

**Shear Minerals Ltd.**  
(a development stage company)

Consolidated Financial Statements  
**November 30, 2005 and 2004**

February 24, 2006

## **Auditors' Report**

### **To the Shareholders of Shear Minerals Ltd.**

We have audited the consolidated balance sheets of **Shear Minerals Ltd.** as at November 30, 2005 and 2004 and the consolidated statements of loss and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the company as at November 30, 2005 and 2004 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

**(Signed) "PricewaterhouseCoopers LLP"**

**Chartered Accountants**

Edmonton, Alberta

**Shear Minerals Ltd.**  
Consolidated Balance Sheets  
As at November 30, 2005 and 2004

	2005 \$	2004 \$
<b>Assets</b>		
<b>Current assets</b>		
Cash and cash equivalents	558,328	7,298,222
Restricted cash (note 4)	1,113,714	-
Short-term investments – market value \$72,883 (2004 – \$160,238)	72,483	129,330
Accounts receivable	319,200	540,225
Operator recoveries	187,854	189,246
Prepaid expenses	25,921	41,516
	<u>2,277,500</u>	<u>8,198,539</u>
<b>Equipment</b> (note 5)	78,816	28,227
<b>Mineral properties</b> (note 6)	<u>12,506,998</u>	<u>9,062,670</u>
	<u>14,863,314</u>	<u>17,289,436</u>
<b>Liabilities</b>		
<b>Current liabilities</b>		
Accounts payable and accruals	326,621	1,607,177
Deposits from exploration partners	635,933	681,531
	<u>962,554</u>	<u>2,288,708</u>
<b>Future income taxes</b> (note 7)	<u>2,587,309</u>	<u>1,043,023</u>
	<u>3,549,863</u>	<u>3,331,731</u>
<b>Shareholders' Equity</b>		
<b>Share capital</b> (notes 8 and 11)	15,775,692	16,469,461
<b>Contributed surplus</b> (note 8)	1,458,825	1,320,700
<b>Deficit</b>	<u>(5,921,066)</u>	<u>(3,832,456)</u>
	<u>11,313,451</u>	<u>13,957,705</u>
	<u>14,863,314</u>	<u>17,289,436</u>

**Approved by the Board of Directors**

(Signed) "Pamela Strand"

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Director

(Signed) "David Mullen"

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Director

# Shear Minerals Ltd.

## Consolidated Statements of Loss and Deficit For the years ended November 30, 2005 and 2004

	2005 \$	2004 \$
<b>Revenue</b>		
Management fees	95,363	82,027
Interest	87,233	89,505
	<u>182,596</u>	<u>171,532</u>
<b>Expenses</b>		
General and administrative	348,706	392,109
Management fees (note 9)	195,225	221,848
Consulting fees	83,394	165,577
Professional fees	80,454	126,041
Amortization	22,049	13,385
Interest	96	116
	<u>729,924</u>	<u>919,076</u>
	(547,328)	(747,544)
<b>Write down of short-term investments</b>	(55,847)	(16,658)
<b>Write down of mineral properties</b>	(165,701)	(780,130)
<b>(Loss) gain on sale of short-term investments</b>	(350)	9,471
<b>Loss before income taxes</b>	(769,226)	(1,534,861)
<b>Future income tax recovery (note 7)</b>	57,365	270,080
<b>Net loss for the year</b>	(711,861)	(1,264,781)
<b>Deficit – Beginning of year</b>	(3,832,456)	(2,567,675)
Distribution of assets on spin off transaction (note 2)	(1,376,749)	-
<b>Deficit – End of year</b>	<u>(5,921,066)</u>	<u>(3,832,456)</u>
<b>Basic and diluted loss per share</b>	<u>0.013</u>	<u>0.026</u>
	#	#
<b>Weighted average number of shares outstanding</b>	<u>54,623,079</u>	<u>49,082,489</u>

