

**Gammon Lake Resources Inc.**  
**Consolidated Financial Statements**

July 31, 2005 and 2004

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# Gammon Lake Resources Inc.

## Contents

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	<b><u>Page</u></b>
Auditor's Report	1
Consolidated Statements of Operations and Deficit	2
Consolidated Balance Sheets	3
Consolidated Statement of Cash Flows	4
Notes to the Consolidated Financial Statements	5-25

## Auditors' Report

To the Shareholders of  
**Gammon Lake Resources Inc.**

We have audited the consolidated balance sheets of **Gammon Lake Resources Inc.** as at July 31, 2005 and July 31, 2004 and the consolidated statements of operations 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 auditing standards generally accepted in Canada and the standards of the Public Company Accounting Oversight Board (United States). These 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 statements present fairly, in all material respects, the financial position of the Company as at July 31, 2005 and July 31, 2004, and the results of its operations and cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.



Halifax, Nova Scotia, Canada  
September 10, 2005

Grant Thornton LLP  
Chartered Accountants

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## Gammon Lake Resources Inc.

### Consolidated Statements of Operations and Deficit

Years Ended July 31	2005	2004
Interest income	\$ 1,199,016	\$ 405,056
Management fees	<u>224,560</u>	<u>230,000</u>
	<u>1,423,576</u>	<u>635,056</u>
Expenses		
Capital tax	140,000	-
Amortization	537,540	146,468
General and administrative	2,593,683	2,173,945
Management fees	278,440	454,808
Professional fees	7,105,542	4,519,252
Wages and benefits	<u>9,651,178</u>	<u>605,584</u>
	<u>20,306,383</u>	<u>7,900,057</u>
Loss before other items	<u>(18,882,807)</u>	<u>(7,265,001)</u>
Foreign exchange gain	312,172	2,022,149
Write-off of mineral property	-	(1,063,448)
Loss on equity investment	<u>(1,226,000)</u>	<u>(652,000)</u>
	<u>(913,828)</u>	<u>306,701</u>
Net loss before income taxes	\$ (19,796,635)	\$ (6,958,300)
Future income tax recovery (Note 10)	<u>(421,040)</u>	<u>-</u>
Net loss	<u>\$ (19,375,595)</u>	<u>\$ (6,958,300)</u>
Loss per share (Note 12)	<u>\$ (0.29)</u>	<u>\$ (0.13)</u>
<hr/>		
Deficit, beginning of period	\$ (13,594,765)	\$ (6,636,465)
Net loss	<u>(19,375,595)</u>	<u>(6,958,300)</u>
Deficit, end of period	<u>\$ (32,970,360)</u>	<u>\$ (13,594,765)</u>

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See accompanying notes to the consolidated financial statements.

# Gammon Lake Resources Inc.

## Consolidated Balance Sheets

	July 31 2005	July 31 2004
<b>Assets</b>		
Current		
Cash and cash equivalents	\$ 35,400,349	\$ 13,020,940
Receivables		
Commodity taxes	5,332,406	2,619,566
Other	129,772	62,975
Prepays and deposits	947,344	116,317
Due from related companies	<u>229,700</u>	<u>384,701</u>
	<b>42,039,571</b>	16,204,499
Deposit on capital equipment (Note 3)	9,138,768	176,265
Long term investment (Note 4)	10,422,000	11,648,000
Capital assets (Note 5)	32,750,554	4,462,243
Mineral properties and related deferred costs (Notes 6 and 7)	<u>115,997,985</u>	<u>80,041,737</u>
	<b>\$ 210,348,878</b>	<b>\$ 112,532,744</b>
<b>Liabilities</b>		
Current		
Payables and accruals	\$ 3,609,306	\$ 4,038,805
Long term debt (Note 8)	8,581,300	9,304,400
Future employee benefits (Note 9)	213,738	-
Future income taxes (Note 10)	<u>8,121,000</u>	<u>10,170,900</u>
	<b>20,525,344</b>	23,514,105
<b>Shareholders' Equity</b>		
Capital stock (Note 11)	204,065,585	98,642,382
Contributed surplus (Note 11)	18,728,309	3,971,022
Deficit	<u>(32,970,360)</u>	<u>(13,594,765)</u>
	<b>189,823,534</b>	89,018,639
	<b>\$ 210,348,878</b>	<b>\$ 112,532,744</b>

Nature of operations and going concern assumption (Note 1)  
 Commitments and contingencies (Note 7)  
 Subsequent events (Note 14)

On behalf of the Board

\_\_\_\_\_  
 "Fred George" Director

\_\_\_\_\_  
 "Brad Langille" Director

See accompanying notes to the consolidated financial statements.

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# Gammon Lake Resources Inc.

## Consolidated Statements of Cash Flows

Years Ended July 31

2005

2004

Increase in cash and cash equivalents

<b>Operating</b>		
Net loss	\$ (19,375,595)	\$ (6,958,300)
Amortization	537,540	146,468
Unrealized foreign exchange gain	(876,706)	(2,022,149)
Stock option expense	13,974,680	3,466,060
Mineral property write-off	-	1,063,448
Future income tax recovery	(421,040)	-
Loss on long term equity investment	1,226,000	652,000
	<u>(4,935,121)</u>	<u>(3,652,473)</u>
Change in non-cash operating working capital (Note 17)	<u>(4,040,163)</u>	<u>925,467</u>
	<u>(8,975,284)</u>	<u>(2,727,006)</u>
<b>Investing</b>		
Acquisition of investment	-	(11,800,000)
Acquisition of capital assets	(28,825,851)	(4,066,596)
Advances from (to) related companies	155,001	(384,701)
Increase in deposits on capital equipment	(8,962,503)	(176,265)
Expenditures on mineral properties and related deferred costs	<u>(37,217,764)</u>	<u>(24,296,684)</u>
	<u>(74,851,117)</u>	<u>(40,724,246)</u>
<b>Financing</b>		
Net proceeds from issuance of capital stock	103,931,580	55,207,578
Proceeds from exercise of options	<u>2,274,230</u>	<u>-</u>
	<u>106,205,810</u>	<u>55,207,578</u>
Net increase in cash and cash equivalents	22,379,409	11,756,326
Cash and cash equivalents		
Beginning of year	<u>13,020,940</u>	<u>1,264,614</u>
End of year	<u>\$ 35,400,349</u>	<u>\$ 13,020,940</u>

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See accompanying notes to the consolidated financial statements.

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# **Gammon Lake Resources Inc.**

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

(Audited)  
July 31, 2005

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### **1. Nature of operations and going concern assumption**

Gammon Lake Resources Inc. (the "Company") is a publicly traded company, engaged in the acquisition, exploration and development of resource properties in Canada and Mexico. The Company is continued under Part 1A of the Companies Act (Quebec) and its common shares are listed on the Toronto Stock Exchange (TSX:GAM) and the American Stock Exchange (AMEX:GRS).

These financial statements have been prepared on the basis of accounting principles applicable to a going concern, which assume that the Company will continue in operation for the foreseeable future and will be able to realize its assets and discharge its liabilities in the normal course of operations.

The Company may have to raise additional funds over and above amounts raised to date to complete the acquisition, exploration and development of its interests and, while it has been successful in doing so in the past, there can be no assurance that it will be able to do so in the future. In addition, the Company will require further financing to meet certain financial commitments under its joint venture and option buy out agreements.

If the going concern assumption were not appropriate for these financial statements, then adjustments would be necessary in the carrying values of assets and liabilities, the reporting revenues and expenses, and the balance sheet classifications used.

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### **2. Summary of significant accounting policies**

#### **Basis of presentation**

The accompanying consolidated financial statements are prepared by management in accordance with Canadian generally accepted accounting principles and contain all adjustments necessary to present fairly Gammon Lake Resources Inc.'s financial position as at July 31, 2005 as well as its operations and cash flows for the years ended July 31, 2005 and July 31, 2004. The accounting principles conform in all material respects to principles generally accepted in the United States of America except as disclosed in Note 15.

These consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, Gammon Lake Resources (NS) Incorporated, Gammon Lake de Mexico S.A. de C.V., Gammon Lake Resources (USA) Inc. and Gammon Lake Resources (Barbados) Inc. Gammon Lake Resources (USA) Inc. was incorporated on February 11, 2005 with a treasury issue of 100 shares for \$100.

#### **Asset retirement obligations**

Effective August 1, 2004, Gammon Lake adopted the new Canadian Institute of Chartered Accountants (CICA) standards for Asset Retirement Obligations (CICA 3110). This section requires the Company to fully recognize the fair value of estimated asset retirement obligations on the balance sheet when a reasonable estimate of fair value can be made. The Company is required to record the estimated present value of future cash flows associated with site closure and reclamation as a liability when the liability is incurred and increase the carrying value of the related assets for the amount. These asset retirement costs will be amortized to expense over the life of the related assets using the unit-of-production method. At the end of each period, the liability is increased to reflect the passage of time and changes in the estimated future cash flows underlying any initial fair value measurements. The Company has not incurred any asset retirement obligations.

#### **Use of estimates**

The presentation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and

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# Gammon Lake Resources Inc.

## Notes to the Consolidated Financial Statements

(Audited)  
July 31, 2005

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disclosure of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those reported.

### 2. Summary of significant accounting policies (continued)

#### Cash and cash equivalents

Cash and cash equivalents include cash on hand and balances with banks, net of bank overdrafts, and highly liquid temporary investments.

#### Mineral properties and related deferred costs

Acquisitions, exploration and development costs relating to mineral properties are deferred until the properties are brought into production, at which time they are amortized on the unit of production method based on estimated recoverable reserves. If it is determined that the deferred costs related to a property are not recoverable over its productive life, those costs will be written down to fair value as a charge to operations in the period in which the determination is made. The amounts at which mineral properties and the related deferred costs are recorded, do not necessarily reflect present or future values.

#### Long term investment

The Company accounts for its investment in a company over which it has significant influence using the equity method of accounting whereby the investment is initially recorded at cost and subsequently adjusted to recognize the Company's share of earnings or losses of the investee company and reduced by dividends received.

#### Capital assets and amortization

Capital assets are recorded at cost. Amortization is calculated on the straight-line basis over the estimated useful lives of the assets as follows:

Computer equipment	3-4 years
Exploration equipment	5-10 years
Furniture and fixtures	5-10 years
Processing plant	8-9 years
Development equipment	8-9 years
Vehicles	4 years
Buildings	20 years

#### Impairment of long lived assets

In August, 2004, the Company adopted the Canadian Institute of Chartered Accountants Handbook Section 3063, "Impairment of Long-Lived Assets", which addresses the recognition, measurement and disclosure of the impairment of long-lived assets. Section 3063 requires that an impairment loss be recognized if the carrying amount of a long-lived asset is not recoverable. The carrying amount of a long-lived asset is not recoverable if the carrying amount exceeds the sum of the undiscounted cash flows expected to result from its use and eventual disposition. The impairment loss to be recognized is measured as the amount by which the carrying amount of the long-lived asset exceeds its fair value. The Company has determined there is an impact on its results of operations and financial position.

