

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	\$ 2,490,295	\$ 847,107
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	\$ -	\$ 2,922
Cash paid for income taxes	\$ -	\$ -

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

- Continued -

SILVER QUEST RESOURCES LTD.
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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
	<u>\$ 283,564</u>	<u>\$ 198,114</u>

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
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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.

MANAGEMENT'S DISCUSSION & ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - FORM 51-502F1

February 28, 2006

This Management's Discussion and Analysis ("MD&A") reviews the activities of Silver Quest Resources Ltd. ("Silver Quest", or the "Company") and compares the financial results for the fiscal year ended February 28, 2006 ("fiscal 2006") with the fiscal year ended February 28, 2005 ("fiscal 2005"). This MD&A should be read in conjunction with the audited financial statements and accompanying notes for the relevant fiscal years. Copies of all such documents are filed on the SEDAR website and with the regulatory authorities⁽¹⁾.

The information contained in this document is provided as of May 24, 2006 (the "Report Date").

Overview

Silver Quest is a mineral exploration company listed on the TSX Venture Exchange under the symbol "SQI". Prior to December 15, 2005, the Company was known as Southern Rio Resources Ltd. ("Southern Rio"). On December 15, 2005, Southern Rio changed its name to Silver Quest Resources Ltd. and the shares were consolidated on a five old for one new basis. All share quantities and per share amounts stated in this MD&A have been adjusted to reflect the share consolidation.

For the last several years, the Company has focused on exploration for gold, silver, copper and molybdenum, principally in the Cordillera of British Columbia. Silver Quest presently holds interests in 13 mineral exploration properties in Canada, principally in British Columbia, but has no producing operations. As a consequence, the Company does not generate any operating income or a positive cash flow. Exploration of its properties is therefore entirely dependent on Silver Quest's ability to access public equity markets to raise sufficient capital, and/or its ability to attract joint venture partners to finance further work on its properties.

Over the past several quarters, a combination of rising precious and base metal prices and an improving climate for mineral exploration in British Columbia has allowed the Company to raise sufficient funds to explore and advance its key projects. In December 2005, the Company completed a private placement financing that raised gross proceeds of \$2,643,099. This financing will enable Silver Quest to broaden its exploration activities, both geographically, to encompass all of the Americas, and by commodity, with an increased emphasis on silver properties.

In the Fall of 2005 and again in March and April 2006, two drilling campaigns (ten holes for a total length of approximately 1,800 metres) were completed on the Davidson and 3Ts properties. Significant new zones of gold and silver mineralisation were encountered on both properties. The results warrant follow-up drilling, and the Company is considering various arrangements for how this work could best be done, including negotiation of a joint venture agreement on either or both properties, or continuing to explore the properties for its own account.

Resource Properties

Silver Quest currently owns, or has the option to earn a majority ownership in, ten mineral properties in British Columbia, a gold project in Ontario comprising two properties, and one silver property in the Yukon. All of the British Columbia properties consist of staked claims, while the Ontario project consists of both staked and patented claims, and the Yukon property consists of mining leases.

(1) The Company prepares its financial statements in accordance with Canadian generally accepted accounting principles. All monetary amounts are in Canadian dollars unless otherwise noted.

FORWARD-LOOKING INFORMATION

This MD&A contains certain forward-looking information. All information, other than historical facts included herein, including without limitation data regarding potential mineralisation, exploration results and future plans and objectives of the Company, is forward-looking information that involves various risks and uncertainties. There can be no assurance that such information will prove to be accurate and future events and actual results could differ materially from those anticipated in the forward-looking information.

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Of the ten properties in British Columbia, seven gold-silver properties are located in the Nechako region of central BC: the Davidson, Sam and Uduk Lake properties; and the Tsacha, Tam, Taken and Tommy Lakes properties. The latter four properties collectively cover approximately 34 square kilometres and are referred to as the **3Ts Project**. The other three BC properties are the Duke copper-gold property, the Ebb copper-molybdenum property and the Rey Lake copper-molybdenum property. All three are located in the southern part of the province.

Davidson Property

The Company acquired a 100% interest in the Davidson property (formerly known as the Blackwater-Davidson property) from West Range Exploration Ltd. in the first quarter of fiscal 2006. The consideration paid consisted of a cash payment of \$40,000 and the issuance of 100,000 shares of the Company with a value of \$40,000. The property consists of 28 contiguous grid claims encompassing approximately 500 hectares located approximately 110 kilometres southwest of Vanderhoof in the Nechako Plateau region of British Columbia. The claims are contiguous with the 19 claim (350 hectares) Whitewater property recently staked by the Company, giving Silver Quest a dominant landholding position in this area.

