

# **LEXAM VG GOLD INC.**

**CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE YEARS ENDED  
DECEMBER 31, 2012 AND 2011**

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## MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS

The accompanying consolidated financial statements have been prepared by and are the responsibility of management of Lexam VG Gold Inc. The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board and reflect management's best estimate and judgment based on currently available information.

Management is also responsible for a system of internal control which is designed to provide reasonable assurance that assets are safeguarded, liabilities are recognized and that financial information is relevant and reliable.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities in respect of financial reporting and internal control. The Audit Committee of the Board of Directors, comprised of independent directors, meets periodically with management and the Company's independent auditors to discuss auditing matters and financial reporting issues. In addition, the Audit Committee reviews the annual consolidated financial statements and provides a recommendation to the Board of Directors on their approval. The Company's independent auditors, KPMG LLP, are appointed by the shareholders to conduct an audit in accordance with generally accepted auditing standards in Canada, and their report follows.

(Signed) Ha Tran

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Ha Tran  
Chief Financial Officer

(Signed) Richard Brissenden

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Richard Brissenden  
Director, capacity of Chief Executive Officer



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## **INDEPENDENT AUDITORS' REPORT**

To the Shareholders of Lexam VG Gold Inc.

We have audited the accompanying consolidated financial statements of Lexam VG Gold Inc., which comprise the consolidated statements of financial position as at December 31, 2012 and December 31, 2011, the consolidated statements of operations and comprehensive loss, changes in shareholders' equity and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

### *Management's Responsibility for the Consolidated Financial Statements*

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, as issued by the International Accounting Standards Board, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### *Auditors' Responsibility*

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

### *Opinion*

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Lexam VG Gold Inc. as at December 31, 2012 and December 31, 2011, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards, as issued by the International Accounting Standards Board.

Chartered Accountants, Licensed Public Accountants  
March 21, 2013  
Toronto, Canada

**LEXAMVU GOLD INC.**  
**CONSOLIDATED STATEMENTS OF FINANCIAL POSITION**  
*(in Canadian dollars)*

|                                             | <b>As at</b>                 |                              |
|---------------------------------------------|------------------------------|------------------------------|
|                                             | <b>December 31,<br/>2012</b> | <b>December 31,<br/>2011</b> |
| <b>ASSETS</b>                               |                              |                              |
| Current                                     |                              |                              |
| Cash and cash equivalents                   | \$ 1,532,091                 | \$ 1,530,894                 |
| Short-term investments                      | 3,588,707                    | 7,000,000                    |
| Amounts receivable                          | 95,975                       | 184,348                      |
| Prepaid expenses and deposits               | 23,786                       | 23,962                       |
|                                             | <u>5,240,559</u>             | <u>8,739,204</u>             |
| Restricted cash                             | 75,435                       | 75,985                       |
| Investment in Uranium Valley Mines (note 7) | 212,984                      | 274,318                      |
| Exploration and evaluation assets (note 8)  | 37,314,802                   | 34,568,488                   |
| Automobile and equipment (note 9)           | 45,344                       | 68,971                       |
|                                             | <u>\$ 42,889,124</u>         | <u>\$ 43,726,966</u>         |
| <b>LIABILITIES</b>                          |                              |                              |
| Current                                     |                              |                              |
| Accounts payable and accrued liabilities    | \$ 278,264                   | \$ 616,370                   |
|                                             | <u>278,264</u>               | <u>616,370</u>               |
| Decommissioning liabilities (note 10)       | 423,917                      | 413,941                      |
|                                             | <u>\$ 702,181</u>            | <u>\$ 1,030,311</u>          |
| <b>SHAREHOLDERS' EQUITY</b>                 |                              |                              |
| Common stock (note 12)                      | 70,105,954                   | 69,764,104                   |
| Common share purchase warrants (note 13)    | -                            | 3,666,667                    |
| Contributed surplus                         | 4,705,661                    | 1,155,743                    |
| Deficit                                     | (32,624,672)                 | (31,889,859)                 |
|                                             | <u>42,186,943</u>            | <u>42,696,655</u>            |
|                                             | <u>\$ 42,889,124</u>         | <u>\$ 43,726,966</u>         |

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

**Approved on Behalf of the Board**

|                             |          |
|-----------------------------|----------|
| <u>'Richard Brissenden'</u> | Director |
| <u>'Robin Dunbar'</u>       | Director |

**LEXAM VG GOLD INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS**  
**FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011**  
*(in Canadian dollars)*

|                                                      | <u>2012</u>         | <u>2011</u>           |
|------------------------------------------------------|---------------------|-----------------------|
| <b>COSTS AND EXPENSES:</b>                           |                     |                       |
| Office, general and administrative                   | \$ 777,099          | \$ 2,641,398          |
| Property holding                                     | 8,937               | 104,716               |
| Share-based compensation                             | 17,601              | 49,867                |
| Depreciation                                         | 22,328              | 12,907                |
| Impairment of automobile and equipment (note 9)      | -                   | 3,600                 |
| Total costs and expenses                             | <u>825,965</u>      | <u>2,812,488</u>      |
| Operating loss                                       | <u>(825,965)</u>    | <u>(2,812,488)</u>    |
| <b>OTHER INCOME (EXPENSES):</b>                      |                     |                       |
| Interest and other income                            | 166,066             | 59,363                |
| Accretion                                            | (9,976)             | (9,741)               |
| Foreign exchange (loss) gain                         | (2,605)             | 29,974                |
| Loss on sale of automobile and equipment             | (999)               | (5,912)               |
| Loss from equity accounted investment (note 7)       | (61,334)            | (25,682)              |
| Loss on disposal of exploration and evaluation asset | -                   | (127,866)             |
| Loss on sale of exploration and evaluation asset     | -                   | (75,094)              |
| Total other income (expense)                         | <u>91,152</u>       | <u>(154,958)</u>      |
| Loss before income taxes                             | (734,813)           | (2,967,446)           |
| Provision for income taxes                           | -                   | (12,814)              |
| Net loss and comprehensive loss                      | <u>\$ (734,813)</u> | <u>\$ (2,980,260)</u> |
| Basic and diluted per share data:                    |                     |                       |
| Net loss - basic and diluted (note 16)               | <u>\$ (0.00)</u>    | <u>\$ (0.01)</u>      |
| Weighted average common shares outstanding:          |                     |                       |
| - basic and diluted                                  | <u>226,131,046</u>  | <u>225,107,760</u>    |

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

**LEXAMVIG GOLD INC.**  
**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**  
**FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011**  
*(in Canadian dollars)*

|                                                 | <b>Common Stock</b> |               | <b>Common<br/>Share Purchase<br/>Warrants</b> | <b>Contributed<br/>Surplus</b> | <b>Accumulated<br/>Deficit</b> | <b>Total</b>  |
|-------------------------------------------------|---------------------|---------------|-----------------------------------------------|--------------------------------|--------------------------------|---------------|
|                                                 | <b>Shares</b>       | <b>Amount</b> |                                               |                                |                                |               |
| Balance, December 31, 2010                      | 186,810,133         | \$ 59,481,623 | \$ 16,079                                     | \$ 905,874                     | \$ (28,909,599)                | \$ 31,493,977 |
| Shares issued upon amalgamation (note 4)        | 112,265,004         | 90,601,188    | -                                             | -                              | -                              | 90,601,188    |
| Shares cancelled upon amalgamation (note 4)     | (75,000,000)        | (81,169,386)  | -                                             | -                              | -                              | (81,169,386)  |
| Warrants issued upon amalgamation (note 4)      | -                   | -             | 3,666,667                                     | -                              | -                              | 3,666,667     |
| Fair value of Lexam options                     | -                   | -             | -                                             | 540,750                        | -                              | 540,750       |
| Fair value of exercised Lexam options (note 12) | -                   | 216,300       | -                                             | (216,300)                      | -                              | -             |
| Share-based compensation                        | -                   | -             | -                                             | 49,867                         | -                              | 49,867        |
| Proceeds on exercise of options (note 12)       | 827,500             | 280,200       | -                                             | -                              | -                              | 280,200       |
| Fair value of exercised options                 | -                   | 124,448       | -                                             | (124,448)                      | -                              | -             |
| Proceeds on exercise of warrants (note 13)      | 424,344             | 63,652        | -                                             | -                              | -                              | 63,652        |
| Fair value of exercised warrants                | -                   | 16,079        | (16,079)                                      | -                              | -                              | -             |
| Shares issued for property acquisition (note 8) | 218,284             | 150,000       | -                                             | -                              | -                              | 150,000       |
| Net loss                                        | -                   | -             | -                                             | -                              | (2,980,260)                    | (2,980,260)   |
| Balance, December 31, 2011                      | 225,545,265         | \$ 69,764,104 | \$ 3,666,667                                  | \$ 1,155,743                   | \$ (31,889,859)                | \$ 42,696,655 |
| Share-based compensation                        | -                   | -             | -                                             | 17,601                         | -                              | 17,601        |
| Warrants expired, net of tax (note 13) (i)      | -                   | 132,500       | (3,666,667)                                   | 3,534,167                      | -                              | -             |
| Proceeds on exercise of options (note 12)       | 50,000              | 7,500         | -                                             | -                              | -                              | 7,500         |
| Fair value of exercised options                 | -                   | 1,850         | -                                             | (1,850)                        | -                              | -             |
| Shares issued for property acquisition (note 8) | 975,595             | 200,000       | -                                             | -                              | -                              | 200,000       |
| Net loss                                        | -                   | -             | -                                             | -                              | (734,813)                      | (734,813)     |
| Balance, December 31, 2012                      | 226,570,860         | \$ 70,105,954 | \$ -                                          | \$ 4,705,661                   | \$ (32,624,672)                | \$ 42,186,943 |

