



**QUARTERLY REPORT**

**For the six months ended June 30, 2006**

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CONSOLIDATED FINANCIAL STATEMENTS

FOR THE SIX MONTHS ENDED  
JUNE 30, 2006

(UNAUDITED)

## **NOTICE OF NO AUDITOR REVIEW OF INTERIM FINANCIAL STATEMENTS**

Under National Instrument 51-102, Part 4, subsection 4.3(3)(a), if an auditor has not performed a review of the interim financial statements, they must be accompanied by a notice indicating that the financial statements have not be reviewed by an auditor.

The accompanying unaudited interim financial statements of the Company have been prepared by, and are the responsibility of, the Company's management.

The Company's independent auditor has not performed a review of these financial statements in accordance with the standards established by the Canadian Institute of Chartered Accountants for a review of financial statements by an entity's auditor.

*"Bahman Yamini"*

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President and Chief Executive Officer

*"Iain MacPhail"*

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Vice President, Finance & CFO

August 29, 2006

**CANASIL RESOURCES INC.**  
**Consolidated Balance Sheets**  
(Unaudited)

|                                     | June 30<br>2006 | December 31<br>2005 |
|-------------------------------------|-----------------|---------------------|
| <b>ASSETS</b>                       |                 |                     |
| <b>Current</b>                      |                 |                     |
| Cash and cash equivalents           | \$ 690,370      | \$ 204,920          |
| Receivables                         | 53,340          | 59,698              |
| Prepaid expenses                    | 5,066           | 4,347               |
|                                     | 748,776         | 268,965             |
| <b>Equipment</b> (note 3)           | 32,527          | 6,692               |
| <b>Resource properties</b> (note 4) | 1,961,147       | 1,827,000           |
| <b>Reclamation bond</b>             | 20,000          | 13,000              |
|                                     | \$ 2,762,450    | \$ 2,115,657        |

**LIABILITIES AND STOCKHOLDERS' EQUITY**

**Current liabilities**

|  |           |           |
|--|-----------|-----------|
| Accounts payable and accrued liabilities | \$ 34,671 | \$ 44,917 |
|--|-----------|-----------|

**Stockholders' equity**

|                              |              |              |
|------------------------------|--------------|--------------|
| Share capital (note 5)       | 6,572,264    | 5,762,048    |
| Contributed surplus (note 6) | 469,755      | 449,081      |
| Deficit                      | (4,314,240)  | (4,140,389)  |
|                              | 2,727,779    | 2,070,740    |
|                              | \$ 2,762,450 | \$ 2,115,657 |

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

**Commitment** (note 10)

**On behalf of the Board:**

\_\_\_\_\_  
*"Gary Nordin"* Director      \_\_\_\_\_  
*"Bahman Yamini"* Director

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

**CANASIL RESOURCES INC.**Consolidated Statements of Operations and Deficit  
(Unaudited)

|  | Three Months Ended June 30 |                       | Six Months Ended June 30 |                       |
|--|----------------------------|-----------------------|--------------------------|-----------------------|
|  | 2006                       | 2005                  | 2006                     | 2005                  |
| <b>EXPENSES</b>                                      |                            |                       |                          |                       |
| Accounting and audit                                 | \$ 8,073                   | \$ 1,789              | \$ 12,985                | \$ 5,739              |
| Amortization   | 357                        | 156                   | 714                      | 313                   |
| Directors fees                                       | 4,500                      | 4,500                 | 9,000                    | 9,000                 |
| Foreign exchange loss                                | 4,083                      | 101                   | 4,185                    | 12,495                |
| General exploration                                  | 2,560                      | 47,714                | 10,736                   | 89,416                |
| Investor relations                                   | 13,056                     | 2,145                 | 28,349                   | 17,669                |
| Legal fees   | 5,844                      | 7,859                 | 7,050                    | 11,145                |
| Management fees                                      | 15,000                     | 15,000                | 30,000                   | 30,000                |
| Office services and supplies                         | 4,613                      | 3,564                 | 14,320                   | 6,382                 |
| Registration, licence and filing                     | 14,759                     | 3,990                 | 23,706                   | 7,284                 |
| Stock-based compensation (note 6)                    | -                          | 33,487                | 20,674                   | 33,487                |
| Stock transfer fees                                  | 1,968                      | 933                   | 2,225                    | 1,725                 |
| Telephones   | 1,199                      | 883                   | 2,304                    | 2,323                 |
| Travel and conferences                               | 427                        | 1,726                 | 8,332                    | 5,406                 |
| <b>Loss before other item</b>                        | <b>76,439</b>              | <b>123,847</b>        | <b>174,580</b>           | <b>232,384</b>        |
| <b>OTHER ITEM</b>                                    |                            |                       |                          |                       |
| Interest income                                      | -                          | (2,666)               | (729)                    | (6,372)               |
| <b>Loss for the period</b>                           | <b>(76,439)</b>            | <b>(121,181)</b>      | <b>(173,851)</b>         | <b>(226,012)</b>      |
| <b>Deficit, beginning of period</b>                  | <b>(4,237,801)</b>         | <b>(3,925,361)</b>    | <b>(4,140,389)</b>       | <b>(3,820,530)</b>    |
| <b>Deficit, end of period</b>                        | <b>\$ (4,314,240)</b>      | <b>\$ (4,046,542)</b> | <b>\$ (4,314,240)</b>    | <b>\$ (4,046,542)</b> |
| <b>Basic and diluted loss per share</b>              | <b>\$ (0.004)</b>          | <b>\$ (0.007)</b>     | <b>\$ (0.009)</b>        | <b>\$ (0.012)</b>     |
| <b>Weighted average number of shares outstanding</b> | <b>18,759,012</b>          | <b>18,432,342</b>     | <b>18,596,580</b>        | <b>18,432,342</b>     |

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

**CANASIL RESOURCES INC.**  
Consolidated Statements of Cash Flows  
(Unaudited)

|   | Three Months Ended June 30 |                   | Six Months Ended June 30 |                   |
|---|----------------------------|-------------------|--------------------------|-------------------|
|   | 2006                       | 2005              | 2006                     | 2005              |
| <b>CASH FLOWS USED IN OPERATING ACTIVITIES</b>                  |                            |                   |                          |                   |
| Loss for the period   | \$ (76,439)                | \$ (121,181)      | \$ (173,851)             | \$ (226,012)      |
| Items not affecting cash:                                       |                            |                   |                          |                   |
| Amortization  | 357                        | 156               | 714                      | 313               |
| Stock-based compensation  | -                          | 33,487            | 20,674                   | 33,487            |
| Changes in non-cash working capital items:                      |                            |                   |                          |                   |
| Decrease (increase) in receivables                              | (19,586)                   | (616)             | 6,358                    | (20,941)          |
| Decrease (increase) in prepaid expenses                         | 3,193                      | (151)             | (719)                    | (3,867)           |
| Increase (decrease) in accounts payable and accrued liabilities | (64,708)                   | (20,877)          | (7,039)                  | 9,308             |
| Net cash used in operating activities                           | (157,183)                  | (109,182)         | (153,863)                | (207,712)         |
| <b>CASH FLOWS USED IN INVESTING ACTIVITIES</b>                  |                            |                   |                          |                   |
| Resource property costs and deferred exploration costs          | (48,812)                   | (19,312)          | (135,274)                | (82,726)          |
| Reclamation deposits  | (7,000)                    | -                 | (7,000)                  | -                 |
| Equipment   | -                          | -                 | (28,629)                 | (1,782)           |
| Net cash used in investing activities                           | (55,812)                   | (19,312)          | (170,903)                | (84,508)          |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>                     |                            |                   |                          |                   |
| Proceeds from private placement, net of issue costs             | 810,216                    | -                 | 810,216                  | -                 |
| Net cash from financing activities                              | 810,216                    | -                 | 810,216                  | -                 |
| <b>Increase (decrease) in cash during the period</b>            | <b>597,221</b>             | <b>(128,494)</b>  | <b>485,450</b>           | <b>(292,220)</b>  |
| <b>Cash, beginning of period</b>                                | <b>93,149</b>              | <b>518,092</b>    | <b>204,920</b>           | <b>681,818</b>    |
| <b>Cash, end of period</b>                                      | <b>\$ 690,370</b>          | <b>\$ 389,598</b> | <b>\$ 690,370</b>        | <b>\$ 389,598</b> |

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

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

**CANASIL RESOURCES INC.**

Notes to the Consolidated Financial Statements

June 30, 2006 and 2005

(Unaudited)

**1. NATURE AND CONTINUANCE OF OPERATIONS**

Canasil Resources Inc. (the "Company") is considered to be in the exploration stage with respect to its interest in resource properties. Based on the information available to date, the Company has not yet determined whether these properties contain economically recoverable ore reserves.