Previous work on the Davidson property by other companies since the late 1970s included 31 diamond drillholes and 34 rotary drillholes, which defined a substantial gold-silver system over an area of about 1,000 metres by 700 metres. The Company has not been able to obtain data on the RC holes, however it is known that many of the holes were very short and did not adequately test the targets. Of particular interest is high-grade structurally controlled gold mineralisation identified in several prior drill holes, which may define a zone of higher grade shear-hosted veins. Approximately 500 metres to the northwest of the gold mineralised area, a separate low-grade silver zone occurs, which is interpreted by previous explorers as a shallow, flat-lying body up to 70 metres thick. This zone remains open in several directions, with average grades in the range of 25 to 40 grams per tonne ("g/t") silver.

During fiscal 2006, the Company completed two drilling campaigns on the Davidson property. Seven holes with a total length of 1,291 metres were drilled -- a total of 938 metres in five holes during September and October 2005, with a further 353 metres in two holes in March and April 2006 to follow-up on encouraging results from last Fall's campaign.

The five holes drilled in the Fall of 2005 were designed to test co-incident geochemical gold-in-soil anomalies, ground geophysical anomalies and interpreted fault structures.

- Drill hole DAV-05-02 intercepted a 14 metre interval from 136 to 150 metres grading 4.94 g/t gold and 17.1 g/t silver, in a previously unexplored portion of the property. This intercept is within a 64 metre interval of mineralisation from 96 to 160 metres grading 1.80 g/t gold and 6.5 g/t silver. The true width and orientation of this mineralised intercept are unknown. The mineralisation appears to be epigenetic and associated with silicified rock adjacent to an interpreted fault structure.
- DAV-05-01 was collared in the Silver Zone and returned intervals from 8 to 24 metres of anomalous silver (12.9 to 21.0 g/t silver);
- DAV-05-03 was abandoned at 52.4 metres, before the target depth was reached, because of difficult drilling conditions. No significant gold and silver values were intersected.
- DAV-05-04 was a redrill of DAV-05-03 and was completed to the target depth of 209.4 metres; however, no significant gold and silver values were returned.
- DAV-05-05 was drilled to test a gold-in-soil anomaly with a coincident, easterly trending VLF-EM conductor, on the margins of a zone of high chargeability. The hole was completed to 136.25 metres, and intersected a mineralised zone with a width of 2.0 metres that returned 0.14 g/t gold, 346.0 g/t silver, and 1.64% lead.
- two hole drilling program comprising 352.6 metres was completed in early 2006 to follow-up on the results from hole DAV-05-02.
- Drill hole DAV-06-06 was collared approximately 70 metres southwest of hole DAV-05-02 and was drilled at an inclination of minus 55 degrees, to a total depth of 157 metres, and intersected a strong zone of gold mineralisation over 26.0 metres (estimated true width 19.5 metres) from a depth of 49.0 to 75.0 metres grading 3.98 g/t gold and 19.0 g/t silver. Within this interval, an 8.0 metre higher grade portion (estimated

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true width 6.0 metres, from a depth of 67.0 to 75.0 metres) assayed 10.70 g/t gold and 42.8 g/t silver. Based on a preliminary interpretation of the results of DAV-05-02 and DAV-06-06, the new zone of disseminated gold-silver mineralisation dips steeply to the north and is hosted in lapilli tuffs, breccias and flows.

- DAV-06-07 was collared 50 metres northwest of DAV-05-02 and intersected a new zone of silver-gold mineralisation at the top of hole. Hole DAV-06-07 returned 12.3 metres from a depth of 36.7 metres to 48.0 metres grading 1.25 g/t gold and 46.1 g/t silver. This mineralized zone was intersected at the base of the overburden at 36.7 metres and is hosted in a rhyolite lapilli tuff unit, associated with a high silver-gold ratio (37 to 1). This new silver zone of mineralisation is geologically similar to the Davidson's previously explored Silver Zone, located approximately 350 metres to the north of hole DAV-06-07. The Silver Zone is described as a shallow, flat-lying body up to 70 metres thick and remains open in several directions. Additional drill testing will be required to determine continuity of mineralisation of this new silver-gold zone. Hole DAV-06-07 also intersected a lower zone of similar mineralisation over 12.0 metres from 64.0 to 76.0 metres, returning 1.02 g/t gold and 17.7 g/t silver. Hole DAV-06-07 was drilled to 195.7 metres and was terminated due to poor ground conditions.

Deferred exploration expenditures on the property in fiscal 2006 totaled \$297,535, most of which was incurred for diamond drilling and geological compilation work.

The Davidson field program is under the supervision of Robert Weicker, P. Geo., a qualified person as defined by National Instrument 43-101.

3Ts Project

The 3Ts project consists of four contiguous properties – the Tsacha, Tam, Taken and Tommy Lakes properties located in the Nechako Plateau region of central British Columbia. Collectively, the project consists of 39 mineral claims totaling 149 units with an approximate area of 34 square kilometres.

