

**HIGHLAND RESOURCES INC.**

**REPORT AND FINANCIAL STATEMENTS**

May 31, 2009 and 2008

(Stated in Canadian Dollars)



**BDO Dunwoody LLP**  
Chartered Accountants

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## **AUDITORS' REPORT**

To the Shareholders,  
Highland Resources Inc.

We have audited the balance sheets of Highland Resources Inc. as at May 31, 2009 and 2008 and the 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 Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at May 31, 2009 and 2008 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

*(signed) "BDO Dunwoody LLP"*

Chartered Accountants

Vancouver, Canada  
September 25, 2009

**HIGHLAND RESOURCES INC.**  
**BALANCE SHEETS**  
 May 31, 2009 and 2008  
 (Stated in Canadian Dollars)

	<b>2009</b>	<b>2008</b>
<b><u>ASSETS</u></b>		
Current		
Cash	\$ 333,540	\$ 354,702
GST recoverable	26,816	2,093
Prepaid expenses – Note 5	2,575	-
<hr/>		
Mineral properties – Notes 3 and 4	362,931	356,795
	<b>962,936</b>	-
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	<b>\$ 1,325,867</b>	<b>\$ 356,795</b>
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<b><u>LIABILITIES</u></b>		
Current		
Accounts payable and accrued liabilities	\$ 15,617	\$ 20,188
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<b><u>SHAREHOLDERS' EQUITY</u></b>		
Share capital – Note 4	1,331,855	518,845
Contributed surplus – Note 4	499,897	43,065
Deficit	(521,502)	(225,303)
<hr/>		
	<b>1,310,250</b>	336,607
<hr/>		
	<b>\$ 1,325,867</b>	<b>\$ 356,795</b>
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Nature of Operations and Ability to Continue as a Going Concern – Note 1  
 Commitments – Notes 3, 4 and 9  
 Subsequent Event – Note 9

APPROVED ON BEHALF OF THE BOARD:

<u>“Roger Blair”</u> Roger Blair	Director	<u>“ Gary Arca ”</u> Gary Arca	Director
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SEE ACCOMPANYING NOTES

**HIGHLAND RESOURCES INC.**  
**STATEMENTS OF OPERATIONS AND DEFICIT**  
**for the years ended May 31, 2009 and 2008**  
(Stated in Canadian Dollars)

	2009	2008
Expenses		
Accounting and office administration – Note 5	\$ 35,061	\$ 20,884
Audit fees	16,167	11,300
Bank charges and interest	911	278
Consulting fees – Note 5	36,662	5,459
Legal and corporate services	59,126	31,360
Management fees – Note 5	35,000	-
Qualifying transaction investigation costs	1,370	5,621
Rent – Note 5	31,480	18,000
Shareholder communications	11,593	4,572
Stock-based compensation – Note 4	-	23,059
Transfer agent and filing fees	35,687	15,736
Loss for the period before other items	(263,057)	(136,269)
Other items		
Foreign exchange	(2,189)	-
Interest income	1,715	9,388
Write-down of mineral properties – Note 3	32,668	-
Net loss and comprehensive loss for the year	(296,199)	(126,881)
Deficit, beginning of the year	(225,303)	(98,422)
Deficit, end of the year	\$ (521,502)	\$ (225,303)
Basic and diluted loss per share	\$ (0.07)	\$ (0.06)
Weighted average number of shares outstanding	4,119,364	2,051,042

SEE ACCOMPANYING NOTES

**HIGHLAND RESOURCES INC.**  
**STATEMENTS OF CASH FLOWS**  
**for the years ended May 31, 2009 and 2008**  
(Stated in Canadian Dollars)