#### Revenue recognition

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# **Gammon Lake Resources Inc.**

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

(Audited)  
July 31, 2005

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Revenue is recognized when: i) persuasive evidence of an arrangement exists; ii) the risks and rewards of ownership pass to the purchaser including delivery of the product; iii) the selling price is fixed and determinable, and iv) collectibility is reasonably assured.

### **2. Summary of significant accounting policies (continued)**

#### **Stock based compensation**

Effective August 1, 2003, the Company prospectively adopted the fair value method of accounting for employee stock-based compensation. This Section establishes standards for the recognition, measurement and disclosure of stock-based compensation and other stock-based payments made in exchange for goods and services. These recommendations require that compensation for all awards made to employees and non-employees be measured and recorded in the financial statements at fair value. The Company's stock option plan is described in Note 11.

#### **Foreign currency transactions**

Foreign monetary assets and liabilities and foreign integrated operations are denominated in foreign currencies, and are translated at the period end exchange rate. Non-monetary assets and liabilities, as well as revenue and expense transactions denominated in foreign currencies are translated at the rate prevailing at the time of the transaction. Translation gains or losses are recognized in the period in which they occur.

#### **Income taxes**

Income taxes are calculated using the asset and liability method of tax accounting. Under this method, current income taxes are recognized for the estimated income taxes payable for the current period. Future income tax assets and liabilities are determined based on the difference between the financial reporting and tax basis of assets and liabilities and on unclaimed losses carried forward and are measured using the substantively enacted tax rates that will be in effect when the differences are expected to reverse or when unclaimed losses are expected to be utilized. A valuation allowance is recognized to the extent that the recoverability of future income tax assets is not considered more likely than not.

#### **Loss per common share**

Loss per common share is calculated based on the weighted average number of common shares outstanding for the period. Diluted loss per common share, when applicable, considers the potential exercise of outstanding options and warrants using the treasury-based method.

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# **Gammon Lake Resources Inc.**

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

(Audited)  
July 31, 2005

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### **2. Summary of significant accounting policies (continued)**

#### **Recent accounting pronouncements**

##### **Flow-through shares**

In March 2004, the CICA Emerging Issues Committee ("EIC") issued EIC Abstract 146, "Flow-through shares", identifying two issues as a result of varying practices related to the date of recognition of the future tax liability and the recognition of previously unrecorded future income tax assets caused by the renouncement of expenditures related to flow-through shares. The future income tax liability must be recognized, and the shareholder's equity reduced, on the date that the Company renounces the tax credits associated with expenditures, provided there is reasonable assurance that the expenditures will be made. The previously unrecorded future income tax assets must be recognized as a reduction of income tax expense included in the determination of net income or loss in the period incurred, except when the "more likely than not" test cannot be satisfied. The Company has not issued any flow-through shares.

##### **Other changes in accounting policies**

In February 2003, the CICA issued AcG-14 "Guarantor's Accounting and Disclosure Requirements for Guarantees". AcG-14 requires guarantors to disclose certain information for guarantees outstanding at the end of the reporting period. At adoption, AcG-14 did not have any impact on the Company's consolidated financial statements.

In January 2003, the CICA issued AuG-15 "Consolidation of Variable Interest Entities" which harmonizes Canadian GAAP with FASB Interpretation No. 46R and provides guidance for applying the principles of Section 1590, "Subsidiaries", to certain special purpose entities. This pronouncement did not have any impact on the Company's consolidated financial statements.

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### **3. Deposits on capital equipment**

The Company has deposits on capital equipment of \$9,138,768 (2004 - \$176,265) relating to the Open-Pit and Underground operations. Remaining amounts due on these contracts are included in commitments and contingencies (Note 7).

# Gammon Lake Resources Inc.

## Notes to the Consolidated Financial Statements

(Audited)  
July 31, 2005

### 4. Long term investment

The Company's long-term investment, carried at equity, consists of 10,900,000 shares, representing approximately a 25% interest in the issued and outstanding common shares of Mexgold Resources Inc. ("Mexgold"). Mexgold is a public junior natural resource issuer, listed on the TSX Venture Exchange (TSXV: MGR), which holds a 100% interest in a Mexican gold and silver mineral exploration property, known as the "Guadalupe Gold-Silver Project" and a 100% interest in Compania Minera Del Cubo, a gold and silver producing mine in Guanajuto State, Mexico.

Pursuant to an agreement with Mexgold, these shares must be held until August 20, 2009, and there will be no sale, transfer, assignment, pledge, encumbrance, grant of a security interest in or other form of conveyance of these shares, directly, indirectly or beneficially, prior to that time unless Mexgold so consents in writing thereto.

	<u>July 31 2005</u>	<u>July 31 2004</u>
Investment in Mexgold Resources Inc.	\$ 12,300,000	\$ 12,300,000
Cumulative equity share of losses in Mexgold Resources Inc.	<u>(1,878,000)</u>	<u>(652,000)</u>
	<b><u>\$ 10,422,000</u></b>	<b><u>\$ 11,648,000</u></b>

The market value of investment as at July 31, 2005 was \$29,430,000 (July 31, 2004 - \$27,468,000). The Company also holds 2.95 million warrants to purchase Mexgold common shares at an exercise price of \$2.50 each, expiring February 26, 2006.

### 5. Capital assets

	<u>July 31, 2005</u>			<u>July 31, 2004</u>		
	<u>Cost</u>	<u>Accumulated Amortization</u>	<u>Net Book Value</u>	<u>Cost</u>	<u>Accumulated Amortization</u>	<u>Net Book Value</u>
Computer equipment	\$ 214,142	\$ 52,572	\$ 161,570	\$ 94,953	\$ 20,445	\$ 74,508
Exploration equipment	6,235,657	537,606	5,698,051	3,624,182	167,677	3,456,505
Development equipment	14,425,673	-	14,425,673	-	-	-
Processing plant	7,966,096	-	7,966,096	-	-	-
Vehicles	680,492	84,269	596,223	184,781	23,557	161,224
Buildings	3,574,509	66,261	3,508,248	629,645	11,727	617,918
Furniture and fixtures	422,372	27,679	394,693	159,530	7,442	152,088
	<b><u>\$33,518,941</u></b>	<b><u>\$ 768,387</u></b>	<b><u>\$32,750,554</u></b>	<b><u>\$ 4,693,091</u></b>	<b><u>\$ 230,848</u></b>	<b><u>\$ 4,462,243</u></b>

Amortization of tangible capital assets does not commence until they are available and in use.

# Gammon Lake Resources Inc.

## Notes to the Consolidated Financial Statements

(Audited)  
July 31, 2005

### 6. Mineral properties and related deferred costs

For the year ended July 31, 2005

Balance, July 31, 2004	\$ 80,041,737
Expenditures during the period	<u>35,956,248</u>
Balance, July 31, 2005	<u>\$ 115,997,985</u>

Included in expenditures for the year ended July 31, 2005 are future income tax adjustments of (\$1,475,253) (July 31, 2004 – \$1,974,832) related to the adjustment of the temporary difference between accounting and tax values of the mineral property.

#### Schedule of deferred mineral property expenditures

	<u>2005</u>	<u>2004</u>
Mineral property, beginning balance	<u>\$ 80,041,737</u>	<u>\$ 54,833,669</u>
Mineral rights	207,097	6,782,663
Geological services and studies	6,469,323	1,055,622
Drilling	4,449,719	4,776,715
Assays	988,219	844,391
Equipment and consumables	10,383,298	5,241,573
Field Office	283,356	291,070
Camp materials and equipment	682,231	341,110
Health and Safety	293,052	52,820
Vehicles	1,034,247	747,310
Consulting fees	800,287	650,149
Contract Mining fees	5,772,270	2,749,807
Travel	2,375,148	763,454
Watering infrastructure	669,358	-
Electrical infrastructure	126,116	-
Heap leach	2,419,254	-
Roads	478,526	-
Future Income tax adjustment	<u>(1,475,253)</u>	<u>1,974,832</u>
Total additions	<u>35,956,248</u>	<u>26,271,516</u>
Write-off of mineral property expenditures	-	<u>(1,063,448)</u>
Mineral property, end of period	<u>\$ 115,997,985</u>	<u>\$ 80,041,737</u>

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# Gammon Lake Resources Inc.

## Notes to the Consolidated Financial Statements

(Audited)  
July 31, 2005

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### 7. Commitments and contingencies

#### Option and joint venture agreements

**a) Minera Fuerte Mayo, S.A. de C.V. ("Fuerte Mayo")/Compania Minera Brenda, S.A de C.V. ("Brenda")**

The Company has a joint venture agreement with Fuerte Mayo respecting the Ocampo property under which the Company has a 60% participating interest in 17 mining claims in Mexico. Under the terms of the joint venture, the Company is the operator and 100% of the sales from production on the property may be applied to the cash payment due to Fuerte Mayo in the joint venture stage. Under the terms of the agreement, a balance of US \$211,526 was due to Fuerte Mayo upon the sale of the property. During the year ended July 31, 2005, in consideration for a consulting payment of Cdn \$250,000 due for services rendered, Fuerte Mayo forgave the US \$211,526 due upon the sale of the property.

On February 21, 2003, the Company acquired the remaining 40% of the title and interest in a group of claims located in the municipality of Ocampo from Compania Minera Brenda S.A. de C.V. ("Minera Brenda"). The Company agreed to pay 8% of net profits attributable to the development of the mining claims and their concessions up to a maximum of US \$2,000,000. An additional US \$250,000 is due if, as a result of the exploration of the claims, a minimum mining reserve of two million ounces of equivalent gold are obtained. In the event that the Company were to sell the property, the full US \$2,000,000 becomes due and payable at that time.

**b) Minerales de Soyopa, S.A. de C.V. ("Soyopa")**

On November 24, 2001, the Company and Soyopa entered into an agreement amending previous option and joint venture agreements. Under the terms of these agreements, the Company acquired 100% of the right, title and ownership to 17 mining claims in the Ocampo district of Mexico. Consideration for title of the properties was US \$100,000 paid on November 24, 2001, US \$125,000 paid on May 23, 2002, the issuance of 5,000,000 common shares of the Company to Soyopa and US \$7,000,000 in long term debt as disclosed in Note 8.

**c) Compania Minera Global, S.A. de C.V. ("Global")**

On July 17, 2000, the Company entered into an agreement with Global for consulting services to assist in the negotiations of an agreement with Soyopa to secure the right to acquire the then remaining fifty-one percent (51%) interest in the Ocampo property.

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# Gammon Lake Resources Inc.

## Notes to the Consolidated Financial Statements

(Audited)  
July 31, 2005

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### 7. Commitments and contingencies (continued)

As part of the consideration for the successful negotiation and execution of the agreement between the Company and Soyopa and upon sale by the Company of the lands, claims and concessions described in the agreements, the Company is required to pay Global U.S. \$1,000,000.

