

## **ALAMOS GOLD INC.**

June 30, 2008

(Unaudited - stated in thousands of United States dollars)

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### **NOTICE TO READER OF THE INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

The interim consolidated financial statements of Alamos Gold Inc. ("the Company") including the accompanying consolidated balance sheets as at June 30, 2008 and December 31, 2007 and the consolidated statements of operations and comprehensive income, deficit and cash flows for the three and six-month periods ended June 30, 2008 and 2007 are the responsibility of the Company's management. The interim consolidated financial statements have been prepared by management and include the selection of appropriate accounting principles, judgments and estimates necessary to prepare these financial statements in accordance with Canadian generally accepted accounting principles for interim financial statements.

**ALAMOS GOLD INC.**  
**CONSOLIDATED BALANCE SHEETS**

(Unaudited - stated in thousands of United States dollars)

	Note Ref.	June 30, 2008	December 31, 2007
<b>A S S E T S</b>			
<b>Current Assets</b>			
Cash and cash equivalents		\$18,393	\$7,757
Amounts receivable	4	483	3,040
Advances and prepaid expenses		702	1,520
Available-for-sale securities	5	1,148	1,195
Inventory	6	34,479	36,222
		55,205	49,734
Mineral property, plant and equipment	7	130,060	126,095
		\$185,265	\$175,829
<b>LIABILITIES</b>			
<b>Current Liabilities</b>			
Accounts payable and accrued liabilities		\$7,049	\$7,907
Income taxes payable	16	2,662	-
Capital lease obligations	9	-	8,575
Current portion of property acquisition obligations	12	450	562
Convertible debenture	10	-	1,297
		10,161	18,341
Future income taxes	16	11,883	11,445
Employee future benefits	8	616	555
Asset retirement obligations	11	3,474	3,460
Property acquisition obligations	12	789	891
<b>Total Liabilities</b>		\$26,923	\$34,692
<b>SHAREHOLDERS' EQUITY</b>			
Share capital	13	\$164,632	\$161,042
Convertible debenture	10	-	293
Contributed surplus	13	8,823	6,810
Deficit		(15,113)	(27,008)
		158,342	141,137
		\$185,265	\$175,829

See notes to interim consolidated financial statements

**ALAMOS GOLD INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME**

(Unaudited - stated in thousands of United States dollars, except per share amounts)

	For the three-month periods ended		For the six-month periods ended	
	June 30, 2008	June 30, 2007	June 30, 2008	June 30, 2007
<b>OPERATING REVENUES</b>				
Gold sales	\$32,337	\$20,797	\$63,366	\$37,755
<b>OPERATING EXPENSES</b>				
Mining and processing	12,816	11,061	25,499	20,080
Royalties	1,579	1,057	3,233	1,949
Amortization	4,811	2,974	9,422	5,428
Exploration	474	589	1,038	1,182
Corporate and administrative	946	798	1,974	1,670
Stock-based compensation	1,450	1,198	2,420	1,635
Accretion expense	77	44	159	89
Employee future benefits	9	135	26	222
	<u>22,162</u>	<u>17,856</u>	<u>43,771</u>	<u>32,255</u>
<b>EARNINGS FROM OPERATIONS</b>	<b>10,175</b>	<b>2,941</b>	<b>19,595</b>	<b>5,500</b>
Interest income	73	52	122	116
Interest expense	(125)	(307)	(312)	(598)
Accretion of convertible debenture discount	-	(16)	(20)	(31)
Foreign exchange loss	(211)	166	(386)	(9)
Other (loss) gain	(271)	189	(204)	70
Earnings before income taxes for the period	<u>9,641</u>	<u>3,025</u>	<u>18,795</u>	<u>5,048</u>
Income taxes				
- Current expense	(3,840)	(137)	(7,490)	(271)
- Future recovery (expense)	390	(1,000)	590	(1,700)
Earnings and comprehensive income for the period	<u>\$6,191</u>	<u>\$1,888</u>	<u>\$11,895</u>	<u>\$3,077</u>
Earnings per share for the period				
- basic	\$0.07	\$0.02	\$0.13	\$0.03
- diluted	\$0.06	\$0.02	\$0.12	\$0.03
Weighted average number of common shares outstanding				
- basic	95,221,000	93,881,000	94,980,000	93,804,000
- diluted	97,412,000	96,347,000	97,072,000	96,446,000

