

## MANAGEMENT'S DISCUSSION AND ANALYSIS

(All dollar amounts are expressed in thousands of United States dollars unless otherwise stated)

Management's discussion and analysis ("MD&A") provides a detailed discussion of Uruguay Mineral Exploration Inc ("the Company") financial and operating results for the year ended 31 May 2006, with comparisons to the previous years. This MD&A should be read in conjunction with the consolidated financial statements and accompanying notes.

The Company's most recent filings are available from the System for Electronic Document Analysis and Retrieval ("SEDAR") and can be assessed through the internet at [www.sedar.com](http://www.sedar.com). The document is presented as at August 23, 2006

### GENERAL

Uruguay Mineral Exploration Inc is a gold producer and exploration company incorporated in Canada and operating in Uruguay. The Company's common shares are listed on the Toronto Venture Stock Exchange (symbol UME) and the London Alternative Investment Market (symbol UGY).

The Company operates the San Gregorio gold project in the northern Department of Rivera, Uruguay. Production for 2005/06 was 100,000 ounces of gold. The company has strategic land holdings throughout the 110 Km long Isla Crystalina Belt and has active near mine and regional exploration programs focused on increasing reserves on this belt.

Uruguay, whilst relatively unexplored, has considerable potential for further gold, nickel, copper and diamond discoveries. The Company has researched, acquired and developed a number of projects during its 9 years in Uruguay and has reached a stage where future cash flow from operations will allow testing of these projects. The company's objective is to achieve profitable growth by realizing the exploration potential of its projects.

### FINANCIAL RESULTS OVERVIEW

Highlights for the year ended 31 May 2006 include:

- Gold production of 101,287 ounces at an average cash cost of \$US 210 per ounce compared to 75,026 ounces at an average cash cost of \$US 275 in the prior year.
- Net profit after tax of \$ 10,583 or basic earnings per share of \$ .23 compared to \$ 1,510 or basic earnings per share of \$ 0.034 for 2005.
- Cash flow from operations before working capital movements was \$ 20,515 compared to \$ 4,293 in 2005.
- At 31 May 2006 the group had cash and cash equivalents of \$ 8,931 and debt of \$ 4,225.
- A new life of mine plan has been produced for Arenal. Under this plan the strip ratio for the remaining tonnes to be mined from Arenal at 1 June 2006 has increased from 3.42 under the previous mine plan to 4.75 under the new mine plan. This will increase costs over the remaining life of the Arenal pit.
- Good progress during the second half of the year occurred at Argentinita where drill intercepts show a mineralised system over a length of 700 meters. Better intersections during the past 6 months include:  
RCARG94      8 meters @ 3.66 g/t from 114 meters

RCARG114 32 meters @ 3.1g/t from 28 meters  
 RCARG94 6 meters @ 5.02 g/t. from 36 meters  
 RCARG151 6 meters @ 5.02 g/t from 98 meters  
 RCARG157 18 meters @ 2.64 from 104 meters

Further infill and extension drilling in the first half of 2006/07 is expected to allow an initial reserve for Argentinita to be completed during 2006/07. Importantly this drilling confirms the potential of the Zapucay shear where mineralization has now been demonstrated at various points over 3-4 km with a number of anomalies still to be tested.

Highlights for the quarter ended 31 May 2006 include:

- Gold production of 25,350 ounces at an average cash cost of \$US 243 per ounce compared to 24,844 ounces at an average cash cost of \$US 229 in the corresponding quarter of 2005. A number of one off costs including pit wall repairs and mill liner change out affected the final quarters costs.
- Net profit after tax of \$ 4,077 or basic earnings per share of \$ .090 per share compared to a profit of \$ 2,544 or basic earnings per share of \$ 0.056 in the corresponding quarter of 2005. The 2006 quarter included retirement and termination benefits of \$ 1,437 for Chris Clark, the President of the Company.
- Cash flow from operations before working capital movements was \$ 6,813 for the quarter.

## FINANCIAL YEAR 2005/2006 FINANCIAL RESULTS

### Operating Earnings

Net profit after tax increased from \$ 1,510 or .034 per share for 2005 to \$ 10,583 or .23 per share for 2006. The 2005 result included a tax benefit of \$610, whereas there is a tax expense of 2,643 for 2006.

The Company's operating profit increased from \$5,707 in 2005 to \$ 19,815 in 2006. These results reflect an increase in metal production from the first full year contribution from San Gregorio and an increase in the realised price of gold sold.

### Operating Revenues

For the 2006 financial year 100,395 ounces of gold were sold at an average price of \$US \$482 per ounce compared to 69,674 ounces at an average price of \$US 418 per ounce during the prior year. Silver ounces sold also increased to 97,815 in 2006 compared to 75,684 in the prior year.

Doré containing a mix of gold and silver is shipped to a refiner in Europe. While risk of loss transfers to the refiner at the mine gate, sales are recognized when precious metals are refined and sold. Refining costs are included in operating expenses.