# Shear Minerals Ltd.

## Consolidated Statements of Cash Flows

For the years ended November 30, 2005 and 2004

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	2005 \$	2004 \$
<b>Cash provided by (used in)</b>		
<b>Operating activities</b>		
Net loss for the year	(711,861)	(1,264,781)
Items not affecting cash		
Amortization	22,049	13,385
Share-based compensation	120,725	229,000
Write down of mineral properties	165,701	780,130
Write down of short-term investments	55,847	16,658
Loss (gain) on sale of short-term investments	350	(9,471)
Future income taxes	(57,365)	(270,080)
	<hr/>	<hr/>
	(404,554)	(505,159)
Net change in non-cash working capital balances relating to operating activities	<hr/>	<hr/>
	(1,088,142)	2,306,748
	<hr/>	<hr/>
	(1,492,696)	1,801,589
<b>Financing activities</b>		
Issuance of shares	175,000	7,075,625
Share issue costs	(142,219)	(383,747)
	<hr/>	<hr/>
	32,781	6,691,878
<b>Investing activities</b>		
Mineral properties		
Acquisition costs	(167,399)	(311,969)
Exploration costs	(3,926,879)	(4,237,489)
Increase in restricted cash	(1,113,714)	-
Purchase of equipment	(72,637)	(13,511)
Net proceeds from sale of short-term investments	650	18,079
	<hr/>	<hr/>
	(5,279,979)	(4,544,890)
<b>(Decrease) increase in cash and cash equivalents</b>	<hr/>	<hr/>
	(6,739,894)	3,948,577
<b>Cash and cash equivalents – Beginning of year</b>	<hr/>	<hr/>
	7,298,222	3,349,645
<b>Cash and cash equivalents – End of year</b>	<hr/>	<hr/>
	558,328	7,298,222
<b>Supplementary information</b>		
Interest received	<hr/>	<hr/>
	110,205	56,320

# Shear Minerals Ltd.

Notes to Consolidated Financial Statements  
November 30, 2005 and 2004

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## 1 Nature of operations

Shear Minerals Ltd. (the “Company” or “Shear”) is in the business of acquiring and exploring mineral properties located primarily in Canada. The Company has not yet determined whether these properties contain precious mineral reserves that are economically recoverable and the Company is not presently carrying on active exploration efforts on certain of its mineral properties. To date, the Company has not earned significant revenues and is considered to be in the development stage. The recoverability of the amounts shown for mineral properties is dependent upon the existence of economically recoverable reserves, securing and maintaining title and beneficial interest in the properties, the ability of the Company to obtain necessary financing to complete the development, and ultimately upon future profitable production or proceeds from disposition of the mineral properties. The amounts shown in note 6 represent costs to date for property acquisition (including mineral claims and permits) and exploration expenditures, and do not necessarily reflect present or future values.

## 2 Spin off transaction

On November 9, 2005, the Company completed a reorganization whereby it has distributed shares of its wholly owned subsidiary Kaminak Gold Corporation (“Kaminak”) to holders of Shear common shares. The spin off has been recorded as a distribution to shareholders at the carrying amount of net assets held by Kaminak immediately prior to the reorganization.

In connection with the transaction:

- a) Shear issued to Hunter Exploration Group (“Hunter”) an aggregate of 1,500,000 common shares of Shear (“Original Shares”) at a deemed price of \$0.43 per Original Share and warrants to acquire an additional 750,000 Original Shares at a price of \$1.50 per Original Share within one year of issuance to acquire an interest in the Hunter Properties. The tax basis of the Hunter Properties was lower than the accounting basis at the time of acquisition. This created a future tax liability of \$216,850 which has been included in the carrying value of the assets transferred to Kaminak;
- b) Shear transferred its interest in the Hunter Properties and Shear’s gold properties (Back River Gold) to Kaminak for 11,225,684 Kaminak Shares; and
- c) Shear exchanged each outstanding Original Share for one new common share of Shear and 1/5 of a common share of Kaminak. All common shares of Kaminak were distributed in this manner to Shear’s shareholders.

