RED HILL ENERGY INC.
(formerly UGL Enterprises Ltd.)

Consolidated Financial Statements
December 31, 2006 and 2005

AUDITORS' REPORT

TO THE SHAREHOLDERS OF RED HILL ENERGY INC.
(formerly UGL Enterprises Ltd.)

We have audited the consolidated balance sheets of Red Hill Energy Inc. (formerly UGL Enterprises Ltd.) as at December 31, 2006 and 2005 and the consolidated statements of operations and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2006 and 2005 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

"Smythe Ratcliffe LLP" (signed)

Chartered Accountants

Vancouver, British Columbia
February 23, 2007, except as to note 11(d)
which is as of March 12, 2007

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RED HILL ENERGY INC.
(formerly UGL Enterprises Ltd.)
Consolidated Balance Sheets
December 31

	2006	2005
Assets		
Current		
Cash and cash equivalents	$ 1,804,484	$ 2,578,895
Accounts receivable	60,556	9,828
Deposits	5,047	3,791
Secured loan (note 9)	0	349,410
	1,870,087	2,941,924
Property and Equipment, net (note 4)	106,583	82,214
Long-Term Investment (note 5)	0	170,500
Mineral Properties (note 6)	7,081,378	1,062,390
	$ 9,058,048	$ 4,257,028
Liabilities		
Current		
Accounts payable and accrued liabilities	$ 32,217	$ 36,843
Shareholders' Equity		
Capital Stock (note 7)	21,199,430	15,334,193
Contributed Surplus (note 7(e))	1,505,366	1,053,337
Share Subscriptions	0	32,649
Deficit	(13,678,965)	(12,199,994)
	9,025,831	4,220,185
	$ 9,058,048	$ 4,257,028

Commitment (note 10)

Approved on behalf of the Board:

"G.A. Armstrong"
.... Director
G.A. Armstrong

"Paul McKenzie"
.... Director
Paul McKenzie

RED HILL ENERGY INC.
(formerly UGL Enterprises Ltd.)
Consolidated Statements of Operations and Deficit
Years Ended December 31

	2006	2005 (note 13)
Expenses		
Consulting	$ 428,388	$ 391,221
Advertising and promotion	303,803	163,672
Salaries and benefits	230,507	102,854
Directors' fees	227,286	186,874
Office	184,916	100,923
Travel	168,359	115,925
Professional fees	70,346	81,524
Stock exchange and shareholder services	55,159	60,877
Foreign exchange loss	14,238	14,536
Interest, net	(70,680)	(61,730)
Amortization	25,416	10,734
Loss Before Other Items	(1,637,738)	(1,167,410)
Other Items		
Gain on sale of marketable securities	301,604	0
Write-off of mineral properties	(142,837)	(2,567,322)
Net Loss for Year	(1,478,971)	(3,734,732)
Deficit, Beginning of Year	(12,199,994)	(8,465,262)
Deficit, End of Year	$ (13,678,965)	$ (12,199,994)
Loss per Share	$ (0.05)	$ (0.15)
Weighted Average Number of Common Shares Outstanding	31,601,656	24,204,986

See notes to consolidated financial statements.

RED HILL ENERGY INC.
(formerly UGL Enterprises Ltd.)
Consolidated Statements of Cash Flows
Years Ended December 31

	2006	2005
		(note 13)
Operating Activities		
Net loss	$ (1,478,971)	$ (3,734,732)
Items not involving cash		
Stock-based compensation	525,606	402,738
Gain on sale of marketable securities	(301,604)	
Amortization	25,416	10,734
Write-off of mineral properties	142,837	2,567,322
Operating Cash Flow	(1,086,716)	(753,938)
Changes in Non-Cash Working Capital		
Accounts receivable	(50,728)	(4,926)
Accounts payable and accrued liabilities	(14,076)	(133,624)
Deposits	(1,256)	5,211
	(66,060)	(133,339)
Cash Used in Operating Activities	(1,152,776)	(887,277)
Investing Activities		
Proceeds from secured loan	349,410	(349,410)
Proceeds on sale of marketable securities	472,104	0
Purchase of property and equipment	(49,784)	(92,948)
Expenditures on mineral properties	(5,732,435)	(937,758)
Cash Used in Investing Activities	(4,960,705)	(1,380,116)
Financing Activities		
Shares issued	5,371,719	4,553,125
Share subscriptions	(32,649)	32,649
Cash Provided by Financing Activities	5,339,070	4,585,774
Inflow (Outflow) of Cash and Cash Equivalents	(774,411)	2,318,381
Cash and Cash Equivalents, Beginning of Year	2,578,895	260,514
Cash and Cash Equivalents, End of Year	$ 1,804,484	$ 2,578,895
Supplemental Cash Flow Information		
Shares issued as finders' fees	$ 119,940	$ 0
Shares issued for property	$ 300,000	$ 0

1. NATURE OF OPERATIONS

The Company is an exploration stage public company. The principal business activity of the Company is the acquisition, exploration and development of mineral properties. Since June 1, 2003, the Company's principal activities have been located in Mongolia through its subsidiary company, Canrim Minerals Limited ("Canrim"). All of the Company's projects in Mongolia are in the initial stages of contract formalization and obtaining necessary government approvals. The ability of the Company to continue operations is dependent upon the continued financial support of its shareholders, other investors and lenders, and with the successful development of the Company's interest in the mineral properties or proceeds from their disposal.

2. SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of presentation

These consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles and are stated in Canadian dollars. The consolidated financial statements include the accounts of the Company and its wholly-owned integrated subsidiary, Canrim, a British Virgin Islands company, and its wholly-owned integrated Mongolian subsidiaries, UGL Enterprises LLC and Red Hill LLC. All intercompany balances and transactions have been eliminated.

(b) Cash and cash equivalents

Cash and cash equivalents consist of cash and short-term deposits with original maturity of less than three months.

(c) Amortization

Amortization of property and equipment is recorded on a declining-balance basis at the following annual rates:

Furniture and equipment	- 20%
Vehicle	- 30%
Computer equipment	- 30%

Additions during the year are amortized at one-half the annual rates.

(d) Mineral properties

The Company capitalizes all costs related to investments in mineral property interests on a property-by-property basis. Such costs include mineral property acquisition costs and exploration and development expenditures, net of any recoveries. Costs are deferred until such time as the extent of mineralization has been determined and mineral property interests are either developed, the property is sold or the Company's mineral rights are allowed to lapse.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(d) Mineral properties (Continued)

All capitalized costs are reviewed quarterly, on a property-by-property basis, to consider whether there are any conditions that may indicate impairment. When the carrying value of a property exceeds its net recoverable amount (as estimated by quantifiable evidence of an economic geological resource or reserve or by reference to option or joint venture expenditure commitments) or when, in the Company's assessment, it will be unable to sell the property for an amount greater than the deferred costs, the property is written down for the impairment in value.

From time to time the Company may acquire or dispose of a mineral property interest pursuant to the terms of an option agreement. As such options are exercisable entirely at the discretion of the optionee, the amounts payable or receivable are not recorded at the time of the agreement. Option payments are recorded as property costs or recoveries when the payments are made or received.

Capitalized costs are depleted over the useful lives of the properties upon commencement of commercial production or written off if the properties are abandoned or the applicable mineral rights are allowed to lapse.

(e) Revenue recognition

The Company recognizes interest income on its cash and cash equivalents on an accrual basis at the stated rates over the term to maturity.

(f) Stock-based compensation

The Company accounts for stock options granted to directors, employees and consultants using the fair value method. The fair value of each option granted is estimated on the date of grant using the Black-Scholes option pricing model and charged to earnings over the vesting period with a corresponding increase in contributed surplus. Upon exercise of the stock options, consideration received together with the amount previously recognized in contributed surplus is recorded as an increase to capital stock.

(g) Loss per share

Loss per share amounts have been calculated and presented in accordance with the treasury stock method. Diluted loss per share amounts have not been presented, as the effect of outstanding options and warrants is anti-dilutive.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

(h) Foreign currency translation

Amounts recorded in foreign currency are translated into Canadian dollars as follows:

(i) Monetary assets and liabilities, at the rate of exchange in effect as at the balance sheet date;

(ii) Non-monetary assets and liabilities, at the exchange rates prevailing at the time of the acquisition of the assets or assumption of the liabilities; and

(iii) Revenues and expenses, at the average rate of exchange for the year.

Gains and losses arising from the translation of foreign currency are included in the net loss for the year.

(i) Use of estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Significant areas requiring the use of estimates include the rates of amortization for property and equipment, the recovery of mineral property interests, estimate of asset retirement obligations and accrued liabilities, the assumptions used in the determination of the fair value of stock-based compensation, and the determination of the valuation allowance for future income tax assets. Management believes the estimates are reasonable; however, actual results could differ from those estimates and would impact future results of operations and cash flows.

(j) Income taxes

Income taxes are calculated using the asset and liability method of tax accounting. Temporary differences arising from the difference between the tax basis of an asset or liability and its carrying amount on the balance sheet are used to calculate future income tax assets or liabilities. Future income tax assets or liabilities are calculated using tax rates anticipated to apply in the periods that the temporary differences are expected to reverse. The effect on future income tax assets and liabilities of a change in tax rates is included in operations in the period in which the change is enacted or substantially assured. A valuation allowance is provided to reduce the asset to the net amount management estimates to be more likely than not to be realized.

(k) Asset retirement obligations

The Company recognizes the liability for retirement obligations associated with long-lived assets at fair value. The asset retirement cost equal to the fair value of the retirement obligation is capitalized as part of the cost of the related asset. These capitalized costs are amortized using a straight-line method based on the estimated life of the asset. Amounts are recorded once they become known or can be readily estimated.

