



HULDRA SILVER INC.

Annual Financial Statements

For the years ended December 31, 2012 and 2011

INDEPENDENT AUDITORS' REPORT

To the Shareholders of
Huldra Silver Inc.

We have audited the accompanying consolidated financial statements of **Huldra Silver Inc.**, which comprise the consolidated statements of financial position as at December 31, 2012 and 2011, and the consolidated statements of operations and comprehensive loss, changes in equity and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of **Huldra Silver Inc.** as at December 31, 2012 and 2011, and its financial performance and its cash flows for the years then ended in accordance with International Financial Reporting Standards.

Emphasis of matter - going concern

Without qualifying our opinion, we draw attention to note 1 to the consolidated financial statements which indicates that the Company had an accumulated deficit of \$29,188,156 as at December 31, 2012 and, as of that date, a working capital deficiency of \$14,566,791. These conditions, along with other matters as set forth in note 1, indicate the existence of material uncertainty that may cast significant doubt on the Company's ability to continue as a going concern.

Vancouver, Canada,
April 29, 2013.

Ernst & Young LLP

Chartered Accountants

HULDRA SILVER INC.
Consolidated Statements of Financial Position
(Expressed in Canadian dollars)

	Note	December 31, 2012	December 31, 2011
Assets			
Current assets			
Cash and cash equivalents	4	\$ 883,169	\$ 1,392,916
Amounts receivable	5	2,742,016	2,220,993
Prepaid expenses and other assets		109,453	335,832
		3,734,638	3,949,741
Non-current assets			
Property, plant, and equipment	6	29,556,353	16,094,608
Mineral Interests	7	766,537	766,537
Restricted cash	9	735,100	80,000
Total assets		\$ 34,792,628	\$ 20,890,886
Liabilities			
Current liabilities			
Accounts payable and accrued liabilities		\$ 2,268,372	\$ 1,348,842
Current portion of Waterton derivative liability	10,17	406,260	141,180
Current portion of Waterton debt obligation	10	10,448,380	2,283,228
Warrant liability	10,17	1,422,005	710,726
Current portion of Craigmont obligation	6	2,962,918	3,000,000
Due to related parties		-	64
Flow-through share premium	15	793,494	-
		18,301,429	7,484,040
Non-current liabilities			
Asset retirement obligation	8	1,405,100	1,405,100
Long-term portion of Waterton derivative liability	10,17	-	67,119
Long-term portion of Waterton debt obligation	10	-	1,960,475
Long-term portion of Craigmont obligation	6	-	2,622,195
Total liabilities		19,706,529	13,538,929
Equity			
Shareholders' equity			
Share capital	12, 13a)	38,693,271	18,974,426
Contributed surplus		5,580,984	3,127,967
Accumulated deficit		(29,188,156)	(14,750,436)
Total equity		15,086,099	7,351,957
Total liabilities and equity		\$ 34,792,628	\$ 20,890,886

Ryan Sharp (signed) Director

Garth Braun (signed) Director

Nature of operations and going concern (Note 1)
Subsequent events (Note 22)

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

HULDRA SILVER INC.
Consolidated Statements of Operations and Comprehensive Loss
(Expressed in Canadian dollars)

	Note	Year Ended December 31	
		2012 (Note 20)	2011 (Note 20)
Operating Expenses			
Exploration costs	7	\$ 7,474,289	\$ 4,997,477
Salaries and benefits		200,839	128,200
Share-based compensation expense	14	1,369,481	1,683,183
Professional fees		211,200	188,156
Management fees	16	96,000	95,000
Consulting fees	16	121,800	92,000
Office and general	16	241,579	125,306
Travel		31,998	28,787
Regulatory fees		13,215	41,158
Transfer agent fees		6,551	17,447
Rent	16	30,000	30,000
Vehicle expenses		10,725	5,585
Depreciation		1,968	1,476
Operating Loss Before Other Items		(9,809,645)	(7,433,775)
Other Items			
Foreign exchange gain		3,835	-
Mark-to-market adjustment on provisionally priced concentrate sales		(64,162)	-
Gravel sales		74,339	37,556
Finance income (costs)		(4,625,583)	(911,004)
Flow-through share premium	15	287,054	317,005
Unrealized gain (loss) on derivative	17	(169,845)	91,701
Unrealized gain (loss) on warrant liability	17	(133,713)	139,607
Net Loss and Comprehensive Loss for the year		\$ (14,437,720)	\$ (7,758,910)
Loss Per Share – Basic and Diluted		\$ (0.36)	\$ (0.36)
Weighted Average Number of Common Shares Outstanding		39,272,169	21,583,768

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

HULDRA SILVER INC.
Consolidated Statements of Cash Flows
(Expressed in Canadian dollars)

		Year Ended December 31	
	Note	2012	2011
Operating Activities			
Net loss for the period		\$ (14,437,720)	\$ (7,758,910)
Adjustments for:			
Share-based compensation expense		1,823,298	1,967,440
Depreciation		499,122	205,414
Loss on disposal of property, plant, and equipment		—	4,523
Gravel sales		(74,339)	(37,556)
Non-cash interest expense	10	4,613,340	915,305
Gain on flow through share premium		(287,054)	(317,005)
Unrealized (gain) loss on derivative	10,17	169,845	(91,701)
Unrealized (gain) loss on warrant liability	10,17	133,713	(139,607)
Foreign exchange gain		(3,027)	—
Mark to market loss on concentrate sales		64,162	—
Changes in non-cash working capital items			
Amounts receivable		(277,153)	(1,354,563)
Prepaid expenses and other receivables		226,379	(48,323)
Accounts payable and other accrued liabilities		20,474	119,288
Cash Used in Operating Activities		(7,528,960)	(6,535,695)
Investing Activities			
Reclamation deposits		(655,100)	—
Purchase of property, plant, and equipment	6	(13,050,411)	(9,122,505)
Proceeds received from sales related to mill commissioning		545,130	—
Purchase of short term-investment		—	(20,000)
Redemption of short-term investment		—	300,000
Cash Used in Investing Activities		(13,160,381)	(8,842,505)
Financing Activities			
Due to directors		(64)	—
Issuance of Special Warrants, net of cash paid share issuance costs		—	8,296,503
Issuance of common shares, net of cash paid share issuance costs		17,935,395	—
Proceeds from Waterton Credit Facility, net of cash borrowing costs		4,898,520	4,578,732
Proceeds from Waterton off-take financing arrangement		221,901	—
Proceeds from exercise of stock options		247,475	110,750
Proceeds from exercise of warrants		2,502,768	1,786,872
Repayment of Craigmont mortgage		(3,000,000)	—
Repayment of Waterton debt obligation		(2,200,000)	—
Payments relating to derivative liabilities		(204,500)	—
Repayment of borrowing under off-take financing arrangement		(221,901)	—
Cash Provided by Financing Activities		20,179,594	14,772,857
Net change in Cash and Cash equivalents for the year		(509,747)	(605,343)
Cash and Cash equivalents, Beginning of year		1,392,916	1,998,259
Cash and Cash equivalents, End of year		\$ 883,169	\$ 1,392,916

Supplemental cash flow information on non-cash transactions 18

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

HULDRA SILVER INC.
Consolidated Statements of Changes in Equity
(Expressed in Canadian dollars)

	Number of Common Shares	Share Capital	Contributed surplus	Accumulated Deficit	Total Equity
Balance, January 1, 2011	17,228,499	\$ 9,165,723	\$ 342,110	(\$ 6,991,526)	\$ 2,516,307
Special Warrant offering, net of cash issuance costs	8,590,246	8,296,503	-	-	8,296,503
Fair value of broker warrants on Special Warrant offering	-	(904,202)	904,202	-	-
Flow through share premium	-	(317,005)	-	-	(317,005)
Common shares issued for cash:					
Stock options exercised	360,000	110,750	-	-	110,750
Warrants exercised	4,634,597	1,786,872	-	-	1,786,872
Transfer to share capital on exercise of warrants	-	18,083	(18,083)	-	-
Transfer to share capital on exercise of stock options	-	67,702	(67,702)	-	-
Common shares issued for land purchase	130,765	150,000	-	-	150,000
Common shares issued for land, permits, mineral claims and mineral leases purchase	372,000	500,000	-	-	500,000
Common shares issued upon execution of Credit Agreement	90,909	100,000	-	-	100,000
Share-based compensation	-	-	1,967,440	-	1,967,440
Net loss for the period	-	-	-	(7,758,910)	(7,758,910)
Balance, December 31, 2011	31,407,016	\$ 18,974,426	\$ 3,127,967	\$(14,750,436)	\$7,351,957
Equity offering, net of cash issuance costs	15,497,314	17,935,394	-	-	17,935,394
Fair value of broker warrants on equity offering	-	(534,868)	534,868	-	-
Flow through share premium	-	(1,080,547)	-	-	(1,080,547)
Common shares issued for cash:					
Stock options exercised	478,500	247,475	-	-	247,475
Warrants exercised	3,206,950	2,502,768	-	-	2,502,768
Transfer to share capital on exercise of warrants	-	99,845	(99,845)	-	-
Transfer to share capital on exercise of stock options	-	250,778	(250,778)	-	-
Common shares issued upon execution of Credit Agreement	266,079	298,000	-	-	298,000
Share-based compensation	-	-	2,268,772	-	2,268,772
Net loss for the period	-	-	-	(14,437,720)	(14,437,720)
Balance, December 31, 2012	50,855,859	\$ 38,693,271	\$ 5,580,984	\$(29,188,156)	\$ 15,086,099

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

HULDRA SILVER INC.
Notes to the Consolidated Financial Statements
(Expressed in Canadian dollars)

1. NATURE OF OPERATIONS AND GOING CONCERN

Huldra Silver Inc. (the "Company" or "Huldra") is a junior exploration company engaged in the business of identification, acquisition and exploration of mineral property interests. The Company's head office is located at # 610 - 837 West Hastings Street, Vancouver, B.C.

Huldra is a publicly listed company incorporated under the Business Corporation Act of British Columbia. The Company is listed on the TSX Venture Exchange and its common shares trade under the symbol "HDA.V".

The recoverability of the amounts shown for resource properties is dependent upon the existence of economically recoverable reserves, the ability of the Company to obtain necessary financing to complete the development of the properties, and upon future profitable production or proceeds from the disposition thereof. The Company presently has no proven or probable reserves and on the basis of information to date, it has not yet determined whether its properties contain economically recoverable ore reserves. Consequently, the Company considers itself to be an exploration stage company. The Company will periodically have to raise funds to continue operations and, although it has been successful in doing so in the past, there is no assurance it will be able to do so in the future.

The consolidated financial statements are prepared on a going concern basis, which assumes that the Company will be able to meet its obligations and continue its operations for its next fiscal year.

As at December 31, 2012, the Company had an accumulated deficit of \$29,188,156 (December 31, 2011 - \$14,750,436) and a working capital deficiency of \$14,566,791 (December 31, 2011 - \$3,534,299 deficit) including current debt obligations of \$13,411,298 (December 31, 2011 - \$5,283,228). These factors represent a material uncertainty that may cast a significant doubt about the Company's ability to continue as a going concern. The Company will be required to raise funds through the issuance of equity or debt, or be successful in the development of the Treasure Mountain mine and Merritt mill. Realization values may be substantially different from carrying values as shown and these consolidated financial statements do not give effect to adjustments that would be necessary to the carrying values and classification of assets and liabilities should the Company be unable to continue as a going concern. (See note 22)

2. BASIS OF PRESENTATION

a) Statement of compliance with International Financial Reporting Standards

The consolidated financial statements of Huldra have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and interpretations of the International Financial Reporting Interpretations Committee ("IFRIC").