# Shear Minerals Ltd.

## Notes to Consolidated Financial Statements November 30, 2005 and 2004

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The aggregate carrying value of the assets transferred from the Company to Kaminak is as follows:

	\$
Mineral properties – Hunter	861,850
Mineral properties – Back River Gold	<u>514,899</u>
	<u>1,376,749</u>

### 3 Accounting policies

#### Use of estimates

These financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada. Because the precise determination of many assets, liabilities, revenues and expenses are dependent on future events, the preparation of financial statements for a period necessarily includes the use of estimates and approximations which have been made using careful judgment. Actual results could differ from those estimates. These financial statements have, in management's opinion, been properly prepared within reasonable limits of materiality and within the framework of the accounting policies summarized below.

#### Consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiary companies 4579 Nunavut Limited and 5098 Nunavut Limited.

#### Revenue recognition

Fees for project management are recorded on an accrual basis as services are provided under the respective operating agreements.

#### Cash and cash equivalents

Cash and cash equivalents are defined as amounts on deposit with banks and readily convertible guaranteed investment certificates with original maturities of less than three months.

#### Short-term investments

Short-term portfolio investments are carried at the lower of cost or market value. When an investment which was previously written down to market value has recovered in market value, a recovery of short-term investments is recorded in the statement of loss and deficit and the carrying value of the investment is adjusted accordingly, up to the maximum of its original cost.

# Shear Minerals Ltd.

Notes to Consolidated Financial Statements  
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## Equipment

Equipment is recorded at cost less accumulated amortization. Amortization is calculated using the straight-line method at 30% per annum on computer equipment and 20% per annum on field equipment. Equipment is considered to be impaired when its carrying value exceeds the total cash flows expected from its use and eventual disposition. The amount of impairment is determined as the carrying amount in excess of fair values and is charged to income in the period incurred.

## Mineral properties

Direct costs relating to the acquisition, exploration and development of mineral properties, including interest on borrowings directly related to a property, are capitalized on an area of interest basis. When the Company is the operator of a project and incurs costs on behalf of joint venture partners, these costs are periodically charged back to the partners and are recorded as operator recoveries. Operator recoveries are credited to exploration costs. Cumulative expenditures will be charged against income, through unit-of-production depletion, when properties are developed to the stage of commercial production. Where the Company's exploration commitments for an area of interest are performed under option agreements with a third party, the proceeds of any option payments under such agreements are applied to the area of interest to the extent of costs incurred. The excess, if any, is credited to operations. The impairment of mineral properties is assessed whenever changes in circumstances indicate the carrying amount may not be recoverable and the properties are written down to estimated fair value. Specifically, if the Company's work program on an area of interest has significantly changed so that it no longer has plans for future exploration, previously deferred costs related to the property are charged to operations.

## Income taxes

The asset and liability method is used for determining income taxes. Under this method, future tax assets and liabilities are recognized for the estimated tax recoverable or payable that would arise if assets and liabilities were recovered and settled at the financial statement carrying amounts. Future tax assets and liabilities are measured using substantively enacted tax rates expected to apply to taxable income in the years in which temporary differences are expected to be recovered or settled. Changes to these balances are recognized in income in the period in which they occur. The amount of future income tax assets recognized is limited to the amount that is more likely than not to be realized.

## Flow-through common shares

The Company credits the proceeds of flow-through common shares, which transfer the deductibility of exploration expenses to the investor, to share capital. A future income tax liability is recorded and share capital is reduced by the cost of future income taxes when the Company files the renouncement documents to renounce the tax credits to the holders of these shares.

# Shear Minerals Ltd.

Notes to Consolidated Financial Statements  
November 30, 2005 and 2004

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## Share-based compensation

The Company grants share options to executive officers, directors and certain consultants pursuant to a share option plan. In addition, from time to time in connection with short form offerings and private placements, the Company issues warrants to agents as commission for services. Awards of share options are accounted for in accordance with the fair value method of accounting for stock-based compensation and result in compensation expense and a credit to contributed surplus when share options are granted. Awards of warrants to agents are also accounted for using the fair value method and result in share issue costs and a credit to contributed surplus when the warrants are issued. Any consideration paid on exercise of share options is credited to share capital.

