



# KERNOW

RESOURCES & DEVELOPMENTS LTD.

2005 ANNUAL REPORT

# **KERNOW RESOURCES & DEVELOPMENTS LTD.**

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## **ANNUAL REPORT**

May 19, 2006

During 2005 Kernow focussed its efforts on gold exploration and development in Northern Portugal. It continues to develop the Jales Gralheira Gold Property which is being funded by St. Elias Mines Ltd. by way of an Option Agreement as described in Kernow's 2005 annual financial statements. St. Elias has now earned a 51% interest in the property.

Most recently the Company announced its intention to apply to the Portuguese mining authorities for an Experimental Mining Licence on the Gralheira Property. This License will allow Kernow and St. Elias to undertake underground drifting and bulk sampling on the Gralheira structure.

During the early part of 2005 a series of 11 diamond drill holes were completed at Gralheira totalling 3,978 meters. These were for the most part targeted at the deep seated anomalies identified by the TITAN 24 deep-penetrating IP Resistivity and Magnetotelluric survey conducted by Quantech Geosciences. The results of this drilling campaign, which was completed in August of 2005, have been the subject of several news releases. The drilling showed that the auriferous mineralising system at Gralheira extends to at least 510 meters below surface.

In addition, a separate drill program, which commenced in fall of 2005 and was completed in the earlier part of 2006, consisted of 12 drill holes totalling 2,400 meters. Following the completion of this round of drilling, data is now available at approximately 50 to 100 meter intervals along the strike of the structure and at 25 to 30 meter centers vertically in and around the "Adit Zone". Previous drilling and tunnelling of the Adit Zone has identified high-grade "shoots" with elevated gold values. The results of this program have further defined the orientation of the high grade "shoots" and the data are assisting in the defining of categories of resources.

During April and May of 2006 there has been an upsurge in local interest in the mining sector in Portugal with several foreign companies announcing development plans for mineral properties in the south of the country. This heightened awareness of the presence of mineral resources in Portugal and the benefits deriving from these new developments we believe will help Kernow in its development of the Gralheira and newly acquired Poco das Freitas and Limrahino gold projects located in the area of Boticas, Portugal represents a stable and favourable environment in which to develop mineral projects.

Kernow is continuing to focus its exploration and development efforts in the Iberian Peninsula and has actively been assessing other opportunities in the region.

Kernow has recently established a web site [www.kernowresources.com](http://www.kernowresources.com). Investors and shareholders are encouraged to visit the site.

"Alan F. Matthews"

President & Chief Executive Officer

## **EXPLORATION ACTIVITIES**

This report briefly describes the activities of Kernow Resources & Developments Ltd. for the year ended December 31, 2005 and the four-month period ended April 30, 2006.

### **PORTUGAL**

#### **JALES GRALHEIRA GOLD PROPERTY**

Significant progress has been made at the property in 2005 with a total of 6,378 meters of diamond drilling having been completed since the last Annual Report. There are several factors worthy of mention at this time, perhaps the most important being that the deep diamond drilling conducted in the early part of the year clearly confirmed that the Gralheira deposit extends to at least 510 meters below surface.

Secondly the project is now entering a new stage and it is hoped that with the granting of the Experimental Mining Licence Kernow and its JV partner will be able to generate sufficient data to enable further advanced development of the deposit.

#### **POCO DAS FREITAS GOLD PROPERTY**

Progress at the Poco das Freitas and Limarinho deposits has been somewhat limited. A large data package has been obtained and reviewed which records the previous drilling under taken at the Limarinho and Poco das Freitas properties by COGEMA (Compagnie Générale des Matières Nucléaires of France) and was submitted to the I.G.M. (“Instituto Geologico e Minerio”) by COGEMA in the normal course of maintaining the contract for the property in the early 1980s.

These data along with field reconnaissance programs conducted by Kernow have identified several drill targets. Kernow is now awaiting permits and permission to drill those targets.

From the data generated from the holes at Limarinho, structural studies, thin section work and limited metallurgical testing COGEMA completed a study outlining of the “Potential of Gold” at Limarinho. COGEMA estimated from the 16 drill holes at Limarinho that the deposit contained 2.07 tonnes of gold at a grade of 2.8 grams per tonne of gold from the current surface to 50 meters below surface. It classified this estimate as “Reservas Possiveis”, the English translation of which is “Possible Reserves”. This category of “Reserve Possiveis” is not a category recognised by National Instrument 43-101 *Standards of Disclosure for Mineral Projects* but may be comparable to an ‘inferred resource’ under NI 43-101. The study was published in 1998 in a document made publicly available by the Portuguese “Instituto Geologico e Minerio” entitled “Mineral Potential of Portugal”.

Kernow believes that this estimate is relevant and reliable, however, a qualified person has not done the work necessary to verify the classification of the resource or reserve. The work required to verify the classification will form part of its ongoing work program. Furthermore, Kernow does not view the “Reservas Possiveis” as a National Instrument 43-101 defined resource or

reserve verified by a Qualified Person accordingly, the historical estimate should not be relied upon.