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

**LEXAM VG GOLD INC.**  
**CONSOLIDATED STATEMENTS OF CASHFLOWS**  
**FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011**  
*(in Canadian dollars)*

|                                                              | 2012                | 2011                |
|--------------------------------------------------------------|---------------------|---------------------|
| Cash (used in) provided by:                                  |                     |                     |
| <b>Operating activities:</b>                                 |                     |                     |
| Net loss for the year                                        | \$ (734,813)        | \$ (2,980,260)      |
| Adjustments to reconcile net loss from operating activities: |                     |                     |
| Depreciation                                                 | 22,328              | 12,907              |
| Share-based compensation                                     | 17,601              | 49,867              |
| Accretion                                                    | 9,976               | 9,741               |
| Unrealized foreign exchange loss                             | 550                 | 454                 |
| Amalgamation costs                                           | -                   | 377,700             |
| Impairment of property, automobile and equipment             | -                   | 3,600               |
| Loss on disposal of exploration and evaluation asset         | -                   | 127,866             |
| Loss on sale of automobile and equipment                     | 999                 | 5,912               |
| Loss on sale of exploration and evaluation asset             | -                   | 75,094              |
| Loss from equity accounted investment                        | 61,334              | 25,682              |
|                                                              | <u>(622,025)</u>    | <u>(2,291,437)</u>  |
| Changes in non-cash working capital (note 14)                | <u>(249,557)</u>    | <u>87,953</u>       |
|                                                              | <u>(871,582)</u>    | <u>(2,203,484)</u>  |
| <b>Investing activities:</b>                                 |                     |                     |
| Purchases of automobiles and equipment                       | -                   | (78,879)            |
| Proceeds from sale of automobile and equipment               | 300                 | 6,750               |
| Proceeds from sale of exploration and evaluation asset       | -                   | 50,000              |
| Proceeds from (purchases of) short-term investments          | 3,411,293           | (7,000,000)         |
| Investment in Uranium Valley Mines                           | -                   | (300,000)           |
| Expenditures on exploration and evaluation assets            | (2,546,314)         | (5,426,033)         |
| Change in restricted cash                                    | -                   | (6,088)             |
| Proceeds from amalgamation                                   | -                   | 14,014,639          |
|                                                              | <u>865,279</u>      | <u>1,260,389</u>    |
| <b>Financing activities:</b>                                 |                     |                     |
| Proceeds on exercise of options and warrants                 | 7,500               | 343,852             |
|                                                              | <u>7,500</u>        | <u>343,852</u>      |
| Net increase (decrease) in cash and cash equivalents         | <u>1,197</u>        | <u>(599,243)</u>    |
| Cash and cash equivalents, beginning of year                 | <u>1,530,894</u>    | <u>2,130,137</u>    |
| Cash and cash equivalents, end of year                       | <u>\$ 1,532,091</u> | <u>\$ 1,530,894</u> |

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

**LEXAM VG GOLD INC.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011**  
*(in Canadian dollars)*

**1. NATURE OF OPERATIONS**

Lexam VG Gold Inc. (the “Company”, or “Lexam VG”) was incorporated under the laws of Ontario through a Plan of Arrangement on January 1, 2011, amalgamating Lexam Explorations Inc. (“Lexam”) and VG Gold Corp (“VG Gold”). The Company is principally engaged in the business of exploring precious metal mineral properties. Substantially all of the efforts of the Company are devoted to these business activities and to date it has generated minimal revenues. As a result, the Company has no regular source of cash flow and will need to raise additional funds in the future in order to advance its exploration efforts. There can be no assurance that the Company will be successful at raising such funds or whether funds raised will be at terms economically favourable to existing shareholders. If in the future the going concern assumption is not appropriate, certain adjustments may be necessary to the financial statements. These adjustments could impact the carrying value of assets or liabilities, such as amounts receivable, prepaid expenses and deposits, accounts payable and accrued liabilities, and reported expenses.

These consolidated financial statements reflect results of operations for the years ended December 31, 2012 and 2011, and the assets, liabilities and shareholders’ equity as at December 31, 2012, and 2011.

As at December 31, 2012, Robert R. McEwen, the non-executive chairman owns 27% of the issued and outstanding common shares of Lexam VG.

The Company’s assets are primarily comprised of 100% interest in the Fuller property, 100% interest in the Buffalo Ankerite property, 60% interest in the Paymaster property and a 68.5% controlling interest in the Davidson Tisdale property.

**2. BASIS OF PRESENTATION**

**Statement of Compliance**

The annual consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”).

The policies applied in these annual consolidated financial statements are based on IFRS issued and outstanding as of March 21, 2013, the date the Board of Directors approved the statements.

**Basis of Measurement and Principles of Consolidation**

The annual consolidated financial statements have been prepared on the historical cost basis.

The annual consolidated financial statements include all the accounts of the Company and all of its subsidiaries and investments, including its principle subsidiaries, Lexam Explorations (USA) Inc. and VG Gold Holdings Inc., as well as other non-significant subsidiaries.

**LEXAM VG GOLD INC.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011**  
*(in Canadian dollars)*

**2. BASIS OF PRESENTATION (Continued)**

**Functional and Presentation Currency**

These annual consolidated financial statements are presented in Canadian dollars, which is the functional currency of the Company and all of its subsidiaries.

**Use of Estimates and Judgement**

The preparation of annual consolidated financial statements in conformity with IFRS requires that management make estimates and assumptions about future events that affect the amounts reported in the annual consolidated financial statements and related notes to the financial statements. Actual results may differ from those estimates.

Significant estimates used in the preparation of these consolidated financial statements include:

(a) Mineral Resources

The information relating to the geological data on the size, depth and shape of the ore body requires complex geological judgements to interpret the data. The Company estimates its mineral resources based on information compiled by appropriately qualified persons. The recoverability of exploration and evaluation costs is assessed for impairment upon demonstrating the viability of a project.

The application of the Company's accounting policy for exploration and evaluation expenditures requires judgement in determining whether future economic benefits may be realized, which are based on assumptions about future events and circumstances.

(b) Depreciation

The depreciation of automobile and equipment is calculated on a declining balance basis based on the estimated useful life of the assets. Management uses its judgement based on prior experience to determine useful lives of automobile and equipment.

(c) Decommissioning Liabilities

The Company's decommissioning liabilities represent management's best estimate of the present value of the future cash outflows required to settle the liability which reflects estimates of future costs, inflation, and the applicable risk-free interest rates for discounting the future cash outflows. Changes to the above factors can result in a change to the provision recognized by the Company.

Management uses its judgement in determining if a present obligation exists at the reporting period by considering all evidence, including the opinion of independent experts. Management also uses its judgement in evaluating variables that are used in determining the present value of the liabilities.