	2009	2008
<b>Operating Activities</b>		
Net loss for the year	\$ (296,199)	\$ (126,881)
Items not affecting cash:		
Stock based compensation	-	23,059
Write-down of mineral properties	<b>32,668</b>	-
	<b>(263,531)</b>	<b>(103,822)</b>
Changes in non-cash working capital balances:		
GST recoverable	<b>(24,723)</b>	1,168
Prepaid expenses	<b>(2,575)</b>	102
Accounts payable and accrued liabilities	<b>(4,571)</b>	10,602
	<b>(295,400)</b>	<b>(91,950)</b>
<b>Cash Flows used in Investing Activities</b>		
Mineral property costs	<b>(324,771)</b>	-
<b>Cash Flows provided by Financing Activities</b>		
Issuance of common shares	<b>729,750</b>	1,500
Share issuance costs	<b>(130,741)</b>	-
	<b>599,009</b>	<b>1,500</b>
Decrease in cash during the year	<b>(21,162)</b>	<b>(90,450)</b>
Cash, beginning of the year	<b>354,702</b>	445,152
Cash, end of the year	<b>\$ 333,540</b>	<b>\$ 354,702</b>
<b>Supplementary disclosure of cash flow information:</b>		
Cash paid for:		
Interest	<b>\$ -</b>	<b>\$ -</b>
Income taxes	<b>\$ -</b>	<b>\$ -</b>

Non-cash Transactions – Note 4

SEE ACCOMPANYING NOTES

**HIGHLAND RESOURCES INC.**  
**NOTES TO THE FINANCIAL STATEMENTS**  
May 31, 2009 and 2008  
(Stated in Canadian Dollars)

**Note 1**     **Nature of Operations and Ability to Continue as a Going Concern**

The Company was incorporated in the Province of British Columbia on June 7, 2006 under the Business Corporations Act of British Columbia. The Company received acceptance from the TSX Venture Exchange (the "Exchange") for the Company's qualifying transaction described in its filing statement dated September 16, 2008. As such the Company is no longer considered a capital pool company and is listed as a Tier 2 issuer on the Exchange.

The Company is in the exploration stage and has entered into option and purchase agreements to acquire resource properties in Canada. The economic recoverability of the properties' reserves has yet to be determined. The recoverability of amounts from the properties will be dependent upon the discovery of economically recoverable reserves, confirmation of the Company's interest in the underlying properties, the ability of the Company to obtain necessary financing to satisfy the expenditure requirements under the property agreement and to complete the development of the properties and upon future profitable production or proceeds from the sale thereof. The outcome of these matters cannot be predicted with any certainty at this time.

The financial statements have been prepared using Canadian generally accepted accounting principles applicable for a going concern which assumes that the Company will realize its assets and discharge its liabilities in the ordinary course of business. As at May 31, 2009, the Company had not yet achieved profitable operations and has accumulated losses of \$521,502 since its inception. Its ability to continue as a going concern is dependent upon the ability of the Company to obtain the necessary financing to meet its obligations and pay its liabilities arising from normal business operations when they come due. These financial statements do not give effect to adjustments that would be necessary to the carrying values and classification of assets and liabilities should the Company be unable to continue as a going concern and therefore be required to realize its assets and discharge its liabilities and commitments at amounts different from those reported in the financial statements. Working capital at May 31, 2009 was \$347,314, however this may not be adequate to meet the Company's obligations over the next twelve months. As such, the Company's ability to continue as a going concern is in substantial doubt. If required, it is anticipated that any additional funding will be in the form of equity financing from the sale of common shares, however there is no guarantee that funding from such financings will be available in amounts sufficient to meet the commitments of the Company.

**Note 2**     **Significant Accounting Policies**

Management has prepared the financial statements of the Company in accordance with Canadian generally accepted accounting principles. The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. These financial statements have been prepared within the framework of the significant accounting policies summarized below.

## Highland Resources Inc.

Notes to the Financial Statements

May 31, 2009 and 2008

(Stated in Canadian Dollars) – Page 2

### Note 2 Significant Accounting Policies – (cont'd)

#### a) Basic and Diluted Loss per Share

Basic loss per share is computed by dividing the loss for the period by the weighted average number of common shares outstanding during the period. Diluted loss per share reflects the potential dilution that could occur if potentially dilutive securities were exercised or converted to common stock. The dilutive effect of options and warrants and their equivalent is computed by application of the treasury stock method. Fully diluted amounts are not presented when the effect of the computations are anti-dilutive due to the losses incurred. Accordingly, there is no difference in the amounts presented for basic and diluted loss per share.

Potentially dilutive common shares (relating to options and warrants outstanding at year-end) totalling 2,507,500 (2008: 542,500) were not included in the computation of loss per share because their effect was anti-dilutive. 3,310,415 common shares held in escrow are also excluded in the computation of loss per share as they are not considered to be outstanding shares for purposes of loss per share calculations.