The recovery of the amounts comprising resource properties and deferred exploration costs is dependent upon the confirmation of economically recoverable reserves, the ability of the Company to obtain necessary financing to successfully complete its exploration and development and upon future profitable production.

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

|                 | June 30        | December 31    |
|-----------------|----------------|----------------|
|                 | 2006           | 2005           |
| Deficit         | \$ (4,314,240) | \$ (4,140,389) |
| Working capital | \$ 714,105     | \$ 224,048     |

**2. SIGNIFICANT ACCOUNTING POLICIES**

These interim consolidated financial statements have been prepared in accordance with accounting principles generally accepted in Canada and follow the same accounting policies and methods as our most recent annual financial statements. Accordingly, these financial statements should be read in conjunction with the Company's 2005 audited consolidated financial statements.

These interim consolidated financial statements include all adjustments that are, in the opinion of management, necessary for fair presentation.

**CANASIL RESOURCES INC.**

Notes to the Consolidated Financial Statements

June 30, 2006 and 2005

(Unaudited)

**3. EQUIPMENT**

|                         | June 30, 2006 |                             |                   | December 31<br>2005 |
|-------------------------|---------------|-----------------------------|-------------------|---------------------|
|                         | Cost          | Accumulated<br>Amortization | Net Book<br>Value | Net Book<br>Value   |
| Site vehicles           | \$ 27,730     | \$ 2,080                    | \$ 25,650         | \$ -                |
| Furniture and equipment | 15,871        | 8,994                       | 6,877             | 6,692               |
|                         | \$ 43,601     | \$ 11,074                   | \$ 32,527         | \$ 6,692            |

**4. RESOURCE PROPERTIES****Tres Marias and Cebollas properties, Mexico**

During 2004, the Company entered into an option agreement with Wheaton River Minerals Ltd. ("Wheaton") and its wholly owned subsidiary Minas Luismin S.A. de C.V. to earn a 51% interest in the Tres Marias and Cebollas Gold / Silver properties located in Durango State, Mexico. In 2005 Wheaton merged with Goldcorp Inc.

In accordance with the terms of the agreement, the Company issued 50,000 common shares at a value of \$8,000 and must also incur exploration expenditures of US\$1,000,000 over five years. The Company's interest may be increased to 75% in the sixth year by incurring an additional US\$700,000 in exploration expenditures. Goldcorp Inc. may buy back a 35% interest in the properties for US\$1,700,000 after the Company has acquired a 75% interest. The property is subject to a 3% net smelter returns royalty ("NSR").

**Sandra and Nora project, Mexico**

During 2005, the Company acquired, through staking, claims located in the Sierra Madre Occidental volcanic belt in Durango State, Mexico.

**Los Azules project, Mexico**

During 2005, the company acquired, through staking, claims in Sinaloa State, Mexico, located 60km southeast of the City of Mazatlan.

**San Francisco project, Mexico**

During 2005, the Company acquired through staking, claims located in the Sierra Madre Occidental volcanic belt in Durango State, Mexico.

**CANASIL RESOURCES INC.**

Notes to the Consolidated Financial Statements  
June 30, 2006 and 2005  
(Unaudited)

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**4. RESOURCE PROPERTIES (continued)****La Esperanza project, Mexico**

During 2005, the Company entered into an option agreement to purchase a 100% interest in the La Esperanza project, subject to a Net Smelter Return royalty of up to 1.5%. The claims are located in Zacatecas State, Mexico. Under the terms of a subsequent definitive agreement, the Company has the right to acquire these claims by making option payments over a period of three years totaling \$174,000 (US\$150,000).

**Colibri project, Mexico**

During 2005, the Company acquired through staking, claims located in Durango State, Mexico. The Colibri District is on the eastern border of Sierra Madre Occidental volcanic province.

**Salamandra project, Mexico**

During the quarter, the Company signed a letter of intent to enter into an option agreement to purchase a 100% interest in the Salamandra project, subject to a NSR of 2%. In accordance with the terms of the agreement, the Company has the right to acquire these claims, which cover 900 hectares, by making option payments over a period of three years totalling \$554,000 (US\$475,000).

The Salamandra project, covering 900 hectares is located 35km northeast of the city of Durango in the in Durango State. The Company has acquired an additional 2,000 hectares by staking ground surrounding the existing claims, making the total claim area covered by the project 2,900 hectares.

**Brenda Claims, Canada**

The Company owns twenty-two mineral claims in North Central British Columbia (expiring May 30, 2015).

**Lil Claim, Canada**

The Company owns two mineral claims in the Omineca Mining division of British Columbia (expiring April 10, 2007).

**Granite Claims, Canada**

The Company owns one mineral claim in the Omineca Mining division of British Columbia (expiring October 6, 2009).

**Vega Claims, Canada**

The Company owns eight mineral claims (expiring October 28, 2006) in the Omineca Mining division of British Columbia.

**CANASIL RESOURCES INC.**

Notes to the Consolidated Financial Statements

June 30, 2006 and 2005

(Unaudited)

**4. RESOURCE PROPERTIES (continued)****Schedule of Deferred Exploration Expenses**

|   | Brenda<br>Claims<br>Canada | Lil<br>Claims<br>Canada | Vega<br>Claims<br>Canada | Tres<br>Marias<br>and<br>Cebollas<br>Mexico | Los Azules<br>Mexico | Sandra<br>and Nora<br>Mexico | San<br>Francisco<br>Mexico | Esperanza<br>Mexico | Colibri<br>Mexico | Salamandra<br>Mexico | Total               |
|---|----------------------------|-------------------------|--------------------------|---|----------------------|------------------------------|----------------------------|---------------------|-------------------|----------------------|---------------------|
| <b>Total as at December 31, 2004</b>      | \$ 1,296,652               | \$ -                    | \$ -                     | \$ 353,909                                  | \$ -                 | \$ -                         | \$ -                       | \$ -                | \$ -              | \$ -                 | \$ 1,650,561        |
| Administration                            | 25                         | -                       | -                        | 544   | -                    | 126                          | 126                        | -                   | -                 | -                    | 821                 |
| Assays                                    | -                          | -                       | -                        | 1,852                                       | 207                  | 3,929                        | -                          | 2,120               | -                 | -                    | 8,108               |
| Geological and field costs                | 4,196                      | -                       | -                        | 37,893                                      | 6,484                | 28,971                       | 697                        | 13,036              | 11,134            | -                    | 102,411             |
| Land holding costs                        | -                          | 441                     | 1,441                    | -   | 11,365               | 3,193                        | 1,308                      | 6,696               | 4,747             | -                    | 29,191              |
| Mapping and surveying                     | 12,832                     | -                       | -                        | 4,857                                       | 22                   | -                            | -                          | -                   | -                 | -                    | 17,711              |
| Transportation and rentals                | -                          | -                       | -                        | 11,422                                      | -                    | 2,777                        | 366                        | 3,172               | 460               | -                    | 18,197              |
| <b>Total expenditures - 2005</b>          | <b>17,053</b>              | <b>441</b>              | <b>1,441</b>             | <b>56,568</b>                               | <b>18,078</b>        | <b>38,996</b>                | <b>2,497</b>               | <b>25,024</b>       | <b>16,341</b>     | <b>-</b>             | <b>176,439</b>      |
| <b>Total as at December 31, 2005</b>      | <b>1,313,705</b>           | <b>441</b>              | <b>1,441</b>             | <b>410,477</b>                              | <b>18,078</b>        | <b>38,996</b>                | <b>2,497</b>               | <b>25,024</b>       | <b>16,341</b>     | <b>-</b>             | <b>1,827,000</b>    |
| Administration                            | -                          | -                       | -                        | -   | 295                  | 1,905                        | -                          | 2,367               | 841               | 295                  | 5,703               |
| Amortization                              | -                          | -                       | -                        | -   | 134                  | 762                          | -                          | 128                 | 815               | 195                  | 2,034               |
| Assays                                    | -                          | -                       | -                        | -   | -                    | 9,702                        | -                          | -                   | 9,576             | -                    | 19,278              |
| Geological and field costs                | 425                        | 348                     | -                        | -   | 5,253                | 31,654                       | 224                        | 11,012              | 32,119            | 5,706                | 86,741              |
| Land holding costs                        | -                          | -                       | -                        | -   | 1,764                | 675                          | 408                        | 1,141               | -                 | 4,039                | 8,027               |
| Mapping and surveying                     | 2,280                      | -                       | 2,808                    | -   | -                    | -                            | -                          | -                   | -                 | -                    | 5,087               |
| Transportation and rentals                | -                          | -                       | -                        | -   | -                    | 4,647                        | -                          | 245                 | 2,384             | -                    | 7,275               |
| <b>Total expenditures - June 30, 2006</b> | <b>2,705</b>               | <b>348</b>              | <b>2,808</b>             | <b>-</b>                                    | <b>7,446</b>         | <b>49,345</b>                | <b>632</b>                 | <b>14,893</b>       | <b>45,735</b>     | <b>10,235</b>        | <b>134,147</b>      |
| <b>Total as at June 30, 2006</b>          | <b>\$ 1,316,410</b>        | <b>\$ 789</b>           | <b>\$ 4,249</b>          | <b>\$ 410,477</b>                           | <b>\$ 25,524</b>     | <b>\$ 88,341</b>             | <b>\$ 3,129</b>            | <b>\$ 39,917</b>    | <b>\$ 62,076</b>  | <b>\$ 10,235</b>     | <b>\$ 1,961,147</b> |

