AQUILA RESOURCES INC.

(an exploration stage enterprise)

CONSOLIDATED FINANCIAL STATEMENTS

(Expressed in Canadian Dollars unless otherwise stated)

DECEMBER 31, 2010

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INDEPENDENT AUDITORS' REPORT

To the Shareholders of
Aquila Resources Inc.:
(an exploration stage enterprise)

We have audited the accompanying consolidated financial statements of Aquila Resources Inc. (the "Company") which comprise the consolidated balance sheets as at December 31, 2010 and 2009 and the consolidated statements of loss, comprehensive loss and deficit and cash flows for the years then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Aquila Resources Inc. as at December 31, 2010 and 2009 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Emphasis of Matter

Without qualifying our opinion, we draw attention to Note 1 in the consolidated financial statements which indicates that the Company has incurred ongoing losses. The Company incurred a net loss of $972,275 during the year ended December 31, 2010. These conditions, along with other matters as set forth in Note 1, indicate the existence of a material uncertainty that may cast significant doubt about the Company's ability to continue as a going concern.

"Edmund Cachia & Co. LLP"
CHARTERED ACCOUNTANTS
Licensed Public Accountants
Toronto, Ontario
March 31, 2011

AQUILA RESOURCES INC.
(an exploration stage enterprise)

Consolidated Balance Sheets
(Expressed in Canadian Dollars)
As at December 31

	2010	2009
Assets		
Current		
Cash	$ 1,029,747	$ 1,866,125
Accounts receivable	93,589	105,063
Prepaid expenses	33,636	37,379
	1,156,972	2,008,567
Security deposits (Note 3(a))	133,802	124,415
Mineral property costs (Note 3)	30,676,113	30,120,135
Capital assets (Note 4)	951,606	976,180
	$ 32,918,493	$ 33,229,297
Liabilities		
Current		
Accounts payable and accrued liabilities (Note 7)	$ 384,952	$ 108,733
Shareholders' Equity		
Share capital (Note 5)	38,819,709	38,510,133
Contributed surplus (Note 6)	4,882,017	4,806,341
Deficit	(11,168,185)	(10,195,910)
	32,533,541	33,120,564
	$ 32,918,493	$ 33,229,297

Nature of operations and going concern considerations (Note 1)

Commitments (Notes 3, 8 and 16)

Subsequent events (Note 16)

Approved on Behalf of the Board:

"*Edward J. Munden*" Director

"*Robin Dunbar*" Director

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

AQUILA RESOURCES INC.
(an exploration stage enterprise)

Consolidated Statements of Loss, Comprehensive Loss and Deficit

(Expressed in Canadian Dollars)
for the years ended December 31

	2010	2009	Cumulative from the date of commencement of exploration stage January 16, 2004
Expenses			
Depreciation	**$ 25,306**	$ 25,745	$ 79,614
Consulting fees	**56,495**	35,700	346,562
Directors' fees (Note 7)	**33,188**	-	210,045
Filing and regulatory fees	**32,527**	33,569	343,677
Foreign exchange loss (gain)	**(9,489)**	31,484	936,210
Interest and bank charges	**3,872**	1,356	100,688
Licenses, taxes and fees	**-**	-	85,000
Management fees (Note 7)	**163,875**	52,500	818,566
Office, general and administrative	**95,168**	66,238	416,972
Professional fees (Note 7)	**70,492**	64,692	555,693
Rent (Note 7)	**14,400**	22,591	92,223
Salaries and benefits	**185,979**	180,464	1,257,880
Stock-based compensation (Note 5(d))	**197,137**	344,420	5,588,684
Travel and promotion	**110,182**	25,651	789,510
Write-down of mineral property costs	**-**	-	768,774
Loss before undernoted	**979,132**	884,410	12,390,098
Interest income and other income	**(6,857)**	(15,169)	(1,221,913)
Net loss and comprehensive loss for the year	**972,275**	869,241	$ 11,168,185
Deficit, beginning of year	**10,195,910**	9,326,669	
Deficit, end of year	**$ 11,168,185**	$ 10,195,910	
Loss per common share			
Basic and Diluted (Note 2)	**$ 0.01**	$ 0.01	
Basic	**82,037,263**	74,676,583	
Diluted	**82,037,263**	74,676,583	

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

AQUILA RESOURCES INC.
(an exploration stage enterprise)

Consolidated Statements of Cash Flows
(Expressed in Canadian Dollars)
For the years ended December 31

	2010	2009	Cumulative from the date of commencement of exploration stage January 16, 2004
Cash flows from operating activities			
Net loss for the year	**$ (972,275)**	$ (869,241)	$ (11,168,185)
Adjustments for:			
Depreciation	**25,306**	25,745	79,614
Financing fee	**-**	-	20,424
Stock-based compensation	**197,137**	344,420	5,588,684
Interest accrual	**-**	-	1,913
Write-down of mineral property costs	**-**	-	768,774
Changes in non-cash working capital (Note 10)	**353,448**	(52,568)	279,817
Cash used in operations	**(396,384)**	(551,644)	(4,428,959)
Cash flows from investing activities			
Purchase of capital assets	**(732)**	-	(367,766)
Security deposits	**(9,387)**	4,680	(129,367)
Mineral properties - acquisition	**(2,626,617)**	(1,392,857)	(10,170,118)
Mineral properties - exploration	**(2,958,855)**	(2,933,516)	(25,337,964)
Recovery of mineral property costs	**4,967,482**	2,379,774	7,347,256
Cash used in investing	**(628,109)**	(1,941,919)	(28,657,959)
Cash flows from financing activities			
Issuance of common shares	**188,115**	2,221,170	36,575,168
Share issue costs	**-**	-	(2,188,236)
Notes payable	**-**	-	117,110
Repayment of mortgages payable	**-**	-	(461,548)
Loans payable	**-**	-	74,171
Cash provided by financing	**188,115**	2,221,170	34,116,665
Net increase (decrease) in cash	**(836,378)**	(272,393)	1,029,747
Cash, beginning of year	**1,866,125**	2,138,518	-
Cash, end of year	**$ 1,029,747**	$ 1,866,125	$ 1,029,747