#### b) Income Taxes

The Company follows the asset and liability method of accounting for income taxes. 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 differences between the tax and accounting basis of assets and liabilities. The future tax assets or liabilities are calculated using the tax rates for the period in which the differences are expected to be settled. Future tax assets are recognized to the extent that they are considered more likely than not to be realized.

#### c) Stock-based Compensation

Stock-based compensation is accounted for at fair value as determined by the Black-Scholes option pricing model using amounts that are believed to approximate the volatility of the trading price of the Company's shares, the expected lives of awards of stock-based compensation, the fair value of the Company's stock and the risk-free interest rate, as determined at the grant date. Changes in these assumptions can materially affect the fair value estimate and, therefore, the existing models do not necessarily provide a reliable single measure of the fair value of the Company's share purchase options. The estimated fair value of awards of stock-based compensation are charged to expense over their vesting period, with offsetting amounts recognized as contributed surplus. Upon exercise of share purchase options, the consideration paid by the option holder, together with the amount previously recognized in contributed surplus, is recorded as an increase to share capital.

#### d) Share issue costs

Share issue costs, which include commissions, professional and regulatory fees are charged directly to share capital.

**Highland Resources Inc.**

Notes to the Financial Statements

May 31, 2009 and 2008

(Stated in Canadian Dollars) – Page 3

**Note 2      Significant Accounting Policies** – (cont'd)

e) Financial Instruments

All financial instruments are classified into one of the following five categories: held for trading, held-to-maturity investments, loans and receivables, available-for-sale assets or other financial liabilities. All financial instruments, including derivatives, are included on the balance sheet and are measured at fair market value upon inception with the exception of certain related party transactions. Subsequent measurement and recognition of changes in the fair value of financial instruments depends on their initial classification. Held-for-trading financial investments are measured at fair value and all gains and losses are included in operations in the period in which they arise. Available-for-sale financial instruments are measured at fair value with revaluation gains and losses included in other comprehensive income until the asset is removed from the balance sheet. Loans and receivables, investments held to maturity and other financial liabilities are measured at amortized cost using the effective interest method. Gains and losses upon inception, derecognition, impairment write-downs and foreign exchange translation adjustments are recognized immediately. Transaction costs related to debt financings will be expensed in the period incurred.

The Company's financial instruments consist of cash, which is classified as held-for-trading, and accounts payable, which is classified as other financial liabilities. It is management's opinion that the Company is not exposed to significant interest, currency or credit risks arising from these financial instruments (Note 7).

f) Mineral Properties

The Company defers the cost of acquiring, maintaining its interest, exploring and developing mineral properties until such time as the properties are placed into production, abandoned, sold or considered to be impaired in value. Costs of producing properties will be amortized on a unit of production basis and costs of abandoned properties are written-off. Proceeds received on the sale of interests in mineral properties are credited to the carrying value of the mineral properties, with any excess included in operations. Write-downs due to impairment in value are charged to operations.

The Company is in the process of exploring and developing its mineral properties and has not yet determined the amount of reserves available. Management reviews the carrying value of mineral properties on an annual basis and will recognize impairment in value based upon current exploration results, the prospect of further work being carried out by the Company, the assessment of future probability of profitable revenues from the property or from the sale of the property. Amounts shown for properties represent costs incurred net of write-downs and recoveries, and are not intended to represent present or future values.

**Highland Resources Inc.**

Notes to the Financial Statements

May 31, 2009 and 2008

(Stated in Canadian Dollars) – Page 4

**Note 2      Significant Accounting Policies** – (cont'd)

g) Asset Retirement Obligations

The Company records the fair value of an asset retirement obligation as a liability in the period in which it incurs a legal obligation associated with the retirement of tangible long-lived assets that results from the acquisition, construction, development, and/or normal use of the assets. The obligation is measured initially at fair value using present value methodology and the resulting costs are capitalized into the carrying amount of the related asset. In subsequent periods, the liability will be adjusted for any changes in the amount or timing of the underlying future cash flows. Capitalized asset retirement costs are depreciated on the same basis as the related asset and the discounted accretion of the liability is included in determining the results of operations.