These consolidated financial statements have been authorized for release by the Company's Board of Directors on April 29, 2013.

Basis of consolidation

These consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, Huldra Holdings Inc., (formerly 0906262 B.C. Ltd), ("Huldra Holdings"), 0913103 B.C. Ltd., Huldra Properties Inc. (formerly Craigmont Holdings Ltd.), and Thule Copper Corporation. All inter-company balances and transactions have been eliminated on consolidation.

b) Basis of Measurement

These consolidated financial statements are presented in Canadian dollars, which is also the Company's and all its subsidiaries functional currency and have been prepared on a historical cost basis, except for the accounts receivable from concentrate sales, the Waterton derivative liability and the warrant liability, all of which are carried at fair value.

HULDRA SILVER INC.
Notes to the Consolidated Financial Statements
(Expressed in Canadian dollars)

2. BASIS OF PRESENTATION (cont'd)

c) Use of Estimates and Judgments

The preparation of the consolidated financial statements in conformity with IFRS requires management to make judgments and estimates which affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. The judgments that have the most significant effect on the amounts recognized in the Company's consolidated financial statements are as follows:

i) Determination that the Company is in the exploration stage

As at and during the year ended December 31, 2012, a majority of the Company's mineral resources are inferred whereby the economic viability of such resources cannot be determined. Accordingly, the removal of mill feed from the Company's Treasure Mountain project is considered exploration and evaluation activity, and as such, all costs associated with the removal of this mill feed are expensed as exploration costs.

ii) Commencement of commercial production

During the commissioning of the Company's mill, costs incurred are capitalized as property, plant and equipment, and any consideration from commissioning sales are offset against costs capitalized. The Company will declare that the mill is in commercial production once 216 tonnes of Lead/Silver concentrate is produced in a 30 day period.

The significant areas requiring the use of management estimates relate to the estimated metal contained in the Company's concentrate shipments, the estimated provisional pricing, the assumptions used in assigning value to the land, permits, and mineral rights acquired upon the acquisition of Craigmont Holdings Ltd., the valuation of the Waterton debt obligation, the valuation of the warrants issued to Waterton, the estimated useful lives of the mineral interest and milling and other permits, the estimate of the asset retirement obligation, and the assumptions used in determining the fair value of share based compensation.

3. SIGNIFICANT ACCOUNTING POLICIES

a) Cash and Cash Equivalents

Cash and cash equivalents includes cash on hand and all highly liquid investments that are readily convertible into cash with maturity dates not exceeding 90 days from the date of issuance.

b) Restricted Cash

Cash is considered to be restricted as it is subject to rights of a government agency.

c) Property, Plant and Equipment

On initial recognition, property, plant and equipment ("PPE") are valued at cost, being the purchase price and directly attributable costs of acquisition or construction required to bring the asset to the location and condition necessary to be capable of operating in the manner intended by the Company, including appropriate borrowing costs and the estimated present value of any future unavoidable costs of dismantling and removing items.

Property, plant and equipment is subsequently stated at cost less accumulated depreciation, less any accumulated impairment losses, with the exception of land which is not depreciated.

HULDRA SILVER INC.
Notes to the Consolidated Financial Statements
(Expressed in Canadian dollars)

3. SIGNIFICANT ACCOUNTING POLICIES (cont'd)

Subsequent costs are included in the asset's carrying amount or recognized as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Company and the cost can be measured reliably. The carrying amount of a replaced asset is derecognized when replaced. Repairs and maintenance costs are charged to the statement of operations and comprehensive loss during the financial period in which they are incurred.

The Company allocates the amount initially recognized in respect of an item of property, plant, and equipment to its significant parts and depreciates separately each part. Residual values, method of depreciation and useful lives of the assets are reviewed annually and adjusted if appropriate.

Gains and losses on disposal of an item of property, plant, and equipment are determined by comparing the proceeds from disposal with the carrying amount of the asset and are recognized within operating expenses in the statement of operations and comprehensive loss. During the year, no depreciation was recognized on the mill or milling permits as the mill was still in the commissioning phase and not available for its intended use.

Property, plant and equipment are depreciated using the following methods:

Automotive equipment	30% declining balance
Camp and other site infrastructure	5 years straight line
Furniture and office equipment	20% declining balance
Computers	20% declining balance
Heavy machinery and equipment	5 years straight-line

d) Impairment of Non-financial Assets

At the date of each statement of financial position, the carrying amounts of the Company's non-financial assets are reviewed to determine whether there is any indication that those assets are impaired. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment, if any. Where the asset does not generate cash flows that are independent from other assets, the Company estimates the recoverable amount of the cash-generating unit to which the asset belongs.

An asset's recoverable amount is the higher of fair value less costs to sell and value in use. Fair value is determined as the amount that would be obtained from the sale of the asset in an arm's length transaction between knowledgeable and willing parties. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. If the recoverable amount of an asset or cash-generating unit is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount and the impairment loss is recognized in the statement of operations and comprehensive loss for the period.

Where an impairment loss subsequently reverses, the carrying amount of the asset (or cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset (or cash-generating unit) in prior years. A reversal of an impairment loss is recognized immediately in the statement of operations and comprehensive loss.

HULDRA SILVER INC.
Notes to the Consolidated Financial Statements
(Expressed in Canadian dollars)

3. SIGNIFICANT ACCOUNTING POLICIES (cont'd)

e) Mineral Interests

The Company follows the method of accounting for its mineral interests whereby all costs related to acquisition and site restoration are capitalized by project, net of recoveries received. The amounts shown as mineral interests represent costs incurred to date less amounts written off, and do not necessarily represent present or future values. These costs will be amortized against revenue from future production or written off if the interest is abandoned or sold. The ultimate recoverability of amounts capitalized for mineral interests is dependent upon the delineation of economically recoverable ore reserves, the Company's ability to obtain the necessary financing to complete development and realize profitable production or proceeds from the disposition thereof. Management's estimates of recoverability of the Company's investment in various mineral interests have been based on current conditions. However, it is reasonably possible that changes could occur in the near term which could adversely affect management's estimates and may result in future write-downs of capitalized property carrying values.

f) Exploration and Evaluation Expenditures

Exploration and evaluation expenditures ("E&E") excluding mineral interest acquisition and site restoration costs are charged to the statement of operations and comprehensive loss as incurred. When it has been established that a mineral deposit is commercially mineable and a decision has been made to formulate a mining plan (which occurs upon completion of a positive economic analysis of the mineral deposit), the costs subsequently incurred to develop the mine on the property prior to the start of the mining operations are capitalized. Any recoveries received that relate to exploration costs are recorded as a recovery of such costs.

g) Borrowing Costs

Interest and financing costs on debt or other liabilities that are directly attributable to the acquisition, construction and development of a qualifying asset are capitalized to the asset.

On commencement of commercial production, the interest and financing costs are amortized over the life of the qualifying asset. All other borrowing costs are expensed as incurred.

h) Sales of Concentrate

Amounts associated with the sale of concentrate are recognized when all significant risks and rewards of ownership of the concentrate are transferred to the customer, which occurs when the concentrate has been delivered to the customer and collectability is reasonably assured. The sales relating to the mill feed used during the mill commissioning process are credited against the cost of the mill. All other sales are recognized as a recovery of exploration costs given that the Company has not yet completed a positive economic analysis of its mineral interests.

The Company's concentrate sales contracts provide for a provisional payment based upon provisional assays and quoted metal prices. Final settlement is based on applicable commodity prices set on specified quoted periods, which occur two months after the shipment arrives at the smelter and is based on average metal prices. For this purpose, the selling price can be measured reliably for the Company's silver, lead, and zinc sales as there exists an active and freely traded commodity exchange such as the London Metals Exchange and the value of product sold by the Company is directly linked to the form in which it is traded on that market.

HULDRA SILVER INC.
Notes to the Consolidated Financial Statements
(Expressed in Canadian dollars)

3. SIGNIFICANT ACCOUNTING POLICIES (cont'd)

Sales amounts are commonly subject to adjustments based on an inspection of the product by the customer. In such cases, the sales amount is initially recognized on a provisional basis using the Company's best estimate of contained metal, and adjusted subsequently. The amounts recognized on provisionally priced sales are recognized as estimates of the fair value of the consideration receivable based on forward market prices. At each reporting date, provisionally priced metal is marked to market based on the forward selling price for the quoted period stipulated in the contract. Variations between the price recorded at the shipment date and the actual final price set under the smelting contracts are caused by changes in metal prices and result in an embedded derivative in the accounts receivable. The embedded derivative is recorded at fair value each period until final settlement occurs, with the fair value adjustments recognized in the statement of operations and comprehensive loss as mark to market adjustments on provisionally priced contracts.

Treatment charges under the Company's concentrate sales agreement are netted against the sales amount recognized based on the estimated value of the contained metal.

i) Financial Instruments

Financial assets and financial liabilities are recognized on the statements of financial position when the Company becomes a party to the contractual provisions of the financial instrument.

Financial assets

Financial assets are classified into one of the following categories, depending on the purpose for which the asset was acquired. The Company's accounting policy for each category is as follows:

Fair value through profit or loss - This category comprises derivatives, or financial assets acquired or incurred principally for the purpose of selling or repurchasing in the near term. They are carried in the statements of financial position at fair value with changes in fair value recognized in the statement of operations and comprehensive loss.

Loans and receivables - These assets are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They are classified as current assets or non-current assets based on their maturity date. They are carried at amortized cost using the effective interest rate method less any provision for impairment. Individually significant receivables are considered for impairment when they are past due or when other objective evidence is received that a specific counterparty will default. The Company's cash and cash equivalents, short-term investments, amounts receivable and restricted cash are included in this category of financial assets.

Held-to-maturity investments - These assets are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Company's management has the positive intention and ability to hold to maturity. These assets are measured at amortized cost using the effective interest rate method. If there is objective evidence that the investment is impaired, determined by reference to external credit ratings and other relevant indicators, the financial asset is measured at the present value of estimated future cash flows. Any changes to the carrying amount of the investment, including impairment losses, are recognized in the statement of operations and comprehensive income or loss. At December 31, 2012, the Company has not classified any financial assets as held-to-maturity investments.

HULDRA SILVER INC.
Notes to the Consolidated Financial Statements
(Expressed in Canadian dollars)

3. SIGNIFICANT ACCOUNTING POLICIES (cont'd)

Available-for-sale investments - Non-derivative financial assets not included in the above categories are classified as available-for-sale. They are carried at fair value with changes in fair value recognized as other comprehensive income and classified as a component of equity. Where a decline in the fair value of an available-for-sale financial asset constitutes objective evidence of impairment, the amount of the loss is removed from equity and recognized in the statement of operations and comprehensive loss. When financial assets classified as available-for-sale are sold, the accumulated fair-value adjustments recognized in other comprehensive income are included in the statement of operations and comprehensive loss. At December 31, 2012, the Company has not classified any financial assets as available-for-sale.

All financial assets except for those classified as fair value through profit or loss are subject to review for impairment at least at each reporting date. Financial assets are impaired when there is any objective evidence that a financial asset or a group of financial assets is impaired. Different criteria to determine impairment are applied for each category of financial assets, which are described above.

Financial liabilities

The Company classifies its financial liabilities into one of two categories, depending on the purpose for which the liability was incurred. The Company's accounting policy for each category is as follows:

Fair value through profit or loss - This category comprises derivatives, or liabilities acquired or incurred principally for the purpose of selling or repurchasing in the near term. They are carried in the statement of financial position at fair value with changes in fair value recognized in the statement of operations and comprehensive loss. At December 31, 2012, the Company has classified the derivative liabilities and the warrant liability associated with the Waterton debt in this category.

