



## **MANAGEMENT DISCUSSION AND ANALYSIS for the three months period ended July 31, 2009**

### **Date of Report**

The following Management Discussion and Analysis (“MD&A”) for Silvermex Resources Ltd. (“Silvermex” or the Company) is prepared as of September 18, 2009, and should be read in conjunction with the interim Consolidated Financial Statements (“Financial Statements”) for the three month period ended July 31, 2009 and the audited financial statements and related notes for the years ended April 30, 2009 and 2008. The Company’s AIF and the risks and uncertainties discussed therein, and the Company’s MD&A for prior periods, are on SEDAR at [www.sedar.com](http://www.sedar.com) and on the Company’s website at [www.silvermexresources.com](http://www.silvermexresources.com).

### **Forward-Looking Statements**

This MD&A contains certain statements that may be deemed “forward-looking statements”. All statements in this MD&A, other than statements of historical fact, that address exploration drilling, exploitation activities and events or developments that the Company expects to occur, are forward looking statements. Forward looking statements are statements that are not historical facts and are generally, but not always, identified by the words “expects”, “plans”, “anticipates”, “believes”, “intends”, “estimates”, “projects”, “potential” and similar expressions, or that events or conditions “will”, “would”, “may”, “could” or “should” occur. Information inferred from the interpretation of drilling results and information concerning mineral resource estimates may also be deemed to be forward looking statements, as it constitutes a prediction of what might be found to be present when and if a project is actually developed. Although the Company believes the expectations expressed in such forward-looking statements are based on reasonable assumptions, such statements are not guarantees of future performance and actual results may differ materially from those in the forward-looking statements. Factors that could cause the actual results to differ materially from those in forward-looking statements include market prices, exploitation and exploration successes, and continued availability of capital and financing, and general economic, market or business conditions. Investors are cautioned that any such statements are not guarantees of future performance and actual results or developments may differ materially from those projected in the forward-looking statements. Forward looking statements are based on the beliefs, estimates and opinions of the Company’s management on the date the statements are made. The Company undertakes no obligation to update these forward-looking statements in the event that management’s beliefs, estimates or opinions, or other factors, should change.

### **Qualified Person**

Pursuant to National Instrument 43-101, Lawrence A. Dick, Phd, P.Geo is the Qualified Person (“QP”) responsible for the technical disclosure in this MD&A.

### **Overall Performance**

The Company is a junior resource company engaged in the acquisition, exploration and development of silver properties in Mexico. To date the Company has measured its success through the growth of its mineral resources, in particular silver resources, at reasonable discovery and/or acquisition cost. The Company has its corporate office in Vancouver and its administrative office in Hermosillo, Sonora, Mexico. The Company also has a field

office near Estacion Llano, Sonora. The Company currently has no revenue from operations and will continue to incur negative cash flow for the foreseeable future. The Company currently has three material properties for purposes of National Instrument 43-101, the Peñasco Quemado Property located in Sonora, the La Frazada property located in Nayarit, and the San Marcial Property located in Sinaloa. These properties have mineral resources as defined by current Canadian Institute of Mining, Metallurgy and Petroleum (CIM) definitions. These projects are discussed in Mineral Properties.

The capital market volatility that is still being experienced worldwide has had a significant impact on the Company's operations. Effects that have been encountered include, but are not limited to, volatility in silver and other commodity prices, volatility in foreign exchange rates, a reduction in the Company's share price, an increase in the cost of capital, and significantly depressed equity and credit markets especially for junior issuers, such as the Company.

Management is concerned with the Company's ability to continue as a going concern should additional short term funding not be secured. However, the Company has previously been successful in funding ongoing exploration programs and operations through equity financings. If the circumstances discussed above continue, it is possible that the Company will not be able to secure financing to complete its planned programs or fund general and administrative expenses. If financing is not completed as required in the near term, management will have to reassess the Company's ability to continue as a going concern. On August 13, 2009, the Company announced a short term interim financing of \$765,000. These funds are to be used for general working capital. This financing closed on September 11, 2009. The Company plans to complete a further private placement in the autumn of 2009.

The Company has had little exploration activity on its properties in recent quarters as it did not have the funds available. The Company does not foresee making any substantial expenditure on its properties in the very near term until the second round of financing has been completed. A substantial portion of the most recent round of financing has been allocated to meeting the Company's obligations on the Rosario project.

