Avnel Gold Mining Limited
Notes to the Consolidated Financial Statements
Year ended December 31, 2005
Tabular amounts expressed in thousands of US Dollars

1. Nature of Operations and Liquidity

Avnel Gold Mining Limited (the "Company") was incorporated under the laws of Guernsey on February 18, 2005. On February 22, 2005, Elliott Associates L.P., Elliott International L.P. (collectively "Elliott") and Fern Trust ("Fern") acquired 100% of the issued and outstanding common shares of the Company in exchange for 95% of the issued and outstanding shares of Avnel Gold, Limited ("Avnel Cayman"), a company incorporated in the Cayman Islands, pursuant to a reorganization agreement. Under the reorganization agreement, obligations of Avnel Cayman to Elliott and Fern in respect of existing shareholder loans of Avnel Cayman were assumed by the Company. The reorganization has been accounted for as an exchange between entities under common control whereby the assets and liabilities of the Avnel Cayman group are initially recognized at their carrying amounts in the accounts of the Avnel Gold Mining Limited group at the date of the transfer. The results and cash flows for the year ended December 31, 2005 comprise the results and cash flows of the Company and the Avnel Cayman group as if they had been combined throughout the year. The results and cash flows for the years ended December 31, 2004 and 2003 and the balance sheet as at December 31, 2004 are the amounts reported by Avnel Cayman in its consolidated financial statements for the year ended December 31, 2004.

The Company, Elliott and Fern also entered into a transfer agreement and call option agreement with the minority shareholder of Avnel Cayman. Pursuant to the transfer agreement, the Company (i) purchased from the minority shareholder the remaining 5% (5,000 shares) of ordinary shares of Avnel Cayman outstanding for $5,000, this amount was paid for by Elliott on behalf of the Company, (ii) granted to the minority shareholder a call option on the shares of the Company as described in a call option agreement (the "Call Option Agreement") and (iii) furthermore agreed to purchase all the rights and obligations with respect to loans of $725,000 owed by Avnel Cayman to the minority shareholder for a consideration of $725,000. At the date of the transfer agreement, the $725,000 consideration was paid jointly by Fern and Elliott at which point the Company agreed to re-pay Elliott and Fern under the original terms of the loan. Under the Call Option Agreement, the minority shareholder has the right to purchase (i) 1,050,000 common shares of the Company at an exercise price of $0.275 at any time before 5p.m. on December 31, 2009 and (ii) 435,400 common shares of the company at Cdn$0.95 at any time before 5p.m. on December 31, 2009.

Avnel Cayman was incorporated in the Cayman Islands on September 28, 2001. On February 14, 2003 it entered into a Foundation Agreement with the Government of Mali for the development of the existing gold mining property at Kalana. Under the terms of the Foundation Agreement, a subsidiary company, SOMIKA, was established in Mali to develop the mining property. Eighty per cent of the voting equity is held by Avnel Cayman and 20 per cent is held beneficially by the Government of Mali. Avnel Cayman agreed to invest $2,500,000 in the project, of which $1,600,000 was invested on inception, $300,000 was paid in 2004 and $600,000 was paid in 2005. Additionally, Avnel Cayman agreed to spend $1,375,000 on exploration and development over the first three years of the project all of which had been spent as of December 31, 2005.

Gold production commenced in January 2004 and the principal markets are European based bullion trading concerns.

The Company's cash flow and profitability is dependent primarily on the volume of production, gold prices, operating costs, interest rates on borrowings and investments and discretionary expenditure levels including exploration, resource development and general and administrative costs. Since the Company has subsidiaries operating in UK, Mali and the Cayman Islands, exposure also arises from fluctuations in currency exchange rates, political risks and varying levels of taxation. While the Company seeks to manage these risks, many of these factors are beyond its control.

The U.S. Dollar is the functional currency of the Company's principal operations.

The consolidated financial statements have been presented on the basis that the Company is a going concern. Accordingly, the financial statements do not include adjustments relating to the carrying value of assets, the amounts and classification of liabilities, or other adjustments that might result should the Company be unable to continue as a going concern. The Company recorded its first commercial production in March 2004. Since then gold production is showing an upward trend and is developing towards the mine's planned capacity. Cost of production is showing a decreasing trend per tonne and the management and workforce continue to gain experience.

The consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States (U.S. GAAP) which differs in certain respects from accounting principles generally accepted in Canada (Canadian GAAP), as described in Note 15 to these consolidated financial statements.

2. Management Estimates and Assumptions

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, as well as reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

3. Summary of Significant Accounting Policies

Basis of Presentation

The consolidated financial statements of the Company include the accounts of Avnel Gold Mining Limited and its subsidiaries Avnel Gold, Limited (Cayman Islands, 100%), Kalana Mine Services Limited (United Kingdom, 100 %), SOMIKA (Mali, 80 %) and Avnel Mali SARL (Mali, 100%). All intercompany balances and transactions have been eliminated in the consolidated financial statements.

Cash and Cash Equivalents

Cash and cash equivalents include highly liquid investments with original maturities of three months or less at the date of purchase and which are not subject to significant risk from changes in interest rates.

Inventories

Processed ores are stated at the lower of average cost or market. No account is taken of work in progress. Materials and supplies are stated at cost on a first in first out (FIFO) basis.

Property, Plant and Equipment

All costs, other than acquisition costs, are expensed prior to the establishment of proven and probable reserves. Gains or losses resulting from the sale or abandonment of properties are included in operations. Acquisition and development costs associated with properties brought into production are charged to operations using the units-of-production method based on estimated proven and probable reserves which can be recovered. Acquisition costs were incurred in relation to the purchase of the assets of the gold mining property at Kalana. Development costs represent costs in relation to improving and extending mine infrastructure to access ore bodies at the Kalana mine. Costs of start-up activities and on-going costs to maintain production are expensed as incurred. Fixed asset costs include production facilities and equipment, vehicles and office equipment. Production facilities and equipment are stated at cost and are amortized over the estimated proven and probable reserves which can be recovered from the related property. The weighted average useful life of production facilities and equipment is nine years. Vehicles and office equipment are stated at cost and are depreciated using the straight-line method over estimated useful lives of three

to five years. Maintenance and repairs are charged to expense as incurred. Gains or losses on dispositions are included in operations.

Impairments

The Company evaluates the carrying value of its properties and equipment when events or changes in circumstances warrant. With respect to properties with proven and probable reserves, an impairment loss is recognized when the estimated future cash flows (undiscounted and without interest) expected to result from the use of the asset are less than the carrying amount of the asset. Measurement of the impairment loss is based on discounted cash flows. Properties with unproven reserves are assessed for impairment when changes in market conditions or events occur and are measured based on fair value. The company has not recorded any impairment losses in any of the periods. The company's estimates of future cash flows are subject to risks and uncertainties. It is reasonably possible that changes in estimates could occur which may affect the expected recoverability of investments in mining properties. Mining property impairment analyses were performed using a long term gold price of $500 per oz (2004: $375 per oz) for gold sold at spot and the contracted price for gold that the company has committed to sell forward.

Site Reclamation

The fair value of a retirement or rehabilitation obligation is recognised as an asset and a liability in the period when it is incurred. The liability is discounted and an accretion expense is recognised using the credit-adjusted risk free rate in effect when the liability is incurred. The retirement asset is included in mining properties and charged to operations using the units of production method based upon estimated proven and probable reserves which can be recovered.

Revenue Recognition

Revenue from the sale of gold is recognized upon delivery when title passes. Gains and losses on gold forward sales agreements are recognised in metal revenue on the delivery date identified at the contract inception. Gold forward sales agreements are exempt from the provisions of Statement of Financial Accounting Standard No. 133 "Accounting for Derivative Instruments and Hedging Activities" (SFAS 133) as normal course sales requiring settlement through physical delivery.

Income Taxes

The Company computes deferred income taxes under the asset and liability method prescribed by Statement of Financial Account Standards No. 109 "Accounting for Income Taxes" (SFAS 109). This method recognizes the tax consequences of temporary differences between the financial statement amounts and the tax bases of certain assets and liabilities by applying statutory rates in effect when the temporary differences are expected to reverse. The Company records a valuation allowance against any portion of those deferred income tax assets that management believes will, more likely than not, fail to be realised.