A summary of the future commitments based on the above noted option and joint venture agreements at July 31, 2005 are set out in the following table:

Agreement	Consideration	Terms
Compania Minera Global, S.A. de C.V.	US\$ 1,000,000	Upon sale of the related property
Compania Minera, Brenda, S.A. de C.V.	US\$ 2,000,000	8% of net profits attributable to related mining claims or upon sale of the related property
Compania Minera, Brenda, S.A. de C.V.	US\$ 250,000	Upon a minimum proven reserve amount

### d) Capital equipment

During the year, the Company placed deposits on several pieces of equipment for the Open-Pit and Underground operations (see Note 3). The Company's future commitments on the equipment is \$20,815,083, and is payable upon shipment and or delivery of the items as outlined in the purchase contracts.

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### 8. Long term debt

	<u>July 31</u> <u>2005</u>	<u>July 31</u> <u>2004</u>
Soyopa loan, non-interest bearing, translated to Canadian dollars at the balance sheet date.	<u>\$ 8,581,300</u>	<u>\$ 9,304,400</u>

The long term debt payable to Soyopa is non-interest bearing with terms of repayment as follows:

- i.) US \$3,500,000 on or before November 23, 2006;
- ii.) US \$3,500,000 on or before November 23, 2007;
- iii.) In the event that the Company has commenced production of gold and/or silver from the mining title acquired prior to November 23, 2006, the Company is required to pay Soyopa US \$1,000,000, annually, commencing on the first anniversary of the start of production which will reduce the remaining amount due;
- iv.) In the event the Company sells or transfers title to the concessions to a third party, the US \$7,000,000 or the amount remaining, becomes due.

The long term debt is secured by a first charge over certain mineral properties.

# Gammon Lake Resources Inc.

## Notes to the Consolidated Financial Statements

(Audited)  
July 31, 2005

### 9. Future Employee Benefits

The Company has commenced accruing future employee benefits for contract workers in Mexico paid through an employment services company. These benefits consist of a one-time payment equivalent to 12 days wages for each year of service (at the employee's most recent salary, but not to exceed twice the legal minimum wage), payable to all employees with 15 or more years of service, as well as to certain employees terminated involuntarily prior to the vesting of their seniority premium benefit. Under Mexican Labour Law, the Company also provides statutorily mandated severance benefits to its employees terminated under certain circumstances. Such benefits consist of a one-time payment of three months wages plus 20 days wages for each year of service payable upon involuntary termination without just cause.

A summary of the principal financial data relative to seniority premiums and pension plans is shown below:

	<u>Pension Benefit Plans</u>	<u>Seniority Premium</u>	<u>Total</u>
Projected benefit obligation:			
Balance, beginning of period	\$209,270	\$4,462	\$213,732
Service cost	38,900	4,933	43,833
Actuarial (gain)	<u>(5,037)</u>	<u>(97)</u>	<u>(5,134)</u>
Balance, end of year	<u>\$243,133</u>	<u>\$9,298</u>	<u>\$252,431</u>
Current benefit obligation:			
Service cost	\$38,900	\$4,943	\$43,843
Additional minimum liability	<u>166,345</u>	<u>3,550</u>	<u>169,895</u>
Balance at end of period	<u>\$205,245</u>	<u>\$8,493</u>	<u>\$213,738</u>
Employee future benefits expense:			
Service cost	\$23,927	\$4,624	\$28,551
Interest cost	9,417	201	9,618
Amortization of prior service costs	<u>5,556</u>	<u>118</u>	<u>5,674</u>
Net expense for the year	<u>\$38,900</u>	<u>\$4,943</u>	<u>\$43,843</u>
Significant assumptions used:			
Discount rate	4.50%	4.50%	4.50%
Rate of compensation increase	1.50%	1.50%	1.50%

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# Gammon Lake Resources Inc.

## Notes to the Consolidated Financial Statements

(Audited)  
July 31, 2005

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### 10. Income taxes

The following table reconciles the expected income tax recovery (payable) at the statutory income tax rate to the amounts recognized in the consolidated statements of operations for the years ended July 31, 2005 and 2004.

	<u>July 31</u> <u>2005</u>	<u>July 31</u> <u>2004</u>
Net Loss	\$ 19,797,000	\$ 6,958,000
Income Tax Rate	38%	38%
Expected income tax recovery	7,523,000	2,644,000
Effect of statutory rate change	(112,000)	-
Tax effect of foreign exchange gains (losses) that are not taxable for income tax purposes	(167,000)	726,000
Tax effect of equity pick-up on investments	(466,000)	(248,000)
Write-off of mineral properties	-	(404,000)
Non-deductible stock option expense	(5,310,000)	(1,317,000)
Valuation allowance	<u>(1,047,000)</u>	<u>(1,401,000)</u>
Provision for income taxes	<u>\$ 421,000</u>	<u>\$ -</u>

The following reflects future income tax liabilities at July 31, 2005 and July 31, 2004.

	<u>July 31</u> <u>2005</u>	<u>July 31</u> <u>2004</u>
Accounting value of mineral properties and related deferred costs in excess of tax value	\$ 26,508,000	\$ 18,831,400
Deductible share issue costs	(3,374,900)	(1,670,800)
Non-capital losses carried forward	<u>(22,558,600)</u>	<u>(12,563,600)</u>
Valuation allowance	574,500	4,597,000
	<u>7,546,500</u>	<u>5,573,900</u>
Future income tax liabilities recognized	<u>\$ 8,121,000</u>	<u>\$ 10,170,900</u>

# Gammon Lake Resources Inc.

## Notes to the Consolidated Financial Statements

(Audited)  
July 31, 2005

### 10. Income taxes (continued)

The Company has tax loss carryforwards expiring in the following years:

	<u>Canada</u>	<u>United States</u>	<u>Mexico</u>	<u>Total</u>
2006	367,364	-	-	367,364
2007	885,266	-	-	885,266
2008	1,240,695	-	-	1,240,695
2009	512,906	-	-	512,906
2010	2,694,155	-	1,560,625	4,254,780
2011	2,556,165	-	-	2,556,165
2012	-	-	2,353,916	2,353,916
2013	-	-	13,203,889	13,203,889
2014	-	-	22,017,348	22,017,348
2015	2,355,660	-	16,222,085	18,577,745
2025	-	397,598	-	397,598
	<u>10,612,211</u>	<u>397,598</u>	<u>55,357,863</u>	<u>66,367,672</u>

### 11. Capital stock

#### Authorized:

Unlimited number of common shares

Unlimited number of non-cumulative, dividends to be determined by the Board of Directors not to exceed 12%, non-participating, non-voting, Class "A" preferred shares, redeemable at their paid-in value.

Unlimited number of non-cumulative, dividends to be determined by the Board of Directors not to exceed 13%, non-participating, non-voting, Class "B" preferred shares, redeemable at their paid-in value.

#### Issued and outstanding:

	<u>Number of Common Shares</u>	<u>Ascribed Value</u>
Balance, July 31, 2004	56,676,715	\$ 98,642,382
Issued during the year ended July 31, 2005		
For cash pursuant to private placement	15,715,000	110,005,000
For cash pursuant to exercise of share purchase options	994,800	2,274,230
Less share issue costs	-	<u>(6,856,027)</u>
Balance, July 31, 2005	<u>73,386,515</u>	<u>\$ 204,065,585</u>

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# Gammon Lake Resources Inc.

## Notes to the Consolidated Financial Statements

(Audited)  
July 31, 2005

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### 11. Capital stock (continued)

#### Escrow shares

As at July 31, 2005, 15,000 common shares issued to promoters of the Company and other investors are held in escrow and will be released subject to certain regulatory approvals.

#### Stock options

The Company has a stock option plan under which options to purchase common shares of the Company may be granted to directors, senior officers, employees and service providers of the Company. The aggregate number of common shares which may be reserved for issuance under the plan shall be 17,527,000. The maximum number of common shares which may be reserved for issuance to any one person under the plan shall be 5% of the shares outstanding at the time of grant (on a non-diluted basis) less the aggregate number of shares reserved for issuance to such person under any other option to purchase shares from treasury granted as a compensation or incentive mechanism.

During the year ended July 31, 2005, 2,512,000 options were granted to consultants, directors and employees, of which 2,016,000 options are subject to shareholder approval. During the year ended July 31, 2005, 521,000 options granted to consultants were expensed based on the fair value of the options on the date granted. As a result, \$29,600 was recorded as professional fees, and \$1,478,080 as wages and benefits with a corresponding credit to contributed surplus. The remaining 2,016,000 options will vest upon shareholder approval, at which time \$3,356,200 will be recorded as professional fees and \$2,675,530 as wages and benefits with a corresponding credit to contributed surplus. The fair value of the options granted was calculated using the Black-Scholes option pricing model with the following assumptions:

Options earned during the 1 <sup>st</sup> quarter:		Options earned during the 2 <sup>nd</sup> quarter:	
Dividend yield	0%	Dividend Yield	0%
Expected volatility	60.88%	Expected volatility	62.11%
Risk free interest rate	2.99%	Risk free interest rate	3.94%
Expected life	1 year	Expected life	5 years

  

Options earned during the 3 <sup>rd</sup> quarter	
Dividend Yield	0%
Expected Volatility	52.34%
Risk Free Interest Rate	3.50%
Expected Life	5 years

# Gammon Lake Resources Inc.

## Notes to the Consolidated Financial Statements

(Audited)  
July 31, 2005

### 11. Capital stock (continued)

During the year ended July 31, 2004, 4,050,000 options that were issued to directors, employees, and consultants were approved at the Company's annual meeting held on October 27, 2004. These options vested upon approval, and the fair value amount of \$5,294,627 was recorded as professional fees and \$7,172,373 as wages and benefits with a corresponding credit of \$12,467,000 to contributed surplus during the year ended July 31, 2005.

The fair value of the option grant that was approved at the annual meeting held on October 27, 2004 was calculated using the Black-Scholes option pricing model with the following average assumptions:

Dividend yield	0%
Expected volatility	63.00%
Risk free interest rate	3.59%
Expected life	5 years

An aggregate of 19,542,300 options have been granted pursuant to the Company's stock option plan of which 7,925,800 have been exercised and 227,000 have expired. Set forth below is a summary of the outstanding options to purchase common shares as at July 31, 2005.