**LEXAM VG GOLD INC.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011**  
*(in Canadian dollars)*

**2. BASIS OF PRESENTATION (Continued)**

(d) Income Taxes

In assessing the probability of realizing income tax assets recognized, management makes estimates related to expectations of future taxable income, applicable tax planning opportunities, expected timing of reversals of existing temporary differences, and the likelihood that tax positions taken will be sustained upon examination by applicable tax authorities. In making its judgements, management gives additional weight to positive and negative evidence that can be objectively verified. At the end of each reporting period, the Company reassesses unrecognized tax assets.

(e) Share-based compensation

The Company measures share based payments using the fair value method, which entails the use of the Black-Scholes option pricing model. The models requires the input of subjective assumptions and estimates, including the expected term of the option, forfeiture rate, risk free interest rate, and stock price volatility. The Company uses a combination of objectively observable evidence and historical data in determining estimates and making judgements.

**Recently Issued Accounting Pronouncements**

The IASB issued the following standards, effective for annual periods beginning on or after January 1, 2013. The Company is in the process of evaluating the impact on its financial statements.

The IASB has issued IFRS 9 “Financial Instruments” which proposes to replace International Accounting Standard (“IAS”) 39, Financial Instruments: Recognition and Measurement (“IAS 39”). The replacement standard has the following significant components: establishes two primary measurement categories for financial assets – amortized cost and fair value; establishes criteria for classification of financial assets within the measurement category based on business model and cash flow characteristics; and eliminates existing held to maturity, available for sale and loans and receivable categories. The section is effective on January 1, 2015.

IFRS 10, “Consolidated Financial Statements” (“IFRS 10”), which replaces parts of IAS 27, “Consolidated and Separate Financial Statements” (“IAS 27”) and all of SIC-12, “Consolidation – Special Purpose Entities”, changes the definition of control that is the determining factor in whether an entity should be consolidated. Under IFRS 10, an investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee. IAS 27, “Separate Financial Statements (2011)” (“IAS 27 (2011)”) was reissued and now only contains accounting and disclosure requirements for when an entity prepares separate financial statements, as the consolidation guidance is now included in IFRS 10.

IFRS 11, “Joint Arrangements” (“IFRS 11”), which replaces IAS 31, “Interests in Joint Ventures” and SIC-13, “Jointly Controlled Entities – Non-monetary Contributions by Venturers”, requires a venturer to classify its interest in a joint arrangement as either a joint operation or a joint venture. For a joint operation, the joint operator will recognize its assets, liabilities, revenue and expenses, and/or its relative share thereof. For a joint venture, the joint venturer will account for its interest in the venture’s net assets using the equity method of accounting. The choice to proportionately consolidate joint

**LEXAM VG GOLD INC.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
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**2. BASIS OF PRESENTATION (Continued)**

ventures is prohibited. IAS 28, “Investments in Associates and Joint Ventures (2011)” was amended as a consequence of the issuance of IFRS 11. In addition to prescribing the accounting for investments in associates, it now includes joint ventures that are to be accounted for by the equity method. The application of the equity method has not changed as a result of this amendment.

IFRS 12 “Disclosure of Interests in Other Entities” is a comprehensive standard on disclosure requirements for all forms of interests in other entities, including subsidiaries, joint arrangements, associates, and structured entities. This standard carries forward the disclosures that existed under IAS 27, IAS 28 and IAS 31, and also introduces additional disclosure requirements that address the nature of, and risks associated with, and entity’s interests in other entities.

IFRS 13, “Fair Value Measurement” (“IFRS 13”) provides guidance on how fair value should be applied where its use is already required by other IFRS standards, and includes a definition of fair value and is a single source of guidance on fair value measurement and disclosure requirements for use across IFRS.

In October 2011, the IFRS Interpretations Committee issued its Interpretation on accounting for waste removal costs - IFRIC Interpretation 20 “Stripping Costs in the Production Phase of a Surface Mine” (“IFRIC 20”), which provides guidance on the accounting for costs related to stripping activity in the production phase of surface mining. When the stripping activity results in the benefit of useable ore that can be used to produce inventory, the related costs are to be accounted for in accordance with IAS 2 “Inventories”. When the stripping activity results in the benefit of improved access to ore that will be mined in future periods, the related costs are to be accounted for as additions to non-current assets when specific criteria are met. IFRIC 20 is effective for annual periods beginning on or after January 1, 2013. The Company expects that there will be no impact on the Company’s financial statements upon adoption of IFRIC 20 on January 1, 2013.

**3. SIGNIFICANT ACCOUNTING POLICIES**

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements.

**(a) Principles of consolidation**

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, VG Gold Holdings Inc, and Lexam Explorations (USA) Inc., which holds the Company’s Baca Project. All significant intercompany balances and transactions have been eliminated on consolidation.

**(b) Foreign currency transactions**

The consolidated financial statements are presented in Canadian dollars. Costs are primarily incurred in Canadian dollars, however, certain of the Company’s financial monetary assets and liabilities are denominated in US dollars. In addition, the Company incurs costs at its Baca

**LEXAM VG GOLD INC.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011**  
*(in Canadian dollars)*

**3. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Project in Colorado primarily in US dollars. Although some transactions are in US dollars, the predominant currency is the Canadian dollar, and as such, it is also the Company's functional currency.

Foreign currency transactions are translated into the functional currency using prevailing exchange rates on the date of the transaction. Foreign exchange gains and losses resulting from settlement of such transactions and from translation of monetary assets and liabilities not denominated in the functional currency are recognized in the statement of operations.

(c) Exploration and evaluation expenditures ("E&E") - note 8

E&E assets consist of exploration and mining concessions, options and contracts. Acquisition and leasehold costs and exploration costs are capitalized and deferred until such time as the property is put into production or the properties are disposed of either through sale or abandonment. These assets are not depreciated as they are currently not in use.

E&E costs consist of:

- Gathering exploration data through topographical and geological studies;
- Exploratory drilling, trenching and sampling;
- Determining the volume and grade of the resource;
- Test work on geology, metallurgy, mining, geotechnical and environmental; and
- Conducting engineering, marketing and financial studies.

Proceeds received from the sale of any interest in a property are first credited against the carrying value of the property, with any excess included in operations for the period. If a property is abandoned, the property and deferred exploration costs are written off to operations.

Where an indicator of impairment exists, a formal estimated recoverable amount is made, which is considered to be the higher of the fair value less costs to sell and value in use. These assessments require the use of estimates and assumptions such as long-term commodity prices, discount rates, future capital requirements, exploration potential and operating performance. Fair value is determined as the amount that would be obtained from the sale of the assets in an arm's length transaction between knowledgeable and willing parties.

(d) Automobile and equipment – note 9

Recognition and Measurement

Automobile and equipment are measured at cost less accumulated depreciation and accumulated impairment losses. Cost includes all expenditures that are directly attributable to the acquisition of the asset.

**LEXAM VG GOLD INC.**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011**  
*(in Canadian dollars)*

**3. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

Depreciation

Automobile and equipment is depreciated on a declining balance basis over the estimated useful life of the asset. The estimated lives of the current and comparative periods are as follows:

|                               |                               |
|-------------------------------|-------------------------------|
| Office and computer equipment | - 20% declining balance basis |
| Automobile                    | - 20% declining balance basis |

Impairment

The carrying amounts of the Company's automobile and equipment is reviewed at each reporting date to determine whether there is indication of impairment. If any such indication exists, the asset's recoverable amount is estimated. Impairment is determined for an individual asset unless the asset does not generate cash inflows that are independent of those generated from other assets or group of assets, in which case, the individual assets are grouped together into cash generating units for impairment purposes.

Impairment exists when the carrying amount of the asset, or group of assets, exceeds its recoverable amount. The impairment loss is the amount by which the carrying value exceeds the recoverable amount and such loss is recognized in the consolidated statement of operations. The recoverable amount of an asset is the higher of its fair value less costs to sell and its value in use.

A previously recognized impairment loss is reversed if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized such that the recoverable amount has increased.

(e) Jointly Controlled Assets – note 8

Jointly controlled assets involve the joint control, and often the joint ownership, of assets dedicated to the joint venture. Each venturer may take a share of the output from the assets and each bears a share of the expenses incurred.

