# HULDRA SILVER INC.

## Condensed Consolidated Interim Financial Statements

## For the three months ended March 31, 2013 and 2012

Notice of disclosure of non-auditor review of interim financial statements pursuant to National Instrument 51-102, Part 4, subsection 4.3(3)(a) issued by the Canadian Securities Administrators.

The accompanying financial statements of the Company for the period ended March 31, 2013 have been prepared in accordance with International Financial Reporting Standards and are the responsibility of the Company's management. The Company's independent auditors have not performed an audit or review of these condensed consolidated interim financial statements.

**HULDRA SILVER INC.**
**Condensed Consolidated Interim Statements of Financial Position**
**(Unaudited)**
**(Expressed in Canadian dollars)**

| | Note | March 31, 2013 | December 31, 2012 |
|---|---|---|---|
| **Assets** | | | |
| **Current assets** | | | |
| Cash and cash equivalents | 4 | $ 2,799,834 | $ 883,169 |
| Amounts receivable | 5 | 2,126,692 | 2,742,016 |
| Prepaid expenses and other assets | | 150,118 | 109,453 |
| | | **5,076,644** | **3,734,638** |
| **Non-current assets** | | | |
| Property, plant, and equipment | 6 | 28,740,090 | 29,556,353 |
| Mineral Interests | 7 | 766,537 | 766,537 |
| Restricted cash | 9 | 1,135,100 | 735,100 |
| **Total assets** | | **$ 35,718,371** | **$ 34,792,628** |
| **Liabilities** | | | |
| **Current liabilities** | | | |
| Accounts payable and accrued liabilities | | $ 2,597,710 | $ 2,268,372 |
| Current portion of Waterton derivative liability | 10,16 | 634,264 | 406,260 |
| Current portion of Waterton debt obligation | 10 | 8,103,488 | 10,448,380 |
| Warrant liability | 10,16 | 1,260,147 | 1,422,005 |
| Current portion of Craigmont obligation | 6 | 1,004,125 | 2,962,918 |
| Convertible debentures | 12 | 9,669,692 | - |
| Flow-through share premium | | 404,825 | 793,494 |
| | | **23,674,251** | **18,301,429** |
| **Non-current liabilities** | | | |
| Asset retirement obligation | 8 | 1,405,100 | 1,405,100 |
| **Total liabilities** | | **25,079,351** | **19,706,529** |
| **Equity** | | | |
| **Shareholders' equity** | | | |
| Share capital | 13a) | 38,692,521 | 38,693,271 |
| Equity component of convertible debenture | | 156,212 | - |
| Contributed surplus | | 5,918,020 | 5,580,984 |
| Accumulated deficit | | (34,127,733) | (29,188,156) |
| Total equity | | **10,639,020** | **15,086,099** |
| Total liabilities and equity | | **$ 35,718,371** | **$ 34,792,628** |

***Ryan Sharp (signed)*** Director ***Garth Braun (signed)*** Director

Nature of operations and going concern (Note 1)
Subsequent events (Note 21)

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

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

| | Note | Three Months Ended March 31 2013 (Note 17) | 2012 (Note 17) |
|---|---|---|---|
| **Operating Expenses** | | | |
| Exploration costs | 7 | $ 2,212,458 | $ 2,255,849 |
| Salaries and benefits | | 89,064 | 40,579 |
| Share-based compensation expense | 14 | 276,853 | - |
| Professional fees | | 53,639 | 22,133 |
| Management fees | 15 | 24,000 | 24,000 |
| Consulting fees | 15 | 64,680 | 21,000 |
| Office and general | 15 | 46,718 | 47,970 |
| Travel | | 22,175 | 11,898 |
| Regulatory fees | | 14,575 | 7,900 |
| Transfer agent fees | | 1,496 | 5,134 |
| Rent | 15 | 7,500 | 7,500 |
| Vehicle expenses | | 846 | 349 |
| Depreciation | | 370 | 400 |
| **Operating Loss Before Other Items** | | (2,814,374) | (2,444,712) |
| **Other Items** | | | |
| Foreign exchange gain | | 34,496 | - |
| Mark-to-market adjustment on provisionally priced concentrate sales | | (326,111) | - |
| Gravel sales | | 2,845 | 3,393 |
| Finance costs | | (866,179) | (870,684) |
| Loss on extinguishment of debt | | (1,399,865) | - |
| Flow-through share premium | | 388,669 | - |
| Unrealized loss on derivative | 16 | (120,916) | (218,106) |
| Unrealized gain (loss) on warrant liability | 16 | 161,858 | (357,719) |
| **Net Loss and Comprehensive Loss for the period** | | $ (4,939,577) | $ (3,887,828) |
| **Loss Per Share – Basic and Diluted** | | $ (0.10) | $ (0.12) |
| **Weighted Average Number of Common Shares Outstanding** | | 50,855,859 | 32,359,388 |

