

# **KERNOW RESOURCES AND DEVELOPMENTS LTD.**

## **FORM 51-102F1 MANAGEMENT DISCUSSION AND ANALYSIS SIX MONTH PERIOD ENDED JUNE 30, 2006**

The following discussion and analysis, prepared as of July 19, 2006 should be read together with the unaudited consolidated financial statements for the six month period ended June 30, 2006 and related notes attached thereto, which are prepared in accordance with Canadian generally accepted accounting principles. All amounts are stated in Canadian dollars unless otherwise indicated.

The reader should also refer to the audited consolidated financial statements for the year ended December 31, 2005 and 2004, and the Management Discussion and Analysis for those years.

Statements in this report that are not historical facts are forward-looking statements involving known and unknown risks and uncertainties, which could cause actual results to vary considerably from these statements. Readers are cautioned not to put undue reliance on forward-looking statements.

Additional information related to the Company is available for view on SEDAR at [www.sedar.com](http://www.sedar.com) and at [www.kernowresources.com](http://www.kernowresources.com)

### **Description of Business**

The Company is a natural resource company engaged in acquisition, exploration, and development of mineral properties. It currently holds two properties in Northern Portugal (Jales and Boticas), two properties in Quebec, one in Labrador and two in the State of Nevada, USA. The Jales property in Portugal is subject to an Option Agreement. The Company trades on the TSX Venture Exchange under the symbol KRD.

### **Performance Summary**

The following is a summary of significant events and transactions that occurred during the six month period ended June 30, 2006:

- 1) Sold 10,000 shares of Bannockburn Resources, Inc that it held as an investment. Bannockburn Resources, Inc. became listed on the Canadian Trading and Quotation System Inc. ("CNQ") under the symbol BKNN on February 2, 2006.
- 2) Sold 12,500 shares of Pathfinder Resources for net proceeds of \$3,415 that it held as an investment.
- 3) Sold 80,000 shares of St. Elias Mines Ltd ("St. Elias") for net proceeds of \$28,340 that it held as an investment.
- 4) Released the drill results from the drilling program conducted on the Gralheira deposit located on the Jales/Gralheira Gold Property in Portugal. The drill program which commenced in fall 2005 and completed in winter 2006 consisted of 12 drill holes totaling 2,400 meters.
- 5) Issued 235,000 common shares pursuant to the exercise of warrants for \$35,250.
- 6) Retained VISA Consultores (VISA) to prepare an Environmental Impact Statement relative to the Jales/Gralheira Gold Property and also to assist the Company in applying to the DGGE for an "Experimental Mining License." This license will allow the Company to undertake underground drifting and bulk sampling on the Gralheira structure. The application for the license was formally filed on June 14, 2006 with the Government of Portugal.
- 7) Held its Annual General Meeting on June 26, 2006 in Vancouver, BC. All proposed resolutions were passed.

## Selected Annual Information

The following table provides a brief summary of the Company's financial operations. For more detailed information, refer to the Financial Statements.

	Three Months Ended June 30, 2006	Three Months Ended June 30, 2005	Six Months Ended June 30, 2006	Six Months Ended June 30, 2005
Total revenues	\$ 9,385	\$ 30,872	\$ 36,149	\$ 33,065
Net income (loss) before extraordinary items	(47,607)	(50,506)	(37,376)	(66,338)
Net income (loss)	(47,607)	(50,506)	(37,376)	(66,338)
Basic and diluted earnings (loss) per share	(0.01)	(0.01)	(0.01)	(0.01)
Total assets	377,429	431,668	377,429	431,668
Total long-term liabilities	-	-	-	-
Cash dividends	-	-	-	-

The Company earns interest revenue from cash held in banks, securities held as short-term investments and by charging an 8% operators' fee to its joint venture partner to manage the Jales Gold Property in Portugal. Revenues from operator fees during the period were \$19,608 and \$17,824 during the 2005 comparative period. During the current period, the Company realized a gain of \$15,342 on the sale of marketable securities. The gain during the same period last year was \$15,030.

The Company's accounting policy is to record its mineral properties at cost. Exploration and development expenditures relating to mineral properties are deferred until either the properties are brought into production, at which time they are amortized on a unit of production basis, or until the properties are sold or abandoned, at which time the deferred costs are written off.

The Company has not paid any dividends on its common shares. The Company has no present intention of paying dividends on its common shares, as it anticipates that all available funds will be invested to finance the growth of its business.