Table 1 Operating Earnings

	2006	2005
	\$000's	\$000's
Revenue	51,206	30,563
Operating expenses	(22,014)	(20,588)
Net profit interest	(635)	(253)
Contribution margin	28,557	9,722
Amortisation	(8,742)	(4,015)
Operating profit	19,815	5,707
Other expenses	(6,589)	(4,807)
Taxes	(2,643)	610
Net earnings/(loss)	10,583	1,510
Basic earnings per share	0,23	0.034

## Production

During the year 8,085,000 tonnes were mined from the Arenal pit including 984,000 tonnes of ore at a grade of 3.03 g/t. The strip ratio on this ore was 7.11:1 compared to the life of mine strip ratio to May 31 2006 of 4.34:1. An additional 65,000 tonnes of ore were produced from other veins at a grade of 2.89 g/t.

After increasing 20% in the prior year the average monthly mill throughput for 2006 was further increased to 105,544 tonnes compared to 99,500 tonnes in 2005. The ongoing improvements result from changes in operating practices and improved mechanical availability.

Gold production increased to 101,287 ounces for 2006 compared to 75,026 ounces for the prior financial year. Grade increased with the higher percentage of Arenal ore in mill feed.

2,189,000 tonnes of waste were removed from the Santa Teresa and San Gregorio East pit for construction of the tailings dam and in anticipation of the redevelopment of these pits.

**Table 2 Key Production Statistics**

	2006	2005
Ore mined (tonnes)	1,050,000	1,165,791
Grade mined (g/t Au)	3.02	2.10
Ore processed (tonnes)	1,266,529	1,194,631
Grade processed (g/t Au)	2.65	2.06
Recovery	93.7%	95.0%
Gold produced (ounces)	101,287	75,026

## Production Costs

Total operating costs were \$ 22,014 for 2006 compared to \$ 20,588 in 2005. Waste removal costs of \$ 3,870 for 2006 were deferred for recognition in future years. This compares to \$ 568 in 2005.

The average cost per ounce produced for 2006 was \$ 210 compared to \$ 275 in 2005. Cost performance was generally in line with expectations with higher energy prices, higher consumption of consumables, pit wall slip repair all increasing costs above last years outlook target of \$200 per ounce.

## Amortization and Depletion

Amortization and depletion expense increased from \$ 4,015 in 2005 to \$ 8,742 in 2006. In November 2005 the Group acquired the 10% net profit interest in the Arenal and surrounding tenements for \$ 3,883, of which \$ 3,500 was allocated to mine properties and \$ 383 to exploration. As a result of this acquisition a cumulative adjustment for amortisation expense relating to prior periods of \$ 810 was incurred in the November quarter. This expense was offset by a gain on settlement of net profit interest of \$888 in the same quarter.

## Other Expenses and Revenues

General and administrative expenses increased from \$ 3,405 in to 2005 to \$ 3,483 in 2006. These amounts include capital and financing taxes of \$ 523 and \$ 604 for each year respectively.

Included in general and administration costs of 2006 are \$ 520 in termination and retirement benefits for Chris Clark, the retiring President of the company.

Non-cash stock-based compensation expenses, excluding termination and retirement benefits for Chris Clark, of \$ 536 was recorded for the year compared to \$ 756 in 2005. The expense relates to 890,000 employee options issued at an average exercise price of \$C 3.74 during the year. The full expense relating to these options will be amortised over 3 years.

As part of Mr Clark's termination and retirement benefits he received 421,000 employee stock options with an associated fair value of \$ 814. The unamortized expense associated with the vesting of 140,000 employee stock options previously granted to Mr Clark in September 2005 resulted in an additional charge of \$ 103. These amounts are recorded in stock compensation expense.

**Table 3 Other Revenue and Costs**

	2006	2005
	\$000's	\$000's
General and administration	3,483	3,405
Stock Compensation	1,453	756
Interest and financing costs	339	555
Other costs and revenue	1,314	91
<b>Total</b>	<b>6,589</b>	<b>4,807</b>

Interest costs were \$ 339 for 2006, including accrued interest of \$ 118 on convertible notes payable for the acquisition of the net profits interest.

Other expenses included an unrealized loss of \$ 2,138 on the fair valuation of gold derivatives at 31 May 2006 compared to \$ 180 unrealised loss for the prior financial year. This relates to 3,589 ounces, deliverable at \$ 436 per ounce and 10,000 ounces deliverable at \$ 486.5 per ounce. This loss has been calculated using the spot gold price at period end, future prices and volatilities.

A gain on settlement of net profit interest of \$ 888 has been included in other costs and revenue.

#### **Provision for income taxes**

An income tax expense of \$ 2,643 was recorded in 2006 compared to a benefit of \$ 610. The Company's statutory tax expense differs from actual tax expense as a result of the following:

- The Company used \$ 1,768 (2005 - \$ 803) in tax benefits granted to it by the Uruguayan government as a result of its investment in Arenal. These benefits are summarized at note 15 (d) to the Financial Statements. Under these benefits the company also deferred \$1,486 in tax payable until future years.
- The Company's Uruguayan subsidiaries submit tax returns in Uruguayan pesos that calculate assessable income including indexation of non-monetary assets and unrealized currency gains. Over the longer term inflation adjustments generally offset currency gains. An expense of \$ 1,841 was recorded for 2005 and a benefit of \$ 810 in 2006.