3. FINANCIAL INSTRUMENTS

(a) Fair value

The carrying values of cash and cash equivalents, accounts receivable, and accounts payable and accrued liabilities approximate their fair values because of the short-term maturity of these financial instruments. The fair value of the long-term investment is disclosed in note 5.

(b) Credit risk

A financial instrument that potentially subjects the Company to a concentration of credit risk is its cash. The Company has placed the majority of its cash with a major Canadian commercial bank. The Company is also exposed to credit risk with respect to its accounts receivable, which consists of an amount receivable from a Mongolian company.

(c) Currency risk

The Company translates the results of US transactions into Canadian currency using rates approximating the average exchange rate for the year. The exchange rate may vary from time to time. The Company translates Mongolian transactions into Canadian currency at rates approximating the average exchange rate for the year. Management believes that the currency risk is minimal for Mongolian dollars as the risk is mitigated by the fact that the majority of the Mongolian transactions are completed in US currency.

4. PROPERTY AND EQUIPMENT

	2006	2005
Furniture and equipment	$ 82,981	$ 64,169
Vehicle	43,463	25,580
Computer equipment	16,290	3,199
	142,734	92,948
Less: Accumulated amortization	36,151	10,734
	$ 106,583	$ 82,214

5. LONG-TERM INVESTMENT

The Company owned 50,000 shares of Mega Uranium Ltd. The shares were sold during the year ended December 31, 2006 for proceeds of $472,104, resulting in a gain of $301,604. The market value of the shares at December 31, 2005 was $241,500.

6. INVESTMENT IN AND EXPENDITURES ON MINERAL PROPERTIES

The Company's investment in and expenditures on mineral properties is comprised of the following:

	Ulaan Ovoo	Argalant	Uranium *	Naranbulag	Khondloy	Gold Ram	Banbury	Bayan Undur	Shavar Uul	Huren Tolgoi	South Valley	Total
	(note 6(a))	(note 6(c))	(note 6(d))	(note 6(e))	(note 6(f))	(note 6(g))	(note 6(h))	(note 6(i))	(note 6(j))	(note 6(k))	(note 6(l))	
Balance, December 31, 2004	$ 0	$ 0	$ 132,623	$ 195,598	$ 49,860	$ 27,282	$ 1	$ 65,865	$ 42,796	$ 1,269,434	$ 1,094,083	$ 2,877,542
Acquisition Costs												
Cash payments	232,940	119,485	168,320	0	0	0	0	0	0	0	0	520,745
Common shares	0	0	0	0	0	0	0	0	0	0	0	0
Option receipt	0	0	(170,500)	0	0	0	0	0	0	0	0	(170,500)
	232,940	119,485	(2,180)	0	0	0	0	0	0	0	0	350,245
Deferred Exploration Costs												
Assaying	0	0	2,114	0	0	0	0	17,509	0	0	4,313	23,936
Drilling	0	72,761	0	0	0	0	0	0	0	3,073	2,357	78,191
Geological consulting	9,949	23,850	72,732	0	14,320	0	0	211	212	312	1,151	122,737
Option exploration funding	0	0	(127,490)	0	0	0	0	0	0	0	0	(127,490)
Other fieldwork	4,500	75,140	138,515	0	42,390	0	0	0	0	0	0	260,545
Transportation and shipping	0	0	5,723	5,146	2,252	9,067	0	15,869	375	5,574	0	44,006
	14,449	171,751	91,594	5,146	58,962	9,067	0	33,589	587	8,959	7,821	401,925
Write-offs	0	0	(187,025)	0	0	0	0	0	0	(1,278,393)	(1,101,904)	(2,567,322)
Balance, December 31, 2005	$ 247,389	$ 291,236	$ 35,012	$ 200,744	$ 108,822	$ 36,349	$ 1	$ 99,454	$ 43,383	$ 0	$ 0	$ 1,062,390