During the previous year the Company announced that it had finalized its formal agreement with Silver Standard Resources Inc. ("Silver Standard") for the acquisition of the San Marcial project. Under the terms of the formal agreement with Silver Standard, Silvermex can acquire a 100 percent interest by issuing three million common shares in three stages by February 1, 2011, at a deemed share value of 75 cents per share for the first one million shares and based on the market price of the shares of Silvermex at the time of each subsequent issuance. This has resulted in the shares previously issued to Silver Standard being returned to treasury during the current quarter. The first 1,000,000 shares, under the formal agreement, were issued to Silver Standard during the current quarter. The cancellation and reissue of the shares has resulted in a reduction of the carrying value of the San Marcial project of \$530,000. Silvermex must also pay US\$15-million (less the deemed value of the three million common shares issued) in either cash or shares at the election of Silver Standard, by February 1, 2012. The Company must also expend US\$1,000,000 on exploration by February 1, 2011. The Company is also obligated to pay Silver Standard US\$100,000 per month commencing after commercial production has begun. These payments will be credited against the purchase price. There is also a 3% net smelter return on the property.

On August 13, 2009, the Company announced that it had arranged a non-brokered private placement to raise gross proceeds of up to \$765,000. The private placement closed on September 11, 2009, and consists of 4,554,000 units at a price of \$0.17 per unit. Each unit consists of one common share and one non-transferable share purchase warrant. Each whole warrant entitles the holder to purchase one additional common share of the Company at a price of \$0.20 until September 11, 2010. Finders' fees of \$17,666 are payable. The proceeds of the private placement are being used for general working capital purposes. A holder of a promissory note elected to convert \$102,000 of the amount outstanding into 600,000 shares in the private placement.

On August 14, 2009, the Company entered into a revised and restated letter of intent (“LOI”) with Aurcana Corp. (“Aurcana”) to acquire a 100% interest in the Rosario Property through the acquisition of all of the issued and outstanding shares of Aurcana de Mexico SA de CV (“Aurcana Mexico”) on or before September 30, 2009. Under this LOI, the Company will pay Aurcana an aggregate of US\$3,750,000 and issue 2,250,000 shares over three years as follows:

- 250,000 shares on Exchange acceptance;
- 1,000,000 shares upon execution of the purchase and sale agreement (“Agreement”); and,
- 1,000,000 shares upon the earlier of 24 months from the execution of the Agreement and the commencement of commercial production.

The shares will be held in escrow and released at a rate of 25% every three months commencing three months from issuance.

The Company will also make the following payments:

- US\$350,000 plus IVA and interest on August 14, 2009 to Industrial Minera Mexico, S.A. de C.V. (“IMM”);
- \$250,000 to Aurcana by November 15, 2009;
- US\$650,000 plus IVA and interest on February 7, 2010;
- US\$500,000 to Aurcana upon the earlier of 30 months of execution of the Agreement or six months after the commencement of commercial production;
- a further US\$500,000 within the following six months;
- US\$500,000 to Aurcana or 500,000 shares at the option of Aurcana, within 18 months following the commencement of commercial production;
- US\$500,000 to Aurcana or 500,000 shares at the option of Aurcana, within 24 months following the commencement of commercial production; and,
- US\$500,000 to Aurcana within 30 months following commencement of commercial production, or 500,000 shares at the option of Aurcana.

Exchange approval of the agreement has been received, however, the agreement is subject to IMM’s consent to change the ownership of the shares of Aurcana Mexico, as well as the completion of satisfactory due diligence by the Company. Due diligence has been completed but a definitive agreement has not been concluded. The Company will need to raise additional funds to meet the obligations as set out in the letter of intent. The next payment is due to be made by November 15, 2009.

The Company has paid US\$366,893 to Aurcana/Aurcana Mexico.

### **Selected Annual Information**

The following is a summary of the Company's financial results for the Company's three most recently completed financial years:

	<b>2009</b>	<b>2008</b>	<b>2007</b>
Total revenues	\$13,404	\$11,465	\$11,184
Net loss	(\$3,289,213)	(\$2,364,336)	(\$1,114,629)
Basic and diluted loss per share	(\$0.10)	(\$0.10)	(\$0.06)
Total assets	\$6,743,681	\$8,150,588	\$3,681,684
Total long term liabilities	Nil	Nil	Nil
Dividends declared	Nil	Nil	Nil

The Financial Statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") as described in Note 2 to the audited Annual Consolidated Financial Statements for the year ended April 30, 2009, as modified by the changes disclosed in Note 2 to the Financial Statements. Except as noted, all dollar amounts contained in this discussion and analysis and in the Financial Statements are in Canadian dollars.

The total revenue figure is interest received and is a direct reflection of the amount of cash the Company had available in the bank throughout the year. This figure is consistent from year-to-year. The increase in net loss from 2007 to 2008 shows the increase in expenditure as the Company moved toward being an operating entity, as opposed to being merely a newly-listed entity. The net loss in 2009 was higher than in 2008 because the Company decided to write-off two resource mineral properties in 2009.

