

**Klondex Mines Ltd.**  
**Consolidated Financial Statements**  
**December 31, 2009 and 2008**

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**Klondex Mines Ltd.****Consolidated Financial Statements**

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**December 31, 2009 and 2008**

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**CHARTERED  
ACCOUNTANTS**

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**Auditors' Report**

**To the Shareholders of  
Klondex Mines Ltd.**

We have audited the consolidated balance sheets of Klondex Mines Ltd. as at December 31, 2009, and 2008, and the consolidated statements of loss, comprehensive loss and deficit, mineral properties and deferred expenses 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 disclosure in these 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, 2009, and 2008, and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

**Vancouver, Canada  
March 10, 2010**

***"MacKay LLP"*  
Chartered Accountants**

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**Klondex Mines Ltd.****Consolidated Balance Sheets**

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| <b>December 31,</b>                                      | <b>2009</b>          | <b>2008</b>          |
|--|----------------------|----------------------|
| <b>Assets</b>  |                      |                      |
| <b>Current</b>   |                      |                      |
| Cash and cash equivalents (note 3)                       | \$ 3,549,458         | \$ 1,848,289         |
| Marketable securities (note 4)                           | 189                  | 108                  |
| Prepaid expenses   | 37,054               | 18,102               |
| Accounts receivable                                      | 45,459               | 18,322               |
|  | <b>3,632,160</b>     | <b>1,884,821</b>     |
| <b>Rent deposit</b> (note 5)                             | <b>1,770</b>         | <b>14,054</b>        |
| <b>Property and equipment</b> (note 6)                   | <b>20,389</b>        | <b>31,976</b>        |
| <b>Mineral properties and deferred expenses</b> (note 7) | <b>23,466,593</b>    | <b>21,282,764</b>    |
| <b>Reclamation bonds</b> (note 8)                        | <b>185,562</b>       | <b>217,122</b>       |
|  | <b>\$ 27,306,474</b> | <b>\$ 23,430,737</b> |
| <b>Liabilities</b>                                       |                      |                      |
| <b>Current</b>   |                      |                      |
| Accounts payable and accruals                            | \$ 454,079           | \$ 988,308           |
| Overdraft – brokerage account (note 3)                   | -                    | 1,107,398            |
| Due to related parties (note 14)                         | 145,082              | 147,555              |
|  | <b>599,161</b>       | <b>2,243,261</b>     |
| <b>Asset retirement obligation</b> (note 8)              | <b>185,562</b>       | <b>217,122</b>       |
| <b>Deferred lease inducement</b> (note 16)               | <b>838</b>           | <b>4,113</b>         |
|  | <b>785,561</b>       | <b>2,464,496</b>     |
| <b>Shareholders' Equity</b>                              |                      |                      |
| <b>Share capital</b> (note 9)                            | <b>37,191,568</b>    | <b>29,566,689</b>    |
| <b>Contributed surplus</b> (notes 9 and 10)              | <b>2,528,431</b>     | <b>2,186,083</b>     |
| <b>Deficit</b>   | <b>(13,199,086)</b>  | <b>(10,786,531)</b>  |
|  | <b>26,520,913</b>    | <b>20,966,241</b>    |
|  | <b>\$ 27,306,474</b> | <b>\$ 23,430,737</b> |

Going concern (note 1)  
Commitments (notes 7, 8 and 16)  
Subsequent events (note 17)  
Contingency (note 18)

Approved on behalf of the Board of Directors:

William J. Solloway (sgd.) Director

Brendan Donohoe (sgd.) Director

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

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**Klondex Mines Ltd.****Consolidated Statements of Loss, Comprehensive Loss and Deficit**

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| <b>For the year ended December 31,</b>               | <b>2009</b>            | <b>2008</b>            |
|--|------------------------|------------------------|
| <b>Administrative expenses</b>                       |                        |                        |
| Amortization   | \$ 11,793              | \$ 12,329              |
| Consulting fees (note 14)                            | 254,333                | 128,988                |
| Legal, audit and accounting (note 14)                | 647,256                | 144,555                |
| Management fees (note 14)                            | 210,706                | 111,914                |
| Office and miscellaneous (note 14)                   | 147,894                | 110,729                |
| Stock-based compensation (note 10)                   | 854,148                | 357,110                |
| Telephone  | 22,535                 | 19,195                 |
| Transfer agent and regulatory fees                   | 49,008                 | 60,401                 |
| Travel, accommodation, meetings                      | 149,837                | 176,106                |
| Other items (note 7(d))                              | -                      | 19,934                 |
| Foreign exchange loss (gain)                         | 67,695                 | 64,128                 |
| Interest earned                                      | (2,541)                | (51,725)               |
|  | <b>2,412,664</b>       | <b>1,153,664</b>       |
| <b>Other item</b>                                    |                        |                        |
| Unrealized loss (gain) on marketable securities      | (109)                  | 474                    |
|  | <b>2,412,555</b>       | <b>1,154,138</b>       |
| <b>Net loss and comprehensive loss for the year</b>  | <b>(2,412,555)</b>     | <b>(1,154,138)</b>     |
| <b>Deficit, beginning of year</b>                    | <b>(10,786,531)</b>    | <b>(9,632,393)</b>     |
| <b>Deficit, end of year</b>                          | <b>\$ (13,199,086)</b> | <b>\$ (10,786,531)</b> |
| <b>Basic and diluted loss per share</b>              | <b>\$ (0.09)</b>       | <b>\$ (0.05)</b>       |
| <b>Weighted average number of shares outstanding</b> | <b>28,357,332</b>      | <b>23,318,488</b>      |

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

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**Klondex Mines Ltd.****Consolidated Statements of Mineral Properties and Deferred Expenses**

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**Nevada Properties**

| <b>For the year ended December 31,</b>  | <b>2009</b>          | <b>2008</b>          |
|---|----------------------|----------------------|
| <b>Balance, beginning of year</b>       | <b>\$ 21,282,764</b> | <b>\$ 15,769,182</b> |
| Acquisition of land                     | 53,610               | 297,560              |
| Advance – Drilling                      | -                    | (99,293)             |
| Assays and core costs                   | 158,064              | 549,046              |
| Consulting                              | 363,641              | 363,745              |
| Drilling                                | 1,104,710            | 3,767,091            |
| Environmental consulting and permitting | 56,557               | 282,918              |
| Field supplies and equipment            | 76,492               | 155,337              |
| Geophysics                              | 118,478              | 31,123               |
| Lease payments, taxes and royalties     | 22,517               | 17,944               |
| Legal                                   | 2,135                | 1,915                |
| Maintenance fees                        | 102,688              | 75,351               |
| Mapping and sampling                    | 7,504                | 520                  |
| Miscellaneous                           | 49,359               | 57,026               |
| Pond                                    | 44,062               | -                    |
| Site visits                             | 24,012               | 13,299               |
| Current period expenditures             | 2,183,829            | 5,513,582            |
| <b>Balance, end of year</b>             | <b>\$ 23,466,593</b> | <b>\$ 21,282,764</b> |

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

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**Klondex Mines Ltd.****Consolidated Statements of Cash Flows**

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| <b>For the year ended December 31,</b>                      | <b>2009</b>         | <b>2008</b>        |
|---|---------------------|--------------------|
| <b>Cash provided by (used in)</b>                           |                     |                    |
| <b>Operating activities</b>                                 |                     |                    |
| Loss for the year   | \$ (2,412,555)      | \$ (1,154,138)     |
| Items not involving cash                                    |                     |                    |
| Amortization  | 11,793              | 12,329             |
| Deferred lease inducement recognized                        | (3,275)             | (3,275)            |
| Foreign exchange  | 67,695              | 64,128             |
| Stock-based compensation                                    | 854,148             | 357,110            |
| Unrealized loss (gain) on marketable securities             | (81)                | 358                |
|   | <b>(1,482,275)</b>  | <b>(723,488)</b>   |
| <b>Change in non-cash working capital items</b>             |                     |                    |
| Accounts receivable   | (27,137)            | 29,287             |
| Prepaid expenses  | (18,952)            | 6,451              |
| Accounts payable  | 171,126             | (170,021)          |
| Rent deposit  | 12,284              | 2,321              |
|   | <b>(1,344,954)</b>  | <b>(855,450)</b>   |
| <b>Financing activities</b>                                 |                     |                    |
| Issue of share capital                                      | 7,333,000           | 2,249,737          |
| Share issue cost, cash                                      | (219,921)           | (96,463)           |
| Advances from (repayment to) directors                      | (2,473)             | 169,117            |
|   | <b>7,110,606</b>    | <b>2,322,391</b>   |
| <b>Investing activities</b>                                 |                     |                    |
| Purchase of property and equipment                          | -                   | (2,314)            |
| Accounts payable related to mineral properties              | (705,355)           | 574,280            |
| Deferred exploration and development expenditures           | (2,183,829)         | (5,513,582)        |
|   | <b>(2,889,184)</b>  | <b>(4,941,616)</b> |
| <b>Effect of foreign exchange on cash balances</b>          | <b>(67,901)</b>     | <b>(23,856)</b>    |
| <b>Net increase (decrease) in cash and cash equivalents</b> | <b>2,808,567</b>    | <b>(3,498,531)</b> |
| <b>Cash and cash equivalents, beginning of year</b>         | <b>740,891</b>      | <b>4,239,422</b>   |
| <b>Cash and cash equivalents, end of year</b>               | <b>\$ 3,549,458</b> | <b>\$ 740,891</b>  |

**Supplemental Cash Flow Information** (notes 3 and 11)

The Company had the following cash transactions:

|                   |      |      |
|-------------------|------|------|
| Interest paid     | \$ - | \$ - |
| Income taxes paid | \$ - | \$ - |

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

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# Klondex Mines Ltd.

## Notes to the Consolidated Financial Statements

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December 31, 2009 and 2008

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### 1. Nature of Operations

The Company is in the business of owning, acquiring, exploiting, exploring, developing and evaluating mineral properties, and either joint venturing or developing these properties further or disposing of them when the evaluation is completed. The Company has interests in the properties all located in the State of Nevada, USA.

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles on a going concern basis, which presume the realization of assets and discharge of liabilities in the normal course of business for the foreseeable future. As at December 31, 2009, the Company had a working capital of \$3,032,999 (2008 working capital deficit - \$358,440). The Company's ability to continue as a going concern is dependent upon achieving profitable operations and upon obtaining additional financing. While the Company is expending its best efforts in this regard, the outcome of these matters can not be predicted at this time. These financial statements do not include any adjustments to the amounts and classification of assets and liabilities that might be necessary should the Company be unable to continue in business.

The recoverability of amounts shown as mineral properties and deferred exploration costs is dependent upon the existence of economically recoverable reserves, the ability of the Company to obtain necessary financing to complete their development, and future profitable production or disposition thereof. The Company is considering a number of alternatives to secure additional capital including additional funding facilities or equity raisings.

### 2. Significant Accounting Policies

#### Financial instruments

Under Section 3251, *Equity*, Section 3855, *Financial Instruments - Recognition and Measurement* and Sections 3862 & 3863, *Financial Instruments - Disclosure and Presentation*, all financial instruments are classified into one of the following five categories: held-for-trading, held-to-maturity investments, loans and receivables, available-for-sale assets or other financial liabilities. All financial instruments, including derivatives, are included on the balance sheet and are measured at fair market value upon inception with the exception of certain related party transactions. Subsequent measurement and recognition of change in the fair value of financial instruments depends on their initial classification. Held-for-trading financial investments are measured at fair value and all gains and losses are included in operations in the period in which they arise. Available-for-sale financial assets are measured at fair value with revaluation gains and losses included in other comprehensive income until the asset is removed from the balance sheet. Loans and receivables, held to maturity investments and other financial liabilities are measured at amortized cost using the effective interest method. Gains and losses upon inception, de-recognition, impairment write-downs and foreign exchange translation adjustments are recognized immediately. Transaction costs related to financial instruments will be expensed in the period incurred.

The Company has designated its cash and cash equivalents, brokerage overdraft and marketable securities as held-for-trading, which are measured at fair value. Amounts receivable are classified as loans and receivables, which are measured at amortized cost. Accounts payable, accrued liabilities and due to related parties are classified as other financial liabilities, which are measured at amortized cost. Reclamation bonds are classified as held to maturity and are measured at amortized cost, adjusted for current exchange rates.