**Table 4 Tax Expense Reconciliation**

	2006	2005
	\$ 000's	\$ 000's
Statutory tax (expense)/benefit	(4,629)	(315)
Investment benefits	1,768	803
Indexation and foreign exchange	810	(1,841)
Consolidated gains on asset sales	-	3,978
Other	(592)	(2,015)
<b>Tax (expense)/benefit</b>	<b>(2,643)</b>	<b>610</b>

## FINANCIAL POSITION

### Cash and other liquid resources

At May 31, 2006, UME had cash resources of \$ 8,931 compared to \$ 5,501 at 31 May 2005. Cash flow from operations before working capital movements was \$ 20,515 for 2006 compared to \$ 4,293 for 2005. After working capital investment of \$ 2,129 in 2006 and \$ 2,169 in 2005 net cash flow from operations was \$ 18,386 for the current year compared with \$ 2,124 for the prior year. Working capital investment relates to the build up in inventories.

### Capital Expenditure

Total capital invested, for 2006 was \$ 11,575 compared to \$ 11,848 in 2005. These investments reconcile to the cash payments for property plant equipment as shown in Table 6.

Mine equipment with a value of \$ 1,755 and an exploration drill with a value of \$408 were purchased during the year. As no significant conversion of resources to reserves occurred during the year development expenditure related to definition drilling has been included in exploration expenditure. In 2005 \$ 791 was incurred on definition drilling. Mine development costs of \$ 955 were incurred in 2006. These costs relate to the removal of waste from the old San Gregorio East and Rieles pits, that had been filled by the previous operator, and pre strip at Santa Teresa. A tailings dam expansion costing \$ 1,334 was completed using waste from the pre-strip of the San Gregorio and Santa Teresa deposits. The company has purchased its office in Montevideo, Uruguay at a cost of \$ 1,224. This facility can be used to support environmental guarantees.

**Table 6 Reconciliation in movement in cost base of property plant and equipment to cash invested in purchase of property plant and equipment**

	2006	2005
	\$000's	\$000's
Montevideo office.	1,224	-
Mine fleet	1,755	8,481
Exploration fleet	408	
Mine development	955	323
Reserve definition	-	791
Tailings dam expansion	1,334	753
NPI purchase	3,500	-
Other	2,399	1,500
<b>Total Expenditure</b>	<b>11,575</b>	<b>11,848</b>
Acquisition of NPI	(3,500)	-
Financed on deferred payment terms.	(1,240)	(4,762)
Repayments of deferred finance amounts.	5,024	115
Cost of assets sold	199	-
<b>Cash invested</b>	<b>12,058</b>	<b>7,201</b>

During the year the Company sold used mine equipment and inventories for \$650. The written down value of the equipment sold was nil with inventories sold having a value of \$764.

### Recoverable value of property, plant and equipment

A review of the future cash flows expected to be generated from UME's mining operations confirmed they exceeded the carrying value of UME's mining assets.

## Exploration

UME's investment in exploration during 2006 and 2005 is presented in the Table 7. Expenditure on Isla Crystalina gold includes drilling on extensions to Arenal, San Gregorio and regional work at Argentinita. The major expenditure on base metals includes the airborne gravity and aeromagnetic surveys on Lascano and Retamosa.

Overhead costs of \$ 215 (2005 - \$120) that do not relate to specific exploration projects that were capitalized during the year and are allocated on the basis of direct expenditure on specific projects.

## Financing

On November 30 2005 the Company extended its secured \$ 2,000 secured working capital facility with Macquarie Bank Limited until September 30 2006. The guarantee facility currently expires on December 2007.

On June 15 2005 a subsidiary financed the purchase of a further \$ 1,352 in mine equipment from Komatsu Latin America Inc. All balances owing under the initial facility of \$ 6,349 were repaid as scheduled during the year and at year end \$ 863 remains to be paid on the new financing.

On November 30, 2005 a subsidiary of the Company issued three secured convertible notes with a face value of \$ 1,050 and 290,000 common shares to acquire the net profit interest described in note 8 (e) to the financial statements. The three notes are payable on or before July 30, 2006, July 30 2007 and July 30, 2008 respectively. Each convertible note can be converted into 250,000 ordinary shares during a 30 day period prior to the payment date.

On May 30 2006 two subsidiaries of the company entered into lease financing facility of \$ 500 and a letter of credit facility of \$ 750 with ABN AMRO BANK N.V. Sucursal Montevideo. The lease financing facility was drawn down to \$ 457 at May 31 2006.

## Shareholders' equity

During the 2006 financial year 1,418,667 common shares were issued for total proceeds including option and warrant value of \$ 3,287 compared to 3,242,000 common shares for \$ 9,114 in 2005. 1,076,667 employee options were exercised at \$C 1,58 per share generating cash proceeds of \$ 1,473. The Company issued 290,000 shares with a value of \$ 1,096 as initial consideration for the acquisition of the net profit interest described in note 8(e) to the financial statements and 50,850 shares with a value of \$ 240 in part payment of survey services by Bell Geospace Inc.

