conjunction with the accompanying interim financial statements. Additional information on the Company is available on SEDAR at [www.sedar.com](http://www.sedar.com).

1.1. Date of Report: October 7, 2005

1.2. Overall Performance

### **Nature of Business and Overall Performance**

The Company is engaged in the production, development and exploration of mineral properties with a primary focus on silver. The Company trades on the TSX Venture Exchange ("TSXV") under the symbol "FR".

1.3. Results of Operations for the year ended June 30, 2005

During the year ended June 30, 2005, the Company incurred a loss of \$3,708,028 or \$0.17 per common share, compared to \$1,616,866 or \$0.15 per share for last year. The increase in loss is mainly attributed to a loss on production of \$326,527 as a result of low recovery of silver from oxide ores and the write off of the Niko Silver Project in Mexico and the Platino Porphyry Project in Argentina amounting to \$1,019,602.

During the year ended June 30, 2005, revenues amounted to \$914,000 as compared to NIL of last year. Revenues were attributed to the production of 130,000 ounces of silver.

Interest income for the year ended June 30, 2005 was \$129,296 (2004 - \$32,297), the increase being attributable to much higher cash balances invested during the year ended June 30, 2005.

Cash decreased during the year ended June 30, 2005 by \$6,324,361 as compared to an increase of \$9,719,673 in 2004. Operating activities in the year ended June 30, 2005 used cash of \$4,853,947 (2004 - \$857,080). In the year ended June 30, 2005, cash flows for investing activities totaled \$3,217,081 (2004 - \$2,429,576) comprised of acquisition of plant and equipment and expenditures on mineral property interests. Financing activities for the year ended June 30, 2005 raised \$1,746,667 (2004 - \$13,322,600) by the issuance of capital stock for private placements, warrants and stock options exercised.

# MANAGEMENT DISCUSSION AND ANALYSIS

FOR THE YEAR ENDED JUNE 30, 2005



The Company has the following mineral property interests:

a) **La Parrilla Silver Mine, Durango, Mexico**

**Overview**

The La Parrilla Silver Mine is located between the cities of Durango and Zacatecas in west central Mexico. First Majestic acquired a 100% interest in La Parrilla in May 2004, and initiated operations at a reduced capacity in October 2004 in order to allow for time to develop the resources within the mine and property boundaries. Underground development in the fiscal year, combined with drilling that commenced in June 2005 is reinforcing the Company's view of the positive potential of the mine.

**Year End Summary**

During the year ended June 2005, 1,183 meters of underground drifting was completed, development of stopes and production from underground areas of the mine, including 16,589 tonnes from old stock piles and 5,555 tonnes of purchased ore totaled 39,800 tonnes produced, at the mill.

During the year the mining activity confirmed ore grade and continuity at the mine while at the mill the metallurgical parameters were defined increasing the recoveries from the 50% range to the 70% range with further anticipated improvements.

A significant new zone of mineralization was encountered to the east of the old mined area. This new area has been defined as the Ore Shoot No. 3 and contains mineralization in an extension of 250 meters in length with a grade of 350 grams per tonne of silver and open to depth. (Ore Shoot No. 3 - see news release dated April 25, 2005). The discovery was made as a result of mining and development activity 50 meters east of Ore Shoots No. 1 and No. 2 in the oxide cap of the identified regional mineralized structure which is 4 kms in length. The purpose of this development, which began in December 2004, has been to supply fresh oxide ore to the mill for silver production and to gain safe access to the sulphides levels to allow for further mine expansion.

During the 12 month period, production at the mill was maintained at a reduced capacity of 130 tpd in order to allow for the upgrade of the mill installations, including the replacement and addition of equipment, the definition of the metallurgical parameters and to complete the construction of 5 new leaching tanks which were finished in March 2005. The objective of adding these tanks is to increase the residence time and improve recoveries to the range of 80%. At the same time, a series of metallurgical tests had been developed in house in order to define the optimum parameters for the leaching circuit.

The processed ore in the year had an average grade of 220 gpt of silver and .25 gpt of gold. A total of 130,000 ounces of equivalent silver was recovered and sent to the smelter during the year.



## MANAGEMENT DISCUSSION AND ANALYSIS

FOR THE YEAR ENDED JUNE 30, 2005

Construction of a flotation circuit was recently completed in anticipation of reaching the sulphide levels in the mine which was accomplished subsequent to year end, in September 2005. Further expansion is now planned for the second quarter of our new fiscal year with expected increases in capacity to 400 tpd; 200 tpd in the cyanidation circuit (oxides) and 200 in the flotation circuit (sulphides).