Foreign Currency

Transactions expressed in foreign currencies are translated into U.S. Dollars at the rate of exchange prevailing on the date of transaction. Monetary assets and liabilities expressed in foreign currencies are re-converted into U.S. Dollars at the rates of exchange prevailing on the balance sheet date.

The financial statements of overseas subsidiaries are remeasured into their functional currency. Mining properties and other non-current assets are remeasured at historical rates. Monetary assets and liabilities are remeasured at current rates, except depreciation and amortisation, which are remeasured at historical rates. Revenue and expense transactions are remeasured at the average rate for the period. Remeasurement gains and losses are included in income.

The assets and liabilities of subsidiaries with functional currencies other than the U.S. Dollar are translated into U.S. Dollars at the closing rate. Revenue and expense transactions are translated at the weighted average rate for the period. Translation gains and losses are included in other comprehensive income.

Foreign Operations Risk
The Company's main operating subsidiary is incorporated under the laws of Mali, and its principal mining facilities are located in Mali. Accordingly, the Company is directly affected by political, economic and military conditions in Mali. There can be no assurance that the Government of Mali will be successful in its attempt to keep prices and exchange rates stable. Instability in Mali may have a material adverse effect on the Company.

Interest
Interest is capitalized during the development phase of a project. Interest capitalization commences with the first expenditure for a qualifying asset and ends when the asset is substantially complete and ready for its intended use (the date when production commences).

The amount of interest cost that may be capitalized for any accounting period may not exceed the actual interest cost that is incurred during the period. Interest capitalized amounted to nil in 2005, $134,000 in 2004 and $343,000 for 2003.

To determine the amount of interest to be capitalized for a particular accounting period, the average accumulated investment in a qualifying asset during that period is calculated. If a specific borrowing is made to acquire the qualifying asset, the interest rate incurred on that borrowing may be used to determine the amount of interest costs to be capitalized. That interest rate is applied to the average accumulated investment for the period to calculate the amount of capitalized interest cost on the qualifying asset. Capitalized interest cost on average accumulated investments in excess of the amount of the specific borrowing is calculated by use of the weighted average interest rate incurred on other borrowings outstanding during the period.

Stock Based Compensation
The Company accounts for stock-based compensation in accordance with Statement of Financial Accounting Standards No. 123R. Stock options awarded to employees are accounted for at estimated fair value, based on the binomial model, and any related expense is recognised over the requisite service period. There has been no compensation charge recorded in prior periods.

Loss per common share
Loss per common share is based on the weighted average number of common shares outstanding during the period. The fully diluted loss per common share has not been disclosed as the inclusion of unexercised options or warrants would be anti-dilutive.

Impact of Recently Issued Accounting Pronouncements
Under the U.S. Securities and Exchange Commission Staff Accounting Bulletin 74 ("SAB 74"), the Company is required to disclose information related to new accounting standards that have not yet been adopted.

In the mining industry, companies may be required to remove overburden and other mine waste materials to access mineral deposits. During the development of a mine (before production begins), it is generally accepted practice that such costs are capitalized as part of the depreciable cost of building, developing and constructing the mine. The capitalized costs are typically amortized over the productive life of the mine using the units-of-production method. A mining company may continue to remove overburden and waste materials, and therefore incur deferred costs, during the production phase of the mine.

In March 2005, the Financial Accounting Standards Board ratified Emerging Issues Task Force Issue No. 04-6 ("EITF 04-6") which addresses the accounting for deferred costs incurred during the production phase of a mine and refers to these costs as variable production costs that should be included as a component of inventory to be recognized in costs applicable to sales in the same period as the revenue from the sale of inventory. As a result, capitalization of costs is appropriate only to the extent product inventory exists at the end of a reporting period. Avnel will adopt the provisions of EITF 04-6 on January 1, 2006. Adoption of EITF 04-6 is not expected to have a significant impact on the Company's consolidated financial statements or cash position.

