# Financial Statements

**To the Shareholders of**
**Azimut Exploration Inc.**

We have audited the balance sheets of Azimut Exploration Inc. (an exploration company) as at August 31, 2003 and 2002 and the statements of earnings, 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 financial statements present fairly, in all material respects, the financial position of the company as at August 31, 2003 and 2002 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

**Chartered Accountants**

Quebec, Quebec, Canada
November 10, 2003,
except for note 14 dated November 24, 2003

# Balance Sheets

**As at August 31, 2003 and 2002**



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

| | 2003<br>$ | 2002<br>$ |
|---|---|---|
| ***Assets*** | | |
| ***Current assets*** | | |
| Cash | 45,782 | 73,117 |
| Amounts receivable (note 3) | 29,666 | 26,027 |
| Prepaid expenses | 13,865 | 1,290 |
| | 89,313 | 100,434 |
| ***Exploration funds*** (note 2) | 23,534 | - |
| ***Long-term investment*** (note 4) | 24,000 | 18,000 |
| ***Property, plant and equipment*** (note 5) | 716 | 1,672 |
| ***Mining properties*** (note 6) | - | 572,038 |
| | 137,563 | 692,144 |
| ***Liabilities*** | | |
| ***Current liabilities*** | | |
| Accounts payable and accrued liabilities | | |
| Related companies (note 10) | 402 | 10,770 |
| Other | 30,679 | 9,831 |
| | 31,081 | 20,601 |
| ***Shareholders' Equity*** | | |
| ***Convertible debentures*** (note 7) | 350,000 | 350,000 |
| ***Share capital*** (notes 8 and 9) | 3,887,960 | 3,744,514 |
| ***Stock options*** (note 9) | 24,695 | - |
| ***Deficit*** | (4,156,173) | (3,422,971) |
| | 106,482 | 671,543 |
| | 137,563 | 692,144 |

***Nature of activities*** (note 1)

***Subsequent events*** (note 14)

***Approved by the Board of Directors***

_______________ Director    Jacques Bonneau _______________ Director

# Statements of Deficit

**For the years ended August 31, 2003 and 2002**



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

| | 2003<br>$ | 2002<br>$ |
|---|---|---|
| *Balance – Beginning of year* | 3,422,971 | 3,390,219 |
| Interest on convertible debentures (notes 7 and 8) | 39,988 | 49,000 |
| Net loss (earnings) for the year | 693,214 | (16,248) |
| *Balance – End of year* | 4,156,173 | 3,422,971 |

# Statements of Earnings

**For the years ended August 31, 2003 and 2002**

| | 2003<br>$ | 2002<br>$ |
|---|---|---|
| *Revenues* | | |
| Interest income | 1,636 | 1,254 |
| Rental income | - | 4,950 |
| Gain on sale of mining properties | 16,000 | 32,150 |
| | 17,636 | 38,354 |
| *Expenses* | | |
| Salaries and fringe benefits | 15,258 | 60 |
| Professional and maintenance fees | 55,152 | 71,128 |
| Management fees and office expenses | 40,608 | 34,027 |
| Travelling and entertainment | 2,371 | 1,231 |
| Interest and bank charges | 191 | 251 |
| Depreciation of property, plant and equipment | 250 | 691 |
| Search for properties | 23,793 | - |
| Loss on abandonment of mining properties | 563,696 | - |
| Loss on sale of marketable securities | - | 144 |
| Writedown of long-term investment | 10,000 | - |
| Loss (gain) on disposal of property, plant and equipment | (469) | 783 |
| Grants | - | (86,209) |
| | 710,850 | 22,106 |
| *Earnings (loss) before income taxes* | (693,214) | 16,248 |
| *Income tax expense* | | |
| Current income taxes | - | 5,700 |
| Income tax recovery as a result of a loss carry-over | - | (5,700) |
| | - | - |
| *Net earnings (loss) for the year* | (693,214) | 16,248 |
| *Basic and diluted net loss per share* (note 12) | (0.082) | (0.004) |