### **Environmental and Social Programs**

Following completion of the Environmental License, development began on a Voluntary Environmental Audit, a Risk Assessment Study, an integrated system of health, and safety and environmental management to fulfill the conditions of these documents. Health, safety and environmental awareness training began; cleaning activities were completed in areas of historic mining activities.

First Majestic is maintaining an excellent relationship with the community and is defining and establishing a social program. First Majestic has created the Community Relations department which already has established a program of work with the community covering areas with the youth, the schools the church and the community in general.

### **b) Chalchihuites Group of Properties ("Chalchihuites"), Mexico**

The Chalchihuites Group of Properties is located approximately 45 kilometers southeast of the La Parrilla Silver Mine. During this year a first phase exploration program was executed, consisting of systematic collection of several rock samples from underground at the Perseverancia Silver Mine and from other drifts within the property boundaries. Based on encouraging results, the second phase program consisting of additional geological mapping, geochemistry and a geophysical program was executed. The geochemistry and geophysical surveys were conducted during the second and third quarters, over 13 line kilometers on 7 lines spaced 150 meters apart with 50 meter sample intervals.

The geochemistry program identified four very well defined anomalies outlining and coinciding with the Perseverancia Silver Mine, the San Juan Silver Mine, La Esmeralda Mine and Las Cotorras Mine.

The Company intends to commence a third stage exploration program this autumn. The program will include 5,000 meters of diamond drilling which will initially focus on testing the depth extensions of the Perseverancia Silver Mine chimneys, targets along the 1 km Contact Zone and the San Juan vein structures along strike and at depth.

### **c) Dios Padre Silver Mine, Mexico**

In November 2004, the Company announced a Letter Agreement for the purchase of the Dios Padre Silver Mine ("Dios Padre") located in the Eastern Sierra Madre Mountain range about midway between Hermosillo and Chihuahua in east central Sonora Mexico. The purchase includes all properties, assets and equipment and all mining concessions consisting of 285 hectares.

# MANAGEMENT DISCUSSION AND ANALYSIS

FOR THE YEAR ENDED JUNE 30, 2005



The Company hired A.C.A. Howe International Limited, London, UK for the purpose of writing a NI 43-101 report which was issued on April 14, 2005. The report outlined the results of the Company's early due-diligence and outlined a program and budget to continue with its valuation. The Company is planning to recommence the program this fall and anticipates completion by the end of the third quarter. Assuming this due-diligence program confirms earlier data (see news release dated November 18, 2004), the Company will enter into a formal purchase document and fulfill the next payments as outlined in the Letter Agreement.

## d) Candameña Mining District

In December 2004, the Company signed two Letter Agreements for the purchase of the Candameña Mining District ("Candameña"), located in the Eastern Sierra Madre Mountain range about midway between Hermosillo and Chihuahua in east central Sonora Mexico. The purchase includes all properties, assets and equipment and all mining concessions consisting of 5,215 hectares.

The Candameña Mining District hosts several highly mineralized areas. Previous exploration programs executed in 1996-97 by Manhattan Minerals Corp. included; mapping, rock chip sampling, and 11,500 meters in 60 diamond drill holes, which tested only a small part of the property.

During the third and fourth quarter a due diligence program was initiated in conjunction with the preparation of an NI 43-101 report. Mr. J.N. Helsen, Ph. D., P. Geo., a 'qualified person' pursuant to the definitions in NI 43-101, prepared a Technical Report dated June 10, 2005 which recommended a work program and budget. It is anticipated that a crew will arrive in the spring to commence Phase 1 exploration consisting of geological mapping and sampling. A systematic approach is required to thoroughly understand this large historically productive land package.

## 1.4 Selected Annual Information

		Years ended June 30	
	<b>2005</b>	2004	2003
Total revenues	914,000	-	-
Net loss for the year	(3,708,028)	(1,616,866)	(522,296)
Basic and diluted loss per share	(0.17)	(0.15)	(0.09)
Total assets	12,455,745	16,634,829	51,156
Total long term liabilities	1,125,842	1,119,994	-
Dividends per share	-	-	-

In year ended June 30, 2004, the Company acquired the Mexican mineral properties. In year ended June 30, 2005, the Company started commercial production at its La Parrilla Silver Mine.