Option Price	Options Outstanding			Options Exercisable	
	Number outstanding	Weighted average remaining contractual life (yrs)	Weighted average exercise price	Number exercisable	Weighted average exercise price
\$ 0.00 - \$ 0.50	30,000	1.16	\$ 0.50	30,000	\$ 0.50
\$ 0.51 - \$ 1.00	467,500	1.59	\$ 0.96	467,500	\$ 0.96
\$ 1.01 - \$ 1.50	1,555,000	1.75	\$ 1.22	1,555,000	\$ 1.22
\$ 2.51 - \$ 3.00	2,750,000	2.93	\$ 3.36	2,750,000	\$ 3.36
\$ 5.01 - \$ 5.50	4,000,000	3.51	\$ 5.45	4,000,000	\$ 5.45
\$ 6.01 - \$ 6.50	2,422,000	4.52	\$ 6.12	496,000	\$ 6.12
\$ 7.01 - \$ 7.50	25,000	1.04	\$ 7.00	25,000	\$ 7.00
\$ 7.51 - \$ 8.00	50,000	3.78	\$ 7.94	50,000	\$ 7.94
\$9.51 - \$10.00	90,000	4.53	\$10.00	-	-

# Gammon Lake Resources Inc.

## Notes to the Consolidated Financial Statements

(Audited)  
July 31, 2005

### 11. Capital stock (continued)

#### Fixed Options

	July 31, 2005		July 31, 2004	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding, beginning of period	9,892,300	\$ 3.44	7,951,000	\$ 1.79
Granted	2,512,000 (2)	\$ 6.27	4,197,000 (1)	\$ 5.48
Expired	(20,000)	\$ (5.45)	(127,000)	\$ (4.70)
Exercised	(994,800)	\$ (2.29)	(2,128,700)	\$ (1.13)
Outstanding, end of period	<u>11,389,500</u>	\$ 4.16	<u>9,892,300</u>	\$ 3.44
Options exercisable, end of period	<u>9,373,500</u>	\$ 3.71	<u>5,797,300</u>	\$ 2.00

(1) Included 4,050,000 options which were approved at the annual and special meeting held on October 27, 2004.

(2) Includes 2,016,000 options subject to shareholder approval.

#### Compensation Warrants

During the year ended July 31, 2005, 314,300 compensation warrants were granted to agents as part of the private placement and were expensed based on the fair value of the warrants on the date granted. As a result, \$782,607 was recorded as share issue costs with a corresponding credit to contributed surplus. The fair value of the warrants granted was calculated using the Black-Scholes option pricing model with the following assumptions:

Dividend yield	0%
Expected volatility	62.00%
Risk free interest rate	2.88%
Expected life	2 years

A summary of the 762,376 outstanding compensation warrants and options to purchase common shares as at July 31, 2005 is as follows:

Number of Common Shares Under Compensation Warrant/option	Expiration Date	Exercise Price
277,344	August 15, 2006	\$ 3.48
170,732	November 21, 2006	\$ 6.15
314,300	December 16, 2006	\$ 7.00

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# Gammon Lake Resources Inc.

## Notes to the Consolidated Financial Statements

(Audited)  
July 31, 2005

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### 12. Loss per share

Loss per share is calculated based on the weighted average number of shares outstanding during the year ended July 31, 2005 of 66,002,431 (2004 – 52,298,985)

Diluted earnings (loss) per share is based on the assumption that options under the stock options plan and warrants have been exercised on the later of the beginning of the year and the date granted. The treasury stock method is used to determine the dilutive effect of stock options and warrants. The treasury stock method assumes that proceeds received from the exercise of the in-the-money stock options and warrants are used to repurchase shares at the average market rate. The diluted weighted average number of shares for the year ended July 31, 2005 and 2004 were not presented, as all factors are anti-dilutive.

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### 13. Related party transactions

The Company paid the following amounts to directors and companies controlled by or related to directors:

	2005	2004
Management fees	\$ 278,440	\$ 412,500
Professional fees	-	29,538
Mineral property exploration expenditures	<u>4,392,431</u>	<u>2,186,478</u>
	<u>\$ 4,670,871</u>	<u>\$ 2,628,516</u>

The Company received the following amounts from related companies:

Professional fees	\$ 51,600	\$ -
Travel	118,110	-
General & Administrative	<u>54,850</u>	<u>-</u>
	<u>\$ 224,560</u>	<u>\$ -</u>

All related party transactions which occur in the normal course of operations are recorded at the exchange amount. During the period, Gammon charged a management fee to Mexgold Resources Inc. to recover expenditures related to professional fees, travel, and general and administrative expenses. The amounts due from Mexgold Resources Inc. are non-interest bearing with no fixed term of repayment.

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### 14. Subsequent events

a) On September 1, 2005, a Director of the Company exercised 150,000 options at \$0.80 for total proceeds of \$120,000.

b) In accordance with National Instrument 51-102, the Company has determined to change its year end from July 31<sup>st</sup> to December 31<sup>st</sup>. The Company will report its interim statements for the two months ended September 30, 2005, and the five months ended December 31, 2005.

# Gammon Lake Resources Inc.

## Notes to the Consolidated Financial Statements

(Audited)  
July 31, 2005

### 15. Differences between Canadian and U.S. generally accepted accounting principles

The following represents additional information to the consolidated financial statements of the Company that were prepared in accordance with accounting principles generally accepted in Canada ("Canadian GAAP"). Set out below are the material adjustments to net loss for the years ending July 31, 2005 and 2004 and to shareholders' equity at July 31, 2005 and 2004 in order to conform to accounting principles generally accepted in the United States of America (U.S. GAAP).

#### Statement of loss:

	Year Ended July 31 2005	Year Ended July 31 2004
Net loss for the year based on Canadian GAAP	\$(19,375,595)	\$(6,958,300)
Deferred exploration costs prior to the establishment of proven and probable mineral reserves (a)	(11,274,760)	(26,266,246)
Write off of mineral properties and related deferred costs capitalized in prior periods under Canadian GAAP (b)	-	1,063,448
Future income taxes relating to deferred exploration costs (a)	(1,475,253)	1,974,800
Amortization of mineral rights (a)	-	(6,376,293)
Future income tax relating to the amortization of mineral rights (a)	-	1,697,611
Foreign exchange gain on future income taxes liability previously expensed	(1,000)	(142,000)
Interest expense on long term debt adjusted to fair value (f)	(526,154)	(575,125)
Foreign exchange gain on adjusted long term debt (f)	(243,463)	(190,434)
<b>Net loss for the year based on U.S. GAAP</b>	<b>\$(32,896,225)</b>	<b>\$ (35,772,539)</b>
<b>Loss per share, basic and diluted</b>	<b>\$ (0.50)</b>	<b>\$ (0.68)</b>

# Gammon Lake Resources Inc.

## Notes to the Consolidated Financial Statements

(Audited)  
July 31, 2005

### 15. Differences between Canadian and U.S. generally accepted accounting principles (continued)

#### Shareholders' equity:

	July 31 2005	July 31 2004
Shareholders' equity based on Canadian GAAP	\$189,823,534	\$89,018,639
Deferred exploration costs prior to the establishment of proven and probable mineral reserves (a)	(49,991,581)	(43,046,290)
Future income taxes relating to deferred exploration costs (a)	3,932,570	5,407,570
Amortization of mineral rights (a)	(12,749,889)	(12,749,889)
Future income taxes relating to the amortization of mineral rights (a)	3,259,142	3,259,142
Foreign exchange gain on future income taxes liability previously expensed with exploration costs (a)	(745,000)	(744,000)
Adjustment for exploration costs on abandoned properties (b)	1,258,296	1,258,296
Interest expense on long term debt adjusted to fair value (f)	(2,194,304)	(1,668,150)
Foreign exchange gain on fair value adjusted long term debt (f)	(851,459)	(607,996)
Shareholders' equity based on U.S. GAAP	\$131,741,309	\$40,127,322

#### Balance sheet differences:

The following material balance sheet differences exist between Canadian and U.S. GAAP.

#### 1) Mineral properties and related deferred costs

	July 31 2005	July 31 2004
Canadian GAAP	\$115,997,986	\$80,041,737
Deferred exploration costs prior to the establishment of proven and probable mineral reserves (a)	(49,991,581)	(43,046,290)
Amortization of mineral rights (a)	(12,749,889)	(12,749,889)
Adjustment for exploration costs on abandoned properties (b)	1,258,296	1,258,296
Adjustment for mineral property purchase at fair value (f)	(3,713,090)	(3,713,090)
U.S. GAAP	\$50,801,722	\$21,790,764

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# Gammon Lake Resources Inc.

## Notes to the Consolidated Financial Statements

(Audited)  
July 31, 2005

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### 15. Differences between Canadian and U.S. generally accepted accounting principles (continued)

#### 2) Long term debt

	July 31 2005	July 31 2004
Canadian GAAP	\$8,581,300	9,304,400
Adjustment of long term debt to fair value (f)	(3,713,090)	(3,713,090)
Interest payable on long term debt adjusted to fair value (f)	2,194,304	1,668,150
Foreign exchange gain on fair value adjusted long term debt (f)	851,459	607,996
U.S. GAAP	\$7,913,973	\$7,867,456

#### 3) Future income taxes

	July 31 2005	July 31 2004
Canadian GAAP	\$8,121,000	\$10,170,900
Future income taxes relating to deferred exploration costs (a)	(3,932,570)	(5,407,570)
Future income taxes relating to the amortization of mineral rights (a)	(3,259,142)	(3,259,142)
Foreign exchange gain on future income tax liabilities previously expensed (a)	745,000	744,000
U.S. GAAP	\$1,674,288	\$2,248,188

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# Gammon Lake Resources Inc.

## Notes to the Consolidated Financial Statements

(Audited)  
July 31, 2005

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### 15. Differences between Canadian and U.S. generally accepted accounting principles (continued)

#### a) Mineral properties and related deferred costs

In March 2002, the Emerging Issues Committee of the CICA issued EIC 126 – “Accounting by Mining Enterprises for Exploration Costs” which affects mining companies with respect to the deferral of exploration costs. EIC 126 refers to CICA Handbook Section 3061 “Property, Plant and Equipment”, paragraph .21 which states that for a mining property, the cost of the asset includes exploration costs if the enterprise considers that such costs have the characteristics of property, plant and equipment. EIC 126 then states that a mining enterprise that has not established mineral reserves objectively, and therefore does not have a basis for preparing a projection of the estimated cash flow from the property is not precluded from considering the exploration costs to have the characteristics of property, plant and equipment. EIC 126 also sets forth the Committee’s consensus that a mining enterprise in the exploration stage is not required to consider the conditions regarding impairment in determining whether exploration costs may be initially capitalized. With respect to impairment of capitalized exploration costs, if an enterprise has not established mineral reserves objectively, and therefore does not have a basis for preparing a projection of the estimated cash flow from the property it is not obliged to conclude that capitalized costs have been impaired. However, such an enterprise should consider the conditions set forth in CICA Handbook Section 3061 in determining whether subsequent write-down of capitalized exploration costs related to mining properties is required.

Under Canadian GAAP, the Company considers that exploration costs have the characteristics of property, plant and equipment and, accordingly, defers such costs. Furthermore, pursuant to EIC 126, deferred exploration costs would not automatically be subject to regular assessment of recoverability, unless certain conditions exist.