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

**HULDRA SILVER INC.**
**Condensed Consolidated Interim Statements of Cash Flows**
**(Unaudited)**
**(Expressed in Canadian dollars)**

| | | Three Months Ended March 31 | |
|---|---|---|---|
| | **Note** | **2013** | **2012** |
| **Operating Activities** | | | |
| Net loss for the period | | $ (4,939,577) | $ (3,887,828) |
| Adjustments for: | | | |
| Share-based compensation expense | | 276,853 | — |
| Depreciation | | 93,541 | 116,479 |
| Gravel sales | | — | (3,393) |
| Loss on extinguishment of debt | | 1,399,865 | — |
| Non-cash interest expense | 10 | 864,070 | 869,896 |
| Gain on flow through share premium | | (388,669) | — |
| Unrealized (gain) loss on derivative | 10,16 | 120,916 | 218,106 |
| Unrealized (gain) loss on warrant liability | 10,16 | (161,858) | 357,719 |
| Foreign exchange gain | | (34,496) | — |
| Mark to market loss on concentrate sales | | 326,111 | — |
| Changes in non-cash working capital items | | | |
| Amounts receivable | | 323,709 | 1,258,221 |
| Prepaid expenses and other receivables | | (40,665) | 280,747 |
| Accounts payable and other accrued liabilities | | 328,453 | (554,915) |
| **Cash Used in Operating Activities** | | (1,831,747) | (1,344,968) |
| **Investing Activities** | | | |
| Reclamation deposits | | (400,000) | — |
| Purchase of property, plant, and equipment | 6 | (2,890,610) | (2,050,991) |
| Proceeds received from sales related to mill commissioning | | 3,715,322 | — |
| **Cash Provided by Investing Activities** | | 424,712 | (2,050,991) |
| **Financing Activities** | | | |
| Repayment of Craigmont mortgage | | (2,000,000) | — |
| Repayment of Waterton debt obligation | | (3,963,011) | — |
| Payments relating to derivative liabilities | | (269,030) | — |
| Convertible debentures, net of cash paid issuance costs | | 9,556,341 | — |
| Due to directors | | — | (63) |
| Proceeds from Waterton Credit Facility, net of cash borrowing costs | | — | 2,450,000 |
| Proceeds from exercise of stock options | | — | 43,999 |
| Proceeds from exercise of warrants | | — | 1,664,925 |
| **Cash Provided by Financing Activities** | | 3,323,700 | 4,158,861 |
| **Net change in Cash and Cash equivalents for the period** | | 1,916,665 | (762,902) |
| **Cash and Cash equivalents, beginning of period** | | 883,169 | 1,392,916 |
| **Cash and Cash equivalents, end of period** | | $ 2,799,834 | $ 2,155,818 |
| Supplemental cash flow information on non-cash transactions | 17 | | |

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

**HULDRA SILVER INC.**
**Condensed Consolidated Interim Statements of Changes in Equity**
**For the three months ended March 31, 2013 and 2012**
**(Unaudited)**
**(Expressed in Canadian dollars)**

| | Number of Common Shares | Share Capital | Contributed surplus | Equity Component of Convertible Debentures | Accumulated Deficit | Total Equity |
|---|---|---|---|---|---|---|
| **Balance, January 1, 2012** | **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 Special Warrant 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)** | **$15,086,099** |
| **Balance, January 1, 2013** | **50,855,859** | **$ 38,693,271** | **$ 5,580,984** | **$ -** | **$(29,188,156)** | **$15,086,099** |
| Share issuance costs | - | (750) | - | - | - | (750) |
| Issuance of Convertible Debentures | - | - | - | 156,212 | - | 156,212 |
| Share-based compensation | - | - | 337,036 | - | - | 337,036 |
| Net loss for the period | - | - | - | - | (4,939,577) | (4,939,577) |
| **Balance, March 31, 2013** | **50,855,859** | **$ 38,692,521** | **$ 5,918,020** | **$ 156,212** | **($34,127,733)** | **$ 10,639,020** |

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

## 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 Corporations 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 March 31, 2013, the Company had an accumulated deficit of $34,127,733 (December 31, 2012 - $29,188,156) and a working capital deficiency of $18,597,607 (December 31, 2012 - $14,566,791 deficit) including current debt obligations of $21,869,895 (December 31, 2012 - $13,411,298). 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.