# Statements of Cash Flows

**For the years ended August 31, 2003 and 2002**



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

| | 2003 | 2002 |
|---|---|---|
| | $ | $ |
| ***Cash flows from operating activities*** | | |
| Net earnings (loss) for the year | (693,214) | 16,248 |
| Items not affecting cash | | |
| Depreciation of property, plant and equipment | 250 | 691 |
| Loss on sale of marketable securities | - | 144 |
| Loss (gain) on disposal of property, plant and equipment | (469) | 783 |
| Gain on sale of mining properties | (16,000) | (32,150) |
| Loss on abandonment of mining properties | 563,696 | - |
| Writedown of long-term investment | 10,000 | - |
| Stock options | 24,695 | - |
| | (111,042) | (14,284) |
| Change in non-cash working capital items | | |
| Amounts receivable | 6,168 | 4,891 |
| Prepaid expenses | (12,575) | 221 |
| Accounts payable and accrued liabilities | 10,480 | 2,381 |
| | 4,073 | 7,493 |
| | (106,969) | (6,791) |
| ***Cash flows from financing activities*** | | |
| Variation in exploration funds | (23,534) | - |
| Increase in share capital | 103,458 | - |
| | 79,924 | - |
| ***Cash flows from investing activities*** | | |
| Proceeds from sale of property, plant and equipment | 1,175 | 845 |
| Increase in mining properties | (1,465) | (296,132) |
| Proceeds from sale of mining properties | - | 50,000 |
| Grant cashed | - | 231,200 |
| Proceeds from sale of marketable securities | - | 386 |
| | (290) | (13,701) |
| ***Decrease in cash*** | (27,335) | (20,492) |
| ***Cash – Beginning of year*** | 73,117 | 93,609 |
| ***Cash – End of year*** | 45,782 | 73,117 |
| ***Additional information*** | | |
| Tax credits receivable applied against mining properties (note 3) | (9,807) | (24,345) |
| Shares issued and to be issued in consideration of the payment of interest on convertible debentures | 39,988 | 49,000 |
| Shares received in consideration of the sale of a mining property | 16,000 | 18,000 |

# Notes to Financial Statements

**August 31, 2003 and 2002**

## 1 Incorporation, nature of activities and going concern concept

The company, incorporated under Part 1A of the Québec Companies Act, is in the business of acquiring and exploring mining properties.

The company will periodically have to raise additional funds to continue its operations, and while it has been successful in doing so in the past, there can be no assurance it will be able to do so in the future. Without new funding being available, the company may be unable to continue its operations, and amounts realized for assets may be less than amounts reflected in these financial statements.

## 2 Summary of significant accounting policies

***Use of estimates***

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates that affect the amounts of assets and liabilities reported in the financial statements. Those estimates also affect the disclosure of contingencies at the date of the financial statements and the reported amounts of revenues and expenses during the years. Significant estimates include the carrying value of mining properties and certain accrued liabilities. Actual results could differ from those estimates.

***Exploration funds***

Exploration funds, which consist of cash, represent the unexpended proceeds of financing under the terms of which the company committed to spending the amounts on the exploration or acquisition of mining properties.

***Long-term investment***

The long-term investment is recorded at cost, less any permanent impairment in value.

***Property, plant and equipment and depreciation***

Property, plant and equipment are recorded at cost less accumulated depreciation and are depreciated using the declining balance method at the rates mentioned in note 5.

***Mining properties***

The company records its interests in mining properties and areas of geological interest at cost less option payments and other recoveries. Exploration and development costs relating to these interests and projects are capitalized on the basis of specific claim blocks or areas of geological interest until the properties to which they relate are placed into production, sold or allowed to lapse. Management reviews the carrying values of mining properties on a regular basis to determine whether any writedowns are necessary. These costs will be amortized over the estimated useful life of mining properties following commencement of production or written off if the mining properties or projects are sold or allowed to lapse. General exploration expenditures not related to specific mining properties are expensed as incurred.