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# **Klondex Mines Ltd.**

## **Notes to the Consolidated Financial Statements**

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**December 31, 2009 and 2008**

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### **2. Significant Accounting Policies (continued)**

#### **Principles of consolidation**

These consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, Klondex Gold and Silver Mining Co. ("Klondex Gold"), a Washington State, U.S.A. corporation. Klondex Gold is registered to conduct business in Nevada, U.S.A. All significant inter-company transactions have been eliminated.

#### **Cash and cash equivalents**

For purposes of reporting cash flows, the Company considers cash and cash equivalents to include amounts held in banks and highly liquid investments with remaining maturities at point of purchase of 90 days or less. The Company places its cash and cash investments with institutions of high-credit worthiness.

#### **Property and equipment**

Equipment is amortized using the declining-balance method at a rate of 20% per annum for furniture and fixtures and telephone equipment and 30% per annum for computer equipment. Leasehold improvements are amortized on a straight line basis over the term of the lease.

#### **Foreign currency translation**

The Company's activities and those of its subsidiaries denominated in currencies other than Canadian dollars are translated as integrated operations using the temporal method. This method translates monetary balances at the rate of exchange at the balance sheet date, non-monetary balances at historic exchange rates and revenues and expense items at exchange rates in effect when incurred. Gains or losses resulting from changes in exchange rates are included in the determination of income or loss.

#### **Mineral properties and deferred exploration costs**

Mineral properties consist of exploration and mining concessions, options and contracts. Acquisition and leasehold costs and exploration costs are capitalized and deferred until such time as the property is put into production or the properties are disposed of either through sale or abandonment. If put into production, the costs of acquisition and exploration will be amortized over the life of the property, based on estimated economic reserves. Proceeds received from the sale of any interest in a property will first be credited against the carrying value of the property, with any excess included in operations for the period. If a property is abandoned, the property and deferred exploration costs will be written-off to operations.

Recorded costs of mineral properties and deferred exploration expenditures are not intended to reflect present or future values of mineral properties.

Although the Company has taken steps to verify title to mineral properties in which it has an interest, in accordance with industry norms for the current stage of exploration of such properties, these procedures do not guarantee the Company's title. Property may be subject to unregistered prior agreements and non-compliance with regulatory requirements.

**December 31, 2009 and 2008**

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**2. Significant Accounting Policies (continued)****Asset retirement obligations**

The Company has adopted the CICA's Handbook Section 3110 "asset retirement obligations" which establishes standards for the recognition, measurement and disclosure of liabilities for asset retirement obligations and the associated asset retirement costs. The standards apply to legal obligations associated with the retirement of long-lived tangible assets that arise from the acquisition, construction, development or normal operation of such assets. The standards require that a liability for an asset retirement obligation be recognized in the period in which it is incurred and when a reasonable estimate of the fair value of the liability can be made. Furthermore, a corresponding asset retirement cost should be recognized by increasing the carrying amount of the related long-lived asset. The asset retirement cost is subsequently allocated in a rational and systematic method over the underlying asset's useful life. The initial fair value of the liability is accreted, by charges to operations, to its estimated future settlement value.

**Loss per share**

The Company uses the treasury stock method of calculating diluted per share amounts whereby any proceeds from the exercise of stock options or other dilutive instruments are assumed to be used to purchase common shares at the average market price during the period. The assumed conversion of outstanding common share options and warrants has an anti-dilutive impact in 2009 and 2008.

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

**Share capital**

- i) The proceeds from the exercise of stock options, warrants and escrow shares are recorded as share capital in the amount for which the option, warrant or escrow share enabled the holder to purchase a share in the Company.
- ii) Commissions paid to underwriters, and other related share issue costs, such as legal, auditing, and printing, on the issue of the Company's shares are charged directly to share capital.

**Income taxes**

Income taxes are accounted for using the future income tax method. Under this method income taxes are recognized for the estimated income taxes payable for the current year and future income taxes are recognized for temporary differences between the tax and accounting bases of assets and liabilities and for the benefit of losses available to be carried forward for tax purposes that are more likely than not to be realized. Future income tax assets and liabilities are measured using tax rates expected to apply in the years in which the temporary differences are expected to be recovered or settled.

**2. Significant Accounting Policies** (continued)**Stock-based compensation**

The Company accounts for stock options granted to directors, officers, employees and nonemployees using the fair value method of accounting. Accordingly, the fair value of the options at the date of the grant is determined using the Black-Scholes option pricing model and stock-based compensation is accrued and charged to operations, with an offsetting credit to contributed surplus, on a straight-line basis over the vesting periods. The fair value of stock options granted to non-employees is re-measured at the earlier of each financial reporting or vesting date, and any adjustment is charged or credited to operations upon re-measurement. If and when the stock options are exercised, the applicable amounts of contributed surplus are transferred to share capital. The Company has not incorporated an estimated forfeiture rate for stock options that will not vest; rather the Company accounts for actual forfeitures as they occur.

**Estimates**

The preparation of financial statements in conformity 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 liabilities at the date of the financial statements, and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those reported.

**Measurement uncertainty**

The future recovery of the recorded cost of the mineral properties, and the provision for a future asset retirement obligation are based on estimates. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods could be significant.

**Valuation of equity units issued in private placements**

The Company has adopted a residual value method with respect to the measurement of shares and warrants issued as private placement units. The residual value method first allocates value to the more easily measurable component based on fair value and then the residual value, if any, to the less easily measurable component.

The fair value of the common shares issued in the private placements was determined to be the more easily measurable component and were valued at their fair value, as determined by the closing quoted bid price on the announcement date. The balance, if any, was allocated to the attached warrants. Any fair value attributed to the warrants is recorded as warrants.

**Impairment of long-lived assets**

The Company has adopted the recommendations of CICA Handbook Section 3063 "Impairment of Long-lived Assets" and abstract EIC 174, "Mining Exploration Costs" ("EIC 174") of the Emerging Issues Committee. Section 3063 requires that long-lived assets and intangibles to be held and used by the Company be reviewed for possible impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If changes in circumstance indicate that the carrying amount of an asset that an entity expects to hold and use may not be recoverable, future cash flows expected to result from the use of the asset and its disposition must be estimated.

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# **Klondex Mines Ltd.**

## **Notes to the Consolidated Financial Statements**

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**December 31, 2009 and 2008**

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### **2. Significant Accounting Policies (continued)**

#### **Impairment of long-lived assets (continued)**

On March 27, 2009, the Emerging Issues Committee of the CICA approved abstract EIC-174 "Mining Exploration Costs", which provides guidance on capitalization of exploration costs related to mining properties in particular and on impairment of long-lived assets in general. The Company has applied this new abstract for the year ended December 31, 2009 and there was no significant impact on its financial statements as a result of applying this abstract.

#### **Accounting Policies to be Adopted**

##### **International Financial Reporting Standards**

In 2006, the Canadian Accounting Standards Board ("AcSB") published a new strategic plan that will significantly affect financial reporting requirements for Canadian companies. The AcSB strategic plan outlines the convergence of Canadian generally accepted accounting principles ("GAAP") and IFRS over an expected five year transitional period. In February 2008 the AcSB announced that 2011 is the changeover date for publicly-listed companies to use IFRS, replacing Canada's own GAAP. The date is for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The transition date of January 1, 2011 will require the restatement for comparative purposes of amounts reported by the Company for the year ended December 31, 2010. While the Company has begun assessing the adoption of IFRS for 2011, the financial reporting impact of the transition to IFRS cannot be reasonably estimated at this time.

##### **Business Combinations**

In January 2009, the CICA issued Handbook Section 1582, Business Combinations, which replaces the existing standards. This section establishes the standards for the accounting of business combinations, and states that all assets and liabilities of an acquired business will be recorded at fair value. Estimated obligations for contingent considerations and contingencies will also be recorded at fair value at the acquisition date. The standard also states that acquisition-related costs will be expensed as incurred and that restructuring charges will be expensed in the periods after the acquisition date. This standard is equivalent to the International Financial Reporting Standards on business combinations. This standard is applied prospectively to business combinations with acquisition dates on or after January 1, 2011. Earlier adoption is permitted. This standard is not expected to have any impact on the Company's financial statements.

##### **Consolidated financial statements**

In January 2009, the CICA issued Handbook Section 1601, consolidated financial statements, which replaces the existing standards. This section establishes the standards for preparing consolidated financial statements and is effective for interim and annual consolidated financial statements beginning on or after January 1, 2011. This standard is not expected to have an impact on the Company's financial statements.

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# Klondex Mines Ltd.

## Notes to the Consolidated Financial Statements

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### 2. Significant Accounting Policies (continued)

#### Accounting Policies to be Adopted (continued)

##### Goodwill and intangible assets

The AcSB issued CICA Handbook Section 3064 which replaces Section 3062, Goodwill and Other Intangible Assets, and Section 3450, Research and Development Costs. This new section establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets. Standards concerning goodwill remain unchanged from the standards included in the previous Section 3062. The section applies to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2008 and is not expected to have an impact on the Company's financial results.

##### Non controlling interests

In January 2009, the CICA issued Handbook Section 1602, Non-controlling interests, which establishes standards for the accounting of non-controlling interests of a subsidiary in the preparation of consolidated financial statements subsequent to a business combination. This standard is equivalent to the International Financial Reporting Standards on consolidated and separate financial statements. This standard is effective for interim and annual consolidated financial statements beginning on or after January 1, 2011. This standard is not expected to have an impact on the Company's financial statements.

### 3. Cash and cash equivalents

| December 31,                  | 2009                | 2008        |
|-------------------------------|---------------------|-------------|
| Canadian chartered bank       | \$ 206,710          | \$ 308,429  |
| Canadian brokerage firm       | 964,030             | 1,539,860   |
| US brokerage firm             | 2,378,718           | -           |
|                               | <b>3,549,458</b>    | 1,848,289   |
| US brokerage firm (overdraft) | -                   | (1,107,398) |
|                               | <b>\$ 3,549,458</b> | \$ 740,891  |

As at December 31, 2008, the Company had an overdraft balance of \$1,107,398 (US\$901,294) in their US dollar Account with Jones, Gable & Company Limited. This overdraft was secured by the balance of \$1,539,860 in the Canadian dollar account.

### 4. Marketable securities

On May 18, 2009, Coeur D'Alene announced a reverse stock split at a split ratio of 1-for-10. The reverse stock split took effect on May 26, 2009. As at December 31, 2009, the Company holds 10 shares of Coeur D'Alene Mines with a market value of \$189 (US\$181).

### 5. Rent Deposit

As part of the lease agreement, the Company paid the last three months of the fourth year (2009) and the last four months of the fifth year (2010) of the lease term in advance. During the year, the Company used \$12,284 of this deposit. These deposits bear interest at approximately 4% per annum, receivable at the end of the fourth and fifth year of the lease term.

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**Klondex Mines Ltd.****Notes to the Consolidated Financial Statements**

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**6. Property and Equipment**

|                        | <b>December 31, 2009</b> |                                     |                       |
|------------------------|--------------------------|-------------------------------------|-----------------------|
|                        | <b>Cost</b>              | <b>Accumulated<br/>amortization</b> | <b>Net book value</b> |
| Computer equipment     | \$ 37,905                | \$ 27,538                           | \$ 10,367             |
| Telephone equipment    | 1,376                    | 1,033                               | 343                   |
| Furniture and fixtures | 29,068                   | 20,909                              | 8,159                 |
| Leasehold improvements | 24,736                   | 23,216                              | 1,520                 |
|                        | <b>\$ 93,085</b>         | <b>\$ 72,696</b>                    | <b>\$ 20,389</b>      |

  

|                        | <b>December 31, 2008</b> |                                     |                       |
|------------------------|--------------------------|-------------------------------------|-----------------------|
|                        | <b>Cost</b>              | <b>Accumulated<br/>amortization</b> | <b>Net book value</b> |
| Computer equipment     | \$ 37,905                | \$ 23,205                           | \$ 14,700             |
| Telephone equipment    | 1,376                    | 964                                 | 412                   |
| Furniture and fixtures | 29,068                   | 18,838                              | 10,230                |
| Leasehold improvements | 24,736                   | 18,102                              | 6,634                 |
|                        | <b>\$ 93,085</b>         | <b>\$ 61,109</b>                    | <b>\$ 31,976</b>      |

**7. Mineral Property and Related Deferred Exploration Expenses****a) Fire Creek Gold Properties, Lander County, Nevada, U.S.A.**

The Company has a 100% ownership interest in this land block which has been expanded to a total of 484 claims, or 9,680 acres, and fee lands of 1,428 acres. In 1988, the Company entered into an agreement with two joint venturers to explore and develop the gold property. Under the terms of the agreement, Klondex received an advance minimum royalty of US\$10,000 per month. The joint venturers terminated the agreement on March 31, 1999. As a result the Company has regained 100% ownership of the property and is not obligated to repay the advance royalty payments amounting to \$1,582,162 (US\$1,220,000). During fiscal 2002, the Company purchased the drill cores and data from the joint venturers for consideration of US\$4,000 and issuance of 15,000 common shares of the Company.