Other financial liabilities - This category includes due to directors, accounts payable and accrued liabilities and the Craigmont obligation, all of which are recognized at amortized cost using the effective interest method. At December 31, 2012, the Company has classified the current portion of the Waterton debt in this category.

Transaction costs in respect of financial instruments at fair value through profit or loss are recognized in the statement of operations and comprehensive loss immediately, while transaction costs associated with all other financial instruments included in the initial measurement of the financial instrument.

j) Share Capital

Common shares are classified as equity. Incremental costs directly attributable to the issue of common shares and share options are recognized as a deduction from equity, net of tax, from the proceeds.

HULDRA SILVER INC.
Notes to the Consolidated Financial Statements
(Expressed in Canadian dollars)

3. SIGNIFICANT ACCOUNTING POLICIES (cont'd)

k) Share-based Payments

The Company has a stock option plan that is described in Note 14a. The stock option plan allows Company employees and consultants of the Company to acquire shares of the Company. The fair value of options granted is recognized as an employee or consultant expense with a corresponding increase in equity. An individual is classified as an employee when the individual is an employee for legal or tax purposes (direct employee) or provides services similar to those performed by a direct employee.

Options issued to Employees and others providing similar services

The fair value of employee options are measured at grant date, and each tranche is recognized using the graded vesting method over the period during which the options vest. The fair value at grant date is determined using a Black-Scholes option pricing model that takes into account the exercise, the term of the option, the impact of dilution, the share price at grant date and expected volatility of the underlying share, the expected dividend yield and the risk free interest rate for the term of the option.

Options issued to Non-Employees

Options issued to non-employees are measured based on the fair value of the goods or services received, at the date of receiving those goods or services. If the fair value of the goods or services cannot be estimated reliably, the options are measured by determining the fair value of the options granted, using a Black-Scholes option pricing model.

l) Income Taxes

Income tax comprises current and deferred tax. Income tax is recognized in the statement of operations and comprehensive loss except to the extent that it relates to items recognized directly in equity, in which case the income tax is also directly recognized as equity.

Current tax expense is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the end of the reporting period, and any adjustments to tax payable in respect of previous years.

Deferred tax is provided using the liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax provided is based on the expected manner of realization or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date.

The carrying amount of deferred tax assets are reviewed at the end of each reporting period and reduced to the extent it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilized. Unrecognized deferred tax assets are reassessed at the end of each reporting period and are recognized to the extent it becomes probable that future taxable profit will be available to allow the deferred tax asset to be recovered.

Deferred tax assets and liabilities are offset when there is a legally enforceable right to offset, and they relate to the income taxes levied by the same tax authority and the Company intends to settle current tax liabilities and assets on a net basis or their tax assets and tax liabilities will be realized simultaneously.

Deferred income tax liabilities are recognized for all taxable temporary differences, except where the deferred income tax liability arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit.

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3. SIGNIFICANT ACCOUNTING POLICIES (cont'd)

m) Provisions

Provisions are recognized where a legal or constructive obligation has been incurred as a result of past events; it is probable that an outflow of resources embodying economic benefit will be required to settle the obligation; and a reliable estimate of the amount of the obligation can be made. If material, provisions are measured at the present value of the expenditures expected to be required to settle the obligation. The increase in any provision due to passage of time is recognized as finance costs in the statement of operations and comprehensive loss.

n) Asset Retirement Obligation

The Company records the present value of estimated costs of legal and constructive obligations required to restore the site in the period in which the obligation is incurred. The nature of these restoration activities include dismantling and removing structures, rehabilitating mines and tailings dam, dismantling facilities, closure of plant and waste sites and restoration, reclamation and re-vegetation of affected areas.

The obligation for mine closure activities are estimated by the Company using mine closure plans or other similar studies which outline the requirements that will be carried out to meet the obligations. Since the obligations are dependent on the laws and regulations of the countries in which the mines operate, the requirements could change as a result of amendments in the laws and regulations relating to environmental protection and other legislation affecting resource companies.

As the estimate of the obligations is based on future expectations, a number of assumptions and judgments are made by management in the determination of closure provisions. The closure provisions are more uncertain the further into the future the mine closure activities are to be carried out.

The present value of decommissioning and site restoration costs are recorded as a non-current liability. The provision is discounted using a real, risk free pre-tax discount rate. Charges for accretion and restoration expenditures are recorded as operating activities. In subsequent periods, the carrying amount of the liability is accreted by a charge to the statement of operations and comprehensive loss to reflect the passage of time and the liability is adjusted to reflect any changes in the timing of the underlying future cash flows.

Changes to the obligation resulting from any revisions to the timing or amount of the original estimate of undiscounted cash flows are recognized as an increase or decrease in the decommissioning provision, and a corresponding change in the carrying amount of the related long-lived asset. Where rehabilitation is conducted systematically over the life of the operation, rather than at the time of closure, or provision is made for the estimated outstanding continuous rehabilitation work at each balance sheet date the cost is charged to the statement of operations and comprehensive loss.

Costs for restoration of subsequent site damage which is created on an ongoing basis during production are provided for at their net present values and charged against the statement of operations and comprehensive loss as extraction progresses.

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3. SIGNIFICANT ACCOUNTING POLICIES (cont'd)

o) Flow-Through Shares

Current Canadian tax legislation permits mining entities to issue flow-through shares to investors. Flow-through shares are securities issued to investors whereby the deductions for tax purposes related to exploration and evaluation expenditures may be claimed by investors instead of the entity. The issue of flow-through shares is in substance an issue of ordinary shares and the sale of tax deductions. At the time the Company issues flow-through shares, the sale of tax deductions is deferred and presented as other liabilities in the statement of financial position to recognize the obligation to incur and renounce eligible resource exploration and evaluation expenditures. The tax deduction is measured as the difference between the current market price of the Company's common shares and the issue price of the flow-through share. Upon incurring and renouncing eligible resource exploration and evaluation expenditures, the Company recognizes the sale of tax deductions as a flow through share premium on the statement of operations and comprehensive loss and reduces the liability.

p) Loss per Share

Basic and diluted loss per share is calculated by dividing the loss attributable to common shareholders of the Company by the weighted average number of common shares outstanding during the period. For all periods presented, the loss available to common shareholders equals the reported loss. Diluted loss per share does not adjust the loss attributable to common shareholders when the effect is anti-dilutive.

As the Company incurred net losses in all periods presented, the stock options and share purchase warrants as disclosed in Notes 14 and 13 respectively, were not included in the computation of diluted loss per share as their inclusion would be anti-dilutive.

q) Related Party Transactions

Parties are considered to be related if one party has the ability, directly or indirectly, to control the other party or exercise significant influence over the other party in making financial and operating decisions. Related parties may be individuals or corporate entities. A transaction is considered to be a related party transaction when there is a transfer of resources, services or obligations.

r) Operating Segments

The Company operates in one segment being the exploration and development of its mineral exploration properties. All of the Company's assets are located in Canada.

s) New Standards, Amendments and Interpretations not yet Effective

The following is an overview of accounting standard changes the Company will be required to adopt in future years. Except as otherwise noted below for IFRS 9 and IAS 32, the standards are effective for the Company's annual periods beginning on or after January 1, 2013, with earlier application permitted. The Company will not adopt any of these standards before their effective dates. The adoption of these standards is not expected to have a material impact on the Company's consolidated financial statements. Some updates that are not applicable or are not consequential to the Company may have been excluded from the list below.

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3. SIGNIFICANT ACCOUNTING POLICIES (cont'd)

IFRS 9 – Financial Instruments Disclosure

IFRS 9 *Financial Instruments* introduces new requirements for the classification and measurement of financial assets. IFRS 9 requires all recognized financial assets that are within the scope IAS 39 *Financial Instruments: Recognition and Measurement* to be subsequently measured at amortized cost or fair value. Specifically, financial assets that are held with a business model whose objective is to collect the contractual cash flows, and that have contractual cash flows that are solely payment of principal and interest on the principal outstanding, are generally measured at amortized cost at the end of subsequent accounting periods. All other financial assets including equity investment are measured at their fair values at the end of subsequent accounting periods.

Requirements for financial liabilities were added in October 2010 and they largely carried forward existing requirements in IAS 39, except that fair value changes due to credit risk for liabilities designated at fair value through profit and loss would generally be recorded in other comprehensive earnings (loss).

IFRS 9 is effective for annual periods beginning on or after January 1, 2015. The Company will continue to evaluate the impact of this standard on its consolidated financial statements.

IFRS 10 – Consolidation

IFRS 10 requires an entity to consolidate an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. Under existing IFRS, consolidation is required when an entity has the power to govern the financial and operation policies of an entity so as to obtain benefits from its activities. IFRS 10 replaces SIC-12 *Consolidation – Special Purpose Entities* and parts of IAS 27 *Consolidated and Separate Financial Statements*.

IFRS 11- Joint Arrangements

IFRS 11 requires a venture to classify its interest in a joint arrangement as a joint venture or joint operation. Joint ventures will be accounted for using the equity method of accounting, whereas for a joint operation the venture will recognize its share of the assets, liabilities, revenue and expenses of the joint operation. Under existing IFRS, entities have the choice to proportionately consolidate or equity account for interest in joint ventures. IFRS 11 supersedes IAS 31, *Interest in Joint Ventures*, and SIC-13, *Jointly Controlled Entities – Non-monetary Contributions by Venturers*.

IFRS 12 – Disclosure of Interest in Other Entities

IFRS 12 establishes disclosure requirements for interest in other entities, such as joint arrangements, associates, special purpose vehicles and off statement of financial position vehicles. The standard carries forward existing disclosures and also introduces significant additional disclosure requirements that address the nature of, and risks associated with, an entity's interest in other entities.

IFRS 13 – Fair Value Measurement

Under existing IFRS, guidance on measuring and disclosing fair value is dispersed among the specific standards requiring fair value measurements. IFRS 13 is a more comprehensive standard for fair value measurement and disclosure requirements for use across all IFRS standards. The new standard clarifies that fair value is the price that would be received to sell an asset, or paid to transfer a liability in an orderly transaction between market participants, at the measurement date. It also establishes disclosures about fair value measurement.

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4. CASH AND CASH EQUIVALENTS

The Company's cash and cash equivalents at December 31, 2012 consisted of cash of \$883,169 and cash equivalents of \$nil (December 31, 2011 - cash of \$1,370,416 and cash equivalents of \$22,500).

5. AMOUNTS RECEIVABLE

	December 31, 2012	December 31, 2011
Accounts receivable from concentrate sales	\$ 593,215	\$ -
Other receivable	\$ 1,298	\$ 1,226
HST receivable, (net)	\$ 326,917	\$ 1,388,105
METC receivable (note 22)	\$ 1,820,586	\$ 831,662
	<u>\$ 2,742,016</u>	<u>\$ 2,220,993</u>

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6. PROPERTY, PLANT AND EQUIPMENT

	Land and Permits \$	Camp and Other Site Infrastructure \$	Ore Processing Mill Deposit & Construction \$	Heavy Machinery and Equipment \$	Computers \$	Furniture and Office Equipment \$	TOTAL \$
Cost							
Balance at January 1, 2011	—	—	—	20,020	3,351	1,605	24,976
Additions	7,928,461	728,393	6,110,863	1,510,270	2,978	3,126	16,284,091
Disposals	—	(5,168)	—	—	—	—	(5,168)
Balance at December 31, 2011	7,928,461	723,225	6,110,863	1,530,290	6,329	4,731	16,303,899
Additions	415,062	5,941	14,266,631	281,536	40,587	—	15,009,757
Recoveries from sales of concentrate	—	—	(1,040,819)	—	—	—	(1,040,819)
Disposals	—	(10,760)	—	—	—	—	(10,760)
Balance at December 31, 2012	8,343,523	718,406	19,336,675	1,811,826	46,916	4,731	30,262,077
Accumulated Depreciation							
Balance at January 1, 2011	—	—	—	2,958	1,404	160	4,522
Depreciation for the period	—	58,053	—	145,730	815	816	205,414
Reclassification	—	(645)	—	131	—	(131)	(645)
Balance at December 31, 2011	—	57,408	—	148,819	2,219	845	209,291
Depreciation for the period	—	136,359	—	358,380	3,588	796	499,123
Disposals	—	(2,690)	—	—	—	—	(2,690)
Balance at December 31, 2012	—	191,077	—	507,199	5,807	1,641	705,724
Carrying Amounts							
At January 1, 2011	—	—	—	17,062	1,947	1,445	20,454
At December 31, 2011	7,928,461	665,817	6,110,863	1,381,471	4,110	3,886	16,094,608
At December 31, 2012	8,343,523	527,329	19,336,675	1,304,627	41,109	3,090	29,556,353

On February 24, 2011, the Company, under a purchase and sale agreement, completed the acquisition of four district lots located at Treasure Mountain, British Columbia for a total consideration of \$350,000 consisting of \$200,000 cash and 130,765 common shares of the Company having a total value of \$150,000. Additionally, property transfer tax paid of \$3,500 was added to the cost base.

