

# Sur American Gold Corporation

## CONSOLIDATED INTERIM BALANCE SHEETS (UNAUDITED)

	<u>June 30, 2004</u>	<u>December 31, 2003</u>
<b>ASSETS</b>		
CURRENT ASSETS		
Cash	\$ 2,198,410	\$ 935,315
Amounts receivable and advances	14,548	20,063
Prepaid expenses	<u>4,833</u>	<u>4,833</u>
	2,217,791	960,211
INVESTMENTS IN AND ADVANCES TO AFFILIATES (Note 5)	2,499,948	1,825,401
CAPITAL ASSETS (Note 6)	<u>67,137</u>	<u>69,046</u>
	\$ <u>4,784,876</u>	\$ <u>2,854,658</u>
<b>LIABILITIES</b>		
CURRENT LIABILITIES		
Accounts payable and accrued liabilities	\$ 327,717	\$ 273,126
Loans payable (Note 7)	<u>353,377</u>	<u>498,877</u>
	681,094	772,003
LOANS PAYABLE (Note 7)	-	-
NON-CONTROLLING INTEREST IN SUBSIDIARY	<u>212,668</u>	<u>212,668</u>
	<u>893,762</u>	<u>984,671</u>
<b>SHAREHOLDERS' EQUITY</b>		
SHARE CAPITAL (Note 8)	12,336,224	9,874,074
SHARES SUBSCRIBED	-	-
CONTRIBUTED SURPLUS (Note 9)	1,937,355	902,324
RETAINED EARNINGS (DEFICIT)	<u>(10,382,465)</u>	<u>(8,906,411)</u>
	<u>3,891,114</u>	<u>(1,869,987)</u>
	\$ <u>4,784,876</u>	\$ <u>2,854,658</u>
GOING CONCERN AND NATURE OF OPERATIONS (Note 1)		
SUBSEQUENT EVENTS (Note 15)		

*See accompanying summary of accounting policies and notes to consolidated financial statements*

Approved by the Board “J. Rennie Blair” Director “Alicia Nicholson” Director

# Sur American Gold Corporation

## CONSOLIDATED INTERIM STATEMENTS OF LOSS AND DEFICIT (UNAUDITED)

	Three months ended		Six months ended	
	June 30,		June 30,	
	2004	2003	2004	2003 (Note 2)
<b>EXPENSES</b>				
Bank charges and interest	\$ 827	\$ 743	\$ 1,330	\$ 1,292
Depreciation and amortization	4,177	1,401	9,144	2,803
Foreign exchange (gain) loss	(32,182)	(4,008)	(25,728)	(4,308)
Interest on loan payable	10,259	10,260	21,519	20,406
Legal and professional	30,711	9,643	50,602	31,114
Office and miscellaneous	8,542	3,703	15,380	8,025
Regulatory and shareholder costs	60,237	23,337	102,941	33,816
Rent	6,000	6,000	12,000	12,000
Salaries and benefits	16,061	22,500	48,263	45,000
Telephone and fax	1,601	856	3,584	1,621
Travel and accommodations	9,640	878	11,040	3,562
Stock-based compensation	<u>                    </u>	<u>                    </u>	<u>1,445,095</u>	<u>                    </u>
<b>INCOME (LOSS) BEFORE OTHER ITEMS</b>	<b><u>(115,873)</u></b>	<b><u>(74,313)</u></b>	<b><u>(1,695,170)</u></b>	<b><u>(155,331)</u></b>
<b>OTHER ITEMS</b>				
Interest income	113,885	246	219,116	1,154
Impairment of resource interests	<u>                    </u>	<u>                    </u>	<u>                    </u>	<u>                    </u>
	<u>113,885</u>	<u>246</u>	<u>219,116</u>	<u>1,154</u>
<b>NET INCOME (LOSS) FOR THE PERIOD</b>	<b>(1,988)</b>	<b>(74,067)</b>	<b>(1,476,054)</b>	<b>(154,177)</b>
<b>RETAINED EARNINGS (DEFICIT), beginning of the period</b>	<b><u>(10,380,477)</u></b>	<b><u>(7,759,749)</u></b>	<b><u>(8,906,411)</u></b>	<b><u>(7,679,639)</u></b>
<b>RETAINED EARNINGS (DEFICIT), end of the period</b>	<b>\$ <u>(10,382,465)</u></b>	<b>\$ <u>(7,833,816)</u></b>	<b>\$ <u>(10,382,465)</u></b>	<b>\$ <u>(7,833,816)</u></b>
<b>EARNINGS (LOSS) PER SHARE, basic and diluted</b>	<b>\$ <u>0.00</u></b>	<b>\$ <u>0.00</u></b>	<b>\$ <u>(0.02)</u></b>	<b>\$ <u>(0.00)</u></b>

*See accompanying summary of accounting policies and notes to consolidated financial statements*

# Sur American Gold Corporation

## CONSOLIDATED INTERIM STATEMENTS OF CASH FLOW (UNAUDITED)

	Three months ended June 30,		Six months ended June 30,	
	2004	2003	2004	2003
<b>CASH FLOW FROM OPERATING ACTIVITIES</b>				
Net income (loss) for the period	\$ (1,988)	\$ (74,067)	\$ (1,476,054)	\$ (154,177)
Adjustments to reconcile net cash provided by (used in) operating activities				
Depreciation and amortization	4,177	1,401	9,144	2,803
Impairment of resource interests	-	-	-	-
Stock-based compensation	-	-	1,445,095	-
Unpaid interest income	(106,973)	-	(208,875)	-
Decrease (increase) in				
Amounts receivable and advances	3,693	3,385	5,515	12,070
Prepaid expenses	-	189	-	736
Increase (decrease) in				
Accounts payable and accrued liabilities	(221,309)	7,137	(90,909)	(12,709)
	<u>322,400</u>	<u>(61,955)</u>	<u>(316,084)</u>	<u>(151,277)</u>
<b>CASH FLOW FROM INVESTING ACTIVITIES</b>				
Expenditures on resource interests	-	(16,739)	-	(40,643)
Purchase of capital assets	-	-	(7,235)	-
Advances to affiliates	(294,220)	(406,312)	(465,673)	(406,312)
Cash held by acquired subsidiary	-	-	-	-
	<u>(294,220)</u>	<u>(423,051)</u>	<u>(472,908)</u>	<u>(446,955)</u>
<b>CASH FLOW FROM FINANCING ACTIVITIES</b>				
Proceeds from issuances of common shares	1,434,470	-	2,300,970	570,000
Share subscription received	-	-	-	-
Share issued costs	(127,577)	-	(248,883)	-
	<u>1,306,893</u>	<u>0</u>	<u>2,052,087</u>	<u>570,000</u>
<b>INCREASE IN CASH DURING THE PERIOD</b>	690,273	(485,006)	1,263,095	(28,232)
<b>CASH, beginning of the period</b>	<u>1,508,137</u>	<u>537,623</u>	<u>935,315</u>	<u>80,849</u>
<b>CASH, end of the period</b>	\$ <u>2,198,410</u>	\$ <u>52,617</u>	\$ <u>2,198,410</u>	\$ <u>52,617</u>