## MANAGEMENT DISCUSSION AND ANALYSIS

FOR THE YEAR ENDED JUNE 30, 2005

### 1.5 Summary of Quarterly Results

The selected information set out below has been gathered from quarterly financial statements for the previous eight quarters:

	2005				2004			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Net Sales	202,518	271,510	439,972	Nil	Nil	Nil	Nil	Nil
Net Loss	(978,743)	(750,323)	(1,649,447)	(329,515)	(932,824)	(569,830)	(86,770)	(27,442)
Basic and diluted net loss per common share	(0.04)	(0.03)	(0.08)	(0.02)	(0.09)	(0.05)	(0.01)	(0.00)

The Company commenced commercial production during the Second Quarter of 2005. In Q2 of 2005, the Company recorded an amount of \$1,019,602 as a write-off of the Niko and Platino properties.

### 1.6 Liquidity and Capital Resources

At June 30, 2005, the Company had working capital of \$3,909,315 and cash balance of \$3,404,723 as compared to June 30, 2004 with a working capital of \$7,202,808 and cash balance of \$9,729,084. The cash is earmarked for the development of mineral properties and invested in highly liquid short-term investments with an initial maturity of two months or less. The funds are not exposed to any liquidity risk and there are no restrictions on the ability of the Company to meet its obligations.

During the year ended June 30, 2005, the Company incurred \$2,950,882 (2004 - \$378,157) in respect of expenditures on mineral property interest and \$266,199 (2004 - \$2,079,552) in respect of plant and equipment.

During the year ended June 30, 2005, the Company issued 1,803,482 shares on the exercise of warrants for proceeds of \$1,519,667. In addition, the Company issued 220,000 shares on stock options exercised for proceeds of \$239,500.

The Company's continued development is contingent upon its ability to raise sufficient financing both in the short and long term. There are no guarantees that additional sources of funding will be available to the Company; however, management is committed to pursuing all possible sources of financing, has very long and supportive shareholders and strongly believes in its existing properties.

The Company's primary capital assets are mineral property interests. All of the Company's mineral property agreements are non-binding. To maintain its interest in the properties, the Company is required to incur various amounts in development and exploration costs by certain dates as outlined in Part 1.3 above.



# MANAGEMENT DISCUSSION AND ANALYSIS

FOR THE YEAR ENDED JUNE 30, 2005



## 1.7 Off-Balance Sheet Arrangements

At June 30, 2005, the Company had no material off-balance sheet arrangements such as guarantee contracts, contingent interest in assets transferred to an entity, derivative instruments obligations or any obligations that trigger financing, liquidity, market or credit risk to the Company.

## 1.8 Transactions with Related Parties

During the year ended June 30, 2005, an amount of \$149,667 (2004 - \$90,376) was paid to the President and/or to a corporation controlled by the President of the Company for management services in respect of day-to-day operations and business of the Company.

During the year ended June 30, 2005, the Company paid fees in the amount of \$22,600 (2004 - \$NIL) to a director and/or a company controlled by a director of the Company for geological and technical services rendered.

During the year ended June 30, 2005, the Company paid fees in the amount of \$150,470 (2004 - \$Nil) to a director of the Company for managing the mining operations of the Company in Mexico.

During the year ended June 30, 2005, the Company incurred exploration expenditures of \$510,710 with a company related by way of a director in common.

## 1.9 Proposed Transactions

There are currently no material transactions being pursued or negotiated by the Company

## 1.10 Changes in Accounting Policies including Initial Adoption

Effective July 1, 2004, the Company adopted the new accounting standard for asset retirement obligations. This change in accounting policy has been adopted retroactively, with the effect that the net loss for the year ended June 30, 2004 was decreased by \$41,350 from \$1,658,216 to \$1,616,866. The change also resulted in an increase in the asset retirement obligation of \$893,264 at the date of acquisition of the La Parrilla Silver Mine and \$985,954 at June 30, 2004. The carrying value of the related asset at the date of acquisition of the La Parrilla Silver Mine was also increased by \$1,027,304.

There have been no other changes in the Company's existing accounting policies.