## Loss per share

Loss per share is calculated using the weighted average number of shares outstanding during the year. Diluted loss per share is calculated using the treasury stock method. Under the treasury stock method, deemed proceeds from the exercise of options and warrants whose exercise prices are below the average market price of the shares are considered to be used to reacquire common shares at the average market price during the year.

## Joint interest options

Certain of the Company's exploration activities are conducted jointly with others. These financial statements reflect only the Company's proportionate interest in such activities.

## Comparative amounts

Certain comparative amounts have been reclassified to conform to the current year presentation.

## Change in accounting policy – asset retirement obligations

Effective December 1, 2004, the Company adopted the new Canadian Institute of Chartered Accountants' Handbook Section 3110, Asset Retirement Obligations. This standard requires liability recognition for retirement obligations associated with long-lived assets, including the abandonment of mineral properties and returning properties to their original conditions. Asset retirement costs must be recognized at fair value in the period incurred, along with a corresponding increase in the carrying value of the related long-lived asset. The liability is subsequently adjusted for the passage of time and recognized as an accretion expense in the statement of loss and deficit. The increase in the carrying value of the asset is amortized on the same basis as the related long-term asset. This change in accounting policy had no effect on the Company's current or prior year financial statements.

# Shear Minerals Ltd.

Notes to Consolidated Financial Statements  
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## Variable interest entities

Effective December 1, 2004, the Company adopted Accounting Guideline 15 "Consolidation of Variable Interest Entities ("VIE"). This guideline requires the consolidation of VIE's by the primary beneficiary: the enterprise that will absorb or receive the majority of the VIE's expected losses, expected residual returns, or both. The adoption of this new standard had no effect on the consolidated financial statements as the Company does not have any VIE's.

## 4 Restricted cash

The Company has provided a guaranteed investment certificate ("GIC") in the amount of \$1,071,714 to secure an irrevocable letter of credit in favour of the Receiver General of Canada. The letter of credit is required to maintain prospecting permits at the Churchill Diamond Project, and expires on June 1, 2006. The funds will be released when the assessment reports of the work completed are filed and approved. \$42,000 in additional GIC's have been provided to secure other letters of credit in support of the Company's exploration activities.

## 5 Equipment

	<b>2005</b>		
	<b>Cost</b>	<b>Accumulated</b>	<b>Net</b>
	<b>\$</b>	<b>amortization</b>	<b>\$</b>
		<b>\$</b>	
Field equipment	92,943	30,867	62,076
Computer equipment	28,909	12,169	16,740
	<u>121,852</u>	<u>43,036</u>	<u>78,816</u>
	<b>2004</b>		
	<b>Cost</b>	<b>Accumulated</b>	<b>Net</b>
	<b>\$</b>	<b>amortization</b>	<b>\$</b>
		<b>\$</b>	
Field equipment	29,405	18,632	10,773
Computer equipment	36,432	18,978	17,454
	<u>65,837</u>	<u>37,610</u>	<u>28,227</u>

# Shear Minerals Ltd.

Notes to Consolidated Financial Statements  
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## 6 Mineral properties

				2005	2004
	Percentage ownership interest %	Acquisition costs \$	Exploration costs \$	Net carrying amount \$	Net carrying amount \$
Northwest and Nunavut Territories					
Churchill Diamond Project	51.00	991,711	8,697,719	9,689,430	6,397,415
Aylmer Lake West	62.40	135,937	730,363	866,300	850,758
XYZ	80.00	160,956	440,441	601,397	546,935
Afridi Lake	58.20	102,222	418,766	520,988	456,452
Back River Gold	-	-	-	-	430,603
Aylmer Lake/Afridi East	100.00	-	-	-	164,977
Hecla	100.00	63,385	184,796	248,181	49,155
Churchill West	22.95	57,111	177,418	234,529	7,904
Alaska					
Shulin Lake	9.20	3,821	229,860	233,681	144,000
Alberta					
Piche	*51.00	5,540	874	6,414	-
Liege	*51.00	11,848	-	11,848	-
Other	100.00	2,016	92,214	94,230	14,471
		<u>1,534,547</u>	<u>10,972,451</u>	<u>12,506,998</u>	<u>9,062,670</u>

\*In the process of earning into an ownership interest through completion of terms in option agreements (see below).