See Note 14.

*See accompanying summary of accounting policies and notes to consolidated financial statements*

# Sur American Gold Corporation

## NOTES TO THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS

### June 30, 2004 and 2003

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#### 1. GOING CONCERN AND NATURE OF OPERATIONS

Sur American Gold Corporation (the "Company") is incorporated under the laws of the Province of Alberta. Its principal business activity is natural resource exploration, presently focusing on unproven mineral interests located in the Philippines.

For the period ended June 30, 2004 the Company incurred a net loss of \$ 1,476,054 (June 2003 - \$ 154,177) and as at June 30, 2004 had a deficit of \$ 10,382,465 (June 2003 - \$ 7,833,816). The Company's ability to continue in operation is dependent on its ability to secure additional financing to fund ongoing administrative, and planned exploration, expenditures, and while it has been successful in doing so in the past, there can be no assurance that it will be able to do so in the future.

These consolidated financial statements are prepared on a going concern basis, which contemplates that the Company will continue to realize its assets and discharge its liabilities in the normal course of business. Accordingly, these consolidated financial statements do not give effect to adjustments that would be necessary should the Company be unable to continue as a going concern and therefore be required to realize its assets and settle its liabilities in other than the normal course of business, possibly at amounts different from those presented in these consolidated financial statements.

#### 2. ACCOUNTING POLICIES

##### **Basis of presentation**

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP") which necessarily involves the use of estimates. The consolidated financial statements have, in management's opinion, been properly prepared within reasonable limits of materiality and within the framework of significant accounting policies summarized below.

##### **Basis of consolidation**

These consolidated financial statements include the accounts of the Company, its wholly-owned subsidiary, Exploradora La Esperanza S.A., and its 70% owned subsidiary Sabena Limited.

##### **Revenue recognition**

Interest income is recognized ratably as earned and when collection is believed to be reasonably assured.

##### **Resource interests**

Costs incurred to acquire and explore a resource interest are capitalized. These capitalized costs are periodically assessed for impairment and an impairment change is recognized in the accounts upon abandonment, upon failure to detect economically recoverable materialization or when exploration activities are not anticipated to occur or to continue in the foreseeable future.

##### **Capital assets**

Capital assets are recorded at cost less accumulated amortization. Amortization is provided on a declining balance basis at annual rates between 20% and 30%.

##### **Earnings (loss) per share**

Earnings (loss) per share is determined using the weighted-average number of common shares outstanding during the period, which amounted to 58,974,114 (Dec. 2003 - 38,901,081) common shares. Diluted earnings (loss) per share has not been presented separately as the effect of common shares issuable on exercise of warrants and stock options is anti-dilutive.

# Sur American Gold Corporation

## NOTES TO THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS

### June 30, 2004 and 2003

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#### 2. ACCOUNTING POLICIES - continued

##### **Foreign currency translation**

Monetary assets and liabilities are translated into Canadian dollars at the rate of exchange on the balance sheet date and non-monetary assets and liabilities at historical rates. Revenues and expenses are translated at appropriate transaction date rates except for depreciation and amortization, which are translated at historical rates. Gains and losses on translation are included in income.

##### **Income taxes**

Income taxes are recorded on a tax allocation basis. Under this method, current income taxes are recognized for the estimated income taxes payable for the year. Future income tax assets and liabilities are recognized for the estimated income tax consequences attributable to differences between the financial statement carrying amounts of assets and liabilities and their respective income tax bases. Future income tax assets and liabilities are recognized using enacted income tax rates. Future income tax assets are recognized with respect to deductible temporary differences and loss carryforwards only to the extent their realization is considered more likely than not.

##### **Comparative figures**

Certain 2003 comparative figures have been reclassified to conform to the presentation used in the current year.

#### 3. CHANGE IN ACCOUNTING POLICY

In the fourth quarter of 2003, the Company adopted the fair value method of accounting for all employee and non-employee stock-based compensation under the amended recommendations of the Canadian Institute of Chartered Accountants' Handbook Section 3870 *Stock-based Compensation and Other Stock-based Payments*. This change has been applied retroactively to January 1, 2003

As permitted by Section 3870, the Company did not adopt the fair value method for certain stock-based compensation granted to employees and directors during the year ended December 31, 2002. The additional disclosure required by Section 3870 as a result of the Company not adopting the fair value method in 2002 is provided in Note 9.

Under the fair value method, stock-based compensation expense is recognized at the time of award with an offsetting increase in contributed surplus.

#### 4. BUSINESS COMBINATION

In June 2003 the Company acquired a 70% equity interest in an Australian corporation, Sabena Limited ("Sabena"), in exchange for 5,000,000 common shares issued from treasury. The remaining 30% of Sabena is held by three individuals, one of whom is presently a director of Sabena, and two of whom are also presently directors of Sabena and the Company and who are former directors of the vendor, Eastern Corporation, an Australian public company.