The Company has performed only preliminary exploratory work on its mineral properties, and has not incurred significant reclamation obligations in the current year or prior periods.

h) Recently Adopted Canadian Accounting Standards

*Going Concern*

Effective June 1, 2008, the Company adopted the amendments to the guidelines of CICA Handbook Section 1400, General Standards of Financial Statement Presentation. The Canadian Accountability Standards Board amended Section 1400, to include requirements for management to assess and disclose an entity's ability to continue as a going concern. The adoption of these amendments resulted in no disclosure changes to the Company's financial statements.

*Financial Instruments*

Effective June 1, 2008, the Company adopted the new guidelines of CICA Handbook Section 3862, Financial Instruments – Disclosures, and Section 3863, Financial Instruments – Presentation. These standards replace CICA Handbook Section 3861, Financial Instruments – Disclosure and Presentation.

These standards increase the disclosures previously required, enabling users to evaluate the significance of financial instruments for an entity's financial position and performance, including disclosures about fair value. In addition, qualitative and quantitative disclosure is required about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk. The quantitative disclosures must provide information about the extent to which the Company is exposed to such risk, based on information provided internally to the entity's key management personnel. The disclosure required under this accounting standard is contained within Note 7.

**Highland Resources Inc.**

Notes to the Financial Statements

May 31, 2009 and 2008

(Stated in Canadian Dollars) – Page 5

**Note 2      Significant Accounting Policies** – (cont'd)

h) Recently Adopted Canadian Accounting Standards – (cont'd)

*Capital Disclosures*

Effective June 1, 2008, the Company adopted the new guidelines of CICA Handbook Section 1535, Capital Disclosures, which requires companies to disclose their objectives, policies and processes for managing capital, quantitative data about what the entity regards as capital, and whether they have complied with externally imposed capital requirements and, if not in compliance, the consequences of such non-compliance. The disclosure required under this accounting standard is contained within Note 8.

i) Future Accounting Changes

*International Financial Reporting Standards (“IFRS”)*

In 2006, the Canadian Accounting Standards Board (“AcSB”) published a new strategic plan that will significantly affect financial reporting requirements for Canadian companies. The AcSB strategic plan outlines the convergence of Canadian generally accepted accounting principles with IFRS over an expected five-year transitional period. In February 2008, the AcSB announced that 2011 is the changeover date for publicly-listed companies to use IFRS, replacing Canada's own generally accepted accounting principles. The effective date for the Company is for interim and annual financial statements relating to fiscal years beginning on or after June 1, 2011. This transition will require the restatement, for comparative purposes, of amounts reported by the Company for the year ended May 31, 2011. The Company continues to monitor and assess the impact of the convergence of Canadian GAAP and IFRS.

**Highland Resources Inc.**

Notes to the Financial Statements

May 31, 2009 and 2008

(Stated in Canadian Dollars) – Page 6

**Note 3 Mineral Properties**a) Summary of Expenditures

	<b>Rickaby Property</b>	<b>Montgomery Pass Property</b>	<b>Total</b>
Balance, May 31, 2008	\$ -	\$ -	\$ -
Acquisition costs:			
Property payments	<b>250,000</b>	<b>10,000</b>	<b>260,000</b>
25,000 common shares at \$0.35	-	<b>8,750</b>	<b>8,750</b>
2,916,666 common shares at \$0.20	<b>583,333</b>	-	<b>583,333</b>
393,749 common shares at \$0.20	<b>78,750</b>	-	<b>78,750</b>
Expense reimbursements	-	<b>13,918</b>	<b>13,918</b>
	<b>912,083</b>	<b>32,668</b>	<b>944,751</b>
Exploration costs:			
Claim maintenance	<b>13,750</b>	-	<b>13,750</b>
Mapping and reports	<b>9,100</b>	-	<b>9,100</b>
Surveys	<b>25,136</b>	-	<b>25,136</b>
Assays and sampling	<b>2,867</b>	-	<b>2,867</b>
	<b>50,853</b>	-	<b>50,853</b>
Subtotal before write-down	<b>962,936</b>	<b>32,668</b>	<b>995,604</b>
Write-off	-	<b>(32,668)</b>	<b>(32,668)</b>
<b>Balance, May 31, 2009</b>	<b>\$ 962,936</b>	<b>\$ -</b>	<b>\$ 962,936</b>

b) Montgomery Pass Property

The Company entered into a letter of agreement with Desert Pacific Exploration Inc. (“Desert Pacific”) dated June 24, 2008 to acquire 81 mineral claims (the “Claims”) in Mineral County, Nevada (the “Acquisition”). Desert Pacific is a private company incorporated in Nevada, U.S.A.

