

SILVER QUEST RESOURCES LTD.
(formerly Southern Rio Resources Ltd.)

CONSOLIDATED FINANCIAL STATEMENTS

FEBRUARY 28, 2006

AUDITORS' REPORT

To the Shareholders of
Silver Quest Resources Ltd.
(formerly Southern Rio Resources Ltd.)

We have audited the consolidated balance sheets of Silver Quest Resources Ltd. (formerly Southern Rio Resources Ltd.) as at February 28, 2006 and 2005 and the consolidated statements of operations and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at February 28, 2006 and 2005 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

“DAVIDSON & COMPANY LLP”

Vancouver, Canada

Chartered Accountants

May 9, 2006

A Member of SC INTERNATIONAL

SILVER QUEST RESOURCES LTD.
(formerly Southern Rio Resources Ltd.)
CONSOLIDATED BALANCE SHEETS
AS AT FEBRUARY 28

	2006	2005
ASSETS		
Current		
Cash and equivalents	\$ 2,490,295	\$ 847,107
Receivables	24,919	38,905
Marketable securities	19,688	11,750
Prepaid expenses	<u>2,000</u>	<u>8,550</u>
	2,536,902	906,312
Equipment (Note 4)	3,775	4,718
Mineral properties (Note 5)	283,564	198,114
Deferred exploration costs (Note 6)	2,730,170	2,414,377
Reclamation deposit (Note 3)	<u>16,000</u>	<u>12,500</u>
	<u>\$ 5,570,411</u>	<u>\$ 3,536,021</u>

LIABILITIES AND SHAREHOLDERS' EQUITY

Current		
Accounts payable and accrued liabilities	\$ 98,879	\$ 211,966
Shareholders' equity		
Capital stock (Note 8)	14,099,748	11,945,355
Contributed surplus (Note 8)	1,119,948	523,176
Deficit	<u>(9,748,164)</u>	<u>(9,144,476)</u>
	<u>5,471,532</u>	<u>3,324,055</u>
	<u>\$ 5,570,411</u>	<u>\$ 3,536,021</u>

Nature and continuance of operations (Note 1)

On behalf of the Board:

<u>“Robert F. Weicker”</u> Robert F. Weicker	Director	<u>“Randy C. Turner”</u> Randy C. Turner	Director
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The accompanying notes are an integral part of these consolidated financial statements.

SILVER QUEST RESOURCES LTD.
(formerly Southern Rio Resources Ltd.)
CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT
YEAR ENDED FEBRUARY 28

	2006	2005
EXPENSES		
Amortization	\$ 943	\$ 1,573
Business development	17,823	21,907
Consulting	33,341	51,333
Management fees and corporate services	51,574	42,000
Office and miscellaneous	26,168	27,406
Professional fees	70,854	51,965
Rent	18,000	18,000
Salaries and benefits	110,521	95,928
Stock-based compensation (Note 9)	508,466	86,211
Regulatory and transfer agent fees	25,189	30,797
Travel	<u>4,427</u>	<u>12,968</u>
Loss before other items and income taxes	<u>(867,306)</u>	<u>(440,088)</u>
OTHER ITEMS		
Interest income	14,392	3,404
(Loss) gain on disposition of marketable securities	(668)	9,552
Write-off of mineral properties (Note 5)	(19,000)	(24,870)
Write-off of deferred exploration costs (Note 6)	(32,725)	(67,376)
Recovery of mineral properties and deferred exploration costs	619	-
Other income	<u>-</u>	<u>34,733</u>
	<u>(37,382)</u>	<u>(44,557)</u>
Loss before income taxes	(904,688)	(484,645)
Future income tax recovery (Note 11)	<u>301,000</u>	<u>383,000</u>
Loss for the year	(603,688)	(101,645)
Deficit, beginning of year	<u>(9,144,476)</u>	<u>(9,042,831)</u>
Deficit, end of year	<u>\$ (9,748,164)</u>	<u>\$ (9,144,476)</u>
Basic and diluted loss per common share	<u>\$ (0.05)</u>	<u>\$ (0.01)</u>
Weighted average number of common shares outstanding	<u>12,011,199</u>	<u>8,758,556</u>