**b) Lander & Eureka Counties, Nevada**

During fiscal 2006, the Company entered into an option agreement to acquire a 100% interest (the "Option") in certain lands located in Lander & Eureka Counties, Nevada (the "Property"), from Fire Creek Lands, LLC (the "Optionor"). In consideration of the Option, the Company must make option payments in the aggregate amount of \$380,000 over a period of five years (US\$305,000 paid to date), and may purchase the Property on or before June 17, 2010 for \$2,500,000 with prior option payments being applied as a credit towards the purchase price.

The agreement was amended August 4, 2009. The amended consideration of the Option is as follows: the Company must make option payments in the aggregate amount of \$480,000 over a period of six years (US\$305,000 paid to date), and may purchase the Property on or before December 17, 2011 for \$2,500,000 with prior option payments being applied as a credit towards the purchase price.

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# Klondex Mines Ltd.

## Notes to the Consolidated Financial Statements

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December 31, 2009 and 2008

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### 7. Mineral Property and Related Deferred Exploration Expenses (continued)

#### b) Lander & Eureka Counties, Nevada (continued)

In the event of the outright purchase of the Property by the Company, the Optionor will retain a 3% net smelter royalty, with the Company having a one-time option to purchase one percent of the royalty in consideration of \$1,000,000, at any time until June 17, 2015.

#### c) Maggie Creek, Elko County, Nevada

The Company has a 66.66% undivided interest in 48 claims (960 acres) situated in sections 8, 16 and 20 in the Maggie Creek area.

#### d) Hot Point Springs, Lander County, Nevada

The Company has a 100% ownership interest in 39 claims (780 acres) situated about 6 miles east of the town of Crescent Valley.

During fiscal 2006, the Company negotiated the principal terms of a 10 year lease of the Hotsprings Point Property to Vasquir Mines Inc. ("Vasquir"). Under the negotiated terms, Vasquir would lease the property for an initial cash payment and share issuance, annual cash payments and exploration expenditures, and a scaled net smelter return royalty of a minimum of 3% to a maximum of 10%.

On December 5, 2006 the Company received a claim filed in the Nevada Supreme Court from Vasquir Mines Inc. ("Vasquir"), a subsidiary of CMQ Resources Inc. in relation to the lease agreement between Vasquir and Klondex Mines Ltd. for Klondex Mines Hot Springs Point property, located 8.5 miles southeast of the Fire Creek Property.

During the year, the companies agreed to amend certain language in the lease and Klondex paid US\$20,000 to Vasquir with respect to legal fees incurred. The Company was notified that Vasquir was abandoning its lease agreement, with no further liabilities nor obligations on the part of either party.

#### e) Reef claims, Churchill County, Nevada

The Company has a 100% ownership interest in 8 claims (160 acres) in the Fairchild District of Churchill County.

### 8. Asset Retirement Obligation

Included in the carrying value of the mineral properties is \$204,975 (US\$177,300) representing the estimated fair value of a liability for asset retirement obligations that arose as a result of drilling activities since fiscal 2004, on the Fire Creek properties. The fair value of the liability \$185,562 was determined to be equal to the estimated drill well site remediation costs as it is assumed that remediation would commence within six months of year end. As at December 31, 2009 the Company has not commenced development of any property and accordingly a reasonable estimate of the timing of the cash flows can not be made. As a result the expected cash costs have been recorded as a current liability.

In previous fiscal years, the Company has posted non-interest bearing bonds totalling \$185,562 (US\$177,300) with the Bureau of Land Management in the State of Nevada as security for these obligations. Fair value can not be reasonably determined and accordingly the bonds have been recorded at historical cost, adjusted for current exchange rates.

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**Klondex Mines Ltd.****Notes to the Consolidated Financial Statements**

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**December 31, 2009 and 2008**

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**9. Share Capital****a) Authorized:** unlimited common shares with no par value**b) Issued**

|                                   | Shares            | Amount               | Contributed<br>Surplus |
|-----------------------------------|-------------------|----------------------|------------------------|
| Balance, December 31, 2007        | 22,989,673        | \$ 27,009,163        | \$ 2,233,225           |
| Issued for cash                   |                   |                      |                        |
| Private placement @ \$1.15        | 1,520,000         | 1,748,000            | -                      |
| Exercise of options               | 710,131           | 501,737              | -                      |
| Fair value of options exercised   | -                 | 404,252              | (404,252)              |
|                                   | 2,230,131         | 2,653,989            | (404,252)              |
| Share issue costs                 |                   |                      |                        |
| Commission on private placement   | -                 | (89,700)             | -                      |
| Legal costs                       | -                 | (6,763)              | -                      |
|                                   | -                 | (96,463)             | -                      |
| Stock based compensation          | -                 | -                    | 357,110                |
| Increase (decrease) for the year  | 2,230,131         | 2,557,526            | (47,142)               |
| Balance, December 31, 2008        | 25,219,804        | 29,566,689           | 2,186,083              |
| Issued for cash                   |                   |                      |                        |
| Private placement @ \$0.60        | 1,500,000         | 900,000              | -                      |
| Private placement @ \$1.75        | 1,714,285         | 3,000,000            | -                      |
| Exercise of options               | 825,000           | 792,000              | -                      |
| Exercise of warrants              | 1,830,000         | 2,641,000            | -                      |
| Fair value of options exercised   | -                 | 511,800              | (511,800)              |
|                                   | 5,869,285         | 7,844,800            | (511,800)              |
| Share issue costs                 |                   |                      |                        |
| Commission on private placements  | -                 | (161,400)            | -                      |
| Legal costs and TSX fees          | -                 | (58,521)             | -                      |
|                                   | -                 | (219,921)            | -                      |
| Stock based compensation          | -                 | -                    | 854,148                |
| Increase (decrease) for the year  | 5,869,285         | 7,624,879            | 342,348                |
| <b>Balance, December 31, 2009</b> | <b>31,089,089</b> | <b>\$ 37,191,568</b> | <b>\$ 2,528,431</b>    |

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**Klondex Mines Ltd.****Notes to the Consolidated Financial Statements**

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**December 31, 2009 and 2008**

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**9. Share Capital (continued)****b) Issued (continued)**

On August 21, 2008, the Company announced that it completed a non-brokered private placement of 1,520,000 units (the "Units") at a price of \$1.15 per share for gross proceeds of \$1,748,000. Each Unit consists of one common share and one share purchase warrant. Each warrant entitles the holder to purchase one additional common share of the Company at a price of \$1.60 for a period for 12 months after closing (August 21, 2009). The warrants are subject to a 30-day early expiration if the stock closes on the Toronto Stock Exchange, for a period of 30 consecutive trading days, at a price of \$1.90 or greater. A 6% commission that applied to a portion of the financing attributable to authorized agents in the amount of \$89,700 was paid.

During the year ended December 31, 2008, 710,131 stock options with exercise prices of \$0.65 and \$1.05 were exercised for gross proceeds of \$501,737.

On March 26, 2009, the Company announced that it had completed a non-brokered private placement of 1,500,000 units (the "Units") at a price of \$0.60 per unit for gross proceeds of \$900,000. Each Unit consists of one common share and one share purchase warrant. Each warrant will entitle the holder to purchase one additional common share of the Company at a price of \$0.90 for a period for 12 months after closing. The warrants are subject to a 30-day early expiration if the stock closes on the Toronto Stock Exchange, for a period of 20 consecutive trading days, at a price of \$1.30 or greater. A 5% commission that applied to a portion of the financing attributable to authorized agents in the amount of \$41,400 was paid.

Although the Company's shares traded at a price of \$1.30 or greater for 20 consecutive days, the Board of Directors decided not to call the early expiration of the warrants.

On June 30, 2009, the Company announced that it had completed a non-brokered private placement of 1,714,285 common shares at a price of \$1.75 per share for gross proceeds of \$3,000,000. A 5% commission that applied to a portion of the financing attributable to authorized agent in the amount of \$120,000 was paid.

During the year ended December 31, 2009, 825,000 stock options with exercise prices of \$0.86 and \$1.05 were exercised for gross proceeds of \$792,000. In addition, 1,830,000 share purchase warrants with exercise prices of \$0.90 to \$1.60 were exercised for gross proceeds of \$2,641,000.

**c) Options outstanding**

A summary of the Company's outstanding stock options as of December 31, 2009 and 2008 and the changes during the years then ended is presented below:

|   | Number of<br>options | Weighted average<br>exercise price |
|---|----------------------|------------------------------------|
| Outstanding and exercisable at December 31, 2007        | 2,130,131            | \$ 1.52                            |
| Options granted (note 10)                               | 1,205,000            | 2.30                               |
| Options exercised                                       | (710,131)            | 0.71                               |
| Options expired   | (50,000)             | 0.65                               |
| Outstanding at December 31, 2008                        | 2,575,000            | 1.51                               |
| Options granted (note 10)                               | 950,000              | 1.00                               |
| Options expired   | (825,000)            | 0.96                               |
| <b>Outstanding and exercisable at December 31, 2009</b> | <b>2,700,000</b>     | <b>\$ 1.50</b>                     |

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**Klondex Mines Ltd.****Notes to the Consolidated Financial Statements**

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**December 31, 2009 and 2008**

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**9. Share Capital (continued)****c) Options outstanding (continued)**

A summary of the Company's outstanding stock options as of December 31, 2009 is presented below:

| Number of Underlying Shares | Weighted average exercise price | Exercisable      | Weighted average exercise price | Exercise Price | Expiry Date        |
|-----------------------------|---------------------------------|------------------|---------------------------------|----------------|--------------------|
| 125,000                     |                                 | 125,000          |                                 | \$ 1.05        | June 10, 2010      |
| 645,000                     |                                 | 645,000          |                                 | \$ 2.35        | July 17, 2011      |
| 150,000                     |                                 | 150,000          |                                 | \$ 2.30        | January 19, 2012   |
| 200,000                     |                                 | 200,000          |                                 | \$ 2.25        | May 7, 2012        |
| 105,000                     |                                 | 105,000          |                                 | \$ 2.30        | January 21, 2013   |
| 775,000                     |                                 | 775,000          |                                 | \$ 0.86        | September 17, 2013 |
| 700,000                     |                                 | 700,000          |                                 | \$ 1.00        | March 2, 2014      |
| <b>2,700,000</b>            | <b>\$1.50</b>                   | <b>2,700,000</b> | <b>\$1.50</b>                   |                |                    |

On June 15, 2009, the Company announced that it received a formal unsolicited offer from Silvercorp Metals Inc. ("Silvercorp") to acquire all of the outstanding shares of the Company for 0.5 of a common share of Silvercorp for each share of the Company. As a result of the unsolicited offer and in accordance with the stock option plan, all vesting provisions on outstanding stock options expired.

**d) Warrants outstanding**

A summary of the Company's outstanding share purchase warrants at December 31, 2009 and 2008 and the changes during the years then ended is presented below:

|   | Number of warrants | Weighted average exercise price |
|---|--------------------|---------------------------------|
| Outstanding and exercisable at December 31, 2007        | Nil                | \$ Nil                          |
| Warrants granted, as per private placement              | 1,520,000          | 1.60                            |
| Outstanding and exercisable at December 31, 2008        | 1,520,000          | 1.60                            |
| Warrants granted, as per private placement              | 1,500,000          | 0.90                            |
| Warrants exercised                                      | (1,830,000)        | (1.44)                          |
| Warrants expired  | (100,000)          | (1.60)                          |
| <b>Outstanding and exercisable at December 31, 2009</b> | <b>1,090,000</b>   | <b>\$ 0.90</b>                  |

At December 31, 2009, there were 1,090,000 outstanding share purchase warrants entitling the holders thereof the right to purchase one common share for each warrant held as follows:

| Number of Shares | Exercise Price | Expiry Date    |
|------------------|----------------|----------------|
| 1,090,000        | \$ 0.90        | March 26, 2010 |

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# Klondex Mines Ltd.