See notes to interim consolidated financial statements

**ALAMOS GOLD INC.**  
**CONSOLIDATED STATEMENTS OF DEFICIT**

(Unaudited - stated in thousands of United States dollars)

	For the three-month periods ended		For the six-month periods ended	
	June 30, 2008	June 30, 2007	June 30, 2008	June 30, 2007
Deficit - beginning of period	(\$21,304)	(\$26,428)	(\$27,008)	(\$27,617)
Earnings for the period	6,191	1,888	11,895	3,077
Deficit - end of period	(\$15,113)	(\$24,540)	(\$15,113)	(\$24,540)

See notes to interim consolidated financial statements

**ALAMOS GOLD INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Unaudited - stated in thousands of United States dollars)

	For the three-month periods ended		For the six-month periods ended	
	June 30, 2008	June 30, 2007	June 30, 2008	June 30, 2007
Cash provided by:				
Operating Activities				
Earnings for the period	\$6,191	\$1,888	\$11,895	\$3,077
Adjustments for items not involving cash:				
Amortization	4,811	2,974	9,422	5,428
Accretion expense	77	61	179	120
Employee future benefits	-	135	26	222
Unrealized foreign exchange loss	522	93	698	105
Future income taxes	(390)	1,000	(590)	1,700
Realized gain on sale of securities	(8)	(37)	(20)	(37)
Stock-based compensation	1,450	1,198	2,420	1,635
Changes in non-cash working capital:				
Fair value of forward contracts	184	(144)	200	(25)
Amounts receivable	581	(2,869)	(1,103)	(3,667)
Inventory	(163)	(741)	791	(1,644)
Prepaid expenses	841	143	818	372
Accounts payable, taxes payable and accrued liabilities	1,102	519	5,264	351
	<u>15,198</u>	<u>4,220</u>	<u>30,000</u>	<u>7,637</u>
Investing Activities				
(Purchase) sale of securities	(31)	107	21	107
Mineral property, plant and equipment	(7,144)	(3,960)	(12,415)	(6,921)
	<u>(7,175)</u>	<u>3,853</u>	<u>(12,394)</u>	<u>(6,814)</u>
Financing Activities				
Common shares issued	347	586	1,706	747
Bank loan	-	2,000	-	2,000
Capital lease repayments	(8,046)	(412)	(8,575)	(680)
Convertible debenture settled	(101)	-	(101)	-
Restricted cash	-	-	-	44
	<u>(7,800)</u>	<u>2,174</u>	<u>(6,970)</u>	<u>2,111</u>
Net increase in cash and cash equivalents	223	2,541	10,636	2,934
Cash and cash equivalents - beginning of period	18,170	5,271	7,757	4,878
Cash and cash equivalents - end of period	<u>\$18,393</u>	<u>\$7,812</u>	<u>\$18,393</u>	<u>\$7,812</u>
Supplemental information:				
Interest paid	\$113	\$242	\$341	\$460
Income taxes paid	\$1,850	\$-	\$1,850	\$-

See notes to interim consolidated financial statements

## **NOTES TO INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited - stated in United States dollars)**

### **1. NATURE OF OPERATIONS**

Alamos Gold Inc. and its wholly-owned subsidiaries (“the Company”) are engaged in the acquisition, exploration, development and extraction of precious metals in Mexico. The Company owns and operates the Mulatos mine (“the Mine”). In addition, the Company holds the mineral rights to the Salamandra group of concessions in the state of Sonora, Mexico, which includes more than nine known satellite gold occurrences.

### **2. SIGNIFICANT ACCOUNTING POLICIES AND BASIS OF PRESENTATION**

These interim financial statements have been compiled in United States dollars in accordance with accounting principles generally accepted in Canada for interim reporting using the same accounting policies and measurement criteria as those utilized in the preparation of the Company’s audited consolidated financial statements for the years ended December 31, 2007 and 2006, except for the changes discussed in Note 3. These interim financial statements do not conform in all respects with disclosures required for annual financial statements and should be read in conjunction with the annual consolidated financial statements and related notes thereto.

### **3. CHANGES IN ACCOUNTING POLICIES AND PRESENTATION**

#### **a) Capital Disclosures**

Effective January 1, 2008, the Company adopted the new Canadian Institute of Chartered Accountants (“CICA”) Handbook Section 1535: Capital Disclosures. This standard requires disclosure of information that enables users of the Company’s financial statements to evaluate the entity’s objectives, policies and processes for managing capital. The disclosures required by adoption of this section are presented in Note 17.