The COGEMA drilling at the Limarinho deposit identified nine parallel grey quartz veins within which higher gold values are found. The veins can be up to two metres in width. First pass review of the assays from each of the holes shows that there is important gold mineralisation between the veins. Mineralisation is hosted in altered, kaolinised two mica granite and some instances associated with arsenopyrite. Portions of the holes show greissenisation.

## **CANADA**

### **SACHEM BAY, LABRADOR**

Kernow believes the property has merit and the property is being maintained in good standing. While over \$750,000 has been spent on the property to date, Kernow does not carry the property at this value as the majority of the funds have been expended by optionees.

### **ORVILLIERS AND JOUTEL, QUÉBEC**

These two properties are located in the Casa Berardi and Joutel gold camps of Québec. The Geological Survey of Québec has recently classified the Volcanogenic Massive Sulphide occurrence at Joutel as worthy of inclusion in its "Study of Base Metal Occurrences in the Abitibi Region". Kernow is seeking joint venture partners to continue the development of the properties.

## **UNITED STATES OF AMERICA**

### **SHAWNEE PROJECT, HUMBOLDT COUNTY, NEVADA**

Kernow did not undertake any work on these claims in 2005. Past drilling on the property has returned several interesting intersections from a sulphide rich gold and base metal mineralising system associated with nearby intrusive rocks. Hole SH6-C contains a near surface intersection of 2.72% copper, 1.67 g/t gold and 57.7 g/t silver over a 4.27 metre length. Hole 97-2 returned assays of 0.67% copper 2.49 g/t gold, 84.4 g/t silver and 2.49 g/t gold across an intercept of 1.5 metres. This system is seen from drilling and geophysical interpretation to have a strike along a strike length of approximately 1,500 feet.

Kernow intends to hold the property and seek a Joint Venture partner to continue its development.

### **DYKE HOT SPRINGS, HUMBOLDT COUNTY, NEVADA**

No work was completed on the property in 2005.

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The foregoing disclosure, including results of Kernow's exploration programs, have been reviewed, verified (including sampling, analytical and test data) and compiled by Kernow's President, Alan F. Matthews, C. Eng. (a 'qualified person' for the purpose of National Instrument 43-101, *Standards of Disclosure for Mineral Projects*).

# **KERNOW RESOURCES AND DEVELOPMENTS LTD.**

## **FORM 51-102F1 MANAGEMENT DISCUSSION AND ANALYSIS YEAR ENDED DECEMBER 31, 2005**

The following discussion and analysis, prepared as of March 6, 2006 should be read together with the unaudited consolidated financial statements for the year ended December 31, 2005 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 annual audited 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).

### **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 year:

1. On March 9, 2005, the Company announced the results of a Titan 24 geophysical survey completed by Quantec Geoscience Inc. on the Jales gold property in Portugal.
2. 300,000 stock options exercisable at \$0.15 expired unexercised.
3. The Company commenced a 5 hole, deep drilling program at the Jales property on April 24, 2005. The drilling program is designed to test at depths of between 400 meters and 500 meters below surface anomalies identified by the geophysical survey undertaken in November 2004.
4. Granted 450,000 stock options at \$0.135 to its directors, officers and employees expiring June 20, 2010.
5. The Company held its Annual and Special Meeting on June 20, 2005. All proposed resolutions were passed.
6. Issued 46,500 common shares for gross proceeds of \$4,650 pursuant to the exercise of stock options.
7. Issued 100,000 common shares for gross proceeds of \$15,000 pursuant to the exercise of warrants.
8. Received 300,000 shares from St. Elias at a value of \$75,000 as required for St. Elias to acquire its 51% in the Jales property.
9. St. Elias exercised its First Option and has acquired a 51% interest in the Jales property. In addition, St. Elias has elected to proceed with the Second Option to earn an additional 24% in the property (to 75%) in consideration of cash payments totalling \$100,000, incurring exploration expenditures of not less than \$2,500,000 and issuing an aggregate of 1,000,000 shares over a three year period (received \$25,000 cash).
10. On September 6, 2005, the Company announced the results of a recently completed drill program on the Jales property in Portugal. The program consisted of 11 drill holes that totalled approximately 3,978 metres.

11. On October 14, 2005, the Company commenced a 2400 meter, 12 drill-hole program on the Jales property.
12. On December 13, 2005, the Company announced that it has drilled 9 holes on the Jales property and sent the samples to OMAC Labs Ltd. in Ireland for assay.

## 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.

	Year Ended December 31, 2005	Year Ended December 31, 2004	Year Ended December 31, 2003
Total revenues	\$ 145,436	\$ 24,358	\$ 30,748
Net income (loss) before extraordinary items	5,909	(61,117)	(341,765)
Net income (loss)	5,909	(61,117)	(341,765)
Basic and diluted earnings (loss) per share	0.01	(0.01)	(0.04)
Total assets	435,865	267,557	255,850
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 operators' fee to its joint venture partner to manage the Jales Gold Property in Portugal. Revenues from operator fees during the current year were \$73,938 and \$23,679 during the 2004 comparative year. During the current year, the Company realized a gain of \$27,645 on the sale of marketable securities. The gain during the previous year was \$335.