## Results of Operations

The Company incurred a net loss of \$37,376 (2005 - \$66,338) during the year six month period ended June 30, 2006. Some of the significant expenses are as follows: paid or accrued \$33,152 (2005 - \$15,993) in accounting, legal and audit fees, \$1,684 (2005 - \$1,605) in bank charges and interest, \$11,792 (2005 - \$9,811) in filing, listing and transfer agent fees, \$8,400 (2005 - \$6,813) in management fees, \$7,582 (2005 - \$5,971) in office, miscellaneous and shareholder costs and \$8,581 (2005 - \$2,695) in travel and related costs.

Most of the current period expenses are comparable to that of the previous period except for an increase in accounting, legal and audit fees over the previous period and an increase in travel and related costs as there was some recovery in travel and related costs during the previous comparable period.

During the six month period ended June 30, 2006, the Company earned \$19,608 (2005 - \$17,824) as an operator fee from its joint venture partner, recovered \$133,081 (2005 - \$222,801) in exploration costs from St. Elias during the current period.

## Jales, Portugal

In October 2001, the Company entered into an agreement to acquire a 100% interest in the Jales gold property from Target Europe Corp. As consideration, the Company issued 800,000 common shares at a value of \$73,430 and will issue a further 750,000 common shares upon the property reaching commercial production. There is a 3% royalty payable to the Government of Portugal on all minerals produced from the property. The Jales property consists of an exploration license granted by the Government of Portugal. This license expired June 16, 2006. The Company has now applied for an experimental mining license with the Government of Portugal. As at June 30, 2006, the license had not yet been granted.

During 2001, the Company also entered into an agreement with Bannockburn whereby Bannockburn assigned its option agreement to earn a 100% interest in the Jales property to the Company in exchange for a promissory note in the amount of \$49,100 (USD\$30,729). During the fiscal year ended December 31, 2004, the Company issued 421,949 common shares at a price of \$0.10 per share to settle the promissory note and accrued interest totalling \$42,195.

During 2002 fiscal year, the Company entered into an option agreement with St. Elias Mines Ltd. (“St. Elias”), a company related by a common director at the time, whereby St. Elias can earn a 51% interest in the property in exchange for cash payments totalling \$50,000 (received), incurring cumulative exploration expenditures of \$1,500,000 (completed) on the property and issuing a total of 500,000 common shares (received) at a value of \$106,000 to the Company over a three year period. St. Elias has earned a 51% interest in the property and elected in 2005 to earn a further 24% interest in exchange for additional cash payments totalling \$100,000 (\$25,000 received), incurring additional exploration expenditures of not less than \$2,500,000 and issuing an additional 1,000,000 common shares over a three year period.

The Company also entered into a Technical Services Contract with St. Elias whereby St. Elias will reimburse the Company, as operator, for exploration costs incurred plus an 8% operator fee based on exploration costs incurred on the property. During the six month period ended June 30, 2006, the Company recovered \$133,081 (2005 - \$222,801) in exploration costs.

### **Poco das Freitas Property (Boticas), Portugal**

During the year ended December 31, 2004, the Company entered into a contract of exploration with the government of Portugal to explore the Poco das Freitas property located in northeast Portugal. The contract is initially for two years and thereafter can be renewed annually for further one year terms. The Company has committed to complete €45,000 (\$73,300) of exploration work on the property in the first two years. The Company was required to provide a guarantee in the amount of €10,000 (\$16,200) related to the property.

In addition to the 3% royalty payable to the Government of Portugal, the Company must pay an additional €50,000 (\$81,400) per year for 5 years in the event of production.

On June 23, 2006 the Company published a news Release detailing the activities it has undertaken at Boticas and also provided an up date regarding the “Plano Director Municipal” (PDM). This is a development plan revised every 10 years and may be considered equivalent to a “Zoning Plan”. Currently the PDM for the Municipality of Boticas, within which the majority of the Company’s Exploration Concession is located, is under review and revision.

Input into the definition of the Land Use is sought by the Municipality from all interested parties and governmental organizations. The Company has been informed that the area which contains the Limarinho and Poco das Freitas deposits contains sites of possible archeological interest which may reduce access to and development of both deposits.

The Company will meet with the Instituto Portugues de Arqueologia (IPAR), which is part of the Ministry of Culture, in July to discuss land use issues at the property and, in particular, matters pertaining to archeological interests.

No further work will be completed on the property until the decision regarding the PDM has been announced.