Under United States GAAP, exploration costs are not considered to have the characteristics of property, plant and equipment and accordingly are expensed prior to the Company determining that proven or provable mineral reserves exist, after which time all such costs are capitalized. Proven and probable mineral reserves were determined on January 31, 2005. Exploration costs subsequent to this date have been capitalized. This is consistent with their treatment under Canadian GAAP.

Prior to May 1, 2004, the Company considered mineral rights to be intangible assets with finite lives pursuant to FAS 142 and amortized over the estimated useful lives of 6 years. EITF-04-2 concluded that mineral rights are tangible property and the aggregate carrying amount of the mineral rights should be reported as a separate component of property, plant and equipment.

#### b) Adjustment for exploration costs on abandoned properties

The Company accounts for mineral properties and related deferred expenditures as described in item (a). During the years ended July 31, 2004, 2001 and 2000, \$1,063,448, \$150,784 and \$44,064 respectively was written-off as the development was not considered economically feasible and therefore abandoned. Under U.S. GAAP these costs would have been expensed in a prior period. The write-off of the mineral rights under U.S. GAAP would be included in expenses and the sub-total “loss before write-off” would not be permitted.

#### c) Stock-based compensation

Effective August 1, 2003, the Company accounted for its stock based compensation under US GAAP in accordance with FAS No. 123 (fair value method) for both employees and non-employees.

Under Canadian GAAP, stock options granted to employees and non-employees prior to August 1, 2002 were accounted for as capital transactions when the options were exercised. For the year ended July 31,

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# Gammon Lake Resources Inc.

## Notes to the Consolidated Financial Statements

(Audited)  
July 31, 2005

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### 15. Differences between Canadian and U.S. generally accepted accounting principles (continued)

2003, under Canadian GAAP, stock options granted to employees and directors continued to be accounted for as capital transactions and stock options granted to non-employees were accounted for using the fair value method. Subsequent to August 1, 2003, under Canadian GAAP, stock options granted to employees and non-employees were accounted for using the fair value method.

Prior to August 1, 1999, the Company had issued stock options to non-employees with a total fair value of \$180,613 which was expensed for U.S. GAAP purposes.

#### d) Statements of cash flows

As a result of the treatment of mining interests under item (a) above, cash expended for exploration costs would be classified as operating rather than investing, resulting in the following totals.

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	Year Ended July 31 2005	Year Ended July 31 2004
Cash used in operations	\$(20,250,044)	\$(27,194,685)
Cash used in investing	\$(63,576,357)	\$(16,256,566)

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#### e) Comprehensive income

Effective for fiscal years beginning after December 15, 1997, Statement of Financial Accounting Standards No. 130 "Reporting Comprehensive Income" ("FAS 130"), is applicable for US GAAP purposes. FAS 130 establishes standards for the reporting and display of comprehensive income and its components in a full set of general purpose financial statements. FAS 130 requires that all items that are required to be recognized under accounting standards as components of comprehensive income be reported in a financial statement.

#### f) Fair value of long term debt

In consideration for the Soyopa claims acquired in November, 2001 (Note 6(b)), the Company entered into a non-interest bearing loan agreement as disclosed in Note 7. Under Canadian GAAP, this loan has been presented at its face value of US \$7,000,000. Under US GAAP, interest must be imputed on this loan in accordance with APB 21. The reduction in the principal amount of the loan as a result of imputing a market rate of interest also reduces the carrying values of the company's mineral properties accordingly.

During the periods subsequent to November, 2001, the interest imputed on the loan is recorded as a period expense.

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### 16. Financial instruments

The Company's financial instruments consisted of cash and cash equivalents, receivables, payables and long term debt. Unless otherwise noted, it is management's opinion that the Company is not exposed to significant interest or credit risks arising from these financial instruments. Some of the Company's receivables and payables are denominated in Mexican Pesos and the Company's long term debt is denominated in United States dollars. Balances are translated at the period end based on the Company's accounting policy as set out in Note 2 to the consolidated financial statements. The long term debt creates a risk to the Company's earnings

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# Gammon Lake Resources Inc.

## Notes to the Consolidated Financial Statements

(Audited)  
July 31, 2005

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### 16. Financial instruments (continued)

that arises from fluctuations in foreign exchange rates and the degree of volatility of these rates. The company does not enter into derivative financial instruments to mitigate the foreign exchange risks related to the foregoing items.

The Company estimates that the fair value of its cash and cash equivalents, receivables, and payables approximate the carrying value of the assets and liabilities. The Company has calculated the fair value of its long term debt as disclosed in Note 15.

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### 17. Supplemental cash flow information

	<u>2005</u>	<u>2004</u>
<b>Change in non-cash working capital:</b>		
Receivables	\$(2,779,637)	\$(1,929,323)
Prepays	(831,027)	(99,393)
Payables and accruals	<u>(429,499)</u>	<u>2,954,183</u>
	<u><b>\$(4,040,163)</b></u>	<u>\$ 925,467</u>
<b>Supplemental information</b>		
Interest paid	\$ Nil	\$ Nil
Income taxes paid	\$ Nil	\$ Nil
<b>Cash and equivalents</b>		
Cash	\$13,752,796	\$ 1,138,591
Temporary money market instruments	<u>21,647,553</u>	<u>11,882,349</u>
	<u><b>\$35,400,349</b></u>	<u>\$13,020,940</u>

Temporary money market instruments consist of commercial paper with terms of less than 30 days, having rates between 2.46%-2.48%.

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### 18. Comparative figures

Certain of the comparative figures for 2004 have been reclassified to conform with the financial statement presentation adopted for 2005.

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**Gammon Lake Resources Inc.**  
**Notes to the Consolidated Financial Statements**

(Audited)  
July 31, 2005

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**Gammon Lake Resources Inc.**  
**Notes to the Consolidated Financial Statements**

(Audited)  
July 31, 2005

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# GAMMON LAKE RESOURCES INC.

## MANAGEMENT DISCUSSION AND ANALYSIS FOR THE YEAR ENDED JULY 31, 2005

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September 30, 2005

*This management discussion and analysis is made as of September 30, 2005, and should be read in conjunction with the consolidated financial statements of the Company for the year ended July 31, 2005, including all accompanying notes to the financial statements.*

Gammon Lake Resources Inc. ("the Company") is a growth-oriented public gold and silver mining exploration company listed on the Toronto Stock Exchange (TSX:GAM) and the American Stock Exchange (AMEX:GRS). The Company has ongoing advanced stage exploration and development at its Ocampo Project located in Chihuahua State, Mexico. As a result, the Company has no current sources of revenue other than interest earned on cash and short-term money-market instruments, all of which were derived from issuances of share capital.

The consolidated financial statements of the Company have been prepared by management in accordance with Canadian generally accepted accounting principles (GAAP) (see Summary of Significant Accounting Policies and Note 2: Basis of Presentation), which differ in certain material respects from accounting principles generally accepted in the United States of America (US GAAP). Differences between GAAP and US GAAP applicable to the Company are described in Note 15 to the consolidated financial statements for the year ended July 31, 2005. The Company's reporting currency is in Canadian dollars unless otherwise noted.

Certain information regarding the Company contained herein may constitute forward-looking statements within the meaning of applicable securities laws. Forward-looking statements may include estimates, plans, expectations, opinions, forecasts, projections, guidance or other statements that are not statements of fact including, without limitation, statements regarding potential mineralization and reserves, including the impact of any future exploration on reserve estimates; expectations regarding the timing and extent of production at the Ocampo project; estimates regarding the future costs related to exploration at Ocampo; the nature and availability of additional funding sources; and future plans and objectives of Gammon Lake. In some cases, you can identify forward-looking statements by the use of words such as may, will, should, could, expect, plan, intend, anticipate, believe, estimate, predict, potential or continue or the negative or other variations of these words, or other comparable words or phrases. Although the Company believes that the expectations reflected in such forward-looking statements are reasonable, it can give no assurance that such expectations will prove to have been correct. Important factors that could cause actual results to differ materially from the Company's expectations include, among others, risks related to international operations, including political turmoil and limited local infrastructure to support large scale mining operations; the actual results of current exploration activities; delays in the construction of the production shaft at Ocampo; unexpected costs overruns in construction including increased labor or material costs or technical construction challenges; conclusions of economic evaluations and changes in project parameters as plans continue to be refined; and fluctuations in future prices of gold and silver. The Company's forward-looking statements are expressly qualified in their entirety by this cautionary statement.

### **2005 Highlights**

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- Gammon Lake announces construction and development of Ocampo Gold-Silver project remains on schedule and on budget for production in first quarter of 2006, August, 2005
- Gammon Lake announces that all Underground and Open-Pit Equipment has been purchased, and that Project Development remains on-schedule and on-budget, April, 2005
- Gammon Lake also reports results of eighth round of surface drilling and underground drilling from Ramp Development, drilling in the Northeast Underground Area of the project returned 37 intercepts above a 3.0 gram per tonne cut off grade in 47 holes, April, 2005
- Gammon Lake announces newly drilled San Ramon returns 18.73 grams per tonne Gold, and 1,026 Grams per Tonne Silver over a 10-metre intercept. A Bonanza Silver Intercept over 1.8 metres encounters grades of 7,052 grams per tonne Silver and 14.0 Grams per tonne Gold, April, 2005.
- Gammon Lake announces purchase of truck fleet for Open-Pit Operations from Terex, February, 2005.
- Gammon Lake assembles Mine Development & Operations team, February, 2005

# GAMMON LAKE RESOURCES INC.

## MANAGEMENT DISCUSSION AND ANALYSIS FOR THE YEAR ENDED JULY 31, 2005

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- Gammon Lake hires Kappes, Cassidy & Associates of Reno, Nevada for Mill and Heap Leach Construction, and announces commencement of construction, February, 2005
- Gammon Lake completes a Private Placement Financing of Cdn\$110,005,000, January, 2005
- Gammon Lake announces new drill results from Ocampo Northeast Underground Project Area, January, 2005
- President of Gammon Lake, Fred George, meets with President Fox of Mexico and confirms Ocampo Project infrastructure support, January, 2005

Further details on the history of the Company, its mineral properties and the risk factors associated with respect to the Company can be found under the Company's associated documents including its Annual Information Form at [www.sedar.com](http://www.sedar.com) or on the Company's website at [www.gammonlake.com](http://www.gammonlake.com).