4. Inventories

	2005	2004
Metal inventory	$ 1,024	$ 374
Materials and supplies	1,094	636
	$ 2,118	$ 1,010

Metal inventory consists of 1,712 oz of gold held at Kalana mine site and 752 oz held to the credit of the company's gold bullion account in Switzerland. There were no material amounts of gold in work in progress or held in sand and ore stockpiles. The gold was valued at net realisable value calculated as the company's forward sales contract price for December 2005 of $415.6 per oz.

5. Property, Plant and Equipment

	Mine acquisition costs	Capitalized Development	Fixed Assets	Total
Cost				
Balance December 31, 2003	$ 3,374	$ 5,794	$ 5,461	$ 14,629
Additions	-	1,967	944	2,911
Translation adjustment	-	-	1	1
Reclamation provision	-	382	-	382
Balance December 31, 2004	3,374	8,143	6,406	17,923
Additions	12	2,013	710	2,735
Reclassification of assets	-	839	(839)	-
Balance December 31, 2005	$ 3,386	$ 10,995	$ 6,277	$ 20,658
Accumulated Depreciation				
Balance December 31, 2003	$ -	$ -	$ 30	$ 30
Expense for year	65	174	595	834
Translation adjustment	-	-	1	1
Balance December 31, 2004	65	174	626	865
Expense for year	108	334	666	1,108
Translation adjustment	-	-	(2)	(2)
Balance December 31, 2005	$ 173	$ 508	$1,290	$ 1,971
Net Book Value				
December 31, 2005	$ 3,213	$ 10,487	$ 4,987	$ 18,687
December 31, 2004	$ 3,309	$ 7,969	$ 5,780	$ 17,058

All property, plant and equipment of the Company relates to the Kalana Mine in Mali except for corporate fixed assets which have a net book value of $28,000 at December 31, 2005 (2004 - $34,000).

6. Accounts Payable and Accrued Liabilities

	2005	2004
Trade creditors	$ 1,042	$ 1,569
Tax creditor	277	-
Accrued expenses	918	1,102
Interest payable to related parties	319	1,744
	$ 2,556	$ 4,415

7. Notes Payable – long term

	2005	2004
Convertible loan notes	$ 10,941	$ -
Term loan	880	-
Shareholder loans	-	19,255
	$ 11,821	$ 19,255

The long term debt of the Company consists entirely of shareholder loans provided by Elliott and Fern, the major shareholders of Avnel (the "Shareholder Loans"). At June 30, 2005 an aggregate principal amount of $19,255,000 of the Shareholder Loans, together with accrued interest thereon in the amount of $2,627,000, was converted into equal amounts of common shares (see Note 9) and convertible loan notes with an aggregate principal amount of $10,941,000.

Each convertible loan note is convertible by the holder into common shares of the Company at Cdn$0.95 per share at any time prior to the close of business of the Company on the fifth business day prior to June 30, 2010. The number of shares issuable on conversion is equal to the principal amount to be converted divided by the U.S. Dollar equivalent of Cdn$0.95. The U.S Dollar equivalent is derived by reference to the Bank of Canada noon rate on the date of conversion. The total number of common shares that could be issued if all the loan notes are converted is dependant on the U.S. Dollar to Canadian Dollar exchange rate. Using the Bank of Canada noon rate as of December 31, 2005, this would equate to 13,427,476 common shares.

The convertible loan notes bear interest at the six month U.S. LIBOR plus 2% payable bi-annually. The Company may elect to pay the interest in common shares in lieu of cash. The numbers of shares payable in lieu of interest is calculated by dividing the cash value of the interest payable by the U.S. Dollar equivalent of the 20-day weighted average trading price of the common shares with the last day being five trading days before the interest payment date. Subsequent to the end of the year the Company issued 390,140 common shares of the Company in settlement of the $324,512 interest accrued.

Upon maturity, the company may elect to repay the outstanding principal amount in common shares at Cdn$0.95 per share if the 40-day weighted average trading price of the common shares prior to the conversion date is equal to the Canadian Dollar equivalent of $1.20. The term of the convertible loan notes is five years with a maturity date of June 30, 2010.