***** Uranium property includes Naidal, Maikhan, Bagnaran and Nergui (written-off in year) properties.

6. INVESTMENT IN AND EXPENDITURES ON MINERAL PROPERTIES (Continued)

	Ulaan Ovoo	Chandgana	Argalant	Uranium *	Naranbulag	Khondloy	Gold Ram	Banbury	Bayan Undur	Shavar Uul	Total
	(note 6(a))	(note 6(b))	(note 6(c))	(note 6(d))	(note 6(e))	(note 6(f))	(note 6(g))	(note 6(h))	(note 6(i))	(note 6(j))	
Balance, December 31, 2005	$ 247,389	$ 0	$ 291,236	$ 35,012	$ 200,744	$ 108,822	$ 36,349	$ 1	$ 99,454	$ 43,383	$ 1,062,390
Acquisition Costs											
Cash payments	3,917,623	454,334	0	0	0	0	0	0	0	0	4,371,957
Common shares	59,940	360,000	0	0	0	0	0	0	0	0	419,940
Option receipt	0	0	0	0	0	0	0	0	0	0	0
	3,977,563	814,334	0	0	0	0	0	0	0	0	4,791,897
Deferred Exploration Costs											
Assaying	30,307	0	8,861	6,147	0	0	0	0	0	0	45,315
Drilling	550,163	0	0	462,940	0	0	0	0	0	0	1,013,103
Geological consulting	429,263	0	0	81,180	0	0	0	0	0	0	510,443
Licenses and tax	39,460	1,464	0	3,896	8,543	12,537	5,597	0	0	0	71,497
Option exploration funding	0	0	0	(775,366)	0	0	0	0	0	0	(775,366)
Other fieldwork	34,101	12,398	3,115	133,767	0	0	0	0	0	0	183,381
I/P resistivity survey	0	0	19,605	210,412	0	0	0	0	0	0	230,017
Transportation and shipping	57,843	0	0	33,695	0	0	0	0	0	0	91,538
	1,141,137	13,862	31,581	156,671	8,543	12,537	5,597	0	0	0	1,369,928
Write-offs	0	0	0	0	0	0	0	0	(99,454)	(43,383)	(142,837)
Balance, December 31, 2006	$ 5,366,089	$ 828,196	$ 322,817	$ 191,683	$ 209,287	$ 121,359	$ 41,946	$ 1	$ 0	$ 0	$ 7,081,378

***** Uranium property includes Naidal, Maikhan and Bagnaran properties.

6. INVESTMENT IN AND EXPENDITURES ON MINERAL PROPERTIES (Continued)

The Company's investment in and expenditures on mineral properties comprises a significant portion of the Company's assets. Realization of the Company's investment in these assets is dependent on establishing legal ownership of the properties, on the attainment of successful commercial production or from the proceeds of their disposal.

(a) Ulaan Ovoo Property

On November 15, 2005, the Company entered into a letter of intent with Ochir LLC ("Ochir") that sets out the terms to acquire a 100% interest in the property known as Ulaan Ovoo coal project. The Ulaan Ovoo Property is located in Selenge Province, Mongolia. It is held by the vendor under a transferable 55-year mining license with a 45-year option for extension granted by the government of Mongolia. The purchase price for the 100% interest, together with all equipment, buildings and other facilities, assembled and constructed at the property is US $9,600,000. The purchase price will be paid as follows:

- US $500,000 (paid) within 14 days of execution of the letter of intent, comprised of a US $200,000 non-refundable deposit and US $300,000 secured loan, which will revert to a payment upon completion of a NI 43-101 technical report and receipt of all necessary regulatory approvals. The remaining US $9,100,000 shall be paid as follows:

  (i) US $500,000 on or before March 1, 2006 (paid);
  (ii) US $500,000 on or before May 1, 2006 (paid);
  (iii) US $500,000 on or before July 1, 2006 (paid);
  (iv) US $1,500,000 on or before November 1, 2006; and
  (v) US $6,100,000 on or before November 1, 2007.

A finder's fee of 75,000 common shares is payable to a third party by the Company in respect of the Ulaan Ovoo purchase.

On May 10, 2006, the Company agreed to amend the purchase agreement as follows:

- Ochir shall incorporate and register with the relevant Mongolian authorities a Mongolian-Canadian Joint Venture Company ("JVC") in Mongolia and transfer into the JVC the Ulan Ovoo mining and exploration licenses. The initial shareholders of the JVC shall be Ochir at 51% and the Company at 49% of the outstanding equity of the JVC. In consideration for the transfer of the licenses to the JVC, an accelerated payment of US $500,000 (paid) shall be paid by the Company to Ochir within 30 days of the successful transfer of the licenses. The remaining US $1,000,000 shall remain due on or before November 1, 2006. Within 30 days of the US $1,000,000 payment, Ochir shall transfer to the Company its 51% interest in the JVC. The final payment of US $6,100,000 remains due on or before November 1, 2007.

6. INVESTMENT IN AND EXPENDITURES ON MINERAL PROPERTIES (Continued)

(a) Ulaan Ovoo Property (Continued)

On September 25, 2006, the Company agreed to further amend the purchase agreement as follows:

- On signing the amendment, US $750,000 (paid) shall be paid and Ochir shall transfer to the Company its 51% interest in the JVC. A payment of US $750,000 shall be due on or before April 1, 2007. The final payment of US $5,600,000 shall be due on or before November 1, 2007.

As at December 31, 2006, the Company had made payments totalling US $3,250,000 and 75,000 shares were issued as a finder's fee to a third party.

On November 15, 2006, the Company entered into an agreement with a private Mongolian corporation to purchase a 100% title and interest in five mineral licenses including licenses that are contiguous and entirely surrounding the Ulaan Ovoo Property. The aggregate purchase price for the licenses is US $400,000, with US $50,000 being payable within 10 days of signing the agreement and the balance of the payment due upon transfer of ownership title to the Company (paid). Under the terms of the agreement the Vendor will retain a 2% net smelter return on the five newly acquired licenses. A finder's fee of 58,500 shares was issued to a third party on the acquisition.