### Overall Performance

*In the past year, the Company reached several of its significant short-term and long-term goals and is well positioned to meet the immediate objective of producing on average **270,000 ounces of gold-equivalent reserves per annum commencing in 2006. Production out-put from the first year of mining is expected to exceed 300,000 ounces gold-equivalent.***

The Company has been in the construction phase since January, 2005 for developing the Ocampo Mine and is on target for production in the first quarter of 2006. The Company has been working closely with Kappes, Cassidy & Associates (KCA) on the engineering, procurement and construction management of the Mine. Ground breaking for the construction of the Ocampo underground, open pit mines, and two surface processing facilities began in early March, 2005. Through July 31, 2005, the Company has achieved the following milestones:

- all major earthworks for the water dam, heap leach crushing facilities and overland conveyer
- phase one of the heap leach pads for the first 10-million tones of heap leach ore
- construction of seven support service buildings
- construction of eight staff hotels, including new kitchen and restaurant
- contractor's camp for 500 men
- procurement of project power generation and distribution facilities
- delivery of all major components for the heap leach crusher area
- stope development commenced in underground for production purposes
- As of July 31, 2005, 69% of the funds necessary for construction have been committed

The Company has also been successful in procuring all of the Underground and Open-Pit Equipment as outlined in the bankable feasibility study for Phase One, and considers this a significant achievement given world-wide shortages in mining equipment and parts.

The Company also continued its aggressive drill program, and has continued an exploration program at the Ocampo Project focused on upgrading inferred resources, as well as expanding the overall project resource/reserve base through the exploration of secondary targets identified on the property. A total of 331 holes have been drilled at Ocampo since the June 10, 2004 cut off. The Company intends to complete a revised resource/reserve calculation prior to the end of the 2005 calendar year. The Company will incorporate a sizable amount of data from ongoing exploration, and this is expected to result in a significant expansion of resources/reserves.

In the latest round of exploration drilling, 39 new holes drilled in the Northeast Underground Area of the project produced 42 intercepts above a 3.0 gram per tonne underground cut off grade. Highlights include hole OU-280 intersecting 2.3 meters grading 58.98 grams per tonne gold and 1,999 grams per tonne silver, for a gold-equivalent grade of 89.7 grams per tonne. Drilling in the Open Pit Area of the project returned 18 intercepts above an open pit cut off grade of 0.3 grams per tonne, in 15 holes. Drilling in this area of the project has encountered a number of high grade intervals significantly above the 0.3 gram per tonne cut off. Results from drilling in the Open Pit Area also continue to demonstrate shallowly emplaced mineralization over significant interval widths.

# GAMMON LAKE RESOURCES INC.

## MANAGEMENT DISCUSSION AND ANALYSIS FOR THE YEAR ENDED JULY 31, 2005

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The Company had also reported results from the seventh and eighth round of surface drilling and underground drilling from ramp development. In the seventh round, the 63 holes reported from the Northeast Underground Project Area produced 79 intercepts above an underground cut off grade of 3 grams per tonne. The 34 holes reported from the Open-Pit Project Area were the focus of exploration efforts targeting San Ramon, a previously undrilled structure. Drilling on San Ramon returned grades of 18.73 grams per tonne gold and 1,026 grams per tonne silver over an intercept of 10 meters in hole OG-212. In the eighth round, drilling in the Northeast Underground Area of the project returned 37 intercepts above a 3.0 gram per tonne cut off grade, in 47 holes.

The Company completed the bankable feasibility study for Phase One of the Ocampo Gold-Silver Project in early November 2004. The independent study was performed by Kappes, Cassidy & Associates of Reno, Nevada and incorporated an independent report on mineral resources and ore reserves prepared by Mintec Inc. of Tucson, Arizona. The independent study demonstrates extremely robust economic potential with **average annual production** expected at **270,000 ounces of gold equivalent (170,000 ounces of gold and 6,200,000 ounces of silver)**.

The first phase of the project involves the development of an open-pit and underground mining operation. Based on detailed mine planning as part of the feasibility study, MINTEC Inc. has calculated proven and probable mineral reserves in the Open-Pit Area amounting to **1.43-million ounces gold-equivalent**, with a further **833,000 ounces of gold-equivalent reserves** contained in the Northeast Underground Area. AST Mining of Sudbury, Ontario, developed the mine plan for the underground reserves. The estimated capital cost is US\$104 million.

Mine production is expected to commence in the first quarter of 2006 at a rate of 11,400 tonnes per day from the Open-Pit Area and 1,500 tonnes per day from the Northeast Underground Area. **Mine production is expected to average 270,000 ounces gold-equivalent per year** over the first seven years of mining at an **average cash cost of US \$151.74 per ounce**.

In January 2005, Gammon Lake **successfully raised gross proceeds of C\$110,005,000** through a private placement. BMO Nesbitt Burns acted as lead agent in a syndicate that included RBC Dominion Securities Inc., and First Associates Investments Inc. A total of **15,715,000 Special Warrants were issued at Cdn\$7.00 per Special Warrant**. The proceeds of the financing are being applied to working capital and the development of Phase One of the Ocampo Gold-Silver Project in accordance with the bankable feasibility study as announced on November 11, 2004. Gammon Lake is also investigating options for project debt financing. **The site preparation for mill and heap-leach construction began in January 2005**, enabling projected production from Ocampo to commence by the first quarter of calendar 2006.

Gammon Lake also **assembled a world class Mine Development and Operations Team**. In February, 2005, Gammon Lake announced that it has hired John C. Thornton as its Chief Operating Officer, John Roberts as its Chief Mine Engineer, and Richard Jeffress as its Manager of Projects. Cumulatively, they bring over **100 years** of industry experience to the Ocampo Project. Gammon Lake also **appointed Kappes, Cassidy & Associates to construct the mill and heap leach under an Engineering, Procurement and Construction Management contract**. **Site preparations for mill and heap-leach construction are now underway at the Project**, including land clearing and road construction. The shaft being constructed from an underground ramp is in the final stages of engineering review and broke through surface in June, 2005. The shaft will be equipped with a hoist, capable of hoisting up to **6,000-tonnes per day**.

The Company continued underground development and exploration on the Ocampo gold-silver project through its two major programs: the construction of six kilometers of underground tunnels and ramps, and a 65,000-metre diamond core drill program in the Underground Area, and a 30,000-metre deep drilling program in the Open-Pit Area. To date, the Ocampo deposits are defined by **980 drill holes** and more than **166,000 metres of drilling**. In January 2005, Gammon Lake announced results from 30 new step-out and in-fill drill holes from the sixth round of surface drilling and underground drilling.

# GAMMON LAKE RESOURCES INC.

## MANAGEMENT DISCUSSION AND ANALYSIS FOR THE YEAR ENDED JULY 31, 2005

### Ocampo Proven and Probable Reserves

Project Area	Deposit Type	Gold (g/t)	Silver (g/t)	Gold-Equivalent (g/t)	Tonnes (000's)	Ounces Gold	Ounces Silver	Ounces Gold-Equivalent*
Northeast Area	Underground	4.51	240	8.42	3,080	447,000	23,768,000	833,000
Open-Pit Area	High-Grade Open-Pit	1.67	62	2.68	14,158	760,000	28,225,000	1,218,000
	Low-Grade Open-Pit	0.27	8	0.40	16,323	142,000	4,199,000	210,000
<b>Total Ocampo Proven &amp; Probable</b>		1.25	52	2.10	33,561	1,349,000	56,192,000	2,261,000

\*Gold equivalent values based on 61.54 grams of silver equals 1 gram of gold (61.54:1)

Mr. James McGlasson, P.Geo., is the qualified person for the purposes of the technical information contained herein pursuant to the requirements of National Instrument 43-101.

### Selected Annual Information

The following selected information has been extracted from the Company's audited consolidated financial statements for the year ended July 31, 2005.

SELECTED ANNUAL INFORMATION (JULY 31)	2005	2004	2003
	\$	\$	\$
Revenue	1,423,576	635,056	466,143
Net loss	(19,375,595)	(6,958,300)	(534,771)
Net loss per share, basic and diluted <sup>(1)</sup>	(0.29)	(0.13)	(0.02)
Cash dividends declared	Nil	Nil	Nil
Assets	210,348,878	112,532,744	57,910,540
Long-Term Liabilities	8,795,038	9,304,400	9,870,000

# GAMMON LAKE RESOURCES INC.

## MANAGEMENT DISCUSSION AND ANALYSIS FOR THE YEAR ENDED JULY 31, 2005

### Summary of Quarterly Results

SELECTED QUARTERLY INFORMATION	FOR THE QUARTER ENDED			
	31-Jul-05	31-Apr-05	31-Jan-05	31-Oct--04
	\$	\$	\$	\$
Revenue	377,852	562,833	392,702	90,189
Net loss	(3,569,729)	(2,276,052)	(1,628,216)	(11,901,598)
Net loss per share, basic and diluted <sup>(1)</sup>	(0.05)	(0.03)	(0.03)	(0.21)
Cash dividends declared	Nil	Nil	Nil	Nil
Assets	210,348,878	208,797,511	209,461,210	108,764,341
Long-Term Liabilities	8,795,038	8,798,300	8,666,000	8,544,900

SELECTED QUARTERLY INFORMATION	FOR THE QUARTER ENDED			
	31-Jul-04	30-Apr-04	31-Jan-04	31-Oct-03
	\$	\$	\$	\$
Revenue	81,017	109,335	138,373	306,331
Net loss	(442,462)	(2,189,825)	(2,370,981)	(1,955,032)
Net loss per share, basic and diluted <sup>(1)</sup>	(0.01)	(0.04)	(0.05)	(0.04)
Cash dividends declared	Nil	Nil	Nil	Nil
Assets	112,532,744	108,052,793	87,635,912	71,563,163
Long-Term Liabilities	9,304,400	9,594,900	9,242,800	9,237,900

<sup>(1)</sup> Net loss per share on a diluted basis is the same as net loss per share on an undiluted basis, as all factors which were considered in the calculation are anti-dilutive.

During the three months ended July 31, 2005, the Company earned income of \$377,852. This represents a decrease from the previous quarter due to lower cash balances, therefore lower cash to invest in the short-term. The Company's net loss for the three months ended July 31, 2005 was \$3,569,729 (July 31, 2004 - \$442,462) and \$0.05 per common share. The Company's asset base increased to \$210,348,878 (July 31, 2004 - \$112,532,744) due to the acquisition of additional assets, and the increase in receivables as it relates to commodity taxes recoverable. The Company's long term debt of \$8,795,038 (July 31, 2004 - \$9,304,400) increased during the quarter due to the commencement of accruing future employee benefits for contract workers in Mexico paid through an employment services company.

Effective August 1, 2003, the Company prospectively adopted the recommendations of CICA Handbook Section 3870, Stock Based Compensation and Other Stock-based Payments for employees and non-employees. During the year ended July 31, 2005, \$14,757,287 (July 31, 2004 - \$3,971,022) was recorded as contributed surplus based on the fair value of employee and consultant's options and broker warrants granted in the year. The corresponding amounts were recorded in professional fees for consultants in the amount of, \$5,324,227 (July 31, 2004 - \$2,633,800), wages for employees in the amount of, \$8,650,453 (July 31, 2004 - \$39,260), and share issue costs in the amount of, \$782,607 (July 31, 2004 - \$1,297,962).