The Company had 2,567,333 stock options, 250,000 warrants to purchase common shares and 750,000 convertible notes outstanding at May 31, 2006. Stock options outstanding represent

**Table 7 Reconciliation in movement in cost base of exploration and development to cash invested in exploration and development**

	2006	2005
	\$000's	\$000's
Minas de Corrales	3,026	1,270
Other Gold	287	18
Base Metals	2,492	611
Diamonds	291	75
Total Expenditure	6,096	1,974
Acquisition of NPI and payment of survey with common shares	(618)	-
Cash invested	5,478	1,974

5.4% of the Company's issued common shares. As at May 31, 2006 UME had 47,524,930 shares outstanding.

At August 23, 2006 the Company had 2,893,333 stock options, 500,000 convertible notes and 48,054,930 shares outstanding. 250,000 warrants were exercised subsequent to the end of the year providing proceeds of \$C 937. The convertible note due to be paid on or before July 31 2006 was paid in cash and not converted into stock.

## REVIEW OF FOURTH QUARTER OF 2006 AND QUARTERLY RESULTS FOR 2006 AND 2005

UME's operating revenues in the fourth quarter of 2006 were \$15,992, compared to \$ 10,284 recorded in the corresponding quarter of 2005. Gold ounces sold were 27,284 ounces at a price of \$ 543 per ounce compared to 22,904 ounces at a price of \$ 422 in the corresponding quarter of 2005.

**Table 8 Quarterly Results for 2006**  
(in thousands of US\$ except where otherwise noted)

	Quarter 1 Aug 2005	Quarter 2 Nov 2005	Quarter 3 Feb 2006	Quarter 4 May 2006	Total
Gold sold (ounces)	26,049	23,832	23,230	27,284	100,395
Average sales price (\$/ounce)	432	456	510	543	486
Cash operating cost (\$/ounce)	212	182	203	243	210
Operating revenues	11,721	11,326	12,167	15,992	51,206
Net profit interest	(306)	(329)	-	-	(635)
Operating expenses	(5,760)	(4,970)	(5,289)	(5,995)	(22,014)
Operating profit	5,655	6,027	6,878	9,997	28,557
Administration expenses	(592)	(655)	(705)	(1,531)	(3,483)
Amortization and depletion	(1,749)	(2,567)	(2,181)	(2,245)	(8,742)
Interest and financing costs	(93)	(81)	(137)	(28)	(339)
Other	(183)	(643)	(1,108)	(833)	(2,767)
Income taxes	(798)	(137)	(425)	(1,283)	(2,643)
Net income for the period	2,240	1,944	2,322	4,077	10,583
Basic earnings per share	0.048	0.042	0.050	0.090	0.230
Cash flow from (used in) operations	4,548	2,794	3,599	7,445	18,386
Cash from financing activities	224	36	168	1,502	1,930
Cash invested	(2,835)	(3,925)	(6,520)	(3,606)	(16,886)
Cash on hand	7,382	6,287	3,590	8,931	8,931
Total Assets	46,635	51,918	51,963	60,008	60,008
Shareholders Equity	33,728	36,236	40,048	45,239	45,239

**Table 9 Quarterly production**

	Quarter 4 May 2005	Quarter 1 Aug 2005	Quarter 2 Nov 2005	Quarter 3 Feb 2006	Quarter 4 May 2006	2006
Ore processed (tonnes)	306,238	312,016	312,881	313,967	327,665	1,266,529
Grade processed (g/t Au)	2.67	2.63	2.71	2.68	2.51	2.65
Recovery	95.2%	95.3%	93.2%	93.90%	92.46%	93.7%
Gold produced (ounces)	24,844	25,163	25,323	25,451	25,350	101,287

During the fourth quarter, 192,000 tonnes of ore were mined from Arenal at an average grade of 3.44 g/t. 13,000 tonnes were also mined from veins at a grade of 2.91 g/t. Plant production for the quarter averaged 108,888 tonnes per month, above the average for the first 9 months of 104,318. Towards the end of the financial year, problems were encountered with respect to higher than anticipated silver values in the Arenal ore. With the plant operating above its original design capacity the elution circuit became overloaded and gold recoveries suffered by 1-2%. This problem will be corrected in the second quarter of 2006/07 with the installation of additional stripping capacity.

