

**Klondex Mines Ltd.**  
**Consolidated Financial Statements**  
**December 31, 2006**

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

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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, 2006, and 2005, and the consolidated statements of loss and deficit, deferred acquisition and exploration 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, 2006, and 2005, 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 13, 2007**

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

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

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<b>December 31,</b>	<b>2006</b>	<b>2005</b>
<b>Assets</b>		
<b>Current</b>		
Cash and equivalents (note 3)	\$ 8,920,320	\$ 2,892,695
Marketable securities (note 4)	459,404	459,404
Prepaid expenses	8,881	18,017
Accounts receivable	48,838	31,237
Due from the president	13,161	-
	<b>9,450,604</b>	<b>3,401,353</b>
<b>Rent deposit</b> (note 5)	<b>16,375</b>	<b>16,375</b>
<b>Property and equipment</b> (note 6)	<b>46,063</b>	<b>50,271</b>
<b>Mineral properties and related deferred expenses</b> (note 7)	<b>10,379,959</b>	<b>5,703,605</b>
<b>Reclamation bonds</b> (note 8)	<b>98,956</b>	<b>98,956</b>
	<b>\$ 19,991,957</b>	<b>\$ 9,270,560</b>
<b>Liabilities</b>		
<b>Current</b>		
Accounts payable and accruals	\$ 368,826	\$ 400,052
Due to directors (note 14)	-	12,016
Asset retirement obligation (note 8)	98,956	45,116
	<b>467,782</b>	<b>457,184</b>
<b>Deferred lease inducement</b> (note 16)	<b>10,663</b>	<b>13,938</b>
	<b>478,445</b>	<b>471,122</b>
<b>Shareholders' Equity</b>		
<b>Share capital</b> (note 9)	<b>25,777,601</b>	<b>14,431,926</b>
<b>Contributed surplus</b> (notes 9 and 10)	<b>2,157,245</b>	<b>1,318,766</b>
<b>Deficit</b>	<b>(8,421,334)</b>	<b>(6,951,254)</b>
	<b>19,513,512</b>	<b>8,799,438</b>
	<b>\$ 19,991,957</b>	<b>\$ 9,270,560</b>

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**Subsequent events (note 17)****Approved by the Directors:**/s/ William J. Solloway Director/s/ Fred Baker Director

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

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<b>For the year ended December 31,</b>	<b>2006</b>	<b>2005</b>
<b>Administrative Expenses</b>		
Amortization	\$ 13,765	\$ 15,389
Consulting fees (note 14)	177,466	132,727
Legal, audit and accounting	136,113	84,986
Management fees (note 14)	105,536	107,487
Office and miscellaneous	87,221	92,660
Stock-based compensation (note 10)	935,250	574,000
Telephone	14,470	19,346
Transfer agent and regulatory fees	24,977	15,855
Travel, accommodation, meetings	424,858	373,886
Write-down of marketable securities	-	41,150
Foreign exchange	(139,844)	96,814
Interest earned	(309,732)	(117,167)
	<b>1,470,080</b>	<b>1,437,133</b>
<b>Loss for the year</b>	<b>(1,470,080)</b>	<b>(1,437,133)</b>
<b>Deficit, beginning of year</b>	<b>(6,951,254)</b>	<b>(5,514,121)</b>
<b>Deficit, end of year</b>	<b>\$ (8,421,334)</b>	<b>\$ (6,951,254)</b>
<b>Basic and diluted loss per share</b>	<b>\$ (0.07)</b>	<b>\$ (0.09)</b>
<b>Weighted average number of shares outstanding</b>	<b>20,951,925</b>	<b>16,000,632</b>

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**Klondex Mines Ltd.****Consolidated Statements of Deferred Acquisition and Exploration Expenses**

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**Nevada Properties**

<b>For the year ended December 31,</b>	<b>2006</b>	<b>2005</b>
Balance, beginning of year	\$ 5,703,605	\$ 2,902,241
Acquisition of land	58,319	210,352
Assays and core costs	449,726	236,707
Consulting	436,874	312,634
Drilling	3,241,590	1,825,328
Field supplies and equipment	76,130	24,448
Geophysics	131,635	-
Lease payments, taxes and royalties	22,862	24,488
Legal	980	9,726
Maintenance fees	105,048	77,116
Mapping and sampling	12,929	-
Miscellaneous	35,057	25,235
Site reclamation	53,840	-
Site visits	51,364	55,330
Current year expenditures	4,676,354	2,801,364
<b>Balance, end of year</b>	<b>\$ 10,379,959</b>	<b>\$ 5,703,605</b>