- The Tsacha property consists of five mineral claims totaling 84 units. The Company optioned the property from Teck Cominco Limited for 80,000 common shares and \$1,200,000 in exploration expenditures. As both conditions have now been satisfied, the Company holds a 100% interest in the property, subject to a sliding scale NSR royalty or a "back-in" right to Teck Cominco. The back-in right must be exercised by Teck Cominco, if at all, within 365 days of the date it receives a Preliminary Feasibility Study concerning development of the property. The back-in right, if exercised, entitles Teck Cominco to re-acquire a 65% interest in a joint venture in respect of the property by completing a feasibility study on the property at Teck Cominco's sole cost. If the costs incurred by Teck Cominco in completing the feasibility study are less than twice Silver Quest's expenditures on the property, Teck Cominco will be obligated to fund 100% of the joint venture's expenses until such funding equals the shortfall. If Teck Cominco elects to enter into a joint venture, the sliding scale royalty will be canceled.
- The Taken property consists of one mineral claim of 20 units. Silver Quest optioned the property from Phelps Dodge Corporation of Canada Limited for 40,000 common shares (40,000 issued to date) and \$250,000 in exploration expenditures. The Company had incurred \$204,339 in exploration expenditures by the end of fiscal 2006. By an amending letter dated January 20, 2006, Phelps Dodge granted the Company an extension until May 23, 2006 in which to incur aggregate exploration expenditures of \$250,000. As that condition has been satisfied, the Company is entitled to a 100% interest in the property. Phelps Dodge retains a sliding scale NSR royalty interest.
- The Tam property consisting of two mineral claims totaling 14 units is owned 100% by Silver Quest, subject to a 1% NSR royalty to Kleinebar Resources Ltd., a private company whose president and majority owner is Robert F. Weicker, who is also the President and a director of Silver Quest. At the time the Tam property was acquired, Mr. Weicker was a consultant to Silver Quest. The Company acquired the property for a consideration of \$4,700 cash and 2,000 shares.
- The Tommy Lakes property consists of 31 claims (31 units) within and around the existing 3Ts claim group. The Tommy Lakes property was acquired from Matthew J. Mason for a consideration of 20,000 shares and reimbursement of acquisition costs totaling \$6,518.

From November 2004 through to early March 2005, the Company carried out a diamond drilling program on the 3Ts

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project. The program totaled 3,845 metres of drilling in 16 holes, with 12 holes, (3,130 metres) completed on the Tsacha property, one hole of 420 metres on the Tam property and three holes totaling 296 metres on the Taken property. Three additional holes were drilled on the 3Ts property in the March 2006 drilling campaign.

Highlights of the March 2005 program include hole TS-05-108, which intersected the Tommy Vein on the Tascha property below a 70 metre thick flat-lying microdiorite sill from 220.56 to 234.93 metres, and returned an 8.86 metre interval from 220.56 to 229.42 metres (estimated true width 6.0 metres) grading 10.89 g/t gold and 60.2 g/t silver, including a higher grade interval of 2.56 metres grading 23.1 g/t gold and 153.2 g/t silver. Two holes were targeted to test the Larry Vein at depth below the sill that cuts the nearby Tommy Vein mineralisation. Both holes intersected what is interpreted as the likely continuation of the Larry Vein below the sill, but gold and silver values were low. Hole TS-05-108 intersected the Larry Vein above the sill from 40.27 to 42.60 metres. A one metre interval from 40.27 metres (estimated true width 0.7 metres) returned 19.7 g/t gold and 150.0 g/t silver.

The Ted Vein was tested by a single drill hole in the March 2005 drilling campaign, to determine the inferred vein position approximately 200 metres below the known mineralisation, and below the microdiorite sill. Hole TT-04-37 intersected 17.4 metres of quartz-carbonate veining from 384.0 to 401.4 metres (estimated true width 10.0 metres). An 11 metre interval from 388.3 - 399.3 metres (estimated true width 6.5 metres) grades 3.74 g/t gold and 59.3 g/t silver. This intersection greatly expands the size potential of the Ted Vein system both along strike and up and down dip, and confirms the presence of a strongly developed epithermal vein system.

One objective of the drilling campaign carried out during March 2006 was to further test the Ted Vein but due to adverse weather conditions, only one hole comprising 328.3 metres was completed on this vein system. However, this hole (TT-06-38) returned the most significant gold and silver results drilled to date by the Company on this project. Over a core length of 30.6 metres (estimated true width of 17.2 metres) from a depth of 289.0 to 319.6 metres, the hole returned 2.68 g/t gold and 152.1 g/t silver. Higher grade intervals include 10.0 metres (estimated true width 5.6 metres) grading 2.78 g/t gold and 241.3 g/t silver and 12.6 metres (estimated true width 7.1 metres) that graded 3.83 g/t gold and 137.3 g/t silver. Hole TT-06-38 is only the second hole drilled on the Ted Vein below the microdiorite sill.