**Table 10 Quarterly Results for 2005**  
(in thousands of US\$ except where otherwise noted)

	Quarter 1 Aug 2004	Quarter 2 Nov 2004	Quarter 3 Feb 2005	Quarter 4 May 2005	Total
Gold sold (ounces)	14,782	14,397	17,591	22,904	69,674
Average sales price (\$/ounce)	396	422	428	422	418
Cash operating cost (\$/ounce)	295	363	245	229	275
Operating revenues	6,077	6,328	7,874	10,284	30,563
Net profit interest	-	-	-	(253)	(253)
Operating expenses	(4,535)	(5,468)	(4,767)	(5,818)	(20,588)
Operating profit	1,542	860	3,107	4,213	9,722
Administration expenses	(341)	(701)	(1,348)	(1,015)	(3,405)
Amortization and depletion	(243)	(694)	(1,293)	(1,785)	(4,015)
Interest and financing costs	(196)	(71)	(99)	(189)	(555)
Other	(570)	(1,829)	842	710	(847)
Income Taxes	-	-	-	610	610
Net income (loss) for the period	192	(2,435)	1,209	2,544	1,510
Basic earnings (loss) per share	0.004	(0.056)	0.022	0.056	0.034
Cash flow from (used in) operations	388	(121)	(316)	2,173	2,124
Cash from financing activities	1,049	2,258	2,719	2,221	8,247
Cash invested	(2,206)	(3,354)	(2,490)	(1,791)	(9,841)
Cash on hand	4,202	2,985	2,898	5,501	5,501
Total Assets	28,648	35,644	37,782	42,651	42,651
Shareholders Equity	21,198	19,311	22,513	31,321	31,321

Operating costs for the fourth quarter of 2006 were \$ 5,995 compared to \$ 5,818 in the corresponding quarter of 2005. The cash cost per ounce for the fourth quarter was \$ 243 compared to \$229 in the corresponding quarter of 2005. The increase in unit cash costs represented repairs for the pit wall slip and mill shutdown costs.

Amortization and depletion expense increased from \$ 1,785 in the fourth quarter of 2005 to \$ 2,245 in the fourth quarter of 2006. This represents the effect of amortisation on capital purchases in the past year.

Cash flow from operations for the quarter of \$ 7,445 compares to \$ 2,173 in the same quarter of 2005 and reflects higher average realised sale price of gold and the sale of 27,284 ounces in the fourth quarter of 2006 compared to 22,904 ounces in the first quarter of 2005. Cash invested during the quarter includes \$ 3,606 on property plant and equipment and exploration and development. Proceeds from stock issues during the quarter were \$ 1,045 and \$ 457 was raised from finance leases for light vehicles.

UME's mining revenues and expenses are in general, not seasonal in nature. Nevertheless, San Gregorio can occasionally be adversely affected by inclement weather during the July to September winter period.

## **OUTLOOK**

### **Financial**

The Company expects to produce 100,000 ounces of gold in the 2006/07 financial year. Cash operating cost are expected to be \$US 240 per ounce. The increase over the current year reflects the change in strip ratio for the remainder of the Arenal pit from 3.42 to 4.75. Depletion and amortisation expense is expected to be consistent with 2005/06.

Capital expenditure on plant and equipment is forecast to include two new exploration drill rigs and associated equipment, the remaining capital for the upgrade/ refurbishment of plant and other land, components and infrastructure. Mine development will include the river, pre strip of San Gregorio East and scoping studies for plant expansion, heap leach and underground mining.

### **Development**

The focus of development activities at the San Gregorio Operations during 2007 will be to increase reserves. Key indicatives include:

- Extension and infill drilling at Argentinita and other targets in the Zapucay district where mineralization is open and new zones along structure remain to be tested.
- Complete drilling and re-modelling of the old San Gregorio system.
- Based on underground mining studies refine targeting of depth extensions at Arenal and San Gregorio and test these targets.
- Evaluate the alternatives to increase plant throughput to offset lower grade and to consider the off potential for heap leach processing of some lower grade ore.
- Follow-up and drill high grade, low volume veins, close to the San Gregorio operation to provide a grade "sweetener" to mill feed in coming years.

**Exploration**

On the Isla Crystalina belt our objective is to significantly add to gold reserves over the medium term. During 2006 the group anticipates completing a detailed ground magnetic survey of the western and central parts of the belt. This will then be extended to the remainder of the belt in 2007. Air photo interpretation of the whole belt was completed during 2006. A re-interpretation of the regional as well as local structures that control mineralization will be performed by external consultants in 2006. A study program has commenced to ascertain the potential of remote sensing in identifying targets. Many additional targets are expected to come from this work and follow up soil sampling, ground magnetic surveys and then drilling will then be used to test the targets.

Additional geologists are being recruited to accelerate evaluation work on other gold areas, including Presidente Terra, Casupa, Texas and Chamizo.

The Company intends to prepare all of its base metals projects for possible joint venture during 2006/2007. Work programs will continue on these projects until a suitable partner is found. We intend to use geophysics, mapping and soil sampling to generate drill targets at Mal Abrigo, Paso de Lugo and Carpintaria during the first half of the financial year. Interpretation of the recently completed gravity and aeromagnetic survey on Retamosa and Maria Albina lead zinc targets will occur during 2006 with follow-up field work then commencing.

Comprehensive geophysical modelling of Lascano will be complete in the first quarter of 2006/2007. Drilling is currently scheduled for the second quarter of 2006/2007 as base metals projects are progressed UME will seek, during 2006/2007, partners to accelerate exploration activities on these projects.

Diamond exploration during 2006/2007 will be focused on locating the more prospective areas by completing closer spaced sampling and using geophysics to identify kimberlites for drill testing.

**Liquidity**

It is planned to finance investment in capital expenditure and the repayment of deferred equipment finance during 2006 via existing cash reserves and cash flow from operations.