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 earned net income (loss) of \$5,909 (2004 - (\$61,117)) during the year ended December 31, 2005. Some of the significant expenses are as follows: paid or accrued \$34,724 (2004 - \$35,509) in accounting, legal and audit fees, \$3,399 (2004 - \$2,571) in bank charges and interest, \$12,602 (2004 - \$12,740) in filing, listing and transfer agent fees, \$13,612 (2004 - \$10,400) in management fees, \$11,357 (2004 - \$8,257) in office, miscellaneous and shareholder costs, \$Nil (2004 - \$1,400) in property investigation costs and \$5,855 (2004 - \$10,176) in travel and related costs.

Most of the current period expenses are comparable to that of the previous period. Management fees increased from the previous comparative period because the Company's director spent more time in managing an active company.

During the year, the Company incurred \$56,452 (2004 - \$Nil) in stock based compensation expense. This non-cash expense represents the fair value of the stock options granted. The Black-Scholes option pricing model was used the value the stock options granted during the year.

During the year ended December 31, 2005, the Company earned \$73,938 (2004 - \$23,679) as an operator fee from its joint venture partner, recovered \$1,035,831 (2004 - \$295,990) in exploration costs and \$100,000 (\$75,000 in shares) (2004 - \$18,000 received in shares) in option payments from St. Elias of which \$911,761 (2004 - \$278,515) was received during the current year.

## 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. The Jales property consists of an exploration license granted by the Government of Portugal on June 19, 2000, with options to renew for up to four years. The license has been renewed to June 16, 2006. 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.

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 the 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 \$100,000 (received), incurring cumulative exploration expenditures of \$1,500,000 (completed) on the property and issuing a total of 500,000 common shares (500,000 received at a value of \$119,000) 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 \$250,000 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 current year, the Company recovered \$1,035,831 (2004 - \$295,990) in exploration costs and received \$100,000 (2004 - \$43,000) in option payments consisting of \$25,000 (2004 - \$Nil) cash and 300,000 (2004 - 100,000) common shares valued at \$75,000 (2004 - \$18,000).

## 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 euros 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 related to the property.

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

## Summary of Quarterly Results

	For the Quarters Ended			
	December 31, 2005	September 30, 2005	June 30, 2005	March 31, 2005
Total assets	\$ 435,865	\$ 361,828	\$ 431,448	\$ 244,048
Mineral properties and deferred costs	57,180	59,779	250,413	113,177
Working capital (deficiency)	220,529	166,572	(64,601)	66,689
Shareholders' equity	305,409	254,051	213,512	207,566
Revenues	23,257	45,970	30,872	2,193
Net income (loss)	43,858	28,389	(50,506)	(15,832)
Earnings (loss) per share	0.01	0.01	(0.01)	(0.01)

### For the Quarters Ended

	December 31, 2004	September 30, 2004	June 30, 2004	March 31, 2004
Total assets	\$ 267,557	\$ 272,943	\$ 290,774	\$ 388,618
Mineral properties and deferred costs	118,191	96,535	90,262	149,752
Working capital (deficiency)	77,507	116,270	131,301	91,582
Shareholders' equity	223,398	240,505	249,263	269,034
Revenues	5,386	2,620	13,136	3,216
Net Income (loss)	(17,107)	(8,758)	(19,771)	(15,481)
Earnings (loss) per share	(0.01)	(0.01)	(0.02)	(0.01)

Significant changes in key financial data from 2004 to 2005 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 \$73,938 in operator fees.

### 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.

	December 31, 2005	December 31, 2004
Working capital	\$ 220,529	\$ 77,507
Deficit	(2,597,512)	(2,603,421)

Net cash used in operating activities for the year ended December 31, 2005 was \$25,749 compared to \$77,017 during the year ended December 31, 2004. The cash used in operating activities for the current year consists primarily of the operating loss and a change in non-cash working capital.

Net cash provided by investing activities for the year ended December 31, 2005 was \$70,457 compared to \$11,054 in net cash provided during the prior year. Net cash used during the current year consisted of exploration expenditures of \$922,202, recoveries on exploration expenditures of \$948,815 and proceeds from the sale of investments of \$43,845.

During the current year, financing activities provided cash of \$19,650. Financing activities provided cash of \$80,000 during comparative period last year.

### 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 Iberian Peninsula 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 is \$7,562 (2004 - \$16,966) due to a director of the Company and \$Nil (2004 - \$1,500) due to a company with a common director.

Included in receivables is \$124,071 (2004 - \$17,475) due from a company with a former common director.

The Company entered into the following transactions with related parties during the year ended December 31, 2005:

- a) Paid or accrued management fees of \$13,612 (2004 - \$10,400) to a director of the Company.
- b) Paid or accrued accounting fees of \$4,160 (2004 - \$4,255) to an officer of the Company.
- c) Paid or accrued technical and professional fees of \$43,310 (2004 - \$29,617) to a director which were charged to the Jales property.
- d) Recovered \$1,035,831 (2004 - \$295,990) in mineral property expenditures and \$100,000 (2004 - \$43,000) in option payments from a company with a former common director.
- e) Settled a promissory note and accrued interest totalling \$42,195 in 2004 with a company having common directors at the time by issuing 421,949 common shares.