The increase in total assets from 2007 to 2008 reflects the acquisition, or acquisition related payments, of the various projects and, in particular, San Marcial, as well as extensive exploration programs performed on the Peñasco Quemado and Cerro de Plata projects. In contrast, the only extensive exploration program undertaken in 2009 was on the San Marcial project. New projects were acquired in 2009. (The La Frazada project was staked.) The increase in the resource property asset is not entirely evident as the Company wrote-off the Cerro de Plata and El Rayo properties.

### **Mineral Properties**

It is management's opinion that its resource properties are not impaired because:

- exploration work has been conducted on each of its properties in the last three years;
- the Company has written off those properties which have yielded unsatisfactory results and/or on which the Company does not plan to perform any exploration work in the foreseeable future;
- the Company plans to make its option payments and complete its work commitments on its remaining properties; and
- the Company plans to conduct exploration activities on its properties within the next year.

### **Peñasco Quemado Property**

No exploration work was conducted on this property during the quarter, and none is planned for this property in the foreseeable future as the Company does not have the funds available.

### **San Marcial Property**

The Company did not conduct any exploration work on this property in the current quarter due to lack of funds. Continuation of the preliminary economic assessment studies on this project has been delayed, as has reconstruction of, and improvements, to the access roads. The results of the metallurgical test program that were expected in mid May are not yet available. Subject to the availability of funds, the Company is contemplating a program costing US\$1,060,000 which includes in-fill core drilling and a scoping study.

### **La Frazada Property**

Minimal work was performed on this property in the current quarter and consequently the anticipated results of the metallurgical test program are not yet available. The Company had also planned to take additional representative bulk samples and ship the resulting material to an independent metallurgical laboratory. The results of these tests were to be used to determine flow process, plant design and equipment selection as part of a pre-feasibility program. As the samples have not been taken, this work will not be completed late in the third quarter of 2009 as originally expected. Subject to the availability of funds the Company is contemplating a program costing US\$1,227,000 should the necessary funds become available. This program will include core drilling, ramps and tunnelling, and a scoping study.

### **Lobos Property**

No exploration work was conducted on this property in the quarter, and little work is planned for this property in the foreseeable future as the Company does not have the funds available.

### **Lety Property**

No exploration work was conducted on this property in the quarter, and none is planned for this property in the foreseeable future as the Company does not have the funds available.

### **Rosario Property**

On August 14, 2009, the Company signed a revised and restated letter of intent with Aurcana to acquire a 100% interest in the silver - gold - lead - zinc Rosario Property located Sinaloa State, Mexico. This property consists of 18 concessions totalling approximately 8,515 hectares and is located approximately 94 kilometres southeast of Mazatlan. It is located within two kilometres of the San Marcial property.

The acquisition will include all facilities and infrastructure, including surface rights, underground workings, tailings dam, water, power, offices, shops, 60 man camp, warehouses and assay lab. The previous operator completed partial renovations to the mine and mill site including; upgrading of electrical substations and wiring, camp accommodations upgrades, mine dewatering and detailed engineering of an 800 tonne per day (t/d) mill. The acquisition also includes an extensive list of mill equipment and vehicles, including: a 9 by 12 ball mill, an 8 by 10 ball mill, numerous feeders and tanks, electrical equipment, loader/backhoe, trucks, pumps, compressors, etc.

The land directly surrounding the Rosario mill site (330 ha) is owned in fee simple and key exploration and mining areas are under a current surface rights agreement which remains in good standing for 20 years. The

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**Containing information as at September 18, 2009**

Company is working on a preliminary pre-feasibility study which will determine mine and production plans based on combining the Rosario and San Marcial projects.

**Comparison of Actual and Proposed Use of Proceeds from the September 11, 2009 Private Placement**

The table below details as at September 18, 2009, the proposed versus actual use of proceeds of this private placement:

	<b>Proposed Use of Proceeds</b>	<b>Actual Use of Proceeds</b>
Gross Proceeds of Private Placement	\$765,000	\$774,180
Cost of Private Placement (1)		17,666
Net Proceeds of Private Placement	<u>\$765,000</u>	<u>\$756,514</u>
General working capital purposes	\$765,000	133,384
Payments to Aurcana and IMM (Rosario Project)		385,300
Conversion of promissory note		102,000
Unallocated		135,830
	<u>\$765,000</u>	<u>\$756,514</u>

(1) The news release states that finders' fees are payable in accordance with Exchange policies.

**Summary of Quarterly Results**

The following is a summary of the Company's financial results for the eight most recently completed quarters.