The Company's secured financing facility entered into in December 2004 provides a guarantee facility of \$1,500 until December 2007 and a working capital facility \$ 2,000, expires during September 2006.

The financing arrangements described above are subject to covenants on the company's financial performance and other restrictions. UME does not expect these conditions to affect the financial performance of the group.

**RISKS TO FINANCIAL OUTLOOK**

UME's net earnings in the near-term are affected principally by its mining operations and, in the longer term, will be affected primarily by the success or failure of its exploration and development activities. The Board recognizes that the exploration and development of natural

resources is a speculative activity that involves a large numbers of uncertainties, and a degree of financial risk. Accordingly the Board considers the risks to which the Corporation is exposed as part of its regular operations, and keeps these under review.

The principal risks are considered to be those set out below.

#### **Sensitivity to commodity prices and foreign exchange rates**

UME's revenues, net earnings and cash flow from operations are affected materially by changes in the price of gold. Gold has historically been subject to large price fluctuations, and is affected by factors which are unpredictable, including international economic and political conditions, speculative activities, the relative exchange rate of the US dollar with other currencies, inflation, global and regional levels of supply and demand and the gold inventory levels maintained by producers and others.

UME's gold sales are priced in US dollars while its operating costs are predominantly incurred in US dollars, Canadian dollars and Uruguayan pesos. UME has financial exposure to foreign exchange fluctuations in the Uruguayan peso and the Canadian dollar relative to the US dollar.

#### **Exploration, Mining and Operational Risks**

Ume's longer term strategy depends to a certain extent on its ability to find commercial quantities of minerals within Uruguay, and to obtain and retain appropriate access to these minerals. The Board cannot guarantee that it will be able to identify appropriate properties, or negotiate acquisitions, on favourable terms.

UME currently has one producing asset, the Minas de Corrales gold project. As more of its projects mature, the Board expects that more projects will develop into producing assets. In common with all mining operations, there is uncertainty, and therefore risk, associated with operating parameters and costs. Whilst costs can be budgeted with a reasonable degree of confidence, operating parameters can be difficult to predict and are often affected by factors outside the Group's control. In addition, other risks, including industrial accidents, technical failures, labour disputes and environmental hazards are also beyond the Group's control.

The nature of resource and reserve quantification studies means that there can be no guarantee that estimates of quantities and grades of minerals will be available to extract. The resources and reserves stated have been quantified according to the Australasian Institute of Mining and Metallurgy Code of Mineral Resource Estimation, which is the basis of reporting used by the Australian Stock Exchange.

The Company's business activities are also affected to varying degrees by government regulations respecting, among other things, tax, royalties, mining legislation and environmental legislation changes.

#### **Title Risks**

All prospecting, exploration and mining licenses and titles in Uruguay are granted by the Government of Uruguay for finite periods of time. The Government is bound by strict rules of priority of application, and security of title once granted. However Uruguay is a sovereign state, and there can be no guarantee that the State will continue to grant or respect mining titles, and that the titles of the properties will not be challenged or negated for political or legal reasons.

Individual titles expire from time to time and UME manages the process of retaining its rights by re-application or conversion to other forms of title relevant to each stage of development. The process of re-application involves some risk however, as released titles must fall open before they can be re-applied for.

### **Political and Economic Risks**

Although political conditions in Uruguay are relatively stable, political and economic conditions have not been stable in the countries that surround it. Changes may occur in Uruguay's political, fiscal and legal system that might affect the ownership or operation of the Group's interests, including inter alia, changes in exchange control regulations, expropriation of mining rights, changes of government and in legislative and regulatory regimes.

### **Arenal Pit Expansion**

In order to mine approximately 60% of the reserves remaining in the Arenal pit the pit must be expanded to the west and a river diversion completed. This diversion requires environmental approval to divert the Corrales River. Studies have been performed by the Company and external independent advisors to assess the environmental impact of diverting the river. These studies concluded that the river can be diverted without significant affect on river flows, flora and fauna. Based on these studies a submission has been made to the Uruguayan environmental authorities seeking this permission and the company is confident that this environmental approval will be granted. Should such environmental approval not be granted the reserves contained in the Arenal pit would have to be revised.

## **FINANCIAL INSTRUMENTS**

UME does not enter into financial instruments for trading or speculative purposes. The levels of derivatives contracts entered into will be consistent with forecast production and must ultimately be capable of satisfaction through by delivery.

In December 2004 the Company entered into a matched collar for 50,000 ounces with a strike price for the put of \$US 400/oz and a strike price for the call of \$US 436/oz. This contract requires deliveries of 2,500 ounces per month and at 31 May 2005 2,500 ounces were still to be delivered.

In October 2005 the Company entered into a matched collar for 10,000 ounces with a strike price for the put of \$ 436 per ounce and a strike price of the call of \$ 486,50 per ounce. This contract requires deliveries of 2,500 ounces per month with deliveries commencing in July 2006. At May 31 2006 10,000 ounces remain to be delivered.