***Mining rights tax credit and tax credit for mining exploration companies***

The company is entitled to a refundable mining rights tax credit on mining exploration expenses incurred in Quebec. This credit is applied against the costs incurred (note 6).

Furthermore, the company is entitled to the refundable tax credit for mining exploration companies on qualified expenditures incurred after March 29, 2001. The refundable tax credit may equal 45% of qualified expenditures incurred before June 12, 2003 and 33.75% for qualified expenditures incurred after that date. This tax credit has been applied against the costs incurred.

*Share capital*

Share capital issued for non-monetary consideration is generally recorded at the quoted market price of the shares over a reasonable period of time before and after the date the agreement to issue the shares was announced.

Flow-through shares are issued in consideration of the proceeds received, which represents their fair value. Upon the acquisition of mining properties, the carrying value may exceed the tax basis since the company renounces the deductions in favour of the investors concerned. The company also issues flow-through shares without any premium or discount regarding the renunciation of the tax benefits in favour of investors.

Share issue expenses are recorded as a reduction of share capital.

*Government grants*

Government grants are recorded as revenues when the company has reasonable assurance that it has complied and will continue to comply with all the conditions related to the grant. Grants related to working capital are included in earnings when the related expenses are incurred. Grants related to mining properties are deducted from the related mining properties.

During fiscal 2002, the company received a grant from the ministère des Ressources naturelles in the amount of $86,209 for its working capital and a grant of $230,000 regarding exploration costs incurred.

*Income taxes*

The company provides for income taxes using the liability method of tax allocation. Under this method, future income tax assets and liabilities are determined based on deductible or taxable temporary differences between financial statement values and tax values of assets and liabilities using enacted or substantially enacted income tax rates expected to be in effect for the year in which the differences are expected to reverse.

The company establishes a valuation allowance against future income tax assets if, based on available information, it is more likely than not that some or all of the future income tax assets will not be realized.

*Earnings per share*

Basic earnings per share are determined using the weighted average number of participating shares outstanding during the year.

Diluted earnings per share are determined using the weighted average number of participating shares outstanding during the year, plus the effects of dilutive potential participating shares outstanding during the year. The calculation of diluted earnings per share must be made using the treasury stock method, as if all dilutive potential participating shares had been exercised at the later of the beginning of the year or the date of issuance, as the case may be, and that the funds obtained thereby be used to purchase participating shares of the company at the average market value of the participating shares during the year.

*Stock-based compensation plan and new accounting policy*

The company maintains a stock-based compensation plan, which is described in note 9. Effective September 1, 2002, the company adopted the new recommendations of the Canadian Institute of Chartered Accountants relating to accounting for stock-based compensation and other stock-based payments. It has elected not to use the fair value method to account for options granted to employees. Accordingly, compensation expense is recorded for the excess, if any, of the fair value of the shares at the date of grant over the exercise price of the options. The company makes pro-forma disclosures of earnings and earnings per share as if the fair value based method of accounting had been applied (note 9). All options and similar instruments granted to non-employees are accounted for at fair value.

## 3 Amounts receivable

| | 2003 $ | 2002 $ |
|---|---|---|
| Tax credit receivable for mining exploration companies | 23,703 | 24,465 |
| Commodity taxes | 5,843 | 1,490 |
| Other | 120 | 72 |
| | 29,666 | 26,027 |

## 4 Long-term investment

| | Interest % | 2003 $ | 2002 $ |
|---|---|---|---|
| Leceister Diamond Mines Ltd., a public mining exploration company, at cost less any permanent impairment in value (quoted market value : $24,000; $8,000 in 2002) | 2.4 (0.8 in 2002) | 24,000 | 18,000 |

## 5 Property, plant and equipment

| | | | | 2003 | 2002 |
|---|---|---|---|---|---|
| | Depreciation rate % | Cost $ | Accumulated depreciation $ | Net $ | Net $ |
| Office furniture | 20 | 2,149 | 1,587 | 562 | 1,479 |
| Office equipment | 20 | 625 | 471 | 154 | 193 |
| | | 2,774 | 2,058 | 716 | 1,672 |