	<b>Q1 July 31, 2009</b>	<b>Q4 April 30, 2009</b>	<b>Q3 January 31, 2009</b>	<b>Q2 October 31, 2008</b>	<b>Q1 July 31, 2008</b>	<b>Q4 April 30, 2008</b>	<b>Q3 January 31, 2008</b>	<b>Q2 October 31, 2007</b>
Total revenues	\$Nil	Nil	\$337	\$1,030	\$12,037	\$2,912	\$3,035	\$832
Net loss	(\$445,738)	(\$1,830,681)	(\$399,280)	(\$480,825)	(\$578,427)	(\$661,604)	(\$617,281)	(\$621,843)
Basic loss per share (1)	(\$0.01)	(\$0.05)	(\$0.01)	(\$0.02)	(\$0.02)	(\$0.02)	(\$0.02)	(\$0.03)

(1) Loss per share on a diluted basis is not disclosed as it is anti-dilutive due to losses incurred.

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The Company's cash expenditures are fairly consistent from quarter to quarter. In general terms, much of the fluctuations seen from quarter to quarter as seen above, are caused by variations in non-cash items, such as stock-

based compensation charges. The above average loss in the first quarter of 2008 was primarily as a result of a bonus paid to a director and officer of the Company in terms of his employment agreement. And, the above average loss in the third quarter of 2008 was partially as a result of a restatement of the foreign exchange loss. The large loss incurred in the fourth quarter of 2009 was caused by writing off \$1,535,434 in mineral properties. These properties were not priorities for the Company and the results of drilling were unimpressive.

## **Results of Operations**

During the three months period ended July 31, 2009, the Company reported a net loss of \$445,738 (\$0.01 per share) compared to a net loss of \$578,427 (\$0.02 per share) for the three months ended July 31, 2008.

The major differences in expenditures for the three months ended July 31, 2009, compared to July 31, 2008, were:

- a. Consulting fees of \$102,867 (2008: \$37,486) increased primarily due to an increase in market activities such as the proposed acquisition of the Rosario property, the promissory notes written, and the private placement, and contracting out of marketing and promotional consultants.
- b. Accounting and audit increased to \$38,281 (2008: \$16,000) as the figure for the current quarter includes \$16,000 relating to audit fees for the audit of the prior year.
- c. Bank charges and interest increased to \$20,251 (2008: \$939) as the 20% bonus (\$20,000) on the two promissory note was recorded in the current quarter.
- d. Stock-based compensation decreased to \$2,024 (2008: \$117,522) as a result of no options being granted during the period.
- e. Salaries and wages expense totaled \$71,984 (2008: \$286,198). The decrease is due to a bonus paid to a director and officer of the Company pursuant to the terms of his employment agreement to reimburse him for his tax liability relating to options granted on the commencement of his employment.
- f. Investor relations expenditure increased to \$108,722 (2008: \$76,712) primarily due to various broker functions.

The Company spent only approximately \$96,000 on the exploration of its properties in the past quarter, half of which went to the San Marcial Project. This is a reflection of the Company's focus. The balance was split between exploration work on the Lety and Peñasco Quemado Projects.

## **Liquidity**

The Company had cash of \$79,010 at July 31, 2009 compared to \$160,327 as at April 30, 2009. The Company had a working capital deficit of \$272,688 as at July 31, 2009 compared to working capital surplus of \$196,340 at April 30, 2009. Other than the decrease in the Company's cash reserves, the largest movements in working capital accounts were in accounts payable and accrued liabilities (July 31, 2009: \$148,838; April 30, 2009: \$34,899) and promissory notes (July 31, 2009: \$220,000, April 30, 2009: \$Nil).

The increase in accounts payable is primarily a reflection of the increase in consulting fees. \$50,396 is owed to various consultants, as well as, amongst others, \$16,800 owed to the Company's auditors for the audit completed during the quarter, \$47,985 due to companies with directors and officers in common for rent and office expenses, and \$20,552 due for services provided for a brokers' function

During the quarter the Company wrote two promissory notes of \$100,000 each. A 20% bonus is payable on each note. A holder of a promissory note elected to convert \$102,000 of the total amount owed to him into 600,000 shares in the private placement that closed on September 11, 2009.

The consolidated financial statements for the year ended April 30, 2009, have been prepared on the basis of accounting principles applicable to a going concern. This assumes that the Company will operate for the foreseeable future and will be able to realize its assets and discharge its liabilities in the normal course of operations. The Company has incurred operating losses since inception, has limited financial resources, no source of operating cash flow, and no assurances that sufficient funding, including adequate financing, will be available to further explore its mineral property projects and to cover general and administrative expenses necessary to maintain a public company. As the Company is facing an immediate cash shortfall, it closed a non-brokered private placement thereby raising gross proceeds of \$774,180 in short term interim financing. The private placement consists of 4,554,000 units at a price of \$0.17 per unit. Each unit consists of one common share and one non-transferable share purchase warrant. Each whole warrant entitles the holder to purchase one additional common share of the Company at a price of \$0.20 for a period of 12 months from the date of closing. The Company plans to complete a further private placement in 2009, as well as continue to renegotiate some of its option payments.