At the date of acquisition Sabena held: an option, exercisable on payment of \$ 150,000 Australian dollars to a corporation with certain directors in common, which was exercised subsequent to the date of acquisition, to acquire a 40% equity interest in Philco Mining Corporation, a Philippine corporation that holds interests in several unproven mineral exploration projects; a 50% interest in the T'Boli Gold Project joint venture, a Philippine mineral exploration joint venture that holds interests in several unproven mineral exploration projects; and an option to acquire the mineral processing rights to all mineralization found on the above noted projects. The Company believes its mineral processing rights would be limited to a 40% interest in such processing due to applicable foreign ownership restrictions in place under Philippine law, at June 30, 2004 this option has being exercised.

# Sur American Gold Corporation

## NOTES TO THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS

### June 30, 2004 and 2003

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#### 4. BUSINESS COMBINATION - continued

During the period ending June 30, 2004 the Company exchanged its 50% interest in the joint venture for a 40% equity interest in the Philippine corporation that held the legal rights to the unproven mineral interests. This was done to comply with the 40% foreign ownership restriction.

The acquisition has been accounted for using the purchase method. The cost of acquisition, being \$ 500,000 (\$ 0.10 per share) was allocated as follows:

Assets acquired:

Option to acquire a 40% equity interest in Philco Mining Corporation	\$ 385,245
50% interest in T'Boli Gold Project joint venture	385,244
Cash	<u>1,649</u>
	772,138

Liabilities assumed:

Accounts payable and accrued liabilities	59,470
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Non-controlling interest in subsidiary	<u>212,668</u>
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Fair value of consideration issued	\$ <u><u>500,000</u></u>
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The operating results of Sabena have been included in these consolidated financial statements from the effective date of acquisition of June 18, 2003. Sabena is essentially a holding company and is therefore inactive.

#### 5. INVESTMENTS IN AND ADVANCES TO AFFILIATES

The Company holds equity interests in three Philippine entities engaged in the exploration of unproven mineral interests located in the Philippines.

Philco Mining Corporation	
40% equity interest	\$ 265,373
Mineral exploration advances	1,207,271
Interest receivable	<u>376,688</u>
	<u>1,849,332</u>

Batoto Resources Corporation	
40% equity interest	<u>265,372</u>
T'Boli Gold Project joint venture	
50% interest	<u>385,244</u>
	\$ <u><u>2,499,948</u></u>

The advances bear interest at 36% per annum, compounded monthly. The Company's ability to recover the investments and mineral exploration advances is dependent upon the investees' success in locating economically recoverable mineral deposits and in successfully developing a profitable extraction, processing and marketing business, or on the sale of the underlying interests in an amount sufficient to allow for repayment of the advances and accrued interest and recovery of the investments.

# Sur American Gold Corporation

## NOTES TO THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS

June 30, 2004 and 2003

### 5. INVESTMENTS IN AND ADVANCES TO AFFILIATES - continued

Batoto Resources Corporation was established after the acquisition of Sabena and holds certain unproven mineral interests previously held by Philco Mining Corporation. As a result, \$ 265,372 of the \$ 530,475 acquisition cost of the interest in Philco Mining Corporation was assigned to the interest in Batoto Resources Corporation.

### 6. CAPITAL ASSETS

	June 2004			Dec 2003
	Cost	Accumulated amortization	Net	Net
Vehicle	\$ 45,646	\$ 12,546	\$ 33,100	\$ 38,800
Office furniture and equipment	<u>108,709</u>	<u>74,672</u>	<u>34,037</u>	<u>30,246</u>
	\$ <u><u>154,355</u></u>	\$ <u><u>87,218</u></u>	\$ <u><u>67,137</u></u>	\$ <u><u>69,046</u></u>

### 7. LOANS PAYABLE

	June 2004	Dec 2003
Loan payable of \$ 250,000 and accrued interest payable of \$ 43,936, due on January 5, 2004, bearing interest at 14% per annum, unsecured	\$ 293,936	\$ 293,936
Due to directors without interest, unsecured and due on January 5, 2004	44,441	44,441
Due on January 5, 2004 without interest and unsecured	15,000	15,000
Due to a corporation with certain directors in common on June 30, 2004, bearing interest at 5% per annum (\$ 150,000 Australian dollars)	-	<u>145,500</u>
	\$ <u><u>353,377</u></u>	\$ <u><u>498,877</u></u>

### 8. SHARE CAPITAL

Authorized

Unlimited common shares without par value

	June 2004		Dec 2003	
	Shares	\$	Shares	\$
Issued				
Beginning of year	50,379,348	\$ 9,874,074	26,801,063	\$ 6,573,394
Common shares issued for:				
Private placements	1,074,766	1,150,000	9,657,000	1,574,250
Exercise of warrants	4,940,000	762,000	1,432,000	159,800
Exercise of stock options	2,450,000	314,000	2,675,000	419,380
Acquisition of subsidiary	130,000	74,970	5,000,000	500,000
Settlement of debt	-	-	4,814,285	674,000
Stock-compensation adjustment	-	<u>410,063</u>	-	-
	58,974,114	12,585,107	50,379,348	9,900,824
Less: Share issued costs	-	<u>248,883</u>	-	<u>26,750</u>
	<u><u>58,974,114</u></u>	\$ <u><u>12,336,224</u></u>	<u><u>50,379,348</u></u>	\$ <u><u>9,874,074</u></u>

# Sur American Gold Corporation

## NOTES TO THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS

### June 30, 2004 and 2003

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#### 8. SHARE CAPITAL -continued

(a) During the period ended June 30, 2004 the Company completed:

- i. a private placement of 1,074,766 units at \$ 1.07 per unit, for gross proceeds of \$ 1,150,000. Each unit consisted of one common share and one half share purchase warrant. Each warrant entitles the holder to purchase one additional common share, for a period of two years, for \$ 1.55 on or before April 30, 2005 and \$ 2.10 on or before April 30, 2006. A commission of \$ 80,500 in cash and 32,243 warrants at \$ 1.07 was paid to Meridian Capital International. A director, who is also the Chief Executive Officer of the Company, purchased the total 1,074,766 units of the private placement; and

(b) At June 30, 2004 the Company had outstanding warrants issued, pursuant to various private placements, which may be exercised to purchase 4,979,626 common shares. The warrants expire at various dates through April 2006.