**CANASIL RESOURCES INC.**

Notes to the Consolidated Financial Statements

June 30, 2006 and 2005

(Unaudited)

**5. CAPITAL STOCK AND CONTRIBUTED SURPLUS**

|   | Number<br>of Shares | Capital<br>Stock | Contributed<br>Surplus |
|---|---------------------|------------------|------------------------|
| Authorized:   |                     |                  |                        |
| Unlimited number of common<br>voting shares without par value |                     |                  |                        |
| Common shares issued:   |                     |                  |                        |
| Balances, December 31, 2004                                   | 18,432,342          | \$ 5,762,048     | \$ 414,403             |
| Stock-based compensation                                      | -                   | -                | 34,678                 |
| Balances, December 31, 2005                                   | 18,432,342          | 5,762,048        | 449,081                |
| Private placement   | 3,303,000           | 825,750          |                        |
| Share issue costs   | -                   | (15,534)         |                        |
| Stock-based compensation                                      | -                   | -                | 20,674                 |
| Balances, June 30, 2006                                       | 21,735,342          | \$ 6,572,264     | \$ 469,755             |

**6. STOCK OPTIONS AND WARRANTS**

The Company has an Incentive Stock Option Plan (the "Plan") which complies with the rules set forth for such plans by the TSX Venture Exchange ("TSX-V") in that at no time may more than 5% of the outstanding issued common shares be reserved for incentive stock options granted to any one individual. The Plan provides for the issuance of options to directors, officers and employees of the Company and its subsidiaries to purchase common shares of the Company. The stock options may be issued at the discretion of the Board of Directors and may be exercisable during a period not exceeding five years. Stock options granted under the Plan will vest in equal quarterly tranches over a period of not less than 18 months. At no time will more than 2,000,000 shares be under option pursuant to the Plan. The exercise price will not be lower than, the greater of, "market price" of the shares on the TSX-V at the time of grant or \$0.10 per share.

At June 30, 2006, the Company had outstanding stock options, enabling holders to acquire common shares as follows:

| Number of Shares | Exercise Price | Expiry Date      |
|------------------|----------------|------------------|
| 100,000          | \$ 0.23        | April 17, 2007   |
| 650,000          | \$ 0.26        | November 6, 2008 |
| 150,000          | \$ 0.10        | August 31, 2010  |
| 800,000          | \$ 0.20        | March 6, 2011    |

**CANASIL RESOURCES INC.**

Notes to the Consolidated Financial Statements

June 30, 2006 and 2005

(Unaudited)

**6. STOCK OPTIONS AND WARRANTS (continued)**

Stock option and share purchase warrant transactions are summarized as follows:

|                                | Warrants         |                                 | Options          |                                 |
|--------------------------------|------------------|---------------------------------|------------------|---------------------------------|
|                                | Number           | Weighted Average Exercise Price | Number           | Weighted Average Exercise Price |
| Balance, December 31, 2004     | 2,250,000        | \$ 0.35                         | 1,050,000        | \$ 0.27                         |
| Cancelled/expired              | (2,250,000)      | 0.35                            | (300,000)        | 0.32                            |
| Granted                        | <u>-</u>         |                                 | <u>150,000</u>   | 0.10                            |
| Balance, December 31, 2005     | -                |                                 | 900,000          | 0.23                            |
| Granted                        | <u>3,303,000</u> | 0.35                            | <u>800,000</u>   | 0.20                            |
| Balance, June 30, 2006         | <u>3,303,000</u> | \$ 0.35                         | <u>1,700,000</u> | \$ 0.22                         |
| Exercisable, December 31, 2005 | -                | \$ -                            | 787,500          | \$ 0.26                         |
| Exercisable, June 30, 2006     | <u>3,303,000</u> | \$ 0.35                         | <u>1,025,000</u> | \$ 0.23                         |

**Stock-based compensation**

During the six months ended June 30, 2006, the Company granted incentive stock options to directors, officers and consultants of the company to acquire up to 800,000 common shares with a weighted fair value of \$0.10 per share. One quarter of these options (200,000) vested during the current period resulting in stock-based compensation expense under the Black-Scholes option pricing model of \$19,483 being recognized. During the 2005 fiscal year, the Company granted 150,000 stock options. One-quarter of these options (37,500) vested in prior years and one-quarter (37,500) vested during the first three months of current year resulting in stock-based compensation expense under the Black-Scholes option pricing model of \$1,191 (June 30, 2005 - \$33,487) being recognized.

**CANASIL RESOURCES INC.**

Notes to the Consolidated Financial Statements

June 30, 2006 and 2005

(Unaudited)

**6. STOCK OPTIONS AND WARRANTS (continued)****Stock-based compensation (continued)**

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

|                          | June 30, 2006 |
|--------------------------|---------------|
| Risk-free interest rate  | 4.07%         |
| Expected life of options | 2 years       |
| Annualized volatility    | 97%           |
| Dividend rate            | 0.00%         |

**7. RELATED PARTY TRANSACTIONS**

The Company entered into the following transactions with related parties:

- a) Paid or accrued \$24,000 (June 30, 2005 - \$24,000) for management fees to a company controlled by a director.
- b) Paid or accrued \$19,910 (June 30, 2005 - \$7,044) for legal services to a law firm in which an officer of the Company is a partner.
- c) Paid or accrued \$9,000 (June 30, 2005 - \$9,000) to a director and to two companies each controlled by a director.
- d) Paid or accrued \$7,745 (June 30, 2005 - \$7,325) to a company controlled by an officer of the Company for accounting and management fees.

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

Included in accounts payable at June 30, 2006 is \$20,236 (December 31, 2005 - \$2,334) due to a director and officer of the Company and to a law firm of which an officer of the Company is a partner.

**CANASIL RESOURCES INC.**

Notes to the Consolidated Financial Statements

June 30, 2006 and 2005

(Unaudited)

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

|  | June 30<br>2006 | June 30<br>2005 |
|--|-----------------|-----------------|
| Cash paid during the year for interest     | \$ -            | \$ -            |
| Cash paid during the year for income taxes | \$ -            | \$ -            |

**9. SEGMENTED INFORMATION**

The Company's one reportable operating segment is the acquisition and exploration of resources properties. Geographic information is as follows:

The Company's assets are located in the following geographic locations:

|        | June 30<br>2006 | December 31<br>2005 |
|--------|-----------------|---------------------|
| Canada | \$ 2,054,140    | \$ 1,521,328        |
| Mexico | 708,310         | 594,329             |
|        | \$ 2,762,450    | \$ 2,115,657        |

**10. COMMITMENT**

The Company and its wholly owned subsidiary Minera Canasil S.A. de C.V., and Oremex Resources Inc. ("Oremex", TSXV: ORM) and Minera Montana S. de R.L. de C.V. ("Minera Montana"), have signed a letter agreement providing for the Company to acquire 100% interest in the Mezquital silver-zinc-lead claims, in which Oremex and Minera Montana have an option to earn 100% interest.