## 6 Mining properties

| | Undivided interest % | Balance as at August 31, 2002 $ | Costs incurred $ | Tax credits, grants and mining properties abandoned $ | Balance as at August 31, 2003 $ |
|---|---|---|---|---|---|
| Flavrian (263 claims) | - | | | | |
| Mining property | | 44,465 | 1,465 | (45,930) | - |
| Exploration costs | | 527,573 | - | (527,573) | - |
| | | 572,038 | 1,465 | (573,503) | - |

| | Undivided interest % | Balance as at August 31, 2001 $ | Costs incurred $ | Tax credits, grants and mining properties sold $ | Balance as at August 31, 2002 $ |
|---|---|---|---|---|---|
| Flavrian (263 claims) | - | | | | |
| Mining property | | 44,012 | 453 | - | 44,465 |
| Exploration costs | | 486,239 | 295,679 | (254,345) | 527,573 |
| | | 530,251 | 296,132 | (254,345) | 572,038 |
| Wemindji (321 claims) | - | | | | |
| Mining property | | 35,850 | - | (35,850) | - |
| Exploration costs | | - | - | - | - |
| | | 35,850 | - | (35,850) | - |
| | | 566,101 | 296,132 | (290,195) | 572,038 |

## 7 Convertible debentures

| | 2003 $ | 2002 $ |
|---|---|---|
| Debentures convertible at the company's option into common shares | | |
| At a conversion price of $0.15 per share, 14%, interest payable by half-yearly instalments through common shares of the company, at the base rate on the date of payment, non-interest bearing if the share is traded at $0.36 and over during the twenty business days preceding the dates of interest instalments, maturing in March 2005 | 100,000 | 100,000 |
| At a conversion price of $0.425 per share, 12%, interest payable by half-yearly instalments through common shares of the company, at the base rate on the date of payment, non-interest bearing if the share is traded at $0.15 and over during the twenty business days preceding the dates of interest instalments for the first two six-month periods ending November 29, 2003 and May 29, 2004 respectively, and at $0.20 for each of the following six-month periods, maturing in May 2006; this debenture replaces the one that matured during the year | 250,000 | - |
| At a conversion price of $0.40 per share, 14%, matured during the year and replaced by a new debenture of the same amount | - | 250,000 |
| | 350,000 | 350,000 |

Debentures have been classified as components of shareholders' equity. They are indeed considered as being part of the invested capital due to the nature of conversion characteristics and the intention and right of the company to pay these debentures through the issuance of common shares.

## 8 Share capital

Authorized
Unlimited number of common shares, without par value, voting and participating

| | 2003 $ | 2002 $ |
|---|---|---|
| Issued and fully paid | | |
| 9,961,522 common shares (8,611,729 in 2002) * | 3,885,580 | 3,726,180 |
| To be issued | | |
| 15,854 common shares (79,266 in 2002) in payment of interest on convertible debentures (note 7) | 2,380 | 18,334 |
| | 3,887,960 | 3,744,514 |

* 482,685 shares are held in escrow and cannot be released without the consent of regulatory authorities.

a) The following table summarizes the share capital activity since September 1, 2001:

| | 2003 | | 2002 | |
|---|---|---|---|---|
| | *Number* | *Stated value $* | *Number* | *Stated value $* |
| Balance – Beginning of year | 8,611,729 | 3,726,180 | 8,430,896 | 3,677,180 |
| Shares issued during the year | 1,143,781 | 114,378 | - | - |
| Share issue expenses for the year | - | (10,920) | - | - |
| Payment of interest on convertible debentures | 206,012 | 55,942 | 180,833 | 49,000 |
| Balance – End of year | 9,961,522 | 3,885,580 | 8,611,729 | 3,726,180 |

b) The following table presents the warrant activity since September 1, 2001 and summarizes information about warrants outstanding as at August 31:

| | 2003 | | 2002 | |
|---|---|---|---|---|
| | *Number* | *Weighted average exercise price $* | *Number* | *Weighted average exercise price $* |
| Outstanding – Beginning of year | - | - | 277,778 | 0.27 |
| Matured or cancelled | - | - | (277,778) | (0.27) |
| Outstanding – End of year | - | - | - | - |

