# Golden Queen Mining Co. Ltd.
## (A Development Stage Company)

## Condensed Consolidated Interim Financial Statements

## September 30, 2013

## (Unaudited - US Dollars)

**GOLDEN QUEEN MINING CO. LTD.**
**(a development stage company)**
**Condensed Consolidated Interim Balance Sheets**
**(Unaudited - US dollars)**

| | | September 30, 2013 | | December 31, 2012 |
|---|---|---|---|---|
| Assets | | | | |
| Current assets: | | | | |
| Cash and cash equivalents | $ | 8,089,943 | $ | 4,031,403 |
| Receivables | | 18,363 | | 16,972 |
| Prepaid expenses and other current assets | | 76,578 | | 81,848 |
| Total current assets | | 8,184,884 | | 4,130,223 |
| Property and equipment, net | | 290,978 | | 298,466 |
| Mineral property interests (Note 2) | | 7,298,072 | | 1,799,301 |
| Reclamation financial assurance | | 479,559 | | 339,079 |
| Total Assets | $ | 16,253,493 | $ | 6,567,069 |
| Liabilities and Shareholders' Equity | | | | |
| Current liabilities: | | | | |
| Accounts payable and accrued liabilities | $ | 1,292,683 | $ | 148,929 |
| Interest payable | | 30,196 | | - |
| Property rent payments | | 6,351 | | 6,351 |
| Current portion of derivative liability – stock options (Note 5) | | 1,296,641 | | - |
| Total current liabilities | | 2,625,871 | | 155,280 |
| Asset retirement obligations | | 475,938 | | 475,938 |
| Convertible debentures (Note 5) | | 4,293,077 | | - |
| Derivative liability – Convertible debentures (Note 5) | | 4,991,522 | | - |
| Derivative liability – Stock options (Note 6) | | 171,651 | | 3,522,071 |
| Total Liabilities | | 12,558,059 | | 4,153,289 |
| Shareholders' Equity | | | | |
| Preferred shares, no par value, 3,000,000 shares authorized; no shares outstanding | | | | |
| Common shares, no par value, 150,000,000 shares authorized; 98,333,383 (2012 – 97,998,383) shares issued and outstanding (Note 3) | | 62,063,452 | | 61,959,471 |
| Additional paid-in capital | | 8,829,268 | | 8,407,935 |
| Deficit accumulated | | (67,197,286) | | (67,953,626) |
| Total shareholders' equity | | 3,695,434 | | 2,413,780 |
| Total Liabilities and Shareholders' Equity | $ | 16,253,493 | $ | 6,567,069 |

Basis of Presentation and Ability to Continue as a Going Concern (Note 1)
Commitments and Contingencies (Notes 2 and 4)
Subsequent Events (Note 8)

Approved by the Directors:

*"H. Lutz Klingmann"*
H. Lutz Klingmann, Director

*"Thomas M. Clay"*
Thomas M. Clay, Director

See Accompanying Summary of Accounting Policies and Notes to Condensed Consolidated Interim Financial Statements

**GOLDEN QUEEN MINING CO. LTD.**
**(a development stage company)**
**Condensed Consolidated Interim Statements of Loss and Comprehensive Loss**
**(Unaudited - US dollars)**

| | Three Months Ended September 30, 2013 | Three Months Ended September 30, 2012 | Nine Months Ended September 30, 2013 | Nine Months Ended September 30, 2012 | Cumulative Amounts From Date of Inception (November 21, 1985) Through September 30, 2013 |
|---|---|---|---|---|---|
| General and administrative recovery (expenses) | $ (766,108) | $ 25,057 | $ (1,668,610) | $ (1,069,135) | $ (8,087,281) |
| Exploration expenditures | - | (10,282) | - | (587,967) | (22,155,531) |
| Asset impairment loss | - | (20,426) | - | (193,340) | (33,678,389) |
| Adjustment to asset retirement obligation changes in cash flow estimates | - | - | - | - | 99,220 |
| Accretion expense | - | - | - | (16,832) | (105,029) |
| Change in fair value of derivative liability including change in foreign exchange | 475,862 | (1,832,050) | 2,760,672 | (248,876) | (3,665,690) |
| Gain on settlement of debt | - | - | - | - | 136,627 |
| | (290,246) | (1,837,701) | 1,092,062 | (2,116,150) | (67,456,073) |
| Interest expense (Note 5) | (349,586) | - | (349,586) | - | (1,262,684) |
| Interest income | 2,088 | 11,870 | 13,864 | 41,447 | 1,745,317 |
| Net and comprehensive income (loss) for the period | $ (637,744) | $ (1,825,831) | $ 756,340 | $ (2,074,703) | $ (66,973,440) |
| Earnings (Loss) per share: | | | | | |
| Income (Loss) per share - basic | (0.01) | (0.02) | 0.01 | (0.02) | |
| Income (Loss) per share - diluted | $ (0.01) | $ (0.02) | $ (0.01) | $ (0.02) | |
| Basic and diluted | | $ 0.00 | $ (0.02) | $ (0.00) | $ (0.03) |
| Weighted average number of common shares outstanding - basic | 98,317,948 | 97,978,383 | 98,184,189 | 97,978,383 | |
| Weighted average number of common shares outstanding - diluted | 105,282,912 | 97,978,383 | 101,804,452 | 97,978,383 | |