The agreement provides for the Company to issue to Oremex 650,000 common shares of the Company and 75,000 share purchase warrants, upon approval of the agreement by the TSX Venture Exchange and transfer of the claim titles, as full payment for 100% interest in the Mezquital claims. Each warrant will entitle Oremex to acquire one common share of the Company at a price of \$0.50 within 12 months of the approval of the final agreement by the TSX Venture Exchange.

**CANASIL RESOURCES INC.**  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
For the Six Months and Quarter ended June 30, 2006

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This Management's Discussion and Analysis ("MD&A") for Canasil Resources Inc. ("the Company") is dated August 29, 2006 and provides information on the Company's activities for the six months and quarter ended June 30, 2006 and to the date of this report. The following discussion and analysis of the financial position of the Company should be read in conjunction with the audited financial statements and related notes, as well as with the MD&A for the year ended December 31, 2005, and the quarter ended March 31, 2006.

### **Business of the Company**

The Company was incorporated in 1984 and is engaged in the exploration and development of mineral properties hosting copper-gold, gold, silver, zinc, and lead prospects located in Durango, Sinaloa and Zacatecas States, Mexico, and in British Columbia, Canada. During the period the Company has implemented the planned exploration programs on its mineral properties in Mexico, and continued with plans for exploration programs on its mineral properties in British Columbia, Canada, for the 2006 field season. In June 2006 the Company signed a letter of intent with Oremex Resources Inc. (TSXV: ORM) to acquire three mineral claims in Durango State, Mexico, to complete the Colibri project claim package. During the six-month period, the Company has exhibited at a number of industry conferences and completed a private placement of \$825,750 to fund continued exploration work and to strengthen the Company's working capital.

### **Overall Performance**

The Company's focus in Mexico during the quarter was to actively implement geological mapping and sampling on the Colibri silver-zinc-lead project in order to define targets for drilling, to prepare for drill programs at the La Esperanza and Sandra projects, as well as preparations for a geophysical survey at the Salamandra project and prospecting at the Los Azules project. During the six-month period and the quarter, expenditures on the Company's Mexican projects were \$128,286 and \$45,835 respectively (six months 2005 - \$69,409); general exploration expenditures for project evaluation and acquisition were \$10,736 and \$2,560 respectively (six months 2005 - \$89,416).

Channel sampling at the Colibri project has confirmed a large mineralized structure returning significant silver, zinc, lead and copper values over a strike length of 1,300 metres with widths of up to 50 metres. Diamond drilling at the La Esperanza project started in late July 2006. The prospecting program at the Los Azules project was undertaken in July and August 2006.

In British Columbia, Canada, the Company completed preparations for a geological mapping program on the Brenda gold-copper project and applied for and obtained necessary permits for a drill program. The Company continued discussions with major companies interested in possible joint ventures on the Brenda project and completed the planned property visit with one prospective partner in early June 2006. Dr. Andre Panteleyev undertook the geological mapping program at the Brenda project in July 2006. Total expenditures on the British Columbia properties during the six-month period and quarter were \$5,861 and \$1,849 respectively (six months 2005 - \$13,317).

The Company exhibited at the Calgary Resource Investment Conference in April 2006, and at the World Gold, PGM & Diamond Investment Conference in Vancouver in June 2006. The Company will be exhibiting at the Toronto Resource Investment Conference in September 2006. Investor relations expenditures during the six-month period and the quarter were \$28,349 and \$13,056 respectively (six months 2005 - \$17,669).

In June 2006, the Company closed a non-brokered private placement of 3,303,000 units at \$0.25 per unit for gross proceeds of \$825,750 to fund its continued exploration activities and for working capital.

### **Financial Condition, Results of Operations and Cash Flows**

The Company's working capital as at June 30, 2006 was \$714,105 (Dec. 31, 2005 - \$224,048). The Company has sufficient working capital to meet current operating requirements and planned expenditures for exploration and maintenance of its mineral property interests through 2006. The Company will undertake additional financing as required to implement drill programs at the Brenda gold-copper project in British Columbia, Canada, and at the Colibri project in Durango State, Mexico. Operating expenditures during the six-month period and quarter were \$174,580 and \$76,439 respectively (six months 2005 - \$232,384), and the Company earned interest income of \$729 during the six-month period (six months 2005 - \$6,372). The operating expenditures included stock-based compensation of \$20,674 (six months 2005 - \$33,487) for 237,500 stock options that vested during the six-month period. Net cash used in the six-month period for operating activities decreased to \$153,863 (six months 2005 - \$207,712). This was primarily due to the lower level of general exploration expenditures of \$10,736 (six months 2005 - \$89,416) as exploration expenditures were focused on specific projects and capitalized as deferred exploration expenditures. Cash used for deferred exploration expenditures on resource properties during the six-month period was \$135,274 (six months 2005 - \$82,726) and for equipment purchases of \$28,629 (six months 2005 - \$1,782). Cash flow from financing activities during the period was \$810,216, which was the net proceeds from a non-brokered private placement after deduction for share issue costs (six months 2005 - Nil).

**Mineral Properties**

The Company acquired the following mineral exploration projects in Mexico during 2005 and to the date of this report:

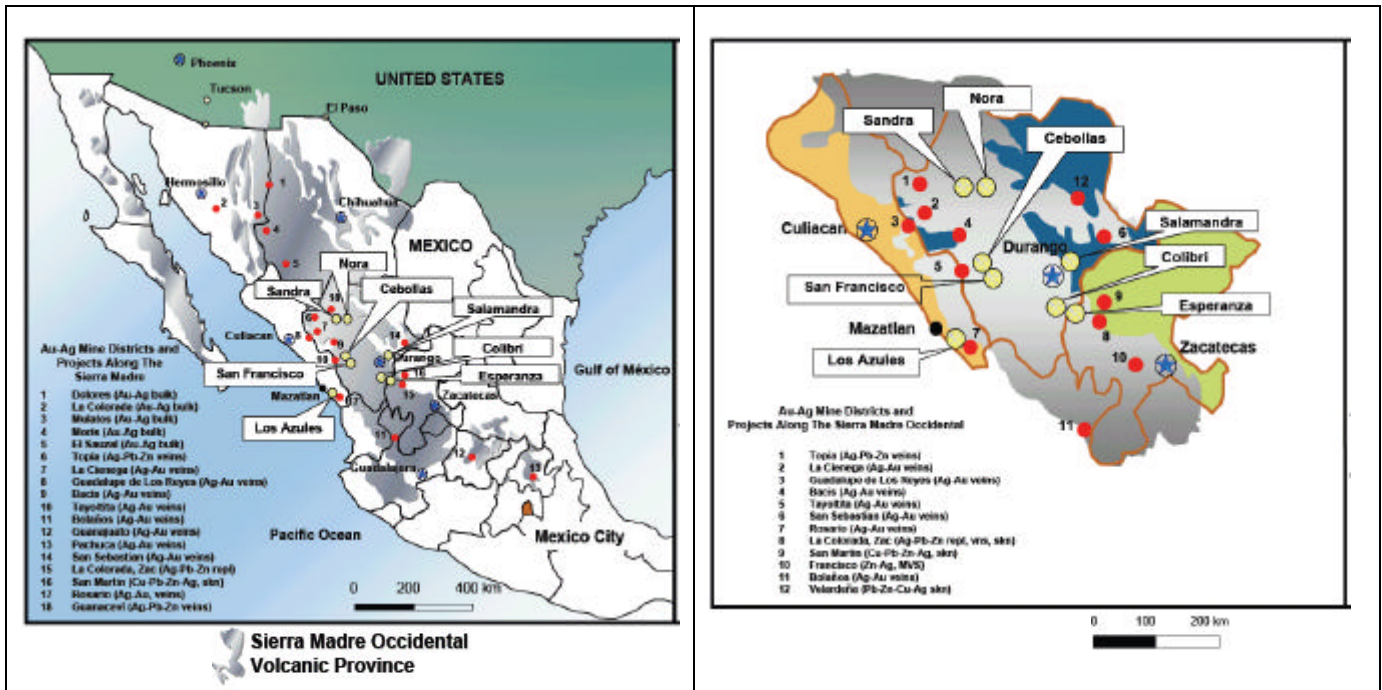
- Sandra and Nora silver-gold project – 100%
- La Esperanza silver-zinc-lead project – option to earn 100%
- San Francisco gold-silver project – 100%
- Colibri silver-zinc-lead project – 100%
- Los Azules gold-silver-copper project – 100%
- Salamandra zinc-silver project (March 2006) – option to earn 100%

Under option and joint venture agreements signed in 2003 with Goldcorp Inc. and Luismin, the Company holds an option to earn up to a 75% interest in the Tres Marias and Cebollas silver-gold properties in the San Dimas District, Durango State, Mexico.