### Results of Annual Operations

During the year ended July 31, 2005, the Company earned income of \$1,423,576 ( July 31,2004 - \$635,056), of which \$1,199,016 (July 31, 2004- \$405,056) was due to interest on short-term investments , \$Nil (July 31, 2004 - \$230,000) to management fees paid by a former joint venture partner, and \$224,560 (July 31, 2004 - Nil) was charged as Management Fees to Mexgold Resources Inc. to recover expenditures related to professional fees, travel and general and administrative costs. In 2004, the Company completed a buy-out of its Ocampo open-pit joint venture partner, which resulted in an elimination of the management fees received from the joint venture earn-in agreement for subsequent periods.

# GAMMON LAKE RESOURCES INC.

## MANAGEMENT DISCUSSION AND ANALYSIS FOR THE YEAR ENDED JULY 31, 2005

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Amortization expense for the year ended July 31, 2005 was \$537,540 (July 31, 2004 - \$146,468). Amortization expense has increased significantly due to the purchase of mining equipment and facilities costs during the current period and in the previous year. The equipment purchased consisted of heavy equipment for the Open-Pit and Underground operations. The Company also constructed new residences and cafeteria for on-site staff.

General and administrative expenses during the year ended July 31, 2005 were \$2,593,683 (July 31, 2004 \$2,173,945). Professional fees during the year ended July 31, 2005 were \$7,105,542 (July 31, 2004 - \$4,519,252). General and administrative and professional fees have increased due to the general support for the Company's activities, as well as promotional and shareholder relations costs related to the operation of a public company and the cost of maintaining dual stock exchange listings. Included in professional fees for the year ended July 31, 2005 is a non-cash charge of \$5,324,227 (July 31 - \$2,633,800) related to the fair value of options issued to consultants during the nine month period. A corresponding amount has been credited to contributed surplus.

During the year ended July 31, 2005 the Company incurred expenses of \$9,651,178 (July 31, 2004 - \$605,584) for wages and benefits. Included in the year ended July 31, 2005 wages and benefits is a non-cash charge of \$8,650,453 (July 31, 2004 - \$39,260) related to the fair value of options issued to employees and directors during the year. A corresponding amount has been credited to contributed surplus. General increases during the year end exclude the options, and are due to the additional staffing in the finance and administrative department.

Foreign exchange gains of \$312,172 (July 31, 2005 - \$2,022,149) earned during the year ended July 31, 2005 were due to a long-term debt denominated in U.S. dollars and the translation of the Company's operations from Mexican pesos to Canadian dollars. The Company will continue to experience these foreign currency exchange fluctuations given its U.S. dollar denominated debt and Mexican operations. To minimize the exposure to foreign currency fluctuations, the Company holds all surplus funds in Canadian dollars.

The Company's carrying value of its investment of 10.9 million shares in Mexgold Resources Inc. was decreased by \$1,226,000 to a carrying value of \$10,422,000 due to its equity share of loss for the year ended July 31, 2005. The market value of the investment on July 31, 2005 was \$29,430,000 based on the TSX Venture Exchange closing price of \$2.70 per share for Mexgold Resources Inc. on July 31, 2005.

The net loss for the year ended July 31, 2005 was \$19,375,595 (July 31, 2005 - \$6,958,300) and \$0.29 per common share (July 31, 2004 - \$0.13 per common share). The increasing losses before foreign exchange gains, mineral property write-offs, and equity share of loss reflects the expenses of supporting the Company's ongoing and expanded exploration and development activities on the Ocampo Project, and the recognition of the fair value of the options granted to directors, employees and consultants.

### **Ocampo Gold-Silver Project**

During the year ended July 31, 2005, the Company continued its development of the Ocampo property with expenditures of \$35,956,248 (July 31, 2004 \$26,300,000) as part of its 166,000-metre drill program and 6-km underground ramp and tunnel development project. Included in the mineral property expenditures was a non-cash future tax adjustment of (\$1,475,253) (July 31, 2004 - 1,974,832). Significant expenditures during the year ended July 31, 2005 on the property consisted of \$10,383,298 for equipment and consumables, \$5,772,270 for underground contract mining fees, \$4,449,719 for diamond core drilling, \$6,469,323 for geological services and studies, \$2,419,254 for development of the Heap leach facility, and \$2,375,148 for travel.

The Company has released an updated resource study dated September 7<sup>th</sup>, 2004 that defines a 3.03 million ounce gold-equivalent measured and indicated resource, with an additional 4.53 million ounce gold equivalent inferred resource. The study was prepared by Mintec Inc., a well-known and respected mining engineering firm based in Tucson, Arizona. The results of this resource study were incorporated in a Feasibility Study completed for the Ocampo Project by Kappes, Cassidy & Associates, a widely recognized metallurgical and engineering firm with extensive experience constructing mines in Latin America. This study includes, but is not limited to: new reserve and resource

# GAMMON LAKE RESOURCES INC.

## MANAGEMENT DISCUSSION AND ANALYSIS FOR THE YEAR ENDED JULY 31, 2005

calculations, mining plans for open-pits of the PGR trend deposits, mining plans for underground mining of the Aventurero, San Juan, Las Animas, Rosario and Maria vein systems in the Northeast Area, Process Plant (Mill) design, a heap leach circuit, site plans, and financial evaluation. The results of this study are discussed in "Overall Performance".

The Company's deferred mineral property expenditures during the year ended July 31, 2005 and 2004 are as follows:

<b>Schedule of deferred mineral property expenditures</b>	<b>31-July-05</b>	<b>31-July-04</b>
Mineral property, beginning balance	<u>\$ 80,041,737</u>	<u>\$ 54,833,669</u>
Mineral rights	207,097	6,782,663
Geological services and studies	6,469,323	1,055,622
Drilling	4,449,719	4,776,715
Assays	988,219	844,391
Equipment and consumables	10,383,298	5,241,573
Field Office	283,356	291,070
Camp materials and equipment	682,231	341,110
Health and Safety	293,052	52,820
Vehicles	1,034,247	747,310
Consulting fees	800,287	650,149
Contract Mining fees	5,772,270	2,749,807
Travel	2,375,148	763,454
Watering infrastructure	669,358	-
Electrical infrastructure	126,116	-
Heap leach	2,419,254	-
Roads	478,526	-
Future Income tax adjustment	<u>(1,475,253)</u>	<u>1,974,832</u>
Total additions	<u>35,956,248</u>	<u>26,271,516</u>
Write-off of mineral property expenditures	<u>-</u>	<u>(1,063,448)</u>
Mineral property	<u>\$ 115,997,985</u>	<u>\$ 80,041,737</u>

### Liquidity

The Company's balance of cash and cash equivalents as at July 31, 2005 was \$35,400,349 (July 31, 2004 - \$13,020,940). The Company maintains surplus funds not required for current exploration in Canadian funds. Investments are held in commercial paper discount notes with terms of less than 60 days. The Company has long-term debt denominated in US dollars and some of the Company's receivables and payables are denominated in Mexican Pesos and US dollars.

As at July 31, 2005, the Company had working capital of \$38,430,265 (July 31, 2004 - \$12,165,694). Current liabilities decreased to \$3,609,306 (as at July 31, 2004 - \$4,038,805). This financial position reflects the significant operational activities during the year ended July 31, 2005 on the Ocampo Project, which entails a higher level of cash requirements.

Details of the Company's operating, financing and investing activities and long term debt agreement are provided below. Other than as discussed herein, the Company is not aware of any trends, demands, commitments, events or

# GAMMON LAKE RESOURCES INC.

## MANAGEMENT DISCUSSION AND ANALYSIS FOR THE YEAR ENDED JULY 31, 2005

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uncertainties that may result in the Company's liquidity or capital resources either materially increasing or decreasing at present or in the foreseeable future. Material increases or decreases in the Company's liquidity and capital resources will be substantially determined by the success or failure of the Company's exploration and development programs on its mineral properties and its ability to obtain equity or other sources of financing. With the completion of the fully subscribed private placement of gross proceeds of Cdn\$110,005,000, the Company believes that it has an adequate liquidity base with which to support its general operations and exploration and development activities on the Ocampo Project. At the present time, the Company would not have adequate funding to complete the first phase of mine development as recommended by the Feasibility Study. Should the Company not have adequate funding to complete the first phase of mine development, the Project would be delayed until such funding is available or, if such funding is not available, curtailed or discontinued. The Company is investigating the availability of project financing for the Ocampo Project.

### **Operating**

Operating activities during the year ended July 31, 2005 consumed cash of \$8,975,284 (July 31, 2004 – \$2,727,006). The increase is due to increased operational needs of the Company as it expands its mine management and administrative capacity to support the growth in the underground exploration and development operations.

### **Financing**

Financing activities during the year ended July 31, 2005 totaled gross proceeds of \$106,205,810 (July 31, 2004 - \$55,207,578). In January 2005, the Company completed a private placement, where BMO Nesbitt Burns Inc. acted as lead agent in a syndicate with RBC Dominion Securities Inc. and First Associates Investments Inc. A total of 15,715,000 Special Warrants were issued at Cdn\$7.00 per Special Warrant for gross proceeds of \$110,005,000. The Company also received \$2,274,230 from the exercise of options.

As of July 31, 2005, the Company had 9,283,500 (July 31, 2004 – 6,245,376) in-the-money exercisable options for a total value of \$33,843,770 (July 31, 2004 - \$13,625,639) with expiry dates in the years 2006 to 2009 based on the exercise price of the options. The Company had 762,376 (July 31, 2004 – 448,076) compensation warrants outstanding for a total value of \$4,215,259 (July 31, 2004 - \$2,015,159) based on the exercise price of the warrants, with expiry dates in the year 2006. As of September 30, 2005, the Company had 73,536,515 common shares outstanding.

### **Investing**

Investing activities during the year ended July 31, 2005 totalled \$74,851,117 (July 31, 2004 - \$40,724,246). Investing activities during the year ended July 31, 2005 primarily relate to four cash expenditures. First, an expenditure of \$37,217,764 (July 31, 2004 - \$24,296,684) was made on the Ocampo Project. The expenditures relate to the purchase of equipment and consumables, diamond drill programs, and the building of ramps and tunnels to permit the extraction of the bulk samples and complete infill drilling from underground drill stations. The Company believes that developing these ramps while still in exploration will act to significantly reduce the capital required for mine development in the operating stage of the project. Second, an expenditure of \$8,962,503 (July 31, 2004 - \$176,265) was made as deposits on capital equipment for the Open-Pit and Underground operations. Third, an expenditure of \$28,825,851 (July 31, 2004 - \$4,066,596) was invested in capital assets related to the Ocampo Project, such capital assets consisting of assorted mining equipment for the purpose of completing the development of the Open Pit and ramps and tunnels on the Company's Ocampo project. Fourth, a receipt of \$155,001 (July 31, 2004 – (\$384,701)) was a result of advances to related companies. In April 2004, the Company incurred an expenditure of \$11,800,000 in order to acquire 10.9 million shares of Mexgold Resources Inc.