Bridge financing loans payable to shareholders as at June 30, 2005 of $2,800,000, together with interest accrued thereon in the amount of $80,000, were converted into a term loan due December 31, 2008, bearing interest at a rate of 8%. On December 31, 2005 the Company repaid $2,000,000 of this amount together with accrued interest thereon in the amount of $116,572.

8. Retirement and rehabilitation obligations

Based on the existing operations the Company's responsibility for asset retirement and rehabilitation would be based on the pre-existing tailings facilities to ensure stabilisation of the soil, re-vegetation and the monitoring of the area, and in particular water quality. Based on experience of similar sites, management has estimated the cost of this work at $700,000 in 2015, and a further $60,000 per annum for the period from 2016 to 2020. Elements of uncertainty in estimating this amount include changes in mine life, reclamation alternatives and potential changes in regulatory requirements. 2004 represented the first year that a rehabilitation liability was recognized, and during 2004 the Company included a liability of $382,000 based on the fair value of this work. A corresponding increase was recorded in the value of mining properties. During 2005, the accretion expense of $32,000 increased the total liability to $414,000.

The Company has used a credit-adjusted risk-free rate of 8.5% to discount future cash flows in arriving at the fair value of its asset retirement and rehabilitation obligations. This is also the rate at which shareholders advanced funds to the Company in 2004.

9. Share Capital

Avnel's authorized share capital consists of an unlimited number of common shares of no par value. The total number of common shares issued is shown in the Statement of Changes of Stockholders' Equity.

On June 30, 2005, the Company completed its initial public offering with the issue of 12,393,605 units (the "Units") of the Company at a price of Cdn$0.76 per Unit. Each Unit consists of one common share (the "Common Shares") of Avnel and one-half of one Common Share purchase warrant, each whole Common Share purchase warrant entitling the holder to purchase one Common Share (the "Warrant Shares") at a price of Cdn$1.06 per Warrant Share at any time before 5p.m. on June 30, 2010. The Company granted the Agents of the IPO a non-transferable option to purchase 279,666 Units at the offer price up to June 30, 2007. Should units be purchased, then the resultant warrants are convertible in to Common Shares at an exercise price of Cdn$1.06 any time before 5p.m. on June 30, 2010.

As discussed in Note 7 above, Shareholder Loans together with accrued interest thereon in the total amount of $10,941,000 was converted into 34,800,000 common shares on June 30, 2005.

On November 29, 2005 the Company completed a private placement of 7,936,000 units at Cdn$1.00 per unit, each unit comprising one common share and one common share purchase warrant, exercisable for two years at Cdn$1.30 per share. The Company granted the Agents of the private placement offering a non-transferable option to purchase 558,600 units at the offer price up to May 29, 2007. Should units be purchased, then the resultant common share purchase warrants are convertible in to common shares at an exercise price of Cdn$1.30 any time before 5p.m. on November 29, 2007.

A summary of options or rights to purchase common shares of Avnel is shown in the following table.

Options or rights to purchase common shares as at December 31, 2004	Nil
Warrants issued through the IPO on June 30, 2005 (1)	6,196,801
Warrants issued through the Private Placement on November 29, 2005 (1)	7,936,000
Agents' warrants related to the IPO (1)(5)	419,499
Broker's warrants related to the private placement (1)(6)	1,117,200
Convertible Loan Notes (2)	13,427,476
Minority shareholder warrants (3)	1,485,400
CEO Compensation Options (4)	2,500,000
Stock Option Plan (4)	1,850,000
Options or rights to purchase common shares as at December 31, 2005	**34,932,376**

Notes to the table
1. As at December 31, 2005, no warrants had been exercised
2. See note 7 to the financial statements
3. See note 1 to the financial statements of the company pursuant to which Avnel granted to the minority shareholder two warrants providing, respectively, a right to acquire (i) 1,050,000 common shares at $0.275 and (ii) a right to acquire 435,400 common shares at Cdn$0.95 and $5,000 in return for 5% of the shares of Avnel Cayman outstanding
4. See note 13 to the financial statements
5. Comprises of 279,666 units , each unit being a warrant to purchase one common share and one half of one common share purchase warrant
6. Comprises of 558,600 units, each unit being a warrant to purchase one common share and one common share purchase warrant

10. Commitments and Contingencies

The Company has entered into operating leases for office space and equipment with a company related to Fern. Pursuant to these leases which expire in June 2008, future minimum payments will amount to £59,000 per annum, which at the 2005 year end exchange rate, is equivalent to $102,000 per annum.