The Company wrote two promissory notes for \$100,000 each during the previous quarter. A bonus of 10% is payable on each promissory note. The principal amounts and the bonuses are convertible at any time into common shares and/or warrants of the Company on the same terms and at a conversion rate equal to the price of the next financing undertaken by the Company before August 28, 2009. Both notes are held by parties unrelated to the Company. A holder of a promissory note elected to convert \$102,000 of the total amount outstanding into 600,000 shares in the private placement that closed on September 11, 2009. Payment of the balance due to the note holders will be renegotiated.

The Company has also received \$89,775 from the conversion of warrants, of which \$25,650 was received subsequent to the quarter end. However, for the Company to remain solvent, to meet its monthly expenses, and to continue with its exploration plans for the San Marcial and La Frazada properties, management has proposed that the Company do a further private placement in the autumn of 2009.

Currently the Company has limited financial resources, has no source of operating income and has no assurance that additional funding will be available to it for further exploration and development of its projects. Although the Corporation has been successful in the past in financing its activities through the sale of equity securities there can be no assurance that it will be able to obtain sufficient financing in the future to carry out exploration and development work on its properties. The ability of the Company to arrange additional financing in the future depends, in part, on the prevailing capital market conditions and exploration and development success. As mentioned in the discussion of Overall Performance, the recent equity and capital market volatility worldwide has had a significant impact on the Company's operations during the last year. While management believes adequate financing on acceptable terms will be secured, there can be no assurance of this occurring.

## Capital Resources

Silvermex has historically relied upon equity financings to satisfy its capital requirements and will continue to depend heavily upon equity capital to finance its activities. There can be no assurance the Company will be able to obtain the financing required in the future on acceptable terms.

The Company has the following cash commitments related to its properties:

	For the year ended April 30			
	2010	2011	2012	2013
<b>Property payments:</b>				
Lety	70,000			
San Marcial (1)			14,250,000	
<b>Exploration commitment:</b>				
San Marcial (2)		1,000,000		
<b>Proposed transaction:</b>				
Rosario acquisition (3)	900,000		1,000,000	1,000,000

- (1) The market value of the 3,000,000 shares issued to Silver Standard over the term of the option agreement will be deducted from the total purchase price of US\$15,000,000. The balance is payable in cash or shares at the option of Silver Standard. To date, 1,000,000 shares have been issued at a deemed price of \$0.75.
- (2) To be spent over the period until February 1, 2011.
- (3) A definitive agreement has not yet been concluded for the Rosario acquisition.
- (4) All amounts are denominated in US dollars

The Company is also obligated to pay Silver Standard US\$100,000 per month commencing if and when commercial production commences on the San Marcial Project, and is also obligated to make a US\$100,000 production payment to International American Resources Inc.

The Company has no other commitments other than its obligation to reimburse Mexican Mine Management Ltd. and Timmins Gold Corp. for shared office premises and expenses.

The Company has closed the recently announced private placement but it also needs to close a second private placement in order to its short term commitments, cover its general and administrative costs, and fund its exploration activities. And, it will have to raise significantly more funds if a final agreement with Aurcana is signed with similar terms to the letter of intent.

## Transactions with Related Parties

During the three months period ended July 31, 2009, the Company entered into the following transactions with related parties:

- a. The Company incurred \$53,298 for consulting services, including geological consulting, to Arturo Bonillas, Miguel Soto, and Eugene Hodgson, all of whom are directors and officers of the Company.

- b. The Company was charged \$35,310 for shared office premises and expenses by Mexican Mine Management Ltd. and Timmins Gold Corp., companies related by common directors and common officers. As of April 30, 2009, \$47,985 was owed to these companies.
- c. The Company incurred \$30,000 of consulting fees to a company controlled by its corporate secretary, Duane Nelson. Mr. Nelson does not receive a salary from the Company and is paid consulting fees for providing investor relations and marketing services, and advice on corporate development.
- d. The Company advanced \$16,702 to a nominee company incorporated in Mexico. These funds were used to pay the salaries of the Company's employees in Mexico.

### **Proposed Transactions**

The Company has signed a LOI to acquire the Rosario Property. This project is located near the Company's San Marcial Property, and management foresees certain synergies between the two properties. The acquisition has received the approval of the Exchange, but still requires the approval of IMM for the transfer of the share ownership of Aurcana Mexico to the Company, and the completion of due diligence. A definitive agreement has not been concluded or signed.

Management is also proposing a further financing to be completed in the autumn of 2009.