Supplemental cash flow information (Note 13)

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

1. Nature of operations and going concern considerations:

Aquila Resources Inc. (the "Company") was incorporated under the Business Corporations Act ("Canada") and its principle business activity is the exploration and development of mineral properties in the United States.

The Company is in the business of exploring for and developing mineral properties. Substantially all of the efforts of the Company are devoted to these business activities. To date the Company has not earned significant revenues and is considered an exploration stage company. For the year ended December 31, 2010, the Company incurred a loss of $972,275 (2009- $869,241) and had an accumulated deficit of $11,168,185 (2009 - $10,195,910). The ability of the Company to carry out its business plan rests with its ability to secure equity and other financing.

These consolidated financial statements have been prepared on the basis of accounting principles applicable to a "going concern", which assumes the Company will continue in operation for the foreseeable future and will be able to realize its assets and discharge its liabilities in the normal course of operations. The business of mining and exploring for minerals involves a high degree of risk and there is no guarantee the Company's exploration programs will yield positive results or the Company will be able to obtain the necessary financing to carry out the exploration and development of its mineral property interests.

These consolidated financial statements do not reflect the adjustments to the carrying values of assets and liabilities, the reported expenses and balance sheet classifications that would be necessary should the going concern assumption be inappropriate. These adjustments could be material.

The recoverability of the carrying value of exploration properties and the Company's continued existence is dependent upon the preservation of its interests in the underlying properties, the development of economically recoverable reserves, the achievement of profitable operations, or the ability of the Company to raise additional financing, if necessary, or alternatively upon the Company's ability to dispose of its interests on an advantageous basis. Changes in future conditions could require material write-downs of the carrying values.

Although the Company has taken steps to verify title to the properties in which it has an interest, in accordance with industry standards for the current stage of exploration of such properties, these procedures do not guarantee the Company's title. Property title may be subject to government licensing requirements or regulations, unregistered prior agreements, undetected defects, unregistered claims, native land claims, and non-compliance with regulatory and environmental requirements.

2. Significant Accounting Policies:

Principles of consolidation:

These consolidated financial statements are prepared in accordance with generally accepted accounting principles in Canada. Summarized below are these policies considered significant to the Company. References to the Company included herein are inclusive of the accounts of Aquila Resources Inc.'s wholly-owned subsidiary Aquila Resources Corp. and its subsidiaries. All inter-company balances and transactions have been eliminated.

Deferred mineral property costs:

The Company capitalizes all costs, net of any recoveries, related to the acquisition, exploration and development of mineral properties. These costs will be amortized on the units-of-production basis over the estimated useful life of the properties following the commencement of production or written-off if the properties are sold, allowed to lapse, or abandoned.

2. Significant Accounting Policies (continued):

Deferred mineral property costs (continued):

Cost includes the cash, consideration paid and the fair market value of any common shares issued on the acquisition of mineral properties. Properties acquired under option agreements, whereby payments are made at the sole discretion of the Company, are recorded in the accounts at such time as the payments are made. The recorded cost of mineral claims and deferred exploration and development costs represent costs incurred and are not intended to reflect present or future values.

The recoverability of costs incurred on the exploration properties is dependent upon numerous factors including exploration results, environmental risks, commodity risks, political risks, and the Company's ability to attain profitable production. It is reasonably possible, based on existing knowledge, that changes in future conditions in the near-term could require a change in the determination of the need for, and amount of, any write down.

The Company reviews capitalized costs on its property interests on a periodic, or annual, basis and will recognize an impairment in value based upon current exploration results and upon management's assessment of the future probability of profitable revenues from the property or from the sale of the property. Management's assessment of the property's estimated current fair market value may also be based upon a review of other property transactions that have occurred in the same geographic area as that of the property under review and the assessment of the ability to recover capitalized costs based on technical, social and environmental issues.

Administrative costs, other than for those that are charged to deferred mineral property costs, are expensed as incurred.

The proceeds of options granted on a mining property are recorded as a reduction of the amounts recorded for mineral property costs and any excess is recorded in the statement of operations.

Capital assets:

Capital assets consist of land, buildings, furniture, fixtures and equipment which are initially recorded at cost. Depreciation is recorded using the following rates and methods:

Buildings	4% Declining balance
Furniture, fixtures and equipment	20% Declining balance

Depreciation is recorded at one-half of the annual rate in the year of acquisition.

Share capital:

Share capital issued for non-monetary consideration is recorded at an amount based on the quoted trading price of those shares on the TSX for a reasonable period before and after the transaction.

Share issue costs are recorded as a reduction of share capital when the related shares are issued.