Three holes totaling 296 metres were drilled on the Taken property in the campaign that ended in March 2005. The objective was to locate the source(s) of gold and silver-mineralised float boulders occurring in the glacial till. Previous prospecting had resulted in the discovery of multiple high-grade boulder occurrences, including the Ringer Zone (eight samples averaging 19.01 g/t gold and 140.1 g/t silver). No significant mineralisation was intersected in the three holes. In the follow-up drilling campaign in March 2006, two short holes comprising 178.0 metres were completed. Hole TK-06-12 was terminated in deep overburden at 36.0 metres due to difficult drilling conditions. Hole TK-06-13 was completed to a depth of 142.0 metres with 41.4 metres of overburden. A narrow 0.5-metre quartz-carbonate vein was intersected in this hole at a depth of 78.2 metres, returned 1.30 g/t gold and 2.2 g/t silver, and is interpreted as a minor vein, not the source of the mineralized float boulders.

The Tommy Vein on the Tascha property has an inferred resource of 552,500 tonnes grading 6.82 g/t gold and 60.9 g/t silver, at a 3.0 g/t gold cut-off. These resources are calculated above the sill. The Ted Vein has an inferred resource of 273,800 tonnes grading 2.00 g/t gold and 133.0 g/t silver, also above the sill. Both tonnage estimates were prepared before the most recent drilling results were received, and consequently do not incorporate the results of that drilling. In particular, it should be noted that hole TT-06-38 returned more than double the average width with higher gold and silver values, indicating a well-developed, robust epithermal vein system with excellent potential to expand the gold and silver resource below the sill on the Ted Vein.

Exploration expenditures totaling \$120,504 were incurred on the 3Ts project during fiscal 2006. Of these, \$13,378 were on the Tam property, \$79,072 on the Tsacha property and \$28,054 on the Taken property. With the exception of \$24,480 incurred on field sampling on the Tsacha property, the expenditures on the 3ts project in fiscal 2006 were primarily related to drilling activities.

The "Qualified Person" ("QP") in charge of the technical work on the 3Ts project is David Pawliuk, P. Geo.

Ebb Property

The Company holds a 100% interest in the Ebb property, consisting of 49 claim units totaling 1,020 hectares located east of Boston Bar in southern British Columbia. The property was acquired for staking costs and up to 10,000 shares (5,000 issued to date).

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Historic sampling carried out in the early 1970s is reported to have returned 67 metres grading 0.09% copper and 0.017% MoS₂ over an outcropping breccia pipe, with an additional 62.5 metres immediately to the east grading 0.20% copper and 0.013% MoS₂.

During fiscal 2006, the Company incurred exploration expenditures of \$35,419, primarily on geology, in the course of reviewing previous geological mapping, geochemical sampling and induced polarization geophysical surveys in the area of known copper-molybdenum mineralisation, to better characterize the nature and extent of the mineralized zone.

Rey Lake Property

The Company had an option agreement with Bearclaw Capital Corp. whereby the Company could acquire an initial 51% interest in the Ray Lake copper-molybdenum property approximately 25 kilometres from the Highland Valley copper mine south of Kamloops, BC. Pursuant to the option agreement, the Company paid Bearclaw \$5,000 in cash and issued 40,000 shares. During the year, the Company incurred exploration expenditures of \$32,725. Based on the results of that work, management concluded the property was unlikely to meet the Company's objectives, the option agreement was terminated and \$19,000 of property acquisition costs and \$32,725 of deferred exploration expenditures were written-off.

Duke Property

The 100%-owned Duke property, consisting of one mineral claim totaling 20 units, is located 32 kilometres west of Merritt in southern British Columbia. The main commodity target on the property is copper. Limited sampling of surface copper showings by Silver Quest has returned gold values ranging from 0.2 to 0.48 g/t gold, and silver values ranging from 1.7 to 20.6 g/t. The property is currently under option to Freegold Ventures Limited ("Freegold"), who may earn an initial 51% interest by spending \$750,000 on exploration by October 1, 2007, making a cash payment of \$10,000 and issuing 100,000 Freegold common shares to the Company.

During fiscal 2006, Freegold completed a limited program of diamond drilling directed at induced polarization geophysical targets. Drilling was hampered by difficult ground conditions and winter weather, however no significant mineralisation was intersected.

Mayo Property

The Company owns 19 quartz mining leases totaling 752 acres in the historic Keno Hill camp in the Mayo Mining District of the Yukon. The area is road accessible and well serviced with mining infrastructure. During the 2002 field season, the Company engaged a geologist to evaluate the Company's holdings in the Keno Hill district. A one metre chip sample collected by the geologist from the Main (Formo) Vein partly exposed in an old open cut assayed 4,400 g/t silver, 31.0% lead and 19.8% zinc, confirming previous reports of high grade silver associated with this vein system.