(b) Chandgana Property, Mongolia

The Company entered into an agreement on March 29, 2006, to acquire a 100% interest in a coal exploration property known as Chandgana. The property, consisting of two licenses, is located in the northeast part of the Nylaga coal basin, approximately 290 kilometres east of Ulaan Bataar. Under the terms of the agreement, the Company paid a total of US $400,000, plus 250,000 common shares of the Company at a deemed price of $1.20 per share. The Company paid a finder's fee of 50,000 common shares at a deemed price of $1.20 per share to a third party. The purchase price was paid as follows:

(i) The issuance of 250,000 common shares of the Company within 3 days of the date that the agreement was accepted and approved by the TSX Venture Exchange;
(ii) US $50,000 within 21 days of signing the letter agreement;
(iii) US $75,000 on or before July 1, 2006;
(iv) US $275,000 on or before October 1, 2006.

During the year ended December 31, 2006, payments totalling US $400,000 were made, 250,000 shares were issued to the vendor, and 50,000 shares were issued as a finder's fee to a third party.

6. INVESTMENT IN AND EXPENDITURES ON MINERAL PROPERTIES (Continued)

(c) Argalant Property

On October 6, 2005, the Company entered into a letter of intent with Planet Exploration Ltd. ("Planet"), which gives the Company an option to earn a 60% interest, and a second option to earn an additional 20% interest, in Planet's 100% owned Argalant Property. Under the terms of the agreement, the Company paid Planet US $100,000 (paid) and will incur an aggregate of US $1,500,000 of exploration expenditures on Argalant within three years. A minimum of US $500,000 shall be spent in the first year with a minimum of US $500,000 to be spent within each of the subsequent two years. The Company has the option to complete the expenditures within a shorter time period if desired. Within a six-month period of completing the US $1,500,000 in expenditures the Company is entitled to, at its discretion, pay Planet US $1,000,000 for an additional 20% interest in the property. If the Company does not exercise its second option the two companies will then proceed forward on a 60%/40% basis. If the Company does exercise its second option the two companies will proceed forward on an 80%/20% basis.

On August 13, 2006, the Company agreed to amend the option agreement as follows:

(i) The Company will incur an aggregate of US $1,500,000 of exploration expenditures on the property within three years; and
(ii) The commitment of annual minimum expenditures has been removed.

(d) Mongolia Uranium Option Agreement

On June 14, 2005, the Company entered into a Letter Agreement with Maple Minerals Corp. (now known as Mega Uranium Ltd. ("Mega")). The agreement covers the Company's current uranium ground holdings in Mongolia, comprised of 13 granted exploration licenses, six exploration license applications and an option to earn 100% of two exploration licenses in the Nergui Project. In addition, Mega and the Company will cooperate during the term of the agreement in the generation and acquisition of other uranium exploration targets in Mongolia. The Company's gold/copper property holdings are not included in this agreement. Upon completion of the due diligence review by Mega, a definitive formal option agreement will be executed. The formal option agreement will grant Mega the exclusive option to earn a 50% interest in the Company's uranium properties through the expenditure of US $1,500,000 over three years, with a minimum of US $350,000 expended within the first year. Mega is required to issue the Company 50,000 common shares (received) in its capital within three business days of the date that the executed formal agreement is accepted and approved by the TSX Venture Exchange. In addition, Mega is required to issue to the Company the equivalent of Cdn $75,000 of Mega's common shares (which shall be determined using the ten-day average closing price) within ten business days of the later of the date upon which the Company issues 250,000 common shares for the acquisition of its interest in the Nergui Property, and the date that the executed formal agreement is accepted and approved by the TSX Venture Exchange.

Upon Mega earning a 50% interest, a joint venture will be formed with the parties contributing pro-rata. Mega will also have the option to increase its interest to 60% by expending a further US $2,000,000 over the subsequent three years.

6. INVESTMENT IN AND EXPENDITURES ON MINERAL PROPERTIES (Continued)

(d) Mongolia Uranium Option Agreement (Continued)

Naidal Property

The Company acquired a 100% interest in a property known as Naidal Uranium Project located in the province of Tuv in northeast Mongolia. The acquisition cost for the Naidal project (39,810 hectares) was US $5,000 and 100,000 shares at a deemed price of $0.40 per share (issued).

Maikhan Property

The Company acquired a 100% interest in a property known as Maikhan. The Maikhan Property was acquired by payment of US $40,000 and is located in the Khentii and Dornod provinces of Mongolia.

Baganaran Property

The Company acquired a 100% interest in a property known as Baganaran by payment of US $30,000. The Baganaran Property is located in the Darnogovi Province of Mongolia.