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

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For the year ended December 31,	2006	2005
<b>Cash provided by (used in)</b>		
<b>Operating activities</b>		
Loss for the year	\$ (1,470,080)	\$ (1,437,133)
Items not involving cash		
Amortization	13,765	15,389
Deferred lease inducement recognized	(3,275)	(2,437)
Foreign exchange	14	1,621
Stock-based compensation	935,250	574,000
Write-down of marketable securities	-	41,150
	(534,326)	(807,410)
<b>Change in non-cash working capital items</b>		
Accounts receivable	(17,601)	(20,218)
Prepaid expenses	9,136	(9,558)
Accounts payable	(31,226)	49,145
	(564,017)	(788,041)
<b>Financing activities</b>		
Issue of share capital	11,831,530	900,000
Share issue cost, cash	(582,627)	11,102
Advances from (repayment to) directors	(25,177)	(66,106)
	11,223,726	844,996
<b>Investing activities</b>		
Purchase of marketable securities	-	(500,000)
Purchase of property and equipment	(9,556)	(43,555)
Rent deposit	-	(16,375)
Reclamation bonds posted	-	(49,556)
Deferred exploration and development expenditures	(4,622,514)	(2,527,926)
	(4,632,070)	(3,137,415)
<b>Effect of foreign exchange on cash balances</b>	(14)	(1,603)
<b>Net increase (decrease) in cash and equivalents</b>	<b>6,027,625</b>	<b>(3,082,060)</b>
<b>Cash and equivalents, beginning of year</b>	<b>2,892,695</b>	<b>5,974,755</b>
<b>Cash and equivalents, end of year</b>	<b>\$ 8,920,320</b>	<b>\$ 2,892,695</b>
<b>Supplemental Cash Flow Information (note 11)</b>		
The company had the following cash transactions:		
Interest received	\$ 309,732	\$ 117,167
Income taxes paid	-	-

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# **Klondex Mines Ltd.**

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

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**December 31, 2006 and 2005**

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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. 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.

### **2. Significant Accounting Principles**

#### **a) 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.

#### **b) Cash and 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.

#### **c) Temporary investments**

The Company has temporary investments which are carried at cost plus accrued interest and are valued at the lower of market value or cost.

#### **d) 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.

**December 31, 2006 and 2005**

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**2. Significant Accounting Principles (continued)****e) Foreign currency translation**

Monetary assets and liabilities are translated at year-end exchange rates; other assets and liabilities have been translated at the rates prevailing at the date of transaction. Revenue and expense items, except for amortization, are translated at the average rate of exchange for the period. Amortization is converted using rates prevailing at dates of acquisition. Gains and losses from foreign currency translation are included in the consolidated statements of loss.

**f) 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 resource 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.

**g) 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.

**h) Loss per share**

The Company uses the treasury stock method of calculating fully 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 has an anti-dilutive impact in 2006 and 2005.

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

**December 31, 2006 and 2005**

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**2. Significant Accounting Principles (continued)****i) Financial instruments**

All significant financial assets, financial liabilities and equity instruments of the Company are either recognized or disclosed in the financial statements together with other information relevant for making a reasonable assessment of future cash flows, interest rate risk and credit risk. Where practicable the fair values of financial assets and financial liabilities have been determined and disclosed; otherwise only available information pertinent to fair value has been disclosed.

**j) 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.

**k) 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.

**l) Stock-based compensation**

The Company has adopted the CICA Handbook Section 3870 "Stock-Based Compensation and Other Stock-Based Payments" ("Section 3870"). The Company measures all compensation costs at fair value using the Black Scholes method. Compensation is reflected in the consolidated statement of operations over the vesting period.

**m) 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.

**n) Measurement uncertainty**

The future recovery of the recorded cost of the 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.