The Company has established a policy that permits a maximum of 25% of planned monthly production to be hedged for a period of 18 months. Given current production levels this equates to 37,500 ounces over an 18 month period. This level of hedging is considered a prudent level to protect short term plans against an unfavourable movement in the price of gold.

## CONTRACTUAL OBLIGATIONS AND COMMITMENTS

Table 11: Payments due by period

	Total	Less than 1 Year	1-2 Years	2-3 years	3-4 years	4-6 Years
Convertible notes (a)	3,050	1,050	1,050	1,050		
Finance Lease	513	180	171	162		
Deferred Equipment payments	863	863				
Asset Retirement obligations	1,665		245	112	116	1,192

(a) As a part of the agreement for the purchase of the net profit interest, as explained in Note 5a and 8d of the financial statements, an additional US\$ 1,050 is also payable after the third anniversary date, if the average monthly price of gold for the previous 36 months exceeds US\$ 400 per ounce.

### CRITICAL ACCOUNTING ESTIMATES

The preparation of UME's financial statements requires management to make certain estimates which affect the amounts reported in the consolidated statements and related notes. The accounting estimates considered to be significant to UME include in-process inventories, net future income and resource tax assets and liabilities, the physical and economic lives of mining assets and mine closure and site restoration costs.

#### Net future income and resource tax assets and liabilities

As at May 31, 2006, UME's had unrecognized tax losses of \$ 3,194 in Uruguay, \$ 3,734 in Canada and \$ 4,415 in Barbados. These tax losses have not been recognized as the group is reliant on future profitable operations in the entities that hold these tax losses within one to three years.

#### Economic lives of mining assets and recoverable value

The economic lives of UME's mining operations and any development asset is based upon the individual mine's mineral reserves. UME's resources and reserves are calculated in accordance with the standards established under the Australasian Institute of Mining and Metallurgy Code of Mineral Resource Estimation, which is the basis of reporting used by the Australian Stock Exchange.

The Company reviews and evaluates the estimated future discounted net cash flows of its mines and development properties to ensure that they exceed the carrying value for each property. These calculations rely on estimated reserves and/or resources, estimated future commodity price and production costs. At each reporting period end, UME reviews the recoverable value of its mining assets. At May 31, 2006, no write down of the carrying value of these assets was appropriate.

#### Share based Compensation

Consistent with note 2 to the consolidated financial statements UME has chosen to use the fair value method to account for stock-based employee compensation plans. The calculation of this benefit relies on estimates of the anticipate life of the option and the volatility of the company's share price.

### Mine closure and site restoration

UME has estimated the ultimate asset retirement obligation costs for its operations at their expected respective closure and site restoration dates. The discounted value of these asset retirement obligations as at May 31 2006 was \$ 1,665 and is included in the mine closure and site restoration liability. The \$ 263K unamortized balance of asset retirement costs as at May 31, 2006 is included in property, plant and equipment. While care was taken to estimate the asset retirement obligations, these amounts are estimates of expenditures that are not due until future years. In addition, UME's asset retirement obligations are reviewed and assessed periodically on an asset by asset basis. Should there be a change in the estimate, the discounted amount of that change would be included in property, plant and equipment as an asset retirement cost with an offsetting amount accrued as an asset retirement obligation. The asset retirement cost would be amortized on a units-of-production basis over the estimated life of the mine while the asset retirement obligation would be accreted through earnings to its ultimate undiscounted amount.

### NON GAAP MEASURES

Cash flow from operations, contribution margin and cash cost per ounce are not measures that have any standardized meaning prescribed by Canadian GAAP and are considered non GAAP measures. Therefore these measures may not be comparable to similar measures presented by other issuers. These measures have been presented in this MD&A as additional information regarding the company's financial performance and financial position.

Cash flow from operations is calculated by adding back non-cash items to earnings. Contribution margin has been calculated by deducting operating expenses from sales. Operating expenses include movements in inventories but exclude operating Amortization and depletion.

Cash cost per ounce are determined according to the Gold Institute Standard and consist of site costs for all mining, processing, administration, royalties, refining charges, silver credits and inventory adjustments relating to metal production. Capital expenditure, depletion and amortisation and financing costs are not included. Cash costs are total cash costs divided by gold ounces produced. This calculation is detailed below.

Table 12 Cash cost per ounce calculation

	Quarter 1 Aug 2005	Quarter 2 Nov 2005	Quarter 3 Feb 2006	Quarter 4 May 2006	Year May 2006
Operating expenses (000)	5,760	4,970	5,289	5,995	22,014
Other (000)	(424)	(362)	(131)	168	(749)
Total cash costs (000)	5,336	4,608	5,158	6,163	21,265
Gold production in ounces	25,163	25,323	25,451	25,350	101,287
<b>Total cash costs per ounce</b>	<b>212</b>	<b>182</b>	<b>203</b>	<b>243</b>	<b>210</b>

## MINERAL PROPERTIES

The following table summaries expenditure on mineral properties during the financial year.