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 December 31, 2005, approximately 84% (2004 - 36%) 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, 2003	9,914,540	\$ 2,704,624	\$ -
Shares for debt	421,949	42,195	-
Private placement	<u>800,000</u>	<u>80,000</u>	<u>-</u>
Balance, December 31, 2004	11,136,489	2,826,819	-
Shares issued pursuant to the exercise of stock options	46,500	4,650	-
Shares issued pursuant to the exercise of warrants	100,000	15,000	-
Stock-based compensation	<u>-</u>	<u>-</u>	<u>56,452</u>
Balance, December 31, 2005	<u>11,282,989</u>	<u>\$ 2,846,469</u>	<u>\$ 56,452</u>

## Stock options

As at December 31, 2005, 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 December 31, 2005, the following share purchase warrants are outstanding:

Number of Shares	Exercise Price	Expiry Date
300,000	\$ 0.15	April 20, 2006

## Subsequent events

The following events occurred subsequent to December 31, 2005:

- i) The Company sold 10,000 shares of Bannockburn Resources, Inc that it held as an investment. Bannockburn Resources, Inc became listed on the CNQ under the symbol BKNN on February 2, 2006.
- ii) Announced that its Annual General Meeting will take place on June 26, 2006.
- iii) 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.

**KERNOW RESOURCES AND DEVELOPMENTS LTD.**

**CONSOLIDATED FINANCIAL STATEMENTS**

**DECEMBER 31, 2005**

**AUDITORS' REPORT**

To the Shareholders of  
Kernow Resources and Developments Ltd.

We have audited the consolidated balance sheets of Kernow Resources and Developments Ltd. as at December 31, 2005 and 2004 and the consolidated statements of operations and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2005 and 2004 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

**"DAVIDSON & COMPANY LLP"**

Vancouver, Canada

Chartered Accountants

March 6, 2006

A Member of *SC INTERNATIONAL*

**KERNOW RESOURCES AND DEVELOPMENTS LTD.**  
**CONSOLIDATED BALANCE SHEETS**  
**AS AT DECEMBER 31**

	2005	2004
<b>ASSETS</b>		
<b>Current</b>		
Cash	\$ 147,792	\$ 83,434
Receivables	126,818	20,657
Marketable securities (market value \$76,375; 2004 - \$17,575)	<u>76,375</u>	<u>17,575</u>
	350,985	121,666
<b>Deposits</b> (Note 3)	25,600	25,600
<b>Investments</b> (Note 4)	2,100	2,100
<b>Mineral properties</b> (Note 5)	<u>57,180</u>	<u>118,191</u>
	<u>\$ 435,865</u>	<u>\$ 267,557</u>

**LIABILITIES AND SHAREHOLDERS' EQUITY**

<b>Current</b>		
Accounts payable and accrued liabilities	\$ 130,456	\$ 44,159
<b>Shareholders' equity</b>		
Capital stock (Note 6)	2,846,469	2,826,819
Contributed surplus (Note 6)	56,452	-
Deficit	<u>(2,597,512)</u>	<u>(2,603,421)</u>
	<u>305,409</u>	<u>223,398</u>
	<u>\$ 435,865</u>	<u>\$ 267,557</u>

**Nature and continuance of operations** (Note 1)

**Contingencies** (Note 12)

**On behalf of the Board:**

(Signed) Alan F. Matthews	Director	(Signed) Robert F. Weicker	Director
Alan F. Matthews		Robert F. Weicker	

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

**KERNOW RESOURCES AND DEVELOPMENTS LTD.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT**  
**YEAR ENDED DECEMBER 31**

	2005	2004
<b>EXPENSES</b>		
Accounting, legal and audit	\$ 34,724	\$ 35,509
Bank charges and interest	3,399	2,571
Filing, listing and transfer agent fees	12,602	12,740
Foreign exchange loss (gain)	1,951	(228)
Management fees	13,612	10,400
Office, miscellaneous and shareholder costs	11,357	8,257
Property investigation	-	1,400
Stock-based compensation (Note 6)	56,452	-
Travel and related	5,855	10,176
Website design and maintenance	<u>1,075</u>	<u>-</u>
<b>Loss before other items</b>	<u>(141,027)</u>	<u>(80,825)</u>
<b>OTHER ITEMS</b>		
Interest income	709	344
Gain on disposal of marketable securities	27,645	335
Operator fees	73,938	23,679
Recovery of mineral property costs (Note 5)	43,144	-
Write-off of accounts payable	1,500	-
Write-down of marketable securities	<u>-</u>	<u>(4,650)</u>
	<u>146,936</u>	<u>19,708</u>
<b>Net income (loss) for the year</b>	5,909	(61,117)
<b>Deficit, beginning of the year</b>	<u>(2,603,421)</u>	<u>(2,542,304)</u>
<b>Deficit, end of the year</b>	<u>\$ (2,597,512)</u>	<u>\$ (2,603,421)</u>
<b>Basic and fully diluted income (loss) per share</b>	<u>\$ 0.01</u>	<u>\$ (0.01)</u>
<b>Weighted average number of shares outstanding</b>	<u>11,168,340</u>	<u>10,825,388</u>