# GAMMON LAKE RESOURCES INC.

## MANAGEMENT DISCUSSION AND ANALYSIS FOR THE YEAR ENDED JULY 31, 2005

### Long term debt agreement

A summary of the Company's financial commitments under its long term debt agreement with Soyopa are as follows:

Year	Soyopa Loan
On or before November 23, 2006	US\$ 3,500,000
On or before November 23, 2007	US\$ 3,500,000

In the event that the Company has commenced production of gold and/or silver from the mining title acquired prior to November 23, 2006, the Company is required to pay Soyopa the principal amount of US \$1,000,000, annually, commencing on the first anniversary of the start of production which will reduce the remaining amount due. In the event the Company sells or transfers title to the concessions to a third party, the US \$7,000,000 or the principal amount remaining, becomes due. The long term debt is secured by a first charge over certain mineral properties, and is non-interest bearing.

The Company intends to fund these obligations from a combination of debt and/or equity financing and cash on hand.

### Commitments and Contingencies

A summary of the future commitments contained in the Company's option and joint venture agreements as at July 31, 2005 are set out in the following table:

Agreement	Consideration	Terms
Compania Minera Global, S.A. de C.V.	US\$ 1,000,000	Upon sale of the Ocampo property to a third party
Compania Minera Brenda, S.A. de C.V.	8% of net profit up to a maximum US\$ 2,000,000	US\$ 2,000,000 less any net profit royalty payments is due and payable upon the sale of the Ocampo project to a third party <sup>1</sup>
Compania Minera Brenda, S.A. de C.V.	US\$ 250,000	Upon a minimum proven reserve of 2 million ounces of gold and gold-equivalent <sup>1</sup>

The Company had a joint venture agreement with Fuerte Mayo respecting the Ocampo property under which the Company has a 100% interest in 17 mining titles in Mexico. Under the terms of the agreement, a balance of US \$211,526 was due to Fuerte Mayo upon the sale of the property. During the year ended July 31, 2005, Fuerte Mayo forgave the US \$211,526 due upon the sale of the property with the result that no further obligations exist pursuant to this agreement.

During the period, the Company placed deposits on several pieces of equipment for the Open-Pit and Underground operations (See Note 3 to the Interim Consolidated Financial Statements). The Company's future commitments on the equipment is \$20,815,083, and is payable upon shipment and or delivery of the items as outlined in the purchase contracts.

The Company intends to fund these obligations from a combination of debt and/or equity financing and cash on hand. Should the Company not have adequate funding to complete these payments, the Project would be delayed until such funding is available.

The discovery, development and acquisition of mineral properties are in many instances unpredictable events and require significant expenditures prior to achieving commercial production. Future precious metal prices, the success of exploration programs and other property transactions can have a significant impact on capital requirements.

<sup>1</sup> Relates to production and reserves from mining titles acquired from Compania Minera Brenda, S.A. de C.V.

# GAMMON LAKE RESOURCES INC.

## MANAGEMENT DISCUSSION AND ANALYSIS FOR THE YEAR ENDED JULY 31, 2005

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There are no known deposits of commercial minerals on any of the mineral exploration properties of the Company and any activities of the Company thereon will constitute exploratory searches for minerals. In the event that unanticipated business opportunities or expenditures arise prior to such time, the Company may require additional financing. The Company will also require additional financing to satisfy the cash payment obligations of its property purchase agreements. If funding is required for any of these reasons, or if a commercial body of ore in addition to those identified in the technical report of Kappes, Cassidy & Associates is confirmed on any of the Company's properties and the Company requires additional financing to initiate development of such body, it may fund its capital requirements by arranging further equity financing, issuing long term debt, arranging joint ventures with other companies or through a combination of the above. Accordingly, the ability of the Company to continue exploration and development of its property interests will be dependent upon its ability to raise significant additional financing. There is no assurance that adequate financing will be available to the Company or that the terms of such financing will be favourable. Should the Company not be able to obtain such financing, its properties may be lost entirely.

### Off-Balance Sheet Arrangements

The Company does not have any off-balance sheet arrangements.

### Transactions with Related Parties

The Company paid the following amounts to directors and companies controlled by or related to directors:

	<u>31-July-2005</u>	<u>31-July-04</u>
Management fees	\$ 278,440	\$ 412,500
Mineral property exploration expenditures	4,392,431	2,186,478
Professional Fees	-	29,538
	<u>4,670,871</u>	<u>2,628,516</u>

The Company received the following amounts from related companies:

Professional fees	51,600	-
Travel	118,110	-
General & Administrative	<u>54,850</u>	<u>-</u>
	<u>\$ 224,560</u>	<u>\$ -</u>

Related party transactions for management, professional fees and mineral property exploration are recorded at fair market value.

No director, senior officer, principal holder of securities or any associate or affiliate thereof of the Company has any interest, directly or indirectly, in material transactions with the Company or any of its direct or indirect wholly-owned subsidiaries, other than the above-noted transactions, which were in the normal course of operations.

Commencing in 2004, the Company has retained mineral exploration and mining contracting services through a Company owned by a related party of a director of the Company. As at July 31, 2005 these non-arm's length mineral exploration expenditures totalled \$4,392,431 (July 31, 2004 - \$2,186,478). These expenditures are recorded at fair value calculated at cost plus 10%. The Company believes that this arrangement gives the Company better quality and control for mineral exploration and mining contracting services than it could otherwise receive through third party independent contractors.

# GAMMON LAKE RESOURCES INC.

## MANAGEMENT DISCUSSION AND ANALYSIS FOR THE YEAR ENDED JULY 31, 2005

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During the year ended July 31, 2005, the Company paid \$278,440 (July 31, 2004 - \$412,500) in management fees and \$Nil (July 31, 2004 - \$29,538) in professional fees to directors and officers to companies controlled by the directors and officers as part of the Company's compensation package for key officers and consultants. During the year ended July 31, 2005 Gammon charged a management fee to Mexgold Resources Inc. to recover expenditures related to professional fees, travel, and general and administrative expenses.

Directors and officers of the Company are entitled to hold management incentive stock options. For this purpose, the Company has adopted a Stock Option Plan for directors, officers, employees and consultants of the Company and its subsidiaries. The purpose of the Stock Option Plan is to encourage ownership of the Company's common shares by the persons who are primarily responsible for the management and profitable growth of the Company's business, as well as provide additional incentive for superior performance by such persons and attract and retain valued personnel. The plan provides that eligible persons thereunder include any director, senior officer, consultant or employee of the Company. A consultant is defined as an individual that is engaged by the Company, under a written contract, to provide services on an ongoing basis and spends a significant amount of time on the Company's business and affairs. The definition of consultant also includes an individual whose services are engaged through a personal holding company. See also "Results of Operations".

### **Critical Accounting Estimates**

Management is required to make estimates and assumptions in the preparation of financial statements in conformity with generally accepted accounting principles. A description of the Company's significant accounting policies can be found in note 2 of the Company's consolidated financial statements. Key accounting estimates for the Company include mineral and mining properties and future income taxes.

#### **Mineral properties**

Mineral properties are the sum of the Company's mineral claims acquisition and related exploration and development expenditures, which are capitalized until the property is producing, abandoned, impaired in value or placed for sale. Costs are transferred to mining properties once a property is placed into commercial production. The Company's recoverability of its recorded value of its mineral property and associated deferred exploration expenses is based on current market conditions for minerals, underlying mineral resources associated with the properties and future costs may be required for ultimate realization through mining operations or by sale. The Company is in an industry that is dependent on a number of factors including environmental, legal and political risks, the existence of economically recoverable reserves, the ability of the Company to obtain necessary financing to complete the development, and future profitable production or the proceeds of disposition thereof.

#### **Future income taxes**

Future income tax assets and liabilities are determined based on differences between the financial reporting and tax basis of assets and liabilities and on unclaimed tax losses carried forward and are measured using the tax rates that will be in effect when the differences are expected to reverse or when unclaimed tax losses are expected to be utilized. A valuation allowance is recognized to the extent that the recoverability of future income tax assets is not considered more likely than not. The Company's future income tax liability arises from the excess accounting value over the tax value of its mineral property in Mexico, as certain transactions of the Company have no tax basis in Mexico. The Company deducts available Canadian and Mexican loss carry forwards and share issue costs, but provides for a valuation allowance of the Canadian loss carry forwards and share issue costs as it is considered more likely than not that the future income tax asset related to these losses will not be realized.

# **GAMMON LAKE RESOURCES INC.**

## **MANAGEMENT DISCUSSION AND ANALYSIS FOR THE YEAR ENDED JULY 31, 2005**

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### **Changes in Accounting Policies Including Initial Adoption**

Effective August 1, 2003, the Company prospectively adopted the recommendations of CICA Handbook Section 3870, Stock-based Compensation and Other Stock-based Payments for employees and non-employees. This Section establishes standards for the recognition, measurement and disclosure of stock-based compensation and other stock-based payments made in exchange for goods and services. These recommendations require that compensation for all awards made to employees and non-employees be measured and recorded in the financial statements at fair value. The Company's stock option plan is described in Note 11 in the consolidated financial statements. Effective August 1, 2004, Gammon Lake adopted the new Canadian Institute of Chartered Accountants (CICA) standards for Asset Retirement Obligations (CICA 3110). In accordance with CICA 3110, asset retirement obligations are recognized when incurred and recorded as liabilities at fair value and the corresponding increase to the asset is depreciated over the life of the asset. The Company has not incurred any current asset retirement obligations.

### **Financial Instruments and Other Instruments**

The Company's functional currency is Canadian dollars. The Company does not currently use any derivative products to manage or mitigate any foreign exchange exposure.

### **Disclosure Controls**

The Company's Chief Executive Officer and Chief Financial Officer are responsible for establishing and maintaining the Company's disclosure controls and procedures, including adherence to the Disclosure Policy adopted by the Company. They are assisted in this responsibility by a member of the Audit Committee who serves as an independent director of the Company. All three individuals sit on the Company's Disclosure Policy Committee ("DPC"). The Disclosure Policy requires all staff to keep the DPC fully apprised of all material information affecting the Company so that they may evaluate and discuss this information and determine the appropriateness and timing for public release. Access to such material information by the DPC is facilitated by the small size of the Company's senior management and the location of all senior management staff in one corporate office.

The Chief Executive Officer and Chief Financial Officer, after evaluating the effectiveness of the Company's disclosure controls and procedures as of July 31, 2005, have concluded that the Company's disclosure controls and procedures were adequate and effective to ensure that material information relating to the Company and its subsidiaries would have been known to them.

# **GAMMON LAKE RESOURCES INC.**

## **MANAGEMENT DISCUSSION AND ANALYSIS FOR THE YEAR ENDED JULY 31, 2005**

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# GAMMON LAKE RESOURCES INC.

## MANAGEMENT DISCUSSION AND ANALYSIS FOR THE NINE MONTHS ENDED APRIL 30, 2005

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