#### **b) Financial Instruments – Disclosure and Presentation**

Effective January 1, 2008, the Company adopted CICA Handbook Section 3862: Financial Instruments – Disclosure (“Section 3862”) and Handbook Section 3863: Financial Instruments – Presentation (“Section 3863”). The objective of Section 3862 is to provide financial statement disclosure to enable financial statement users to evaluate the significance of financial instruments on the Company’s financial position and performance and the nature and extent of risks arising from financial instruments that the Company is exposed to during the reporting period and at the balance sheet date, and how the Company is managing those risks. The purpose of Section 3863 is to enhance the financial statement user’s understanding of the significance of financial instruments to the Company’s financial position, performance and cash flows. The disclosures required by adoption of these sections are presented in Note 5.

#### **c) Inventories**

Effective January 1, 2008, the Company adopted CICA Handbook Section 3031: Inventories. This section requires that inventory be recorded at the lower of cost or net realizable value. This section also clarifies that the allocation of fixed production overhead requires the consistent use of either first-in, first-out or the weighted average method to measure inventory, and requires that any previous write-downs be reversed when the value of the

inventory increases. The amount of the reversal is limited to the amount of the original write-down. The disclosures required by adoption of this section are presented in Note 6.

#### 4. AMOUNTS RECEIVABLE

	<b>June 30, 2008</b>	<b>December 31, 2007</b>
	(\$000)	(\$000)
Accounts receivable	103	107
Mexican value-added tax	380	2,933
	<u>\$483</u>	<u>\$3,040</u>

#### 5. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

##### a) Categories of Financial Assets and Liabilities

Financial instruments are classified into one of the following five categories under Canadian generally accepted accounting principles: held-for-trading, held to maturity investments, loans and receivables, available-for-sale financial assets and other financial liabilities. The carrying value of the Company's financial instruments is classified into the following categories:

	<b>June 30, 2008</b>	<b>December 31, 2007</b>
	(\$000)	(\$000)
Held for trading <sup>(1)</sup>	18,393	7,757
Available-for-sale <sup>(2)</sup>	1,148	1,195
Loans and receivables <sup>(3)</sup>	483	3,040
Other financial liabilities <sup>(4)</sup>	8,088	10,657
Gold forward contracts designated as Held-for-trading <sup>(5)</sup>	<u>200</u>	<u>-</u>

<sup>(1)</sup> Includes cash and cash equivalents.

<sup>(2)</sup> Includes the Company's investment in the common shares of Castle Gold Corporation ("Castle", formerly Morgain Minerals Inc.).

<sup>(3)</sup> Includes amounts receivable.

<sup>(4)</sup> Includes accounts payable and accrued liabilities, property acquisition obligations and the debt component of the convertible debenture liability.

<sup>(5)</sup> Includes the Company's gold forward sales contracts which are not considered to be effective hedges for accounting purposes. Classified within accounts payable and accrued liabilities in the consolidated balance sheet.

The Company has determined the estimated fair values of its financial instruments based on appropriate valuation methodologies; however, considerable judgment is required to develop these estimates. The fair values of the Company's financial instruments are not materially different from their carrying values.

In 2006, the Company sold its La Fortuna property to Castle for consideration of 2.5 million common shares of Castle and a 1% net smelter royalty on future production from the La Fortuna property. In the six-month period ended June 30, 2008, the Company sold 167,000 common shares of Castle. At June 30, 2008, the Company held 2,228,500 shares of Castle with a fair value of \$1,067,000 as determined with reference to published price quotations. In

addition to its investment in the common shares of Castle, the Company holds other securities valued at \$81,000 at June 30, 2008.

## **b) Derivative Financial Instruments**

The Company may utilize financial instruments to manage the risks associated with fluctuations in the market price of gold and foreign exchange rates. At June 30, 2008, the Company had outstanding contracts to deliver up to 9,200 ounces of gold (nil at December 31, 2007) in the third quarter of 2008 at prices below the period-end market price resulting in a mark-to-market loss of approximately \$200,000. The Company did not have any foreign exchange forward contracts outstanding at June 30, 2008 or at December 31, 2007.