Results of Operations

The Company has no producing properties, and consequently no sales or revenues from operations.

The Company's accounting policy is to capitalize all costs to acquire and explore mineral properties until the property to which they relate is placed into production, sold, abandoned, or management determines there is an impairment in value. As abandonment decisions are largely driven by exploration results, the amounts written-off from quarter to quarter can be highly variable and unpredictable in advance of the receipt of those results and other information relating to the underlying value of the properties in question. Amounts written-off can cause significant variability in the net loss reported in different periods. The net loss for the year ended February 28, 2006 ("fiscal 2006") was \$603,688 vs \$101,645 in fiscal 2005. The net loss in both fiscal years would have been larger, except for future income tax recoveries of \$301,000 and \$383,000 in fiscal 2006 and fiscal 2005, respectively.

In fiscal 2006, general and administrative expenses were \$867,306 (fiscal 2005 - \$440,088). Stock-based compensation expense in fiscal 2006 of \$508,466 (fiscal 2005 - \$86,211) incurred as a result of stock options granted during the year was largely responsible for the increase in general and administration expenses. The \$17,992 reduction in consulting expense (fiscal 2006 - \$33,341 vs fiscal 2005 - \$51,333) is the result of geological services that were provided on a consulting basis in the prior year being provided by salaried personnel during fiscal 2006. This

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change was largely responsible for the \$14,593 increase in salary expense (fiscal 2006 - \$110,521 vs fiscal 2005 - \$95,928). Management fees increased from the prior year, (fiscal 2006 - \$9,574 vs fiscal 2005 - \$Nil) as some duties carried out by employees in fiscal 2005 and earlier periods are now performed by contract personnel. Professional fees, which are expenses for legal services and work performed by the Company's auditors, increased by \$18,889, from \$51,965 in fiscal 2005 to \$70,854 in fiscal 2006.

The magnitude of stock-based compensation expense (which is a non-cash expense) and its impact on results of operations is dependent upon the number of options granted, the term and exercise price of the options, share price volatility assumptions and other factors that cannot be predicted in advance of when the options are granted.

In the three month period ended February 28, 2006 ("fourth quarter fiscal 2006"), the Company incurred a net loss of \$467,495 (2005 – income of \$227,152). General and administrative expenses in the fourth quarter fiscal 2006 were \$628,789 (fourth quarter fiscal 2005 - \$109,734). The larger loss is mainly due to stock-based compensation expense of \$482,701 recorded in the fourth quarter fiscal 2006 as the result of stock options granted in that quarter. No stock options were granted in the fourth quarter fiscal 2005.

Write-offs of mineral property acquisition costs and deferred exploration costs were both higher in fiscal 2005 as compared to fiscal 2006. Mineral property acquisition costs written off in the fourth quarter fiscal 2006 were \$19,000 (fourth quarter fiscal 2005 - \$24,870). Deferred exploration costs written off in the fourth quarter fiscal 2006 were \$32,725 (fourth quarter fiscal 2005 - \$67,376). The Company recorded a recovery of \$619 of deferred exploration costs in the fourth quarter fiscal 2006. There was no recovery in the comparable quarter of fiscal 2005.

The Company recorded a future income tax recovery in the fourth quarter of \$301,000 (fourth quarter fiscal 2005 - \$383,000) being the amount of the tax-effected renunciation of exploration expenditures financed using the proceeds of the issuance of flow-through shares.

Quarterly Results

The following table summarizes information derived from the Company's financial statements for each of the eight most recent quarters:

Quarter Ended: Year:	Feb. 28 2006	Nov. 30 2005	Aug. 31 2005	May 31 2005	Feb. 28 2005	Nov. 30 2004	Aug. 31 2004	May 31 2004
(a) Net sales or total revenue	\$Nil	\$Nil	\$Nil	\$Nil	\$Nil	\$Nil	\$Nil	\$Nil
(b) Income (loss) from continuing operations:								
(i) in total (000s)	\$(467)	\$37	\$(94)	\$(79)	\$227	\$(75)	\$(131)	\$(122)
(ii) on a per share basis	\$(0.05)	\$0.01	\$(0.01)	\$(0.01)	\$0.03	\$(0.01)	\$(0.02)	\$(0.01)
(c) Net income or loss:								
(i) in total (000s)	\$(467)	\$37	\$(94)	\$(79)	\$227	\$(75)	\$(131)	\$(122)
(ii) on a per share basis	\$(0.05)	\$0.01	\$(0.01)	\$(0.01)	\$0.03	\$(0.01)	\$(0.02)	\$(0.01)

Per share amounts are calculated using the weighted average number of shares outstanding, after giving effect to the five for one share consolidation that occurred on December 15, 2005. Fully diluted loss per share amounts have not been calculated, as they would be anti-dilutive.