Nergui Property

The Company acquired a 100% interest in a property known as Nergui. The Nergui Property is located in the Bulgan Province of Mongolia. The purchase price for the Nergui Property was US $136,500 and 250,000 shares of the Company at a deemed price of $0.60 per share. During the year ended December 31, 2005, the Company decided not to complete the acquisition and wrote-off its investment in the Nergui Property. The shares were not issued.

(e) Naranbulag Property, Mongolia

The Company purchased a 100% interest in the Naranbulag Property (1,428 hectares) located in Zavkhan Province. The Company agreed to purchase the license from the vendor for US $26,000 and Cdn $152,000 payable through the issuance of 200,000 shares at a deemed price of $0.76 per share (paid and issued).

(f) Khondloy Property, Mongolia

The Company has a 100% interest in the Khondloy Property (9,078 hectares) located in Bayanhonger Province, Mongolia.

(g) Gold Ram Property, Mongolia

The Company, through Canrim, holds a 100% interest in the Gold Ram Property in South Gobi, Mongolia. The Gold Ram project (15,533 hectares) is located in the western Gobi region of Mongolia. Canrim holds a 100% interest in the Gold Ram property, subject only to annual government license fees.

6. INVESTMENT IN AND EXPENDITURES ON MINERAL PROPERTIES (Continued)

(h) Banbury Property, BC, Canada

The Company owns a 100% undivided interest in six mineral claims near Hedley, BC, described as the Banbury Property. The interest is recorded at a nominal value of $1.

(i) Bayan Undur Property, Mongolia

The Company acquired a 100% interest in a property known as Bayan Undur (28,830 hectares) located in Bulgan sum of Khovd Province.

During the year ended December 31, 2006, the Company wrote-off its investment in the Bayan Undur Property.

(j) Shavar Uul Property, Mongolia

The Company acquired a 100% interest in a property known as Shavar Uul (2,933 hectares) located in the area of Erdene sum of Gobi Altai Province.

During the year ended December 31, 2006, the Company wrote-off its investment in the Shavar Uul Property.

(k) Huren Tolgoi Property, Mongolia

The Company, through Canrim, entered into a Joint Venture Option Agreement with the license holders of the Huren Tolgoi Gold/Copper Porphyry project. The Huren Tolgoi project comprises of 2,632 hectares located in north Jinst, a sub-province of Bayanhonger Province, south Mongolia. The Huren Tolgoi project is held by Canrim under an option agreement with Monresources Co. Ltd. (the “Optionor”). Under the terms of the option agreement, the Company had a first option to acquire an 80% interest in the Huren Tolgoi project.

During the year ended December 31, 2005, the Company terminated the option agreement and wrote-off the investment in the Huren Tolgoi Property.

(l) South Valley Property, Mongolia

The Company entered into an Option Agreement to acquire up to 60% of an exploration property known as South Valley. The South Valley Property (1,464 hectares) is located near Choilbasen in Mongolia’s Dornod Province. Under the terms of the agreement, the Company paid the license holder US $100,000 upon execution of the agreement on January 15, 2004. The Company had the right to incur US $500,000 in exploration expenditures on the property within one year of the agreement date, and US $500,000 in the second year, totalling US $1,000,000 over two years. Upon completion of the exploration, the Company would have been required to pay the license holder US $1,000,000. This payment must be made within 60 days of receiving the final report on the two years of exploration work. Upon completion of the cash payment and exploration expenditures, the Company would have acquired a 60% interest in the property. After the Company has earned the 60% interest in the property, the project will continue as a joint venture with each party responsible for their share of ongoing costs. The Company had a first right of purchase of the license holders’ 40% interest.

6. INVESTMENT IN AND EXPENDITURES ON MINERAL PROPERTIES (Continued)

(l) South Valley Property, Mongolia (Continued)

During the year ended December 31, 2005, the Company terminated the option agreement and wrote-off its investment in the South Valley Property.

7. CAPITAL STOCK

(a) Authorized
Unlimited common shares without par value

(b) Issued

	2006		2005	
	Number of Shares	Amount	Number of Shares	Amount
Balance, beginning of year	26,062,937	$ 15,334,193	16,250,105	$ 10,808,126
Issued during year				
Private placement	3,300,000	2,475,000	9,290,910	4,510,001
Finders' fees	0	(78,750)	194,422	(57,058)
Share subscription	163,243	32,649	0	0
Shares issued as finders' fees for properties	183,500	119,940	0	0
Property payment (note 6(b))	250,000	300,000	0	0
Exercise of stock options	175,000	82,000	0	0
Exercise of warrants	5,783,694	2,860,821	327,500	73,124
Fair value of stock options exercised	0	73,577	0	0
Balance, end of year	35,918,374	$ 21,199,430	26,062,937	$ 15,334,193

(i) On February 7, 2005, the Company closed a $1,600,000 private placement. Under the placement, the Company issued 4,000,000 units at $0.40 per unit, each unit comprised of one common share and one-half of one share purchase warrant. Each whole share purchase warrant entitles the holder to acquire one additional common share for a period of two years at a price of $0.60 per share. A finder's fee of 5% of the proceeds placed payable in units was paid on portions of the placement. A total of 157,150 units, on the same basis as above, were issued as a finder's fee. The fair value of the finder's fees units was $18,858 as described in note 7(b)(iii).