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6. PROPERTY, PLANT AND EQUIPMENT (cont'd)

The Company announced on May 5, 2011 that it had completed the definitive strategic acquisition agreement dated March 30, 2011 (the "Original Agreement") with Craigmont Holdings Ltd. ("Craigmont") and a wholly owned subsidiary of the Company whereby the Company acquired 100% of the shares (the "Craigmont Shares") of Craigmont. The Company paid the vendor consideration consisting of cash of \$500,000, the issuance of 372,000 shares of the Company with a value of \$500,000 and the granting of a non-interest bearing vendor mortgage where \$3,000,000 was payable on January 31, 2012 and \$3,100,000 (net of estimated environmental remediation costs of \$900,000) is payable on January 31, 2013. Because the vendor mortgage is non-interest bearing, the Company discounted the repayment amounts at a discount rate of 14%, such that the amount recorded for the mortgage on the date of the transaction was \$5,164,724. This value has been accreted to face value and capitalized as a borrowing cost relating to the acquisition of the assets acquired at a rate of 14% over the term of the mortgage. During the year ended December 31, 2012, \$415,062 (2011 - \$495,426) of interest on this mortgage has been capitalized. With regards to the allocation of consideration, the Company allocated \$7,064,724 to land and permits, \$900,000 to asset retirement obligation (See note 8), \$200,000 to mineral interests and \$200,000 to accrued liabilities relating to the continuing interest retained by the vendors in the mineral interests.

In connection with the closing of the acquisition of Craigmont, the Company caused Craigmont to grant to the vendors a guarantee of the obligation of the Company to pay the amounts outstanding to the vendors; and a mortgage in favour of the vendors over the seven parcels of land owned by Craigmont as security for such guarantee. The vendors agreed that, upon payment of the \$3,000,000 due to the vendors on January 31, 2012, the vendors will discharge the mortgage with respect to all of the parcels of land except for two parcels. Until such payment was made, the Company was not entitled to cause any secondary charges to be placed on the titles to any of the mortgaged parcels of land. The vendors will continue to hold a mortgage over those two parcels until the balance of the cash consideration owing under the purchase agreement is paid to the vendors.

On January 31, 2012, the repayment terms of the vendor mortgage were amended. Pursuant to the terms of the amended agreement, the parties agreed to revise the time in which the vendor may recover magnetite from the Company's milling property and to extend and amend payments due to the vendor by the Company.

Under the amended agreement, the \$3,000,000 payment originally due January 31, 2012, was split into two installments where the first installment of \$800,000 was payable on January 31, 2012 and the second installment of \$2,200,000 was payable upon the earlier of (i) the commissioning of the Company's mill and (ii) June 30, 2012. The first installment was paid by the Company on January 31, 2012 and the second installment was paid in two payments, where \$500,000 was paid May 24, 2012 and the remaining \$1,700,000 was paid on June 29, 2012.

In addition, the payment originally due January 31, 2013 was also amended so that \$3,100,000 (net of estimated environmental remediation costs of \$900,000) is payable January 31, 2013 and the Company is required to pay the vendors on or prior to June 30, 2014, a final adjustment amount to reimburse the vendors for any site remediation undertaken by the vendors prior to June 30, 2014. The Company has recognized the estimated environmental remediation costs associated with the site as part of its asset retirement obligation. (See note 8).

Subsequent to December 31, 2012, the Company further amended the terms of the mortgage with the Craigmont vendors. (See note 22e).

On June 21, 2011, the Company announced that it had entered into a Purchase and Service Agreement with Canadian Royal Mining Corporation of Chilliwack, British Columbia, to acquire a two hundred (200) ton per day modular silver, lead, zinc process plant. The mill was delivered to the Company's milling property in Merritt, British Columbia during the fourth quarter of 2011 and at December 31, 2012 was currently in the commissioning phase.

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7. MINERAL INTERESTS

Upon incorporation in 1980, the Company acquired from two directors in consideration of 750,000 vendor's shares, a 100% interest in 38 mineral claims at Treasure Mountain, located 27 km east of Hope, British Columbia. These 38 mineral claims, or their subsequent conversions, covering the area of the developed vein deposit, the projected vein extensions and several other exploration targets, have been maintained in continuous good standing since 1980. In May 2011, the Company acquired a 100% interest in 20 mineral claims and 10 mineral leases through its 100% share acquisition of Craigmont.

The Company's group of claims consists of the following:

	December 31, 2012	December 31, 2011
	\$	\$
a) The Company acquired from its directors the Treasure Mountain group of claims located in the Similkameen Mining Division of British Columbia for a consideration of 750,000 shares at \$0.01 per share.	7,500	7,500
b) The Company acquired a Crown Grant mineral claim to Lot 1210 in the Yale Mining Division contiguous to the Treasure Mountain Claims known as the "Eureka" for cash consideration of \$14,437.	14,437	14,437
c) The Company acquired the surface rights to Lot 1209 located in the Yale Mining Division of British Columbia known as the "Whynot Fraction" for cash consideration of \$39,500.	39,500	39,500
d) The Company acquired 20 mineral claims and 10 mineral leases as part of its 100% share acquisition of Craigmont. Of the total consideration, \$200,000 was allocated to the mineral claims and mineral leases.	200,000	200,000
e) Provision for Treasure Mountain reclamation.	505,100	505,100
	<u>766,537</u>	<u>766,537</u>

HULDRA SILVER INC.
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7. MINERAL INTERESTS (cont'd)

Cumulative exploration costs incurred are as follows:

	Year Ended December 31,	
	2012 \$	2011 \$
EXPLORATION COSTS, beginning of period	10,881,717	5,884,240
Costs incurred during the year		
Engineering	232,224	280,348
Insurance	50,832	26,980
Meals and travel living allowance	5,065	4,894
Property tax	27,498	16,808
Assessment work and assay costs	98,228	40,779
Exploration supplies and camp expenses	1,089,524	711,345
Water sampling	20,931	27,801
Salaries and benefits	3,558,784	1,452,784
Share-based compensation	453,817	284,257
Construction planning	6,250	97,123
Fuel and propane	693,217	338,132
Vehicle & equipment expense	200,306	137,066
Depreciation	497,154	203,938
Permitting	117,363	134,411
Metallurgical	3,000	10,000
Road rehabilitation	179,998	339,210
Drilling	—	814,831
Surveying	155,318	9,494
Outsourced labor	353,787	142,913
Tenure lease	6,329	2,749
Excavation	—	—
Freight	43,154	26,970
Equipment rentals	308,403	391,516
Geological	104,487	31,671
Geotechnical	7,502	—
Explosives	287,551	195,404
Trucking expense	128,058	101,896
Data compilation and field program	2,500	10,319
Recovery of costs	(1,156,991)	(836,162)
Total costs incurred during the year	<u>7,474,289</u>	<u>4,997,477</u>
CUMULATIVE EXPLORATION COSTS, end of year	<u>18,356,006</u>	<u>10,881,717</u>

8. ASSET RETIREMENT OBLIGATION

As part of the acquisition of Craigmont, the Company assumed the asset retirement obligation relating to the Craigmont property. Based on costs negotiated with the vendor, and a prior study of the costs to be incurred that was performed in 2002, management estimated the cost to remediate the Craigmont property on the date of acquisition (as expressed in current dollars at the time of the acquisition) at \$900,000. As the Company intends to settle the obligation at the end of the estimated useful life of the mill of 30 years, the Company has discounted the estimated costs using a real discount rate of 0%.

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8. ASSET RETIREMENT OBLIGATION (cont'd)

As part of the original acquisition agreement with the vendors, the Company had agreed to commission a detailed study of the costs required to remediate the Craigmont property. As a result of an amendment to the agreement subsequent to year end, the detailed study is no longer required and the Company has agreed with the vendor that the environmental remediation costs will be settled for \$900,000 and are no longer subject to further adjustment. (See note 22e). As at December 31, 2012, there has been no change in either the estimated costs to settle the obligation or the real discount rate. In order to obtain its milling permits, the Company posted collateral of \$230,000 with the government in May 2012 and agreed to deposit further collateral of \$400,000 in March 2013. (See note 22h).

The Company's asset retirement obligation associated with the Treasure Mountain site is calculated as the net present value of estimated future net cash outflows of the reclamation costs, which at December 31, 2012 total \$505,100 (December 31, 2011 - \$505,100) and are required to satisfy the obligations, discounted using a real discount rate of 0% per annum (December 31, 2011 - 0% per annum). The settlement of the obligation is currently expected to occur in 2017.

In order to obtain its final permits, the Company posted collateral with the government in an amount equal to this obligation.

9. RESTRICTED CASH

The Company has in place deposits amounting to \$735,100 as at December 31, 2012 (December 31, 2011 - \$80,000) registered in the name of the British Columbia Ministry of Finance as security for its mining permit and for reclamation clean up at both the Treasure Mountain property and the Merritt Mill property.

10. WATERTON DEBT

On June 16, 2011, the Company entered into a credit agreement (the "Credit Agreement") with Waterton Global Value, L.P. ("Waterton") pursuant to which Waterton agreed to make a \$10,000,000 credit facility (the "Credit Facility") available to the Company, which could be drawn down, at the Company's option, in up to four advances, with the first advance consisting of \$3,000,000, the second advance consisting of \$2,000,000 and each of the third and fourth advances consisting of \$2,500,000. Provision of any advances under the Credit Facility by Waterton was subject to the satisfaction or waiver of certain conditions as set out in the Credit Agreement.

The Company was permitted to draw down the advances at any time until May 31, 2012 and all amounts outstanding were originally to be repaid on a monthly basis during the period from May 2012 to April 2013. If the price of silver exceeds \$27.50 per ounce on a given repayment date, an additional amount is required to be paid (the "Silver Adjustment Provision"). In addition, the Company may prepay any portion of the amounts borrowed at any time, and, is required to repay the amounts borrowed immediately in the event of the change in control. Because the Silver Adjustment Provision, the prepayment option, and the change in control requirement are not closely related to the underlying debt instrument, the Company has separately accounted for these features as derivative liabilities on a fair value basis.

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10. WATERTON DEBT (cont'd)

In connection with the entry into the Credit Facility, the Company and its wholly owned subsidiary, Huldra Holdings agreed to grant Waterton security over substantially all of their respective assets to secure the repayment obligations under the Credit Facility. The Credit Facility is secured by guarantees provided by each of the Company and Huldra Holdings Inc.; general security agreements with the Company and Huldra Holdings, pursuant to which Waterton holds a security interest in all present and after-acquired personal property of the Company and Huldra Holdings; and a debenture pursuant to which Waterton holds a charge over the real property and mineral claims comprising the Treasure Mountain property.