## Notes to the Consolidated Financial Statements

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December 31, 2009 and 2008

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### 10. Stock Based Compensation

The Company has adopted an incentive stock option plan (the "Plan"). The essential elements of the Plan provide that the aggregate number of common shares of the Company's capital stock issuable pursuant to options granted under the Plan may not exceed 15% of the number of issued shares of the Company at the time of the granting of the options. Options granted under the Plan will have a maximum term of ten years. The exercise price of options granted under the Plan will not be less than the discounted market price of the common shares (defined as the last closing market price of the Company's common shares immediately preceding the issuance of a news release announcing the granting of the options, less the maximum discount permitted under TSE policies), or such other price as may be agreed to by the Company and accepted by the TSE. According to the 2008 stock option plan, the vesting periods of options granted under the plan may vary at the discretion of the Plan Administrator, subject to Regulatory approval.

On January 22, 2008 the Company granted directors, officers and consultants 105,000 incentive stock options at an exercise price of \$2.30 per share expiring on January 21, 2013. Options vest at 25% every six months with the first 25% vesting July 22, 2008.

On September 17, 2008, the Company granted directors, officers and consultants 1,100,000 incentive stock options at an exercise price of \$0.86 per share expiring on September 17, 2013. These optioned shares may be acquired as follows:

- (i) Up to 50% of the optioned shares may be acquired at any time after March 17, 2009 and prior to the expiry date;
- (ii) The balance of 50% of the optioned shares may be acquired at any time after September 17, 2009 and prior to the expiry date.

On March 2, 2009 the Company granted directors, officers and consultants 950,000 incentive stock options at an exercise price of \$1.00 per share expiring on March 2, 2014. Options have no vesting period imposed and are immediately exercisable.

On June 15, 2009, the Company announced that it received a formal unsolicited offer from Silvercorp to acquire all of the outstanding shares of the Company for 0.5 of a common share of Silvercorp for each share of the Company. As a result of the unsolicited offer and in accordance with the stock option plan, all vesting provisions on outstanding stock options expired.

During the year ended December 31, 2009, 950,000 options were granted (2008 – 1,205,000) with a weighted average fair value of \$0.37 per option (2008 - \$0.62 per option). The fair value of each option granted is estimated on the grant date using the Black-Scholes option-pricing model with the following weighted average assumptions:

| <b>Date of grant<br/>2009</b> | <b>02-Mar-09</b> | <b>Total or<br/>Average</b> |
|-------------------------------|------------------|-----------------------------|
| Number of options             | 950,000          | 950,000                     |
| Number expected to vest       | 950,000          | 950,000                     |
| Estimated life                | 5 years          | 5 years                     |
| Share price at date of grant  | \$0.63           | \$0.63                      |
| Option exercise price         | \$1.00           | \$1.00                      |
| Risk free interest rate       | 2.5%             | 2.5%                        |
| Estimated annual volatility   | 84.44%           | 84.44%                      |
| Option fair value             | \$0.37           | \$0.37                      |
| <b>Compensation cost</b>      | <b>\$355,889</b> | <b>\$355,889</b>            |

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**Klondex Mines Ltd.****Notes to the Consolidated Financial Statements**

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**December 31, 2009 and 2008**

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**10. Stock Based Compensation (continued)**

| <b>Date of grant<br/>2008</b> | <b>22-Jan-08</b> | <b>17-Sep-08</b> | <b>Total or<br/>Average</b> |
|-------------------------------|------------------|------------------|-----------------------------|
| Number of options             | 105,000          | 1,100,000        | 1,205,000                   |
| Number expected to vest       | 78,750           | 1,100,000        | 1,178,750                   |
| Estimated life                | 5 years          | 5 years          | 5 years                     |
| Share price at date of grant  | \$2.15           | \$0.89           | \$1.00                      |
| Option exercise price         | \$2.30           | \$0.86           | \$0.99                      |
| Risk free interest rate       | 3.75%            | 3.25%            | 3.29%                       |
| Estimated annual volatility   | 80.12%           | 70.52%           | 71.36%                      |
| Option fair value             | \$1.40           | \$0.54           | \$0.62                      |
| <b>Compensation cost</b>      | <b>\$73,500</b>  | <b>\$598,000</b> | <b>\$745,000</b>            |

**11. Non Cash Transactions**

The following non-cash transactions were recorded during the year ended:

| <b>December 31,</b>                                  | <b>2009</b> |           | <b>2008</b>  |
|--|-------------|-----------|--------------|
| <b>Operating activities</b>                          |             |           |              |
| Accounts payable related to property                 | \$          | 232,537   | \$ 937,892   |
| <b>Financing activities</b>                          |             |           |              |
| Contributed surplus allocated on exercise of options | \$          | 511,800   | \$ 404,252   |
| Share capital allocated from contributed surplus     | \$          | (511,800) | \$ (404,252) |

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**12. Income Taxes**

At December 31, 2009, the Company has Canadian tax losses of approximately \$1,293,000 available for carry-forward. The Company has US tax losses of approximately \$2,156,000 available for carry-forward. If unused, the losses will expire as follows:

| <b>Expiry Date</b> | <b>Canada</b>       | <b>United States</b> |
|--------------------|---------------------|----------------------|
| 2029               | \$ 939,000          | \$ 496,000           |
| 2028               | -                   | 375,000              |
| 2027               | -                   | 398,000              |
| 2026               | 172,000             | 310,000              |
| 2025               | -                   | 265,000              |
| 2024               | -                   | 145,000              |
| 2023               | -                   | 43,000               |
| 2022               | -                   | 31,000               |
| 2021               | -                   | 37,000               |
| 2020               | -                   | 29,000               |
| 2019               | -                   | 27,000               |
| 2018               | -                   | -                    |
| 2015               | 182,000             | -                    |
|                    | <b>\$ 1,293,000</b> | <b>\$ 2,156,000</b>  |

The Company also has available mineral resource related expenditure pools totaling approximately \$25,700,000 which may be deducted against future taxable income on a discretionary basis.

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**Klondex Mines Ltd.****Notes to the Consolidated Financial Statements**

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**December 31, 2009 and 2008**

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**12. Income Taxes** (continued)

Income tax expense varies from the amount that would be computed from applying the combined federal and provincial income tax rate to loss before taxes as follows:

|  | 2009           | 2008           |
|--|----------------|----------------|
| Net loss for the year                      | \$ (2,369,202) | \$ (1,237,414) |
| Statutory Canadian corporate tax rate      | 30.00%         | 31.00%         |
| Anticipated tax expense (recovery)         | (731,819)      | (397,711)      |
| Change in tax rates                        | 178,894        | 15,539         |
| Rate differential due to foreign operation | (21,058)       | (14,113)       |
| Items not deductible for tax purposes      | 353,724        | 357,309        |
| Change in valuation allowance              | 220,259        | 38,976         |
| Actual income tax recovery                 | \$ -           | \$ -           |

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

|                                 | 2009        | 2008        |
|---------------------------------|-------------|-------------|
| <b>December 31,</b>             |             |             |
| Property and equipment          | \$ 907      | \$ 1,048    |
| Exploration deductions          | 419,819     | 510,989     |
| Share issue costs               | 87,585      | 80,658      |
| Marketable securities           | 674         | 830         |
| Capital loss                    | 1,172       | 1,218       |
| Non-capital loss carry forwards | 1,090,481   | 785,635     |
|                                 | 1,600,638   | 1,380,378   |
| Valuation allowance             | (1,600,638) | (1,380,378) |
| Net future tax assets           | \$ -        | \$ -        |

**13. Financial Instruments****a) Currency risk**

Currency risk is the risk to the Company's earnings that arises from fluctuations of foreign exchange rates and the degree of volatility of these rates. The Company does not use derivative instruments to reduce its exposure to foreign currency risk.

The Company had the following financial assets and liabilities in US dollars:

| <b>December 31,</b>                      | <b>2009</b> | <b>2008</b> |
|--|-------------|-------------|
| Cash                                     | \$2,377,026 | \$ 205,916  |
| Marketable securities                    | \$ 181      | \$ 88       |
| Reclamation bonds                        | \$ 177,300  | \$ 177,300  |
| Overdraft (brokerage account)            | \$ -        | \$ 904,294  |
| Accounts payable and accrued liabilities | \$ 251,431  | \$ 770,814  |
| Due to related parties                   | \$ 92,244   | \$ 92,720   |
| Asset retirement obligation              | \$ 177,300  | \$ 177,300  |

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# Klondex Mines Ltd.

## Notes to the Consolidated Financial Statements

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December 31, 2009 and 2008

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### 13. Financial Instruments (continued)

#### a) Currency risk (continued)

At December 31, 2009 US dollar amounts were converted at a rate of \$1.0466 (2008 - \$1.2246) Canadian dollars to \$1.00 US dollar. Based on current levels of assets and liabilities held in US dollars over the last year, for every 10% fluctuation in foreign exchange rates, there will be an approximate \$203,353 effect on its foreign exchange gain (loss).

#### b) Credit risk

Credit risk arises from cash held with banks and financial institutions. The maximum exposure to credit risk is equal to the carrying value of the financial assets. The Company's cash is held with the Bank of Montreal, Jones Gable & Company, Citibank, Bank of America, and Wells Fargo.

#### c) Interest rate risk

Included in the loss for the year in the consolidated financial statements is interest income on Canadian dollar cash. As at December 31, 2009, the Company was not subject to or exposed to any interest rate risk.

#### d) Liquidity risk

The Company manages liquidity risk by maintaining sufficient cash balances to enable settlement of transactions on the due date. Accounts payable and accrued liabilities are current.

#### e) Commodity price risk

The Company's ability to raise capital to fund operation of its gold property is subject to risks associated with fluctuations in the market prices of gold.

#### f) Capital risk management

The Company includes cash and equity, comprising of issued common shares, contributed surplus and deficit, in the definition of capital.

The Company's objective when managing capital is to maintain its ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders.

The Company manages its capital structure and makes adjustments to it, based on the funds available to the Company, in order to support the acquisition and exploration of mineral properties. The Board of Directors does not establish quantitative return on capital criteria for management but rather relies on the expertise of the Company's management and consultants to sustain future development of the business.

The Company's properties are in the exploration stage and as such the Company is dependent upon external financings to fund activities. In order to carry out planned exploration and pay for administrative costs, the Company will spend its existing working capital and raise additional funds required.

Management reviews its capital management approach on an ongoing basis and believes that this approach is reasonable given the relative size of the Company.

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**Klondex Mines Ltd.****Notes to the Consolidated Financial Statements**

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**December 31, 2009 and 2008**

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**13. Financial Instruments** (continued)**f) Capital risk management** (continued)

There were no changes in the Company's approach to capital management during the year ended December 31, 2009. The Company is not subject to externally imposed capital requirements.

**14. Related Party Transactions**

The following transactions with related parties have been valued in these financial statements at the exchange amount, which is the amount of consideration established and agreed to by the parties:

- a) During the year ended December 31, 2009, the Company incurred consulting fees of \$48,000 (2008 - \$49,606) and mineral property services of \$142,300 (2008 - \$61,000) to companies controlled by each of an officer and a director, respectively.
- b) During the year ended December 31, 2009, the Company incurred salary and benefit expenses of \$169,758 (2008 - \$73,532) and rent of \$28,397 (2008 - \$13,793) to the President.
- c) During the year ended December 31, 2009, the Company incurred management fees of \$40,948 (2008 - \$38,382) and rent of \$6,825 (2008 - \$6,397) to a director.
- d) During the year ended December 31, 2009, the Company incurred accounting fees of \$82,063 (2008 - \$58,715) to an officer.
- e) During the year ended December 31, 2009, the Company incurred consulting fees of \$25,000 from directors and an officer directly related to the Silvercorp Metals Inc. unsolicited take-over bid.
- f) Amounts owing to directors and officers of \$145,082 (2008 - \$147,555) are non-interest bearing, unsecured, and payable upon demand. Fair value cannot be reliably determined.