## **c) Risk Management**

The Company's activities expose it to a variety of financial risks: market risk (including commodity price, foreign exchange and interest rate risk), credit risk and liquidity risk. The Company's risk management program focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the Company's financial performance. The Company may use derivative financial instruments to hedge certain risk exposures. The Company does not purchase derivative financial instruments for speculative investment purposes.

Risk management is the responsibility of the corporate finance function. The Company's corporate finance function identifies, evaluates and where appropriate, hedges financial risks. Material risks are monitored and are regularly discussed with the Audit Committee of the Board of Directors.

### *i. Commodity Price Risk*

The Company is exposed to commodity price risk associated with the volatility in the market price of gold. Gold prices are affected by factors beyond the Company's control, including central bank sales, producer hedging activities, the relative exchange rate of the United States dollar with other major currencies, global and regional demand and political and economic conditions. Worldwide gold production levels also affect gold prices, and the price of gold can be subject to high levels of short-term volatility due to speculative activities. The Company may enter into derivative financial instruments to manage the Company's exposure to commodity price risk. However at this time, the Company has elected not to actively manage its long-term exposure to commodity price risk through the use of derivative financial instruments.

### *ii. Foreign Exchange Risk*

Certain of the Company's financial assets and liabilities are denominated in Canadian dollars or Mexican pesos. In addition, the Company incurs certain operating costs denominated in both the Canadian dollar and the Mexican peso. Accordingly, the Company is exposed to financial gain or loss as a result of foreign exchange movements against the United States dollar, and the Company's operating costs are affected by changes in foreign exchange rates in those currencies.

The Company has elected not to hedge its exposure to fluctuations in the Canadian dollar by buying fixed rate forward contracts in Canadian dollars. Corporate and administrative costs associated with the Company's head office in Toronto are denominated in Canadian dollars. A 10% increase in the value of the Canadian dollar compared to the United States dollar could increase the Company's reported corporate and administrative costs by approximately \$0.4 million annually.



The Company has exposure to monetary assets and liabilities denominated in Mexican pesos, and significant outstanding amounts receivable, accounts payable or future tax liabilities denominated in Mexican pesos may result in a foreign exchange gain or loss. The Company has elected not to hedge this exposure by buying fixed rate forward contracts in Mexican pesos at this time. The Company does however maintain a portion of its cash and cash equivalents in Mexican pesos in order to partially offset its exposure to fluctuations in the value of the Mexican peso compared to the United States dollar on its net-Peso denominated monetary liability position. The Company is also exposed to foreign exchange risk as a portion of its costs are denominated in Mexican pesos. A 10% increase in the value of the Mexican peso compared to the United States dollar could increase the Company's reported mining and processing costs by approximately \$2.5 million annually.

### *iii. Interest Rate Risk*

The Company's interest rate risk is currently minimal as the Company has repaid its capital lease obligations and bank loan. Further, the Company's interest-bearing convertible debenture liability was converted into common shares in the second quarter of 2008.

As a result of the Company's minimal exposure to fluctuations in market interest rates, the Company has elected not to enter into interest rate swaps or other active interest rate management programs at this time.

### *iv. Credit Risk*

Credit risk arises from cash and cash equivalents held with banks and financial institutions, derivative financial instruments (including forward gold sales contracts) and amounts receivable. The maximum exposure to credit risk is equal to the carrying value of the financial assets.

The objective of managing counter party credit risk is to prevent losses in financial assets. The Company assesses the quality of its counter parties, taking into account their creditworthiness and reputation, past experience and other factors. The Company only enters into forward gold sales contracts with large reputable financial institutions.

The carrying amount of amounts receivable are reduced through the use of an allowance account (when applicable) and the amount of any allowance is recognized as a loss and included in operating expenses. When a receivable balance is considered uncollectible, it is written off against the allowance for amounts receivable. The majority of the Company's receivable balances consist of Mexican value-added tax recoverable claims. The Company is exposed to credit risk in the case that the tax department of the Mexican government is unable to pay the amounts receivable. As at June 30, 2008, the Company was owed \$380,000 from the Mexican government.

### *v. Liquidity Risk*

Liquidity risk arises through the excess of financial obligations due over available financial assets at any point in time. The Company's objective in managing liquidity risk is to maintain sufficient readily available cash reserves and credit in order to meet its liquidity requirements at any point in time. The Company achieves this by maintaining sufficient cash and cash equivalents. As at June 30, 2008 the Company had cash and cash equivalents of \$18,393,000.