IAS 31, Interest in Joint Ventures, allows the venturer to recognize in its financial statements its share of the joint assets, any liabilities that it has incurred directly and its share of any liabilities incurred jointly with the other venturers, income from the sale or use of its share of the output of the joint venture, its share of expenses incurred by the joint venture and expenses incurred directly in respect of its interest in the joint venture.

The Company continues to record its portion of the expenditures and liabilities pertaining to the Davidson Tisdale property and the Paymaster property.

(f) Investments in Associates (Equity Accounted Investments) – note 7

Associates are those entities in which the Company has significant influence, but not control, over the financial and operating policies which are neither subsidiaries nor interests in joint

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**3. SIGNIFICANT ACCOUNTING POLICIES (Continued)**

ventures. Significant influence is presumed to exist when the Company holds between 20 and 50 percent of the voting power of another entity.

Investments in associates are accounted for using the equity method (“equity-accounted investees”) and are recognized initially at cost. The cost of the investment includes transaction costs. The equity method involves recording the initial investment at cost and subsequently adjusting the carrying value of the investment for the Company’s proportionate share of the profit or loss and other changes in the associate’s net assets.

The consolidated statements include the Company’s share of the profit or loss of equity accounted investees, after adjustments to align the accounting policies with those of the Company, from the date the significant influence commences until the date that significant influence or joint control ceases.

When the Company’s share of losses exceeds its interest in an equity-accounted investee, the carrying amount of that interest, including any long-term investments, is reduced to zero, and the recognition of further losses is discontinued except to the extent that the Company has an obligation or has made payments on behalf of the investee.

At each balance sheet date the Company assesses the investment in associates for indicators of impairment. An impairment exists when the carrying amount of the associate exceeds its recoverable amount. The impairment loss is the amount by which the carrying value exceeds the recoverable amount and such loss is recognized in the consolidated statement of operations. The recoverable amount of an asset is the higher of its fair value less costs to sell and its value in use.

The Company’s investment in Uranium Valley Mines (note 7) is accounted for using the equity method.

(g) Accounting for income taxes – note 17

Income tax expense is comprised of current and deferred tax expense. Current tax expense is the expected tax payable or receivable on the taxable income or loss for the period, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years. Deferred tax assets and liabilities are recognized in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes. Income tax expense is recognized in profit or loss except to the extent that it relates to a business combination, or items recognized directly in equity. Deferred taxes are calculated using the asset and liability method of accounting for income taxes. Under the asset and liability method, deferred tax assets and liabilities are recognized for the deferred tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis and for tax losses and other deductions carried forward.

Deferred income tax assets and liabilities are calculated using enacted or substantively enacted tax rates expected to apply when the asset is realized or the liability is settled. An asset (liability)

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**3. SIGNIFICANT ACCOUNTING POLICES (Continued)**

is recognized on the statement of financial position when it is probable that the future economic benefits will flow to (away from) the entity and the asset has a cost or value that can be measured reliably. The effect, on deferred tax assets and liabilities, of changes in tax rates are recognized in income in the period in which the change is substantively enacted.

(h) Basic loss per common share – note 16

Basic loss per common share is calculated by dividing net loss by the weighted average number of common shares outstanding during the period.

(i) Share-based payments – note 12

The Company accounts for share-based payments using the fair value method. Under this method, compensation expense is measured at fair value on the date of grant using the Black-Scholes option pricing model, and is recognized as an expense or capitalized, depending on the nature of the grant, with a corresponding increase in equity, over the period that the employees earn the options. The amount recognized as an expense is adjusted to reflect the number of share options expected to vest. The Black-Scholes option pricing model requires the input of subjective assumptions, including the expected term of the option, forfeiture rate, risk free interest rate and stock price volatility. Historical data has been considered in setting the assumptions.

Warrants, stock options, and other equity instruments issued as purchase consideration in non-cash transactions, other than as consideration for E&E assets, are recorded at fair value determined by management using the Black-Scholes option pricing model. The fair value of the shares issued as purchase consideration for E&E assets is based upon the trading price of those shares on the TSX on the date of the agreement to issue shares as determined by the Board of Directors.

(j) Decommissioning liabilities – note 10

A legal or constructive obligation to incur restoration, rehabilitation, and environmental costs may arise when environmental disturbance is caused by exploration, development, or production. The Company's exploration activities are subject to various governmental laws and regulations relating to the protection of the environment. These environmental regulations are continually changing and are generally becoming more restrictive. The Company has recorded a liability for the estimated future costs of decommissioning liabilities, based on independent estimates of the costs to comply with the regulations. However, these estimates are subject to change based on changes in circumstances and any new information that becomes available.

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**3. SIGNIFICANT ACCOUNTING POLICES (Continued)**

The fair value of the liability for a decommissioning liability is recorded when it is incurred and the corresponding increase to the asset is amortized over the life of the asset. The liability is increased over time to reflect an accretion element considered in the initial measurement at fair value. The Company has made, and intends to make in the future, expenditures to comply with such laws and regulations.

(k) Warrants – note 13

Proceeds from unit placements are allocated between shares and warrants issued according to their relative fair value.

The fair value of the share component is credited to common stock and the fair value of the warrant component as calculated by the Black Scholes method is credited to contributed surplus. Upon exercise of the warrants, consideration paid by the warrant holder together with the amount previously recognized in the contributed surplus account is recorded as an increase to common stock.

(l) Financial instruments – note 5

The Company holds certain financial instruments such as cash and cash equivalents, short-term investments, receivables, accounts payable and accrued liabilities, the fair value of which approximates their carrying value due to the short-term nature of these instruments. IAS 39, requires classification of financial instruments into one of five categories: financial assets at fair value through profit and loss, held-to-maturity investments, loans and receivables, available-for-sale securities and other financial liabilities through amortized cost.

*Loans and receivables*

Loans and receivables are financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are recognized initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition, loans and receivables are measured at amortized costs using the effective interest method, less any impairment losses. The Company defines accounts receivable as assets that fall under this category.

The Company does not have any assets designated under the held-to-maturity or available-for-sale categories.

*Impairment of financial assets*

Financial assets are assessed for indicators of impairment at the end of each reporting period. Financial assets are impaired when there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial assets, the estimated future cash flows of the investment have been negatively impacted.

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**3. SIGNIFICANT ACCOUNTING POLICES (Continued)**

Evidence of impairment could include:

- Significant financial difficulty of the issuer or counter party; or
- Default or delinquency in interest or principal payments; or
- It becomes probable that the borrower will enter into bankruptcy or financial reorganization.

The carrying amount of the financial asset is directly reduced by any impairment loss. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized, the previously recognized impairment loss is reversed through profit or loss to the extent that the carrying amount of the investment at the date the impairment is reversed does not exceed what the amortized cost would have been had the impairment not been recognized.

*Other Financial liabilities at amortized cost*

Accounts payable and accrued liabilities are classified as other financial liabilities and are measured at amortized cost. The Company initially recognizes debt securities issued and subordinated liabilities on the date that they are originated. All other financial liabilities (including liabilities designated at fair value through profit or loss) are recognized initially on the trade date at which the Company becomes a party to the contractual provisions of the instruments.

The Company derecognizes a financial liability when its contractual obligations are discharged, cancelled or expired. Financial assets and liabilities are offset and the net amount is presented in the statement of financial position when, and only when, the Company has a legal right to offset the amounts and intends to either settle on a net basis or to realize the assets and settle the liability simultaneously.

*Financial instruments recorded at fair value*

Financial instruments recorded at fair value on the consolidated statements of financial position are classified using a financial value hierarchy that reflects the significance of the inputs used in marking the measurements. The fair value hierarchy has the following levels:

- Level 1 – valuation based on quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 – valuation techniques based on inputs other than quoted prices including Level 1 that are observable for assets or liabilities, either directly (i.e. as prices) or indirectly (i.e. derived from prices);
- Level 3 – valuation techniques using inputs for the asset and liability that are not based on observable market data (unobservable inputs).

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**3. SIGNIFICANT ACCOUNTING POLICES (Continued)**

(m) Cash and cash equivalents

Cash and cash equivalents include cash, and those short-term money market instruments that are readily convertible to cash with an original term of less than 90 days. The Company has classified its cash and cash equivalents as financial assets at fair value through profit and loss.