Details of warrants issued during the period ended June 30, 2004 and year ended 2003 are as follows:

	<u>June 2004</u>	<u>Dec 2003</u>
Issued, beginning of year	9,350,000	1,100,000
Issued pursuant to private placements	569,626	9,682,000
Exercised	<u>(4,940,000)</u>	<u>(1,432,000)</u>
	<u>4,979,626</u>	<u>9,350,000</u>

The following table summarizes information about warrants issued and exercisable at June 30, 2004.

<u>Exercise price</u>	<u>Warrants outstanding</u>	<u>Expiry date</u>
\$ 0.20	458,000	March 27, 2005
0.35/0.50	3,952,000	November 19, 2005
1.07/1.55/2.10	<u>569,626</u>	April 30, 2006
	<u>4,979,626</u>	

During the year ended December 31, 2003 the Company completed:

- ii. a private placement of 5,600,000 units at \$ 0.10 per unit, for gross proceeds of \$ 560,000. Each unit consisted of one common share and one warrant. Each warrant entitles the holder to purchase one additional common share, for a period of two years, for \$ 0.15 on or before March 27, 2004 and \$ 0.20 on or before March 27, 2005. A commission of \$ 2,500 in cash and 25,000 warrants was paid on a portion of the private placement. Persons related to a director purchased 22,000 units of the private placement; and
- iii. a private placement of 4,000,000 units at \$ 0.25 per unit, for gross proceeds of \$ 1,000,000. Each unit consisted of one common share and one warrant. Each warrant entitles the holder to purchase one additional common share, for a period of two years, for \$ 0.35 until November 19, 2004 and \$ 0.50 until November 19, 2005. A commission of \$ 10,000 in cash and 57,000 units was paid on a portion of the private placement. Directors and a person related to a director purchased 724,000 units of the private placement.

- (c) At December 31, 2003 the Company had outstanding warrants issued, pursuant to various private placements, which may be exercised to purchase 9,350,000 common shares. The warrants expire at various dates through November 2005.

Details of warrants issued during the years ended December 31, 2003 and 2002 are as follows:

	<u>2003</u>	<u>2002</u>
Issued, beginning of year	1,100,000	1,100,000
Issued pursuant to private placements	9,682,000	—
Exercised	<u>(1,432,000)</u>	<u>—</u>
	<u>9,350,000</u>	<u>1,100,000</u>

The following table summarizes information about warrants issued and exercisable at December 31, 2003.

<u>Exercise price</u>	<u>Warrants outstanding</u>	<u>Expiry date</u>
\$ 0.15/0.20	5,293,000	March 27, 2005
0.35/0.50	<u>4,057,000</u>	November 19, 2005
	<u>9,350,000</u>	

- (c) See also Note 15.

## 9. STOCK-BASED COMPENSATION

The Company has an incentive stock option plan (the "Plan"). Under the Plan a total of 10% of the Company's outstanding common shares are reserved for the issuance of stock options to directors, officers, employees and consultants. The terms of the option and the option price are fixed by the directors at the time of grant subject to price restrictions imposed by the TSX Venture Exchange. Stock options awarded have a maximum term of five years and vest on the date of award.

# Sur American Gold Corporation

## NOTES TO THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS

### June 30, 2004 and 2003

#### 9. STOCK-BASED COMPENSATION - continued

The following is a summary of the total number of stock options outstanding:

	Options outstanding	Weighted average exercise price
Balance at January 1, 2002	725,000	\$ 0.56
Expired	(375,000)	0.87
Awarded	<u>1,750,000</u>	<u>0.10</u>
Balance at January 1, 2003	2,100,000	0.12
Awarded	5,575,000	0.17
Expired	(50,000)	0.25
Exercised	<u>(2,675,000)</u>	<u>0.10</u>
Balance at January 1, 2004	4,950,000	\$ 0.19
Awarded	1,400,000	1.30
Expired	(275,000)	0.25
Exercised	<u>(2,450,000)</u>	<u>0.13</u>
Balance at June 30, 2004	<u>3,625,000</u>	\$ <u>0.79</u>

The following summarizes information about stock options outstanding at June 30, 2004:

Exercise price	Number outstanding and exercisable	Expiry date
\$ 0.25	200,000	September 2004
0.10	50,000	May 2007
0.11	665,000	September 2008
0.15	660,000	September 2008
0.45	850,000	December 2008
1.30	<u>1,200,000</u>	February 2009
	<u>3,625,000</u>	

As discussed in Note 3, effective January 1, 2003 the Company adopted the amendments to Section 3870 in respect of accounting for stock-based compensation. As the Company did not adopt the fair value method of accounting for stock options granted to employees and directors in 2002, Section 3870 requires disclosure of pro forma amounts that reflect the impact as if the Company had adopted the fair value based method of accounting. Had compensation costs for the Company's stock options granted to employees and directors been accounted for under the fair value method, the Company's net loss and loss per share would have increased as follows:

# Sur American Gold Corporation

## NOTES TO THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS

### June 30, 2004 and 2003

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#### 9. STOCK-BASED COMPENSATION - continued

	<u>2002</u>
Net income (loss) as reported	\$ (538,744)
Pro forma stock option expense	<u>(90,993)</u>
Net income (loss) – pro forma	\$ <u>(629,737)</u>
Earnings (loss) per share – as reported	\$ (0.02)
Earnings (loss) per share – pro forma	\$ (0.02)

The fair value of stock options awarded to employees, directors and consultants was estimated on the dates of award using the Black-Scholes option pricing model with the following assumptions:

	<u>2003</u>	<u>2002</u>
Risk-free interest rate	2.8 to 4.13%	4.13%
Estimated volatility	134% to 164%	134%
Expected life	5 years	5 years

The average fair value of stock options awarded during the 2002 fiscal year, calculated using the Black-Scholes option pricing model, was \$ 0.14.

The Black-Scholes option pricing model was developed for use in estimating the fair value of stock options that have no vesting provisions and are fully transferable. Also, option-pricing models require the use of estimates and assumptions including the expected volatility. The Company uses expected volatility rates which are based upon historical volatility rates. Change in the underlying assumptions can materially affect the fair value estimates.