During 2005, the Company wrote off the carrying amounts related to the Aylmer Lake/Afridi East property as the Company has no current plans for further exploration on this property.

During 2004, the Company wrote off the carrying amounts related to the OBED-Edson, Elektra, Hippogrif, and Coronation properties as the Company has no current plans for further exploration on these properties.

### Contractual options and commitments

#### a) Churchill Diamond Project

The Company is currently exploring the Churchill Diamond Project with Stornoway Diamond Corp. ("Stornoway") and BHP Billiton Diamonds Inc. ("BHPB") where the Company holds a 51% interest, and Stornoway and BHPB have 35% and 14% interest, respectively in the diamond rights to the property. The property is subject to a 2.0% gross overriding royalty and net smelter royalty in favour of the Hunter Exploration Group ("Hunter") with respect to the commercial production of diamonds.

# Shear Minerals Ltd.

## Notes to Consolidated Financial Statements November 30, 2005 and 2004

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On May 30, 2003, the Company entered into an agreement with BHPB whereby BHPB will fund the entire cost to collect, sample and process the initial 200 tonnes of kimberlitic material from the Churchill Property and sign a standstill agreement for a four year period whereby BHPB is prohibited from participating in a takeover bid, merger, or acquisition of more than 10% of the voting securities of Shear.

Shear is the operator of the project.

b) Aylmer Lake West

This project operates under a joint venture agreement with Diamondex Resources Ltd. Shear is obligated to pay a 3.5% gross underlying royalty on production from the property.

c) XYZ

This project operates under a joint venture agreement with Hunter. Hunter retains a 2.0% net smelter royalty on non-diamond production as well as a 2.0% gross overriding royalty on diamond production from the property. Shear is required to pay Hunter a \$10,000 annual advance royalty payment which increases to \$25,000 annually commencing June 30, 2008.

d) Afridi Lake

This project operates under a joint venture agreement with International Samuel Exploration Corporation ("Samuel"), New World Resource Corp. ("New World" – formerly Dasher Energy Corp.) and Mantle Resources Inc. ("Mantle"). Shear currently holds 58.2% interest in the property and Samuel, New World and Mantle have 25.4%, 8.2% and 8.2%, respectively.

The Company is obligated to issue 100,000 of its common shares to Mantle for each diamondiferous kimberlite discovered on the property, to a maximum of three kimberlites. The Company is also obligated to pay a 5% gross overriding royalty and net smelter fee on production of the property.

e) Back River Gold

The Back River Gold property is an amalgamation of the Bathurst, BR and Needle gold properties.

The Back River Gold property was spun out into Kaminak Gold Corporation on November 9, 2005 (see note 2).

f) Hecla

Shear has agreed to issue an aggregate of 200,000 common shares as a finder's fee upon the following milestones being achieved: 25,000 shares upon the successful acquisition of the land (completed); 75,000 shares upon the discovery of a kimberlite; and 100,000 shares upon the discovery of one or more diamonds per kilogram in any 25 kilogram sample of kimberlite.

# Shear Minerals Ltd.

## Notes to Consolidated Financial Statements November 30, 2005 and 2004

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In addition, Shear has granted a 2% gross overriding royalty fee, of which 1% can be purchased by Shear for \$1.5 million.

g) Churchill West

The Company is currently exploring the Churchill West project with Samuel, Stornoway and BHPB where the Company holds a 22.95% interest, and Samuel, Stornoway and BHPB have interests of 55.00%, 15.75% and 6.3%, respectively in the diamond rights to the property. The property is subject to a 2.0% gross overriding royalty and net smelter royalty in favour of Hunter with respect to the commercial production of diamonds. Hunter currently holds the non-diamond rights to the property although Shear and Stornoway have a joint right of refusal on these rights.

h) Shulin Lake

During 2003 and 2004, the Company allowed its vested interest in the Shulin Lake project to become diluted to 12%, then 9.2% by not participating in the fall 2003 and fall 2004 exploration programs. However, due to positive exploration results, the Company did participate in the winter 2004 drilling program, maintaining their interest at 9.2%.