(n) Short-term investments

Short-term investments include short-term money market instruments with terms to maturity at acquisition of between three and twelve months. The carrying value of short-term investments approximates fair value.

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**4. LEXAM VG AMALGAMATION**

On November 11, 2010 VG Gold and Lexam issued a joint management information circular, indicating the intention of the two companies to amalgamate through a Plan of Arrangement, forming Lexam VG Gold Inc., effective January 1, 2011. On December 13, 2010 the shareholders of each company voted unanimously to approve the amalgamation.

Under the Plan of Arrangement common shareholders of VG Gold received one common share of Lexam VG for each common share of VG Gold held, and common shareholders of Lexam received 2.1 common shares of Lexam VG for each common share of Lexam held. Furthermore, the 75,000,000 VG Gold shares held by Lexam were cancelled upon amalgamation.

For accounting purposes the transaction has been accounted for using IFRS 2, Share-based payments. Under IFRS 2, the entity shall measure the goods or services received, and the corresponding increase in equity, directly, at the fair value of the goods received. The attributable equity is based on the fair value of Lexam's net assets as at December 31, 2010 calculated as follows:

|                                                                                              |    |                         |
|----------------------------------------------------------------------------------------------|----|-------------------------|
| Cash                                                                                         | \$ | 14,014,639              |
| Amounts receivable                                                                           |    | 80,492                  |
| Prepays                                                                                      |    | 2,790                   |
| Restricted cash (a)                                                                          |    | 70,350                  |
| Equity accounted investment in VG Gold (b)                                                   |    | 82,500,000              |
| Accounts payable and accrued liabilities                                                     |    | (303,346)               |
| Income taxes payable                                                                         |    | (225,706)               |
| Future tax liability on VG Gold investment (b)                                               |    | (1,330,614)             |
| Warrants (c)                                                                                 |    | <u>(3,666,667)</u>      |
| Fair value of Lexam's net assets                                                             |    | 91,141,938              |
| Less: Fair value of outstanding Lexam stock options (d)                                      |    | <u>(540,750)</u>        |
| Fair value attributable to Lexam VG common shares issued in exchange for Lexam common shares | \$ | <u>90,601,188</u>       |
| Cancellation of VG Gold common shares (b)                                                    |    | (82,500,000)            |
| Removal of future tax liability on VG Gold investment (b)                                    |    | <u>1,330,614</u>        |
| Net attributable equity to Lexam VG common shares issued in exchange of Lexam common shares  | \$ | <u><u>9,431,802</u></u> |

(a) Lexam Explorations (USA) Inc., a wholly owned subsidiary of Lexam, held a deposit of US\$70,000, through a financial institution, with the State of Colorado Oil and Gas Conservation Commission, pertaining to surface reclamation bonds on the Baca property. During 2011 US\$45,000 of the deposits were returned to Lexam VG.

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**4. LEXAM VG AMALGAMATION (Continue)**

(b) Lexam held 75,000,000 shares in VG Gold. On December 31, 2010 these shares were valued at \$1.10, which translate to a fair value of \$82,500,000. The future tax liability corresponds to the difference between Lexam's accounting and tax value. Upon amalgamation, these shares were cancelled, and as a result, the investment and future tax liability have been removed.

(c) The fair value of the warrants were calculated on January 1, 2011 using the following assumptions: Stock price - \$1.10, strike price - \$1.00, dividend yield - 0%, estimated life - 2 years, risk-free rate - 1.71%, and volatility - 123%.

(d) The fair value of the options were calculated on January 1, 2011 using the following assumptions: Stock price - \$1.10, strike price - \$0.07, dividend yield - 0%, estimated life - 8.5 months, risk-free rate - 1.40%, and volatility - 78%. Previously under Lexam management, 250,000 options were granted on August 14, 2001, with a 10 year life, and a strike price of \$0.15. Upon conversion, these 250,000 Lexam options were converted to 525,000 Lexam VG options, priced at \$0.07.

|                                                      |                     |
|------------------------------------------------------|---------------------|
| VGGold common shares outstanding - December 31, 2010 | 186,810,133         |
| Common shares issued to acquire Lexam(e)             | 112,265,004         |
| VGGold common shares held by Lexam                   | <u>(75,000,000)</u> |
| Total amalgamated common shares - January 1, 2011    | 224,075,137         |
| VGGold warrants outstanding                          | 424,344             |
| VGGold options outstanding                           | 2,810,000           |
| Common shares issuable for Lexam warrants (e)        | 5,208,334           |
| Common shares issuable for Lexam options (e)         | <u>525,000</u>      |
| Diluted shares outstanding - January 1, 2011         | <u>233,042,815</u>  |

(e) As at December 31, 2010, Lexam had a total of 53,459,605 shares outstanding, which include 4,960,318 shares issued to Mr. McEwen as part of the private placement. Lexam also had 2,480,159 warrants outstanding corresponding to the private placement, along with 250,000 options outstanding. The conversion ratio of 2.1 Lexam VG common shares for each Lexam common share was used in calculating the capital structure for Lexam VG.

The Company incurred \$377,700 of costs relating to the execution of the amalgamation. These costs have been expensed during the first quarter of 2011. These costs were recorded as prepaid expenses and deposits at December 31, 2010.

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**5. FINANCIAL INSTRUMENTS**

The Company manages its exposure to a number of different financial risks arising from operations as well as from the use of financial instruments including market risks (commodity prices, foreign currency exchange rate and interest rate), credit risk and liquidity risk through its risk management strategy. The objective of the strategy is to support the delivery of the Company's financial targets while protecting its future financial security and flexibility.

Financial risks are primarily managed and monitored through operating and financing activities. The Company does not use derivative financial instruments. The financial risks are evaluated regularly with due consideration to changes in key economic indicators and to up-to-date market information.

**(a) Market Risk**

Market risk is the risk of uncertainty arising primarily from possible commodity market price movements and their impact on the future economic viability of the Company's projects and ability of the Company to raise capital. These market risks are evaluated by monitoring changes in key economic indicators and market information on an on-going basis and adjusting operating and exploration budgets accordingly.

**(b) Liquidity Risk**

Liquidity risk encompasses the risk that a company cannot meet its financial obligations in full. The Company's main sources of liquidity are its cash and cash equivalents and short-term investments. These funds are primarily used to finance working capital, exploration expenditures, capital expenditures, and acquisitions.

The Company manages its liquidity risk by regularly monitoring its cash flows from operating activities and holding adequate amounts of cash and cash equivalents and short-term investments.

Accounts payable and accrued liabilities are current financial instruments expected to be settled in the normal course of operations.

As at December 31, 2012 the Company held cash and cash equivalents of \$1,532,091 and short-term investments of \$3,588,707.

**(c) Interest Rate Risk**

Interest rate risk is the risk borne by an interest-bearing asset or liability as a result of fluctuations in interest rates.

Financial assets and financial liabilities with variable interest rates expose the Company to cash flow interest rate risk. The Company's cash and cash equivalents include highly liquid investments that earn interest at market rates. The Company does not have any interest bearing liabilities.

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**5. FINANCIAL INSTRUMENTS (Continued)**

Although the Company endeavours to maximize the interest income earned on excess funds, the Company's policy focuses on cash preservation, while maintaining the liquidity necessary to conduct operations on a day-to-day basis. The Company's policy limits the investing of excess funds to liquid term deposits, treasury bills and banker's acceptances.

Fluctuations in market interest rates have not had a significant impact on the Company's results of operations due to the short term maturity of the investments held.

**(d) Commodity Price Risk**

The value of the Company's exploration and evaluation assets are related to the price of gold, and the outlook for this mineral. Adverse changes in the price of gold can also significantly impair the economic viability of the Company's projects, along with the ability to obtain future financing.

Gold prices historically have fluctuated widely and are affected by numerous factors outside of the Company's control, including, but not limited to, industrial and retail demand, central bank reserves management, forward sales by producers and speculators, levels of worldwide production, short-term changes in supply and demand due to speculative hedging activities, macro-economic variables and certain other factors related specifically to gold.