The Company holds 100% interest in the following mineral properties located in the Omineca Mining District, in North-central British Columbia, Canada:

- Brenda, gold-copper property
- Vega, gold-copper property
- Granite, gold-silver property
- LIL, silver property

**Exploration Projects in Mexico**



**Tres Marias and Cebollas silver-gold properties, Durango State, Mexico**

The Tres Marias and Cebollas properties, covering 3,163 hectares, are located 150 km west of the city of Durango and 14 km southeast of Luismin's San Dimas/Tayoltita mine. The Company has an option agreement with Goldcorp Inc. and Luismin to earn up to a 75% interest in these properties by issuing 50,000 shares and incurring US\$1,700,000 in exploration expenditures over five years. Goldcorp/Luismin retains an option to buy back a 35% interest in the properties for US\$1,700,000 after the Company has acquired a 75% interest. There was no additional exploration work on these projects during the quarter. The Company has fulfilled its obligations under the agreements to October 2006.

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*Sandra and Nora silver-gold project, Durango State, Mexico*

The Sandra project covers 1,200 hectares, located 183 km northeast of the city of Durango in Durango State, Mexico, and benefits from excellent infrastructure and access. The Company has 100% title to the Sandra claims, which were acquired by staking and are located immediately south of a large claim group controlled by Pan American Silver Corp. The initial surface sampling and geological mapping program during the third quarter of 2005 identified a number of mineralized veins over an area of approximately 2,000 x 750 metres in the central area of the Sandra claims. Rock and chip samples from these veins returned encouraging grades of up to 9.74 g/t gold, 635 g/t silver, 2.46% copper and 20.06% lead as announced on November 2, 2005.

Trench sampling during the first quarter of 2006 confirmed silver and gold mineralization observed in earlier surface samples from the Barite, Maria Fernanda and Encino veins. Assay results returned silver grades of up to 888 g/t (25.9 oz/t) silver over 0.7 metres at the Barite vein, and up to 9.95 g/t (0.29 oz/t) gold and 365 g/t (10.65 oz/t) silver over 0.5 metres at the Maria Fernanda vein, where trench samples indicate consistent silver/gold mineralization over a strike length of approximately 300 metres. A diamond drill program for a total of 1,000 metres in 10 – 12 drill holes and is planned to test these vein systems at depth. Expenditures on the Sandra and Nora project during the six-month period were \$49,345 (six months 2005 - \$7,140).

*La Esperanza silver-zinc-lead project, Zacatecas State, Mexico*

The Company has an option agreement to purchase a 100% interest in the La Esperanza project, subject to a Net Smelter Return royalty of up to 1.5%. Under the terms of the agreement, the Company has the right to acquire these claims by making option payments over a period of three years totalling \$174,000 (US\$150,000). The La Esperanza project, covering 435 hectares, is located in the state of Zacatecas, 100 km south-southeast of the city of Durango. The project area is easily accessible from the Company's operating base in Durango and is well served with power lines, water access and services for supporting exploration and mining operations.

Results from a geological mapping and surface sampling program carried out in 2005 and first quarter of 2006 have defined drill targets. A diamond drill program is now in progress with plans for up to 8 drill holes for a total of 1,000 metres. Four drill holes for a total of 458 metres have been completed to date. Expenditures on the La Esperanza project during the period were \$14,893 (six months 2005 - \$ Nil).

*Colibri silver-zinc-lead project, Durango State, Mexico*

The Company acquired the Colibri claims, covering a total of 6,413 hectares, through direct staking of the claim blocks, giving the Company 100% title. There are a number of mineralized structures in the project area carrying silver, zinc and lead as well as gold and copper. The project site is located 70 km southeast of the city of Durango with a travel time of approximately 1.5 hours. The infrastructure at the property is excellent with access to power, water and all required services. In June 2006 the Company signed a letter of intent with Oremex Resources Inc. to acquire three additional claims covering 161 hectares within in the Colibri claim area.

The Company started a geological mapping and surface sampling program in March 2006, and continued through the second quarter with an active channel sampling program. This program has now outlined broad, banded, mineralized structure with a strike length of 1,300 metres and widths up to 30 – 50 metres. Specific zones within this structure returned high silver, zinc, copper, and lead values. The sampling program has defined drill targets for further exploration. Expenditures on the Colibri claims during the period were \$45,735 (six months 2005 – \$ Nil).

*Los Azules gold-silver-copper project, Sinaloa State, Mexico*

The Company acquired a 100% interest in the Los Azules claims in Sinaloa State, Mexico, covering 7,844 hectares, by direct staking between May and August 2005. The claims host prospects for epithermal low sulphidation vein type mineralization carrying gold, silver and copper. The Los Azules property is located 60 km southeast of the city of Mazatlan. The infrastructure at the property is excellent with the new Mazatlan-Escuinapa highway providing direct and easy access to the city and port facilities of Mazatlan. Power and water are available throughout the district. In July and August 2006 the Company completed a prospecting and sampling program at Los Azules to identify potential mineralized structures. Expenditures during the period at Los Azules were \$7,446 (six months 2005 - \$15,079).

*Salamandra silver-zinc project, Durango State, Mexico*

In March 2006, the Company signed a letter of intent to enter into an option agreement to purchase a 100% interest in the Salamandra project, subject to a Net Smelter Return royalty of 2%. Under the terms of the proposed agreement, the Company has the right to acquire these claims by making option payments over a period of three years totalling \$554,000 (US\$475,000). The Salamandra silver-zinc project, covering 900 hectares in Durango State, is located 35 km northeast of the city of Durango, with good access via paved and gravel roads. The Company has acquired a further 2,000 hectares by staking ground surrounding the existing claims, making the total claim area covered by the project 2,900 hectares. The access, infrastructure,