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

SILVER QUEST RESOURCES LTD.
(formerly Southern Rio Resources Ltd.)
CONSOLIDATED STATEMENTS OF CASH FLOWS
YEAR ENDED FEBRUARY 28

	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Loss for the year	\$ (603,688)	\$ (101,645)
Items not affecting cash:		
Amortization	943	1,573
Stock-based compensation	508,466	86,211
(Gain) loss on disposition of marketable securities	668	(9,552)
Write-off of mineral properties	19,000	24,870
Write-off of deferred exploration costs	32,725	67,376
Recovery on mineral properties and deferred exploration costs	(619)	-
Future income tax recovery	(301,000)	(383,000)
Changes in non-cash working capital items:		
Decrease in receivables	13,986	7,649
Decrease in prepaid expenses	6,550	3,150
Decrease in accounts payable and accrued liabilities	<u>(174,698)</u>	<u>(104,745)</u>
Net cash used in operating activities	<u>(497,667)</u>	<u>(408,113)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Reclamation deposit	(3,500)	(9,000)
Acquisition of mineral properties	(45,950)	(11,968)
Deferred exploration costs	(430,511)	(1,021,644)
Deferred exploration costs recovery	138,623	-
Option payments received	-	90,000
Proceeds from disposal of marketable securities	<u>4,894</u>	<u>16,552</u>
Net cash used in investing activities	<u>(336,444)</u>	<u>(936,060)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Capital stock	2,643,099	1,401,300
Share issuance costs	(165,800)	(88,158)
Repayments to related parties	<u>-</u>	<u>(14,250)</u>
Net cash provided by financing activities	<u>2,477,299</u>	<u>1,298,892</u>
Change in cash and equivalents during the year	1,643,188	(45,281)
Cash and equivalents, beginning of year	<u>847,107</u>	<u>892,388</u>
Cash and equivalents, end of year	<u>\$ 2,490,295</u>	<u>\$ 847,107</u>
Cash and equivalents consists of:		
Cash	\$ 1,490,295	\$ 847,107
Term deposits	<u>1,000,000</u>	<u>-</u>
	<u>\$ 2,490,295</u>	<u>\$ 847,107</u>
Cash paid for interest	<u>\$ -</u>	<u>\$ 2,922</u>
Cash paid for income taxes	<u>\$ -</u>	<u>\$ -</u>

Supplemental disclosure with respect to cash flows (Note 10)

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

SILVER QUEST RESOURCES LTD.
(formerly Southern Rio Resources Ltd.)
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FEBRUARY 28, 2006

1. NATURE AND CONTINUANCE OF OPERATIONS

Silver Quest Resources Ltd. ("the Company") was incorporated under the laws of British Columbia. During the year ended February 28, 2006, the Company changed its name from Southern Rio Resources Ltd. and consolidated its common shares on a 5:1 basis. All share and per share amounts have been restated to reflect the share consolidation. The Company's principal business is the acquisition and exploration of mineral properties. The Company is considered to be in the exploration stage.

The recoverability of the amounts comprising mineral properties and deferred exploration costs are dependent upon the confirmation of economically recoverable reserves, the ability of the Company to obtain necessary financing to successfully complete its exploration and development and upon future profitable production.

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles with the assumption that the Company will be able to realize its assets and discharge its liabilities in the normal course of business rather than through a process of forced liquidation. Continued operations of the Company are dependent on the Company's ability to receive continued financial support, complete public equity financing, or generate profitable operations in the future.

The financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts and classification of liabilities that might be necessary should the Company be unable to continue in existence.

	2006	2005
Deficit	\$ (9,748,164)	\$ (9,144,476)
Working capital	2,438,023	694,346

2. SIGNIFICANT ACCOUNTING POLICIES

Principles of consolidation

These consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, Golden Pavilion Resources Ltd., a British Columbia corporation. All inter-company balances and transactions have been eliminated upon consolidation.

Estimates

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period.

Cash and equivalents

Cash equivalents are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

SILVER QUEST RESOURCES LTD.
(formerly Southern Rio Resources Ltd.)
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FEBRUARY 28, 2006

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd...)