**15. Segmented Information**

| <b>2009</b>              | <b>Canada</b>         | <b>United States</b> | <b>Total</b>          |
|--------------------------|-----------------------|----------------------|-----------------------|
| Interest earned          | \$ 2,541              | \$ -                 | \$ 2,541              |
| Expenses                 | (1,845,284)           | (569,812)            | (2,415,096)           |
| <b>Loss for the year</b> | <b>\$ (1,842,743)</b> | <b>\$ (569,812)</b>  | <b>\$ (2,412,555)</b> |
| Identifiable assets      | \$ 3,548,535          | \$ 23,757,939        | \$ 27,306,474         |
| <b>2008</b>              | <b>Canada</b>         | <b>United States</b> | <b>Total</b>          |
| Interest earned          | \$ 51,725             | \$ -                 | \$ 51,725             |
| Expenses                 | (818,707)             | (387,156)            | (1,205,863)           |
| <b>Loss for the year</b> | <b>\$ (766,982)</b>   | <b>\$ (387,156)</b>  | <b>\$ (1,154,138)</b> |
| Identifiable assets      | \$ 1,669,404          | \$ 21,761,333        | \$ 23,430,737         |

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## Klondex Mines Ltd.

### Notes to the Consolidated Financial Statements

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December 31, 2009 and 2008

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#### 16. Commitments

As at December 31, 2008, the Company has shared lease commitments for office space expiring in February 2010. Minimum lease payments including estimated taxes and excluding operating costs for each of the next year are as follows:

|      |          |
|------|----------|
| 2010 | \$ 2,005 |
|------|----------|

As an inducement to enter into the new office space lease the landlord funded \$65,000 of leasehold improvements on behalf of the 4 tenants. The Company's share of these improvements has been capitalized and the resulting deferred leasehold inducement is recognized as a reduction of rent expense over the term of the lease.

#### 17. Subsequent events

On February 10, 2010, the Company granted 1,350,000 incentive stock options to directors, officers, and consultants at an exercise price of \$1.25 per share. The options are exercisable for a period of ten years, ending February 10, 2020. The options shall be immediately exercisable, subject only to the regulatory 4-month hold from the date of grant (i.e. no vesting periods shall be imposed on the options).

The options have a fair value of \$1,632,000 and were estimated using the Black-Scholes option pricing model with the following assumptions:

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|                             |                   |
|-----------------------------|-------------------|
| Number of options           | 1,350,000 options |
| Number expected to vest     | 1,350,000 options |
| Dividend rate               | 0.00 %            |
| Risk-free interest rate     | 3.43 %            |
| Expected life               | 10 years          |
| Estimated annual volatility | 124.96 %          |
| Strike price                | \$ 1.21           |
| Spot price                  | \$ 1.25           |

On March 10, 2010, the Company announced an update on permitting for its underground development program focused on bulk sampling and exploration drilling.

The Company posted a U.S. \$1,407,937 reclamation bond required pursuant to the Company's U.S. Bureau of Land Management permits (BLM) issued in late December 2009. To fund the bond without issuing common stock at current levels, the Company secured a loan facility bearing interest at 6% per year, which matures on May 16, 2011. The Company has also executed a contract with Western Cultural Resource Management (WCRM) to perform archeological site work also required pursuant to BLM permits.

**18. Contingency**

On July 20, 2009 the Company entered into a letter agreement (the "Letter Agreement") with Paramount Gold and Silver Corp. ("Paramount") setting out the principal terms upon which Paramount would acquire, pursuant to a plan of arrangement, all of the outstanding shares of the Company on the basis of 1.45 shares of the Paramount common stock for each of common share of the Company. On September 24, 2009, the Company terminated the Letter Agreement pursuant to its terms. The Company announced the termination in a news release on September 25, 2009. In its news release, the Company specified the reasons for the termination.

On September 30, 2009, Paramount commenced an action in the Supreme Court of British Columbia seeking payment of a break fee in the amount of US\$2.85 million, and unspecified damages for breach of contract, malicious falsehood and defamation. The Company denies that it has any liability to Paramount, and intends to mount an aggressive, vigorous defence against Paramount's claims. As of the date of this report, the Company's legal counsel is preparing the defence and counterclaim. No accrual has been made in these financial statements as the resolution is not considered to be determinable.

# **KLONDEX MINES LTD.**

## **MANAGEMENT DISCUSSION & ANALYSIS**

**For the Year Ended December 31, 2009**

**Directors and Officers as at March 26, 2010:**

**Directors:**

William J. Solloway  
Brendan Donohoe  
Robert Sibthorpe  
Ronald Shorr  
Weiguo Lang

**Officers:**

President – William J. Solloway  
Chief Financial Officer – Jorge Avelino  
Secretary – Fred Baker

**Contact Name:**

Fred Baker  
Telephone: (604) 638-3273  
(604) 602-4935  
Fax: (604) 602-4936

**Toronto Stock Exchange Symbol:**

KDX

# KLONDEX MINES LTD.

## MANAGEMENT DISCUSSION & ANALYSIS

For the Year Ended December 31, 2009

### 1.1 Date of This Report

March 26, 2010

*This MD&A includes certain statements that may be deemed “forward-looking statements”. All statements in this discussion, other than statements of historical facts, that address exploration drilling, exploitation activities and events or developments that the Company expects, are forward-looking statements. Although the Company believes the expectations expressed in such forward-looking statements are based on reasonable assumptions, such statements are not guarantees of future performance and actual results or developments may differ materially from those in the forward-looking statements. Factors that could cause actual results to differ materially from those in forward-looking statements include market prices, exploitation and exploration successes, continued availability of capital and financing and general economic, market or business conditions. Investors are cautioned that any such statements are not guarantees of future performance and actual results or developments may differ materially from those projected in the forward-looking statements.*

### 1.2 Overall Performance

#### *Description of Business*

Klondex Mines Ltd. (“Klondex” or the “Company”) was founded in 1974 and is listed on the Toronto Stock Exchange under the symbol '[KDX](#)'. Klondex Mines is engaged in acquiring, exploring and developing gold and silver properties in Nevada.

Klondex holds mineral interests in the prime area of northern Nevada's mining industry. The Company's principal property is the 100% owned Fire Creek Property. The Fire Creek Property comprises leasehold land and fee land along the Northern Nevada Rift in North Central Nevada. It is strategically located in the Crescent Valley area of the Battle Mountain gold belt between the past producing Mule Canyon Mine to the north and the world-class Pipeline and Cortez gold deposits to the south.

### 1.3 Selected Annual Information

The highlights of financial data for the Company for the three most recently completed financial years are as follows:

|                                       | December 31,<br><u>2009</u> | December 31,<br><u>2008</u> | December 31,<br><u>2007</u> |
|---------------------------------------|-----------------------------|-----------------------------|-----------------------------|
| (a) Total revenue                     | Nil                         | Nil                         | Nil                         |
| (b) Loss before extraordinary items   |                             |                             |                             |
| (i) Total loss                        | \$2,412,555                 | \$1,154,138                 | \$1,252,259                 |
| (ii) Loss per share - basic           | \$0.09                      | \$0.05                      | \$0.06                      |
| (iii) Loss per share - diluted        | \$0.09                      | \$0.05                      | \$0.06                      |
| (c) Net loss                          |                             |                             |                             |
| (i) Total loss                        | \$2,412,555                 | \$1,154,138                 | \$1,252,259                 |
| (ii) Loss per share - basic           | \$0.09                      | \$0.05                      | \$0.06                      |
| (iii) Loss per share - diluted        | \$0.09                      | \$0.05                      | \$0.06                      |
| (d) Total assets                      | \$27,306,474                | \$23,430,737                | \$20,366,135                |
| (e) Total long-term liabilities       | \$838                       | \$4,113                     | \$7,388                     |
| (f) Cash dividends declared per-share | N/A                         | N/A                         | N/A                         |

### 1.4 Results of Operations

#### *Discussion of Acquisitions, Operations and Financial Condition*

The following should be read in conjunction with the financial statements of the Company and notes attached hereto.

#### NEVADA MINERAL PROPERTIES

##### Acquisition and Exploration expenditures:

| <b>Nevada Properties</b>                 | <b>December 31, 2009</b> | <b>December 31, 2008</b> |
|--|--------------------------|--------------------------|
| <b>Balance, beginning of the year</b>    | <b>\$ 21,282,764</b>     | <b>\$ 15,769,182</b>     |
| Acquisition of land                      | 53,610                   | 297,560                  |
| Advance - Drilling                       | -                        | (99,293)                 |
| Assays and core costs                    | 158,064                  | 549,046                  |
| Consulting - geological                  | 363,641                  | 363,745                  |
| Drilling                                 | 1,104,710                | 3,767,091                |
| Environmental consulting & permitting    | 56,557                   | 282,918                  |
| Field supplies and equipment             | 76,492                   | 155,337                  |
| Geophysics                               | 118,478                  | 31,123                   |
| Lease payments, taxes and royalties      | 22,517                   | 17,944                   |
| Legal                                    | 2,135                    | 1,915                    |
| Maintenance fees                         | 102,688                  | 75,351                   |
| Mapping and sampling                     | 7,504                    | 520                      |
| Miscellaneous                            | 49,359                   | 57,026                   |
| Pond                                     | 44,062                   | -                        |
| Site visits                              | 24,012                   | 13,299                   |
| <b>Current expenditures for the year</b> | <b>2,183,829</b>         | <b>5,513,582</b>         |
| <b>Balance, end of year</b>              | <b>\$ 23,466,593</b>     | <b>\$ 21,282,764</b>     |

## 1.4 Results of Operations (continued)

### **Fire Creek Gold Properties, Lander County, Nevada**

The Company has a 100% ownership interest in this land block which was expanded during fiscal 2003 by 2,720 acres to a total of 4,875 acres. During fiscal 2004, the Company acquired four additional blocks of land (80 acres) in the area for Cdn\$69,567 (US\$52,983). During fiscal 2006, the Company acquired additional blocks of land, which totaled 130 acres for Cdn\$119,030 (US\$97,009). These acquisitions were necessary to ensure logistical access to the main mineralized zones and to acquire areas which represent the strike extensions of these zones. During the year ended December 31, 2007, the Company acquired an additional 50 acres for \$70,433 (US\$66,490).

During the year ended December 31, 2008, the Company acquired an additional 400 acres for \$184,504 (US\$182,475). The Company includes the Woodtick and Corral Canyon claims in the greater Fire Creek Project area. The total unpatented claims within the project area now total 484 claims, or 9,680 acres and fee lands now total 1,428 acres.

### **Corral Canyon, Lander County, Nevada**

The Company has a 100% ownership interest in 42 claims (840 acres) in Corral Canyon, Lander County, Nevada. The claims are in good standing and were renewed on September 1, 2009. These claims were added to the Fire Creek project in fiscal 2007 and are included in the Fire Creek discussion.

### **Woodtick claims, Lander County, Nevada**

The Company has a 100% ownership interest in these 26 claims (520 acres). They lie directly north-east of Fire Creek along the Mule Canyon-Fire Creek-Buckhorn volcanic trend. These claims provide access to the northern Fire Creek block from the powerline road. The claims are in good standing and were renewed on September 1, 2009. These claims were added to the Fire Creek project in fiscal 2007 and are included in the Fire Creek discussion.

### **Exploration Results and Future Plans & Developments**

On March 2, 2009, the Company announced the assays from the final 15 holes of its 2008 drill program. The holes continued the program of drilling untested geophysical anomalies and extending known resource zones. These drill holes were incorporated in an NI 43-101-compliant resource update for its 100%-owned Fire Creek high-grade gold property, which was filed on SEDAR on March 31, 2009.

On April 1, 2009, the Company announced that it had received an NI 43-101-compliant update report on its 100%-owned Fire Creek gold property in the Battle Mountain-Eureka Trend in Northern Nevada which contains the following information:

*“Through extensive drill campaigns carried out over the past 5 years Klondex has defined an Indicated Mineral Resource estimated at 5,043,033 metric tons averaging 10.11 grams per metric ton (gpt) for 1,639,822 ounces of gold equivalent with an average interval true width of 5.5 meters using a cut-off grade of 5.0 gpt. This cut-off grade also resulted in an inferred resource estimate of 1,833,423 metric tons tonnes grading 8.63 gpt for 508,799 ounces of gold.”*

## 1.4 Results of Operations (continued)

### Fire Creek Gold Properties, Lander County, Nevada

The current mineral resource figures at various cut-off grades are presented in the table below and all represent a significant increase in tonnage and contained gold over the September 2006 resource estimate of an indicated resource of 1,636,555 tonnes grading 19.88 gpt containing 1,045,738 ounces of gold.