### **Critical Accounting Estimates**

The preparation of financial statements in conformity with GAAP requires the Company to make estimates and assumptions that determine the reported amounts of assets and liabilities at the balance sheet date, and reported costs and expenditures during the reporting period. Estimates and assumptions may be revised as new information is obtained, and are subject to change. The Company's accounting policies and estimates used in the preparation of the financial statements are considered appropriate in the circumstances, but are subject to judgements and uncertainties inherent in the financial reporting process.

Critical accounting estimates used in the preparation of the financial statements include the Company's estimate of recoverable value of its mineral properties and related deferred expenditures, asset retirement obligations, as well as the value of stock-based compensation. All of these estimates involve considerable judgement and are, or could be, affected by significant factors that are beyond the Company's control.

### **Exploration and Development Expenditures**

The Company capitalizes exploration and development expenditures directly related to its properties until such time that the properties are placed into production, sold, abandoned, or management determines impairment in the realizable value of the property/properties has occurred. The Company's policy to capitalize exploration costs on a project by project basis is consistent with GAAP, and that of other exploration companies that do not have established mineral reserves. If and when a mineral property is commissioned, the associated deferred costs will be amortized on a systematic basis. And if and when an impairment in value of a property is determined, the property value will be written-down to its realizable value at that time, and the write-down charged to operations. The recoverability of the recorded value of the Company's mineral properties and associated deferred expenses is

based on market conditions for minerals, the underlying mineral resources associated with the properties, and future costs that may be required for ultimate realization through mining operations or by sale. The impairment reviews are made annually by management, or earlier if warranted. A write-down may also be required when a property is sold or abandoned, if exploration activity ceases on a property due to unsatisfactory results, or if there is insufficient funding to continue exploration on a property.

### **Asset Retirement Obligations**

The Company will recognize contractual, statutory and legal obligations associated with the retirement of mining properties when those obligations result from the acquisition, construction, development or normal operation of the assets. Initially, a liability for asset retirement obligations will be recognized at its fair value in the period in which it is incurred. Upon initial recognition of the liability, the corresponding asset retirement cost will be added to the carrying amount of that asset and the cost will be amortized as an expense over the economic life of the related asset, once production of that asset commences. Following the initial recognition of the asset retirement obligation, the carrying amount of the liability could be increased for the passage of time, and adjusted for changes to the amount or timing of the underlying cash flows to settle the obligation. As at April 30, 2009, the Company has made no provision for site restoration costs or potential environmental liabilities as the ultimate liability is not reasonably determinable and neither is it currently material.

### **Stock-based Compensation**

The Company follows accounting guidelines in determining the value of stock option compensation, as disclosed in Note 6 to the financial statements. This is a calculated amount not based on historical cost, but on subjective assumptions introduced to an option pricing model, in particular: (1) an estimate for the average expected hold period of issued stock options before exercise, expiry or cancellation, and (2) expected volatility of the Company's share price in the expected hold period, using historical volatility or comparables as a reference. As there is no market for the options and they are not transferable, the resulting calculated value is not necessarily the value which the holder of the option could receive in an arm's length transaction.

### **Changes in Accounting Policies including Initial Adoption**

The CICA has issued new standards which may affect the financial disclosures and results of operations of the Company for interim and annual periods beginning on or after January 1, 2009. The Company will adopt the requirements on the date specified in each respective section and is considering the impact this will have on the consolidated financial statements.

### **Section 3064 – Goodwill and Intangible Assets**

This new standard replaces the former CICA 3062 – Goodwill and other intangible assets and establishes standards for the recognition, measurement and disclosure of goodwill and intangible assets. CICA 3064 is effective for interim and annual financial statements for years beginning on or after January 1, 2009. The Company believes that adoption of this section will result in no material changes to the results of operations or financial position of the Company.

### **Section 1582 Business combinations, Section 1601 consolidated financial statements and Section 1602 non-controlling interests**

These sections replace the former CICA 1581, Business Combinations and CICA 1600, Consolidated Financial Statements and establish a new section for accounting for a non-controlling interest in a subsidiary. These

sections provide the Canadian equivalent to FASB Statements No. 141(R), Business Combinations and No. 160 Non-controlling Interests in Consolidated Financial Statements. CICA 1582 is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011. CICA 1601 and CICA 1602 apply to interim and annual consolidated financial statements relating to years beginning on or after January 1, 2011.

### **Credit Risk and the Fair Value of Financial Assets and Financial Liabilities**

In January 2009 the CICA issued EIC-173, "Credit Risk and the Fair Value of Financial Assets and Financial Liabilities" which requires the Company to consider its own credit risk as well as the credit risk of its counterparty when determining the fair value of financial assets and liabilities, including derivative instruments. The accounting treatments provided in EIC-173 have been applied in the preparation of these financial statements and as required have been applied retrospectively without restatement of prior periods. The adoption of this standard did not have a material impact on the valuation of financial assets or liabilities.