The Company has a commitment to purchase laboratory equipment used in relation to exploration and development from SGS Analabs in Mali. The commitment amounts to $52,000.

11. Financial Instruments

The Company does not acquire, hold or issue financial instruments for trading purposes. The estimated fair values of the Company's financial instruments approximate carrying values at December 31, 2005. The following methods and assumptions were used to estimate the fair value of each class of financial instrument:

Cash and cash equivalents - carrying amounts approximate fair value based on the short term maturity of those instruments.

Long term debt - carrying amounts approximate fair value as the debt bears interest at market rates.

As at December 31, 2005, the Company had sold forward 19,490 ounces of gold at an average price of $427 per ounce. The Company believes that these forward sales qualify as normal sales contracts under SFAS 133 and will record the revenues when the gold sold forward is

delivered. These forward sales agreements were entered into with Elliott, one of the shareholders of the Company.

At December 31, 2005, based on the spot price of $513 per oz, the mark-to-market value of the company's gold forward sales agreements was negative $1,990,000 (2004: negative $549,000). The company has 12,630 ounces of gold sold forward in 2006 at an average price of $418.5 per oz and 6,860 ounces of gold sold forward in 2007 at an average price of $441.2 per oz.

The credit risk in relation to financial instruments is the risk that a third party might fail to fulfil its performance obligations under the terms of a financial instrument. For cash and cash equivalents, credit risk represents the carrying amount on the balance sheet. The Company holds the majority of its cash and cash equivalents at large, reputable financial institutions. For forward sales, when the mark-to-market value is positive, this creates credit risk. When the mark-to-market value of a forward sale is negative, there is no credit risk. A table showing the concentration of credit risk as at December 31, 2005 is shown in the following table.

	United Kingdom	Mali	Total
Cash and cash equivalents	$ 5,145	$ 275	$ 5,420
Number of counterparties	1	1	2

12. Related Party Transactions

As described in note 10, the Company has entered into operting leases for office space and equipment with Fern. Rent expense amounted to $108,000 (2004: $93,000; 2003: $11,000) and the amount outstanding at December 31, 2005 was nil (2004: nil). The rental payments are denominated in Sterling so the U.S. Dollar amount payable is subject to fluctuation with the movement in exchange rates between Sterling and the U.S. Dollar.

As described in note 11, the company has entered into forward sales agreements with a shareholder. Metal revenue includes $2,919,000 from forward sales agreements (2004: $2,102,000; 2003: nil) and the amount outstanding at December 31, 2004 was nil (2003: nil). As at December 31, 2005 the planned forward sales for 2006 were 12,630 ounces which would generate revenue of $5,286,000.

SOMIKA purchased $171,000 of explosives during 2005 from African Explosives Limited ("AEL"). Mr. Ibrahim Kantao, a director of Avnel and SOMIKA, is also the Director-General of AEL Mali.

The Company received bridge financing loans as described in Note 7.

The funding of SOMIKA has principally been through advances by Fern, Elliott and the minority shareholder of Avnel Cayman. In July 2003, a separate entity, Caynton, advanced funds to SOMIKA at commercial interest rates. Avnel Cayman then assigned to Caynton, $3.5 million of its outstanding loans with SOMIKA. The shareholders subsequently advanced further loans to SOMIKA through Caynton. The entire Caynton Loan of $17.92 million, including accrued interest, was assigned to Avnel Cayman on December 31, 2004. The subsequent shareholder Bridge Financing Loans have been made to Avnel Cayman. All outstanding loans have subsequently been assigned to Avnel on February 23, 2005.