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

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**December 31, 2006 and 2005**

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**3. Cash and cash equivalents**

<b>December 31,</b>	<b>2006</b>		<b>2005</b>	
Cash on deposit	\$	<b>920,294</b>	\$	144,472
Treasury bills		<b>8,000,026</b>		2,748,223
	\$	<b>8,920,320</b>	\$	2,892,695

**4. Marketable securities**

During the previous year the Company purchased convertible debentures of the Retirement Residences REIT with a face value of \$500,000 for a cost of \$500,000. The convertible debentures bear interest at 5.5%, paid semi-annually and are convertible at the option of the holder at any time up to the maturity date of March 31, 2015 at a price of \$11.35 per unit. At December 31, 2005 the market value of the debentures was \$458,850 and accordingly a write-down of \$41,150 was recorded. At December 31, 2006, the market value of the debentures was \$500,050. The REIT convertible debentures were redeemed on March 13, 2007 at 101% of the principal amount, which amount (\$505,000) was received by the Company.

The company also holds 100 shares of Coeur D'Alene Mines with a book value of \$475 and a market value of \$495.

**5. Rent Deposit**

As part of the lease agreement, the Company paid the last three months of the fourth year and the last four months of the fifth year of the lease term in advance. These deposits bear interest at approximately 4% per annum, receivable at the end of the fourth and fifth year of the lease term.

**6. Property and Equipment**

	<b>December 31, 2006</b>		
	<b>Cost</b>	<b>Accumulated amortization</b>	<b>Net book value</b>
Computer equipment	\$ 28,370	\$ 10,726	\$ 17,644
Telephone equipment	1,376	765	611
Furniture and fixtures	25,600	12,689	12,911
Leasehold improvements	24,736	9,839	14,897
	\$ 80,082	\$ 34,019	\$ 46,063

  

	<b>December 31, 2005</b>		
	<b>Cost</b>	<b>Accumulated amortization</b>	<b>Net book value</b>
Computer equipment	\$ 20,748	\$ 7,571	\$ 13,177
Telephone equipment	1,376	615	761
Furniture and fixtures	23,552	7,076	16,476
Leasehold improvements	24,736	4,879	19,857
	\$ 70,412	\$ 20,141	\$ 50,271

**December 31, 2006 and 2005**

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**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 was expanded during the fiscal 2003 by 2,720 acres to a total of 4,875 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 \$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 the fiscal year 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.

During the fiscal year 2004, the Company acquired 4 additional blocks of land (80 acres) in the area for Cdn\$69,567 (US\$52,983). These acquisitions were necessary to insure logistical access to the main mineralized zones and to acquire areas which represent the strike extensions of these zones.

During the fiscal year 2005, the Company acquired 5 additional blocks of land, which totaled 13 acres for \$65,686 (US\$53,594). In the second quarter of this year, an additional 100 acres were acquired for \$53,344 (US\$43,415). These new acquisitions bring the total acreage to 5,185 acres.

**b) 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\$80,000 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.

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) Corral Canyon, Lander County, Nevada**

The Company has a 100% ownership interest in 42 claims (840 acres) in Corral Canyon, Lander County, Nevada.

**e) 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. These claims provide access to the northern Fire Creek block from the powerline road.

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## **Klondex Mines Ltd.**

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

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**December 31, 2006 and 2005**

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

##### **f) 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 the period, 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%.

The Company has been made aware of CMQ Resources Inc.'s ("CMQ"), the parent company of Vasquir Mines Inc. (Vasquir), news release of November 6, 2006 regarding lease arrangements for Company's Hot Springs Point property, located 8.5 miles southeast of the Fire Creek Property. CMQ has not contacted the Company with regard to the allegations made in its news release. Despite the execution of a form of lease agreement on August 1, 2006, no consideration has yet passed and the terms of the lease arrangements have been the subject of ongoing discussions. On November 6, 2006, CMQ Resources Inc. issued a press release advising that it had terminated talks for a \$10 million financing as a result of purported communications from Klondex that the lease was invalid. In that same news release, CMQ advised that it would seek confirmation of the court that it had a valid lease with Klondex. Klondex has received no communication from CMQ with respect to the news release. Klondex is concerned that a number of terms set out in the proposed lease may be uncertain, and had requested that clarifying revisions be made to the lease.