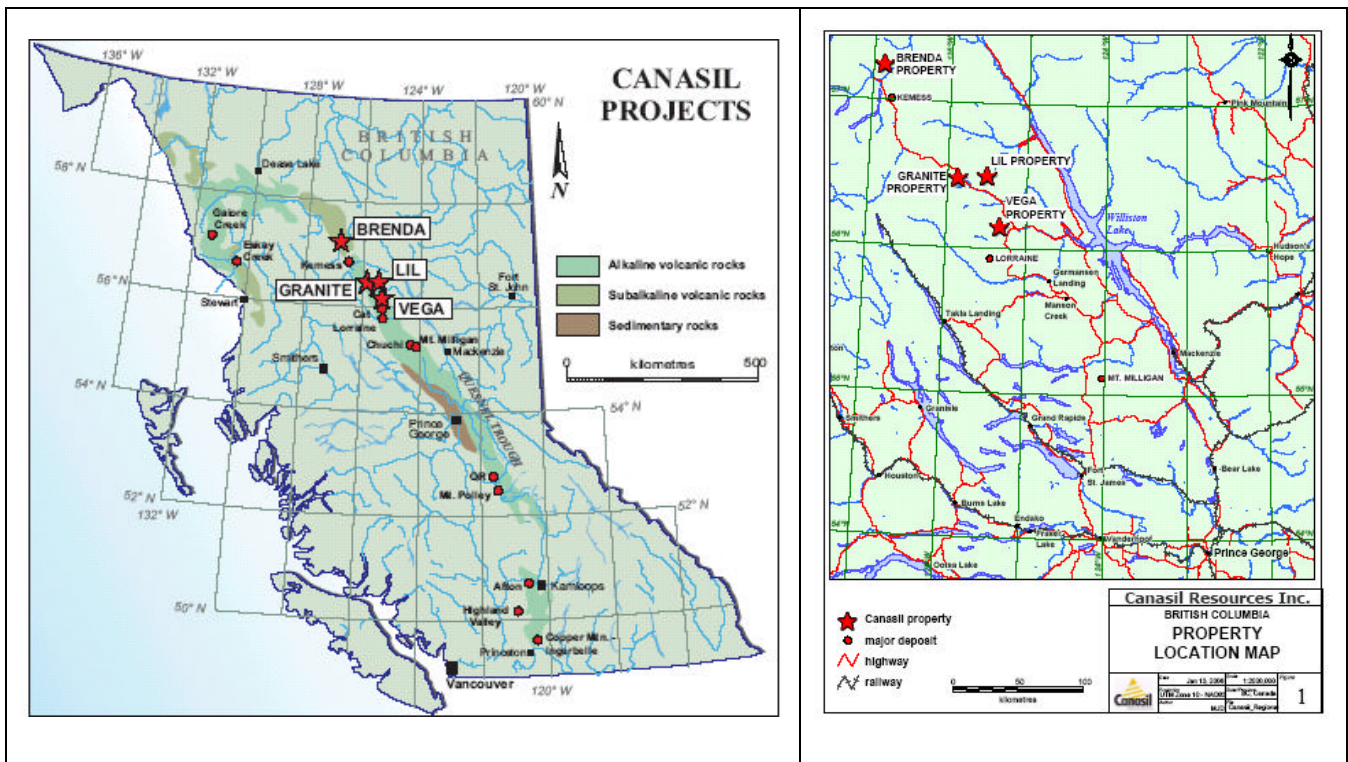
climate, and topography at Salamandra provide favourable conditions for exploration and development. A geophysical survey is planned over an area of 2,000 metres by 1,200 metres to investigate potential mineralized structures. Expenditures on the Salamandra project during the quarter were \$10,235 (six months 2005 – \$ Nil).

*San Francisco gold-silver project, Durango, Mexico*

The San Francisco property, covering 500 hectares, is located approximately 104 km west of the city of Durango, and approximately 12 km south of the Company's Tres Marias and Cebollas silver-gold projects, located 14 km southeast of the Tayoltita mine in the San Dimas mining district of Durango. The claims are within view of the community of San Francisco. The access road cuts through the centre of the property, as does the main power line supplying the Tayoltita mine.

There was no exploration work on the San Francisco project during the quarter, and expenditures were \$632 (six months 2005 - \$1,926).

**Exploration Projects in British Columbia, Canada**



*Brenda gold-copper property, British Columbia, Canada*

The Company holds 100% interest in the Brenda property which consists of 178 claim units, covering 4,450 hectares (44.5 square kilometres). The project is located in the core of the Kemsess-Toodoggone porphyry copper-gold district in the Omineca Mining Division, approximately 450 km northwest of Prince George, B.C. All claims are currently in good standing to May 30, 2015.

The Brenda property is an advanced gold-copper exploration project located centrally in the highly prospective Kemsess-Toodoggone district. There has been over \$3,000,000 in cumulative exploration expenditures on the property, covering geologic mapping, geochemistry, ground and aerial geophysics, satellite imaging and over 8,000 metres of drilling in 58 drill holes. Compilation and review of the data has indicated several large untested target zones for further drilling.

During the period, the Company continued the data compilation work to define drill targets, and applied for and received a work permit for the 2006 field season covering up to 3,000 metres of diamond drilling in 10 drill holes. In July and August 2006 the Company completed the planned geological mapping program at the Brenda project, undertaken by Dr. Andre Panteleyev. The Company plans to undertake a drill program of 1,500 metres in 4 -5 drill holes depending on the availability of drills and crews and funding for the program. Total expenditures on the Brenda project during the period were \$2,705 (six months 2005 - \$13,317).

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The Company has received interest from major companies for a potential joint venture to advance exploration on the Brenda project. A property visit was undertaken in June 2006 with one of the interested parties.

*Vega gold-copper property, British Columbia, Canada*

The 100% owned Vega claims are located in the Omineca Mining Division of British Columbia, 300 km northwest of Prince George. Access to the property is via the Omineca Mines Access Road and logging roads. The claim area was increased by staking in July 2006 to cover 6,716 hectares. The Company is carrying out a data compilation program to determine further exploration work covering geological mapping, sampling and geophysics to define drill targets. Expenditures on the Vega project during the period were \$2,808 (six months 2005 - \$ Nil).

*LIL property, British Columbia, Canada*

The 100% owned LIL claims, covering 875 hectares, are located in the Omineca Mining Division, 350 km northwest of Prince George, British Columbia. Logging roads provide four-wheel drive access to within 2 km of the property. Mineralization on the property consists of narrow high-grade, silver bearing quartz veins and breccia zones, which have been identified over a distance of 300 metres, with grades ranging from 4.3 ounces/ton to 325.54 ounces/ton silver over 0.20 to 0.90 meters. Large silver bearing floats, found downstream in LIL Creek, indicate a possibility of wider mineralized veins on the property.

There was no active exploration work on the LIL project during the period.

*Granite property, British Columbia, Canada*

The 100% owned Granite gold-silver claim, covering 500 hectares in the Johansson Lake area, Omineca Mining Division of British Columbia, is located 360 km northwest of Prince George. The Omineca Resource Access Road and auxiliary roads provide four-wheel drive access to the property.

Historical exploration records reported encouraging gold assays from trenches and sampling in the old underground workings. Three mineralized shear zones with gold/silver mineralization have been identified to date on the property and outlined a broad 300 metres by 2.0 kilometres gold soil anomaly. Small diamond drill programs by Hemlo Gold Mines Inc. in 1995, and the Company in 1997, intersected several sections with anomalous gold and silver values, however failed to locate sections corresponding in grade to the many samples recovered from these zones. There was no active exploration on the Granite property during the quarter. The project is being reviewed to determine future exploration potential.

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A discussion of general conditions, trends, and competitive and environmental factors affecting the Company's business and operations is included following the financial and other information.

**Selected Annual Information**

The information in the following table provides selected audited financial information of the Company for the 2005 and the two preceding financial years. This information is derived from the audited financial statements and should be read in conjunction with those statements and notes.

The loss for the year increased over the past three years reflecting the Company's increased level of exploration activity to acquire and develop new mineral exploration projects in Mexico during 2003, 2004 and 2005. The increase in total assets in 2003 reflects the financing of \$1,125,000 completed in December 2003, and the exercise of outstanding warrants for \$150,000 in November and December 2003.

| Year Ended December 31                   | 2005         | 2004         | 2003         |
|--|--------------|--------------|--------------|
| Total Revenue                            | Nil          | Nil          | Nil          |
| Loss from continuing operations          | \$ (319,859) | \$ (222,378) | \$ (163,193) |
| Loss per Share – basic and fully diluted | \$ (0.017)   | \$ (0.012)   | \$ (0.0089)  |
| Loss for the year                        | \$ (319,859) | \$ (222,378) | \$ (163,193) |
| Loss per share – basic and fully diluted | \$ (0.017)   | \$ (0.012)   | \$ (0.0089)  |
| Total Assets                             | \$2,115,657  | \$ 2,377,868 | \$2,610,274  |
| Long Term Financial Liabilities          | Nil          | Nil          | Nil          |
| Cash Dividends per Share                 | Nil          | Nil          | Nil          |
| Shareholders' Equity                     | \$2,070,740  | \$2,355,921  | \$2,511,326  |
| Working Capital                          | \$224,048    | \$690,120    | \$1,167,128  |
| Write-off of Mineral Property Costs      | Nil          | Nil          | Nil          |

**Selected Quarterly Information**

The following tables provides selected financial information of the Company for each of the last eight quarters ending at the end of the most recently completed financial year:

| Year                                     | 2006       |            | 2005       |            |            |            | 2004       |            |
|--|------------|------------|------------|------------|------------|------------|------------|------------|
|  | Jun. 30    | Mar. 31    | Dec. 31    | Sept. 30   | Jun. 30    | Mar. 31    | Dec. 31    | Sept. 30   |
| Loss from continuing operations          | (76,439)   | (98,451)   | (53,223)   | (40,624)   | (121,181)  | (104,831)  | (67,407)   | (31,758)   |
| Loss per share – basic and fully diluted | (0.004)    | (0.0053)   | (0.0029)   | (0.0022)   | (0.0065)   | (0.0057)   | (0.0037)   | (0.0018)   |
| Loss                                     | (76,439)   | (98,451)   | (53,223)   | (40,624)   | (121,181)  | (104,831)  | (67,407)   | (31,758)   |
| Loss per share – basic and fully diluted | (0.004)    | (0.0053)   | (0.0029)   | (0.0022)   | (0.0065)   | (0.0057)   | (0.0037)   | (0.0018)   |
| Shares issued                            | 21,735,342 | 18,432,342 | 18,432,342 | 18,432,342 | 18,432,342 | 18,432,342 | 18,432,342 | 18,432,342 |

During the second quarter 2006, the Company incurred deferred exploration expenditures of \$47,684 compared to \$19,311 in the same period in 2005.