#### 10. INCOME TAXES

As at December 31, 2003, the Company has approximately \$ 2,600,000 of non-capital losses available to offset future taxable income in Canada which expire between 2004 and 2009. The potential benefit of these losses have not been recognized in the consolidated financial statements as there is no reasonable assurance such benefit will be realized.

#### 11. FINANCIAL INSTRUMENTS

The Company's financial instruments consist of cash, amounts receivable and advances, investments in and advances to affiliates, accounts payable and accrued liabilities and loans payable.

##### Fair value

The fair value of cash, amounts receivable and advances and accounts payable and accrued liabilities approximate their carrying amounts due to their short terms to maturity.

The fair value of the interest-bearing loans payable is believed to approximate the carrying amount as the loans is believed to bear fair market rates of interest for debt of similar risk. The fair value of the amounts due to directors is not readily obtainable.

It is not practicable to determine the fair value of the investments in and advances to affiliates.

# Sur American Gold Corporation

## NOTES TO THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS

### June 30, 2004 and 2003

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#### 11. FINANCIAL INSTRUMENTS -continued

##### Interest rate risk

The interest-bearing loans payable bear interest at fixed rates, and the amounts due to directors are non-interest bearing. Therefore these amounts do not expose the Company to interest rate cash flow risk.

##### Credit risk

The Company's maximum exposure to credit risk is represented by the book value of the Company's financial instruments. Credit risk associated with advances to affiliates is concentrated in minority-held, mineral exploration entities located in the Philippines.

#### 12. RELATED PARTY TRANSACTIONS

Included in amounts receivable and advances is \$ 0 ( Dec.2003 - \$9,125) due from directors.

Included in accounts payable and accrued liabilities is \$ 67,626 (Dec. 2003 - \$177,026 ) payable to directors and a corporation controlled by a director.

During the period ending June 30, 2004, gross rent of \$ 12,000 ( Dec. 2003 - \$ 26,000) was paid to a director.

See Notes 7, 8 and 9.

#### 13. SEGMENTED INFORMATION

The Company's corporate assets are located in Canada and the Company holds investments in corporations located in the Philippines and Australia and natural resource exploration activities have occurred in Colombia in past years.

	June 2004				
	Canada	Australia	Philippines	Colombia	Consolidated
Current assets	\$ 2,205,310	\$ 6,270	\$ -	\$ 6,210	\$ 2,217,790
Capital assets	<u>49,938</u>	<u>-</u>	<u>-</u>	<u>17,199</u>	<u>67,137</u>
	\$ <u>2,255,248</u>	\$ <u>6,270</u>	\$ <u>-</u>	\$ <u>23,409</u>	\$ <u>2,284,927</u>
	December 2003				
	Canada	Australia	Philippines	Colombia	Consolidated
Current assets	\$ 952,168	\$ 1,833	\$ -	\$ 6,210	\$ 960,211
Capital assets	<u>51,847</u>	<u>-</u>	<u>-</u>	<u>17,199</u>	<u>69,046</u>
	\$ <u>1,004,015</u>	\$ <u>1,833</u>	\$ <u>-</u>	\$ <u>23,409</u>	\$ <u>1,029,257</u>

# Sur American Gold Corporation

## NOTES TO THE CONSOLIDATED INTERIM FINANCIAL STATEMENTS

### June 30, 2004 and 2003

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#### 14. SUPPLEMENTAL CASH FLOW INFORMATION

The Company has conducted non-cash financing activities as follows:

	<u>2004</u>	<u>2003</u>
Investing activities		
Acquisition of subsidiary	\$	\$ (770,489)
Financing activities		
Common shares issued to acquire subsidiary	74,970	500,000
Common shares issued for subscriptions received	-	90,000
Subscription settled with common shares	-	(90,000)
Debt settled for common shares	-	674,000
Shares issued to settle debt	-	(674,000)
Non-controlling interest in subsidiary	-	212,668
Notes payable issued to settle accounts payable and accrued liabilities	<u>-</u>	<u>-</u>
	\$ <u>74,970</u>	\$ <u>(57,821)</u>

The Company has paid interest of \$ 0 (2003 - \$ 71,712).

#### 15. SUBSEQUENT EVENTS

Subsequent to June 30, 2004:

- 200,000 stock options were exercised for cash of \$ 22,000 by a director.
- 20,000 warrants were exercised for proceeds of \$ 7,000.

# **SUR AMERICAN GOLD CORPORATION**

## **MANAGEMENT DISCUSSION AND ANALYSIS FOR THE QUARTER ENDED JUNE 30, 2004**

### **Background**

This discussion and analysis of financial position and results of operation is prepared as at August 27, 2004 and should be read in conjunction with the unaudited interim consolidated financial statements for the six months ended June 30, 2004 and 2003 and the audited consolidated financial statements for the years ended December 31, 2003 and 2002 of Sur American Gold Corporation ( the "Company") where necessary. Those financial statements have been prepared in accordance with Canadian generally accepted accounting policies.

### **Company Overview**

The Company is a junior mineral exploration company engaged in the exploration and development of gold projects located in the Philippines. The Company is currently focusing its financial resources in conducting an exploration program for gold and gold-copper in its Comval and T'Boli Projects. As of the date of the MD&A, the Company has not earned any production revenue, but has commenced a long term trial mining and metallurgical test program which is significant enough to produce refined gold. To date approximately \$US 50,000 of refined gold has been produced from this program which commenced in July, 2004.

Subject to necessary Philippine regulatory approvals the Company intends to continue its trial mining and metallurgical test program in order to generate realistic data suitable for full feasibility studies designed to ascertain the commercial viability of the various mineral deposits. As the Company has only developed several hundred metres of exploratory tunnels and has mapped and sampled older pre-existing tunnels and undertaken surface sampling no resources or reserves have yet been established. However the Company is in the final phase of a geological and geophysical program which will lead to the Batoto gold project being drilled either in the final quarter 2004 or the first quarter 2005. Upon completion of the initial drilling program the Company may be in a position to undertake resource estimates and therefore initial feasibility studies.

The Company trades on the TSX Venture Exchange ("TSXV") under the symbol "SUR".