## 9 Stock option plan

The company established a stock option plan under which certain managers, directors, key employees and suppliers may be granted stock options for shares of the company. A maximum of 1,421,685 stock options may be granted (maximum of 5% of the number of common shares outstanding in favour of one person).

Options granted expire after a maximum period of ten years following the granting date. There is no vesting period, except for 280,000 options granted to a director during fiscal years ended August 31, 1996, 1998 and 2000. In June 2003, following this director's separation and his acceptance of an executive counsellor position, the company modified the terms of the initial agreement for the granting of options. Consequently, the options have not been cancelled at the end of the 90-day period ended after the date of separation from service as a director and moreover, out of the 280,000 options that were fully exercisable, 25% become exercisable immediately and the balance will be exercisable at the rate of 25% per annum from June 18, 2004. In June 2003, a second director also gave up to render services as a director and has become an executive counsellor. An amount of $16,415 representing the fair value of these stock options has been included in the statement of earnings under the item "Professional and maintenance fees" and in Shareholders' Equity under the item "Stock options".

The following tables present the stock option activity since September 1, 2001 and summarize information about fixed stock options outstanding and exercisable as at August 31:

| | *2003* | | *2002* | |
|---|---|---|---|---|
| | *Number* | *Weighted average exercise price $* | *Number* | *Weighted average exercise price $* |
| Outstanding – Beginning of year | 725,000 | 0.16 | 795,000 | 0.16 |
| Granted | 120,000 | 0.24 | - | - |
| Matured or cancelled | (50,000) | 0.16 | (70,000) | 0.16 |
| Outstanding – End of year | 795,000 | 0.18 | 725,000 | 0.16 |
| Exercisable – End of year | 585,000 | 0.19 | 725,000 | 0.16 |

| | *Options outstanding* | | *Options currently exercisable* |
|---|---|---|---|
| *Exercise prices* | *Number* | *Weighted average remaining contractual life* | *Number* |
| $0.16 | 500,000 | 3.11 | 290,000 |
| $0.18 | 175,000 | 6.41 | 175,000 |
| $0.24 | 120,000 | 4.81 | 120,000 |
| | 795,000 | 4.09 | 585,000 |

***Accounting for the stock-based compensation plan***

The company has elected not to use the fair value-based method to measure the compensation cost related to grants of stock options. In this instance, however, under Section 3870, Stock-Based Compensation and Other Stock-Based Payments, the company is required to make pro-forma disclosures of earnings and basic and diluted earnings per share as if the fair value based method of accounting had been applied.

The fair value of options granted was estimated using the Black-Scholes option pricing model with the following weighted average assumptions:

| *Year ended August 31, 2003* | *Options granted to suppliers* | *Options granted to a manager and a director* |
|---|---|---|
| Risk-free interest rate | 2.90% | 3.37% |
| Expected volatility | 110% | 110% |
| Dividend yield | Nil | Nil |
| Weighted average expected life | 24 months | 36 months |
| Weighted average fair value of options granted | $0.138 | $0.162 |

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions, and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the stock options granted to managers, directors and key employees have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of stock options granted to managers, directors and key employees.