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

**KERNOW RESOURCES AND DEVELOPMENTS LTD.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**YEAR ENDED DECEMBER 31**

	2005	2004
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income (loss) for the year	\$ 5,909	\$ (61,117)
Items not affecting cash:		
Gain on disposal of marketable securities	(27,645)	(335)
Stock-based compensation	56,452	-
Write-off of accounts payable	(1,500)	-
Write-down of marketable securities	-	4,650
Recovery of mineral property costs	(43,144)	-
Changes in non-cash working capital items:		
(Increase) decrease in receivables	5,856	(13,039)
Increase (decrease) in accounts payable and accrued liabilities	<u>(21,677)</u>	<u>(7,176)</u>
Net cash used in operating activities	<u>(25,749)</u>	<u>(77,017)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Proceeds from issuance of capital stock	<u>19,650</u>	<u>80,000</u>
Net cash provided by financing activities	<u>19,650</u>	<u>80,000</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Mineral property recoveries	948,814	320,990
Expenditures on mineral properties	(922,202)	(311,636)
Proceeds on sale of marketable securities	<u>43,845</u>	<u>1,700</u>
Net cash provided by investing activities	<u>70,457</u>	<u>11,054</u>
<b>Increase in cash during the year</b>	<b>64,358</b>	<b>14,037</b>
<b>Cash, beginning of the year</b>	<u><b>83,434</b></u>	<u><b>69,397</b></u>
<b>Cash, end of the year</b>	<b>\$ 147,792</b>	<b>\$ 83,434</b>
<b>Cash paid during the year for interest</b>	<b>\$ -</b>	<b>\$ -</b>
<b>Cash paid during the year for income taxes</b>	<b>\$ -</b>	<b>\$ -</b>

**Supplemental disclosure with respect to cash flows (Note 8)**

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

**KERNOW RESOURCES AND DEVELOPMENTS LTD.**  
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 2005

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**1. NATURE AND CONTINUANCE OF OPERATIONS**

The Company is incorporated under the laws of the Province of British Columbia. The Company is in the process of exploring its mineral properties and has not yet determined whether these properties contain ore reserves that are economically recoverable. To date, the Company has not generated significant revenues and is considered to be in the development stage.

The recoverability of the amounts shown for mineral properties and related deferred exploration costs are dependent upon the existence of economically recoverable reserves, the ability of the Company to obtain necessary financing to complete the development of those reserves and upon future profitable production.

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles with the assumption that the Company will be able to realize its assets and discharge its liabilities in the normal course of business rather than through a process of forced liquidation. Continued operations of the Company are dependent upon its ability to receive continued financial support, complete public equity financings, or generate profitable operations in the future. These consolidated financial statements do not include any adjustments relating to the recoverability and classification of recorded assets and liabilities that might be necessary, should the Company be unable to continue as a going concern.

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	2005	2004
Working capital	\$ 220,529	\$ 77,507
Deficit	(2,597,512)	(2,603,421)

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**2. SIGNIFICANT ACCOUNTING POLICIES**

**Principles of consolidation**

These consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant inter-company balances and transactions have been eliminated upon consolidation.

**Use of estimates**

The preparation of consolidated financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the year. Actual results may differ from those estimates.

**Foreign currency translation**

The Company's foreign subsidiaries and activities are translated into Canadian dollars using the temporal method. Under this method, monetary items are translated at the exchange rate in effect at the balance sheet date, non-monetary items are translated at historical rates and revenue and expense items are translated at exchange rates prevailing when such items are recognized in the results of operations. Exchange gains or losses arising on translation of foreign currency items are included in the results of operations.

**2. SIGNIFICANT ACCOUNTING POLICIES (cont'd...)**

**Investments and marketable securities**

Marketable securities are carried at the lower of cost and net realizable value.

Long-term investments are recorded at cost. If it is determined that there is an other than temporary decline in the value of an investment, it will be written-down to its estimated net realizable value.

**Mineral properties**

The Company records its interests in mineral properties and areas of geological interest at cost. All direct and indirect costs relating to the acquisition, exploration and development of these interests are capitalized on the basis of specific claim blocks or areas of geological interest until the properties to which they relate are placed into production, sold, abandoned or management has determined there to be an impairment. These costs will be amortized on the basis of units produced in relation to the proven reserves available on the related property following commencement of production. Mineral properties which are sold before that property reaches the production stage will have all revenues from the sale of the property credited against the cost of the property. Properties which have reached the production stage will have a gain or loss calculated based on the portion of that property sold.

The recorded cost of mineral exploration interests is based on cash paid, the value of share consideration and exploration and development costs incurred, net of recoveries. The recorded amount may not reflect recoverable value as this will be dependant on the development program, the nature of the mineral deposit, commodity prices, adequate funding and the ability of the Company to bring its projects into production.

**Asset retirement obligations**

The Company recognizes the fair value of a liability for an asset retirement obligation in the year in which it is incurred when a reasonable estimate of fair value can be made. The carrying amount of the related long-lived asset is increased by the same amount as the liability.

**Income taxes**

Future income taxes are recorded using the asset and liability method whereby future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future tax assets and liabilities are measured using the enacted or substantively enacted tax rates expected to apply when the asset is realized or the liability settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the year that substantive enactment or enactment occurs. To the extent that the Company does not consider it more likely than not that a future tax asset will be recovered, it provides a valuation allowance against the excess.