Proceeds from unit placements are allocated between shares and warrants issued according to the residual value method. The fair value of the shares is determined based on the quoted market price on the date the shares are issued with the residual value being allocated to the warrants.

2. Significant Accounting Policies (continued):

Use of estimates:

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant areas requiring the use of management estimates relate to the identification and capitalization of deferred exploration expenditures, determination of impairment in the carrying values of long-lived assets, amounts recorded for related party transactions and balances, financial instrument valuations, future income tax valuation reserves, and the existence of asset retirement obligations or contingent assets and liabilities. Actual results could differ from these estimates. Management believes that the estimates are reasonable.

Revenue recognition:

Interest income is recognized on an accrual basis as it is earned.

Assets retirement obligation:

The Company recognizes a liability for an asset retirement obligation when it is determinable and calculates the liability based upon undiscounted future payments to be made. A corresponding amount is added to the carrying amount of the related long-term asset, and this amount is subsequently allocated to expense over its expected life. Adjustments will also be made in subsequent periods to changes in asset retirement obligations due to changes in estimates. As at December 31, 2010, the Company does not have any asset retirement obligations.

Impairment of long-lived assets:

Long-lived assets, including capital assets and other assets, are reviewed for impairment whenever events or changes in circumstances indicates that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset.

Income taxes:

The Company accounts for and measures future tax assets and liabilities in accordance with the asset and liability method.

Under this method, future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amount of existing assets and liabilities and their respective tax bases. Future tax assets and liabilities are measured using the enacted or substantially-enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be reversed or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the date of enactment or substantive enactment of the change. When the future realization of income tax assets does not meet the test of being more likely than not to occur, a valuation allowance in the amount of the potential future benefit is taken and no net asset is recognized. Assuming the Company's operations remain at the exploration stage, such an allowance will continue to apply fully for the foreseeable future to all potential income tax assets. Accordingly, the Company's accounting policy for the future income taxes currently has no effect on the consolidated financial statements of the fiscal periods presented.

2. Significant Accounting Policies (continued):

Stock-based compensation:

The Company has a stock option plan, which is described in note 5(d). The Company uses the Black-Scholes option pricing model to estimate the fair value of each stock-option at the date of grant. Stock options that vest immediately are recorded at the date of grant. Stock options that vest over time are recorded over the vesting period using the straight-line method. Stock option compensation is recognized as an expense with a corresponding increase in contributed surplus. On exercise of the stock option, consideration received and the estimated fair value previously recorded in contributed surplus is recorded as share capital.

Loss per share:

Basic loss per share is computed by dividing loss available to common shareholders by the weighted average number of common shares outstanding during the year. The treasury stock method is used to calculate diluted loss per share.

Diluted loss per share:

Diluted loss per share is similar to basic loss per share, except that the denominator is increased to include the number of additional common shares that would have been outstanding assuming that options and warrants with an average market price for the year greater than their exercise price are exercised and the proceeds used to repurchase common shares. The fully diluted loss per share has not been computed, as the effect would be anti-dilutive.

Translation of foreign currencies:

Monetary assets and liabilities denominated in foreign currencies are translated into Canadian dollars at exchange rates prevailing at the balance sheet date. Non-monetary assets and liabilities are translated into Canadian dollars at approximate exchange rates prevailing at the transaction date. Revenue and expenses are translated at average exchange rates prevailing during the year. The resulting gains and losses are included in loss for the year.

Property option agreements:

From time to time, the Company may acquire or dispose of properties pursuant to the terms of option agreements. Due to the fact that options are typically exercisable entirely at the discretion of the optionee, the amounts payable or receivable are not recorded. Option payments are recorded as resource property costs or recoveries when the payments are made or received.

Mineral property pre-acquisition costs:

The Company capitalizes pre-acquisition costs investigating potential property acquisition. However, if the Company determines that a specific property acquisition will not be concluded, the costs associated with the specific property are charged to operations in the current period.

Financial assets and liabilities:

Assets or liabilities held-for-trading

Financial instruments classified as assets or liabilities held for trading are reported at fair value at each balance sheet date, and any change in fair value is recognized in net income (loss) in the period in which the change occurs.

2. Significant Accounting Policies (continued):

Financial assets and liabilities (continued):

Held-to-maturity investments, loans and receivables and other financial liabilities

Financial instruments classified as loans and receivables, held-to-maturity investments and other financial liabilities are carried at amortized costs using the effective interest method. Interest income or expenses is included in net income (loss) over the expected life of the instrument.

Available-for-sale

Financial instruments classified as available for sale are recorded at fair value at each balance sheet date and any change in fair value is recognized in other comprehensive income in the period in which these changes occur. Securities classified as available for sale and with no quoted market price in an active market are carried at cost. Available-for-sale securities are written down to fair value (impairment recognized in loss) when it is necessary to reflect an other-than-temporary impairment. Upon derecognition, any accrued gains or losses in accumulated other comprehensive income are then recognized in net income (loss).

Classification of financial instruments:

The Company designates its cash as held-for-trading, which is measured at fair value. Accounts receivable are classified as loans and receivables, which are measured at amortized cost. Accounts payable and accrued liabilities are classified as other financial liabilities which are measured at amortized cost. Due to the short-term nature of these instruments, their carrying value approximates their fair value.