On June 17, 2011, the Company borrowed the first advance of \$3,000,000 under the Credit Agreement. As the Silver Adjustment Provision, the prepayment option, and the change in control requirement are accounted for separately, the estimated value of these features of \$180,000 has been deducted from the proceeds received. In addition, the Company incurred transaction costs of \$1,300,601 associated with the arrangement of the Credit Facility and drawdown of the first advance, which include \$850,333 assigned to the warrants (See notes 13 and 17). These transaction costs have also been deducted from the proceeds received to determine the initial face value of the host debt instrument of \$1,519,399. The host debt instrument is accounted for on an amortized cost basis using the effective interest rate method. The effective interest rate of the host debt for the first advance at the time the advance was drawn was 70.41%.

On July 28, 2011, the Company drew down the second advance of \$2,000,000. As the Silver Adjustment Provision, the prepayment option, and the change in control requirement are accounted for separately, the estimated value of these features of \$120,000 has been deducted from the proceeds received. In addition, the Company incurred transaction costs of \$71,000 associated with the drawdown of the second advance. These transaction costs have also been deducted from the proceeds received to determine the initial face value of the host debt instrument of \$1,809,000. The host debt instrument is accounted for on an amortized cost basis using the effective interest rate method. The effective interest rate of the host debt for the second advance at the time the advance was drawn was 28.87%. There were no warrants issued in connection with the second advance.

On January 17, 2012, the Company drew down the third advance of \$2,500,000. As the Silver Adjustment Provision, the prepayment option, and the change in control requirement are accounted for separately, the estimated value of these features of \$139,609 has been deducted from the proceeds received. In addition, the Company incurred transaction costs of \$677,566 associated with the drawdown of the third advance, which include \$577,566 assigned to the warrants (See notes 13 and 17). These transaction costs have also been deducted from the proceeds received to determine the initial face value of the host debt instrument of \$1,682,825. The host debt instrument is accounted for on an amortized cost basis using the effective interest rate method. The effective interest rate of the host debt for the third advance at the time the advance was drawn was 86.41%.

On May 16, 2012, the Company entered into an amending agreement (the "First Amendment") with Waterton pursuant to which it amended the terms of the Credit Agreement. Under the terms of the First Amendment, the repayment dates were changed from 12 monthly repayments of equal amounts starting May 31, 2012 to 10 monthly repayments of equal amounts starting July 31, 2012. The Silver Adjustment Provision was also amended so that it was also payable only on the new repayment dates starting in July 2012. Furthermore, the First Amendment also amended the conditions necessary for the drawdown of the fourth advance such that the Company was entitled to drawdown the fourth advance immediately as the Company had received a Mining Lease and a British Columbia Mines Act Permit approving a mine plan and reclamation program for the Treasure Mountain Project, along with an Amended Permit approving construction and operation of a processing plant at the mill site.

In consideration of the foregoing, the Company agreed to increase the number of warrants to be given to Waterton in connection with the drawdown of the fourth advance from 650,000 to 1,000,000. The terms of the warrants were also amended so that, if issued, they would have an exercise price of \$1.30 throughout the term of the warrant.

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10. WATERTON DEBT (cont'd)

The Company has determined that the terms of the First Amendment were not substantially different from the terms of the original Credit Agreement. Therefore, no gain or loss was recognized as a result of the First Amendment and the effective interest rate of the debt associated with the first advance was amended from 70.41% to 57.94%, the effective interest rate of the debt associated with the second advance was amended from 28.87% to 24.37%, and the effective interest rate of the debt associated with the third advance was amended from 86.41% to 70.71%.

On May 23, 2012, the Company drew down the fourth advance of \$2,500,000. As the Silver Adjustment Provision, the prepayment option and the change in control requirement are accounted for separately, the estimated value of these features of \$92,008 has been deducted from the proceeds received. In addition, the Company incurred transaction costs of \$101,481 associated with the drawdown of the fourth advance. These transaction costs have also been deducted from the proceeds received to determine the value of the host debt instrument of \$2,306,511. The host debt instrument is accounted for on an amortized cost basis using the effective interest rate method. The effective interest rate of the host debt for the fourth advance at the time the advance was drawn was 65.08%. Furthermore, because the warrants issued in connection with the fourth advance are considered equity instruments (see note 13) and the Company estimates that the fair value of the host debt equals or exceeds \$2,306,511 no amount has been allocated to the warrants issued.

On July 30, 2012, the Company entered into a second amending agreement (the "Second Amendment") with Waterton pursuant to which it further amended the terms of the Credit Agreement. Under the Second Amendment, the repayment terms were amended from 10 equal payments starting on July 31, 2012 to 9 monthly payment of varying amount starting August 31, 2012 and ending April 30, 2013. In this regard, the Second Amendment reduced the amount of the August and September payments by over fifty percent however this resulted in an increase in the repayment amounts starting October 31, 2012. The Silver Adjustment Provision was also amended so that it was also payable only on the new repayment dates starting in August 2012.

In consideration for these amendments, the Company agreed to (i) issue 180,000 common shares of the Company to Waterton (which were issued) and (ii) pay to Waterton a \$200,000 cash payment on April 30, 2013 which has been added to the final principal payment amount of the debt. The fair value of the common shares issued was \$198,000 and was considered a transaction cost associated with the Second Amendment. The Company has determined that the terms of the Second Amendment were not substantially different from the terms of the First Amendment. Therefore, no gain or loss was recognized as a result of the Second Amendment and the effective interest rate of the debt associated with the first advance was amended from 57.94% to 52.30%, the effective interest rate of the debt associated with the second advance was amended from 24.37% to 26.06%, the effective interest rate of the debt associated with the third advance was amended from 70.71% to 61.97%, and the effective interest rate of the debt associated with the fourth advance was amended from 65.08% to 57.75%.

On October 24, 2012, the Company entered into a third amending agreement (the "Third Amendment") with Waterton pursuant to which it further amended the terms of the Credit Agreement. Under the Third Amendment, the repayment term for the payments to be made between October 31, 2012 and April 30, 2013 were amended so that the October 31, 2012 and November 30, 2012 repayment amounts have each been reduced by \$887,607, with such reduction resulting in a corresponding increase in the March 29, 2013 and April 30, 2013 repayment amounts. The Silver Adjustment Provision was also amended so that the amount payable on each repayment date continued to be based on the debt repayment amount for that date.

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10. WATERTON DEBT (cont'd)

In consideration for these amendments, the Company agreed to pay to Waterton an additional \$300,000 cash payment on April 30, 2013 which has been added to the final principal payment amount of the debt. In addition, the Company has agreed to enter into a legally binding and effective concentrate off-take agreement with Waterton whereby Waterton will purchase concentrate from the Company under terms and conditions acceptable to Waterton, acting reasonably. The Company has determined that the terms of the Third Amendment were not substantially different from the terms of the Second Amendment. Accordingly, no gain or loss was recognized as a result of the Third Amendment and the effective interest rate of the debt associated with the first advance was amended from 52.30% to 46.52%, the effective interest rate of the debt associated with the second advance was amended from 26.06% to 30.15%, the effective interest rate of the debt associated with the third advance was amended from 61.97% to 53.68%, and the effective interest rate of the debt associated with the fourth advance was amended from 57.75% to 50.57%.

On December 31, 2012, the Company agreed with Waterton to extend the December 31, 2012 payment so that \$600,000 of the required debt and Silver Participation Amounts of \$1,792,675 was payable immediately with the remaining amount being payable on or before January 30, 2013. The amount due immediately was repaid on January 2, 2013 and the remaining amount was further amended subsequent to December 31, 2012 (See note 22). As consideration for this extension, the Company agreed to pay on January 30, 2013, a fee equal to the aggregate of \$23,854 and the sum of 2% of the remaining December 31, 2012 repayment amount outstanding if any, on January 15, 2013 and 2% of the remaining December 31, 2012 repayment amount outstanding, if any, on January 29, 2013.

The Credit Facility, as amended, requires the Company to satisfy certain covenants so long as any amount owing under the Credit Agreement remains unpaid or the Company has any obligation under the Credit Agreement, which among others include the following:

- a) The Company shall not dispose of any asset (including, without limitation, any securities other than securities issued directly from the Company's treasury) other than (i) bona fide sales of inventory (including tailings produced at the Company's mining properties) in the ordinary course of business for the purposes of carrying on the business and at fair market value, (ii) the sale of any asset (other than securities) which has no material economic value in the business and is obsolete provided the fair value of such asset does not exceed, when aggregated with the fair market value of all other assets sold, \$100,000, (iii) any disposal to the extent that the related disposal proceeds are applied in repayment and/or repayment of the advances made under the Credit Facility, with the exception of certain assets as set out in the agreement.
- b) The Company shall not declare, make or pay any dividend or other distribution on issued shares of the Company or any of its subsidiaries.

During the years ended December 31, 2012 and 2011, the change in the Waterton debt obligation is summarized as follows:

	2012	2011
Opening Balance	\$ 4,243,703	-
Initial Drawdown, net of transaction costs and fair value allocated to derivative liabilities	\$ 3,989,337	3,328,399
Finance Costs	\$ 4,613,340	915,904
Transaction costs relating to amendments	(198,000)	-
Repayments	\$ (2,200,000)	-
	<u>\$ 10,448,380</u>	<u>4,243,703</u>
Less: current portion	\$(10,448,380)	(2,283,228)
Long-term portion	<u>\$ Nil</u>	<u>1,960,475</u>

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11. 2011 SPECIAL WARRANT FINANCING

On July 14, 2011, the Company announced that it raised aggregate gross proceeds of \$9,336,763 by way of a brokered private placement financing (the "Special Warrant Financing") of 6,476,880 special warrants (the "Special Warrants") at a price of \$1.05 per Special Warrant and 2,113,366 flow-through special warrants (the "FT Special Warrants") at a price of \$1.20 per FT Special Warrant (the Special Warrants and FT Special Warrants collectively, the "Offered Securities"). The Special Warrant Financing was completed pursuant to an agency agreement dated July 14, 2011 among the Company, National Bank Financial Inc. ("NBF") and Pope & Company Limited ("Pope") (NBF and Pope collectively, the "Agents"). Bayfront Capital Partners Ltd. ("Bayfront") received a finder's fee in connection with the Special Warrant Financing.

The Company used the proceeds of the Special Warrant Financing to advance its Treasure Mountain project towards production, for mill design and construction and for general working capital purposes. The Company used the gross proceeds of the sale of the FT Special Warrants to incur expenses that qualify as "Canadian exploration expenses" and "flow-through mining expenditures" for purposes of the Income Tax Act (Canada), and renounced an amount equal to such gross proceeds of the sale of the FT Special Warrants in favour of the holders of the FT Special Warrants, with an effective date of no later than December 31, 2011.

Each Special Warrant entitled the holder thereof, upon exercise of each Special Warrant, to receive, without payment of additional consideration, one common share of the Company and one common share purchase warrant (the "Warrants"). The Warrants are governed by a warrant indenture dated July 14, 2011 ("the Warrant Indenture") between the Company and Computershare Trust Company of Canada. Each Warrant entitles the holder thereof to acquire one additional common share at a price of \$1.35 per share until July 14, 2013.

The FT Special Warrants were issued as "flow-through shares" as defined in subsection 66(15) of the Income Tax Act (Canada). Each FT Special Warrant entitled the holder thereof, upon exercise of each FT Special Warrant, to receive without payment of additional consideration, one common share of the Company.