Marketable securities

Marketable securities are recorded at the lower of cost or market value. The market value of marketable securities at February 28, 2006 was \$34,350 (2005 - \$16,400).

Equipment and amortization

Equipment, being furniture and equipment, is recorded at cost less accumulated amortization. Amortization is being provided for using the straight-line method over five years.

Mineral properties and deferred exploration costs

All costs related to the acquisition, exploration and development of mineral properties are capitalized by property. If economically recoverable ore reserves are developed, capitalized costs of the related property are reclassified as mining assets and amortized using the unit of production method. When a property is abandoned, all related costs are written off to operations. If, after management review, it is determined that the carrying amount of a mineral property is impaired, that property is written down to its estimated net realizable value. A mineral property is reviewed for impairment whenever events or changes in circumstances indicate that its carrying amount may not be recoverable.

The amounts shown for mineral properties do not necessarily represent present or future values. Their recoverability is dependent upon the discovery of economically recoverable reserves, the ability of the Company to obtain the necessary financing to complete the development, and future profitable production or proceeds from the disposition thereof.

Government mining tax credits

The Company carries on certain mineral exploration activities in British Columbia and is eligible to earn tax credits based on qualifying expenditures. Mining tax credits are recorded as either a reduction of the cost of applicable assets or credited in the statement of operations depending on the nature of the expenditures which gave rise to the credits. Claims for tax credits are accrued upon the Company attaining reasonable assurance of collection. Should any or part of these claims be adjusted, the tax credit receivable and the statements of operations and deficit will be affected accordingly.

Asset retirement obligations

The Company recognizes the fair value of a liability for an asset retirement obligation in the year in which it is incurred when a reasonable estimate of fair value can be made. The carrying amount of the related long-lived asset is increased by the same amount as the liability.

Changes in the liability for an asset retirement obligation due to the passage of time will be measured by applying an interest method of allocation. The amount will be recognized as an increase in the liability and an accretion expense in the statement of operations. Changes resulting from revisions to the timing or the amount of the original estimate of undiscounted cash flows are recognized as an increase or a decrease to the carrying amount of the liability and the related long-lived asset.

SILVER QUEST RESOURCES LTD.
(formerly Southern Rio Resources Ltd.)
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FEBRUARY 28, 2006

2. SIGNIFICANT ACCOUNTING POLICIES (cont'd...)

Stock-based compensation

The Company accounts for the granting of stock options to employees and non-employees using the fair value method whereby all awards to employees and non-employees will be recorded at fair value on the date of grant. The Company estimates the fair value of each stock option at the date of grant using the Black-Scholes option pricing model and expenses the fair value over the period of vesting. Any consideration paid by the option holders to purchase shares is credited to capital stock.

Loss per share

The Company uses the treasury stock method to compute the dilutive effect of options, warrants and similar instruments. Under this method the dilutive effect on loss per share is recognized on the use of the proceeds that could be obtained upon exercise of options, warrants and similar instruments. It assumes that the proceeds would be used to purchase common shares at the average market price during the year. For the years presented, this calculation proved to be anti-dilutive.

Basic loss per share is calculated using the weighted average number of common shares outstanding during the year.

Future income taxes

Future income taxes are recorded using the asset and liability method whereby future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply when the asset is realized or the liability settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the year that substantive enactment or enactment occurs. To the extent that the Company does not consider it to be more likely than not that a future tax asset will be recovered, it provides a valuation allowance against the excess.

Flow-through common shares

Canadian tax legislation permits a company to issue flow-through shares whereby the deduction for tax purposes relating to qualified resource expenditures is claimed by the investors rather than the Company. Recording these expenditures for accounting purposes gives rise to taxable temporary differences.

Effective March 19, 2004, the Emerging Issues Committee of the Canadian Institute of Chartered Accountants requires that, when flow-through expenditures are renounced, a portion of the future income tax assets that were not recognized in previous years, due to the recording of a valuation allowance, be recognized as a recovery of income taxes in the statement of operations.

Comparative figures

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

SILVER QUEST RESOURCES LTD.
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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FEBRUARY 28, 2006

3. RECLAMATION DEPOSIT

The Company has provided a deposit as security against potential future reclamation work relating to its mineral properties. As at February 28, 2006, a total of \$16,000 (2005 - \$12,500) had been lodged with the British Columbia Ministry of Energy and Mines.