### **Forward Looking Statements**

Certain information included in this discussion may constitute forward-looking statements. Forward-looking statements are based on current expectations and entail various risks and uncertainties. These risks and uncertainties could cause or contribute to actual results that are materially different than those expressed or implied. The Company disclaims any obligation

or intention to update or revise any forward-looking statement, whether as a result of new information, future events or otherwise.

## **Exploration Projects**

### **BATOTO GOLD PROJECT**

The Batoto Gold Project is located in Compostela Valley Province, South Eastern Mindanao Island where work completed (*by a previous explorer in the late 1970's and early 1980's*) outlined a large area of gold mineralization within an altered diorite intrusion.

The Batoto deposit is part of a major zone of gold mineralization extending 12 km northwards from Batoto through to the Panag Project.

Work commenced at Batoto in September 2003 and by using basic prospecting methods such as mapping, trenching and sampling 48, 0.5 metre to 20 metre wide sub-parallel massive quartz veins distributed across a 2,500 metre wide zone of altered diorite have been found to date.. Alteration consists of silicification and abundant micro veinlets subparallel to the main veins. The veins tend to have short strike lengths of between 100 and 500 metres and occur over a vertical interval of at least 200 metres.

Up to December 2003 work consisted of setting up sampling procedures and mapping and sampling known vein systems. This work confirmed much of the previous work undertaken more than 20 years ago. ie high grade vein separated by lower grade quartz stockwork zones. This work is on-going.

Since January 2004 work has focused on a new area in the SE quadrant of the Batoto system called Tarale where more than 20 high grade veins have been located. Whilst most of the veins in the Tarale area are relatively narrow-between 0.5-2 metres in true thickness they also tend to contain high grades from 3-4g/t gold up to nearly 800g/t (over a 1 metre thickness) in the Tarale 7 vein.

The grade distribution within the Tarale veins is highly variable although a trend from lower grade to higher grade is often obtained as the veins are developed from the surface into Batoto hill. For instance Tarale 15, a 1 metre wide vein was only 1g/t at the surface but steadily increased to 4g/t, 9.3 g/t and 20.8 g/t several metres into the tunnel. The same pattern has been observed at most of the Tarale vein developments. The reason is not fully understood at this time although surficial leaching of gold particles is suspected as one of the reasons.

In February the Company announced the discovery of two additional high grade vein structures Tarale 55 and Tarale 56 -also within the Tarale zone of the Batoto stockwork deposit. Tarale 55 outcrop assayed 10.87 g/t gold over a 0.7 metres channel and Tarale 55a outcrop assayed 10.4 g/t gold over a 0.5 metres channel. The average grade to date of the Tarale 56 vein structure based on random sampling of more than 425, 500g-1kg grab samples from broken

rock in sample bags appears to be about 16.22 g/t gold. The vein is a 1 metre wide gray-white vein containing considerable pyrite and chalcopyrite as well as appreciable fine free gold in small cavities. In addition another a new vein called Tarale 1000 was discovered during the quarter.

These discoveries further extend the known limits of gold mineralization at the Batoto deposit.

Like the rest of Batoto extensive silicification and stockwork veining is apparent between all vein structures. The distance from Tarale 55 to the 1 metre wide Jennifer Vein (51 g/t gold) located to the north is about 1,500 metres.

Bulk sampling of the Batoto roads and tunnels continues to clearly demonstrate the potential bulk mineability of the large Batoto stockwork deposit with long intervals grading nearly 1/g gold not including any of the larger and higher grade veins. The focus continues to be on sampling fresher (less oxidized and weathered) rock. To this end a recently discovered tunnel cutting through the stockwork deposit which, as previously advised assayed in excess of 1g/t gold over a 64 metre interval encountered much higher grades in an intensely altered and mineralized zone which extends from 64 metres until the present face at 86 metres. This interval which is currently 22 metres wide grades in excess of 8g/t gold. The exploration cross cut is project to extend a further 100-200 metres to the south in order to provide further geological information. In order to understand more about the metallurgy of the mineralization in the crosscut the mineralization is being processed at the Monkayo CIP plant which the Company is using for its metallurgical testing program

During the period the Company made several new vein discoveries. Perhaps the most significant of the new discoveries was the Tarale 11 structure. To date about 80 tonnes of Tarale 11 has been processed through the Monkayo test plant with average grades slightly higher than 20g/t gold.

Another new discovery that has also commenced trial development is the Tarale 61 vein where the initial surface channel sampling returned 113.7g/t gold over 0.85 metres.

As a result of the results from the initial programs at Batoto the Company has set two main goals for its planned future exploration. First it plans to establish the extent of the high grade vein systems and second to establish the extent of the lower grade intervening mineralization. The Company has set its 2004-2005 goal to determine the full extent of mineralized zone(s) by systematic geological mapping and extensive sampling.

Even though no drilling has been undertaken to date at Batoto the known horizontal and vertical extent of the high grade veins based on surface mapping, has prompted the Company as previously advised in several news releases to accelerate the development of the Batoto deposit by building a 50-100 tonnes per day trial mining and processing operation from which it plans to obtain more detailed geological, mining and metallurgical information to be used in a feasibility study in 2005. Prior to this trial mining commencing the Company is processing the mineralization obtained from the various veins currently being developed.

## **PANAG**

During the quarter the focus was on undertaking a gradient array geophysical survey over the area. Preliminary survey results suggest that the Company's planned tailing impoundment area near the town of Magangit will require drilling as an induced polarisation anomaly has been interpreted in the middle of the area. At least two sulphide bearing structures have been located since the completion of the survey in this area.

## **COPPER-GOLD PORPHYRY DEPOSITS OF TAGPURA, TAGPURA SOUTH, MA-ANGOB AND KALAMATAN**

The Comval copper-gold-silver project comprises three known deposits at which more than 24,000 metres of drilling was conducted in the 1970's. As part of the planning process for the upcoming drilling program the Company is systematically mapping and sampling as many of the higher grade copper structures in order to more completely understand the structure of the deposit.