## 2. BASIS OF PRESENTATION

### a) Statement of compliance with International Financial Reporting Standards

These unaudited condensed consolidated interim financial statements of Huldra have been prepared in accordance with International Accounting Standards ("IAS") 34, Interim Financial Reporting on a basis consistent with the accounting policies disclosed in Note 3. Effective January 1, 2013, the Company adopted IFRS 10, IFRS 11, IFRS 12, and IFRS 13. There was no significant impact upon adoption of these standards.

These condensed consolidated interim financial statements should be read in conjunction with the audited consolidated financial statements of the Company for the year ended December 31, 2012 prepared in accordance with International Financial Reporting Standards ("IFRS").

These condensed consolidated interim financial statements have been authorized for release by the Company's Board of Directors on May 30, 2013.

**Basis of consolidation**

These condensed consolidated interim 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 are eliminated on consolidation.

## 2. BASIS OF PRESENTATION (cont'd)

### b) Basis of Measurement

These condensed consolidated interim 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 Waterton derivative liability and the warrant liability, both of which are carried at fair value.

### c) Use of Estimates and Judgments

The preparation of the condensed consolidated interim 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 condensed consolidated interim 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 condensed consolidated interim financial statements are as follows:

i) Determination that the Company is in the exploration stage

As at and during the period ended March 31, 2013, 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 Company announced that as of March 26, 2013, it has achieved commercial production of the mill based on current production levels.

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.

### 3. SIGNIFICANT ACCOUNTING POLICIES (cont'd)

#### 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.

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.

**3. SIGNIFICANT ACCOUNTING POLICIES (cont'd)**

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.

**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.

**3. SIGNIFICANT ACCOUNTING POLICIES (cont'd)**

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.

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.

## 3. SIGNIFICANT ACCOUNTING POLICIES (cont'd)

*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 March 31, 2013, the Company has not classified any financial assets as held-to-maturity investments.

*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 March 31, 2013, 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 March 31, 2013, 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 March 31, 2013, 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 are included in the initial measurement of the financial instrument.

**3. SIGNIFICANT ACCOUNTING POLICIES (cont'd)**

**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.

**k) Share-based Payments**

The Company has a stock option plan that is described in Note 14a). The stock option plan allows directors, officers, 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

**3. SIGNIFICANT ACCOUNTING POLICIES (cont'd)**

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.

**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 the 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.

**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. 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.

## 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.

## 4. CASH AND CASH EQUIVALENTS

The Company's cash and cash equivalents at March 31, 2013 consisted of cash of $2,799,834 and cash equivalents of $nil (December 31, 2012 - cash of $883,169 and cash equivalents of $nil).

## 5. AMOUNTS RECEIVABLE

| | March 31, 2013 | December 31, 2012 |
|---|---|---|
| Accounts receivable from concentrate sales | $ 823,765 | $ 593,215 |
| Other receivable | $ 4,286 | $ 1,298 |
| HST receivable, (net) | $ 243,551 | $ 326,917 |
| METC receivable | $ 1,055,090 | $ 1,820,586 |
| | $ 2,126,692 | $ 2,742,016 |

## 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, 2012 | 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 |
| Additions | 39,132 | 33,320 | 3,025,685 | — | — | — | 3,098,138 |
| Recoveries from sales of concentrate | — | — | (3,820,821) | — | — | — | (3,820,821) |
| Disposals | — | — | — | — | — | — | — |
| **Balance at March 31, 2013** | 8,382,655 | 751,726 | 18,541,539 | 1,811,826 | 46,916 | 4,731 | 29,539,394 |
| **Accumulated Depreciation** | | | | | | | |
| Balance at January 1, 2012 | — | 57,408 | — | 148,819 | 2,219 | 845 | 209,291 |
| Depreciation for the period | — | 136,359 | — | 358,380 | 3,588 | 796 | 499,123 |
| Reclassification | — | (2,690) | — | — | — | — | 2,690 |
| Balance at December 31, 2012 | — | 191,077 | — | 507,199 | 5,807 | 1,641 | 705,724 |
| Depreciation for the period | — | 24,364 | — | 67,006 | 2,056 | 154 | 93,580 |
| Disposals | — | — | — | — | — | — | — |
| **Balance at March 31, 2013** | — | 215,440 | — | 574,205 | 7,863 | 1,795 | 799,304 |
| **Carrying Amounts** | | | | | | | |
| At January 1, 2012 | 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 |
| **At March 31, 2013** | 8,382,655 | 536,285 | 18,541,539 | 1,237,621 | 39,053 | 2,936 | 28,740,090 |