**Table 13: Movement in exploration and development costs**

Project Area	Balance 31 May 2005	Expenditure 2006	Balance 31 May 2006
Minas de Corrales Gold Belt	\$ 411	\$ 3,026	\$ 3,437
Base Metals Projects	2,834	2,492	5,326
Other Gold Projects	1,367	287	1,654
Diamonds	189	291	480
Regional Exploration	287	0	287
Total	\$ 5,088	\$ 6,096	\$ 11,184

Each of the major project areas is described below. Details of work performed in the current financial year on each of the projects are included in the Company's Exploration Report for 2007 and details of work for 2007 are included in the Exploration report and Outlook statement in this Management Discussion and Analysis.

### **Minas de Corrales Gold Project ("MCGP"):**

The MCGP is situated in an inlier of Proterozoic rocks approximately 110 km in length and 40 km in width. It is located in the north of Uruguay approximately 450 km from Montevideo. The San Gregorio processing plant and existing San Gregorio mining operations are located on the western end of the belt. The two largest deposits discovered to-date are the San Gregorio deposit, which has produced over 500,000 ounces since it was discovered in the mid 1880's, and the Arenal deposit, which was discovered in 2004. To May 31 2006 152,000 ounces have been mined from Arenal and a further 303,000 remain in reserves to be mined. Both the San Gregorio and Arenal deposits are open at depth

### **Base Metals Projects:**

These include the *Dom Feliciano Mobile Belt* iron/copper/gold project where a substantial belt of copper and gold anomalism has been identified approximately 300 km north-east of Montevideo. At *Mal Abrigo*, located approximately 140 km WNW of Montevideo, a large, layered mafic/ultramafic complex is the subject of study for nickel/copper/platinoids. Disseminated copper and nickel sulphides are visible at the surface in a number of places. At *Lascano*, located approximately 250 kilometers north-east of Montevideo, a very strong gravity high approximately 70 kilometers long by up to 40 kilometers wide is considered to be a capable of hosting Norilsk-style nickel mineralisation. At *Carpinteria*, which is situated approximately 500 km north of Montevideo, an extensive sequence of komatiitic basalts and ultramafic flows with strong nickel anomalism is currently being evaluated.

**Other Gold Projects.** These include *Presidente Terra*, which is located approximately 240 kilometers north east of Montevideo, where work conducted during 2000 and 2001 identified high-grade mineralized float over a 12 km strike length of a large gold-mineralized shear system. This project has been on hold due to competing priorities. *Mirta*, which is located near Colonia in the south-west of Uruguay, is a complex, shear-hosted gold deposit and the company has been assessing the mineralisation controls in order to define further drill targets. The deposit is characterized by a series of short, plunging, high-grade ore zones contained within a broader, low-grade mineralisation envelope. At *Chamizo*, which is located

approximately 120 km ENE of Montevideo, a gold-bearing metamorphosed acid tuff is being investigated. A new gold project Casupa, located 100 km north of Montevideo, has been generated and a drill program is planned for this area.

**Diamonds including Cinco Rios Project.** This project is located in the North of Uruguay and includes the Minas de Corrales area as well as the properties obtained with the acquisitions of Cinco Rios SA. Systematic drainage sampling has identified an area where positive kimberlite indicator minerals are clustered, and a close-space airborne gravity survey is scheduled for May 2006. The company has previously recovered several macro-and micro-diamonds, together with G9 and G10 garnets from this area.

**Regional Exploration.** The company has an ongoing program of identifying and field-checking geochemical anomalies obtained from reviewing data held within the Company's proprietary data-base. Where appropriate successful prospects are designated and allocated to the major project groupings shown above.

#### **DISCLOSURE CONTROLS AND PROCEDURES**

Disclosure controls and procedures are designed to provide reasonable assurance that all relevant information is gathered and reported to senior management, including the Corporation's President and Chief Executive Officer and Chief Financial Officer, on a timely basis so that appropriate decisions can be made regarding public disclosure. As at the end of the period covered by this management's discussion and analysis, management of the Corporation, with the participation of the President and Chief Executive Officer and the Chief Financial Officer, evaluated the effectiveness of the Corporation's disclosure controls and procedures as required by Canadian securities laws. Based on that evaluation, the President and Chief Executive Officer and the Chief Financial Officer have concluded that, as of the end of the period covered by this management's discussion and analysis, the disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed in the Corporation's annual filings and interim filings (as such terms are defined under Multilateral Instrument 52-109 – *Certification of Disclosure in Issuers' Annual and Interim Filings*) and other reports filed or submitted under Canadian securities laws is recorded, processed, summarized and reported within the time periods specified by those laws and that material information is accumulated and communicated to management of the Corporation, including the President and Chief Executive Officer and the Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

#### **Forward Looking Statements**

Certain information contained in this Management Discussion and Analysis constitutes "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995 and forward looking information under applicable Canadian Securities Legislation. Such forward-looking statements or information, included but not limited to those with respect to prices for gold, estimated future production, estimated costs of production, the Company's hedging policy involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of the Company to be materially different from any future results, performance or achievements expressed or implied by such forward looking statements or information. Important factors that could cause actual results to differ materially from those in the forward looking statements contained herein, include among others, gold price, weather, exploration results, development and mining activities, geotechnical assumptions, environmental approvals and the availability of technical personnel.