Cumulative information for exploration stage companies:

The Company has adopted CICA Handbook Accounting Guideline #11 with respect to financial statement presentation for exploration stage companies. Accordingly, the statements of loss, comprehensive loss and deficit and cash flows have been altered to include a column outlining the cumulative revenues, expenses and cash flows from the date of commencement of exploration stage activities being January 16, 2004 to the fiscal year end date of the consolidated financial statements.

Financial Instruments:

In June 2009, the CICA amended Section 3862, Financial Instruments - Disclosures, to include additional disclosure requirements about fair value measurement for financial instruments and liquidity risk disclosures. These amendments require a three level hierarchy that reflects the significance of the inputs used in making the fair value measurements. Fair value of assets and liabilities included in Level 1 are determined by reference to quoted prices in active markets for identical assets and liabilities. Assets and liabilities in Level 2 include valuations using inputs other than quoted prices for which all significant inputs are based on observable market data, either directly or indirectly. Level 3 valuations are based on inputs that are not based on observable market data.

Financial instruments classified as level 1 – quoted prices in active markets include cash.

Sections 3862 and 3863 place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks. The Company has included disclosures recommended by the section in note 12 to these consolidated financial statements.

2. Significant Accounting Policies (continued):

Comprehensive income:

Comprehensive income, composed of net income and other comprehensive income, is defined as the change in shareholders' equity from transactions and other events from non-owner sources. Other comprehensive income ("OCI") includes unrealized gains and losses on available-for-sale securities and changes in the fair market value of derivatives designated as cash flow hedges, all net of related income taxes. The components of comprehensive income are disclosed in the statement of loss, comprehensive loss and deficit. Cumulative changes in other comprehensive income are included in accumulated other comprehensive income ("AOCI") which is presented as a category in shareholders' equity. The Company does not currently have any OCI items or AOCI. Therefore, comprehensive loss is equal to net loss for the years ended December 31, 2010 and 2009.

Capital disclosures:

Section 1535 specifies the disclosure of (i) an entity's objectives, policies and processes for managing capital; (ii) quantitative data about what the entity regards as capital; (iii) whether the entity has complied with any capital requirements; and (iv) if it has not complied, the consequences of such noncompliance. The Company has included disclosures recommended by the Handbook section in note 11 to these consolidated financial statements.

Future accounting changes:

Business Combinations:

In January 2009, the CICA issued Handbook Sections 1582 "Business Combinations", 1601 "Consolidated Financial Statements" and 1602 "Non-controlling Interests" which replace CICA Handbook Sections 1581 "Business Combinations" and 1600 "Consolidated Financial Statements". Section 1582 establishes standards for the accounting for business combinations that is equivalent to the business combination accounting standard under IFRS. Section 1601 together with Section 1602 establishes standards for the preparation of consolidated financial statements. These Sections are applicable for interim and annual consolidated financial statements for fiscal years beginning January 1, 2011. Early adoption of these Sections is permitted and all these Sections must be adopted concurrently.

International Financial Reporting Standards ("IFRS"):

In January 2006, the CICA's Accounting Standards Board ("AcSB") formally adopted the strategy of replacing Canadian GAAP with IFRS for Canadian enterprises with public accountability. On February 13, 2008 the AcSB confirmed that the use of IFRS will be required in 2011 for publicly accountable profit oriented enterprises. For these entities, IFRS will be required for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The Company will be required to have prepared, in time for its first quarter of fiscal 2011 filing, comparative financial statements in accordance with IFRS for the three months ended March 31, 2010. The Company is currently assessing the impact that implementing IFRS will have on its financial statements.

2. Mineral property costs and commitments:

Total accumulated deferred mineral property costs are detailed as follows:

2010	Balance beginning of year	Acquisition	Exploration	JV reimbursements/ recoveries	Write-down	Balance end of year
Back Forty Project	$ 30,120,135	$ 2,528,000	$ 2,405,395	$(4,772,140)	$ -	$30,281,390
Michigan Gold	-	32,454	292,450	-	-	324,904
Other	-	66,163	223,205	-	-	289,368
Exploration Alliance	-	-	37,805	(257,354)	-	(219,549)
	$ 30,120,135	$ 2,626,617	$ 2,958,855	$(5,029,494)	$ -	$30,676,113

2009	Balance beginning of year	Acquisition	Exploration	JV reimbursements/ recoveries	Write-down	Balance end of year
Back Forty Project	$ 28,252,770	$ 1,392,857	$ 2,943,146	$(2,468,638)	$ -	$ 30,120,135

a) Back Forty Project

The Back Forty Project controls approximately 6,800 acres (2009-9,300) of surface and mineral rights which are 49% (2009- 100%) owned or held under lease or option by a 100% owned U.S. subsidiary, Aquila Resources USA Inc. Some lands are subject to net smelter royalties varying from 1% to 3.5%, with certain lands subject to a 2% - 7% state royalty, which under state law can be renegotiated. Annual option and property acquisition costs for 2010 were $2,528,000 (2009-$1,392,857). The entire project is subject to a 7% net distributable earnings royalty ("Net Profits after Payback") payable to a former joint venture partner.

HudBay Option and Joint Venture Agreement

On August 6, 2009, the Company signed a Subscription, Option and Joint Venture Agreement (the "Agreement") with HudBay Minerals Inc. ("HudBay"). Under the terms of the agreement, the following events came into effect:

I) HudBay subscribed for 12,141,051 common shares of the Company at $0.1827 per share for gross proceeds of $2,218,170 (see note 5(b)). These shares were subject to a four month hold period.