13. Employee Stock Based Compensation

(i) The Stock Option Plan

On February 23, 2005, the board of directors of Avnel adopted the Company's Stock Option Plan (the "Plan") effective upon the completion of the IPO Offering of June 30, 2005.

The Plan was adopted by the board of directors in order to have a stock option plan which complies with the rules and policies of the Toronto Stock Exchange in place upon completion of the IPO Offering. The maximum number of Common Shares reserved for issuance under the Plan is 4,739,360. Options granted under the Plan are subject to the following terms and conditions:

(a) the maximum number of common shares which may be reserved for issuance under the Plan, together with any other compensation arrangement of the Company, to insiders shall not exceed 5% of the outstanding common shares, and to any one insider and such insider's associates in any 12 month period shall not exceed 5% of the outstanding common shares. Under the Plan the maximum number of common shares reserved for issuance to any one person shall be 5% of the outstanding common shares at the date of issuance.

(b) The exercise price of an option shall not be lower than the closing price of the common shares on the TSX on the day immediately preceding the day of grant of such option.

(c) The Board of the Company shall determine the time during which any options may vest and the method of vesting or that no vesting restriction shall exist.

(d) Options shall have a maximum term of ten years from the date of the grant, subject to any limits of any law or other regulatory body having jurisdiction.

(e) Unless otherwise determined by the Board of the Company, an option will terminate 90 days after an optionee ceases to be an eligible participant (i.e. upon ceasing to be a director, officer or consultant of the Company).

(f) In the event of the death of an eligible participant, the option will be exercisable, unless by its terms it sooner terminates or expires, within 90 days following such death by the persons to whom the eligible participant's rights, under the Plan, pass by will or the laws of descent and distribution, and

(g) Options are non-transferable without the consent of the Board.

(ii) The CEO Compensation Option

On February 23, 2005, Avnel granted to Roy Meade, Chief Executive Officer of Avnel, an option (the "CEO Compensation Option") to acquire up to 2.5 million common shares of Avnel at an exercise price per share of the Canadian Dollar equivalent of US$0.275. One third of the option was exercisable on June 30, 2005, one-third on February 23, 2006, and the remaining one-third is exercisable on February 23, 2007. The maximum number of options that can be issued under the CEO Compensation Option is 2.5 million. As at December 31, 2005, none of these options had been exercised. Mr. Meade's entitlement to any unexercised portion of the CEO Compensation Option will terminate in the event he leaves employment of Avnel at his own volition prior to the exercise date. The CEO Compensation Options do not form part of Avnel's Stock Option Plan.

At the time of the Company's reorganization referred to in Note 1, the CEO Compensation Option was granted to replace the existing arrangement between Mr Meade and Avnel Cayman in September 2003 under which no compensation was recorded as performance conditions were not met.

(iii) Summary of Options Granted

The fair value of the options for both the stock option plan and the CEO Compensation Option has been estimated using the Binomial option model with the following assumptions:

Risk-free interest rate	3.9% - 4.1%
Expected option term	10 years

Expected volatility	40%
Expected dividend yield	Nil%

The maximum expected option term of ten years has been used as Avnel does not have any previous history of issuing options and has no reason to conclude that a shorter term is more appropriate. The interest rate assumptions used are available by reference to Canadian market data. Credifinance, the Company's advisors for the initial public offering, estimated the volatility of Avnel by reference to their proprietary databases of similar companies as being 40%. This figure was accepted by Avnel, and is still believed to be the best estimate for volatility in the absence of adequate trading data or a suitable reference index.

Using these assumptions the total value of the options granted amounts to $1,947,000. For the year ended December 31, 2005 administration expense includes compensation expense of $1,126,000 (2004- nil) and the corresponding amount has been credited to Additional Paid in Capital. In addition a further $821,000 of stock option expense is expected to be amortized over a weighted average period of 1.9 years.

The table below summarizes the options granted and outstanding at December 31, 2005.