Pursuant to the letter of agreement, the Company could have acquired a 100% undivided interest, subject to a 3% net smelter royalty (“NSR”), in return for reimbursement of Desert Pacific’s costs related to the Claims, including filing fees and fees paid to maintain the Claims in good standing (paid), and by paying US\$247,500 in cash (paid \$10,000), issuing 775,000 shares (issued 25,000 shares valued using the market value of the shares as of the date of issuance) and incurring exploration expenditures of US\$3,850,000.

**Highland Resources Inc.**

Notes to the Financial Statements

May 31, 2009 and 2008

(Stated in Canadian Dollars) – Page 7

**Note 3**     **Mineral Properties** – (cont'd)

b) Montgomery Pass Property – (cont'd)

Subsequent to May 31, 2009, the Company terminated the proposed acquisition of the Montgomery Pass Property. The Company recorded a write-down of \$32,668 in the statement of operations and deficit relating to this property.

c) Rickaby Property

During the year ended May 31, 2009, the Company entered into a Property Purchase & Joint Venture Agreement (the “Agreement”) with Canadian Prospector Inc. (“CPI”). The Agreement, as amended on January 23, 2009, grants the Company an option to acquire an undivided 51% interest in 88 mineral claims located in the Beardmore-Geraldton Belt of the Thunder Bay Mining District, Ontario (“Rickaby Property”). The Agreement was accepted by regulatory authorities on May 6, 2009 (the “Approval Date”). Consideration payable is as follows:

- (i) payment of an aggregate \$250,000 (paid);
- (ii) expenditures by the Company in the aggregate amount of \$1,000,000 by May 6, 2010; and
- (iii) issuance of 2,916,666 shares (issued) to be held in escrow until \$1,000,000 in exploration expenditures have been incurred by the Company. In the event the Company does not incur \$1,000,000 of expenditures, the shares shall be returned to the Company for cancellation. These shares were valued using the market value of the shares as of the Approval Date.

In connection with the Agreement, a finder’s fee was paid by the issue of 393,749 shares of the Company. These shares were valued using the market value of the shares as of the Approval Date.

d) Environmental Protection Practices

The Company is subject to laws and regulations relating to environmental matters in all jurisdictions in which it operates, including provisions relating to property reclamation, discharge of hazardous material and other matters. The Company may also be held liable should environmental problems be discovered that were caused by former owners and operators of its properties and properties in which it has previously had an interest. The Company is not aware of any existing environmental problems related to any of its current or former properties that may result in material liability to the Company.

**Note 4     Share Capital and Contributed Surplus**

a) Authorized:

Unlimited common shares without par value.

b) Issued:

	<b>Number</b>	<b>Amount</b>
Balance, May 31, 2007	4,050,001	\$ 516,932
Issued for cash pursuant to:		
Exercise of agents' warrants            - at \$0.20	7,500	1,500
Transferred from contributed surplus on exercise of agents' warrants	-	413
Balance, May 31, 2008	4,057,501	518,845
Issued for cash pursuant to:		
Private placement                            - at \$0.15	4,605,000	332,750
Exercise of stock options                - at \$0.20	195,000	39,000
Issued pursuant to:		
Property option agreement	25,000	8,750
Property purchase and joint venture agreement	2,916,666	583,333
Finders fee	393,749	78,750
Share issue costs:		
Cash payments		(130,741)
Agents' options granted		(116,000)
Transferred from contributed surplus on exercise of stock options	-	17,168
<b>Balance, May 31, 2009</b>	<b>12,192,916</b>	<b>\$ 1,331,855</b>

- i) During the year ended May 31, 2008, the Company issued 7,500 common shares at \$0.20 per share, for proceeds of \$1,500 pursuant to the exercise of agents' warrants. The Company transferred \$413 from contributed surplus to share. This non-cash amount has been excluded from the statement of cash flows.
- ii) During the year ended May 31, 2009, the Company issued 195,000 common shares at \$0.20 per share, for proceeds of \$39,000 pursuant to the exercise of stock options. The Company transferred \$17,168 from contributed surplus to share capital pursuant to the exercise of the stock options. This non-cash amount has been excluded from the statement of cash flows.