4. EQUIPMENT

	2006			2005		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Furniture and equipment	\$ 17,560	\$ 13,785	\$ 3,775	\$ 17,560	\$ 12,842	\$ 4,718

5. MINERAL PROPERTIES

The Company holds interests in various mineral claims, located in Canada, as follows:

	2006	2005
Tam property, British Columbia A 100% interest, subject to a 1% net smelter returns royalty ("NSR").	\$ 5,700	\$ 5,700
Tsacha property, British Columbia A 100% interest in certain claims subject to varying NSR's, one half of which may be purchased back at any time, up to the end of the first year of commercial production for \$2,000,000.	66,130	57,130
Taken property, British Columbia An option to acquire a 100% interest in certain claims. To earn its interest the Company must incur \$250,000 (incurred) in exploration expenditures and issue 40,000 common shares on or before May 23, 2006 (issued to date 32,000 shares at a value of \$22,200). The property is subject to a sliding scale NSR ranging from 2% to 4%.	22,200	18,800
Minnitaki property, Ontario A 100% interest, subject to a sliding scale NSR ranging from 1.5% to 3%.	35,000	35,000

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SILVER QUEST RESOURCES LTD.
(formerly Southern Rio Resources Ltd.)
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FEBRUARY 28, 2006

5. MINERAL PROPERTIES (cont'd...)

	2006	2005
<i>Continued...</i>		
Duke property, British Columbia A 100% interest, subject to a 1% NSR.		
During the 2005 fiscal year, the Company entered into an agreement, subsequently amended, whereby an optionee can earn a 51% interest. To acquire its interest, the optionee must pay \$10,000 (received), issue 100,000 common shares (received, valued at \$22,250) and incur \$750,000 (incurred \$100,000 to date) in exploration expenditures by October 1, 2007. To acquire an additional 19%, the optionee must pay \$150,000, 50% of which may be through share issuances, within two years and incur \$1,000,000 in exploration expenditures within three years from the election date. The election date must be within 120 days from when the initial 51% interest is earned.	-	7,900
Bond & Johnson property, Ontario A 100% interest, subject to a 2.5% NSR, 1.5% of which may be purchased back at any time for \$1,500,000.	25,000	25,000
Davidson property, British Columbia A 100% interest, subject to a 2% NSR, which may be purchased back for \$2,000,000.	80,000	-
Uduk Lake property, British Columbia A 100% interest, subject to a 3% NSR, 2% of which may be purchased back at any time for \$2,000,000.	22,500	22,500
Sam property, British Columbia A 100% interest, acquired by staking.	5,616	5,616
Tommy Lake property, British Columbia A 100% interest.	17,518	17,518
Atna Bay property, British Columbia A 100% interest, acquired by staking.	950	-
Ebb property, British Columbia A 100% interest. The Company may be required to issue 5,000 additional common shares under certain terms and conditions.	2,950	2,950
	\$ 283,564	\$ 198,114

Title to mineral properties involves certain inherent risks due to the difficulties of determining the validity of certain claims as well as the potential for problems arising from the frequently ambiguous conveyancing history characteristic of many mineral properties. The Company has investigated title to all of its mineral properties and, to the best of its knowledge, title to all of its properties are in good standing.

During the year ended February 28, 2006, the Company incurred \$19,000 of acquisition costs on the Rey Lake property that were written-off during fiscal 2006.

SILVER QUEST RESOURCES LTD.
(formerly Southern Rio Resources Ltd.)
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FEBRUARY 28, 2006