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.

## 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 vendors 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) was 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. 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 would 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 continued to hold a mortgage over those two parcels until the balance of the cash consideration owing under the purchase agreement was 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 vendors may recover magnetite from the Company's milling property and to extend and amend payments due to the vendors 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 such that $3,100,000 (net of estimated environmental remediation costs of $900,000) was 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).

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

On February 12, 2013, the Company entered into a second amending agreement ("Amending Agreement") to the Original Agreement. The final payment was 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 on or prior to April 1, 2013 (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.

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

## 7. MINERAL INTERESTS

Upon incorporation in 1980, the Company acquired from two directors in consideration of 750,000 common 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:

| | March 31, 2013 $ | December 31, 2012 $ |
|---|---|---|
| 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 |
| | 766,537 | 766,537 |

## 7. MINERAL INTERESTS (cont'd)

Cumulative exploration costs incurred are as follows:

| | Three Months Ended March 31, | |
|---|---|---|
| | **2013** | **2012** |
| | $ | $ |
| **EXPLORATION COSTS, beginning of period** | 18,356,006 | 10,881,717 |
| **Costs incurred during the period** | | |
| Engineering | 44,850 | 72,531 |
| Insurance | 14,211 | 11,116 |
| Meals and travel living allowance | 1,386 | 4,558 |
| Property tax | 6,794 | 5,440 |
| Assessment work and assay costs | 23,534 | 30,681 |
| Exploration supplies and camp expenses | 304,235 | 285,789 |
| Water sampling | - | 4,466 |
| Salaries and benefits | 802,444 | 944,284 |
| Construction planning | - | 5,250 |
| Fuel and propane | 208,621 | 276,362 |
| Vehicle & equipment expense | 34,265 | 34,271 |
| Depreciation | 93,210 | 116,079 |
| Permitting | 19,718 | 41,750 |
| Road rehabilitation | 88,839 | 99,185 |
| Surveying | - | 113 |
| Outsourced labor | 54,900 | 78,118 |
| Tenure lease | 1,450 | 725 |
| Freight | 2,676 | 3,510 |
| Equipment rentals | 79,215 | 110,882 |
| Geological | 67,684 | 2,644 |
| Geotechnical | 9,108 | - |
| Explosives | 65,647 | 104,012 |
| Trucking expense | 306,478 | 24,083 |
| Recovery of costs | (16,807) | - |
| **Total costs incurred during the period** | 2,212,458 | 2,255,849 |
| **CUMULATIVE EXPLORATION COSTS, end of period** | 20,568,464 | 13,137,566 |

## 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 vendors, 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%.

As part of the Original 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 Original 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. As at March 31, 2013, 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 posted further collateral of $400,000 in March 2013.

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 March 31, 2013 total $505,100 (December 31, 2012 - $505,100) and are required to satisfy the obligations, discounted using a real discount rate of 0% per annum (December 31, 2012 – 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 $1,135,100 as at March 31, 2013 (December 31, 2012 - $735,100) 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.

**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 and 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 included $850,333 assigned to the warrants (See notes 13 and 16). 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 included $577,566 assigned to the warrants (See notes 13 and 16). 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.

**10. WATERTON DEBT (cont'd)**

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 such that, if issued, they would have an exercise price of $1.30 throughout the term of the warrant.

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 payments of varying amounts 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 (i) issued 180,000 common shares of the Company to Waterton and (ii) agreed to 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 such that the October 31, 2012 and November 30, 2012 repayment amounts were each 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.

**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 were 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. As consideration for this extension, the Company paid 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.