**KERNOW RESOURCES AND DEVELOPMENTS LTD.**  
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 2005

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**2. SIGNIFICANT ACCOUNTING POLICIES (cont'd...)**

**Loss per share**

The Company uses the treasury stock method to compute the dilutive effect of options, warrants and similar instruments. Under this method the dilutive effect on loss per share is recognized on the use of the proceeds that could be obtained upon exercise of options, warrants and similar instruments. It assumes that the proceeds would be used to purchase common shares at the average market price during the year. For the years presented, this calculation proved to be anti-dilutive.

Basic loss per share is calculated using the weighted average number of shares outstanding during the year.

**Stock-based compensation**

The Company accounts for the granting of stock options to employees and non-employees using the fair value method whereby all awards to employees and non-employees will be recorded at fair value on the date of grant. The Company estimates the fair value of each stock option at the date of grant using the Black-Scholes option pricing model. Any consideration paid by the option holders to purchase shares is credited to capital stock.

**Comparative figures**

Certain comparative figures have been reclassified to conform with the current year's presentation.

**3. DEPOSITS**

The Company posted refundable term deposits totaling \$25,600 (€16,000) as security with the Bank of Portugal to support a performance guarantee written by the bank to the Portuguese Government relating to the exploration of mineral properties in Portugal (Note 5).

**4. INVESTMENTS**

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	2005	2004
Bannockburn Resources, Inc.	\$ 2,100	\$ 2,100

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The Company owns 29,666 common shares of Bannockburn Resources, Inc. ("Bannockburn") which were written down by \$29,425 to a carrying value of \$2,100 in the 2002 fiscal year. The president and director of the Company became a director of Bannockburn during the 2003 fiscal year and resigned during the year ended December 31, 2005.

**5. MINERAL PROPERTIES**

Title to mineral properties involves certain inherent risks due to the difficulties of determining the validity of certain claims as well as the potential for problems arising from the frequently ambiguous conveyancing history characteristic of many mineral properties. The Company has investigated title to all of its mineral properties and, to the best of its knowledge, title to all of its properties are in good standing.

**KERNOW RESOURCES AND DEVELOPMENTS LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2005**

**5. MINERAL PROPERTIES (cont'd...)**

<b>2005</b>	Jales	Boticas	Joutel	Orvilliers	Voisey's Bay	Shawnee	Dyke Hot Springs	Total
Balance, beginning of year	\$ 69,637	\$ 11,761	\$ 5,460	\$ 6,150	\$ 4,761	\$ 10,573	\$ 9,849	\$ 118,191
Additions:								
Administration	15,267	-	-	-	-	-	-	15,267
Assays	40,256	1,830	-	-	-	-	-	42,086
Claim fees	8,952	(169)	-	-	-	1,610	1,289	11,682
Core storage	4,193	-	-	-	-	358	-	4,551
Drilling and sampling	767,352	-	-	-	-	-	-	767,352
Field accommodations	19,447	-	-	-	-	-	-	19,447
Field supplies	19,144	-	-	-	-	-	-	19,144
Labour	20,160	-	-	-	-	-	-	20,160
Technical and professional	107,229	3,648	-	-	-	-	-	110,877
Travel and transport	21,050	60	-	-	-	-	-	21,110
	1,023,050	5,369	-	-	-	1,968	1,289	1,031,676
Recoveries and option payments	(1,135,831)	-	-	-	-	-	-	(1,135,831)
	(112,781)	5,369	-	-	-	1,968	1,289	(104,155)
Net recovery recognized as income	43,144	-	-	-	-	-	-	43,144
	(69,637)	5,369	-	-	-	1,968	1,289	(61,011)
Balance, end of year	\$ -	\$ 17,130	\$ 5,460	\$ 6,150	\$ 4,761	\$ 12,541	\$ 11,138	\$ 57,180

**KERNOW RESOURCES AND DEVELOPMENTS LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2005**

**5. MINERAL PROPERTIES (cont'd...)**

<b>2004</b>	Jales	Boticas	Joutel	Orvilliers	Voisey's Bay	Shawnee	Dyke Hot Springs	Total
Balance, beginning of year	\$ 118,949	\$ -	\$ 5,000	\$ 5,000	\$ 161	\$ 7,996	\$ 8,439	\$ 145,545
Additions:								
Acquisition	-	8,525	-	-	-	-	-	8,525
Administration	18,609	-	-	-	-	-	-	18,609
Assays	19,091	-	-	-	-	-	-	19,091
Claim fees	10,514	-	460	1,150	4,600	1,761	1,410	19,895
Core storage	3,561	-	-	-	-	816	-	4,377
Drilling and sampling	82,736	-	-	-	-	-	-	82,736
Field accommodations	13,001	-	-	-	-	-	-	13,001
Field supplies	6,061	-	-	-	-	-	-	6,061
Labour	21,997	-	-	-	-	-	-	21,997
Technical and professional	87,098	3,236	-	-	-	-	-	90,334
Travel and transport	27,010	-	-	-	-	-	-	27,010
	289,678	11,761	460	1,150	4,600	2,577	1,410	311,636
Recoveries	(338,990)	-	-	-	-	-	-	(338,990)
	(49,312)	11,761	460	1,150	4,600	2,577	1,410	(27,354)
Balance, end of year	\$ 69,637	\$ 11,761	\$ 5,460	\$ 6,150	\$ 4,761	\$ 10,573	\$ 9,849	\$ 118,191

**5. MINERAL PROPERTIES (cont'd...)**

**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. The Jales property consists of an exploration license granted by the Government of Portugal. The license has been renewed to June 16, 2006. 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.