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 a 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. Vasquir has claimed that Klondex repudiated the agreement, and seeks: (i) a declaration from the court that the agreement is valid and enforceable lease, (ii) specific performance of the agreement, (iii) damages for slander of title and (iv) damages for breach of contract. Vasquir has also claimed damages for interference with economic advantage, claiming that Klondex's purported repudiation of the agreement resulted in the loss of a \$10 million financing by CMQ, and a decrease in the market capitalization of CMQ of \$8.3 million. The Company has denied all of the allegations of Vasquir and intends to vigorously defend the claim.

##### **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 \$98,956 representing the fair value of a liability for asset retirement obligations that arose as a result of drilling activities during fiscal 2004, 2005 and 2006 on the Fire Creek properties. The fair value of the liability \$98,956 was determined to be equal to the estimated drill well site remediation costs of as it is assumed that remediation would commence within six months of year end. As at December 31, 2006 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.

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

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**8. Asset Retirement Obligation (continued)**

During the fiscal year December 31, 2004 the company posted non-interest bearing bonds of \$49,400 (US\$41,003) with the Bureau of Land Management in the State of Nevada as security for these obligations. On December 31, 2005, the company posted additional non-interest bearing bonds of \$49,556 (US\$42,500).

**9. Share Capital**

a) **Authorized:** unlimited common shares with no par value

b) **Issued**

	Shares	Amount	Contributed Surplus
Balance, December 31, 2004	15,651,317	\$ 13,520,824	\$ 744,766
Issued for cash			
Exercise of warrants	1,500,000	900,000	-
Share issue costs			
Refund of 2004 legal fees	-	11,102	-
Stock based compensation	-	-	574,000
Balance, December 31, 2005	17,151,317	14,431,926	1,318,766
Issued for cash			
Private placement	3,250,000	7,312,500	-
Exercise of options	280,000	212,000	-
Exercise of warrants	1,570,550	3,690,793	-
Exercise of agents' warrants	263,681	616,237	-
Fair value of options exercised	-	162,800	(162,800)
Fair value of agents' warrants exercised	-	254,747	(254,747)
	5,364,231	12,249,077	(417,547)
Share issue costs			
Commission	-	(511,875)	-
Agents' warrants	-	(320,775)	320,775
TSX filing fees	-	(32,000)	-
Legal fees & others	-	(38,752)	-
		(903,402)	320,775
Stock based compensation	-	-	935,250
Total increase (decrease) for the year	5,364,231	11,345,675	(838,478)
<b>Balance, December 31, 2006</b>	<b>22,515,548</b>	<b>\$ 25,777,601</b>	<b>\$ 2,157,245</b>

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

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**9. Share Capital (continued)****c) Private placement**

On March 29, 2006, the Company announced that it had completed the private placement announced on March 9, 2006. The Company issued 3,250,000 units at \$2.25 for gross proceeds of \$7,312,500. Each unit consists of one common share and one half of one common share purchase warrant. Each whole warrant entitles the holder to purchase one additional common share for a period of 18 months from closing at an exercise price of \$3.00 per share. The Company has the right to accelerate the expiry of the warrants if the common shares of the Company close at or above \$4.00 for a minimum of 20 consecutive trading days.

The agents received a total cash commission of \$511,875 and 227,500 agents' units warrants from the sale of the units. Each agent unit warrant will be exercisable to purchase one unit for a period of 18 months from closing at a price of \$2.25 per unit, the units are comprised of one common share and one half of one common share purchase warrant with the same terms as the placement warrants.

The fair value of the agents' warrants was estimated on the grant date using the Black-Scholes option pricing model with the following assumptions:

Dividend rate	0.00 %	Expected annual volatility	98%
Risk-free interest rate	3.94 %	Strike price	\$ 2.25
Expected life	18 Months	Spot price	\$ 2.72

Using the above assumptions, the fair value of each warrant granted is \$1.41. Share issue costs of \$320,775 were recorded for the year ended December 31, 2006.