7. CAPITAL STOCK (Continued)

(b) Issued (Continued)

(ii) On April 11, 2005, the Company closed a $2,910,001 private placement. Under the placement, the Company issued 5,290,910 units at $0.55 per unit, each unit is comprised of one common share and one-half of one share purchase warrant. Each whole share purchase warrant entitles the holder to acquire one additional common share for a period of two years at a price of $0.75 per share. A finder's fee of 5% on the proceeds placed payable in cash or units will be paid on portions of the placement. A total of $30,000 cash and 37,272 units, on the same basis as above, were issued as a finder's fee as described in note 7(b)(iii).

(iii) During the year ended December 31, 2005, the Company granted 157,150 and 37,272 units as finder's fees. Compensation expense of $18,858 and $8,200, respectively, was recognized using the Black-Scholes option pricing model. The Black-Scholes model was calculated based on the following assumptions:

Expected life (years)	2
Interest rate	4%
Volatility	150%
Dividend yield	0%

(iv) On December 12, 2006, the Company closed a $2,475,000 private placement. Under the private placement, the Company issued 3,300,000 units, each unit is comprised of one common share and one-half of one share purchase warrant. Each whole share purchase warrant entitles the holder to acquire one additional common share for a period of two years at a price of $1 per share for the first year, and $1.25 for the second year. A finder's fee of $78,750, equal to 7.5% on the proceeds placed, was paid on a portion of the placement.

(c) Share purchase options

The Company's stock option plan is a rolling plan that authorizes the directors to grant stock options equal to 10% of the issued and outstanding capital stock. As at December 31, 2006, the Company has 996,837 stock options available for issuance.

7. CAPITAL STOCK (Continued)

(c) Share purchase options (Continued)

Details of the status of the Company's stock option plans as at December 31, 2006 and 2005 and changes during the respective years are as follows:

	2006		**2005**	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Outstanding, beginning of year	1,840,000	$ 0.51	1,290,000	$ 0.48
Granted	930,000	$ 0.60	750,000	$ 0.54
Exercised	(175,000)	$ 0.43	0	$ 0.00
Cancelled	0	$ 0.00	(200,000)	$ 0.05
Outstanding and exercisable, end of year	2,595,000	$ 0.53	1,840,000	$ 0.51

As at December 31, 2006 and 2005, the following director, employee and consultant stock options were outstanding:

Expiry Date	Exercise Price	Number of Options **2006**	**2005**
January 21, 2007 (note 11(b))	$ 0.40	200,000	200,000
February 10, 2007	$ 0.45	0	50,000
November 24, 2008	$ 0.48	365,000	390,000
June 10, 2009	$ 0.50	650,000	700,000
March 1, 2010	$ 0.60	500,000	500,000
January 31, 2011	$ 0.45	600,000	0
February 9, 2011	$ 0.65	100,000	0
March 15, 2011	$ 1.20	50,000	0
April 3, 2011	$ 1.10	130,000	0
Balance, end of year		2,595,000	1,840,000
Weighted average outstanding life of options		2.89 years	2.15 years

The Company applies the fair value method using the Black-Scholes option pricing model to account for options granted to employees, directors and non-employees.

7. CAPITAL STOCK (Continued)

(c) Share purchase options (Continued)

During the year ended December 31, 2006, the Company granted 930,000 (2005 - 750,000) stock options to non-employees and as a result, additional compensation expense of $525,606 (2005 - $402,738) was recognized in the accounts of the Company. The Black-Scholes model was calculated based on the following assumptions:

	2006	**2005**
Expected life (years)	5	4
Interest rate	4.07%	4%
Volatility	104%-108%	143%
Dividend yield	0%	0%

(d) Warrants outstanding

	2006		**2005**	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Outstanding, beginning of year	7,140,166	$ 0.53	4,888,242	$ 0.50
Granted	1,650,000	$ 1.00	4,742,666	$ 0.68
Cancelled	0	$ 0.00	(2,163,242)	$ 0.85
Exercised	(5,783,694)	$ 0.49	(327,500)	$ 0.22
Outstanding and exercisable, end of year	3,006,472	$ 0.85	7,140,166	$ 0.53

7. CAPITAL STOCK (Continued)

(d) Warrants outstanding (Continued)

The following warrants are outstanding at December 31, 2006 and 2005:

Expiry Date	Exercise Price	Number of Warrants **2006**	**2005**
January 28, 2006	$ 0.20	0	1,325,000
January 28, 2006	$ 0.25	0	1,072,500
February 4, 2007 (notes 7(b)(i) and (ii))	$ 0.60	665,000	2,067,700
March 8, 2007 (notes 7(b)(i) and (ii))	$ 0.60	562	10,875
March 31, 2007 (notes 7(b)(i) and (ii))	$ 0.75	633,334	700,417
April 8, 2007 (note 7(b)(ii))	$ 0.75	57,576	1,952,621
April 9, 2007 (note 7(b)(ii))	$ 0.75	0	11,053
December 12, 2007/2008 (note 7(b)(iv))	$ 1.00 / $ 1.25	1,650,000	0
Balance, end of year		3,006,472	7,140,166
Weighted average life of warrants outstanding		1.15 years	1 year

(e) Contributed surplus

	2006	**2005**
Balance, beginning of year	$ 1,053,337	$ 623,542
Finder’s fee	0	27,057
Options exercised	(73,577)	0
Stock-based compensation expense	525,606	402,738
Balance, end of year	$ 1,505,366	$ 1,053,337

(f) Escrow shares

On January 28, 2005, the regulatory authorities affected a 15% escrow release of the original escrow shares of the Company held pursuant to the escrow agreement. There were 150,000 shares released. The remaining balance of 300,000 shares held in escrow was also released in 2005.

8. INCOME TAX LOSSES

The Company has operating losses that may be carried forward to apply against future years' income for Canadian income tax purposes. The tax effect has not been recorded in these financial statements. The losses expire as follows:

Available to		
2007	$	57,000
2008		90,000
2009		56,000
2010		194,000
2014		395,000
2015		688,000
2026		615,000
	$	2,095,000

The components of the future income tax assets are as follows:

		2006		2005
Future income tax assets (liabilities)				
Non-capital loss carry-forwards for Canadian tax purposes	$	2,095,000	$	1,480,000
Tax value over book value of capital assets		164,245		126,905
Book value over tax value of share issue costs		63,000		0
Book value of secured loan		0		(349,410)
Tax value over book value of mineral properties		6,583,952		6,945,367
		8,906,197		8,202,862
Appropriate tax rate		34.12%		34.12%
		3,039,000		2,798,800
Valuation allowance		(3,039,000)		(2,798,800)
	$	0	$	0

The valuation allowance reflects the Company's estimate that the tax assets, more likely than not, will not be realized.

8. INCOME TAX LOSSES (Continued)

Significant components of the provision for income taxes are as follows:

		2006		2005
Income tax benefits at statutory rates	$	(504,600)	$	(1,274,300)
Stock-based compensation		179,300		137,400
Non-taxable portion of gain on sale of marketable securities		(51,500)		0
Temporary differences		52,400		879,600
Future income tax benefit resulting from unrecognized losses		324,400		257,300
Income tax expense	$	0	$	0

9. RELATED PARTY TRANSACTIONS

The Company has:

(a) paid accounting fees of $12,000 (2005 - $12,000), management consulting fees of $22,500 (2005 - $nil), and rent of $18,000 (2005 - $18,000) to a company controlled by a common director;

(b) incurred legal fees of $19,513 (2005 - $12,649) with a law firm in which a director is a principal; and

(c) entered into a letter of intent on October 26, 2005 with a company that has a common director (see note 6(c)).

The above charges were measured by the exchange amount, which is the amount agreed upon by the transacting parties and are on terms and conditions similar to non-related entities.

10. COMMITMENT

The Company has entered into an investor relations services contract with the Richmond Club Corp, effective December 21, 2006. The Richmond Club will receive a monthly fee of $1,450 and will be granted 45,000 stock options, vesting 25% every three months exercisable at $0.78 per share, expiring January 29, 2010. The term of the investor relations contract with the Richmond Club is one year.

11. SUBSEQUENT EVENTS

Subsequent to December 31, 2006:

(a) 653,062 warrants at $0.60 per share were exercised, and 15,000 warrants at $0.75 per share were exercised;

(b) 200,000 stock options expired unexercised;

(c) 12,500 share purchase warrants expired; and

11. SUBSEQUENT EVENTS (Continued)

(d) On March 12, 2007, the Company arranged a non-brokered private placement of 5,500,000 units at a price of $0.80 per unit. Each unit consisted of one common share and one-half of one non-transferable warrant. Each whole warrant entitles the holder to purchase one additional share of the Company at a price of $1 per share for the first year of the warrant term, and $1.25 during the second year of the warrant term, subject to forced exercise provisions. A finder's fee of 7.5% of the proceeds placed payable in cash or warrants (exercisable at a price of $0.80 per share) paid on a portion of the placement.

12. SEGMENTED INFORMATION

The Company's one reportable operating segment is the acquisition and exploration of mineral properties. Geographic information is as follows:

	2006	2005
Assets		
Canada	$ 1,927,304	$ 2,841,619
Mongolia	7,130,744	1,415,409
	$ 9,058,048	$ 4,257,028

13. COMPARATIVE FIGURES

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