## **Liquidity and Capital Resources**

The Company has sufficient financial resources to undertake currently planned exploration programs and expenditures. In June 2006, the Company closed a non-brokered private placement of 3,303,000 units at a price of \$0.25 per unit for gross proceeds of \$825,750. Each unit consists of one common share of the Company and one share purchase warrant. Each warrant entitles the holder to purchase one common share of the Company at a price of \$0.35 within one year from closing of the private placement.

Future exploration and subsequent development of the Company's properties beyond planned expenditures will depend on the Company's ability to obtain additional financing. The Company has limited financial resources, and there is no assurance that additional funding will be available to allow the Company to fulfil its obligations on existing exploration (or joint venture) properties. Failure to obtain financing could result in the delay or indefinite postponement of further exploration and the possible partial or total loss of interest in certain properties.

The Company is dependent on raising funds by the issuance of shares or disposing of interests in its mineral properties (by options, joint ventures or outright sale) in order to finance further acquisitions, undertake exploration and development of mineral properties and meet general and administrative expenses in the immediate and long term. There can be no assurance that the Company will be successful in securing the required financing.

The Company had working capital at June 30, 2006 of \$714,105 (at Dec. 31, 2005 – \$224,048). The Company had no material income from operations.

As at June 30, 2006, the Company had no long-term debt.

For the six-month period ended June 30, 2006, the Company experienced positive cash flow of \$485,450 (six months 2005 – negative \$292,220) from operating, investing and financing activities. This included cash used in operating activities of \$153,863 (six months 2005 - \$207,712) and net cash used in investing activities of \$170,903 (six months 2005 - \$84,508).

In March 2006, 800,000 incentive stock options were granted to directors, officers and consultants of the Company, enabling the holders to acquire 800,000 common share of the Company at a price of \$0.20 per share.

## **Other Information and Disclosures**

### ***Related Party Transactions***

During the six-month period ended June 30, 2006 the Company paid or accrued a total of \$60,655 (six months 2005 - \$47,369) to related parties covering Directors' and management fees and geological and legal services and share issue costs.

### ***Off-Balance Sheet Arrangements***

The Company does not have any off-balance sheet arrangements and does not contemplate such arrangements in the foreseeable future. There are no contingent liabilities.

### ***Critical Accounting Estimates***

The preparation of financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities, the disclosure of commitments and contingencies at the date of the financial statements, and the reported amount of revenue and expenses during the period. The most significant accounting estimates for the Company relate to the carrying value of its mineral property assets and accounting for stock-based compensation. The Company's accounting policies are set out in full in note 2 to the consolidated audited financial statements.

### ***Mineral Property Costs***

The Company is in the exploration stage and defers all expenditures related to its mineral properties until such time as the properties are put into commercial production, sold or abandoned. Under this method, all amounts shown as mineral properties represent costs incurred to date less amounts amortized and/or written off and do not necessarily represent present or future values.

If the properties are put into commercial production, the expenditures will be depleted based upon the proven reserves available. If the properties are sold or abandoned, the expenditures will be charged to operations. The Company does not accrue the estimated future costs of maintaining in good standing its mineral properties.

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In the event that reserves are determined, the carrying values of mineral interests, on a property-by-property basis, will be reviewed by management at least annually to determine if they have become impaired. If impairment is deemed to exist, the mineral property will be written down to its net recoverable value. The ultimate recoverability of the amounts capitalized for the mineral properties is dependent upon the delineation of economically recoverable ore reserves, the Company's ability to obtain the necessary financing to complete their development and realize profitable production or proceeds from the disposition thereof. Management's estimates of recoverability of the Company's investment in various projects have been based on current conditions. However, it is reasonably possible that changes could occur in the near term which could adversely affect management's estimates and may result in future write-downs of capitalized property carrying values.

From time to time, the Company may acquire or dispose of properties pursuant to the terms of option agreements. Due to the fact that options are exercisable entirely at the discretion of the optionee, the amounts payable or receivable are not recorded. Option payments are recorded as mineral property costs or recoveries when the payments are made or received.

*Stock-based Compensation*

The fair value of stock options is determined by the Black-Scholes option pricing model, which require the input of highly subjective assumptions, including the expected price volatility of the Company's common shares and the expected life of the options. Changes in the subjective input assumptions can materially affect the fair value estimate, and therefore, the model does not necessarily provide a reliable single measure of the fair value of the Company's stock options granted/vested during the year.

**New Accounting Pronouncements**

*Variable Interest Entities*

The CICA has issued Accounting Guideline 15, "Consolidation of Variable Interest Entities", which became effective for annual and interim periods beginning on or after November 1, 2004. This guideline addresses the application of consolidation principles to entities that are subject to control on a basis other than ownership of voting interests. The Company adopted the guideline on January 1, 2005. The adoption of this guideline did not have any impact on the Company's consolidated financial statements.

**Financial Instruments**

The Company's financial instruments consist of cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities. It is management's opinion that the Company is not exposed to significant interest, currency or credit risks arising from its cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities. The fair value of these financial instruments approximates their carrying value due to their short-term maturity.

**Outstanding Share Data as at June 30, 2006**

- (a) Authorized and issued shares as at June 30, 2006 are as follows:

| <b>Class</b> | <b>Par Value</b>  | <b>Authorized</b> | <b>Issued</b> | <b>Amount</b> |
|--------------|-------------------|-------------------|---------------|---------------|
| Common       | Without par value | Unlimited         | 21,735,342    | \$6,572,264   |

- (b) As at June 30, 2006, a total of 1,700,000 incentive stock options were outstanding of which 1,025,000 incentive stock options were exercisable.

|  | <b>Number of Shares</b> | <b>Exercise Price</b> | <b>Expiry Date</b> |
|--|-------------------------|-----------------------|--------------------|
|  | 100,000                 | 0.23                  | April 17, 2007     |
|  | 650,000                 | 0.26                  | November 6, 2008   |
|  | 150,000                 | 0.10                  | August 31, 2010    |
|  | 800,000                 | 0.20                  | March 15, 2011     |
|  | <b>1,700,000</b>        |                       |                    |

- (c) No shares are subject to escrow or pooling arrangements.

### ***Investor Relations***

The Company maintains a website, [www.canasil.com](http://www.canasil.com), with detailed corporate information and information covering its mineral exploration projects and operations. The Company exhibited at the Vancouver Resource Investment Conference and the Vancouver Exploration Roundup in January 2006. The Company exhibited at the Prospectors and Developers Association of Canada Conference in Toronto in March 2006, at the Calgary Resource Investment Conference in April 2006, and at the World Gold, PGM & Diamond Investment Conference in Vancouver in June 2006. During the six-month period investor relations expenditures were \$28,349 (six months 2005 - \$17,669).

### ***Recent Developments***

In July and August 2006, the Company has completed a geological mapping program (undertaken by Dr. Andre Panteleyev) on the Brenda gold-copper project in British Columbia, Canada, a prospecting and sampling program at the Los Azules project in Sinaloa, Mexico, and has started the diamond drill program at the La Esperanza project in Zacatecas, Mexico. The Company has also arranged for and completed field visits by Dr. Peter Christopher on the La Esperanza, Sandra, Colibri, Salamandra, and Los Azules projects for the preparation of 43-101 qualifying and summary reports.