A protracted period of depressed prices could impair the Company's operations and development opportunities, and significantly erode shareholder value.

**(e) Credit Risk**

Credit risk arises from cash held with banks and financial institutions and amounts receivable. The maximum exposure to credit risk is equal to the carrying value of the financial assets. The objective of managing counter party credit risk is to prevent losses in financial assets. The Company assesses the quality of its counter parties, taking into account their creditworthiness and reputation, past experience and other factors.

The Company's receivable balance includes a reimbursement of exploration expenditures spent on the Davidson Tisdale property. The Company is the operator of the Davidson Tisdale property, holding a 68.5% ownership, while SGX Resources Inc. ("SGX") is the beneficial owner of a 31.5% interest. The 31.5 % ownership interest was originally owned by San Gold Corp ("San Gold"). On April 18, 2012, SGX purchased the 31.5% interests from San Gold. The Company is exposed to credit risk in connection with the timing of processing of refund payments related to exploration expenditures. As at December 31, 2012, the Company recorded receivables of approximately \$23,139 due from SGX.

**(f) Fair Value**

Cash and cash equivalents are held at fair value through profit and loss. Amounts receivable are classified as loans and receivables, and measured at amortized cost. Accounts payable and accrued liabilities are classified as other financial liabilities, and measured at amortized cost.

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**5. FINANCIAL INSTRUMENTS (Continued)**

Cash and cash equivalents and short-term investments would be classified as a level 1 item under the fair value hierarchy.

**6. CAPITAL MANAGEMENT**

The Company defines capital management as the manner it manages its shareholders' equity. As at December 31, 2012 the Company's common stock was \$70,105,954 (2011 - \$69,764,104). Changes in common stock over prior year end resulted from the issuance of 50,000 common shares from exercises of share options and 975,595 common shares for property acquisition during 2012.

There were no changes in the Company's approach to capital management during the year ended December 31, 2012 and the Company is not subject to any externally imposed capital requirements.

The Company's objectives when managing capital are:

- a) To safeguard the Company's financial capacity and liquidity for future earnings in order to continue to provide an appropriate return to shareholders and other stakeholders;
- b) To maintain a flexible capital structure which optimizes the cost of capital at an acceptable risk;
- c) To enable the Company to maximize growth by meeting its capital expenditure budget, to expand its budget to accelerate projects, and to take advantage of acquisition opportunities.

The Company regularly monitors and reviews the amount of capital in proportion to risk and future development and exploration opportunities. The Company manages the capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets. In order to maintain or adjust the capital structure, the Company may issue new debts or equity or similar instruments, or make adjustments to its capital expenditure program.

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**7. INVESTMENT IN URANIUM VALLEY MINES**

On May 12, 2011, Lexam VG and Golden Valley Mines Ltd. (“Golden Valley”) entered into a property transfer and share purchase agreement, whereby each company transferred \$300,000, along with their respective 50% interest in the Otish & Mistassini Property, located north central Quebec, to Uranium Valley Mines Ltd. (“UVM”). In addition, Golden Valley also contributed its wholly owned Beartooth project to UVM.

Lexam VG holds 4,000,000 common shares of UVM, reflecting an approximate ownership of 36%. The Company’s investment in UVM is accounted for using the equity method. The following is a schedule of the equity accounted investment:

|                           | As at                    |                          |
|---------------------------|--------------------------|--------------------------|
|                           | <u>December 31, 2012</u> | <u>December 31, 2011</u> |
| Beginning of period       | \$ 274,318               | \$ 300,000               |
| Loss on equity investment | <u>(61,334)</u>          | <u>(25,682)</u>          |
| End of period             | <u>\$ 212,984</u>        | <u>\$ 274,318</u>        |

As at December 31, 2012, UVM had total assets approximating \$1,853,000, primarily consisting of exploration and evaluation assets, and minimal liabilities, with a net loss approximating \$170,000 for the year ended December 31, 2012.

UVM trades on the TSX Venture under the symbol VZZ. Based on UVM’s closing share price of \$0.11 per share on December 31, 2012, the market value of 4,000,000 shares was \$440,000.

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**8. EXPLORATION AND EVALUATION ASSETS**

|                      | December 31,<br>2011 | Exploration         | December 31,<br>2012 |
|----------------------|----------------------|---------------------|----------------------|
| Fuller (a)           | \$ 13,520,229        | \$ 917,251          | \$ 14,437,480        |
| Davidson-Tisdale (b) | 6,462,587            | 19,506              | 6,482,093            |
| Buffalo Ankerite (c) | 8,900,711            | 1,223,173           | 10,123,884           |
| Paymaster (d)        | 5,684,961            | 586,384             | 6,271,345            |
|                      | <u>\$ 34,568,488</u> | <u>\$ 2,746,314</u> | <u>\$ 37,314,802</u> |

|                      | December 31,<br>2010 | Exploration         | Disposal of<br>Property | December 31,<br>2011 |
|----------------------|----------------------|---------------------|-------------------------|----------------------|
| Fuller (a)           | \$ 12,942,004        | \$ 578,225          | \$ -                    | \$ 13,520,229        |
| Davidson-Tisdale (b) | 6,438,449            | 24,138              | -                       | 6,462,587            |
| Buffalo Ankerite (c) | 5,568,457            | 3,332,254           | -                       | 8,900,711            |
| Paymaster (d)        | 4,045,135            | 1,639,826           | -                       | 5,684,961            |
| Augdome (e)          | 126,276              | 1,590               | (127,866)               | -                    |
| Windsor (f)          | 125,094              | -                   | (125,094)               | -                    |
|                      | <u>\$ 29,245,415</u> | <u>\$ 5,576,033</u> | <u>\$ (252,960)</u>     | <u>\$ 34,568,488</u> |

a) Fuller

The Company holds 100% of the surface and mining rights to the Fuller Property. The Company also owns the mineral rights to surrounding properties, a portion of which is subject to a 10% net profit interest ("NPI") calculated after all capital and operating costs have been recovered, payable to The Summit Organization, Inc.

b) Davidson-Tisdale

The Company is the legal and beneficial owner of 68.5% and SGX is the legal and beneficial owner of 31.5% of the Davidson Tisdale property. This is accounted for as a jointly controlled asset where the venturer bears the agreed percentage of expenses incurred on the property, corresponding to ownership.

In May 2011, the Company was transferred title of the restrictive time deposit of \$50,560 held with the Northern Development and Mines for the Davidson-Tisdale Mine Closure Plan. Prior to the transfer, the title was held by the previous claim holder.

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**8. EXPLORATION AND EVALUATION ASSETS (Continued)**

c) Buffalo Ankerite

The Company has a 100% interest in mining rights to the Buffalo Ankerite property and continued exploration activities during the year. The property is subject to a 10% NPI, except for the south pit area of the South Mine, where it is subject to a 20% NPI on ore mined by open pit, payable to The Summit Organization, Inc. During the second quarter of 2012, the Company acquired additional surface rights surrounding the Buffalo Ankerite property for a total of \$207,780.

d) Paymaster

Under the terms of the agreement, the Company has the option to earn an undivided 60% interest in 17 claims by incurring exploration expenditures of \$6,000,000 over 4 years, subject to a back-in-right. As of June 30, 2012, the Company met all exploration expenditure requirements and exercised its earn-in option. Goldcorp had a six month period, expiring on December 13, 2012, to exercise a back-in right to increase its interest from 40% to 70%, and become the operator, by making a payment of \$710,000 to Lexam VG plus incurring exploration and development expenditures of \$8,250,000 on the property within two years of the back-in right notice and by completing a feasibility study within three years of the back-in right notice. On December 13, 2012 the Company was informed that Gordcorp will not be exercising its back-in right. As a result the Company now holds a 60% interest in the claims forming Paymaster. This is accounted for as a jointly controlled asset where the venturer bears the agreed percentage of expenses incurred on the property, corresponding to ownership.

e) Augdome Property

The Company had a right to 100% ownership in the Augdome property. In December 2011, the Company signed a release to be fully indemnified from any claims on this property, and the property ownership reverted back to the previous claim owners. The abandonment was effective December 31, 2011. All exploration and evaluation costs were written off in 2011.

f) Windsor

The Company had a 100% interest in the property subject to a 2% net smelter royalty. In June 2011, the Company disposed of its 100% interest in the Windsor property for proceeds of \$50,000 resulting in a loss of \$75,094. The capitalized exploration and evaluation asset balance was \$125,094.