II) While HudBay maintains at least a 10% ownership interest, HudBay will have the right to nominate a director to the Company's Board of Directors and will have pre-emptive rights to maintain its ownership interest. In addition, should HudBay choose to dispose of its equity interest in the Company, HudBay has agreed to do so in an orderly manner pursuant to the Agreement.

III) HudBay can earn a 51% interest in the Back Forty Project (the "Project") by expending a minimum of $10 million in aggregate over a 3-year period with a minimum of US$3 million by the first anniversary, an additional US$3 million by the second anniversary, and an additional US$4 million by the third anniversary (As of August 31, 2010, Hudbay exercised its option to earn a 51% interest in the Back Forty Project).

3. Mineral property costs and commitments (continued):

a) Back Forty Project (continued)

HudBay Option and Joint Venture Agreement (continued)

IV) After HudBay completes the initial 51% interest, HudBay and the Company will form a joint venture reflective of their proportionate ownership interest in the Project.

V) Subsequent to HudBay earning the initial 51% interest, HudBay will have the option to increase its interest in the Project to 65% by funding and completing a feasibility study, funding and submitting a permitting application, and making outstanding specified option payments.

VI) In the event a feasibility study is completed and permitting applications are submitted, and HudBay elects to put the Project into production and issues a Development Notice, the Company will have 90 days to arrange financing for its share of project costs. If the Company is unable or elects not to obtain financing, HudBay, by assuming the obligation to finance 100% of the development costs, will increase its ownership in the Project by a further 10% to 75%. Pursuant to the Agreement, the Company's 25% share of the development costs would then be deducted from the Company's proportionate share from Net Proceeds from the Project.

VII) While HudBay retains the largest ownership interest in the Project, HudBay will be the manager and operator. HudBay will also have exclusive marketing rights to sell production to HudBay or third parties on commercial terms.

VIII) If the feasibility study is not completed and all applications for permitting are not submitted on or before the fourth anniversary of the Agreement, the Company has the right to re-acquire HudBay's 51% joint venture interest by reimbursing HudBay 50% of its total expenditures in respect of the Project incurred from the execution of the Agreement. If the Project is not brought into commercial production within four years from the grant of mining permits, the Company may re-acquire HudBay's 65% joint venture interest by reimbursing HudBay 50% of its total Project expenditures incurred after execution of the Agreement. Notwithstanding the Company exercising the foregoing right, HudBay shall retain the marketing rights and the product rights as provided for in the Agreement. In addition, if the Company exercises this right after HudBay earns a 51% interest in the Project, then HudBay shall have its participating interest converted to a 1% NSR.

During 2009, in connection with securing the Agreement with HudBay, fees of US$305,000 were paid in cash, and 300,000 stock options were issued valued at $60,600 using the Black Scholes option pricing model (see note 5).

On August 31, 2010, pursuant to the Agreement, HudBay acquired a 51% interest in the Project. Hudbay will act as operator of the joint venture with authority and discretion as to the exploration and potential development of the Project and will have exclusive rights to purchase and market the minerals produced from the property. Although called a joint venture in the agreement, management has determined that a joint venture by accounting standards does not exist. CICA Handbook Section 3055 requires that the ventures have joint control over the strategic operating, investing and financing decisions of the venture. In this agreement the Company does not have joint control.

As of December 31, 2010, the Company has incurred net acquisition and exploration costs totaling $30,281,390 (2009- $30,120,135) on the Back Forty Project. In addition, as of December 31, 2010, aggregate reimbursements of $62,012 (2009- $88,846) were receivable from Hudbay for costs incurred by the Company on the Project.

3. Mineral property costs and commitments (continued):

a) Back Forty Project (continued)

HudBay Option and Joint Venture Agreement (continued)

The Company maintains cash deposits in the amount of $133,802 (2009- $124,415), pursuant to escrow agreements. The amounts are being held as security for the fulfillment of obligations in accordance with certain agreements pursuant to the Back Forty Project. During the year, the deposits accrued interest of $5,080 (2009- $6,120).

Future Back Forty Project Commitments

Estimated lease, option and property acquisition costs related to the Back Forty Project in each of the next five years are as follows:

2011 - US$1,733,789; 2012 - US$1,575,741; 2013 - US$2,244,581; 2014 - US$1,527,195; 2015 - US$1,557,852

b) Michigan Gold Property

On October 21, 2010, the Company entered into an option agreement with Minerals Processing Corporation ("MPC") to earn a 100% interest in certain surface and mineral rights located in Marquette County, Michigan.

In order for the Company to earn a 100% interest in this property, the Company has annual commitments per the table below:

Due Date	Cash Payment (US$)	Shares (see below)	Exploration Expenditures (US$)
October 21, 2010	25,000 (fulfilled)	100,000	-
October 21, 2011	25,000	100,000	150,000
October 21, 2012	25,000	100,000	200,000
October 21, 2013	25,000	100,000	300,000
October 21, 2014	25,000	100,000	400,000
	125,000	500,000	1,050,000

For each stock payment, MPC may elect to receive US$50,000 in lieu of 100,000 common shares of the Company.

In addition to the above noted commitments, in order to complete the 100% acquisition of the property, the Company must purchase the mineral and surface rights owned by the vendor for US$1,300 per acre. The property is comprised of 332 acres for surface and mineral land and 1,799 acres of mineral rights.

MPC and the Company have common directors and officers.

A net smelter royalty ranging from 1% to 4% is payable in the event of mineral production on the property.