#### Fire Creek Project - Indicated and Inferred Resource

| Gold Cut-off<br>GPT | Classification   | Metric Tons       | Grade<br>GPT | Oz. Gold*        |
|---------------------|------------------|-------------------|--------------|------------------|
| <b>8.0</b>          | <b>Indicated</b> | <b>2,408,299</b>  | <b>16.42</b> | <b>1,271,392</b> |
| 8.0                 | Inferred         | 1,074,308         | 13.57        | 468,856          |
| <b>5.0</b>          | <b>Indicated</b> | <b>5,043,033</b>  | <b>10.11</b> | <b>1,639,822</b> |
| 5.0                 | Inferred         | 1,833,423         | 8.63         | 508,799          |
| <b>2.0</b>          | <b>Indicated</b> | <b>14,056,610</b> | <b>4.67</b>  | <b>2,111,002</b> |
| 2.0                 | Inferred         | 8,877,720         | 3.74         | 1,068,488        |

\* Gold equivalent with silver at 60:1

This Mineral Resource Update was based on information from an additional 101 drill holes totaling 147,110 feet (44,837 meters) received between August 2006 and December 2008. The estimation method used was the polygonal technique. Key assumptions included an average mining width of 5.5 meters (for the 5.0 gpt cut off estimate) for dilution and a bulk tonnage factor of 2.55 was applied based on specific gravity measurements of representative core. High gold values were not cut but their area of influence was limited by a number of constraints. The Mineral Resource Update reflects three different mineral cutoffs. The September 2006 mineral resource was based on a cutoff of 10 gpt and an average mining width of less than 3 meters. The reduced GPT cutoffs and increased mining widths utilized in the Mineral Resource Update were deemed appropriate given the significant increase in the price of gold over the past 2 ½ years. The silver to gold grade ratio is approximately 1:1 and silver does not have a significant economic impact on the overall resource at Fire Creek but is important locally within the zones.

On July 9, 2009, the Company announced that it had resumed surface drilling on the Fire Creek Project. The drilling, part of the program recommended in the Company's March 2009 NI 43-101-compliant resource update, will further test the two high-grade gold vein sets which make up the Main Zone and which are primary targets for Klondex's planned bulk sampling initiative.

On November 18, 2009, the Company announced the results from the first five holes of its 2009 drill campaign and provided an exploration and permitting update on its 100%-owned Fire Creek high-grade underground gold deposit in Nevada. At Fire Creek Klondex has defined an Indicated Mineral Resource estimated to contain 1,639,822 ounces of gold equivalent and an Inferred Mineral Resource estimated to contain 508,799 ounces of gold equivalent.

## 1.4 Results of Operations (continued)

### **Fire Creek Gold Properties, Lander County, Nevada**

#### **2009 Exploration and Drilling Results**

In 2009 KDX completed an additional geophysical survey over Fire Creek and is in the process of completing a 15-hole drill program. The first five drill holes encountered the following high-grade gold mineralization:

- FC0901 (17.3 grams per metric ton (g/t) gold over 2.1 meters true width)
- FC0903 (25.0 g/t gold over 6.3 meters true width)
- FC0904 (10.7g/t over 3.7 meters true width)
- FC0905 (18.0 g/t gold over 2.2 meters true width)

The first five holes targeted untested areas within the Main Zone mineralization. Drill holes FC0906 through FC0915 are sited to test extensions of known mineralized zones and to test anomalies generated by the recent geophysical survey.

On January 20, 2010, the Company announced the final results from its 2009 drilling campaign. The 2009 program included RC drilling of two IP anomalies, one of which yielded the discovery of two new veins. The IP anomaly targets were developed in a geophysical survey also conducted in 2009. KDX completed 15 holes totaling 20,221 feet (6,163 meters) within the Fire Creek project in 2009.

#### **2009 Geophysical Survey Identifies 15 Drilling Targets**

In the summer of 2009 a new detailed, multi-method geophysical survey was run at Fire Creek (FC). The survey identified 15 untested anomalies that are drilling targets. Using a reverse circulation (RC) drill rig Klondex tested two of the anomalies. Drill holes FC0912RC through FC0915RC tested two anomalies located east of the Main vein zone. Holes FC0912RC and FC0913RC intersected two high-angle dikes with weakly anomalous gold values near the margins of the dikes below the first anomaly drilled.

#### **RC Program Identifies Two New Veins**

Hole FC0914RC intersected a broad zone of +0.03 oz/ton gold occurring between 925 and 1360 feet. Within this anomaly are two veins consisting of 3.5 feet (1.1 meter) true width of 0.26 oz/ton (9.1 g/t) gold and 0.76 oz/ton (25.9 g/t) silver and 3.5 feet (1.1 meter) true width of 0.26 oz/ton (9.1 g/t) gold and 0.18 oz/ton (6.3 g/t) silver. This new discovery is approximately 300 feet (91 meters) east of the nearest vein. FC0915RC was lost before reaching the mineralized horizon. Core drilling of the new discovery is planned in the spring of 2010.

#### **Main Zone Definition Drilling Yields 1.45 oz/ton Intercept**

Holes FC0901 through FC0905 were targeted within the Main vein zone and were used to further define areas suitable for bulk sampling once underground work is initiated. These results included several +0.25 oz/ton gold values including 8.8 feet (2.7 meters) true width of 1.45 oz/ton (49.9 g/t) gold and 0.88 oz/ton (30.1 g/t) silver in hole FC0903.

1.4 Results of Operations (continued)

**Fire Creek Gold Properties, Lander County, Nevada**

| Summary 2009 Drill Results - Fire Creek |   |           |                 |                   |               |                 |                     |                    |                      |              |             |
|---|---|-----------|-----------------|-------------------|---------------|-----------------|---------------------|--------------------|----------------------|--------------|-------------|
| Hole No.                                | From (feet)   | To (feet) | Interval (feet) | True Width (feet) | Gold (oz/ton) | Silver (oz/ton) | True Width (meters) | Gold (grams/tonne) | Silver (grams/tonne) | Target Area  |             |
| FC0901 including                        | 885   | 945       | 60              | 42.0              | 0.124         | 0.312           | 12.8                | 4.25               | 10.7                 | Main         |             |
|   | 885   | 893       | 8               | 5.6               | 0.237         | 0.663           | 1.7                 | 8.12               | 22.7                 | Main         |             |
|   | 935   | 945       | 10              | 7.0               | 0.505         | 0.461           | 2.1                 | 17.30              | 15.8                 | Main         |             |
| FC0902                                  | 1035  | 1055      | 20              | 14.0              | 0.055         | 0.091           | 4.3                 | 1.90               | 3.1                  | Main         |             |
| FC0903 including                        | 220   | 270       | 50              | 40.0              | 0.104         | 0.057           | 12.2                | 3.56               | 1.9                  | Main         |             |
|   | 250   | 260       | 10              | 8.0               | 0.331         | 0.044           | 2.4                 | 11.34              | 1.5                  | Main         |             |
|   | 915   | 943.2     | 28.2            | 20.8              | 0.730         | 0.470           | 6.3                 | 25.00              | 16.1                 | Main         |             |
| including                               | 915   | 927.5     | 12.5            | 8.8               | 1.457         | 0.879           | 2.7                 | 49.90              | 30.1                 | Main         |             |
| FC0904                                  | 727.8   | 745       | 17.2            | 12.0              | 0.312         | 0.572           | 3.7                 | 10.70              | 19.6                 | Main         |             |
|   | 810   | 815       | 5               | 3.5               | 0.295         | 0.149           | 1.1                 | 10.10              | 5.1                  | Main         |             |
| FC0905                                  | 575   | 590       | 15              | 10.7              | 0.043         | 0.006           | 3.3                 | 1.47               | 0.2                  | Main         |             |
|   | 612.5   | 625       | 12.5            | 8.8               | 0.067         | 0.047           | 2.7                 | 2.30               | 1.6                  | Main         |             |
|   | 785   | 795       | 10              | 7.1               | 0.526         | 0.435           | 2.2                 | 18.00              | 14.9                 | Main         |             |
|   | 915   | 1001      | 86              | 60.2              | 0.050         | 0.199           | 18.3                | 1.70               | 6.8                  | Main         |             |
| FC0906                                  | 500   | 510       | 10              | 7.0               | 0.093         | 0.219           | 2.1                 | 3.17               | 7.5                  | S. Main Ext. |             |
|   | 615   | 625       | 10              | 7.0               | 0.063         | 0.234           | 2.1                 | 2.17               | 8.0                  | S. Main Ext. |             |
| FC0907                                  | 905   | 920       | 15              | 10.6              | 0.062         | 0.059           | 3.2                 | 2.14               | 2.0                  | N. Main Ext. |             |
| FC0908                                  | 850   | 885       | 35              | 29.8              | 0.077         | 0.053           | 9.1                 | 2.63               | 1.8                  | N. Main Ext. |             |
|   | 1195  | 1220      | 25              | 20.0              | 0.046         | 0.172           | 6.1                 | 1.56               | 5.9                  | N. Main Ext. |             |
| FC0909                                  | No Values >10 feet @ > 0.03 oz/ton Gold             |           |                 |                   |               |                 |                     |                    |                      | N. Main Ext. |             |
| FC0910                                  | 790   | 805       | 15              | 12.0              | 0.053         | 0.053           | 3.7                 | 1.80               | 1.8                  | New North    |             |
| FC0911                                  | 815   | 840       | 25              | 20.0              | 0.044         | 0.155           | 6.1                 | 1.51               | 5.3                  | New North    |             |
|   | 895   | 910       | 15              | 12.0              | 0.063         | <0.015          | 3.7                 | 2.16               | <0.5                 | New North    |             |
| FC0912RC                                | No Values >10 feet @ > 0.03 oz/ton Gold             |           |                 |                   |               |                 |                     |                    |                      | IP Anom. #2  |             |
| FC0913RC                                | No Values >10 feet @ > 0.03 oz/ton Gold             |           |                 |                   |               |                 |                     |                    |                      | IP Anom. #2  |             |
| FC0914RC including                      | 925   | 940       | 15              | 12.0              | 0.053         | 0.020           | 3.7                 | 1.83               | 0.7                  | IP Anom. #1  |             |
|   | 1010  | 1025      | 15              | 12.0              | 0.032         | 0.140           | 3.7                 | 1.10               | 4.8                  | IP Anom. #1  |             |
|   | 1115  | 1125      | 10              | 7.1               | 0.054         | 0.126           | 2.2                 | 1.84               | 4.3                  | IP Anom. #1  |             |
|   | 1225  | 1235      | 10              | 7.1               | 0.196         | 0.581           | 2.2                 | 6.70               | 19.9                 | IP Anom. #1  |             |
|   | including   | 1225      | 1230            | 5                 | 3.5           | 0.265           | 0.756               | 1.1                | 9.08                 | 25.9         | IP Anom. #1 |
|   | including   | 1345      | 1360            | 15                | 10.5          | 0.127           | 0.143               | 3.2                | 4.35                 | 4.9          | IP Anom. #1 |
|   | including   | 1350      | 1355            | 5                 | 3.5           | 0.265           | 0.184               | 1.1                | 9.07                 | 6.3          | IP Anom. #1 |
| FC0915RC                                | No Values >10 feet @ > 0.03 oz/ton Gold – Hole Lost |           |                 |                   |               |                 |                     |                    |                      | IP Anom. #1  |             |

Note: Table only includes values equivalent to ≥ 10 feet @ ≥ 0.03 oz/ton gold

**Main and New North Zone Extension Drilling**

Six of the remaining holes were targeted on possible extensions of the Main zone to the north and south and the north extension of the New North vein zone. FC0906 is the first hole to test the southernmost extension of Main, and it found two sub-grade veins worthy of further testing. FC0907 through FC0909 tested the northern extension of the Main zone. FC0907 and FC0908 both hit sub-grade veins with FC0908 intersecting 29.8 feet (9.1 meters) true width of 0.08 oz/ton (2.6 g/t) gold. Located on the northernmost discovery at Main, this major fault zone will be tested further. FC0909 did not intersect any significant veining.

## 1.4 Results of Operations (continued)

### **Fire Creek Gold Properties, Lander County, Nevada**

Drill holes FC0910 and FC0911 tested the northern extension of the New North zone. FC0910 was a 100-meter step-out and the first hole to explore this far north. The sub-grade vein intersected indicates the mineralized structure is still present, and a fence of holes are planned to further test this area. FC0911 was drilled to test directly west of a previous vein intercept and intercepted two sub-grade veins.

On March 10, 2010, the Company announced an update on permitting for its underground development program focused on bulk sampling and exploration drilling.