If the Company decides not to participate in future exploration costs, this interest will be diluted on a pro-rata basis to a minimum 4% profit interest.

i) Piche

On November 16, 2005, the Company acquired an option on the Piche Lake Property in north central Alberta. Under the terms of the agreement Shear can earn into an initial 51% by incurring a total of \$500,000 of exploration expenditures over two years inclusive of \$100,000 in exploration within the first year. In addition, Shear has the ability to earn an additional 24% in the property by spending an additional \$1 million in exploration expenditures over two years after earning 51%.

j) Liege

On November 30, 2005, the Company acquired a farm-out agreement on a significant land position in north central Alberta for diamond exploration. The property, known as the Liege Diamond Project, was acquired from a Canadian oil and natural gas exploration, development and production company. Under the terms of the agreement, Shear can earn into an initial 51% interest by incurring a total of \$1,000,000 of exploration expenditures over three years inclusive of \$325,000 in exploration within the first year. A \$10,000 cash finder's fee was paid by Shear under the terms of the agreement.

# Shear Minerals Ltd.

Notes to Consolidated Financial Statements  
November 30, 2005 and 2004

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## 7 Income taxes

The income tax provision differs from the amount computed by applying the statutory rates to pre-tax income as a result of the following:

	2005 \$	2004 \$
Income tax recovery expected based on a combined federal and provincial (territorial) tax rate of 37.71% (2004 – 39.04%)	290,075	599,210
Increase (decrease) in recovery resulting from		
Impact of tax rate changes	(6,791)	(34,482)
Unrecognized deductible temporary differences	(180,394)	(205,246)
Share-based compensation	(45,525)	(89,402)
	<u>57,365</u>	<u>270,080</u>

The future income tax assets and liabilities comprise the following temporary differences:

	2005 \$	2004 \$
Non-capital losses	885,037	774,608
Deductible finance fees	211,324	254,887
Equipment	21,674	14,686
Valuation allowance	(1,118,035)	(1,044,181)
Future income tax assets	-	-
Mineral properties	(2,587,309)	(1,043,023)
Future income tax liabilities	<u>(2,587,309)</u>	<u>(1,043,023)</u>

The Company has incurred the following non-capital losses for tax purposes, which have not been recognized as future income tax assets:

	Non-capital loss \$	Expiry date
November 30, 2000	224,238	2007
2001	197,042	2008
2002	292,721	2009
2003	656,382	2010
2004	774,737	2014
2005	487,351	2015
	<u>2,632,471</u>	

# Shear Minerals Ltd.

Notes to Consolidated Financial Statements  
November 30, 2005 and 2004

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## 8 Share capital and contributed surplus

### Common shares

#### Authorized

Unlimited number of common shares  
Unlimited number of preferred shares

#### Issued and issuable

	2005		2004	
	Common shares #	Amount \$	Common shares #	Amount \$
Balance – Beginning of year	53,903,421	16,469,461	42,747,532	10,687,686
Shares issued for cash	-	-	6,037,014	5,000,000
Share options exercised	700,000	175,000	-	-
Warrants exercised	-	-	5,018,875	2,075,625
Shares issued for other consideration	1,525,000	658,250	100,000	73,000
Redemption of Original Shares (note 2)	(56,128,421)	-	-	-
Issuance of new shares (note 2)	56,128,421	-	-	-
Share issue costs	-	(142,219)	-	(453,747)
Future income taxes	-	(1,384,800)	-	(913,103)
Balance – End of year	56,128,421	15,775,692	53,903,421	16,469,461

During 2005, the Company issued 1,500,000 common shares to acquire the Hunter properties as described in note 2.