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 was paid on February 8, 2013. 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 Silver Adjustment Provision 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 Silver Adjustment Provision 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

**10. WATERTON DEBT (cont'd)**

order to trigger a Silver Adjustment Provision amount payable and the maximum amount payable in the formula was based on $34.00 per ounce.

As a result of the adjustment made to the Silver Adjustment Provision payable calculation per the Fourth Amendment, the Company has determined that the terms of the loan have changed sufficiently such that the Fourth Amendment should be accounted for as a debt extinguishment. The impact on the Company is a $1,399,865 charge to the statement of operations and comprehensive loss for the three months ended March 31, 2013. Additionally, the Company has used a fair value discount rate of 20% to value the loan on a going forward basis.

**11. 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.

## 11. 2012 FINANCINGS (cont'd)

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.

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.

## 12. CONVERTIBLE DEBT

The Company completed a private placement of unsecured convertible debentures (the "Debentures") in various tranches between February 8, 2013 and February 13, 2013, for aggregate gross proceeds of $10,003,800. 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.

The principal amount of the Debentures will be convertible into common shares of the Company (each, a "Share) 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 convertible debentures are compound instruments and the proceeds are required to be bifurcated to record the fair value of the separate debt and equity components. The fair value of the debt was determined using a discounted cash flow model using an estimated market interest rate for equivalent debt of 20% given the Company's industry and risk profile. The fair value of the debt was calculated to be $9,835,896 with the residual portion of $156,212, allocated to equity. Transaction costs of $447,459 offset the carrying value and are amortized using the effective interest method as finance costs over the expected life of the debentures.

## 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, 2012 to March 31, 2013:

| | Number of Warrants | Weighted Average Exercise Price |
|---|---|---|
| **Balance at January 1, 2012** | 11,090,662 | $ 1.16 |
| Issue of warrants | 5,372,778 | $ 1.48 |
| Exercise of warrants | (3,206,950) | $ 0.78 |
| Expiring of warrants | (25,000) | $ 0.75 |
| **Balance at December 31, 2012** | 13,231,490 | |
| Issue of warrants | - | |
| Exercise of warrants | - | |
| Expiring of warrants | - | |
| **Balance at March 31, 2013** | 13,231,490 | |

## 13. SHARE CAPITAL AND RESERVES (cont'd)

As at March 31, 2013, the Company had outstanding warrants as follows:

| Security | Number | Exercise Price | Expiry Date |
|---|---|---|---|
| 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 | 858,059 | $1.75 | September 26, 2014 |
| Warrants | 200,000 | $1.75 | October 1, 2014 |
| Warrants | 514,541 | $1.75 | October 9, 2014 |
| Warrants | 37,500 | $1.75 | October 12, 2014 |
| Warrants | 357,700 | $1.75 | October 19, 2014 |
| Warrants | 50,000 | $1.75 | October 29, 2014 |
| Warrants | 250,000 | $1.75 | November 13, 2014 |
| Warrants | 282,000 | $1.75 | November 14, 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.

## 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 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.

The following is a summary of changes in stock options from January 1, 2012 to March 31, 2013:

| | Number of Options | Weighted Average Exercise Price |
|---|---|---|
| **Balance at January 1, 2012** | 2,630,000 | $ 0.93 |
| Issue of options | 1,915,000 | $ 1.44 |
| Exercise of options | (478,500) | $ 0.52 |
| **Balance at December 31, 2012** | 4,066,500 | |
| Issue of options | 500,000 | $ 0.95 |
| Exercise of options | - | - |
| **Balance at March 31, 2013** | 4,566,500 | $ 1.19 |

**14. SHARE-BASED PAYMENTS (cont'd)**

As at March 31, 2013, 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 | 2.00 | March 29, 2015 |
| 150,000 | 150,000 | $ 0.25 | 2.08 | May 4, 2015 |
| 150,000 | 150,000 | $ 0.385 | 2.25 | June 28, 2015 |
| 31,500 | 31,500 | $ 0.95 | 2.83 | January 28, 2016 |
| 270,000 | 270,000 | $ 1.40 | 3.08 | May 2, 2016 |
| 1,050,000 | 1,050,000 | $ 1.44 | 3.33 | July 28, 2016 |
| 60,000 | 60,000 | $ 1.35 | 3.63 | November 16, 2016 |
| 1,535,000 | 1,535,000 | $ 1.45 | 4.44 | September 10, 2017 |
| 380,000 | 380,000 | $ 1.40 | 4.58 | November 1, 2017 |
| 150,000 | 150,000 | $ 0.95 | 4.90 | February 25, 2018 |
| 350,000 | 350,000 | $ 0.95 | 4.91 | February 27, 2018 |
| 4,566,500 | 4,566,500 | | 3.76 | |

**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 March 31, 2013 was $0.95 per option (March 31, 2012: $nil). 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 Company expensed $276,853 during the three months ended March 31, 2013 (March 31, 2012 - $nil) as well as incurred $60,183 in share-based compensation costs that will be added to the capitalized cost of the mill (March 31, 2012- $nil).