### **Summary of Quarterly Results**

	<b>For the Quarters Ended</b>				
	June 30, 2006	March 31, 2006	December 31, 2005	September 30, 2005	
Total assets	\$ 377,429	\$ 409,023	\$ 435,865	\$ 361,828	
Mineral properties and deferred costs	121,421	103,161	57,180	59,779	
Working capital (deficiency)	154,870	201,987	220,529	166,572	
Shareholders’ equity	303,283	332,140	305,409	254,051	
Revenues	9,385	26,764	23,257	45,970	
Net income (loss)	(47,607)	10,231	43,858	28,389	
Earnings (loss) per share	(0.01)	0.01	0.01	0.01	

### For the Quarters Ended

	June 30, 2005	March 31, 2005	December 31, 2004	September 30, 2004
Total assets	\$ 431,448	\$ 244,048	\$ 267,557	\$ 272,943
Mineral properties and deferred costs	250,413	113,177	118,191	96,535
Working capital (deficiency)	(64,601)	66,689	77,507	116,270
Shareholders' equity	213,512	207,566	223,398	240,505
Revenues	30,872	2,193	5,386	2,620
Net Income (loss)	(50,506)	(15,832)	(17,107)	(8,758)
Earnings (loss) per share	(0.01)	(0.01)	(0.01)	(0.01)

Significant changes in key financial data from 2004 to 2006 can be attributed to a write-off of various mineral properties to nominal carrying values, revenues generated from interest income, sale of various short term investments and earning an operators' fee for managing the Jales Gold Project in Portugal. Revenues increased particularly during 2005 as the Company earned an operator fee from its joint venture partner.

### Liquidity

The Company has financed its operations to date primarily through the issuance of common shares and exercise of stock options. The Company continues to seek capital through various means including the issuance of equity and/or debt.

The financial statements have been prepared on a going concern basis which assumes that the Company will be able realize its assets and discharge its liabilities in the normal course of business for the foreseeable future. The continuing operations of the Company are dependent upon its ability to continue to raise adequate financing and to commence profitable operations in the future.

	June 30, 2006	December 31, 2005
Working capital	\$ 154,870	\$ 220,529
Deficit	(2,634,888)	(2,597,512)

Net cash provided by operating activities for the six month period ended June 30, 2006 was \$29,872 compared to \$182,641 in net cash provided during the comparative period. The cash provided by operating activities for the current period consists primarily of the operating income and a change in non-cash working capital.

Net cash used in investing activities for the six month period ended June 30, 2006 was \$97,799 compared to \$120,902 in net cash provided during the comparative period. Net cash used during the current period consisted of exploration expenditures of \$197,322, recoveries on exploration expenditures of \$133,081, acquisition of investments of \$60,641 and proceeds from the sale of investments of \$27,083.

During the current period, financing activities provided cash of \$35,250 from the exercise of warrants. There were no financing activities during the comparative period.

### Capital Resources

The Company has sufficient funds to meet its property maintenance payments for 2006 and cover anticipated administrative expenses throughout the 2006 year. It will continue to focus exploration and development efforts in the Portugal and maintain its landholdings in Nevada and Canada. Joint venture partners will be sought for its Canadian properties.

## Related Party Transactions

Included in accounts payable at June 30, 2006 is \$5,357 (December 31, 2005 - \$7,562) due to a director of the Company.

The Company entered into the following transactions with related parties during the six month period ended June 30, 2006:

- a) Paid or accrued management fees of \$8,400 (2005 - \$6,812) to a director of the Company.
- b) Paid or accrued accounting fees of \$2,360 (2005 - \$1,780) to an officer of the Company.
- c) Paid or accrued technical and professional fees of \$19,205 (2005 - \$16,002) to a director which were charged to the Jales property.

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

## Financial Instruments

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

At June 30, 2006, approximately 61% (December 31, 2005 – 84%) of the Company's accounts payable and accrued liabilities are denominated in Euro's. The Company does not use derivative instruments or foreign exchange contracts to hedge against gains or losses arising from foreign exchange fluctuations.

## Outstanding Share Data

	Number of Shares	Amount	Contributed Surplus
Authorized			
Unlimited common shares without par value			
Issued			
Balance, December 31, 2005	11,282,989	\$ 2,846,469	\$ 56,452
Exercise of warrants	<u>235,000</u>	<u>35,250</u>	<u>-</u>
Balance, June 30, 2006	<u>11,517,989</u>	<u>\$ 2,881,719</u>	<u>\$ 56,452</u>

During the six month period ended June 30, 2006, the Company issued 235,000 common shares for proceeds of \$35,250 from the exercise of warrants priced at \$0.15 per warrant.

## Stock options

As at June 30, 2006, the following stock options are outstanding:

	Number of Shares	Exercise Price	Expiry Date
	153,500	\$ 0.10	June 7, 2007
	450,000	0.135	June 20, 2010

**Warrants**

As at June 30, 2006, there were no share purchase warrants outstanding.

**Subsequent events**

There were no events to report.