During 2005, the Company issued 25,000 (2004 – 100,000) shares at a deemed value of \$13,250 (2004 – \$73,000) to acquire and satisfy contractual obligations for mineral properties.

On June 8, 2004, the Company issued 1,037,014 units in a non-brokered sale to BHPB at a price of \$0.9643 per unit for gross proceeds of \$1,000,000. Each unit consisted of one common share and one common share purchase warrant. Each whole warrant entitles the holder to purchase one common share at \$1.21 up to June 2005.

On July 12, 2004, the Company issued 5,000,000 flow-through common shares in a private placement at a price of \$0.80 per share for gross proceeds of \$4,000,000. The Company will be required to incur \$4,000,000 of qualifying expenditures to be renounced to the holders of the flow-through shares. In addition, agents received 398,000 warrants as commission at an exercise price of \$0.80 per common share, which expire in July 2005. Related to this, the Company recorded share-based compensation in the amount of \$70,000 as a share issue cost.

# Shear Minerals Ltd.

## Notes to Consolidated Financial Statements

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During 2005, the Company renounced \$4,000,000 (2004 - \$2,637,500) of qualifying expenditures to holders of flow-through shares, resulting in future income taxes of \$1,384,800 (2004 - \$913,103) which is reflected as a cost of issuing flow through shares.

### Share options

The Company has a share option plan for the benefit of directors, management and certain consultants of the Company. Under the plan, the Company may grant options for up to 10% of the issued common shares. The exercise price of each option may be discounted up to 25% from the market price of the Company's common shares on the date of grant and an option's maximum term is five years.

The following table summarizes activity related to share options:

	<b>2005</b>		<b>2004</b>	
	<b>Number of options outstanding #</b>	<b>Weighted average exercise price \$</b>	<b>Number of options outstanding #</b>	<b>Weighted average exercise price \$</b>
Balance – Beginning of year	4,450,000	0.55	3,870,000	0.51
Granted	1,525,000	0.40	580,000	0.82
Exercised	(700,000)	0.25	-	-
Balance – End of year	<u>5,275,000</u>	<u>0.55</u>	<u>4,450,000</u>	<u>0.55</u>

The following table summarizes information about the Company's share options outstanding:

	<b>2005</b>			<b>2004</b>		
<b>Number of options outstanding #</b>	<b>Weighted average exercise price \$</b>	<b>Weighted average remaining contractual life Years</b>	<b>Number of options outstanding #</b>	<b>Weighted average exercise price \$</b>	<b>Weighted average remaining contractual life Years</b>	
400,000	0.25	0.6	1,100,000	0.25	0.7	
311,000	0.21	1.3	311,000	0.21	2.3	
734,000	0.26	2.2	734,000	0.26	3.2	
1,725,000	0.84	2.8	1,725,000	0.84	3.8	
530,000	0.83	3.2	530,000	0.83	4.2	
50,000	0.75	3.8	50,000	0.75	4.8	
1,475,000	0.40	4.2	-	-	-	
50,000	0.41	4.4	-	-	-	
<u>5,275,000</u>	<u>0.55</u>	<u>2.9</u>	<u>4,450,000</u>	<u>0.55</u>	<u>2.9</u>	

# Shear Minerals Ltd.

## Notes to Consolidated Financial Statements November 30, 2005 and 2004

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5,175,000 of the share options outstanding were exercisable at November 30, 2005.

The Company has recorded share-based compensation and contributed surplus in the amount of \$138,125 (2004 – \$229,000) related to the 1,525,000 (2004 – 580,000) options granted in the year. The share based compensation was charged to general and administrative expenses (2005 – \$2,175; 2004 – \$nil); management fees (2005 – \$102,225; 2004 – \$139,848); consulting fees (2005 – \$16,325; 2004 – \$78,869); professional fees (2005 – \$nil; 2004 – \$10,283) and the Churchill mineral property (2005 – \$17,400; 2004 – \$nil). The compensation expense has been determined based on the fair value of the options at the grant date. The fair value of each share option granted is estimated on the date of granting the options using the Black-Scholes option-pricing model with the following weighted average assumptions:

	<b>2005</b>	<b>2004</b>
Risk-free rate	2.5%	2.5%
Expected volatility	57.0%	104.0%
Annual dividend yield	0.0%	0.0%
Expected life of options	1.0 year	1.5 years

Option pricing models require the input of highly subjective assumptions including the expected price volatility of the Company's common shares. Changes in the subjective input assumptions can materially affect the fair value estimate, and therefore, the existing models do not necessarily provide a reliable measure of the fair value of the Company's share options.