## MANAGEMENT DISCUSSION AND ANALYSIS

FOR THE YEAR ENDED JUNE 30, 2005

### 1.11 Financial Instruments and Other Risks

The Company's financial instruments consist of cash and cash equivalents, amounts receivable and advances, accounts payable accrued liabilities. It is management's opinion that the Company is not exposed to significant interest, currency or credit risks arising from these financial instruments. The fair market values of these financial instruments approximate their carrying values, unless otherwise noted.

In conducting business, the principal risks and uncertainties faced by the Company centre on development of its mineral properties, metal and mineral prices and market sentiment.

The prices of metals and minerals fluctuate wildly and are affected by many factors outside of the Company's control. The relative prices of metals and minerals and future expectations for such prices have a significant impact on the market sentiment for investment in mining and mineral exploration companies. The Company relies on equity financing for its working capital requirements and to fund its development and exploration programs. There is no assurance that such financing will be available to the Company, or that it will be available on acceptable terms.

### 1.12 Outstanding share data:

At the date of this report the Company has 24,329,717 issued and outstanding common shares.

### 1.13 Subsequent events:

- a) Subsequent to year end, the Company announced a non-brokered private placement offering of \$5,691,292 consisting of 3,076,374 units of the Company at a price of \$1.85 per unit. Each unit will consist of one common share and one -half of one common share purchase warrant with a full Warrant entitling the holder to purchase one additional common share of the Company at an exercise price of \$2.25 per warrant share for a period of two years after the closing of the Offering. Finders fees ranging from 1% to 7% are payable on portions of this private placement.
- b) Subsequent to year end, the Company entered into an agreement with Oremex Resources Inc. to acquire a 100% interest in mineral claims known as the La Encarnacion and San Ignacio Dos mining claims located at La Parrilla, Durango, Mexico. As consideration, the Company paid \$40,000 and is required to issue 200,000 common shares in the Company. The acquisition agreement is subject to regulatory approval.
- c) Subsequent to June 30, 2005, the Company issued:
  - i) 430,000 shares for cash of \$228,400 as stock options exercised
  - ii) 495,000 shares for cash of \$148,500 as warrants exercised

# CORPORATE INFORMATION



## CORPORATE HEADQUARTERS

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Telephone 604 688 3033  
Fax 604 601 2010  
Toll Free 866 529 2807

Email [info@firstmajestic.com](mailto:info@firstmajestic.com)  
Website [www.firstmajestic.com](http://www.firstmajestic.com)

## BOARD OF DIRECTORS AND OFFICERS

### **Keith Neumeyer**

President & Director

### **Ramon Davila, Ing, (M.Sc.Eng.)**

Chief Operating Officer, Director

### **George Lim, CA, CGA**

Chief Financial Officer

### **David A. Shaw, Ph.D.**

Director & Technical Advisor

### **Paul Matysek, M.Sc., P.Geo.**

Director

### **Tony Pezzotti**

Director

### **Jude Fawcett**

Corporate Secretary

## INVESTOR RELATIONS CONTACT

### **Ryan Mulhern**

Investor Relations

### **Jill Anne Arias**

Executive Assistant & Corporate Relations

Telephone 604 688 3033  
Toll Free 866 529 2807 (North America only)  
Email [info@firstmajestic.com](mailto:info@firstmajestic.com)

## STOCK TRANSFER AGENT

### **Pacific Corporate Trust Company**

625 Howe Street  
Vancouver, BC V6C 3B8

Telephone 604 689 9853  
Fax 604 689 8144  
Attention Heather Plume

## LEGAL ADVISORS

### **Axiom Law Group**

1055 Dunsmuir Street  
Bentall 4, Suite 3350  
Vancouver, B.C. V7X 1L2  
Attention: Joseph Guiffre

## INDEPENDENT AUDITORS

### **Deloitte & Touche**

P.O. Box 49279  
Four Bentall Centre  
2800 - 1055 Dunsmuir Street  
Vancouver, BC V7X 1P4  
Attention: Terry Neil

## ANNUAL AND SPECIAL MEETING

Date: Tuesday, December 15, 2005  
Time: 10:00 a.m.  
Suite 1480 - 885 West Georgia Street  
Vancouver, BC V6C 3E8

## MARKET INFORMATION

Trading Symbol: **FR**  
Stock Exchange: **TSX Venture**  
Frankfurt/Berlin: **905910**  
Pink Sheets: **FMJRF**



FIRST MAJESTIC  
RESOURCE CORP.

[www.firstmajestic.com](http://www.firstmajestic.com)