The Company's requirements for capital in the foreseeable future may include funds for the potential construction of a mill to process high-grade ore. The total cost and planned timing of this project is not currently determinable and it is not currently known whether the

Company will require external financing to complete this or other similar development and/or construction projects.

## 6. INVENTORY

	<b>June 30, 2008</b>	<b>December 31, 2007</b>
	(\$000)	(\$000)
Precious metals dore and refined precious metals	5,137	4,760
In-process precious metals	19,698	22,693
Parts and supplies	9,644	8,769
	<b>\$34,479</b>	<b>\$36,222</b>

The carrying value of inventory is calculated using weighted average cost. The amount of inventory charged to operations as mining and processing costs during the three and six-month periods ended June 30, 2008 was \$12,677,000 and \$25,273,000. The amount of inventory charged to operations as amortization in the three and six-month periods ended June 30, 2008 was \$3,454,000 and \$6,722,000 respectively.

## 7. MINERAL PROPERTY, PLANT AND EQUIPMENT

In 2003, the Company acquired a 100% interest in certain properties within the Salamandra group of concessions which currently comprises approximately 28,500 hectares, in consideration for the payment of CDN\$11,154,000. Certain concessions within the acquired properties are subject to a sliding scale net smelter royalty on the first 2,000,000 ounces of gold production. The royalty rate is 5% when the market price of gold exceeds \$400 per ounce.

Included within the Salamandra group of concessions is the Mulatos mine which began operations in 2005.

	<b>June 30, 2008</b>		<b>December 31, 2007</b>	
	Cost	Accumulated Amortization	Net Book Value	Net Book Value
	(\$000)	(\$000)	(\$000)	(\$000)
Mineral property and mine development	63,166	(11,572)	51,594	50,437
Mining plant and equipment	101,181	(22,931)	78,250	75,422
Office and computer equipment	519	(303)	216	236
	<b>\$164,866</b>	<b>(\$34,806)</b>	<b>\$130,060</b>	<b>\$126,095</b>

## 8. EMPLOYEE FUTURE BENEFITS

The Company accrues employee future benefits for all contract workers paid through its subsidiary employment services company. These benefits consist of a one-time payment equivalent to twelve days' wages for each year of service (at the employee's most recent salary, but not to exceed twice the legal minimum wage), payable to all employees with fifteen or more years of service, as well as to certain employees terminated involuntarily prior to the vesting of their seniority premium benefit. Under Mexican Labour Law, the Company

also provides statutorily mandated severance benefits to its employees terminated under certain circumstances. Such benefits consist of a one-time payment of three months' wages plus twenty days' wages for each year of service payable upon involuntary termination without just cause.

The liability associated with the seniority and termination benefits is calculated as the present value of expected future payments. In determining the expected future payments, assumptions regarding employee turnover rates, inflation, minimum wage increases and expected salary levels are required and are subject to review and change.

## **9. CAPITAL LEASE OBLIGATIONS**

In the second quarter of 2008, the Company prepaid its capital lease obligations. The amount of interest expense related to the obligations under capital lease included in the determination of earnings for the six-month period ended June 30, 2008 was \$234,000 (six-month period ended June 30, 2007 - \$383,000). In conjunction with the repayment of the capital lease obligations, the Company charged \$187,000 of unamortized financing costs to other expense.

## **10. DEBT**

### **a) Convertible Debenture**

Effective February 2, 2005, the Company issued a CDN\$50 million aggregate principal amount 5.5% convertible unsecured subordinated debenture maturing on February 15, 2010. Interest on the convertible debenture is payable semi-annually in arrears on February 15 and August 15 of each year at an annual rate of 5.5%. Under the terms of the trust indenture, the debenture is convertible into common shares at a rate of 18.86792 common shares for each CDN\$100 principal amount of debenture on maturity.

In 2006, the Company announced an incentive conversion period to allow for early conversion at incentive conversion ratios. Debentures representing CDN\$48,444,000 or approximately 97% of the outstanding balance were converted into common shares at incentive conversion ratios ranging from 20.3824 to 20.5907 common shares for each CDN\$100 principal of debenture, resulting in the issuance of 9,966,982 common shares. In addition, accrued interest related to the converted debentures was settled through the issuance of common shares at 18.86792 common shares per CDN\$100 of accrued interest, resulting in the issuance of 174,520 common shares. Convertible debentures representing CDN\$25,000 were converted during 2007. The face value of the outstanding convertible debentures at December 31, 2007 was CDN\$1,471,000.