**Highland Resources Inc.**

Notes to the Financial Statements

May 31, 2009 and 2008

(Stated in Canadian Dollars) – Page 9

**Note 4**     **Share Capital** – (cont'd)

b) Issued: – (cont'd)

- iii) During the year ended May 31, 2009, the Company issued 25,000 common shares valued at \$8,750 pursuant to the letter of agreement with Desert Pacific (Note 3b). The value of these shares, \$8,750, has been excluded from the statement of cash flows.
- iv) During the year ended May 31, 2009, the Company issued 2,916,666 common shares valued at \$0.20 per share pursuant to the Rickaby Property acquisition (Note 3c). The Company also issued 393,749 common shares as finder's fees in the acquisition. The values of these shares, \$583,333 and \$78,750 respectively, have been excluded from the statement of cash flows.
- v) In connection with the Acquisition (Note 3b), the Company issued 4,605,000 units at \$0.15 per unit for proceeds of \$690,750. Each unit consisted of one common share and one-half of one transferable share purchase warrant. Each whole warrant is exercisable to purchase one share at a price of \$0.30 per share for the first 12 months ending April 29, 2010 or \$0.40 per share for the second 12 month period ending April 29, 2011. The proceeds were allocated to the fair value of the warrants of \$358,000 with the remainder allocated to share capital.

The Agents received cash commissions of \$55,260 and 690,750 Agents' options. Each Agent's option exercisable into one unit at \$0.15 per unit until April 29, 2011. The fair value of the Agents' options of \$116,000 is included in share issue costs. Other legal and corporate fees of \$47,092 were incurred.

The fair values of the warrants and the Agent's options are non-cash and have been excluded from the statement of cash flows. Fair values were calculated using the Black-Scholes model with the following weighted-average assumptions:

Dividend rate	0%
Risk-free interest rate	1.33%
Expected life	2 Years
Expected annual volatility	187%

**Highland Resources Inc.**

Notes to the Financial Statements

May 31, 2009 and 2008

(Stated in Canadian Dollars) – Page 10

**Note 4**    **Share Capital** – (cont'd)c) Commitments:Stock-based Compensation

The Company, in accordance with the policies of the Exchange, is authorized to grant options to directors, officers, and employees to acquire up to 10% of common stock outstanding. Options may be granted for a maximum term of five years. Option shares originally vested in accordance with the vesting provisions as to one quarter of the options each three months. During the year ended May 31, 2008, the shareholders elected to remove all vesting provisions from the option plan. During the year ended May 31, 2009, the Company expensed \$Nil (2008: \$23,059) representing the fair value of unvested options that were deemed to vest by the shareholders.

In conjunction with its public listing during the year ended May 31, 2007, the Company granted 400,000 stock options (390,000 to directors and 10,000 to a registered charity). Each directors' option allows the holder to acquire an additional common share of the Company at \$0.20 per share for a period of five years until September 22, 2011. The registered charity options are exercisable at \$0.20 per share and expire on the earlier of August 20, 2016, or the 90<sup>th</sup> day following the date the charity ceases to be an eligible charitable organization.

The fair value of the 400,000 options granted was estimated to be \$35,216 using the Black-Scholes option-pricing model with the following weighted average assumptions at date of grant:

Dividend rate	0%
Risk-free interest rate	4.06%
Expected life	5 Years
Expected annual volatility	44%

During the period ended May 31, 2009, the Company incurred \$Nil (2008: \$23,059) for stock-based compensation expense.