6. DEFERRED EXPLORATION COSTS

2006	Tam Property	Tsacha Property	Taken Property	Minnitaki Property	Duke Property	Davidson Property	Ebb Property	Rey Lake Property	Other	Total
Balance, beginning of year	\$ 811,760	\$1,139,724	\$ 176,285	\$ 194,878	\$ 3,406	\$ -	\$ -	\$ -	\$ 88,324	\$2,414,377
Data management	-	-	-	79	-	1,924	1,495	995	-	4,493
Drilling	10,175	44,164	21,784	-	144	267,064	-	-	-	343,331
Field sampling	2,139	24,480	3,443	-	-	1,859	8,714	8,195	-	48,830
Geology	490	534	1,032	125	-	26,006	2,685	3,171	3,473	37,516
Geophysics	-	-	-	-	-	-	20,271	20,364	-	40,635
Land retention	574	9,894	1,795	114	2,004	682	2,254	-	-	17,317
	13,378	79,072	28,054	318	2,148	297,535	35,419	32,725	3,473	492,122
Option recovery	-	-	-	-	(4,981)	-	-	-	-	(4,981)
Written off during the year	-	-	-	-	-	-	-	(32,725)	-	(32,725)
BC Mining Exploration Tax Credit recovery	(65,608)	(58,141)	(10,844)	-	(573)	-	-	-	(3,457)	(138,623)
	(52,230)	20,931	17,210	318	(3,406)	297,535	35,419	-	16	315,793
Balance, end of year	\$ 759,530	\$1,160,655	\$ 193,495	\$ 195,196	\$ -	\$ 297,535	\$ 35,419	\$ -	\$ 88,340	\$2,730,170

SILVER QUEST RESOURCES LTD.
(formerly Southern Rio Resources Ltd.)
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FEBRUARY 28, 2006

6. DEFERRED EXPLORATION COSTS (cont'd...)

2005	Tam Property	Tsacha Property	Taken Property	Minnitaki Property	Duke Property	Trout Property	Other	Total
Balance, beginning of year	\$ 700,349	\$ 500,773	\$ 88,159	\$ 194,878	\$ 11,162	\$ -	\$ 63,538	\$1,558,859
Data management	2,126	1,242	32	-	-	-	-	3,400
Drilling	93,558	600,728	77,798	-	90,994	63,802	-	926,880
Field sampling	5,094	20,820	8,497	-	-	-	-	34,411
Geology	10,633	6,165	1,799	-	-	-	13,564	32,161
Geophysics	-	-	-	-	-	-	5,377	5,377
Land retention	-	442	-	-	-	3,574	1,796	5,812
Land permitting	-	9,554	-	-	-	-	4,049	13,603
	111,411	638,951	88,126	-	90,994	67,376	24,786	1,021,644
Option recovery	-	-	-	-	(98,750)	-	-	(98,750)
Written off during the year	-	-	-	-	-	(67,376)	-	(67,376)
	111,411	638,951	88,126	-	(7,756)	-	24,786	855,518
Balance, end of year	\$ 811,760	\$1,139,724	\$ 176,285	\$ 194,878	\$ 3,406	\$ -	\$ 88,324	\$2,414,377

SILVER QUEST RESOURCES LTD.
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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FEBRUARY 28, 2006

7. RELATED PARTY TRANSACTIONS

During the 2006 fiscal year, the Company entered into the following transactions with related parties:

- a) Paid or accrued \$18,000 (2005 - \$18,000) for rent to a company controlled by a director.
- b) Paid or accrued \$24,856 (2005 - \$25,668) for professional fees to a law firm in which an officer of the Company is a partner.
- c) Paid or accrued \$95,463 (2005 - \$91,816) for salaries and benefits to directors of the Company.
- d) Paid or accrued \$9,574 (2005 - \$Nil) for management fees to a company controlled by an officer of the Company.

Included in accounts payable is \$2,881 (2005 - \$Nil) owed to a company controlled by an officer of the Company.

These transactions were in the normal course of operations and were measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

8. CAPITAL STOCK AND CONTRIBUTED SURPLUS

	Number of Shares	Capital Stock	Contributed Surplus
Authorized			
Unlimited common shares without par value			
Issued			
As at February 29, 2004	8,101,723	\$ 10,969,034	\$ 426,594
For cash - private placements	2,232,000	1,401,300	-
Finders' fees	-	(10,371)	10,371
Share issue costs	-	(88,158)	-
For mineral property options	58,000	56,550	-
Stock-based compensation	-	-	86,211
Tax benefits renounced to flow-through share subscribers	-	(383,000)	-
As at February 28, 2005	10,391,723	11,945,355	523,176
For cash - private placements	8,155,331	2,643,099	-
Finders' fees	-	(86,676)	86,676
Share issue costs	-	(165,800)	-
For mineral property options	168,000	66,400	-
Cancellation of escrow shares	(32,700)	(1,630)	1,630
Stock-based compensation	-	-	508,466
Tax benefits renounced to flow-through share subscribers	-	(301,000)	-
As at February 28, 2006	18,682,354	\$ 14,099,748	\$ 1,119,948