The Tagpura deposit comprises both gold-rich copper porphyry and many multiple, semi-parallel high grade stratabound copper-gold-silver lenses occurring within a 400 metre wide 1500 metre long zone defined by a pronounced IP (induced polarization anomaly). The deposit is open to the south and at depth and represents a major and high potential drilling target.

Based on three dimensional re-interpretation of a previous geophysical survey an unknown and potentially large target has been discovered south of the Tagpura deposit. It is the intent of the Company to confirm this target by a new geophysical survey and to test that target by drilling at a date to be decided.

The deposits supported a 10,000 t/d open cut operation during the late 70's and early 80's. The mine closed supposedly due to low copper prices. Of great interest to the Company is the presence of considerable gold mineralization within and surrounding the copper mineralization which occurs in all the deposits as well as in the intervening areas between the deposits. Apart from placing all the previous data into a three dimensional format for the purpose of recalculating the mineral resources, the Company plans to re-evaluate the extent of the gold mineralization within and around the copper-gold deposits.

It should be noted that none of the areas outlined above has been subject to modern exploration methods and the Company is confident that the application of such methods will enhance the areas and possibly discover new targets.

A gold rich skarn body originally was discovered in the Comval copper-gold belt on the eastern flank of the Agusan River which broadly separates the gold belt from the copper-gold belt. Many massive sulphide skarn bodies have subsequently been located and the systematic

evaluation of these is a major task in itself. The initial skarn body assayed 1.4g/t gold over an impressive 55 metres. This body has now been traced to the north and south for more than 100 metres in both directions and occurs within a 6km long zone of skarn deposits.

At the Tagpura copper-gold deposit work continued to outline further high grade massive sulphide copper-gold zones. One of the larger structures that has been studied in some detail is called the Salvacion zone which returned a 60 metre wide interval grading 1.45% copper and 0.9g/t gold including a 25 metre interval grading 2.77% copper and 1.39g/t gold. This structure is part of a much wider zone estimated to be more than 100 metres wide although further work including drilling will be required to determine the actual thickness.

## **T'BOLI GOLD PROJECT**

This is a steeply dipping gold bearing epithermal vein system located in South Cotabato Province in south Mindanao Island. Previous work by Sabena Limited personnel included drilling 23 core holes totalling 7,050 metres. The drilling and underground development work outlined an Inferred Resource of 2.4 million tonnes grading 5.5 g/t gold and 21 g/t silver containing 420,000 ozs of gold and 1.6 million ozs of silver.

The veins tested by drilling and underground development are all open at depth and also along strike. Several more gold veins occur nearby which have not yet been tested. As stated in a previous News Release on December 4, 2002, the Company plans to construct a 50-100 t/d pilot plant in order to obtain further metallurgical, mining and geological data to be used for a future feasibility study. Until the small plant has been constructed however mineralization from the planned development operation scheduled to commence in the 4<sup>th</sup> quarter 2004 will be trucked to the Monkayo plant for further evaluation.

A highly experienced team of geological and mining personnel has also been assembled to carry out the planned field programs.

Initial results from this renewed exploration effort at T'Boli has been very encouraging with the apparent strong indication that both the North vein and South vein sets may continue at least several hundred more metres to the west from their currently known limits.

Extensive trenching and mapping of small scale miners tunnels are in progress. The results of this work will be reported in due course.

In addition to the surface geological activities sufficient work has been carried out to confirm that in the vicinity of the T'Boli north and south vein sets wide mineralized alteration zones averaging 0.72g/t gold and 5g/t silver exist up to 30 metres either side of the main veins. This work opens up the possibility of bulk mineability in certain areas of the project area. In addition to the initial geological work, the Company commenced rehabilitation of the main access tunnel into the vein systems and also purchased mining equipment including compressors, generators and a truck as well as timber and other consumables in preparation for initial mining access operations scheduled to commence in the 4<sup>th</sup> quarter 2004.

## Selected Financial Data

(CDN \$ in 000, except per share data)

The following selected financial information is derived from the audited annual consolidated financial statements of the Company prepared in accordance with Canadian GAAP.

	Years ended December 31,		
	2003 \$	2002 \$	2001 \$
<b>Operations:</b>			
Revenues	-	-	-
Income(loss)	-1227	-539	-2433
Income (Loss) per share	-0.03	-0.02	-0.1
Dividends per share	-	-	-
<b>Balance Sheet:</b>			
Working capital	188	-14	-827
Total assets	2855	142	205
Total Long-term liabilities	-	-1027	-

The following selected financial information is derived from the unaudited consolidated interim financial statements of the Company prepared in accordance with Canadian GAAP.

	2004		2003				2002		
	June 30 \$	Mar.31 \$	Dec.31 \$	Sept.30 \$	Jun.30 \$	Mar.3 1 \$	Dec.31 \$	Sept.30 \$	Jun.30 \$
<b>Operations:</b>									
Revenues	-	-	-	-	-	-	-	-	-
Net income(loss)	(1,476)	(1,474)	(1,115)	-112	-74	-80	-78	-74	-80

Loss per share	0.02	0.03	0	0	0	0	0	0	0
Dividends per share	-	-	-	-	-	-	-	-	-
<b>Balance Sheet:</b>									
Working capital	1,537	624	188	-41	363	453	-14	-31	-923
Total assets	4,784	3,706	2855	1428	1045	612	142	272	248
Total long-tem liabilities	-	-	-	354	1027	1027	1027	992	-

## Results of Operations

During the period ended June 30, 2004 the Company recorded a loss of \$1,476,054 compared with a loss of \$154,177 for the comparable 2003 period.

The difference of \$ 1,321,877 was mainly due to increases in bank charges and interest \$38, depreciation and amortization \$6,341, interest on loans \$ 1,113, legal and professional \$19,488, office supplies and miscellaneous \$ 7,354, regulatory and shareholders costs \$69,125, salaries and benefits \$ 3,263, stock based compensation expense \$1,445,095, telephone and fax \$1,963 and travel and accommodation for \$ 7,478, these increased expenditures were offset by foreign exchange gain of \$21,420 and by an increase in interest income for an amount of \$217,962, this interest income relates to advances made by the Company to our affiliate Philco Mining Corporation (Philippines) and Tribal Mining Corporation (T' Boli), as well as interest charged on expenditures incurred by the Company on their behalf.