### ***General Conditions Affecting the Company's Operations***

#### *General Trends*

The principal business of the Company is the acquisition, exploration and, if warranted, development of natural resource properties of merit. The Company is not geographically limited to any particular region but in recent years has focused attention on natural resource properties in Canada and Mexico.

There has been a trend towards improving base and precious metal prices over the past year, particularly for gold, silver and copper. This trend is forecasted to continue over the coming year. The mining and minerals industry is experiencing increased demand for minerals and metals, in particular from economic growth in Asia. This has resulted in greater interest from the financial community in financing mineral exploration and development projects

#### *Competitive Conditions*

Significant competition exists for natural resource acquisition opportunities. As a result the Company may be unable to acquire rights to exploit additional attractive mining properties on terms it considers acceptable

#### *Environmental Protection*

Environmental legislation is evolving in a manner such that standards, enforcement, fines, and penalties for non-compliance are becoming stricter. Environmental assessments of proposed projects carry a heightened degree of responsibility for companies and directors, officers and employees. The cost of compliance with changes in government regulations has the potential to reduce the profitability of future operations. To the Company's knowledge, it is in compliance with all environmental laws and regulations affecting its operations.

#### *Number of Employees*

As of June 30, 2006, the Company had no employees. All administrative and certain geological services are provided to the Company by consultants or companies controlled by related parties.

### ***Risk Factors Relating to the Company's Business***

The Company's ability to generate revenue and profit from its natural resource properties, or any other resource property it may acquire, is dependent upon a number of factors, including, without limitation, the following:

#### *Precious and Base Metal Price Fluctuations*

The Company's ability to finance its mineral property acquisition, exploration and eventual development is dependent upon the market price of certain precious and base metals. The price of such metals has fluctuated widely and is affected by numerous economic and political factors, consumption patterns, speculative activities, levels of supply and demand, increased production due to new mine developments and productivity, metal substitutes and stock levels. These fluctuations may result in the Company not receiving an adequate return on invested capital or the investment retaining its value.

#### *Operating Hazards and Risks*

Mining operations generally involve a high degree of risk, which even a combination of experience, knowledge and careful evaluation may not be able to overcome. Operations in which the Company has a direct or indirect interest will be subject to all the hazards, risks and liabilities normally incidental to exploration, development and production of precious and base metals. The Company presently carries no liability insurance, and any liabilities arising from its operations may have a material, adverse effect on the Company's financial position.

#### *Exploration and Development*

There is no known body of commercial ore on the Company's mineral properties. Development of the Company's properties will only follow upon obtaining satisfactory exploration results. Mineral exploration and development involves a high degree of risk and few exploration properties are ultimately developed into producing mines. There is no assurance that the Company's mineral exploration and development activities will result in any commercially viable discoveries.

Substantial expenditures are required to establish reserves through drilling, to develop metallurgical processes and the mining and processing facilities and infrastructure at any site chosen for mining. Although substantial benefits may be derived from the discovery of a major mineralized deposit, no assurance can be given that minerals will be discovered in sufficient quantities to justify commercial operations or that the funds required for development can be obtained on a timely basis.

The marketability of any minerals acquired or discovered may be affected by numerous factors which are beyond the Company's control and which cannot be accurately predicted, such as market fluctuations, the proximity and capacity of milling facilities, mineral markets and processing equipment, and such other factors as government regulations, including regulations relating to royalties, allowable production, importing and exporting minerals and environmental protection.

#### *Calculation of Reserves and Mineralization and Precious and Base Metal Recovery*

There is a degree of uncertainty attributable to the calculation of reserves and mineralization and corresponding grades being mined or dedicated to future production. In addition, there can be no assurance that precious or other metal recoveries in small-scale laboratory tests will be duplicated in larger scale tests under on-site conditions or during production.

#### *Government Regulation*

Operations, development and exploration on the Company's properties are affected to varying degrees by government regulations relating to such matters as environmental protection, health, safety and labour; mining law reform; restrictions on production; price controls; tax increases; maintenance of claims; tenure; and expropriation of property. There is no assurance that future changes in such regulation, if any, will not adversely affect the Company's operations.

#### *Environmental Factors*

All phases of the Company's operations are subject to environmental regulation in the various jurisdictions in which it operates. Environmental legislation is evolving and requires stricter standards and enforcement, increased fines and penalties for non-compliance, more stringent assessments of proposed projects and a heightened degree of responsibility for companies and their officers, directors and employees. There is no assurance that future changes in environmental regulation will not adversely affect the Company's operations. Environmental hazards may exist on the Company's properties, which are unknown to the Company at present and which have been caused by previous or existing owners or operators of the properties.

#### *Title to Assets*

Although the Company has or will receive title opinions for any properties in which it has a material interest, there is no guarantee that title to such properties will not be challenged or impugned. The Company has not conducted surveys of the claims in which it holds direct or indirect interests and therefore, the precise area and location of such claims may be in doubt. The Company's claims may be subject to prior unregistered agreements or transfers or native land claims and title may be affected by undetected defects.

#### *Foreign Operations*

The Company operates in Mexico and has acquired four mineral properties, through staking, and has option agreements to acquire interests in two other mineral properties. The Company is currently engaged in exploration activities on these properties.

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MANAGEMENT'S DISCUSSION AND ANALYSIS  
For the Six Months and Quarter ended June 30, 2006

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*Management and Directors*

The Company is dependent on a small number of directors and officers: Alvin Jackson, Michael McInnis, Gary Nordin, Bahman Yamini, Iain MacPhail, and Graham Scott. The loss of any of these persons could have an adverse effect on the Company. The Company does not maintain key person insurance on any of its management.

*Conflicts of Interest*

Certain officers and directors of the Company are officers and/or directors of other natural resource companies that acquire interest in mineral properties. Such associations may give rise to conflicts of interest from time to time. The directors are required by law to act honestly and in good faith with a view to the best interests of the Company and its shareholders. They are also required to disclose any personal interest in any material transaction, which is proposed to be entered into with the Company, and to abstain from voting as a director for the approval of any such transaction.

*Limited Operating History - Losses*

The Company has experienced losses in all years of its operations. There can be no assurance that the Company will operate profitably in the future. As of June 30, 2006, the Company's accumulated deficit was \$4,314,240.

*Price Fluctuations and Share Price Volatility*

In recent years the securities markets in the United States and Canada have experienced a high level of price and volume volatility. The market price of securities of many mineral exploration companies have experienced wide fluctuations in price, which has not necessarily been related to their operating performance, underlying asset value or prospects. During the twelve months ended June 30, 2006, the price of the Company's shares fluctuated from a low of \$0.06 to a high of \$0.42 per share. There can be no assurance that continued fluctuations in price will not occur.

*Shares Reserved for Future Issuance - Dilution*

As at June 30, 2006, a total of 21,735,342 common shares of the Company were issued and outstanding. There were 1,700,000 stock options outstanding pursuant to which additional common shares may be issued in the future, which would result in further dilution to the Company's shareholders and pose a dilutive risk to potential shareholders.

**Forward-Looking Statements**

Any statements in this discussion, other than statements of historical facts, that address future production, reserve potential, exploration 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. Actual results and 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, exploration results, availability of capital and financing, and general economic, market and business conditions.

**Corporate Disclosures**

The Company maintains a system of internal controls to provide reasonable assurance that assets are safeguarded and financial information is accurate and reliable. The Board of Directors has responsibility for developing and implementing the Company's approach to governance issues. Committees of the Board presently consist of an Audit Committee and a Management Compensation Committee. The Audit Committee consists of two unrelated, outside directors and one related director. The role of the audit committee is to oversee the Company's financial reporting obligations, systems and disclosure and to act as a liaison between the Board and the Company's auditors. The Board has also appointed a Management Compensation Committee that consists of three unrelated outside directors. The role of the Management Compensation Committee is to determine the remuneration of executive officers and to administer the Company's Stock Option Plan.

**Approval**

The Board of Directors of the Company has approved the disclosure contained in this annual MD&A.

A copy of this MD&A and previously published financial statements and MD&A, as well as other information is available on the SEDAR website at [www.sedar.com](http://www.sedar.com), and on the Company's website at [www.canasil.com](http://www.canasil.com)