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, 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 (2004 – 200,000 shares at a value of \$31,000) 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 current year, the Company recovered \$1,035,831 (2004 - \$295,990) in exploration costs and received \$100,000 (2004 - \$43,000) in option payments consisting of \$25,000 (2004 - \$Nil) cash and 300,000 (2004 – 100,000) common shares valued at \$75,000 (2004 - \$18,000).

**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 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 related to the property (Note 12).

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

**5. MINERAL PROPERTIES (cont'd...)**

**Joutel, Quebec, Canada**

The Company owns a 100% interest in certain mining claims in northwestern Quebec. The claims are subject to a 1% net smelter returns royalty, to a maximum of \$2,000,000.

During the 2003 fiscal year, the Company wrote-down the carrying value of the Joutel property by \$245,440 to a nominal value of \$5,000.

**Orvilliers, Quebec, Canada**

The Company owns a 100% interest in certain claims in the Orvilliers Township in Quebec.

During the 2003 fiscal year, the Company wrote-down the carrying value of the Orvilliers property by \$86,870 to a nominal value of \$5,000.

**Voisey's Bay – Claim I (Sachem Bay), Labrador, Canada**

The Company owns a 100% interest in certain mining claims in Labrador, Canada.

The Company entered into an agreement with Pathfinder Resources Ltd. (“Pathfinder”) whereby it granted an option to Pathfinder to earn a 100% interest in its Voisey’s Bay property. During the 2003 fiscal year, the Company received \$10,000 cash, and 50,000 shares of Pathfinder valued at \$6,500. During the 2004 fiscal year, the agreement was terminated.

**Shawnee, Nevada, U.S.A.**

The Shawnee property consists of a 100% interest in certain mining claims in north central Nevada, U.S.A.

During the year ended December 31, 2002, the Company wrote-down the carrying value of the Shawnee property by \$249,861 to a nominal value of \$5,000.

**Dyke Hot Springs, Nevada, U.S.A.**

The Company owns a 100% interest in certain mining claims in northwestern Nevada, U.S.A.

**KERNOW RESOURCES AND DEVELOPMENTS LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2005**

**6. CAPITAL STOCK AND CONTRIBUTED SURPLUS**

	Number of Shares	Amount	Contributed Surplus
Authorized			
Unlimited common shares without par value			
Issued			
Balance, December 31, 2003	9,914,540	\$ 2,704,624	\$ -
Shares for debt	421,949	42,195	-
Private placement	<u>800,000</u>	<u>80,000</u>	<u>-</u>
Balance, December 31, 2004	11,136,489	2,826,819	-
Exercise of stock options	46,500	4,650	-
Exercise of warrants	100,000	15,000	-
Stock-based compensation	<u>-</u>	<u>-</u>	<u>56,452</u>
Balance, December 31, 2005	<u>11,282,989</u>	<u>\$ 2,846,469</u>	<u>\$ 56,452</u>

During the year ended December 31, 2005, the Company altered its authorized share capital to unlimited from 50,000,000 common shares.

During the year ended December 31, 2004 the Company:

- 1) Issued 421,949 common shares at a price of \$0.10 per share to settle a promissory note and accrued interest totalling \$42,195.
- 2) Completed a private placement of 800,000 units at a price of \$0.10 per unit for gross proceeds of \$80,000. Each unit consisted of one common share and one half of one share purchase warrant. Each whole warrant was exercisable at a price of \$0.15 per share expiring on April 20, 2006.

**Stock options**

The Company has established an incentive stock option plan whereby the Board of Directors may grant options to directors, officers, employees or consultants for up to 10% of the issued and outstanding capital stock of the Company. The exercise price of the options cannot be less than the greater of \$0.10 per share or the closing trading price of the Company's shares on the day before the grant. Any options granted will have a term up to 5 years with vesting provisions determined by the board of directors.

As at December 31, 2005, 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

**KERNOW RESOURCES AND DEVELOPMENTS LTD.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**DECEMBER 31, 2005**

**6. CAPITAL STOCK AND CONTRIBUTED SURPLUS (cont'd...)**

**Stock options (cont'd...)**

Stock option transactions are summarized as follows:

	Number of Shares		Weighted Average Exercise Price
Balance, December 31, 2003 and 2004	500,000	\$	0.13
Options exercised	(46,500)		0.10
Options expired	(300,000)		0.15
Options granted	<u>450,000</u>		0.135
Balance, December 31, 2005	603,500	\$	0.126
Number of options currently exercisable	603,500	\$	0.126

**Stock-based compensation**

During the year ended December 31, 2005, the Company granted 450,000 stock options to directors, officers and consultants. The estimated fair value of these options is \$56,452, or \$0.13 per option. This amount has been expensed as stock-based compensation in the statement of operations with a corresponding amount recorded as contributed surplus in shareholders' equity.