3. Mineral property costs and commitments (continued):

b) Michigan Gold Property (continued)

The Company is currently in arrears in meeting its property commitment to issue 100,000 shares of the Company to MPC with respect to the Michigan Gold Property. The Company is working towards the issuance of these shares. To date, MPC has not issued a default notice.

Future additional Michigan Gold Property Commitments

In addition to the above mentioned commitments, estimated acquisition costs related to the Michigan Gold Property in each of the next five years are as follows:

2011 - US$103,120; 2012 - US$48,400; 2013 - US$54,600; 2014 - US$60,800; 2015 - US$62,000

c) Other mineral properties

During the year ended December 31, 2010, the Company entered into exploration and lease agreements with an option to purchase other gold properties located in the U.S. Initial consideration paid pursuant to these agreements was US$65,717. Over the next five years, in order to maintain the aforementioned exploration and lease agreements in good standing on one of the properties, annual lease and option payments of US$19,812 are required to be made. On another of the properties, option payments are required to be made over the next two years: 2011-US$50,000 and 2012- US$60,000.

See Note 16 for additional mineral properties information.

d) Exploration alliance

On October 15, 2010, the Company formed an exploration alliance with HudBay whereby HudBay will fund exploration conducted by the Company in Michigan and other surrounding areas as agreed. HudBay has made an initial payment to the Company of US$250,000, which the Company is using to seek out exploration targets. The Company will present HudBay with a minimum of five exploration targets and if HudBay agrees to continue to fund any such target it will fund exploration up to US$2,000,000, following which the parties would form a 50/50 joint venture with respect to the project. HudBay would then be able to increase its interest to 65% by funding and completing a feasibility study and required mine permit applications.

In addition, subsequent to December 31, 2010, HudBay invested $1,985,160 in a private placement of the Company's shares (refer to Note 16 (b)) at $0.8916 per share.

See Note 16 (e) for additional exploration alliance information.

4. Capital assets:

	2010			2009
	Cost	**Accumulated depreciation**	**Net book value**	Net book value
Land	**$ 507,363**	**$ -**	**$ 507,363**	$ 503,962
Buildings	**528,728**	**102,173**	**426,555**	452,602
Furniture, fixtures and equipment	**31,877**	**14,189**	**17,688**	19,616
	$ 1,067,968	**$ 116,362**	**$ 951,606**	$ 976,180

5. Share capital:

a) Authorized
Unlimited number of common shares

b) Issued
Common shares

	Number of Common Shares	Amount
Issued at December 31, 2008	**69,609,478**	**$ 36,286,711**
Shares issued to HudBay for cash (See Note 3)	12,141,051	2,218,170
Issued for cash on exercise of options	20,000	3,000
Fair value of options exercised reallocated from contributed surplus	-	2,252
Issued at December 31, 2009	**81,770,529**	**38,510,133**
Issued for cash on exercise of options	886,182	188,115
Fair value of options exercised reallocated from contributed surplus	-	121,461
Issued at December 31, 2010	**82,656,711**	**$ 38,819,709**

c) Warrants:

There were no warrants issued or outstanding as of December 31, 2010, 2009 and 2008.

d) Stock-options and stock-based compensation:

The Company maintains a Stock Option Plan (the "Plan") for the benefit of directors, officers, employees, consultants and other service providers of the Company and its subsidiaries in order to assist the Company in attracting, retaining, and motivating such persons by providing them with the opportunity, through stock options to acquire an increased proprietary interest in the Company. Under the Plan, options are non-assignable and may be granted for a term not exceeding five years. The number of common shares that may be reserved for issuance to any one person must not exceed 5% of the outstanding common shares. The exercise price of an option may not be lower than the closing price of the common shares on the TSX, subject to applicable discounts, on the business day immediately proceeding the date the option is granted. The options are non-transferable.

As at December 31, 2010, common share stock options held by directors, officers, employees and consultants are as follows:

Number of options outstanding	Exercise Price	Expiry Date	Number of options exercisable
1,300,000	$0.30	May 10, 2011	1,300,000
500,000	$0.70	May 14, 2011	500,000
100,000	$1.00	June 8, 2011	100,000
1,275,000	$2.15	February 8, 2012	1,275,000
1,345,693	$0.15	March 2, 2014	1,345,693
843,125	$0.25	November 10, 2014	468,125
5,363,818			4,988,818

5. Share capital (continued):

d) Stock-options and stock-based compensation (continued):

The fair value of each option was estimated on the date of grant. Under Black-Scholes, the options vested during the year ended December 31, 2010 have been valued at $197,137 (2009- $344,420), and expensed to loss, using the following assumptions at the measurement date:

	2010	2009
Risk-free interest rate	**2.71%**	1.91%-3.26%
Expected life	**5 years**	5 years
Price volatility	**137%**	145%
Dividend yield	**Nil**	Nil

A summary of the status of the Company's stock option plan as of December 31, 2010 and 2009, and changes during the years are presented below:

	2010		2009		
	Number of options	**Weighted average exercise price**	**Number of options**		**Weighted average exercise price**
Balance, beginning of the year	**7,705,000**	**0.73**	4,830,000	$	1.13
Exercised	**(886,182)**	**0.21**	(20,000)		0.15
Expired	**(1,455,000)**	**0.97**	(505,000)		0.82
Granted	**-**	**-**	3,400,000		0.19
Balance, end of the year	**5,363,818**	**0.70**	7,705,000	$	0.73

See note 16 for additional stock option information.