SILVER QUEST RESOURCES LTD.
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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FEBRUARY 28, 2006

8. CAPITAL STOCK AND CONTRIBUTED SURPLUS (cont'd...)

On December 15, 2005, the Company consolidated its share capital on a 5:1 basis, as approved by the shareholders of the Company. All share and per share amounts have been restated to reflect this share consolidation. Additionally, during the year ended February 28, 2006, the Company changed its authorized share capital to an unlimited number of common shares without par value.

On December 23, 2005, the Company issued 1,965,000 flow-through shares at a price of \$0.40 per share and 6,190,331 units at a price of \$0.30 in a non-brokered private placement. Each unit consisted of one common share and one-half of a common share purchase warrant. Each whole common share purchase warrant is exercisable into an additional common share at \$0.50 until December 23, 2006 and at \$0.65 until December 23, 2007. Finders' fees included the Company paying \$165,800 and issuing 419,322 warrants exercisable into additional common shares at \$0.35 per share until June 23, 2007. The finders' warrants have been recorded at a fair value of \$86,676, which is included in contributed surplus.

On July 26, 2004, the Company issued 480,000 flow-through units at a price of \$0.75 per unit in a brokered private placement. Each flow-through unit consisted of one flow-through common share and one-half of a common share purchase warrant. Each whole common share purchase warrant is exercisable into an additional common share at \$1.50 until July 26, 2005. Finders' fees included the Company paying \$27,000 and issuing 48,000 warrants exercisable into additional common shares at \$1.50 per share until July 26, 2005. The finders' warrants have been recorded at a fair value of \$3,446, which is included in contributed surplus.

On December 20, 2004, the Company issued 1,102,000 flow-through units at a price of \$0.65 per unit and 650,000 non flow-through units at a price of \$0.50 per unit in a non-brokered private placement. Each flow-through unit consisted of one flow-through common share and one-half of a common share purchase warrant. Each whole common share purchase warrant is exercisable into an additional common share at \$1.00 until December 20, 2005. Each non flow-through unit consisted of one common share and one-half of a common share purchase warrant. Each whole common share purchase warrant is exercisable into an additional common share at \$0.75 until December 20, 2005. Finders' fees included the Company paying \$51,383 and issuing 109,000 warrants exercisable into additional common shares at \$0.75 per share until December 20, 2005. The finders' warrants have been recorded at a fair value of \$6,925, which is included in contributed surplus.

9. STOCK OPTIONS AND WARRANTS

Stock options

The Company, in accordance with its shareholder approved stock option plan as amended, is authorized to grant options to directors, officers, employees and consultants, to acquire up to 10% of the issued and outstanding common shares. The exercise price of each option equals the market price of the Company's stock as calculated on the date of grant. Options can be granted for a maximum term of five years and vest on grant.

SILVER QUEST RESOURCES LTD.
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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FEBRUARY 28, 2006

9. STOCK OPTIONS AND WARRANTS (cont'd...)

Stock options (cont'd...)

The following incentive stock options were outstanding at February 28, 2006:

Number of Shares	Exercise Price	Expiry Date
90,000	\$ 0.75	June 4, 2006
10,000	0.75	February 28, 2007
200,000	1.00	May 15, 2007
120,000	0.75	October 7, 2008
30,000	1.35	February 13, 2009
10,000	0.75	September 8, 2009
230,000	0.75	August 2, 2010
1,160,000	0.45	January 13, 2011

Stock option transactions are summarized as follows:

	Number of Options	Weighted Average Exercise Price
Outstanding, February 29, 2004	520,000	\$ 0.90
Granted	10,000	0.75
Exercised	-	-
Expired/cancelled	-	-
Outstanding, February 28, 2005	530,000	0.90
Granted	1,390,000	0.50
Exercised	-	-
Expired/cancelled	(70,000)	0.82
Outstanding February 28, 2006	1,850,000	\$ 0.60
Options exercisable, February 28, 2006	1,850,000	\$ 0.60

Stock-based compensation

The Company granted 1,390,000 (2005 - 10,000) stock options during the 2006 fiscal year all of which are vested, resulting in a fair value using the Black-Scholes option-pricing model of \$508,466 (2005 - \$3,957). Additional compensation of \$82,254 was recognized in fiscal 2005 due to vesting of options granted in fiscal 2004. The weighted average fair value of the stock options granted during the year was \$0.36 (2005 - \$0.40) per option.

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9. STOCK OPTIONS AND WARRANTS (cont'd...)

Stock-based compensation (cont'd...)

The following weighted average assumptions were used for the Black-Scholes valuation of stock options granted:

	2006	2005
Risk-free interest rate	4.03%	2.95%
Expected life	5 years	5 years
Annualized volatility	114.06%	87.53%
Dividend rate	0.00%	0.00%

Warrants

As at February 28, 2006, the Company had outstanding share purchase warrants, enabling the holders to acquire further shares as follows:

Number of Shares	Exercise Price	Expiry Date
551,000	\$ 1.00	December 20, 2006
325,000	0.75	December 20, 2006
419,322	0.35	June 3, 2007
3,095,161	0.50	December 23, 2006
	if not, then at 0.65	December 23, 2007

During the year ended February 28, 2006, the Company extended the expiry date of 876,000 warrants from December 20, 2005 to December 20, 2006.

Share purchase warrant transactions were as follows:

	Number of Warrants	Weighted Average Exercise Price
Outstanding, February 29, 2004	1,820,298	\$ 1.15
Granted	1,273,000	1.05
Exercised	-	-
Expired/cancelled	(1,490,813)	1.15

- Continued -

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9. STOCK OPTIONS AND WARRANTS (cont'd...)

Warrants (cont'd...)

	Number of Warrants	Weighted Average Exercise Price
<i>Cont'd...</i>		
Outstanding, February 28, 2005	1,602,485	1.10
Granted	3,514,483	0.48
Exercised	-	
Expired/cancelled	<u>(726,485)</u>	1.37
Outstanding, February 28, 2006	4,390,483	\$ 0.57

The following weighted average assumptions were used for the Black-Scholes valuation of finders' warrants granted:

	2006	2005
Risk-free interest rate	3.99%	3.10%
Expected life	1.5 years	1 year
Annualized volatility	124.68%	75.38%
Dividend rate	0.00%	0.00%

10. SUPPLEMENTAL DISCLOSURE WITH RESPECT TO CASH FLOWS

Significant non-cash transactions for the year ended February 28, 2006 included:

- a) The issuance of 20,000 common shares, with a value of \$9,000 as consideration towards the acquisition of the Tsacha property in British Columbia (Note 5).
- b) The issuance of 8,000 common shares with a value of \$3,400 as consideration towards the acquisition of the Taken property in British Columbia (Note 5).
- c) The issuance of 100,000 common shares with a value of \$40,000 as consideration towards the acquisition of the Davidson property in British Columbia (Note 5).
- d) The issuance of 40,000 common shares with a value of \$14,000 as consideration towards the acquisition of the Rey Lake property in British Columbia (Note 6).

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10. SUPPLEMENTAL DISCLOSURE WITH RESPECT TO CASH FLOWS (cont'd...)

- e) The cancellation of 32,600 escrow common shares returned to treasury with a value of \$1,630.
- f) The receipt of 75,000 common shares with a value of \$13,500 as consideration from an option agreement on the Duke property in British Columbia (Note 5) allocated as to deferred exploration costs of \$4,981, mineral property acquisitions of \$7,900 and \$619 as a recovery of mineral properties and deferred exploration costs.
- g) The Company issuing 419,322 warrants with a fair value of \$86,676 as finders' fees relating to private placements. The fair value of the warrants was allocated to contributed surplus.
- h) The accrual of \$61,611 of deferred exploration costs as at February 28, 2006.
- i) The recording of a decrease to share capital of \$301,000 and a corresponding increase to future income tax recovery resulting from the renunciation of flow-through shares.