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**9 AUTOMOBILE AND EQUIPMENT**

|                                 | Office & computer<br>equipment | Automobiles      | Total            |
|---------------------------------|--------------------------------|------------------|------------------|
| <u>Cost</u>                     |                                |                  |                  |
| Balance, December 31, 2010      | \$ 7,018                       | \$ 17,714        | \$ 24,732        |
| Additions                       | 44,448                         | 34,431           | 78,879           |
| Impairment                      | (5,245)                        | -                | (5,245)          |
| Disposals                       | (1,773)                        | (14,814)         | (16,587)         |
| Balance, December 31, 2011      | <u>\$ 44,448</u>               | <u>\$ 37,331</u> | <u>\$ 81,779</u> |
| Disposals                       | -                              | (2,900)          | (2,900)          |
| Balance December 31, 2012       | <u>\$ 44,448</u>               | <u>\$ 34,431</u> | <u>\$ 78,879</u> |
| <u>Accumulated Amortization</u> |                                |                  |                  |
| Balance, December 31, 2010      | \$ 1,232                       | \$ 4,239         | \$ 5,471         |
| Additions                       | 5,301                          | 7,606            | 12,907           |
| Impairment                      | (1,645)                        | -                | (1,645)          |
| Disposals                       | (567)                          | (3,358)          | (3,925)          |
| Balance, December 31, 2011      | <u>\$ 4,321</u>                | <u>\$ 8,487</u>  | <u>\$ 12,808</u> |
| Additions                       | 14,816                         | 7,512            | 22,328           |
| Disposals                       | -                              | (1,601)          | (1,601)          |
| Balance, December 31, 2012      | <u>\$ 19,137</u>               | <u>\$ 14,398</u> | <u>\$ 33,535</u> |
| <u>Carrying amounts</u>         |                                |                  |                  |
| As at December 31, 2011         | <u>\$ 40,127</u>               | <u>\$ 28,844</u> | <u>\$ 68,971</u> |
| As at December 31, 2012         | <u>\$ 25,311</u>               | <u>\$ 20,033</u> | <u>\$ 45,344</u> |

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**10. DECOMMISSIONING LIABILITIES**

The Company recorded a decommissioning liability in 2010 pertaining to its Buffalo Ankerite property, based on an estimate performed by a third party. The estimated discounted obligation as at December 31, 2012 is \$423,917. The obligation relates to re-sloping existing pit walls, revegetation and labour costs. The undiscounted liability is expected to be settled in 2015 for approximately \$455,000, and has been discounted using a discount rate of 2.4%. As the Company continues its exploratory activities and investigates potential production scenarios, costs associated with the remediation work will be reconsidered. Currently, the Company has not been required to post a reclamation bond with the Ministry of Northern Development. However, this requirement may change upon submission of a closure plan.

|                                    | <u>2012</u>       | <u>2011</u>       |
|------------------------------------|-------------------|-------------------|
| Obligations, beginning of year     | \$ 413,941        | \$ 404,200        |
| Accretion of discounted cash flows | 9,976             | 9,741             |
| Obligations, end of year           | <u>\$ 423,917</u> | <u>\$ 413,941</u> |

**11. COMMITMENTS AND CONTRACTUAL OBLIGATIONS**

|                                             | Less than<br>1 year | 1 - 3 years       | 4 - 5 years | After 5 years | Total             |
|---------------------------------------------|---------------------|-------------------|-------------|---------------|-------------------|
| Decommissioning liabilities                 | -                   | 423,917           | -           | -             | 423,917           |
| Accounts payable and<br>accrued liabilities | 278,264             | -                 | -           | -             | 278,264           |
|                                             | <u>\$ 278,264</u>   | <u>\$ 423,917</u> | <u>\$ -</u> | <u>\$ -</u>   | <u>\$ 702,181</u> |

**12. COMMON STOCK**

(a) Authorized

Authorized common stock of the Company consists of an unlimited number of common shares without par value.

(b) Common Share Purchase Options

The Company has a stock option plan available to its employees, officers, directors and service providers. The number of common shares reserved for the purpose of the plan is 22,400,000.

The exercise price of options granted in accordance with the plan must not be lower than the fair market value share price as quoted on the Toronto Stock Exchange ("TSX") on the last business day prior to the date of the grant less any discounts permitted by the TSX. The period for exercising an option shall not extend beyond a period of five years following the date the option is granted.

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**12. COMMON STOCK (Continued)**

The total number of options held by insiders of the Company must not exceed 10% of the total number of shares issued and outstanding.

The following table summarizes options activity for the years ended December 31, 2012 and 2011.

|                      | 2012                |                                    | 2011                |                                    |
|----------------------|---------------------|------------------------------------|---------------------|------------------------------------|
|                      | Number<br>of Shares | Weighted Average<br>Exercise Price | Number<br>of Shares | Weighted Average<br>Exercise Price |
| Opening Balances     | 1,980,000           | \$ 0.42                            | 2,810,000           | \$ 0.42                            |
| Exercised (i)        | (50,000)            | 0.15                               | (827,500)           | 0.34                               |
| Expired or Cancelled | (920,000)           | 0.56                               | (527,500)           | 0.25                               |
| Granted (ii)         | -                   | -                                  | 525,000             | 0.07                               |
|                      | <u>1,010,000</u>    | <u>\$ 0.31</u>                     | <u>1,980,000</u>    | <u>\$ 0.42</u>                     |

(i) The share price on the date of exercise was \$0.40.

(ii) On January 1, 2011 525,000 options issued representing replacement options awarded to prior option holders of Lexam. These options were originally granted by Lexam on August 14, 2001. During the third quarter of 2011, 210,000 of the options were exercised and the remaining 315,000 options expired unexercised.

|                                                                   | 2012          | 2011          |
|-------------------------------------------------------------------|---------------|---------------|
| Weighted average fair value of<br>options granted during the year | <u>\$0.00</u> | <u>\$1.03</u> |

The following common share purchase options are outstanding at December 31, 2012:

| Date of Grant   | Number of<br>Shares | Exercise<br>Price | Expiry Date     |
|-----------------|---------------------|-------------------|-----------------|
| May 28, 2009    | 200,000             | 0.15              | May 11, 2014    |
| October 2, 2009 | 400,000             | 0.40              | October 1, 2014 |
| May 28, 2009    | 200,000             | 0.15              | May 11, 2014    |
| October 2, 2009 | <u>210,000</u>      | <u>0.40</u>       | October 1, 2014 |
|                 | <u>1,010,000</u>    | <u>\$ 0.30</u>    |                 |

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**13. COMMON SHARE PURCHASE WARRANTS**

The following table summarizes the warrants activity for the years ended December 31, 2012 and 2011:

|                 | 2012               |                                 |              | 2011               |                                 |              |
|-----------------|--------------------|---------------------------------|--------------|--------------------|---------------------------------|--------------|
|                 | Number of Warrants | Weighted Average Exercise Price | Fair Value   | Number of Warrants | Weighted Average Exercise Price | Fair Value   |
| Opening Balance | 5,208,334          | \$ 1.00                         | \$ 3,666,667 | 424,344            | \$ 0.15                         | \$ 16,079    |
| Exercised       | -                  | -                               | -            | (424,344)          | 0.15                            | (16,079)     |
| Issued          | -                  | -                               | -            | 5,208,334          | 1.00                            | 3,666,667    |
| Expired         | (5,208,334)        | 1.00                            | (3,666,667)  | -                  | -                               | -            |
| Closing Balance | -                  | \$ -                            | \$ -         | 5,208,334          | \$ 1.00                         | \$ 3,666,667 |

The 5,208,334 warrants issued on January 1, 2011 represent replacement warrants awarded to prior warrant holders of Lexam. The warrants were convertible to common shares at an exercise price of \$1.00 with an expiry date of December 30, 2012. On December 30, 2012, the warrants expired unexercised and as a result the company recorded a reduction in Common Share Purchase Warrants of \$3,666,667 and an off setting increase of \$3,534,167 to Contributed Surplus and \$132,500 to Common Stock. The proceeds attributable to the warrants, on the initial offering, were \$1,000,000, with an effective tax rate of 13.25%.