The increases in the expenditures are the direct result of the Company being extremely active and the exposure provided to the Company for investor relations activities in the retail market as compare to 2003 and increase in stock based compensation expense is the direct result of the Company adopting section 3870 in respect of accounting for stock based compensation.

The Company believes that the T'Boli and Comval Projects contain demonstrated high grade veins which based on work completed to date, have a high probability of being successfully exploited to provide significant cash flow. In this regard the company as stated above working towards trial mining and processing operations at both areas in an effort to generate reliable data for the input into feasibility studies to ascertain the viability of building larger plants at both locations.

Operating costs in the Philippines are generally low and combined with the apparent high grades at both, T'Boli and Comval and apparent good metallurgical characteristics of the mineralization, the Company is confident that such feasibility studies will lead to commercial mining operations and therefore the loan agreements with our 40 % owned Philippine

companies have a very high probability of collection.

Information on Business Combination and Investment in and Advances to Affiliates:

Note 4 and Note 7 of the December 31, 2003 ,Audited Financial Statements and June 30, 2004, unaudited Financial Statements, reflect the acquisition of the option to acquire Philco, costed at \$ 385,245. Added to that is the option price of \$ 145,500 mentioned in Note 7. This gives a combined amount of \$ 530,745, which was split 50/50, between Philco and Batoto, \$ 265,373 each.

During the period ending June 30, 2004 , the Company was involved in the process of arranging a financing and has now been closed, the amount raised was \$ 1,150,000 in a non brokered private placement, each unit consisting of one share and one half share purchase warrant, the shares being issued at \$ 1.07 and the warrants at \$ 1.55 in the first year and \$2.10 in the second year, these funds will be used to further advance the development of the Philippine's projects and for general and administrative costs.

During the period ending June 30 31, 2004, 2,450,000 stock options were exercised for total cash proceeds of \$314,000. Of this amount 2,190,000 were exercised by directors for total cash proceeds of \$ 263,500.

During the period ending June 30, 2004, The Company issued 4,940,000 shares upon the exercise of warrants for total proceeds of \$ 762,000, of this amount 3,450,000 shares were issue to a director of the Company, to a Corporation and trust controlled by the director and to members of his immediate family for proceeds of \$ 517,500 as follows:

- By the director 800,000 warrants at a price of \$ 0.15 for total proceeds of \$ 120,000.
- By a corporation and a trust controlled by the director, 2,040,000 warrants at a price of \$0.15 for total proceeds of \$ 306,000.
- By members of the director's immediate family, 610,000 warrants at a price of \$ 0.15 for total proceeds of \$ 91,500.

During the period ended June 30, 2004, the Company awarded 1,400,000 stock options exercisable at \$ 1.30 per share until February 28, 2009.

During the period ended June 30, 2004, the Company made additional mineral exploration

advances to the Philippine Companies and incurred expenditures on their behalf in the amount of \$ 465,673 and charged \$208,875 in interest on advances made.

### **Financial Condition/ Capital Resources**

As at June 30, 2004 the company had a working capital of \$1,536,697, as compared to a working capital of \$ 188,208 at December 31, 2003.

The Company believes that it currently has sufficient resources to undertake all of its anticipated exploration activities and ongoing level of corporate activities for at least 18 months.

### **Critical Accounting Estimates**

A detailed summary of all the Company's significant accounting policies is included in Notes 2, 3 and 9 of the annual consolidated financial statements for the year ended December 31, 2003.

### **Changes in Accounting principles**

Effective January 1,2003, the Company adopted the fair value method of accounting for all employee and non-employee stock-based compensation under the amended recommendations of the Canadian Institute of Chartered Accountants' Handbook Section 3870 *Stock-based Compensation and Other Stock-based Payments*.

Under the fair value method, stock-based compensation expense is recognized at the time of award with an offsetting increase in contributed surplus.

### **Transactions With Related Parties**

Included in accounts payable and accrued liabilities is \$ 67,626 payable to directors and a corporation controlled by a director.

During the period ending June 30,2004, gross rent of \$ 12,000 was paid to a director of the Company.

During the period ending June 30, 2004, 2,190,000 stock options were exercised by

directors and a former director of the Company

## **Risks and Uncertainties**

The company is in compliance in all material regulations applicable to its exploration activities. Existing and possible future environmental legislation, regulations and actions could cause additional expense, capital expenditures, restrictions and delays in the activities of the Company, the extent of which cannot be predicted. Before production can commence on any properties, the Company must obtain regulatory and environmental approvals. There is no assurance that such approvals can be obtained on a timely basis. The cost of compliance with changes in governmental regulations has the potential to reduce the profitability of operations.

The Company's mineral properties are located in the Philippines and consequently are subject to certain risks, including currency fluctuations and possible political and economic instability which may result in the impairment or loss of mining title or other mineral rights, and mineral exploration and mining activities may be affected in varying degrees by political stability and governmental regulations to the mining industry.

## **Investor Relations Activities**

During the period ended June 30, 2004, the Company's expenditures for investor relations amounted to \$ 58,733 and are included in regulatory and shareholders costs and relate to updating of the web-site, to the payment of the Company's investor relations for professional fees to provide market awareness and more exposure in the retail market, the wire distribution of the Company's news releases and costs associated with the Vancouver Gold Conference in January 2004.

## **Outstanding Share Data**

The Company's authorized share capital is an unlimited number of shares without par value. As at June 30, 2004, there were 58,974,114 compared to 50,379,348 shares outstanding at December 31, 2003. The increase reflects the success of the Company in raising new equity through private placements financing and the exercise of stock options and warrants. The Company also issued shares in the year 2003, for the acquisition of its 70% owned subsidiary Sabena Limited and for shares for debt owing to two employees, the CEO and CFO which are also directors of the Company. As at June 30, 2004, there were 3,625,000 stock options outstanding which were outstanding and exercisable with exercise prices

ranging from \$0.10 and \$1.30 per share, in addition there were 4,979,626 warrants outstanding and which expire between March 27, 2005 and April 30, 2006, with exercise prices between \$0.20 and \$2.10 per share.