On March 24, 2008, in accordance with the terms of the trust indenture, the Company announced that it had issued a notice of redemption to debenture holders. The notice of redemption indicated that any outstanding debentures on April 28, 2008 would be redeemed for cash. Debentures representing CDN\$1,371,000 were converted into common shares prior to the redemption date, resulting in the issuance of 258,677 common shares. The outstanding principal amount of debentures of CDN\$100,000 plus accrued interest at the redemption date was redeemed for cash. Accordingly, the convertible debenture balance at June 30, 2008 is nil.

### **b) Bank Loan**

On July 21, 2005, the Company obtained a bank line of credit consisting of a \$10 million unsecured revolving facility and a non-margin hedging line. The initial term was for one-year, and was extended at the discretion of the lender to July 21, 2008. On August 25, 2007, the bank agreed to increase the amount available to the Company to \$15 million. Interest was

payable at a rate of 2.25% above applicable LIBOR on the drawn portion of the facility, and 0.75% on the undrawn portion. On April 30, 2008, the Company requested that the bank line of credit be cancelled as the Company had no intention of drawing funds prior to the end of its term in July 2008.

## 11. ASSET RETIREMENT OBLIGATIONS

The fair value of a liability for an asset retirement obligation is recognized in the period in which it is incurred, on a discounted cash flow basis, if a reasonable estimate can be made. The liability accretes to its full value over time through charges to operations. In addition, the fair value is added to the carrying amount of the Company's mineral property, plant and equipment, and is amortized on a units-of-production basis over the life of the Mine.

A continuity of asset retirement obligations is as follows:

	<b>Six-month period ended June 30, 2008</b>	<b>Year ended December 31, 2007</b>
	(\$000)	(\$000)
Obligations at start of period	3,460	2,640
Revisions in estimated cash flows and changes in assumptions	(115)	604
Liabilities incurred	17	33
Accretion of discounted cash flows	112	183
Obligations at end of period	<u>\$3,474</u>	<u>\$3,460</u>

The assumptions used in the determination of the asset retirement obligations are as follows as at:

	<b>June 30, 2008</b>	<b>December 31, 2007</b>
Estimated cost (\$000)	5,403	5,374
End of mine life	2014	2014
Discount rate	6.48% - 8.33%	6.48% - 6.70%

## 12. PROPERTY ACQUISITION OBLIGATIONS

The Company is in the process of acquiring property adjacent to its present and prospective mining operations, including property comprising the town of Mulatos. Property owners and possessors are being offered a comprehensive benefits package including compensation for their property and/or relocation benefits. In certain cases, relocation benefits include deferred monthly payments over periods varying from three to five years. Obligations are recognized when a legal contract is signed by both parties and are measured at the discounted value of expected future payments. At June 30, 2008, the Company has applied a discount rate of approximately 7.00% to expected future payments.

## 13. SHARE CAPITAL

a) Authorized share capital of the Company consists of unlimited common shares without par value.

	<b>Number of Shares</b>	<b>Amount</b>
		(\$000)
Outstanding at January 1, 2007	93,710,515	158,971
Exercise of stock options	801,000	1,695
Conversion of convertible debenture	4,716	21
Transfer of contributed surplus to share capital for exercised stock options	-	355
Outstanding at December 31, 2007	94,516,231	161,042
Exercise of stock options	659,100	1,707
Conversion of convertible debenture	258,677	1,476
Transfer of contributed surplus to share capital for exercised stock options	-	407
Outstanding at June 30, 2008	95,434,008	\$164,632

b) Stock options outstanding and exercisable as at June 30, 2008:

Range of exercise prices (\$CDN)	<b>Outstanding</b>			<b>Exercisable</b>	
	Number of options	Weighted average exercise price (\$CDN)	Weighted average remaining contractual life (years)	Number of options	Weighted average exercise price (\$CDN)
\$1.01 - \$2.00	135,000	\$1.13	0.06	135,000	\$1.13
\$2.01 - \$3.00	1,197,000	\$2.42	0.67	1,197,000	\$2.42
\$3.01 - \$4.00	891,400	\$3.73	1.92	891,400	\$3.73
\$6.01 - \$7.00	2,120,000	\$6.31	4.15	652,800	\$6.31
\$7.01 - \$8.00	1,925,000	\$7.29	3.25	1,146,200	\$7.29
\$8.01 - \$9.00	954,500	\$8.90	2.50	926,700	\$8.90
	<u>7,222,900</u>	<u>\$5.85</u>	<u>2.76</u>	<u>4,949,100</u>	<u>\$5.47</u>

c) Summary of stock option activity:

	<b>Number</b>	<b>Weighted average exercise price (\$CDN)</b>
Outstanding at January 1, 2007	5,185,500	\$4.32
Granted	2,472,000	7.22
Exercised	(801,000)	2.16
Forfeited	(302,000)	7.86
Outstanding at December 31, 2007	6,554,500	\$5.52
Granted	1,495,000	6.12
Exercised	(659,100)	2.60
Forfeited	(167,500)	8.14
Outstanding at June 30, 2008	<u>7,222,900</u>	<u>\$5.85</u>

d) Summary of contributed surplus activity:

	<u>Amount</u>
	(\$000)
Balance at January 1, 2007	3,740
Stock-based compensation	3,425
Transfer of contributed surplus to share capital for exercised stock options	<u>(355)</u>
Balance at December 31, 2007	6,810
Stock-based compensation	2,420
Transfer of contributed surplus to share capital for exercised stock options	<u>(407)</u>
Balance at June 30, 2008	<u>\$8,823</u>

#### 14. STOCK-BASED COMPENSATION

The Company has a stock option plan, originally approved by the Board of Directors (the "Board") on April 17, 2003, to allow the Company to grant incentive stock options to its directors, officers, employees and consultants. At the Company's annual general meeting held on May 24, 2005, as amended and ratified on May 25, 2007 and May 15, 2008, the shareholders of the Company approved an amendment to the Company's stock option plan. Under the amended stock option plan, the number of shares reserved for issuance cannot exceed 10% of the total number of shares which are outstanding on the date of grant. The exercise price, term (not to exceed ten years) and vesting provisions are authorized by the Board at the time of the grant.

Stock options granted to directors, officers and certain consultants are exercisable for a five-year period, and options granted to employees are generally exercisable for a three-year period. All incentive stock options granted vest 20% on the date of grant, and 20% at each six-month interval following the date of grant.

During the second quarter of 2008, the Company granted incentive stock options to directors, officers, employees and a consultant to purchase up to 1,495,000 common shares in the capital of the Company at exercise prices ranging from CDN\$6.00 to CDN\$6.76 per share. In the prior period, the Company granted 1,990,000 stock options at an exercise price of CDN\$7.29 on April 16, 2007.

The fair value of stock options granted were estimated using the Black-Scholes option pricing model with the following assumptions:

	<u>June 30, 2008</u>	<u>June 30, 2007</u>
For options granted in the six-month periods ended		
Risk-free rate	2.75%	4.00%
Expected dividend yield	nil	nil
Expected stock price volatility	50%	50%
Expected option life, based on terms of the grants (months)	27-40	27-40
Weighted average per share fair value of options granted	\$2.27	\$2.41

Option pricing models require the input of highly subjective assumptions, particularly as to the expected price volatility of the stock. Changes in these assumptions can materially affect

the fair value estimate, and therefore it is management's view that the existing models may not provide a single reliable measure of the fair value of the Company's stock option grants.

As at June 30, 2008, 4,949,100 stock options were exercisable. The remaining 2,273,800 stock options vest over the following two years. Subsequent to June 30, 2008, 338,400 stock options were exercised at an average exercise price of CDN\$2.67.

## 15. SEGMENTED REPORTING

The Company operates in one business segment (the exploration, mine development and extraction of precious metals, primarily gold) in two geographic areas: Canada and Mexico.

	<b>June 30, 2008</b>	<b>December 31, 2007</b>
	(\$000)	(\$000)
Assets, by geographic segment		
- Mexico	182,706	173,890
- Canada	2,559	1,939
	<u>\$185,265</u>	<u>\$175,829</u>

<b>Six-month periods ended</b>	<b>June 30, 2008</b>			<b>June 30, 2007</b>		
	Mexico (\$000)	Canada (\$000)	Total (\$000)	Mexico (\$000)	Canada (\$000)	Total (\$000)
Revenues	63,366	-	63,366	37,755	-	37,755
Earnings	16,455	(4,560)	11,895	6,479	(3,402)	3,077