Significant non-cash transactions for the year ended February 28, 2005 included:

- a) The issuance of 20,000 common shares, with a value of \$25,500 as consideration towards the acquisition of the Tsacha property in British Columbia (Note 5).
- b) The issuance of 8,000 common shares, with a value of \$10,800 as consideration towards the acquisition of the Taken property in British Columbia (Note 5).
- c) The issuance of 5,000 common shares, with a value of \$6,750 as consideration towards the acquisition of the Trout property in British Columbia (Note 5).
- d) The issuance of 20,000 common shares, with a value of \$11,000 as consideration towards the acquisition of the Tommy Lake property in British Columbia (Note 5).
- e) The issuance of 5,000 common shares, with a value of \$2,500 as consideration towards the acquisition of the Ebb property in British Columbia (Note 5).
- f) The Company issuing 157,000 warrants with a fair value of \$10,371 as finders' fees relating to private placements. The fair value of the warrants was allocated to contributed surplus.
- g) The receipt of 25,000 common shares, with a value of \$8,750 as consideration from an option agreement on the Duke property in British Columbia (Note 5).
- h) The recording of a decrease to share capital of \$383,000 and a corresponding increase to future income tax recovery resulting from the renunciation of flow-through shares.

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11. INCOME TAXES

A reconciliation of income taxes at statutory rates with reported taxes is as follows:

	2006	2005
Loss before income taxes	\$ (904,688)	\$ (484,645)
Expected income tax recovery	\$ (346,000)	\$ (173,000)
Non-deductible items	59,000	91,000
Stock-based compensation	195,000	31,000
Recognized benefit of non-capital losses carried forward	<u>(209,000)</u>	<u>(332,000)</u>
Total income tax recovery	<u>\$ (301,000)</u>	<u>\$ (383,000)</u>
Represented by:		
Income tax expense	\$ -	\$ -
Future income tax recovery	<u>(301,000)</u>	<u>(383,000)</u>
	<u>\$ (301,000)</u>	<u>\$ (383,000)</u>

Significant components of the Company's future income tax assets are as follows:

	2006	2005
Future income tax assets		
Equipment	\$ 4,000	\$ 4,000
Financing costs	86,000	71,000
Mineral properties and deferred exploration costs	204,000	377,000
Non-capital losses available for future periods	380,000	363,000
Capital losses available for future periods	<u>16,000</u>	<u>17,000</u>
	690,000	832,000
Valuation allowance	<u>(690,000)</u>	<u>(832,000)</u>
Net future income tax assets	<u>\$ -</u>	<u>\$ -</u>

The Company has not recorded in these financial statements, the future income tax benefits of approximately \$1,018,000 of non-capital losses which may be applied to reduce taxable income in future years. If not utilized, the losses expire through to 2016. In addition, the Company has exploration and development expenditures of approximately \$4,891,000 available to reduce taxable income of future years. Future tax benefits which may arise as a result of these future income tax assets have not been recognized in these financial statements and have been offset by a valuation allowance.

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11. INCOME TAXES (cont'd...)

During the year ended February 28, 2006, the Company issued 1,965,000 (2005 – 1,582,000) common shares on a flow-through basis for gross proceeds of \$786,000 (2005 – \$1,076,300). The flow-through agreements require the Company to renounce certain tax deductions for Canadian exploration expenditures incurred on the Company's mineral properties to the flow-through participants. During the fiscal 2006 year, the Company renounced exploration expenditures of \$786,000 which resulted in a future income tax recovery of \$301,000 and a charge against capital stock.

12. FINANCIAL INSTRUMENTS

The Company's financial instruments consist of cash and equivalents, receivables, marketable securities, and accounts payable and accrued liabilities. Unless otherwise noted, it is management's opinion that the Company is not exposed to significant interest, currency or credit risks arising from these financial instruments. The fair value of these financial instruments approximates their carrying values, unless otherwise noted.

13. SEGMENTED INFORMATION

The Company operates in one reportable operating segment, being the acquisition and exploration of mineral properties in Canada.