### **Mining Exploration Costs**

In March 2009 the CICA issued EIC-174, "Mining Exploration Costs" which provides guidance to mining enterprises related to the measurement of exploration costs and the conditions that a mining enterprise should consider when determining the need to perform an impairment review of such costs. The accounting treatments provided in EIC-174 have been applied in the preparation of these financial statements and did not have a material impact on the valuation of exploration assets.

### **Financial Instruments and Other Instruments**

The Company's financial assets and liabilities consist of cash, amounts receivable, and accounts payable and accrued liabilities. Some of the accounts payable and accrued liabilities are denominated in US dollars and Mexican pesos. Amounts denominated in non-Canadian dollars are translated into Canadian dollars at the rates applicable to the period end date. The Company has financial gains or losses as a result of foreign exchange movements against the Canadian dollar. The Company manages its foreign exchange risk by adjusting balances in currencies other than the Canadian dollar from time to time. The Company has certain commitments to acquire assets in foreign currencies and it incurs the majority of its exploration costs in foreign currencies, either the US dollar or Mexican peso. The Company may acquire foreign currencies to fix costs in Canadian funds, if management considers it advantageous.

The carrying value of financial instruments, which include cash, amounts receivable, prepaid expenses, accounts payable and accrued liabilities, promissory notes, and advances due to/from related parties approximate fair value because of the short-term maturity of those instruments. 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.

### **International Financial Reporting Standards**

On February 13, 2008, the Canadian Accounting Standards Board ("AcSB") confirmed the mandatory changeover date to International Financial Reporting Standards ("IFRS") for Canadian profit-oriented publicly accountable entities ("PAE's") such as the Company.

The AcSB requires that IFRS compliant financial statements be prepared for annual and interim financial statements commencing on or after January 1, 2011. The Company's first audited annual financial statements will be for the year ending April 30, 2012, with comparative financial information for the year ended April 30, 2011. This also means that all the opening balance sheet adjustments relating to the adoption of IFRS must be reflected in the May 1, 2010 opening balance sheet which will be issued as part of the comparative financial information in the July 31, 2011 unaudited interim financial statements.

The Company will adopt these requirements as set out by the AcSB and other regulatory bodies. At this time, the impact of adopting IFRS cannot be reasonably quantified. The Company continues to evaluate the impact of IFRS on the Company and is in the process of developing a plan for the conversion to IFRS. If the Company decides not to early adopt the standards, the actual conversion work will occur in late 2009 and 2010, in anticipation of the preparation of the May 1, 2010 balance sheet that will be required for comparative purposes for all periods ending in 2011.

The Company has been assessing some of the optional exemptions as part of the transition process to IFRS. The following preliminary elections have been made thus far under IFRS1:

- The Company will not restate business combinations prior to the adoption of IFRS;
- The Company will continue to capitalize exploration costs on a project-by-project basis even prior to mineral reserves being established; and
- The Company will be electing to recognize all of its cumulative translation differences of its foreign subsidiaries into opening retained earnings.

These elections are preliminary and may change prior to the formal adoption of IFRS.

The Company has also identified other areas relating to IFRS that could materially affect the Company:

- **Foreign currency:** The adoption of IFRS will involve the identification of a functional currency. At present, it appears that the Canadian dollar is the Company's functional currency and the Mexico peso is the subsidiaries' functional currency. Upon consolidation, the presentation currency will be that of the parent's functional currency. The Company will have to examine whether its functional currency will change to the US dollar assuming the Company moves into production.
- **Income taxes:** Although there are many areas where GAAP is similar to IFRS, there are differences such as the differentiation between deferred tax assets and deferred tax liabilities; and whether deferred tax is to be charged to the income statement, equity or goodwill.

At present the Company has no contracts, debt covenants, capital requirements or compensation requirements that may be affected by changes to financial reporting because of IFRS.

Management is taking professional development courses relating to IFRS conversion, and it is comfortable that its accounting services company will also be adequately prepared for the conversion.

## **Risk Factors**

The Company is engaged in the exploration for mineral deposits. These activities involve significant risks which even with careful evaluation, experience and knowledge may not, in some cases, be eliminated. The Company's success depends on a number of factors, many of which are beyond its control. The primary risk factors affecting the Company include inherent risks in the mining industry, metal price fluctuations and operating in foreign countries and currencies.

### **Inherent Risks within the Mining Industry**

The commercial viability of any mineral deposit depends on many factors, not all of which are within the control of management. Some of the factors that will affect the financial viability of a given mineral deposit include its size, grade and proximity to infrastructure. Government regulation, taxes, royalties, land tenure and use, environmental protection and reclamation and closure obligations could also have a profound impact on the economic viability of a mineral deposit.