6. Contributed surplus:

		2010		2009
Balance, beginning of the year	**$**	**4,806,341**	$	4,464,173
Fair value of stock-based compensation		**197,137**		344,420
Fair value of stock options exercised		**(121,461)**		(2,252)
Balance, end of the year	**$**	**4,882,017**	$	4,806,341

7. Related party transactions:

For the year ended December 31, 2010, management fees amounting to $103,875 (2009 - $52,500) were charged by a company controlled by the CFO and a director of the Company.

During 2010, the President and CEO, and related individuals received remuneration of $327,800 (2009-$285,133). Accounts payable includes $60,000 (2009-$1,397) owing to these related parties at December 31, 2010.

7. Related party transactions (continued):

A total of US$226,325 (2009 - US$82,441) was charged in the operations by a geological consulting company of which the President and CEO and another director are major shareholders. A management fee calculated on a percentage of wages payable was included in the amount charged by the geological consulting company to the Company. As at December 31, 2010, accounts payable includes $Nil (2009-$30,165) owing to this related party.

During the year, the Company was charged Directors' fees totaling $33,188 (2009 - $Nil) by non-executive directors. As of December 31, 2010, accounts payable includes $2,750 (2009- $Nil) owing to these related parties.

During the year, the Company was charged legal fees totaling $38,503 (2009-$91,090) by a law firm whose partner is an officer of the Company. As at December 31, 2010, accounts payable includes $1,998 (2009-$Nil) due to this related party.

Rental expenditures in the amount of $14,400 (2009-$22,591) were charged by a company with common directors. As at December 31, 2010, accounts payable includes $3,600 (2009- $Nil) owing to this related party.

See notes 3 and 16 for additional related party information.

Management believes these transactions are in the normal course of business and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

8. Commitments:

Future minimum warehouse lease payments under a non-cancelable lease are as follows:

2011	US $ 48,000
2012	US $ 48,000
2013	US $ 32,000

9. Income taxes:

(a) The Company's provision for income taxes differ from the amounts computed by applying the basic current rates to loss for the year before taxes, as shown in the following table:

		2010		2009
Statutory rate applied to loss for the year before income taxes	$	(161,887)	$	(286,850)
Increase (decrease) in taxes resulting from:				
Stock-based compensation cost		49,284		113,659
Amortization of exploration costs		(541,131)		(615,978)
Share issue costs		(129,471)		(177,541)
Other items		1,008		132
Loss not tax-benefited		782,197		966,578
Future income tax (recovery)	$	-	$	-

9. Income taxes (continued):

(b) The tax effects of temporary differences that give rise to future income tax assets (liabilities) at December 31, 2010 and 2009 are as follows:

		2010		2009
Future tax assets (liabilities):				
Non-capital losses carry forward	$	4,328,061	$	4,074,762
Mineral property		(1,402,745)		(510,515)
Capital assets		(96,597)		248
Share issue costs		135,909		350,300
		2,964,628		3,914,795
Less: valuation allowance		(2,964,628)		(3,914,795)
Net asset	$	-	$	-

(c) The Company has non-capital losses of approximately $14,965,633 which expire through 2030. The benefit of these losses has not been recognized for financial statements purposes.

(d) During the year, the Company paid $ Nil (2009 - $Nil) in respect of income taxes.

10. Changes in non-cash operating working capital:

		2010		2009
Accounts receivable	**$**	**73,486**	$	48,610
Prepaid expenses		**3,743**		1,718
Accounts payable and accrued liabilities		**276,219**		(102,896)
	$	**353,448**	$	(52,568)

11. Capital management:

The Company considers its capital to include components of shareholders' equity.

The Company's objectives in managing its capital are: to maintain adequate levels of funding to support its expenditures arising from the Company's investments; to safeguard the Company's ability to continue as a going concern in order to pursue the exploration of its properties; to maintain a flexible capital structure for its projects for the benefit of its stakeholders; to maintain corporate and administrative functions necessary to support the Company's operations and corporate functions; and to seek out and acquire new projects of merit.

The Company manages its capital structure and makes adjustments to it, based on the funds available to the Company in order to support the acquisition, exploration and development of mineral properties. The Board of Directors does not establish quantitative return on capital criteria for management, but rather relies on the expertise of the Company's management to sustain future development of the business.

The properties in which the Company currently has an interest are in the exploration stage; as such the Company is dependent on external financing to fund its activities. In order to carry out the planned exploration and pay for administrative costs, the Company will spend its existing working capital and raise additional amounts as needed. The Company will continue to assess new properties and seek to acquire an interest in additional properties if it feels there is sufficient geologic or economic potential and if it has adequate financial resources to do so.

11. Capital management (continued):

The Company's investment policy is to invest excess cash in low risk, highly liquid, short-term interest bearing investments, selected with regards to the expected timing of upcoming expenditures.

The Company expects its current capital resources will be sufficient to carry out its exploration plans, operation plans and operations through its current operating period.

Management reviews its capital management approach on an ongoing basis and believes that this approach, given the relative size of the Company, is reasonable.

There were no changes in the Company's approach to capital management during the year ended December 31, 2010.

12. Financial instruments:

Financial Risks

The Company's activities expose it to a variety of financial risks: credit risk, liquidity risk, market risk, including interest rate, foreign exchange rate, and commodity price risk.