Pursuant to the Agency Agreement, the Company paid to the Agents a cash fee equal to 8.0% of the gross proceeds from Offered Securities sold by the Agents, issued to the Agents that number of special warrants (the "Special Broker Warrants") equal to 8.0% of the number of Special Warrants sold by the Agents and issued to the Agents that number of flow-through special warrants (the "FT Special Broker Warrants") equal to 8.0% of the number of FT Special Warrants sold by the Agents (the "Special Broker Warrants and the FT Special Broker Warrants are collectively referred to herein as the "Broker Securities").

Each Special Broker Warrant, upon exercise thereof, entitled the holder thereof to receive, without payment of additional consideration, one broker warrant (a "Broker Warrant"). Each Broker Warrant entitles the holder to acquire one common share (a "Broker Share") and one common share purchase warrant (a "BW Warrant") at an exercise price of \$1.05 until July 14, 2013. Each BW Warrant entitles the holder to acquire one common share (a "BW Share") at an exercise price of \$1.35 per BW Share until July 14, 2013. The BW Warrants were issued pursuant to the Warrant Indenture. Each FT Special Broker Warrant, upon the exercise or deemed exercise thereof, entitles the holder thereof to receive, without payment of additional consideration, one broker warrant (an "FT Broker Warrant"). Each FT Broker Warrant entitles the holder to acquire one common share (an "FT Broker Share") at an exercise price of \$1.05 per FT Broker Share until July 14, 2013.

Pursuant to the Agency Agreement, the Company agreed to prepare and file a prospectus and all other necessary documents in order to qualify the securities issuable upon conversion of the Offered Securities (the "Underlying Securities") to subscribers resident in Canada, or otherwise subject to the Canadian securities laws, upon exercise of the Broker Securities.

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11. 2011 SPECIAL WARRANT FINANCING (cont'd)

On September 8, 2011, the Company received a receipt for its final short form prospectus dated September 7, 2011 from the securities commissions of British Columbia, Alberta, and Ontario that qualified the Underlying Securities.

12. 2012 FINANCINGS

In June 2012, the Company entered into an agreement with NBF on behalf of a syndicate of agents including BayFront and Pope, under which the agents agreed to undertake a brokered private placement on behalf of the Company on a best efforts basis pursuant to which the Company would issue up to 2,777,777 common shares at a price of \$1.08 per share for gross proceeds of up to \$3,000,000 and up to 3,333,333 flow-through common shares at a price of \$1.20 per share for gross proceeds of up to \$4,000,000, for aggregate gross proceeds of up to \$7,000,000 (the "Brokered Portion"). The Company also announced that it would issue, on a non-brokered basis, up to 1,250,000 flow-through shares at a price of \$1.20 per share for gross proceeds of \$1,500,000 (the "Non-Brokered Portion"). The size of the Non-Brokered Portion was subsequently increased with the consent of the TSX Venture Exchange. The Brokered Portion closed effective June 29, 2012 and the Non-Brokered Portion closed in various tranches between June 26, 2012 and August 7, 2012. In connection with both the Brokered Portion and the Non-Brokered Portion (together, the "Summer Offering"), the Company raised aggregate gross proceeds of \$9,650,079.

In connection with the Brokered Portion, the Company issued an aggregate of 2,367,500 flow-through common shares at a price of \$1.20 per share and 1,225,000 common shares, issued on a non-flow through basis, at a price of \$1.08 per share, for aggregate gross proceeds of \$4,164,000.

With respect to the Non-Brokered Portion, the Company issued an aggregate of 2,470,399 flow-through common shares at a price of \$1.20 per share and 2,334,815 common shares, issued on a non-flow-through basis, at a price of \$1.08 per share, for aggregate gross proceeds of \$5,486,079.

The Company paid finder's fees in connection with the Summer Offering consisting of cash commissions equal to 8.0% of the gross proceeds raised under the Summer Offering from subscribers introduced to the Company by certain finders, and the issuance of non-transferable broker warrants equal to 8.0% of the number of securities sold pursuant to the Summer Offering to subscribers that were introduced to the Company by such finders. Each broker warrant issued is exercisable into one common share of the Company at a price of \$1.08 per share for two years from the date of issuance.

On September 17, 2012, the Company announced that it intended to issue up to 5,000,000 units at a price of \$1.35 per unit for gross proceeds of up to \$6,750,000 (the "Fall Offering"), with each unit to consist of one common share of the Company and one-half of one common share purchase warrant, with each whole warrant to entitle the holder to acquire an additional common share of the Company at \$1.75 per share for a period of six months from the date of issuance.

The Company completed various tranches of the Fall Offering between September 26, 2012 and November 14, 2012 in which it issued an aggregate of 5,099,600 units at a price of \$1.35 per unit for gross proceeds of \$6,884,460. The Company issued commissions to certain finders consisting of: (i) a cash payment of 8.0% of the gross proceeds derived from subscribers introduced to the Company by the finder; and (ii) the issuance of finder warrants equal to 8.0% of the number of units sold to subscribers introduced to the Company by the finder. Each finder warrant is exercisable into one common share of the Company at a price of \$1.35 per share for a period of 12 months. Because the subscription price of the units did not exceed the Company's share price, no value was assigned to the warrants. The fair value assigned to the broker warrants was \$446,163.

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12. 2012 FINANCINGS (cont'd)

On December 12, 2012, the Company announced that it had completed a private placement of 2,000,000 flow-through common shares at a price of \$1.55 per share for gross proceeds of \$3,100,000 (the "Winter Offering"). The premium per share was \$0.25 per share with a resulting liability of \$500,000. The Company paid finder's fees consisting of cash commissions equal to 6.0% of the gross proceeds raised under the Winter Offering and the issuance of non-transferable broker warrants equal to 6.0% of the number of flow-through shares sold under the Winter Offering. Each broker warrant will be exercisable into one common share of the Company, issued on a non-flow-through basis, at a price of \$1.55 per share for a period of 12 months from the closing of the Winter Offering. The fair value assigned to the broker warrants was \$36,384.

13. SHARE CAPITAL AND RESERVES

a) Common Shares

Authorized, Issued and Outstanding

During 2010, the authorized capital stock of the Company was changed from 50,000,000 common shares without par value to unlimited number of common shares without par value.

b) Share Purchase Warrants

The following is a summary of changes in warrants from January 1, 2011 to December 31, 2012:

	Number of Warrants	Weighted Average Exercise Price
Balance at January 1, 2011	7,679,120	\$ 0.53
Issue of warrants	8,046,139	\$ 1.32
Exercise of warrants	<u>(4,634,597)</u>	\$ 0.39
Balance at December 31, 2011	11,090,662	
Issue of warrants	5,372,778	\$ 1.48
Exercise of warrants	(3,206,950)	\$ 0.78
Expiring of warrants	<u>(25,000)</u>	\$ 0.75
Balance at December 31, 2012	<u>13,231,490</u>	

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13. SHARE CAPITAL AND RESERVES (cont'd)

As at December 31, 2012, the Company had outstanding warrants as follows:

<u>Security</u>	<u>Number</u>	<u>Exercise Price</u>	<u>Expiry Date</u>
Warrants	858,059	\$1.75	March 26, 2013
Warrants	200,000	\$1.75	April 1, 2013
Warrants	514,541	\$1.75	April 9, 2013
Warrants	37,500	\$1.75	April 12, 2013
Warrants	357,700	\$1.75	April 19, 2013
Warrants	50,000	\$1.75	April 29, 2013
Warrants	250,000	\$1.75	May 13, 2013
Warrants	282,000	\$1.75	May 14, 2013
Warrants	6,342,880	\$1.35	July 14, 2013
Warrants	488,265*	\$1.05/\$1.35	July 14, 2013
Warrants	165,147	\$1.05	July 14, 2013
Warrants	11,924	\$1.35	July 14, 2013
Warrants	115,512	\$1.35	September 26, 2013
Warrants	32,000	\$1.35	October 1, 2013
Warrants	72,520	\$1.35	October 9, 2013
Warrants	6,000	\$1.35	October 12, 2013
Warrants	56,032	\$1.35	October 19, 2013
Warrants	8,000	\$1.35	October 29, 2013
Warrants	40,000	\$1.35	November 13, 2013
Warrants	45,120	\$1.35	November 14, 2013
Warrants	120,000	\$1.55	December 11, 2013
Warrants	54,324	\$1.08	June 26, 2014
Warrants	287,400	\$1.08	June 29, 2014
Warrants	2,124	\$1.08	July 4, 2014
Warrants	3,012	\$1.08	July 20, 2014
Warrants	254,758	\$1.08	August 3, 2014
Warrants	26,672	\$1.08	August 7, 2014
Warrants	900,000**	\$1.28	June 16, 2016
Warrants	650,000**	\$1.21	January 17, 2017
Warrants	1,000,000	\$1.30	May 23, 2017
	13,231,490		

*Upon exercise of each warrant at \$1.05, the holder receives one common share and one common share purchase warrant exercisable into one common share at \$1.35.

**On the third anniversary of issuance date of the warrants, the exercise price will increase by 20% provided that, and only if (i) during the prior full fiscal year the Company has produced a minimum of 1.25 million silver equivalent ounces, and (ii) the settlement price of silver (Bloomberg: SLVRLN) during the prior 90 days is at least \$35. The adjustment shall take effect as of the first day of the Company's next fiscal quarter following the second anniversary of the issuance date of the relevant warrants. Because the exercise price of the warrants is dependent in part, on the price of silver, the warrants are classified as derivative liabilities.

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13. SHARE CAPITAL AND RESERVES (cont'd)

c) Special Warrants

The following is a summary of changes in Special Warrants from January 1, 2011 to December 31, 2012:

	Number of Warrants	Weighted Average Exercise Price
Balance at January 1, 2011	—	\$ nil
Issue of Special Warrants	8,590,246	\$ 1.09
Exercise of Special Warrants	<u>(8,590,246)</u>	\$ 1.09
Balance at December 31, 2011	—	
Issue of Special Warrants	—	\$ nil
Exercise of Special Warrants	<u>—</u>	\$ nil
Balance at December 31, 2012	—	

14. SHARE-BASED PAYMENTS

a) Stock Option Plan

The Company's Board of Directors approved the adoption of a Stock Option Plan (the "Plan") in accordance with the policies of the TSX Venture Exchange. The Board of Directors is authorized to grant options to directors, officers, consultants or employees. The exercise price of options granted under the Stock Option Plan shall be as determined by the Board of Directors when such options are granted, subject to any limitations imposed by any relevant stock exchange or regulatory authority.

The Company shall not grant options under the Plan which will, when exercised, exceed 10% of the issued and outstanding shares, and further subject to the applicable rules and regulations of all regulatory authorities to which the Company is subject, including the TSX Venture Exchange, provided that the number of shares reserved for issuance, within any twelve-month period:

- i) to any one option holder shall not exceed 5% of the total number of issued shares;
- ii) to any one consultant shall not exceed 2% in the aggregate of the total number of issued shares, and
- iii) to all persons employed or engaged to provide investor relations activities shall not exceed 2% in the aggregate of the total number of issued shares. In addition, options issued to consultants performing investor relations activities must vest in stages over 12 months with no more than ¼ of the options vesting in any three-month period.

If any option expires or otherwise terminates for any reason without having been exercised in full, the number of shares which would have been acquired on the exercise of such option shall again be available for the purposes of the Plan.