**d) Options outstanding**

A summary of the Company's outstanding stock options as of December 31, 2006 and 2005 and the changes during the year then ended is presented below:

	Number of options	Weighted average exercise price
Outstanding and exercisable at December 31, 2004	984,750	\$ 0.65
Options granted (note 10)	580,381	1.05
Options exercised	-	-
Outstanding and exercisable at December 31, 2005	1,565,131	0.80
Options granted (note 10)	645,000	2.35
Options exercised	(280,000)	0.76
<b>Outstanding and exercisable at December 31, 2006</b>	<b>1,930,131</b>	<b>\$ 1.32</b>

At December 31, 2006, there were 1,930,131 stock options outstanding and exercisable entitling the holders thereof the right to purchase one common share for each option held as follows:

Number of Shares	Exercise Price	Expiry Date
659,750	\$ 0.65	November 28, 2008
120,000	\$ 0.65	June 29, 2009
505,381	\$ 1.05	June 10, 2010
645,000	\$2.35	July 17, 2011
<b>1,930,131</b>		

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

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**9. Share Capital (continued)****e) Warrants outstanding**

A summary of the Company's outstanding share purchase warrants at December 31, 2006 and 2005 and the changes during the years then ended is presented below:

	Number of warrants	Weighted average exercise price
Outstanding and exercisable at December 31, 2004	3,385,300	\$ 1.54
Warrants exercised	(1,500,000)	0.60
Warrants expired	(10,000)	1.25
Outstanding and exercisable at December 31, 2005	1,875,300	2.29
Warrants granted	1,625,000	3.00
Agents' unit warrants granted	227,500	2.25
Agents' warrants granted	113,750	3.00
Warrants exercised	(1,570,550)	2.35
Agents' warrants exercised	(229,556)	2.35
Agents' unit warrants exercised	(22,750)	2.25
Agents' warrants exercised*	(11,375)	2.25
Warrants expired	(74,450)	2.35
Agents' warrants expired	(744)	2.35
<b>Outstanding and exercisable December 31, 2006</b>	<b>1,932,125</b>	<b>\$ 2.88</b>

At December 31, 2006, there were 1,932,125 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
1,625,000	\$ 3.00	September 28, 2007
204,750	\$ 2.25	September 28, 2007
102,375	\$ 3.00	September 28, 2007
<b>1,932,125</b>		

**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 10% 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 five 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 TSX Venture Exchange policies), or such other price as may be agreed to by the Company and accepted by the TSX Venture Exchange. Options granted under the plan vest immediately, except for consultants conducting investor relation activities who will become vested with the right to exercise one-fourth of the option upon the conclusion of each three month period subsequent to the date of the grant of the option.

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

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**December 31, 2006 and 2005**

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

During the period ended September 30, 2006 the Company granted 645,000 (2005 – 580,381) incentive stock options to directors, officers and consultants at an exercise price of \$2.35 per share expiring on July 17, 2011.

The fair value of the incentive stock options granted is estimated on the grant date using the Black-Scholes option pricing model with the following assumptions:

	<b>2006</b>	<b>2005</b>
Dividend rate	0.00 %	0.00 %
Risk-free interest rate	4.30 %	3.30 %
Expected life	5 years	5 years
Expected annual volatility	98 %	103 %
Strike price	\$ 2.35	\$ 1.05
Spot price	\$ 2.00	\$ 1.25

Using the above assumptions the fair value of each option granted was \$1.45 (2005 - \$0.99). Compensation expense of \$935,250 has been expensed in the statement of operations and credited to contributed surplus for the fiscal year December 31, 2006 (2005- \$574,000).

**11. Non Cash Transactions**

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

<b>December 31,</b>	<b>2006</b>	<b>2005</b>
<b>Financing activities</b>		
Contributed surplus allocated on exercise of options	\$ 162,800	\$ -
Fair value of agent's warrants granted	\$ 254,747	\$ -
Asset retirement obligation recorded	\$ 53,840	\$ -
<b>Investing activity</b>		
Asset retirement obligation recorded as mineral property costs	\$ (53,840)	\$ -

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

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**December 31, 2006 and 2005**

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**12. Income Taxes**

At December 31, 2006, the Company has Canadian tax losses of approximately \$709,624 available for carry-forward and will expire as late as 2026. The Company has US tax losses of approximately \$2,959,472 available for carry-forward and will expire as late as 2026.