The Company's risk exposures and the impact on the Company's financial instruments are summarized below:

Credit risk

Credit risk is the risk of loss associated with a counterparty's inability to fulfill its payment obligations. The Company's credit risk is primarily attributable to cash and receivables. Cash is held with reputable financial institutions which are monitored by management. Financial instruments included in receivables consist of HST/GST recoverable and amounts reimbursable from HudBay with respect to certain costs associated with the Back Forty Project. Management believes that the credit risk concentration with respect to financial instruments included in cash and receivables is minimal.

Liquidity risk

The Company's approach to managing liquidity risk is to ensure that it will have sufficient liquidity to meet liabilities when due. As at December 31, 2010, the Company had cash of $1,029,747 (2009- $1,866,125) to settle accounts payable and accrued liabilities of $384,952 (2009 - $108,733). The ability of the Company to continue to purse its exploration activities is dependant on its ability to secure additional equity or other financing. All of the Company's financial liabilities have contractual maturities of less than 30 days and are subject to normal trade terms.

Market risk

(a) Interest rate risk

The Company has cash and no interest bearing debt. Therefore, the Company is not exposed to any significant interest rate risk.

12. Financial instruments (continued):

(b) Foreign currency risk

The Company is exposed to currency risk arising from fluctuations in foreign exchange rates. The Company raises funds from equity financing primarily in Canadian dollars and pays for a significant amount of expenditures relating to its mineral property interests in U.S. dollars.

(c) Price risk

The Company is exposed to price risk with respect to commodity and equity prices. Equity price risk is defined as the potential adverse impact on the Company's earnings due to movements in individual equity prices or general movements in the level of the stock market. Commodity price risk is defined as the potential adverse impact on earnings and economic value due to commodity price movements and volatilities. The Company monitors commodity prices, as it relates to minerals and individual equity movements, and the stock market to determine the appropriate course of action to be taken by the Company.

Fair value

The carrying values of cash, receivables and accounts payable and accrued liabilities approximate their fair values due to the relatively short periods to maturity of these financial instruments.

Sensitivity analysis

Based on management's knowledge and experience of the financial markets, the Company believes the following movements are "reasonably possible" over a three month period.

i) The Corporation is exposed to foreign currency risk on fluctuations of financial instruments related to cash, receivables, and accounts payable and accrued liabilities that are denominated predominantly in United States Dollars. Sensitivity to a plus or minus 10% change in the foreign exchange rate would affect net loss by approximately $20,000 (2009- $13,000).

ii) Commodity price risk could adversely affect the Company. In particular, the Company's future profitability and viability from mineral exploration depends upon the world market price of valuable minerals. Commodity prices have fluctuated significantly in recent years. There is no assurance that, even as commercial quantities of minerals may be produced in the future, a profitable market will exist for them.

As of December 31, 2010, the Company is not a producer of minerals. As a result, commodity price risk may affect the completion of future equity transactions such as equity offerings and the exercise of stock options. This may also affect the Company's liquidity and its ability to meet its ongoing obligations.

13. Supplemental cash flow information:

Non-cash activities were as follows:

		2010		2009
Fair value of options exercised reallocated from contributed surplus to share capital	**$**	**121,461**	$	2,252
Recovery of mineral property costs included in receivables	$	62,012	$	88,864

14. Segmented information:

The Company operates in a single reportable operating segment, the exploration and development of mineral properties. Segmented geographic information is as follows:

The following table allocates assets by segment:

As at December 31	2010	2009
Canada	$ **902,958**	$ 1,900,844
United States	**32,015,535**	31,328,453
Total assets	$ **32,918,493**	$ 33,229,297

The following table allocates net loss by segment:

Year ended December 31	2010	2009
Canada	$ **(665,882)**	$ (628,096)
United States	**(306,393)**	(241,145)
Net loss	$ **(972,275)**	$ (869,241)

15. Comparative figures:

Certain comparative figures have been reclassified to conform to the current year's presentation. These reclassifications did not affect the prior year's net loss.

16. Subsequent events and commitments:

a) In January and February of 2011, 111,625 common shares were issued as a result of stock options being exercised for cash consideration of $32,244, in aggregate.

b) On February 15, 2011, the Company issued 2,226,514 common shares for cash proceeds of $1,985,160 to HudBay Minerals Inc., pursuant to the exploration alliance agreement entered into with HudBay during the year ended December 31, 2010.

c) Subsequent to year end, the Company granted 1,750,000 fully vested incentive stock options exercisable at $0.90 for a period of five years to officers, directors and employees.

d) During February and March 2011, the Company entered into exploration agreements with an option to lease/purchase the properties at the end of the exploration periods. The properties consist of 318 acres. Initial consideration paid under the terms of the agreement amounted to US$9,000. Annual payments to keep the agreement in good standing amount to 2012 - US$11,000; 2013 - US$6,000; 2014 - US$7,000; and, 2015 - US$8,000. The Company plans additional mineral rights acquisitions in the project area.

e) Subsequent to year end, the Company identified exploration properties, pursuant to the terms of the exploration and alliance agreement with HudBay and entered into exploration agreements with an option to purchase/lease certain properties at the end of the exploration periods. Certain of the properties are located in Michigan and Minnesota. Initial aggregate consideration paid was US$55,500. In order to keep the agreements in good standing the following amounts are required to be paid: 2012- US$75,500; 2013- US$105,500; and, 2014- US$120,500.