A summary of stock option activity during the years ended May 31, 2009 and 2008 is as follows:

	Number Of Shares	Weighted Average Exercise Price
Options outstanding, May 31, 2007 and 2008	400,000	\$0.20
Exercised	(195,000)	\$0.20
<b>Options outstanding, May 31, 2009</b>	<b>205,000</b>	<b>\$0.20</b>

**Highland Resources Inc.**

Notes to the Financial Statements

May 31, 2009 and 2008

(Stated in Canadian Dollars) – Page 11

**Note 4    Share Capital** – (cont'd)c) Commitments: – (cont'd)Stock-based Compensation – (cont'd)

At May 31, 2009, there were 205,000 stock options outstanding entitling the holders thereof to purchase one common share for each option held as follows:

Number of Shares	Number Exercisable	Exercise Price	Expiry Date	Contractual Life Remaining
195,000	195,000	\$0.20	September 22, 2011	2.31 years
10,000	10,000	\$0.20	September 22, 2016	7.32 years
<b>205,000</b>	<b>205,000</b>	<b>\$0.20</b>		<b>2.56 years</b>

Warrants

A summary of warrant activity during the years ended May 31, 2009 and 2008 is as follows:

	Number Of Shares	Weighted Average Exercise Price
Balance, May 31, 2007	150,000	\$0.20
Exercised	(7,500)	\$0.20
Balance, May 31, 2008	142,500	\$0.20
Issued	2,302,500	\$0.30
Expired	(142,500)	\$0.20
<b>Balance, May 31, 2009</b>	<b>2,302,500</b>	<b>\$0.30</b>

Each of the warrants outstanding at May 31, 2009 are exercisable to purchase one share at a price of \$0.30 per share for the first 12 months ending April 29, 2010 or \$0.40 per share for the second 12 month period ending April 29, 2011.

Agents' Options

Each Agent's option is exercisable for one unit at \$0.15 per unit until April 29, 2011. Each unit consists of one common share and one-half of one transferable share purchase warrant. Each whole warrant is exercisable to purchase one share at a price of \$0.30 per share for the first 12 months ending April 29, 2010 or \$0.40 per share for the second 12 month period ending April 29, 2011. A summary of Agent's options activity during the years ended May 31, 2009 and 2008 is as follows:

**Highland Resources Inc.**

Notes to the Financial Statements

May 31, 2009 and 2008

(Stated in Canadian Dollars) – Page 12

**Note 4    Share Capital** – (cont'd)

## c) Commitments: – (cont'd)

Agents' Options – (cont'd)

	Number Of Units	Weighted Average Exercise Price
Balance, May 31, 2008 and 2007	-	N/A
Granted	690,750	\$0.15
<b>Balance, May 31, 2009</b>	<b>690,750</b>	<b>\$0.15</b>

d) Contributed Surplus:

	Year Ended May 31, 2009	Year Ended May 31, 2008
Balance, beginning of period	\$ 43,065	\$ 20,419
Stock-based compensation	-	23,059
Private placement warrants issued	358,000	-
Agents' options granted	116,000	-
Transferred to share capital on exercise of warrants	-	(413)
Transferred to share capital on exercise of options	(17,168)	-
Balance, end of period	<b>\$ 499,897</b>	<b>\$ 43,065</b>

e) Escrow Shares:

As at May 31, 2009 4,810,416 (2008: 2,000,001) shares were held in escrow. 1,500,001 shares will be released bi-annually in five (5) releases of 300,000 (on March 25 and September 25) until September 25, 2011. 2,916,666 plus 393,749 shares will be released or cancelled in accordance with the agreement disclosed in Note 3(c).

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**Note 5      Related Party Transactions**

The Company incurred the following costs with companies controlled by directors of the Company and with companies controlled by significant shareholders:

	<b>May 31, 2009</b>	May 31, 2008
Consulting fees	\$ 24,000	\$ -
Management fees	35,000	-
Rent	9,000	18,000
Accounting and office administration	4,500	9,000
	<b>\$ 72,500</b>	<b>\$ 27,000</b>

Included in prepaid expenses at May 31, 2009, is \$2,575 (2008: \$Nil) for prepaid rent with a company with a director in common.

These transactions were measured at the exchange amount, which is the amount agreed upon by the transacting parties.