These amounts also include an expense of $232,559 for the three months ended March 31, 2013, related to 390,000 options granted to non-employees, determined by using the Black-Scholes option pricing model as the Company could not estimate reliably the fair value of the services received.

## 15. RELATED PARTY TRANSACTIONS

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

| | Three Months Ended March 31, 2013 | 2012 |
|---|---|---|
| | $ | $ |
| Management fees paid to a director and a company controlled by a director (i) | 24,000 | 24,000 |
| Consulting fees paid to a director (ii) | 6,000 | 6,000 |
| Office Rental payments made to a company controlled by a director (iii) | 7,500 | 7,500 |
| Office and general expenses paid to a director of the Company (iv) | 360 | 360 |

i) Management fee is $8,000 per month.

ii) Consulting fee is $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.

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 three months included $nil in share-based compensation expense (March 31, 2012: $nil).

## 16. 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.

**16. FINANCIAL INSTRUMENTS (cont'd)**

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 as at March 31, 2013 as the sum of the fair value of a series of call options on silver with an exercise price of $32.00 per ounce and expiring on each repayment date plus the sum of the fair value of a series of put options on silver with an exercise price of $32.00 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 | $31.15 per ounce |
| Exercise Price | $32.00 |
| Risk Free Rate | 1.00% |
| Discount Rate | 1.00% |
| Expected Life | 0.08 years to 0.83 years, as applicable |
| Number of Options Granted | 14,260 |
| Credit Adjustment Factor | 20.00% |

The Company estimated the change in control option and the prepayment option at $nil on March 31, 2013 on the basis that neither of these events are expected to occur.

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 March 31, 2013 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 | 3.21 years or 3.79 years as applicable |

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 three months ended March, 2013:

| | Liability at December 31, 2012 | Extinguishment of Debt | Profit Participation Payments | Mark to market (gain) loss | Liability at March 31, 2013 |
|---|---|---|---|---|---|
| Waterton derivative liability | $ 406,260 | $ 376,718 | $ (269,630) | $ 120,916 | $ 634,264 |
| Warrant liability | $ 1,422,005 | $ - | $ - | $ (161,858) | $ 1,260,147 |
| | $ 1,828,265 | $ 376,718 | $ (269,630) | $ (40,942) | $ 1,894,411 |

## 16. FINANCIAL INSTRUMENTS (cont'd)

*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 $4.9 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.

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 | $ 2,597,710 | $ - | $ - | $ - |
| Waterton Debt Obligation | $ 1,946,969 | $ 7,314,393 | $ - | $ - |
| Craigmont Obligation | $ 1,004,125 | $ - | $ - | $ - |
| Convertible Debentures | $ - | $ 11,604,408 | $ - | $ - |
| | $ 5,548,804 | $ 18,918,801 | $ - | $ - |

## 16. FINANCIAL INSTRUMENTS (cont'd)

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.

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.

## 17. SUPPLEMENTAL CASH FLOW INFORMATION

| | Three Months Ended March 31 | |
|---|---|---|
| | 2013 | 2012 |
| Issued common shares upon amendment of Credit Agreement | $ - | $ 50,000 |

## 18. 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.

## 19. 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 $184,874 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 2013 were $3,820,821 (March 31, 2012 - $nil). Sales earned during the commissioning phase of the mill are offset against the capital cost of the mill construction.

## 20. COMMITMENTS

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 2013 in order to fulfill its commitment.

## 21. SUBSEQUENT EVENTS

Subsequent events to March 31, 2013 are as follows:

**a)** On April 1, 2013, the Company made the March 2013 debt payment to Waterton in the amount of $973,485.

**b)** On April 8, 2013, the Company made the final payment owing on the Craigmont obligation. All payments pursuant to the Amending Agreement have been made and the mortgage on the Craigmont Property has been discharged.