The Company posted a U.S. \$1,407,937 reclamation bond required pursuant to the Company's U.S. Bureau of Land Management permits (BLM) issued in late December 2009. To fund the bond without issuing common stock at current levels, the Company secured a loan facility bearing interest at 6% per year, which matures on May 16, 2011. The Company has also executed a contract with Western Cultural Resource Management (WCRM) to perform archeological site work also required pursuant to BLM permits.

### **Lander & Eureka Counties, Nevada**

The Company has an option to acquire a 100% interest (the "Option") in certain lands located in Lander & Eureka Counties, Nevada (the "Property"), from Fire Creek Lands, LLC (the "Optionor"). The Property has the potential for copper, silver, gold and other valuable mineral deposits. In consideration of the Option, the Company must make option payments in the aggregate amount of \$380,000 over a period of five years (US\$305,000 paid to date), and may purchase the Property on or before June 17, 2010 for \$2,500,000 with prior option payments being applied as a credit towards the purchase price.

The agreement was amended August 4, 2009. The amended consideration of the Option is as follows: the Company must make option payments in the aggregate amount of \$480,000 over a period of six years (US\$305,000 paid to date), and may purchase the Property on or before December 17, 2011 for \$2,500,000 with prior option payments being applied as a credit towards the purchase price.

In the event of an outright purchase of the Property by the Company, the Optionor will retain a 3% net smelter royalty, with the Company having a one-time option to purchase one percent of the royalty in consideration of \$1,000,000, at any time until June 17, 2015.

### **Maggie Creek, Elko County, Nevada**

The Company has a 66.66% undivided interest in 48 claims (960 acres) situated in sections 8, 16 and 20 in the Maggie Creek area in Elko County, Nevada. The claims are in good standing and were renewed on September 1, 2009. The property is subject to U.S. federal and state environmental statutes. No future work is planned for the property at this time. The claims are being held due to their strategic location.

## 1.4 Results of Operations (continued)

### **Reef claims, Churchill County, Nevada**

The Company has a 100% ownership interest in 8 claims (160 acres) in the Fairchild District of Churchill County. Anomalous gold and silver were previously detected along a siliceous reef which runs approximately a half mile in length. The claims are in good standing and were renewed on September 1, 2009. The property is subject to U.S. federal and state environmental statutes. No future work is planned for the property at this time.

### **Hot Springs Point, Lander County, Nevada**

The Company has a 100% ownership interest in 39 claims (780 acres) situated about 6 miles east of the town of Crescent Valley. They are in a basalt-andersite setting. The claims are in good standing and were renewed on September 1, 2009.

### ***Discussion of Operations and Financial Condition***

#### **Results of Operations**

Interest income for the year ended December 31, 2009 was \$2,541 compared to \$51,725 for the year ended December 31, 2008. The loss for the year ended December 31, 2009 was \$2,412,555 as compared with a loss of \$1,154,138 for the year ended December 31, 2008.

The increase in the loss for the year ended December 31, 2009 compared to the year ended December 31, 2008 is related to the following:

- Stock-based compensation increased by \$497,038 during the year ended December 31, 2009. As a result of the unsolicited take-over bid from Silver Corp Metals and in accordance with the stock option plan, all vesting provisions in outstanding stock options expired. The Company expensed \$854,148 as stock-based compensation during the current year and \$357,110 in the comparative year.
- Office and general expenses increased by \$37,165 during the year ended December 31, 2009. In the current year, the Company incurred rent expense of US\$24,600 for the office of the president in New York (2008 - \$Nil). In addition, the Company incurred \$18,258 in interest due to an overdraft in the US\$ brokerage account with Jones Gable and interest expense of US\$9,461 from several US suppliers for unpaid drilling bills.
- Consulting fees and Legal and Accounting fees increased by \$125,345 and \$502,701 respectively. This was a result of the Company's efforts in responding to the unsolicited take-over bid by Silver Corp Metals and the Paramount business combination letter agreement.

A breakdown of the "Consulting Fees" expense is as follows:

|  |          |               |
|--|----------|---------------|
| Corporate & administration fees  | \$       | 16,856        |
| Shareholders communication (Canada)  |          | 54,250        |
| Shareholders communication (USA)   |          | 80,411        |
| Fees directly related to the Silvercorp take-over bid and Paramount business combination |          | 102,816       |
| <hr/> Total  | <hr/> \$ | <hr/> 254,333 |

## 1.4 Results of Operations (continued)

### *Discussion of Operations and Financial Condition (continued)*

A breakdown of the “Travel, accommodation and meetings” expense is as follows:

|  |    |         |
|--|----|---------|
| Travel                                 | \$ | 64,005  |
| Communication, Conference and meetings |    | 69,702  |
| Meals & entertainment                  |    | 16,130  |
| <hr/>                                  |    |         |
| Total                                  | \$ | 149,837 |
| <hr/>                                  |    |         |

### **Investor Relations Activities**

During the period, the Company responded to investor inquiries and conducted shareholder and investor mailouts. The responsibility for responding directly to all investor inquiries and for conducting shareholder and investor mailouts is handled by the Corporate Secretary in Vancouver and by the 2 directors in New York.

In January 2007, the Company entered into a one year agreement with Jaffoni & Collins (“JCI”) to provide investor relations services for the Company (automatically renews for successive one year periods). Founded in 1994, JCI ([www.jcir.com](http://www.jcir.com)) is a full-service investor relations agency exclusively focused on creating and executing communication programs for public companies. JCI will be responsible for developing and implementing, and advising the Company with respect to investor relations and financial policies and opportunities. JCI is based in New York, New York and works closely with institutional investors, sell-side analysts, brokers, and private investors and the media in Canada and the United States. JCI and its principals are at arm’s length to the Company.

JCI’s monthly fee is US\$5,000 plus expenses related to dissemination of information. JCI currently has stock options of 150,000 at \$2.30 per share, 25,000 at \$0.86 per share and 25,000 @ \$1.00 per share.

Subsequent to the year ended December 31, 2009, the Company engaged the services of Bryson Goodwin as Director of Investor Relations to manage the market strategies and outreach program across Canada, the United States, Asia, and Europe. Under the direction of Bryson Goodwin, for the purpose of dissemination of important news and information, the Company engaged the services of the following companies – Jay’s Watchlist, Vantage Communication, and Robertson Walters Investment Capital Corp.

### **Financings, Principal Purposes & Milestones**

On March 26, 2009, the Company announced that it had completed a non-brokered private placement of 1,500,000 units (the “Units”) at a price of \$0.60 per unit for gross proceeds of \$900,000. Each Unit consisted of one common share and one share purchase warrant. Each warrant entitles the holder to purchase one additional common share of the Company at a price of \$0.90 for a period for 12 months after closing. The warrants are subject to a 30-day early expiration if the stock closes on the Toronto Stock Exchange, for a period of 20 consecutive trading days, at a price of \$1.30 or greater. A 5% commission (\$41,400) was paid to authorized agents.

On June 30, 2009, the Company announced that it had completed a non-brokered private placement of 1,714,285 common shares at a price of \$1.75 per share for gross proceeds of \$3,000,000. A 5% commission that applied to a portion of the financing attributable to authorized agent in the amount of \$120,000 was paid.

## 1.4 Results of Operations (continued)

### Financings, Principal Purposes & Milestones (continued)

For a discussion on “Principal Purposes & Milestones”, please refer to the detailed discussion on the Fire Creek Property.

On July 20, 2009, the Company announced that it had entered into a binding letter of agreement with Paramount Gold and Silver Corp. (“Paramount”) to combine the two companies under a plan of arrangement in a transaction valued at approximately C\$80 million (the “Transaction” or the “Paramount Transaction”). The Letter Agreement was unanimously approved by the Board of Directors of both Companies.

Pursuant to the Letter Agreement, each Klondex share would have been exchanged for 1.45 Paramount shares, implying a purchase price of C\$2.32 per Klondex share using closing share prices on the TSX on July 17, 2009. The Transaction represented a premium of 33.3% to the closing price of Klondex shares and a 30.3% premium to the implied value of the unsolicited proposal by Silvercorp Metals Inc. (“Silvercorp.”) as of July 17, 2009. The Silvercorp proposal was announced on June 8, 2009, and was rejected by the Klondex Board of Directors as providing inadequate consideration for Klondex shareholders.

On September 24, 2009, the Company announced that it had terminated the July 20, 2009 letter agreement (the “Letter Agreement”) with Paramount Gold and Silver Corp. (“Paramount”) in respect of a proposed business combination of Klondex and Paramount. The Letter Agreement was terminated by the Company in accordance with its terms. As a result of Paramount’s breach of the terms of the Letter Agreement, the Company believes it is entitled to a reverse break fee of US\$2.85 million plus damages and denies it has any obligation to pay Paramount any break fee.

The Company’s decision to terminate the agreement was based on the results of its due diligence which revealed that Paramount’s public disclosure record contained material misstatements and omissions regarding the inferred resource at Paramount’s San Miguel Project in Mexico. The Company believes that these misrepresentations have a material adverse affect on the value and potential of the San Miguel Project. The Company formally advised Paramount of the misrepresentations on September 13, 2009.

On Friday, September 18, 2009, after notice from the Company of its due diligence review of the San Miguel Project, Paramount made publicly available only on SEDAR an updated 83 page technical report in respect of the San Miguel Project dated September 15, 2009 (the “New Report”). After review of the New Report, the Company concluded that the New Report confirms the results of its due diligence investigation and provides first time public disclosure that a significant portion of the newly identified higher grade mineralized material located in Clavo 66 and Clavo 99 of the San Miguel Project resource (the “San Miguel Resource”) is actually located on a neighbouring property, in which Paramount has no known ownership rights. The Company has been unable to confirm the amount of the higher-grade mineralization located on the neighboring property as Paramount has refused to provide to Klondex the underlying data used to calculate the San Miguel Resource. The Company believes that the amount of mineralization in question is significant.

From its review of the New Report, the Company also determined that, although the resource reported in Clavos 66 and 99 is open to depth, a portion of the resource that is open to depth is actually located on the neighbouring property, in which Paramount has no known ownership rights. Klondex is of the view that this materially limits the prospects for the San Miguel Project.

## 1.4 Results of Operations (continued)

### Financings, Principal Purposes & Milestones (continued)

The foregoing information was not publicly available and not readily apparent from the public record at the time the Company entered into the Letter Agreement. The public record at that time made no reference to claim boundaries in relation to the mineralized zones at Clavos 66 and 99 and consistently referred to these zones as being open to depth. The Company only became aware of the discrepancy after completing a site visit and interviewing members of Paramount's personnel.

On September 30, 2009, Paramount commenced an action in the Supreme Court of British Columbia seeking payment of a break fee in the amount of US\$2.85 million, and unspecified damages for breach of contract, malicious falsehood and defamation. The Company denies that it has any liability to Paramount, and intends to mount an aggressive, vigorous defence against Paramount's claims. As of the date of this report, the Company's legal counsel is preparing the defence and counterclaim.

On October 6, 2009, the Company issued a press release asserting unequivocally that the letter agreement was terminated solely for the reasons set out in the Company's September 24, 2009 news release. The Company intends to mount an aggressive, vigorous defense of Paramount's claims and pursue a counterclaim for the reverse break free of US \$2.85 million plus damages.

On December 17, 2009, the Company announced that it had received initial permits from the US Bureau of Land Management (BLM) for its underground confirmation program at Fire Creek, its high-grade gold deposit in North Central Nevada. The approvals also pave the way for Klondex to extend to the south its Main Zone surface exploration program. To complete the permitting process, Klondex must post a reclamation bond (posted March 10, 2010), finish additional site work at Fire Creek and secure Nevada state approvals. KDX now anticipates the permitting process will be completed between April and June of 2010.

On March 2, 2010, the Company announced the hiring of two strategic and vital components of its go forward strategy. Blane W. Wilson has been appointed as Executive Mining Advisor, Nevada Operations, to oversee the advancement of the Company's mining and production programs at its high-grade Fire Creek gold deposit, and Bryson Goodwin has been appointed as Director of Investor Relations to manage our market strategies and outreach.

On March 10, 2010, the Company announced that it had posted a U.S. \$1,407,937 reclamation bond required pursuant to the Company's U.S. Bureau of Land Management permits (BLM) issued in late December 2009. To fund the bond without issuing common stock at current levels, the Company secured a loan facility bearing interest at 6% per year, which matures on May 16, 2011. The Company has also executed a contract with Western Cultural Resource Management (WCRM) to perform archeological site work also required pursuant to BLM permits.