As the Company is actively exploring its properties and has no sales or operating revenues to generate earnings and cash flow, in most quarters losses can be expected due to the general and administrative expenses incurred in running the Company. Moreover, there can be significant increases in such costs in those quarters in which the Directors grant stock options, as this action results in stock-based compensation expense in such quarters. Stock option grants were largely responsible for the higher losses recorded in the quarters ended August 31, 2004 and February 28, 2006. The income recorded in the quarter ended February 28, 2005 was largely the result of a future income tax recovery of \$383,000 recorded in that quarter.

Annual Financial Information

The following table sets forth selected financial information for Silver Quest for the last three completed fiscal years ended February 28, 2006 and 2005 and February 29, 2004. This information has been derived from the Company's audited financial statements for each of those years, and should be read in conjunction with those financial statements

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and the notes thereto.

	As at and for the fiscal year ended		
	Feb. 28, 2006	Feb. 28, 2005	Feb. 29, 2004
(a) Net sales or total revenues	\$Nil	\$Nil	\$Nil
(b) Income (loss) from continuing operations:			
(i) in total	\$(603,688)	\$(101,645)	\$(387,066)
(ii) on a per share basis ⁽¹⁾	\$(0.05)	\$(0.01)	\$(0.01)
(c) Net income (loss):			
(i) in total	\$(603,688)	\$(101,645)	\$(387,066)
(ii) on a per share basis ⁽¹⁾	\$(0.05)	\$(0.01)	\$(0.01)
(d) Total assets	\$5,570,411	\$3,536,021	\$2,683,758
(e) Total long-term financial liabilities	\$Nil	\$Nil	\$Nil
(f) Cash dividends declared per share	\$Nil	\$Nil	\$Nil

(1) Fully diluted loss per share amounts have not been calculated, as they would be anti-dilutive.

Liquidity and Capital Resources

Working Capital and Operating Expenditures

The Company had working capital of \$2,438,023 as at February 28, 2006 (\$694,346 as at February 28, 2005). The increase in working capital is due largely to the financing completed in December 2005, partially offset by expenditures for on-going exploration work and general corporate expenses that were incurred in fiscal 2006.

Certain of the Company's exploration expenditures incurred on its British Columbia mineral properties since August 1, 1998 qualify for the 20% British Columbia Mining Exploration Tax Credit ("METC"). This is a refundable tax credit, and to the extent the METC exceeds provincial income tax otherwise payable, the Company receives a payment from the provincial government for the excess. During fiscal 2006, the Company received a payment of \$138,623. This payment was allocated to several of the Company's properties, as more particularly shown in the table below.

The Company incurred deferred exploration expenditures of \$492,122 during fiscal 2006 (fiscal 2005 - \$1,021,644), before option recoveries of \$4,981 (fiscal 2005 - \$98,750), write-offs of \$32,725 (fiscal 2005 - \$67,376), and the British Columbia METC of \$138,623 (fiscal 2005 - \$Nil). Exploration expenditures, net of the foregoing, were \$315,793 (fiscal 2005 - \$855,518). There were no expenditures on the Trout property in fiscal 2006, as the property was abandoned in fiscal 2005, after drilling results fell short of expectations.

The following table sets forth the exploration expenditures on Silver Quest's properties during fiscal 2006:

Year ended February 28, 2006	Tam Property	Tsacha Property	Taken Property	Duke Property	Davidson Property	Ebb Property	Rey Lake Property	Other Properties	Total
Balance, beginning of year	\$811,760	\$1,139,724	\$176,285	\$ 3,406	\$ -	\$ -	\$ -	\$283,202	\$2,414,377
Data management	-	-	-	-	1,924	1,495	995	79	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	-	26,006	2,685	3,171	3,598	37,516
Geophysics	-	-	-	-	-	20,271	20,364	-	40,635
Land tenure	574	9,894	1,795	2,004	682	2,254	-	114	17,317
Expenditures in year	13,378	79,072	28,054	2,148	297,535	35,419	32,725	3,791	492,122
Option recovery	-	-	-	(4,981)	-	-	-	-	(4,981)
Written off during year	-	-	-	-	-	-	(32,725)	-	(32,725)
METC payment	(65,608)	(58,141)	(10,844)	(573)	-	-	-	(3,457)	(138,623)
	(52,230)	20,931	17,210	(3,406)	297,535	35,419	-	334	315,793
Balance, end of year	\$759,530	\$1,160,655	\$193,495	\$ -	\$297,535	\$35,419	\$ -	\$283,536	\$2,730,170

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The following table sets forth the exploration expenditures on Silver Quest's properties during fiscal 2005:

Year ended	Tam	Tsacha	Taken	Duke	Trout	Other	Total
February 28, 2005	Property	Property	Property	Property	Property		
Balance, beginning of year	\$700,349	\$ 500,773	\$ 88,159	\$ 1,162	\$ -	\$258,416	\$1,558,859
Data management	2,126	1,242	32	-	-	-	3,400
Drilling	93,558	600,728	77,798	90,994	63,803	-	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
Expenditures in year	111,411	638,951	88,126	90,994	67,376	24,786	1,021,644
Option recovery	-	-	-	(98,750)	-	-	(98,750)
Written off during year	-	-	-	-	(67,375)	-	(67,376)
	<u>111,411</u>	<u>638,951</u>	<u>88,126</u>	<u>(7,756)</u>	<u>-</u>	<u>24,786</u>	<u>855,518</u>
Balance, end of year	\$811,760	\$1,139,724	\$176,285	\$ 3,406	\$ -	\$283,202	\$2,414,377

The Company will continue to rely on the equity markets to provide the funds needed to enable it to advance its properties and to evaluate and acquire additional properties of merit.

Financings

On December 23, 2005, the Company closed a non-brokered private placement of 1,965,000 flow-through common shares at a price of \$0.40 per common share and 6,190,331 units (the "Units") at a price of \$0.30 per Unit, raising gross proceeds of \$2,643,099. Each Unit consisted of one common share and one half of one common share purchase warrant. Each whole warrant will be exercisable until December 23, 2006 into one common share at an exercise price of \$0.50 per warrant, with the exercise price increasing thereafter to \$0.65 per warrant. The warrants will expire on December 23, 2007, subject to acceleration. Finders' fees consisting of a 7% cash commission and 419,322 finders' warrants were paid in connection with a portion of the private placement. Each finder's warrant is exercisable into an additional common share until June 23, 2007 at an exercise price of \$0.35. The finders' warrants were recorded at a fair value of \$86,676, which is included in contributed surplus. The expiry dates of all of the warrants issued in connection with this financing are subject to acceleration, at the sole option of the Company, to 21 business days following the date on which the Company gives notice that the Company's common shares have closed for 20 consecutive trading days at a price greater than \$0.75 per share.

During the fiscal year ended February 28, 2005, the Company completed two financings:

- On July 26, 2004, the Company issued 480,000 flow-through units in a brokered private placement at \$0.75 per unit, for gross proceeds of \$360,000. Each unit consisted of one flow-through common share and one-half of a common share purchase warrant exercisable into one additional common share at an exercise price of \$1.50 per share. The common share purchase warrants associated with this financing expired unexercised on the expiry date, which had been extended from July 26, 2005 to December 26, 2005. The commission payable on this financing included a cash payment of \$27,000 and the issuance of 48,000 finders' warrants recorded at a fair value of \$3,446 which was included in contributed surplus. The finders' warrants were exercisable into additional common shares at \$1.50 per share until July 26, 2005, but expired unexercised.
- On December 20, 2004, the Company completed a non-brokered financing of 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 to raise gross proceeds of \$1,041,300. Each flow-through unit consisted of one flow-through common share and one-half of one common share purchase warrant, while each non flow-through unit consisted of one common share and one-half one common share purchase warrant. In both cases, the original expiry date on the warrants was December 20, 2005, and the exercise price per whole warrant was \$1.00 for the warrants attached to the flow-through units, and \$0.75 for the warrants attached to the non flow-through units. On November 8, 2005, the TSX Venture Exchange agreed to extend the expiry date on the warrants to December 20, 2006.

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Finders' fees payable on the financing included a cash payment of \$51,383 and the issuance of 109,000 finders' warrants exercisable into additional common shares at \$0.75 per share until December 20, 2005. The finders' warrants were recorded at a fair value of \$6,925, which was included in contributed surplus. The finders' warrants expired unexercised.

During fiscal 2006, the Company issued 168,000 shares with an aggregate value of \$66,400 pursuant to agreements to acquire certain mineral interests. During fiscal 2005, the Company issued 58,000 shares with an aggregate value of \$56,550 pursuant to agreements to acquire certain mineral interests.

The Company does not use debt financing, nor does it rely on hedging transactions or other derivative financial instruments. It has not to date entered, and has no current plans to enter, into off-balance sheet financings.

Cash invested in the Company's business and assets in fiscal 2006 was \$336,444 (fiscal 2005 - \$936,060), most of which represented exploration costs that were deferred (\$430,511 in fiscal 2006 vs \$1,021,644 in fiscal 2005). Expenditures incurred on the acquisition of mineral properties in fiscal 2006 were \$45,950 (fiscal 2005 - \$11,968), while amounts posted for reclamation bonds required \$3,500 in fiscal 2006 (fiscal 2005 - \$9,000). The Company received \$90,000 in option payments during fiscal 2005. No option payments were received in fiscal 2006, but the Company realized \$4,894 in fiscal 2006 from the disposal of marketable securities (fiscal 2005 - \$16,552).