	Shares	Weighted average exercise price	Weighted average remaining contractual term	Aggregate Intrinsic Value
Stock Option Plan				
Outstanding at December 31, 2004	-	-	-	-
Granted	1,850,000	$ 0.65	-	-
Exercised	-	-	-	-
Forfeited or expired	-	-	-	-
Outstanding at December 31, 2005	1,850,000	$ 0.65	9.7	$ 383
Exercisable at December 31, 2005	550,000	$ 0.64	9.7	$ 118
CEO Compensation Option				
Outstanding at December 31, 2004	-	-	-	-
Granted	2,500,000	$ 0.28	-	-
Exercised	-	-	-	-
Forfeited or expired	-	-	-	-
Outstanding at December 31, 2005	2,500,000	$ 0.28	9.1	$ 1,478
Exercisable at December 31, 2005	833,333	$ 0.28	9.1	$ 493

A summary of the status of the Company's nonvested share options as of December 31, 2005, and changes during the year ended December 31, 2005, is presented below.

	Shares	Weighted average grant-date fair value
Stock Option Plan		
Nonvested at December 31, 2004	-	-
Granted	1,850,000	$ 0.54
Vested	(550,000)	$ 0.53
Forfeited	-	-
Nonvested at December 31, 2005	1,300,000	$ 0.54
CEO Compensation Option		
Nonvested at December 31, 2004	-	-
Granted	2,500,000	$ 0.38
Vested	(833,333)	$ 0.38
Forfeited	-	-
Nonvested at December 31, 2005	1,666,667	$ 0.38

All vested shares that are outstanding are also exercisable.

Upon exercise of an option, the Company will issue new common shares. The Company's authorised capital consists of an unlimited number of common shares.

14. Provision for taxes based on income

The Company has income tax expense for the years ended December 31, 2005, 2004 and 2003 resulting from taxable income in companies which cannot be offset by losses incurred in other companies which operate in different tax jurisdictions.

The Company's statutory income tax rate for the years ended December 31, 2005, 2004 and 2003 is nil in the jurisdictions of Guernsey and the Cayman Islands in which the Company and Avnel Cayman are incorporated.

	2005	2004	2003
Statutory tax rate applied to pre-tax loss representing			
Income tax benefit of loss before tax	$ Nil	$ Nil	$ Nil
Reconciling item:			
Withholding tax	277	-	-
Foreign tax charges	28	25	10
Income tax expense	$ 305	$ 25	$ 10

The components of deferred income taxes, net as of December 31 2005, 2004 and 2003, are as follows (in thousands):

Deferred tax liabilities:	2005	2004	2003
Net operating loss and credit carryforwards	2,552	1,290	Nil
Valuation allowance	(2,552)	(1,290)	-
Total deferred tax liabilities	Nil	Nil	Nil

No other deferred tax assets and liabilities resulting from temporary differences in recognition of income and expenses for tax and financial reporting purposes existed at December 31, 2005, 2004 or 2003.

The provision for income taxes for the years ended December 31, 2005, 2004 and 2003 result in effective tax rates of (4.5)%, (0.5)% and (1.8)%, respectively.

15. Canadian Generally Accepted Accounting Principles

Canadian Generally Accepted Accounting Principles ("Canadian GAAP") vary in certain respects from U.S. GAAP. The effect of the principal measurement differences on the Company's consolidated financial statements are described below.

Comprehensive Income (Loss)

Under Canadian GAAP there is no requirement to disclose comprehensive income (loss).

Convertible Loan Notes

Under Canadian GAAP, the Company's convertible loan notes would be recorded in part as debt and in part as shareholders' equity, rather than entirely as debt as considered under U.S. GAAP. The amount recorded as debt represents the present value of future interest and principal amounts of the notes. The amount will be accreted to the face value of the notes over the term to maturity through periodic charges to interest expense.

Under Canadian GAAP, the convertible loan notes liability would originally decrease by $916,000, and other paid in capital, included in shareholders' equity, would increase by $916,000.

The following table presents the net loss and loss per share following Canadian GAAP:

		2005		2004		2003
Net loss under US GAAP	$	(7,106)	$	(5,074)	$	(573)
Accretion of convertible notes		(91)		Nil		Nil
Net loss under Canadian GAAP		(7,197)		(5,074)		(573)
Net loss per share under Canadian GAAP	$	(0.29)	$	(58.00)	$	(11.46)