**Note 6      Income Taxes**

A reconciliation of the income tax provision computed at statutory rates to the reported income tax provision is as follows:

	<b>May 31, 2009</b>	May 31, 2008
Basic statutory and provincial income tax rate	<b>29.96%</b>	33.03%
Loss before income taxes	<b>\$ (296,199)</b>	\$ (126,881)
Expected tax recovery on net loss, before income tax	<b>\$ (88,700)</b>	\$ (41,900)
Differences due to recognition of items for tax purposes:		
Permanent differences	-	7,600
Effect of reduction in statutory rate	17,200	7,300
Increase in valuation allowance	71,500	27,000
Income tax provision	<b>\$ -</b>	<b>\$ -</b>

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**Note 6** **Income Taxes** – (cont'd)

Significant components of the Company's future tax assets and liabilities are as follows:

	<b>May 31, 2009</b>	May 31, 2008
Future income tax assets		
Non-capital losses carried forward	\$ 133,000	\$ 58,000
Deferred exploration costs	8,000	-
Share issuance costs	34,000	13,000
	<b>175,000</b>	71,000
Less: valuation allowance	<b>(175,000)</b>	(71,000)
Future income tax assets	\$ -	\$ -

The Company has recorded a valuation allowance against its net future income tax assets based on the extent to which it is more-likely-than-not that sufficient taxable income will not be realized during the carry-forward period to utilize all the net future tax assets.

At May 31, 2009, the Company has accumulated non-capital losses totalling \$529,000, which may be applied against future years' taxable income. The non-capital losses expire as follows:

2027	\$ 103,000
2028	120,000
2029	<u>306,000</u>
	<u>\$ 529,000</u>

**Note 7** **Financial Instruments**a) **Interest Rate Risk**

The Company's cash earns interest at a variable interest rate. Because of the nature of this financial instrument, fluctuations in market rates do not have a significant impact on estimated fair values as of May 31, 2009. Future cash flows from interest income on cash will be affected by interest rate fluctuations. Interest rate risk consists of two components:

- (i) To the extent that payments made or received on the Company's monetary assets and liabilities are affected by changes in the prevailing market interest rates, the Company is exposed to interest rate cash flow risk.
- (ii) To the extent that changes in prevailing market interest rates differ from the interest rates in the Company's monetary assets and liabilities, the Company is exposed to interest rate price risk.

The Company's exposure to interest rate fluctuations is minimal.

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### **Note 7**     **Financial Instruments** – (cont'd)

#### b) Credit Risk

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. The Company is exposed to credit risk with respect to its cash, the balance of which at May 31, 2009 is \$333,540. Cash is held at a chartered Canadian financial institution.

#### c) Liquidity Risk

Liquidity risk arises from the excess of financial obligations over available financial assets due at any point in time. The Company's objective in managing liquidity risk is to maintain sufficient readily available reserves in order to meet its liquidity requirements. The Company achieves this by maintaining sufficient cash reserves. As at May 31, 2009, the Company was holding cash of \$333,540. The Company's accounts payable and accrued liabilities are due in the short term.

#### (d) Currency Risk

Currency risk is the risk that funds held in currencies other than the operating currency will fluctuate negatively, resulting in a foreign exchange loss. The Company holds all of its cash in Canadian dollars and does not have significant transactions denominated in foreign currencies. As such, the Company is not significantly exposed to currency risk.

### **Note 8**     **Capital Management**

The Company's objective when managing capital is to safeguard the Company's ability to continue as a going concern, so that it can continue to provide returns for shareholders and benefits for other stakeholders.

The Company considers the items included in shareholders' equity as capital. 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 shares through private placements, sell assets to reduce debt or return capital to shareholders. The Company is not subject to externally imposed capital requirements.

### **Note 9**     **Subsequent Event**

#### Financing

Subsequent to May 31, 2009, the Company announced it had arranged a non-brokered private placement for proceeds of up to \$1,500,000. The private placement will consist of:

- (a) up to 4,000,000 flow-through common shares (the "Shares") at a price of \$0.15 per Share; and

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**Note 9      Subsequent Event – (cont'd)**

Financing – (cont'd)

- (b) up to 6,000,000 non-flow-through Units (the “Units”) at a price of \$0.15 per Unit. Each Unit will consist of one common share of the Company and one-half non-transferable share purchase warrant (the “Warrant”). Each whole Warrant will entitle the holder to purchase one additional common share of the Company at a price of \$0.20 if exercised in the first year, or \$0.30 if exercised in the second year.

Options

On August 18, 2009, the Company granted incentive stock options to directors, officers and consultants of the Company, entitling them to purchase up to 775,000 common shares at \$0.15 per share exercisable up to August 18, 2014.