Related Party Transactions

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

- (a) Paid or accrued \$18,000 (fiscal 2005 - \$18,000) for rent to Rand Explorations Ltd., a private company controlled by Randy Turner, a director of the Company;
- (b) Paid or accrued \$24,856 (fiscal 2005 - \$25,668) for professional fees to Gowling LaFleur Henderson LLP and Vector Corporate Finance Lawyers, respectively. Louis Montpellier, who is the Company Secretary, is a partner in Gowling Lafleur Henderson. Graham Scott, a former officer of the Company, is a principal of Vector Corporate Finance Lawyers;
- (c) Paid or accrued \$9,574 (fiscal 2005 - \$Nil) for management fees to Adera Company Management Inc., a private company controlled by J. Christopher Mitchell, the Company's Chief Financial Officer; and
- (d) Paid or accrued \$95,463 (fiscal 2005 - \$91,816) for salary and benefits to Robert F. Weicker, the Company's current President and a director of the Company, and to Lindsay Bottomer, former President and a director of the Company.

Risk Factors

The prices of major mineral commodities such as copper, gold and silver may be affected by many factors beyond the control of the Company, and events which cannot be accurately predicted such as political and economic instability, terrorism, environmental factors, and changes in government regulations and taxes.

The recent rapid increase in the price of many commodities is severely taxing the ability of the industry to increase supply in the face of such strong demand. The boom follows a prolonged period of underinvestment in the minerals sector brought about by depressed metal prices. During the slump, few young people were attracted to the industry, and many experienced personnel left to pursue more lucrative careers elsewhere. As a result, there is a severe shortage of personnel with the requisite knowledge and skills to design and execute exploration programs. Companies are also encountering difficulties in arranging contracts for drilling and other exploration services.

The Company is dependent on equity market financings to fund its exploration programs and maintain its mining properties in good standing. In the past, the Company was successful in being able to raise the necessary funds, but there is no assurance that this will continue to be the case in the future.

Most of the Company's projects are located in the province of British Columbia. While the current government is supportive of the industry, there is no assurance that a future government will not change environmental regulations, taxes or mineral royalties in a manner that could have an adverse effect on the Company's financial condition and impair its ability to raise further funds for exploration.

Title to resource properties involves certain inherent risks and uncertainties due to the difficulties of determining the validity of certain claims as well as the potential for problems arising from the sometimes ambiguous conveyancing

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characteristic of many resource properties. The Company has investigated title to all of its resource properties and to the best of its knowledge title to all properties is in good standing, but there can be no assurance that unrecorded documents do not exist that could adversely affect the Company's title to one or more of its mineral properties.

Outstanding Share Data

On the Report Date, the Company had 18,725,091 common shares issued and outstanding, or 24,922,838 common shares on a fully diluted basis. On that date, there were 1,850,000 stock options outstanding under the Company's incentive stock option plan exercisable at an average price of \$0.60 per share and with expiry dates to January 13, 2011, and 4,347,747 warrants outstanding that expire on or prior to December 23, 2007, exercisable at an average price of \$0.57 per share. If all warrants and all incentive stock options outstanding were to be exercised, the Company would issue 6,197,747 common shares and would realize \$3,574,690.

Outlook

For the last several years, the Company has been focused on exploration for gold, silver, copper and molybdenum, principally in the Cordillera of British Columbia. With the completion of the recent private placement financing, Silver Quest intends to broaden its exploration endeavours both geographically, within North America, and by commodity, with an increased emphasis on silver properties.

On the Davidson Property, the drilling programs completed in the Fall of 2005 and early 2006 uncovered a significant new zone of gold mineralisation that requires additional follow-up drilling. The projected west-to-west-southwest extension of the gold mineralisation encountered in holes DAV-05-02 and DAV-06-06 has not been adequately tested, and additional drilling is required to determine the strike orientation of this zone of gold mineralisation.

On the 3Ts project, the Tommy Vein has an inferred resource of 552,500 tonnes grading 6.92 g/t gold and 60.9 g/t silver, at a 3.0 g/t gold cut-off, previously calculated in accordance with NI 43-101 guidelines. These resources are calculated only above the microdiorite sill. With several significant intercepts below the sill, there remains excellent potential to expand the resource. The Ted Vein has an inferred resource of 273,800 tonnes grading 2.00 g/t gold and 133.0 g/t silver above the sill at a 4.0 g/t gold equivalent cut-off, that had been previously calculated in accordance with NI 43-101 guidelines. Total combined inferred resources for the Tommy and Ted veins are 826,300 tonnes, grading 5.22 g/t gold and 84.8 g/t silver, for an in-situ content of 138,775 ounces of gold and 2,252,000 ounces of silver.

Subsequent Events

The Company issued 42,736 shares upon the exercise of warrants.