Mining activities also involve risks such as unexpected or unusual geological operating conditions, floods, fires, earthquakes, other natural or environmental occurrences and political and social instability. It is not always possible to obtain insurance against all such risks and the Company may decide not to insure against certain risks as a result of high premiums or for other reasons. The Company does not currently maintain insurance against political or environmental risks. Should any uninsured liabilities arise, they could result in increased costs, reductions in profitability, and a decline in the value of the Company's securities.

There is no assurance at this time that the Company's current mineral properties will be economically viable for development and production.

### **Prices for Silver and Other Commodities**

Metals prices are subject to volatile price fluctuations and have a direct impact on the commercial viability of the Company's exploration properties. Price volatility results from a variety of factors, including global consumption and demand for metals, international economic and political trends, fluctuations in the US dollar and other currencies, interest rates, and inflation. The Company has not hedged any of its potential future silver sales. The Company closely monitors silver prices to determine the appropriate course of action to be taken by the Company.

### **Foreign Currency Risks**

The Company uses the Canadian dollar as its measurement and reporting currency, and therefore fluctuations in exchange rates between the Canadian dollar and other currencies may affect the results of operations and financial position of the Company. The Company does not currently have any foreign currency or commercial risk hedges in place.

The Company raises the majority of its equity financings in Canadian dollars while foreign operations are predominately conducted in Mexican pesos and US dollars. Fluctuations in the exchange rates between the Canadian dollar, US dollar and Mexican pesos may impact the Company's financial condition.

### **Risks Associated with Foreign Operations**

The Company's investments in foreign countries such as Mexico carry certain risks associated with different political, business, social and economic environments. The Company is currently evaluating silver and/or other commodities in Mexico, but will undertake new investments only when it is satisfied that the risks and uncertainties of operating in different cultural, economic and political environments are manageable and reasonable relative to the expected benefits.

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 ambiguous conveyance and regulatory characteristics of property rights in certain foreign countries.

Future government, political, legal or regulatory changes in the foreign jurisdictions in which the Company currently operates or plans to operate could affect many aspects of the Company's business, including title to properties and assets, environmental protection requirements, labour relations, taxation, currency convertibility, repatriation of profits or capital, the ability to import the necessary materials or services, or the ability to export produced materials.

### **Disclosure Controls and Procedures**

As required by Multilateral Instrument 52-109, management is responsible for the design, establishment and maintenance of disclosure controls and procedures over the public disclosure of financial and non-financial information regarding the Company, and internal control over financial reporting to provide reasonable assurance regarding the integrity of the Company's financial information and reliability of its financial reporting. Management maintains appropriate information systems, procedures and controls to ensure integrity of the financial statements and maintains appropriate information systems, procedures and controls to ensure that information used internally and disclosed externally is complete and reliable.

The Company's designed the disclosure controls and procedures to provide reasonable assurance that material information relating to the Company, including its consolidated subsidiary, is made known to them on a timely basis; and designed internal controls over financial reporting to provide reasonable assurance regarding the reliability of the Company's financial reporting. The Company's management believes that any disclosure controls and procedures or internal controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Due to the inherent limitations in all controls systems, they cannot provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been prevented or detected. Accordingly, because of the inherent limitations in a cost effective control system, misstatements due to error or fraud may occur and not be detected.

Management believes appropriate segregation of duties within the finance department have been maintained. However, where segregation of duty deficiencies exist, the Company relies on certain compensating and detection controls, including dual signatories on all cheque disbursements, review and approvals of all bank reconciliations by persons other than the preparer, and quarterly and annual review of financial statements, and other information by the Audit Committee. And, the Company's day-to-day accounting in the Vancouver office and initial preparation of the financial statements is outsourced to independent accountants.

Management believes the Company's disclosure controls and procedures were effective in providing reasonable assurance that the material information relating to the Company was made known to them on a timely basis and was processed and disclosed within the appropriate reports and time periods. The Company's management also believes that the Company's internal controls over financial reporting were effective.

### **Disclosure of Outstanding Share Capital as at September 18, 2009**

Details of the common share outstanding are:

Common shares	54,071,751
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Details of the warrants outstanding are as follows:

Number of Warrants	Exercise Price	Expiry Date
8,769,000	\$ 0.15	July 30, 2010
4,554,000	\$0.20	September 11, 2010

Details of the stock options outstanding are:

Number of Options	Exercise Price	Expiry Date
100,000	\$ 0.25	November 12, 2010
1,000,000	\$ 0.30	July 31, 2011
550,000	\$ 1.11	April 12, 2012
100,000	\$ 0.90	April 12, 2012

Details of the agents' options outstanding are:

Number of Agents' Options	Exercise Price	Expiry Date
1,350,000	\$0.10	July 30, 2010