## 1.5 Summary of Quarterly Results

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

|            | <b>Q4</b>     | <b>Q3</b>     | <b>Q2</b>     | <b>Q1</b>     | <b>Q4</b>     | <b>Q3</b>     | <b>Q2</b>     | <b>Q1</b>     |
|------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|---------------|
|            | <b>Dec-09</b> | <b>Sep-09</b> | <b>Jun-09</b> | <b>Mar-09</b> | <b>Dec-08</b> | <b>Sep-08</b> | <b>Jun-08</b> | <b>Mar-08</b> |
| Total loss | (440,232)     | (531,358)     | (649,424)     | (791,541)     | (480,823)     | (199,354)     | (269,448)     | (204,513)     |
| Per share  | (\$0.02)      | (\$0.02)      | (\$0.02)      | (\$0.03)      | (\$0.02)      | (\$0.01)      | (\$0.01)      | (\$0.01)      |

### *Discussion*

For a detailed discussion on the year ended December 31, 2009, please refer to Section 1.4 - Results of Operations.

## 1.6 Liquidity

The Company has no revenue generating projects at this time. The Company's historical capital needs have been met by equity subscriptions. As at December 31, 2009, the Company had working capital of \$2,847,437 (December 31, 2008 – working capital deficit of \$575,562). The Company currently has sufficient working capital for general and administration expenses. The Company will require capital to meet the exploration program for the Fire Creek property. However, this is a forward-looking statement as it involves known and unknown risks, uncertainties and other factors, which could affect the actual results, performance or achievements of the Company and impact on the adequacy of working capital required for the year 2009 and 2010 expressed by such forward-looking statement. Also, the ability of the Company to continue with recommended exploration programs on its current properties, and/or to successfully acquire and develop additional properties in the resource sector is conditional on its ability to secure financing when required. The Company proposes to meet any additional financing requirements through the exercise of outstanding stock options and warrants, or arranging other equity financing, and/or finalizing a joint venture agreement with a partner(s) who will be able to assume the costs of recommended exploration programs. In light of the continually changing financial markets, there is no assurance that funding by equity subscriptions or finding a joint venture partner will be possible at the times required or desired by the Company.

### Currency Risk

Currency risk is the risk to the Company's earnings that arises from fluctuations of foreign exchange rates and the degree of volatility of these rates. The Company does not use derivative instruments to reduce its exposure to foreign currency risk.

At December 31, 2009 the Company had the following financial assets and liabilities:

| <b>December 31,</b>                      | <b>2009</b> | <b>2008</b> |
|--|-------------|-------------|
| Cash                                     | \$2,377,026 | \$ 205,916  |
| Marketable securities                    | \$ 181      | \$ 88       |
| Reclamation bonds                        | \$ 177,300  | \$ 177,300  |
| Overdraft (brokerage account)            | \$ -        | \$ 904,294  |
| Accounts payable and accrued liabilities | \$ 251,431  | \$ 770,814  |
| Due to related parties                   | \$ 92,244   | \$ 92,720   |
| Asset retirement obligation              | \$ 177,300  | \$ 177,300  |

## 1.6 **Liquidity** (continued)

At December 31, 2009 and 2008 US dollar amounts were converted at a rate of \$1.0466 (2008 - \$1.2246) Canadian dollars to \$1.00 US dollar.

### Capital risk management

The Company includes cash and equity, comprising of issued common shares, contributed surplus and deficit, in the definition of capital.

The Company's objectives when managing capital is to maintain its ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders.

The Company manages its capital structure and makes adjustments to it, based on the funds available to the Company, in order to support the acquisition and exploration of mineral properties. The Board of Directors does not establish quantitative return on capital criteria for management but rather relies on the expertise of the Company's management and consultants to sustain future development of the business.

The Company's properties are in the exploration state and as such the Company is dependent upon external financings to fund activities. In order to carry out planned exploration and pay for administrative costs, the Company will spend its existing working capital and raise the additional funds required.

Management reviews its capital management approach on an ongoing basis and believes that this approach is reasonable given the relative size of the Company.

There were no changes in the Company's approach to capital management during the year ended December 31, 2009. The Company is not subject to externally imposed capital requirements.

## 1.7 **Capital Resources**

The only capital resources of the Company are its mineral properties with a historical cost of \$23,466,593 and its property and equipment with a net book value of \$20,389.

## 1.8 **Off Balance Sheet Arrangements**

There are no off-balance sheet arrangements to which the Company is committed.

## 1.9 **Transactions with Related Parties**

The Financial Statements attached hereto provide disclosure on related party transactions for the year ended December 31, 2009, with breakdown as follows:

| <b>Expense</b>               | <b>31-Dec-09</b>  | <b>31-Dec-08</b>  |
|------------------------------|-------------------|-------------------|
| Management salaries & fees   | \$ 210,706        | \$ 111,914        |
| Consulting fees:             |                   |                   |
| - Shareholders communication | 48,000            | 49,606            |
| - Related to take-over bid   | 25,000            | -                 |
| Accounting fees              | 82,063            | 58,715            |
| Rent                         | 35,222            | 20,190            |
| Deferred geological fees     | 142,300           | 61,000            |
| <b>Total for the period</b>  | <b>\$ 543,291</b> | <b>\$ 301,425</b> |

## **1.9 Transactions with Related Parties (Continued)**

Amounts due to directors and officers of \$145,082 (2008 - \$147,555) are non-interest bearing, unsecured, and payable upon demand.

The President, Chief Financial Officer and Corporate Treasurer are under management contracts with base annual compensation of US\$150,000, Cdn\$60,000 and US\$75,000 respectively. In the event of a change of control, a termination payment is triggered to each of these officers in the lump sum amounts of US\$225,000, Cdn\$75,000 and US\$112,500 respectively. Additionally, in the case of the President, a termination payment equivalent to 100% of the annual compensation is triggered by the executive's death or permanent physical or mental disability. These management contracts have a term of 5 years expiring on January 4, 2015.

## **1.10 Fourth Quarter – 2009:**

The fourth quarter expenditures do not differ significantly from other quarters and were in the normal course of the business with exception of the increased accounting, consulting and legal fees directly related to Silvercorp take-over-bid and the Paramount business combination.

## **1.11 Proposed Transactions**

None

## **1.12 Critical Accounting Estimates**

In preparing financial statements, management has to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Based on historical experience, current conditions and expert advice, management makes assumptions that are believed to be reasonable under the circumstances. These estimates and assumptions form the basis for judgments about the carrying value of assets and liabilities and reported amounts for revenues and expenses. Different assumptions would result in different estimates and actual results may differ from results based on these estimates. These estimates and assumptions are also affected by management's application of accounting policies. Critical accounting estimates are those that affect the consolidated financial statements materially and involve a significant level of judgment by management. Please refer to Note 2 of the Annual Financial Statements.

## **1.13 Changes in Accounting Policies**

Please refer to Note 2 of the Financial Statements.

## **1.14 Financial and Other Instruments**

The carrying value of cash and cash equivalents, marketable securities, accounts receivable, brokerage account overdraft, accounts payable and due from (to) related parties approximate their fair values due to the short maturity of those instruments.

## 1.15 Other

### 1.15.1 Share Capital

#### *Disclosure of Outstanding Share Capital (March 26, 2010)*

|               | Number     | Book Value   | Contributed<br>Surplus |
|---------------|------------|--------------|------------------------|
| Common Shares | 32,219,089 | \$38,227,368 | \$2,513,631            |

### 1.15.1 Share Capital (continued)

#### *Summary of incentive stock options: (March 26, 2010)*

| Number of Shares | Expiry Date        | Exercise Price |
|------------------|--------------------|----------------|
| 125,000          | June 10, 2010      | \$1.05         |
| 595,000          | July 17, 2011      | \$2.35         |
| 150,000          | January 19, 2012   | \$2.30         |
| 200,000          | May 7, 2012        | \$2.25         |
| 105,000          | January 21, 2013   | \$2.30         |
| 775,000          | September 17, 2013 | \$0.86         |
| 660,000          | March 2, 2014      | \$1.00         |
| 1,350,000        | February 10, 2020  | \$1.25         |
| 3,960,000        |                    |                |

#### *Summary of warrants outstanding: (March 26, 2010)*

| Number of Shares | Expiry Date | Exercise Price |
|------------------|-------------|----------------|
| Nil              | -           | -              |

### 1.15.2 Disclosure Controls and Procedures

The Company has disclosure controls and procedures in place to provide reasonable assurance that any information required to be disclosed by the Company under securities legislation is recorded, processed, summarized and reported within the applicable time periods and to ensure that required information is gathered and communicated to the Company's management so that decisions can be made about timely disclosure of that information. The Company's Chief Executive Officer and Chief Financial Officer evaluated the Company's disclosure controls and procedures for the year ended December 31, 2009. Management and the Board have found those disclosure controls and procedures to be adequate for the above purposes.

## 1.15.2 Disclosure Controls and Procedures (continued)

### Internal Controls over Financial Reporting

The Chief Executive Officer, the Chief Financial Officer and the Audit Committee of the Company are responsible for designing a system of internal controls over financial reporting, or causing them to be designed under their supervision, in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes in accordance with Canadian generally accepted accounting principles. The Chief Executive Officer, the Chief Financial Officer and the Audit Committee have designed and implemented a system of internal controls over financial reporting which they believe is effective for the Company. During the review of the design of the Company's control system over financial reporting it was noted that due to the limited number of staff, there is an inherent weakness in the system of internal controls due to our inability to achieve appropriate segregation of duties. The limited number of staff may also result in identifying weaknesses with respect to accounting for complex and non-routine transactions due to a lack of technical resources, and a lack of controls governing our computer systems and applications within the Company. While management of the Company has put in place certain procedures to mitigate the risk of material misstatement in the Company's financial reporting, it is not possible to provide absolute assurance that this risk can be eliminated.

### 1.15.4 Subsequent Event

On February 10, 2010, the Company granted 1,350,000 incentive stock options to directors, officers, and consultants at an exercise price of \$1.25 per share. The options are exercisable for a period of ten years, ending February 10, 2020. The options shall be immediately exercisable, subject only to the regulatory 4-month hold from the date of grant (i.e. no vesting periods shall be imposed on the options).

The options have a fair value of \$1,426,150 and were estimated using the Black-Scholes option pricing model with the following assumptions:

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|                             |                   |
|-----------------------------|-------------------|
|                             | 1,350,000 options |
| Dividend rate               | 0.00 %            |
| Risk-free interest rate     | 3.43 %            |
| Expected life               | 10 years          |
| Estimated annual volatility | 124.96 %          |
| Strike price                | \$ 1.21           |
| Spot price                  | \$ 1.25           |

On March 10, 2010, the Company announced an update on permitting for its underground development program focused on bulk sampling and exploration drilling.

The Company posted a U.S. \$1,407,937 reclamation bond required pursuant to the Company's U.S. Bureau of Land Management permits (BLM) issued in late December 2009. To fund the bond without issuing common stock at current levels, the Company secured a loan facility bearing interest at 6% per year, which matures on May 16, 2011. The Company has also executed a contract with Western Cultural Resource Management (WCRM) to perform archeological site work also required pursuant to BLM permits.

### **1.15.5 Contingency**

On July 20, 2009 the Company entered into a letter agreement (the “Letter Agreement”) with Paramount Gold and Silver Corp. (“Paramount”) setting out the principal terms upon which Paramount would acquire, pursuant to a plan of arrangement, all of the outstanding shares of the Company on the basis of 1.45 shares of the Paramount common stock for each of common share of the Company. On September 24, 2009, the Company terminated the Letter Agreement pursuant to its terms. The Company announced the termination in a news release on September 25, 2009. In its news release, the Company specified the reasons for the termination.

On September 30, 2009, Paramount commenced an action in the Supreme Court of British Columbia seeking payment of a break fee in the amount of US\$2.85 million, and unspecified damages for breach of contract, malicious falsehood and defamation. The Company denies that it has any liability to Paramount, and intends to mount an aggressive, vigorous defence against Paramount’s claims. As of the date of this report, the Company’s legal counsel is preparing the defence and counterclaim. No accrual has been made in the financial statements as the resolution is not considered to be determinable.

### **1.15.6 Additional information**

Additional information relating to the Company is on SEDAR at [www.sedar.com](http://www.sedar.com).