The company recognizes, as a compensation cost arising from awards to officers, directors and key employees the excess, if any, of the fair value of the shares at the date of grant over the exercise price of the options. The fair value of stock options granted during the year amounts to $18,000. Out of this sum, an amount of $8,280, (nil in 2002), representing the fair value of options granted to suppliers, has been included in the statement of earnings under the items "Search for properties" and "Management fees and office expenses" and in Shareholders' Equity under the item "Stock options", and an amount of $9,720 (nil in 2002), representing the fair value of options granted to a manager and a director, has not been recognized in the financial statements for the year ended August 31, 2003. If the fair value based method had been used to account for stock-based compensation costs related to stock options granted to a manager and a director, the net loss and related net loss per share would be as follows:

| | *Years Ended August 31,* | |
|---|---|---|
| | ***2003*** *$* | ***2002*** *$* |
| Pro-forma net earnings (loss) for the year | (702,934) | 16,248 |
| Interest on debentures | (39,988) | (49,000) |
| Loss used in the pro-forma net basic and diluted loss per share calculation | (742,922) | (32,752) |
| Pro-forma net basic and diluted loss per share | (0.083) | (0.004) |

## 10 Related party transactions

The company entered into the following transactions mainly with a director and a company owned by a director:

| | 2003<br>$ | 2002<br>$ |
|---|---|---|
| Management fees | 7,500 | 10,000 |
| Office expenses | 4,765 | 3,344 |

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

## 11 Income taxes

The company has the following tax benefits, which have not been recorded in the financial statements as at August 31, 2003:

- The company has accumulated non-capital losses which can be carried forward against future years' taxable income and which will expire as follows:

| | $ |
|---|---|
| 2004 | 223,000 |
| 2005 | 202,000 |
| 2006 | 247,000 |
| 2007 | 199,000 |
| 2008 | 6,000 |
| 2009 | 92,000 |
| 2010 | 142,000 |
| | 1,111,000 |

- The company has also accumulated capital losses of approximately $17,000 ($17,000 in 2002).
- In 2003, the tax value of mining properties exceeds the carrying value by approximately $759,000 ($114,000 in 2002). The difference between the tax value and the amounts capitalized in the financial statements mainly results from writeoffs of mining properties.
- The unamortized balance, for income tax purposes, of share issue expenses amounts to $13,625 ($24,000 in 2002) and will be deductible during the next four years.

## 12 Earnings per share

The following table summarizes the basic and diluted loss per share calculation:

| | *Years Ended August 30,* | |
|---|---|---|
| | ***2003*** *$* | ***2002*** *$* |
| Net earnings (loss) for the year | (693,214) | 16,248 |
| Interest on debentures | (39,988) | (49,000) |
| Loss used in the basic and diluted net loss per share calculation | (733,202) | (32,752) |
| Basic and diluted weighted average number of shares outstanding | 8,925,857 | 8,543,436 |
| Basic and diluted net loss per share | (0.082) | (0.004) |

For the years ended August 30, 2003 and 2002, the diluted weighted average number of shares outstanding was the same as the basic weighted average number of shares outstanding since the effect of stock options and convertible debentures would have been anti-dilutive. Accordingly, the diluted net loss per share for those years was calculated using the basic weighted average number of shares outstanding.

## 13 Financial instruments

***Fair value***

Cash, amounts receivable, exploration funds and accounts payable and accrued liabilities are financial instruments whose fair value approximates their carrying value due to their short-term maturity or to current market rates. The fair value of convertible debentures has not been determined due to the related specific conditions.

***Interest rate risk***

As at August 31, 2003, the company's exposure to interest rate risk is summarized as follows:

| | |
|---|---|
| Cash | 2.25% |
| Amounts receivable | Non-interest bearing |
| Exploration funds | 2.25% |
| Accounts payable and accrued liabilities | Non-interest bearing |
| Convertible debentures | As described in note 7 |

## 14 Subsequent events

On November 12, 2003, the company announced the closing of a $450,000 financing, for one part with SIDEX through a private placement amounting to $250,000 and, for the other part, with the Fonds de Solidarité FTQ through a convertible debenture of $200,000.

On November 24, 2003, the company announced the staking of seven projects totalling 375 mining claims that cover an area of 188 km$^2$ in Quebec. The company is waiting for confirmation of the staked claims by the Ministère des Ressources naturelles, de la Faune et des Parcs.