**14. SUPPLEMENTAL CASH FLOW INFORMATION**

Changes in non-cash working capital balances for the years ended:

|                                                                   | 2012                | 2011              |
|-------------------------------------------------------------------|---------------------|-------------------|
| Amounts receivable                                                | \$ 88,373           | \$ 435,176        |
| Prepaid expenses and deposits                                     | 176                 | (28,309)          |
| Accounts payable and accrued liabilities                          | (338,106)           | (93,208)          |
| Income tax payable                                                | -                   | (225,706)         |
|                                                                   | <u>\$ (249,557)</u> | <u>\$ 87,953</u>  |
| Interest received                                                 | <u>\$ 160,008</u>   | <u>\$ 59,363</u>  |
| Taxes paid                                                        | <u>\$ -</u>         | <u>\$ 210,419</u> |
| Equivalent dollar value of shares issued for property acquisition | <u>\$ 200,000</u>   | <u>\$ 150,000</u> |
| Shares issued for property acquisition                            | <u>975,595</u>      | <u>218,284</u>    |

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**15. RELATED PARTY TRANSACTIONS**

In the prior year, the Company had a management services agreement (“services agreement”) with 2083089 Ontario Inc. (“208”) pursuant to which the Company agreed to reimburse 208 for rent, personnel, office expenses and other administrative services on a cost recovery basis. 208 is owned by Robert McEwen, the chairman of the Company and beneficial owner of more than 5% of its voting securities. Mr. McEwen is also the Chief Executive Officer and Director of 208. For the year ended December 31, 2011, the Company incurred and paid management fees of \$199,100 to 208 under the management service agreement.

Effective January 2012, the Company no longer required the services agreement with 208 as those costs are now paid directly to McEwen Mining Inc. (“McEwen Mining”). Mr. McEwen is the Chief Executive Officer of McEwen Mining and holds a 25% ownership in McEwen Mining, which is a publicly listed company, trading on the New York Stock Exchange and the TSX. For the year ended December 31, 2012, the Company paid rent, personnel and office expenses of \$114,300 to McEwen Mining. During the fourth quarter of 2011, as a result of moving the Company’s corporate office, the Company incurred rent and office expenses, totaling \$30,000, charged by McEwen Mining.

All related party transactions are recorded at the exchange amount, agreed to between the parties. Management believes these transactions are in the normal course of business and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

During 2012, the Company’s directors and other key management received remuneration accumulating to \$93,048 for short-term benefits (2011 - \$316,120).

Short-term benefits include salaries, bonuses payable and other annual employee benefits.

Key management personnel are defined to include the Senior Leadership Team and members of the Board of Directors.

**16. BASIC AND DILUTED LOSS PER SHARE**

Basic loss per share has been calculated by dividing the net loss per the financial statements by the weighted average number of shares outstanding during the period. The fully diluted loss per share would be calculated using a common share balance increased by the number of common shares that could be issued on the exercise of outstanding warrants and options of the Company. As the Company is in a loss position for the years ended December 31, 2012 and 2011, the inclusion of options and warrants would be anti-dilutive.

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**17. INCOME TAXES**

**a) Loss Before Taxes**

|               | <b>2012</b>       | <b>2011</b>         |
|---------------|-------------------|---------------------|
| Canada        | \$ 706,323        | \$ 2,913,368        |
| United States | 28,490            | 54,078              |
| Total         | <u>\$ 734,813</u> | <u>\$ 2,967,446</u> |

**b) Tax Expense (Recovery)**

|                            | <b>2012</b> | <b>2011</b>      |
|----------------------------|-------------|------------------|
| Provision for income taxes | <u>\$ -</u> | <u>\$ 12,814</u> |

**c) Reconciliation to statutory rate**

The following table reconciles income taxes calculated at combined Canadian federal and provincial tax rates with the income tax expense in the financial statements. The applicable rate used for 2012 was 26.50% (2011 – 28.25%).

|                                                 | <b>2012</b>  | <b>2011</b>      |
|-------------------------------------------------|--------------|------------------|
| Loss per financial statements before tax        | \$ (734,813) | \$ (2,967,446)   |
| Statutory tax rates                             | 26.50%       | 28.25%           |
| Expected income tax recovery                    | (194,725)    | (838,303)        |
| Tax benefit not recognized                      | 321,421      | 564,557          |
| Non-deductible expenses                         | 5,528        | 51,249           |
| Non-taxable gain/loss on equity investment      | 8,127        | -                |
| Increase in tax rate effect on DIT              | (144,611)    | -                |
| Deferred and current tax rate differential      | -            | 203,480          |
| Foreign earnings subject to different tax rates | (3,007)      | (3,109)          |
| True up adjustments                             | 9,850        | 37,681           |
| Other                                           | (2,583)      | (2,741)          |
| Income tax expense (recovery)                   | <u>\$ -</u>  | <u>\$ 12,814</u> |

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**17. INCOME TAXES (Continued)**

**d) Deferred Income Taxes**

The temporary differences that give rise to deferred income tax assets and deferred income tax liabilities are presented below:

|                                           | <b>Consolidated Statement of<br/>financial position</b> |              | <b>Consolidated Statement of<br/>operations</b> |             |
|-------------------------------------------|---------------------------------------------------------|--------------|-------------------------------------------------|-------------|
|                                           | <b>2012</b>                                             | <b>2011</b>  | <b>2012</b>                                     | <b>2011</b> |
| Deferred income tax assets (liabilities): |                                                         |              |                                                 |             |
| Non-capital losses                        | \$ 2,021,435                                            | \$ 1,879,538 | \$ 141,897                                      | \$ 19,100   |
| Share issuance costs                      | -                                                       | -            | -                                               | (69,840)    |
| Exploration costs                         | (2,021,435)                                             | (1,879,538)  | (141,897)                                       | 50,740      |
| Net deferred income tax assets            | <u>\$ -</u>                                             | <u>\$ -</u>  | <u>\$ -</u>                                     | <u>\$ -</u> |

**Unrecognized temporary differences**

|                                                       | <b>2012</b>          | <b>2011</b>          |
|-------------------------------------------------------|----------------------|----------------------|
| Non-capital losses                                    | \$ 6,214,846         | \$ 5,508,482         |
| Exploration costs                                     | 3,484,741            | 3,486,066            |
| Automobiles and equipment                             | 1,507,138            | 1,483,434            |
| Share issuance costs                                  | 70,934               | 141,868              |
| Equity investment                                     | 987,016              | 925,682              |
| Decommissioning Liabilities                           | 19,716               | -                    |
| Write-down of loss receivable                         | 219,650              | 219,650              |
| Capital loss                                          | 28,085               | 28,085               |
| Intangible costs                                      | 642,892              | 691,281              |
| Temporary difference with investment<br>in subsidiary | 8,147,745            | 5,592,587            |
| Other                                                 | 137,897              | 137,778              |
| Net unrecognized temporary differences                | <u>\$ 21,460,660</u> | <u>\$ 18,214,913</u> |

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**17. INCOME TAXES (Continued)**

**e) Non-Capital Loss Carry-Forwards**

The Company has non-capital loss carry-forwards in Canada of approximately \$12,488,311 (2011 – \$11,795,118) and in the US of US\$1,255,117 (2011 – US\$1,210,930) available in certain circumstances to reduce future taxable income for Canadian and US income tax purposes. These losses expire between 2014 and 2032.

The years of expiry for the Canadian and the US losses are as follows:

| <u>Years of Expiry</u> | <u>Canada</u>        | <u>US (in US\$)</u> |
|------------------------|----------------------|---------------------|
| 2014                   | \$ 598,289           | \$ -                |
| 2015                   | 1,052,856            | -                   |
| 2026                   | 1,487,310            | -                   |
| 2027                   | 1,675,126            | -                   |
| 2028                   | 1,453,582            | 1,155,711           |
| 2029                   | 1,368,821            | -                   |
| 2030                   | 1,761,765            | -                   |
| 2031                   | 2,380,411            | 84,822              |
| 2032                   | 710,151              | 14,584              |
|                        | <u>\$ 12,488,311</u> | <u>\$ 1,255,117</u> |