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:

	<b>2006</b>	2005
Net loss for the year	\$ (1,470,080)	\$ (1,437,133)
Statutory Canadian corporate tax rate	34.12%	34.12%
Anticipated tax expense (recovery)	(501,591)	(490,350)
Change in tax rates resulting from:		
Rate differential due to foreign operation	43,275	81,802
Items not deductible for tax purposes	327,474	199,490
Items recognized for tax purposes	(83,928)	(38,803)
Unrecognized benefit of non-capital losses	214,770	247,861
Actual income tax recovery	\$ -	\$ -

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

<b>December 31,</b>	<b>2006</b>	2005
Property and equipment	\$ 3,138	\$ 2,516
Exploration deductions	141,716	112,748
Share issue costs	304,421	145,387
Capital loss	4,904	4,904
Non-capital loss carry forwards	686,045	629,324
Valuation allowance	1,140,224	894,879
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.

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# Klondex Mines Ltd.

## Notes to the Consolidated Financial Statements

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December 31, 2006 and 2005

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### 13. Financial Instruments (continued)

#### b) Currency risk (continued)

At December 31, 2006 the Company had the following financial assets and liabilities:

		US Dollars
Cash	\$	44,321
Marketable securities	\$	475
Reclamation bonds	\$	83,503
Accounts payable	\$	265,062
Due from Directors	\$	11,283

At December 31, 2006 US dollar amounts were converted at a rate of \$1.16638 Canadian dollars to \$1.00 US dollar.

#### c) Credit risk

At December 31, 2006 the Company held a treasury bill and marketable securities of \$8,845,000 (2005 - \$3,248,222) in an account with a Canadian brokerage firm. This amount is in excess of the \$1,000,000 insurance coverage provided by the Canadian Investor Protection Fund.

### 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 related parties:

- a) During the year, the Company paid consulting fees of \$91,000 (2005 - \$90,500) and mineral property services of \$82,000 (2005 - \$76,700) to 3 companies controlled by each of 2 directors and an officer.
- b) During the year, the Company incurred salary & benefit expenses of \$73,317 (2005 - \$78,447) to the President.
- c) During the year, the Company incurred management fees of \$32,219 (2005 - \$29,040) and rent of \$8,465 (2005 - \$7,260) to a director of the wholly-owned subsidiary.
- d) During the year, the Company incurred accounting fees of \$42,285 (2005- \$Nil) to an officer.
- e) Amounts owing from the president of \$13,161 (2005 - \$12,016 due to directors) are non-interest bearing, unsecured, and payable upon demand. Fair value cannot be reliably determined.

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

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**December 31, 2006 and 2005**

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**15. Segmented Information**

<b>2006</b>	<b>Canada</b>	<b>United States</b>	<b>Total</b>
Revenue	\$ -	\$ -	\$ -
Expenses	1,243,747	226,333	1,470,080
Loss for the year	\$ (1,243,747)	\$ (226,333)	\$ (1,470,080)
Identifiable assets	\$ 9,440,985	\$ 10,550,972	\$ 19,991,957

  

<b>2005</b>	<b>Canada</b>	<b>United States</b>	<b>Total</b>
Revenue	\$ -	\$ -	\$ -
Expenses	1,009,299	427,834	1,437,133
Loss for the year	\$ (1,009,299)	\$ (427,834)	\$ (1,437,133)
Identifiable assets	\$ 3,392,766	\$ 5,877,794	\$ 9,270,560

**16. Commitments**

As at December 31, 2006, 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 four years are as follows:

2007	\$ 16,042
2008	\$ 16,042
2009	\$ 16,042
2010	\$ 4,011

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 will be recognized as a reduction of rent expense over the term of the lease.

**17. Subsequent Events**

- a) On January 19, 2007, the Company entered into a contract to retain the services of Jaffoni & Collins to provide investor relations services for \$5,000 per month for 12 months. Jaffoni & Collins will also be granted an option to purchase 150,000 common shares at \$2.30 per share, of which 37,250 options vest upon each of the three, six, nine and twelve month anniversaries of the signing of the contractual agreement.
- b) On February 26, 2007, the common shares of Klondex Mines Ltd. were approved for listing on the Toronto Stock Exchange under the symbol 'KDX.'
- c) Subsequent to year end 11,375 shares issued on the exercise of warrants were returned to treasury.