The following table summarizes the weighted average grant date fair value of options granted during 2005 and 2004:

	<b>2005</b>		<b>2004</b>	
	<b>Weighted average exercise price \$</b>	<b>Weighted average grant date fair value of options \$</b>	<b>Weighted average exercise price \$</b>	<b>Weighted average grant date fair value of options \$</b>
Market price of shares at grant date equal to option exercise price	0.40	0.09	0.82	0.39

# Shear Minerals Ltd.

Notes to Consolidated Financial Statements  
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## Warrants

The following table summarizes activity related to warrants:

	2005		2004	
	Number of warrants #	Weighted average exercise price \$	Number of warrants #	Weighted average exercise price \$
Balance – Beginning of year	1,435,014	1.10	7,741,876	0.59
Issued	750,000	1.50	1,435,014	1.10
Expired	(1,435,014)	1.10	(2,723,001)	0.90
Exercised for shares	-	-	(5,018,875)	0.41
Balance – End of year	<u>750,000</u>	<u>1.50</u>	<u>1,435,014</u>	<u>1.10</u>

The Company has recorded share issue costs in the amount of \$70,000 relating to warrants issued to agents in lieu of cash compensation relating to the private placement during 2004. The warrants vested four months from the issue date, and the fair values were calculated using the Black-Scholes option pricing model with the following weighted average assumptions:

	2004
Risk-free rate	2.5%
Expected volatility	72.0%
Annual dividend yield	0.0%
Expected life of warrants	1 year

Warrants issued in 2005 had a fair value of \$nil.

## Contributed surplus

The following table summarizes activity related to contributed surplus:

	2005	2004
	\$	\$
Balance – Beginning of year	1,320,700	1,021,700
Value of share options granted	138,125	229,000
Value of agent warrants issued	-	70,000
Balance – End of year	<u>1,458,825</u>	<u>1,320,700</u>

# Shear Minerals Ltd.

Notes to Consolidated Financial Statements  
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## 9 Related party transactions

During 2005, the Company incurred management fees of \$119,100 (2004 – \$116,962) to Encore Resources Inc., a company in which certain directors and officers of the Company have significant influence. In the opinion of management, these fees are considered to be at market value.

Shear Minerals Ltd. is currently participating in a joint venture at the Shulin Lake Property. One of the partners is Shulin Lake Mining, a private company in which a director of Shear Minerals Ltd. has a 50% ownership position.

## 10 Financial instruments

The Company's financial instruments recognized in the balance sheet consist of cash and cash equivalents, restricted cash, short-term investments, accounts receivable, operator recoveries, accounts payable and accruals, and deposits from exploration partners. The Company has no unrecognized financial instruments.

The fair value of short-term investments is determined by the trading price of the shares at the balance sheet date. The estimated fair market values of the other financial instruments approximate their carrying values due to their short-term maturities.

Operator recoveries are due from companies which operate in the mining exploration industry and accordingly, are subject to the risks associated with this industry. All of the operator recoveries are due from three companies.

## 11 Subsequent events

On December 30, 2005, the Company closed a non-brokered private placement of an aggregate of 4,832,664 flow-through common shares at a price of \$0.30 per flow-through share for aggregate proceeds of \$1,449,800. In connection with the private placement, the Company issued non-transferable share purchase warrants to acquire an aggregate of 318,441 common shares of Shear. The warrants are exercisable at a price of \$0.30 within one year of issuance and will result in share issuance costs of \$24,185.