The following weighted average assumptions were used for the Black-Scholes valuation of stock options granted during the year:

	2005	2004
Risk-free interest rate	2.92%	-
Expected life of options	5.0 years	-
Annualized volatility	158.60%	-
Dividend rate	0.00%	-

**Warrants**

As at December 31, 2005, the following share purchase warrants are outstanding:

Number of Shares	Exercise Price	Expiry Date
300,000	\$ 0.15	April 20, 2006

The only share purchase warrant activity during the 2005 and 2004 fiscal years was the exercise of 100,000 warrants at \$0.15 per share during 2005.

**7. RELATED PARTY TRANSACTIONS**

Included in accounts payable is \$7,562 (2004 - \$16,966) due to a director of the Company and \$Nil (2004 - \$1,500) due to a company with a common director.

Included in receivables is \$124,071 (2004 - \$17,475) due from a company with a former common director.

The Company entered into the following transactions with related parties during the year ended December 31, 2005:

- a) Paid or accrued management fees of \$13,612 (2004 - \$10,400) to a director of the Company.
- b) Paid or accrued accounting fees of \$4,160 (2004 - \$4,255) to an officer of the Company.
- c) Paid or accrued technical and professional fees of \$43,310 (2004 - \$29,617) to a director which were charged to the Jales property.
- d) Recovered \$1,035,831 (2004 - \$295,990) in mineral property expenditures and \$100,000 (2004 - \$43,000) in option payments from a company with a former common director.
- e) Settled a promissory note and accrued interest totalling \$42,195 in 2004 with a company having common directors at the time by issuing 421,949 common shares.

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

**8. SUPPLEMENTAL DISCLOSURE WITH RESPECT TO CASH FLOWS**

Significant non-cash transactions for the year ended December 31, 2005 consisted of:

- a) Receiving marketable securities consisting of 300,000 shares of St. Elias at a value of \$75,000 as an option payment on mineral properties.
- b) Recognizing mineral property cost recoveries of \$112,017 through receivables.
- c) Incurring mineral property costs of \$109,474 through accounts payable.

Significant non-cash transactions for the year ended December 31, 2004 consisted of:

- a) Issuing of 421,949 common shares to settle a promissory note and accrued interest totaling \$42,195.
- b) Receiving marketable securities consisting of 100,000 shares of St. Elias at a value of \$18,000 as an option payment on mineral properties.

**KERNOW RESOURCES AND DEVELOPMENTS LTD.**  
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 2005

**9. INCOME TAXES**

A reconciliation of income taxes at statutory rates with the reported taxes is as follows:

	2005	2004
Income (loss) for the year	\$ 5,909	\$ (61,117)
Expected income tax recovery (expense)	\$ (2,060)	\$ 21,757
Difference in foreign tax rate	1,744	(639)
Non-deductible and other items	(18,354)	(6,251)
Recognized (unrecognized) benefit of non-capital losses	<u>18,670</u>	<u>(14,867)</u>
Net income tax recovery (expense)	\$ -	\$ -

The significant components of the Company's future income tax assets are as follows:

	2005	2004
Future income tax assets:		
Non-capital and operating loss carryforwards	\$ 128,000	\$ 153,000
Resource properties	<u>526,000</u>	<u>558,000</u>
	654,000	711,000
Valuation allowance	<u>(654,000)</u>	<u>(711,000)</u>
Net future income tax assets	\$ -	\$ -

The Company has non-capital losses of approximately \$348,300 available to offset against taxable income of future years. These losses, if not utilized, will expire through to 2015. The Company also has approximately \$28,000 of U.S. Federal operating loss carryforwards available to apply against U.S. source income that expires through to 2022. Subject to certain restrictions, the Company also has approximately \$1,318,000 of resource expenditures available to reduce taxable income in Canada in future years. Future tax benefits which may arise as a result of these non-capital and operating losses and resource expenditures have been offset by a valuation allowance and have not been recognized in these consolidated financial statements.

**KERNOW RESOURCES AND DEVELOPMENTS LTD.**  
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS  
DECEMBER 31, 2005

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**10. SEGMENTED INFORMATION**

The Company operates in one business segment, the exploration of mineral properties. Geographic information is as follows:

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	2005	2004
Net income (loss) for the year		
Canada	\$ (17,756)	\$ (76,900)
Portugal	<u>23,665</u>	<u>15,783</u>
	<u>\$ 5,909</u>	<u>\$ (61,117)</u>
Identifiable assets		
Canada	\$ 242,183	\$ 118,024
United States	23,679	20,422
Portugal	<u>170,003</u>	<u>129,111</u>
	<u>\$ 435,865</u>	<u>\$ 267,557</u>

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**11. 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 December 31, 2005, approximately 84% (2004 – 36%) 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.

**12. CONTINGENCIES**

The Company has provided letters of guarantee to the Government of Portugal for its exploration contracts on the mineral properties in Portugal totalling €24,965, €16,000 of which was secured by term deposits in 2004 (Note 3).

**KERNOW  
RESOURCES & DEVELOPMENTS LTD.  
TSX Venture Exchange: KRD**

**CORPORATE PROFILE**

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