## 16. INCOME TAXES

Effective January 1, 2008, the Company is subject to a new Single Rate Tax Law enacted by the Mexican government on September 28, 2007. Under the new Single Rate Tax Law, the Company's Mexican operating subsidiaries are subject to a tax equivalent to 17.5% (with lower transitional rates in 2008 of 16.5% and 2009 of 17%) of the Company's revenues less certain allowable deductions (as determined on a cash basis). The single rate tax is payable each year to the extent that it exceeds income tax otherwise payable pursuant to the pre-existing Mexican income tax laws. Any excess single rate tax paid cannot be credited against income taxes payable in future periods. In the six-month period ended June 30, 2008, the application of the new single rate tax did not impact the Company's tax expense.

## 17. MANAGEMENT OF CAPITAL

The Company defines capital that it manages as its shareholders equity. The Company's objectives when managing capital are to safeguard the entity's ability to continue as a going concern so that it can continue to provide returns for shareholders and benefits for other stakeholders. As at June 30, 2008, total managed capital was \$158,342,000 (December 31, 2007 - \$141,137,000).

The Company's capital structure reflects the requirements of a company focused on sustaining strong cash flows from its current mining operations and financing both internal

and external growth opportunities and development projects. The Company faces lengthy development lead times as well as risks associated with increasing capital costs and project completion timing due to the availability of resources, permits and other factors beyond the Company's control. The Company's operations are also significantly affected by the volatility of the market price of gold.

The Company continually assesses its capital structure and makes adjustments to it with reference to changes in economic conditions and risk characteristics associated with its underlying assets. In order to maintain or adjust the capital structure, the Company may issue new shares, pay dividends or sell assets to reduce debt.

The Company manages its capital structure by performing the following:

- Maintaining a liquidity cushion in order to address any potential operational disruptions or industry downturns
- Preparing detailed budgets and cash flow forecasts for each of mining operations, exploration, development projects and corporate activities that are approved by the Board of Directors
- Regular internal reporting and Board of Directors meetings to review actual versus budgeted spending and cash flows
- Detailed project financial analysis to assess or determine new funding requirements

## **18. COMMITMENTS AND CONTINGENCIES**

### **a) Royalty**

Production from the Mine is subject to a sliding scale production royalty, which at current gold prices above \$400 per ounce is set at a rate of 5% of the value of gold and silver produced, less certain allowed refining and transportation costs. Valuations are based on daily average London PM Fix gold prices, not actual prices realized by the Company.

### **b) Mulatos Town Relocation**

The Company commenced the planned relocation of the town of Mulatos in 2007. Relocation contracts have been signed with in excess of half of the families residing in Mulatos. Property owners and possessors are being offered a comprehensive benefits package including compensation for their property and/or relocation benefits. In certain cases, relocation benefits include deferred monthly payments. Since the start of the relocation effort in 2007, the Company has capitalized approximately \$4,848,000 in property acquisition, relocation benefits, legal and related costs. The Company has also recognized a liability of \$1,239,000 representing the discounted value of expected future payments for relocation benefits to property owners and possessors that had signed contracts with the Company as at June 30, 2008. The discounted value of the liability was capitalized to mineral property, plant and equipment.

During the second quarter of 2008, the Company entered into a land purchase agreement with certain landowners. Pursuant to the land purchase agreement, the Company made a payment of \$1,250,000 in order to secure temporary occupation rights to specified land. An additional payment of \$1,250,000 is payable once the land has been vacated and is transferred to the Company. The probability and timing of this additional payment is currently unknown to the Company and has not been accrued in the consolidated balance sheet.

Additional future property acquisition, relocation benefits, legal and related costs may be material. The Company cannot currently determine the expected timing, outcome of negotiations or costs associated with the relocation of the remaining property owners and possessors and potential land acquisitions.



**c) Lawsuit**

In 2005, the Company acquired certain used mobile mining equipment from a United States construction company. In 2006, a court judgment was issued in the United States allowing a finance company to repossess the equipment from the construction company which had failed to make required loan payments on the equipment. In April 2008, the Company was notified that the finance company would seek compensation in the amount of \$840,000 from the Company for the unpaid balance. No court judgment has been issued in Mexico or elsewhere against the Company. The Company is currently obtaining legal advice from counsel in the United States and Mexico, and cannot currently determine the outcome of this dispute.

**19. RECLASSIFICATION**

Certain comparative figures have been reclassified to conform to the current period presentation.