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14. SHARE-BASED PAYMENTS (cont'd)

The following is a summary of changes in stock options from January 1, 2011 to December 31, 2012:

	Number of Options	Weighted Average Exercise Price
Balance at January 1, 2011	1,520,000	\$ 0.95
Issue of options	1,510,000	\$ 1.40
Expiring of options	(40,000)	\$ 1.43
Exercise of options	(360,000)	\$ 0.31
Balance at December 31, 2011	2,630,000	
Issue of options	1,915,000	\$ 1.44
Exercise of options	(478,500)	\$ 0.52
Balance at December 31, 2012	4,066,500	\$ 1.22

As at December 31, 2012, the following stock options were outstanding and exercisable:

Number Outstanding	Number Exercisable	Exercise Price	Weighted Average Contractual Life (Years)	Expiry Date
440,000	440,000	\$ 0.25	2.24	March 29, 2015
150,000	150,000	\$ 0.25	2.34	May 4, 2015
150,000	150,000	\$ 0.385	2.49	June 28, 2015
31,500	31,500	\$ 0.95	3.08	January 28, 2016
270,000	270,000	\$ 1.40	3.34	May 2, 2016
1,050,000	1,050,000	\$ 1.44	3.58	July 28, 2016
60,000	60,000	\$ 1.35	3.88	November 16, 2016
1,535,000	1,535,000	\$ 1.45	4.70	September 10, 2017
380,000	380,000	\$ 1.40	4.84	November 1, 2017
4,066,500	4,066,500		3.87	

b) Fair Value of Options Issued During the Period

The weighted average fair value at grant date of options granted during the three months ended December 31, 2012 was \$1.44 per option (December 31, 2011: \$1.07). The weighted average fair value at grant date of options granted during the year ended December 31, 2012 was \$1.22 per option (December 31, 2011: \$1.20). Other than options granted for investor relations these options vested immediately on the date of grant. None of the options granted allow for cash settlement.

The model inputs for options granted during the year ended December 31, 2012 included:

Grant Date	Expiry Date	Share Price at Grant Date \$	Exercise Price \$	Risk-Free Interest Rate	Expected Life	Volatility Factor	Dividend Yield
09/10/2012	09/10/2017	1.45	1.45	1.45%	60 months	127.28%	0%
11/01/2012	11/01/2017	1.40	1.40	1.43%	60 months	126.99%	0%

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14. SHARE-BASED PAYMENTS (cont'd)

The Company expensed \$1,823,298 during the year ended December 31, 2012 as well as incurred \$445,474 in share-based compensation costs that will be added to the capitalized cost of the mill (December 31, 2011- \$1,916,103 expensed). Of the amount expensed, \$453,817 (December 31, 2011 - \$284,257) has been included as part of exploration costs.

These amounts also include an expense of \$155,653 for the year ended December 31, 2012, related to 190,000 options granted to a non-employee, determined by using the Black-Scholes option pricing model as the Company could not estimate reliably the fair value of the services received.

15. INCOME TAXES

During the year ended December 31, 2012, the Company renounced exploration and evaluation expenses deductible for Canadian income tax purposes of \$8,905,479 in respect of flow-through shares issued in 2012. As at December 31, 2012, the Company has incurred eligible exploration and developments costs exceeding \$3,940,786. Accordingly, the Company has reduced the liability to sell the tax deductions, initially recognized at \$1,080,548, and recognized a flow through share premium in the consolidated statement of operations and comprehensive loss during the year ending December 31, 2012 of \$287,054 (December 31, 2011 - \$317,005).

The Company's current and deferred income tax expense for the year ended December 31, 2012, is \$nil and \$nil (2011 - \$nil and \$nil). A reconciliation of the statutory tax rate to the effective rate for the Company is as follows:

	<u>2012</u>	<u>2011</u>
Loss before income taxes	\$ <u>(14,437,720)</u> 25.0%	\$ <u>(7,758,910)</u> 26.5%
Income tax (recovery) computed at statutory rates	\$ (3,609,430)	\$ (2,056,111)
Share based compensation	455,824	521,372
Renunciation of flow-through shares	985,197	672,050
Non-deductible portion of Waterton debt	610,670	94,548
Flow-through share premium	(71,763)	(84,006)
Share issue costs	(599,286)	(62,737)
Other permanent differences	(45,500)	(58,782)
Income tax rate changes	-	55,113
Tax benefits not yet realized	<u>2,274,288</u>	<u>918,553</u>
Income tax recovery	\$ <u>-</u>	\$ <u>-</u>

The tax effect of the temporary differences that have not been recognized are as follows:

	<u>2012</u>	<u>2011</u>
Non-capital loss carryforward	\$ 1,585,586	\$ 384,681
Resource interests	1,776,540	1,131,523
Waterton liability	-	118,566
Property, plant, and equipment	99,239	52,323
Share issue costs	<u>728,004</u>	<u>229,570</u>
	\$ <u>4,189,369</u>	\$ <u>1,916,663</u>

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15. INCOME TAXES (cont'd)

As at December 31, 2012, the Company has approximately \$6,342,346 (2011 - \$1,026,296) of non-capital losses for tax purposes to be carried forward at various dates until 2032 and applied against future income for tax purposes. The non-capital losses expire as follows:

<u>Year</u>	<u>Total</u>
2014	\$ 26,453
2015	32,403
2026	61,127
2027	53,696
2028	75,768
2029	80,111
2030	187,871
2031	1,401,045
2032	<u>4,423,872</u>
	<u>\$ 6,342,346</u>

16. RELATED PARTY TRANSACTIONS

The following is a summary of the Company's related transactions during the period:

	Year	
	Ended December 31,	
	2012	2011
	\$	\$
Management fees paid to a director and a company controlled by a director (i)	96,000	95,000
Consulting fees paid to a director (ii)	24,000	19,000
Office Rental payments made to a company controlled by a director (iii)	30,000	30,000
Office and general expenses paid to a director of the Company (iv)	1,440	1,440
Sale of trailer to a company controlled by a director	<u>8,070</u>	<u>-</u>

- i) Management fee is \$8,000 per month.
- ii) Consulting fee was \$1,000 per month until June 2011. Consulting fee is now \$2,000 per month. There is no formal agreement.
- iii) Office rental payment is \$2,500 per month.
- iv) Office and general expense is reimbursed at \$120 per month.

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16. RELATED PARTY TRANSACTIONS (cont'd)

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Company, directly or indirectly, and consist of its directors, the Chief Executive Officer, and the Chief Financial Officer. Key management personnel remuneration during the year included \$974,585 in share-based compensation expense (December 31, 2011: \$1,281,474).

17. FINANCIAL INSTRUMENTS

Fair Value

The Company records its financial instruments at fair value using various techniques. These include estimates of fair values based on prevailing market prices (bid and ask prices, as appropriate) for instruments with similar characteristics and risk profiles or internal and external valuation models, such as discounted cash flow analyses, using, to the extent possible, observable market-based inputs.

The financial instruments have been characterized on a fair value hierarchy based on whether the inputs to those valuation techniques are observable (inputs reflect market data obtained from independent sources) or unobservable (inputs reflect the Company's market assumptions).

The three levels of fair value estimation are:

Level 1 – quoted prices in active markets for identical instruments.

Level 2 – quoted prices in active markets for similar instruments; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets.

Level 3 – valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

The Company has categorized the Waterton derivative liabilities, and the warrant liability as Level 3 on the fair value hierarchy. The accounts receivable from concentrate sales is categorized as Level 2 on the fair value hierarchy.

The Company estimated the fair value of the derivative liabilities issued in connection with the third advance under the Credit Facility to be \$139,609 as the sum of the fair value of a series of call options on silver with an exercise price of \$27.50 per ounce and expiring on each repayment date minus the sum of the fair value of a series of call options on silver with an exercise price of \$34.00 per ounce and expiring on each repayment date. The fair value of each option was estimated using the Black-Scholes model with the following assumptions:

Spot Price of Silver	\$30.26 per ounce
Exercise Price	\$27.50 or \$34.00 as applicable
Risk Free Rate	1.00%
Dividend Rate	1.00%
Expected Life	0.37 years to 1.29 years, as applicable
Number of Options Granted	4,951
Credit Adjustment Factor	20.00%

The Company estimated the change in control option and the prepayment option at \$nil on the date of the third advance on the basis that neither of these events are expected to occur.

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17. FINANCIAL INSTRUMENTS (cont'd)

The Company estimated the fair value of the derivative liabilities issued in connection with the fourth advance under the Credit Facility to be \$92,008 as the sum of the fair value of a series of call options on silver with an exercise price of \$27.50 per ounce and expiring on each repayment date minus the sum of the fair value of a series of call options on silver with an exercise price of \$34.00 per ounce and expiring on each repayment date. The fair value of each option was estimated using the Black-Scholes model with the following assumptions:

Spot Price of Silver	\$27.60 per ounce
Exercise Price	\$27.50 or \$34.00 as applicable
Risk Free Rate	1.00%
Dividend Rate	1.00%
Expected Life	0.19 years to 0.94 years, as applicable
Number of Options Granted	5,942
Credit Adjustment Factor	20.00%

The Company estimated the change in control option and the prepayment option at \$nil on the date of the fourth advance on the basis that neither of these events are expected to occur.

The Company estimated the fair value of the derivative liabilities as at December 31, 2012 as the sum of the fair value of a series of call options on silver with an exercise price of \$27.50 per ounce and expiring on each repayment date minus the sum of the fair value of a series of call options on silver with an exercise price of \$34.00 per ounce and expiring on each repayment date. The fair value of each option was estimated using the Black-Scholes model with the following assumptions:

Spot Price of Silver	\$29.80 per ounce
Exercise Price	\$27.50 or \$34.00 as applicable
Risk Free Rate	1.00%
Discount Rate	1.00%
Expected Life	0.08 years to 0.33 years, as applicable
Number of Options Granted	31,096
Credit Adjustment Factor	20.00%

The Company estimated the change in control option and the prepayment option at \$nil on December 31, 2012 on the basis that neither of these events are expected to occur.

The Company estimated the fair value of the fair value of the warrants issued in connection with the third advance under the Credit Facility at the date of issuance using the Black-Scholes model with the following assumptions:

Share Price	\$1.05
Exercise Price	\$1.21
Risk Free Rate	0.00%
Discount Rate	1.26%
Expected Life	5 years

The Company estimated the fair value of the warrant liability relating to the warrants issued to Waterton for the first and third advances under the Credit Facility as at December 31, 2012 using the Black-Scholes model with the following assumptions:

Share Price	\$1.34
Exercise Price	\$1.21 or \$1.28 as applicable
Risk Free Rate	0.00%
Discount Rate	1.37%
Expected Life	3.46 years or 4.04 years as applicable

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17. FINANCIAL INSTRUMENTS (cont'd)

The following table presents the changes in the fair value of the Company's Level 3 financial instruments that are carried at fair value during the twelve months ended December, 2012:

	Liability at December 31, 2011	Drawdown of Waterton Debt	Profit Participation Payments	Mark to market (gain) loss	Liability at December 31, 2012
Waterton derivative liability	\$ 208,299	\$ 231,616	\$ (203,500)	\$ 169,845	\$ 406,260
Warrant liability	\$ 710,726	\$ 577,566	\$ -	\$ 133,713	\$ 1,422,005
	\$ 919,025	\$ 809,182	\$ (203,500)	\$ 303,558	\$ 1,828,265

	Liability at December 31, 2010	Drawdown of Waterton Debt	Profit Participation Payments	Mark to market (gain) loss	Liability at December 31, 2011
Waterton derivative liability	\$ -	\$ 300,000	\$ -	\$ (91,701)	\$ 208,299
Warrant liability	\$ -	\$ 850,333	\$ -	\$ (139,607)	\$ 710,726
	\$ -	\$ 1,150,333	\$ -	\$ (231,308)	\$ 919,025

Risk Exposure and Management

Overview

The Company has exposure to risks of varying degrees of significance which could affect its ability to achieve its strategic objectives. The principal financial risks to which the Company is exposed are credit risk, liquidity risk, metal price risk, and currency risk.

Credit Risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its obligations. The Company's maximum exposure to credit risk at the balance sheet date under its financial instruments is approximately \$3.6 million.

All of the Company's cash and cash equivalents are held with a major financial institution in Canada and management believes the exposure to credit risk with respect to such institutions is not significant. Those financial assets that potentially subject the Company to credit risk are primarily receivables. The Company considers the risk of material loss to be significantly mitigated due to the financial strength of the parties from whom the receivables are due, including government organizations.

Liquidity Risk

Liquidity is the risk that the Company will not be able to meet its obligations associated with financial liabilities. The Company has a planning and budgeting process in place by which it projects the funds required to support its operations as well as the development of its Treasure Mountain Property.

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17. FINANCIAL INSTRUMENTS (cont'd)

Management anticipates that, subject to financing, it will make substantial expenditures towards developing the Treasure Mountain Property. However, there is no assurance that the Company will operate profitably or will generate positive cash flow in the future. The Company has a significant working capital deficit, no history of profitable operation and no assurance that additional funding will be available to it for further exploration and development of the Treasure Mountain Property if required. The Company may also need further financing if it decides to obtain additional mineral properties. As such, the Company is subject to many risks common to exploration enterprises, including undercapitalization, cash shortages and limitations with respect to personnel, financial and other resources and lack of revenues. Although the Company has been successful in the past in obtaining financing through credit facilities or the sale of equity securities, there can be no assurance that the Company will be able to obtain adequate financing in the future or that the terms of such financing will be favorable. Such means of financing typically result in dilution of the positions of existing shareholders, either directly or indirectly. Failure to obtain additional financing could result in the delay or indefinite postponement of further exploration and development of the Treasure Mountain property or the loss or substantial dilution of any of its property interests.

The following is a summary of the maturities for the Company's non-derivative financial liabilities:

	Less than 30 days	30 days to 1 year	1 year to 2 years	More than 2 years
Accounts Payable and Accrued Liabilities	\$ 2,068,372	\$ 200,000	\$ -	\$ -
Waterton Debt Obligation	\$ 1,710,271	\$ 9,733,182	\$ -	\$ -
Craigmont Obligation	\$ -	\$ 3,100,000	\$ -	\$ -
	<u>\$ 3,778,643</u>	<u>\$ 13,033,182</u>	<u>\$ -</u>	<u>\$ -</u>

Metal Price Risk

Metal price risk is the risk that changes in metal prices will affect the Company's income or the value of its related financial instruments. The Company has sales of silver, lead, and zinc where the value of such sales is dependent on metal prices that have shown significant volatility and are beyond the Company's control. A 10% change in the price of silver would increase or decrease the value of the Company's 2012 sales by approximately \$130,000.

Foreign Exchange Rate Risk

Since the Company's sales of concentrate are denominated in U.S. dollars and the Company's operating costs are denominated primarily in Canadian dollars, the Company is negatively impacted by the strengthening of the Canadian dollar relative to the U.S. dollar and positively impacted by the inverse.

18. SUPPLEMENTAL CASH FLOW INFORMATION

	<u>Year Ended December 31</u>	
	<u>2012</u>	<u>2011</u>
Issued common shares to acquire land	\$ —	\$ 650,000
Issued common shares upon execution of Credit Agreement	\$ 298,000	\$ 100,000
Issued common shares upon amendment of Credit Agreement	<u>\$ 100,000</u>	<u>\$ -</u>

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19. OFF-TAKE FINANCING ARRANGEMENT

On November 23, 2012, the Company entered into a Concentrate Off-Take Financing Arrangement with Waterton. Under the terms of the Concentrate Off-Take Financing Arrangement, Waterton agreed to provide funding for 80% of the value of concentrates delivered to the smelter on a spot basis for a 2% fee during the period from November 23, 2012 to March 31, 2013. Any amounts borrowed under this arrangement are to be repaid within 30 days of the sale of the concentrate.

20. LEAD AND ZINC CONCENTRATE PURCHASE AGREEMENTS

On March 13, 2012, the Company entered into Lead Silver Ore Purchase Agreement with a smelter whereby the Company agreed to sell approximately 35 to 40 wet metric tonnes of lead silver material.

Sales recognized under the agreement were \$168,067 and were classified as a recovery of exploration and evaluation costs.

On October 24, 2012, the Company entered into a Lead Concentrate Purchase Agreement with a smelter whereby the Company has agreed to sell approximately 1,000 – 2,000 dry metric tonnes until March 31, 2013. The Company also entered into a Zinc Purchase Agreement to sell approximately 1,000- 2,000 dry metric tonnes until March 31, 2013. The payments to be made are based on the price of silver, lead, and zinc during the period that is two months after shipment. Subsequent to March 31, 2013, the agreement will continue on a year to year basis and may in the absence of default, be terminated upon 12 months notice by either party.

Sales recognized under the agreement during 2012 were \$1,040,819. Sales earned during the commissioning phase of the mill are offset against the capital cost of the mill construction.

21. COMMITMENTS

With respect to the Company's amended permit approving the construction and operation of the processing plant and lined tailings facility, further security of \$400,000 is required to be deposited by March 31, 2013.

With respect to the Company's flow-through share issuances in 2012, the Company is required to incur eligible expenditures of approximately \$4,964,693 in order to fulfill its commitment.

22. SUBSEQUENT EVENTS

Subsequent events to December 31, 2012 are as follows:

- a) On February 4, 2013, Huldra and 0913103 BC Ltd. were named in a lawsuit (the "CRMC Lawsuit") by CRMC Canadian Royal Mining Corp. ("CRMC"), whereby CRMC is claiming that it is owed \$461,099.36 pursuant to a Mining Equipment Purchase and Services Agreement, dated June 21, 2011 (the "CRMC Agreement") and an undetermined amount in connection with the alleged breach by Huldra of the CRMC Agreement. CRMC is also seeking interest and costs in connection with the CRMC Lawsuit. Huldra filed a defence to the CRMC Lawsuit claiming that CRMC breached the CRMC Agreement by failing to provide the required equipment and components, failing to provide the staff to supervise the assembly of the mill and by failing to design the mill to the specified requirements. Huldra has also counterclaimed against CRMC, David Brian Archibald and Dennis Peter Dornan seeking an unspecified amount of damages because of CRMC's breach of the CRMC Agreement. Huldra is also seeking costs in connection with the CRMC Lawsuit.

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22. SUBSEQUENT EVENTS (cont'd)

- b) On January 29, 2013, the Company announced it intended to complete a private placement of unsecured convertible debentures (the "Debentures") in the aggregate principal amount of up to \$6,000,000. The principal amount of the Debentures will mature twelve (12) months after issuance (the "Maturity Date") and accrue interest at 16% per annum payable on the Maturity Date. On February 12, 2013, the aggregate principal amount was increased to \$10,000,000.

The principal amount of the Debentures and any accrued but unpaid interest thereon will be convertible, at the option of the subscriber, into common shares of the Company (each, a "Share") at a price of \$1.35 per Share, subject to adjustment. The Company has the right to prepay, upon ten (10) days' notice (the "Notice Period"), all or part of the principal amount of any Debenture, and any accrued but unpaid interest thereon, together with payment of a prepayment penalty of 5% of the principal amount being prepaid. Subscribers will have the right to convert the principal amount and any accrued but unpaid interest of the Debentures during the Notice Period.

On February 6, 2013, the Company amended the terms of the Debenture. The revised terms provide that, at the option of the subscriber, the principal amount of the Debentures will be convertible into Shares at a price of \$1.05 per Share, and any accrued but unpaid interest thereon will be convertible into Shares at the greater of (i) \$1.05 per Share and (ii) the Market Price (as defined in the policies of the TSX Venture Exchange) per Share at the time of any notice of conversion, each subject to adjustment as provided by the terms of the Debentures. The principal amount of the Debentures and any accrued but unpaid interest thereon will not be pre-payable by the Company.

The Company sold Debentures which closed in various tranches between February 8, 2013 and February 13, 2013, for aggregate gross proceeds of \$10,003,800. In connection with the closing of the Debentures, the Company paid aggregate cash commissions of \$306,700.

- c) On January 29, 2013, the Company entered into a fourth amending agreement (the "Fourth Amendment") with Waterton pursuant to which it has further amended the terms of the Credit Agreement. Under the terms of the Fourth Amendment, Waterton agreed to amend the repayment terms of the Credit Agreement such that the maturity date has been extended from April 2013 to November 2013 and the repayment amounts, other than for January 2013 have been reduced accordingly. The payment for January 2013 was \$1,921,039 and was due on or before February 8, 2013 (paid). As consideration for the amendment, the Company agreed to pay a restructuring fee of \$125,000 per month for the remainder of the term subject to a minimum restructuring fee of \$750,000. Additionally, the calculation for the monthly derivative liability payable formula was changed so that the amount payable is based on the higher of the settlement price per ounce of silver on the business day preceding the repayment date of \$32.00 per ounce. Prior to the Fourth Amendment, the calculation for the monthly derivative liability payable required the settlement price per ounce of silver on the business day immediately preceding the repayment date to be at a minimum of \$27.50 per ounce in order to trigger a derivative liability amount payable and the maximum amount payable in the formula was based on \$34.00 per ounce.
- d) On February 8, 2013, the Company received its 2011 British Columbia Mineral Exploration and Tax Credit payment of \$765,495 plus interest.
- e) On February 12, 2013, the Company entered into a second amending agreement ("Amending Agreement") to the Original Agreement. The final payment will be extended and made in three equal payments, pursuant to the terms of the Amending Agreement, as follows:
- (i) \$1,000,000 on or prior to February 12, 2013;
 - (ii) \$1,000,000 on or prior to February 28, 2013; and
 - (iii) \$1,100,000 (net of agreed upon estimated remediation costs of \$900,000) less any payment made to the vendor from gravel sales during the period from May 5, 2011 to January 31, 2013.

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22. SUBSEQUENT EVENTS (cont'd)

For consideration, the Company will pay interest at a rate of 5% per annum on the amounts outstanding after February 12, 2013 until payment is received by the vendors.

All payments pursuant to the Amending Agreement have been made and the mortgage on the Craigmont Property has been discharged.

- f) On February 13, 2013, the Company announced that it has granted 500,000 stock options to certain employees and consultants of the Company. Each option is exercisable into one common share of the Company at a price of \$0.95 per share for a period of five years. The options are subject to the terms of the Company's Plan.
- g) On March 14, 2013, the Company announced that it made an application to the TSX Venture Exchange to extend the term of the following warrants, each of which is exercisable into one share at \$1.75 per share, by 18 months: (i) 858,059 warrants that were originally issued on September 26, 2012 and expire March 26, 2013, (ii) 200,000 warrants that were originally issued on October 1, 2012 and expire April 1, 2013, (iii) 514,541 warrants that were originally issued on October 9, 2012 and expire April 9, 2013, (iv) 37,500 warrants that were originally issued on October 12, 2012 and expire April 12, 2013, (v) 357,700 warrants that were originally issued on October 19, 2012 and expire April 19, 2013, (vi) 50,000 warrants that were originally issued on October 29, 2012 and expire April 29, 2013, (vii) 250,000 warrants that were originally issued on November 13, 2012 and expire May 13, 2013, and (viii) 282,000 warrants that were originally issued on November 14, 2012 and expire May 14, 2013. The extension of the term of these warrants was approved by the TSX Venture Exchange.
- h) On March 22, 2013, the Company posted the \$400,000 security required as a condition of its amended permit approving the construction and operation of the processing plant and lined tailings facility.
- i) On April 5, 2013, the Company announced that as of March 26, 2013, it has achieved commercial production of the mill based on current production levels.