See Accompanying Summary of Accounting Policies and Notes to Condensed Consolidated Interim Financial Statements

**GOLDEN QUEEN MINING CO. LTD.**
**(a development stage company)**
**Condensed Consolidated Interim Statements of Shareholders' Equity (Capital Deficit)**
**(Unaudited - US dollars)**

| | Common Shares | | Amount | | Additional Paid-in Capital | | Deficit Accumulated | | Total Shareholders' Equity (Capital Deficit) |
|---|---|---|---|---|---|---|---|---|---|
| Balance, December 31, 2011 | 97,978,383 | $ | 61,906,619 | $ | 8,407,935 | $ | (66,682,638) | $ | 3,631,916 |
| Issuance of common shares for mineral property interests | 20,000 | | 52,852 | | - | | - | | 52,852 |
| Net loss for the year | - | | - | | - | | (1,270,988) | | (1,270,988) |
| Balance, December 31, 2012 | 97,998,383 | | 61,959,471 | | 8,407,935 | | (67,953,626) | | 2,413,780 |
| Issuance of common shares for mineral property interests | 15,000 | | 22,568 | | - | | - | | 22,568 |
| Stock options exercised | 320,000 | | 81,413 | | 247,231 | | - | | 328,644 |
| Stock-based compensation | - | | - | | 174,102 | | - | | 174,102 |
| Net income for the period | - | | - | | - | | 756,340 | | 756,340 |
| Balance, September 30, 2013 | 98,333,383 | $ | 62,063,452 | $ | 8,829,268 | $ | (67,197,286) | $ | 3,695,434 |

See Accompanying Summary of Accounting Policies and Notes to Condensed Consolidated Interim Financial Statements

**GOLDEN QUEEN MINING CO. LTD.**
**(a development stage company)**
**Condensed Consolidated Interim Statements of Cash Flows**
**(Unaudited - US dollars)**

| | Nine Months Ended September 30, 2013 | Nine Months Ended September 30, 2012 | Cumulative from Date of Inception (November 21, 1985) through September 30, 2013 |
|---|---|---|---|
| Operating activities: | | | |
| Net income (loss) for period | $ 756,340 | $ (2,074,703) | $ (66,973,440) |
| Adjustments to reconcile net loss to cash used in operating activities: | | | |
| Asset impairment loss | - | 193,340 | 33,678,389 |
| Amortization and depreciation | 7,488 | 7,488 | 497,268 |
| Amortization of debt discount | 319,622 | - | 694,622 |
| Adjustment to asset retirement obligation based on changes in cash flow estimates | - | - | (99,220) |
| Accretion expense | - | 16,832 | 105,029 |
| Change in fair value of derivative liability including change in foreign exchange | (2,760,672) | 248,876 | 3,665,690 |
| Gain on disposition of property and equipment | - | - | (10,032) |
| Stock option compensation | 378,228 | - | 1,794,676 |
| Financing charges related to modification of warrants | - | - | 889,117 |
| Mineral property expenditures | - | - | (22,395,449) |
| Unrealized foreign exchange loss | 4,372 | - | 4,372 |
| Changes in assets and liabilities: | | | |
| Receivables | (1,391) | 2,155 | (18,363) |
| Prepaid expenses and other current assets | 5,270 | (10,734) | (163,488) |
| Accounts payable and accrued liabilities | 114,521 | (210,124) | 183,457 |
| Interest payable | 30,196 | - | 30,196 |
| Royalty and mining rights payable | - | 2,628 | 6,351 |
| Cash used in operating activities | (1,146,026) | (1,824,242) | (48,110,825) |
| Investment activities: | | | |
| Additions to mineral property interests | (4,446,970) | (649,591) | (15,018,048) |
| Deposits on mineral properties | - | - | (1,017,551) |
| Purchase of financial assurance | (140,480) | (3,312) | (479,559) |
| Purchase of property and equipment | - | - | (1,434,367) |
| Proceeds from sale of property and equipment | - | - | 47,153 |
| Cash used in investing activities | (4,587,450) | (652,903) | (17,902,372) |

See Accompanying Summary of Accounting Policies and Notes to Condensed Consolidated Interim Financial Statements

**GOLDEN QUEEN MINING CO. LTD.**
**(a development stage company)**
**Condensed Consolidated Interim Statements of Cash Flows**
**(Unaudited - US dollars)**

| | Nine Months Ended September 30, 2013 | Nine Months Ended September 30, 2012 | Cumulative from Date of Inception (November 21, 1985) through September 30, 2013 |
|---|---|---|---|
| Financing activities: | | | |
| Borrowing under long-term debt | $ - | $ - | $ 3,918,187 |
| Payment of long-term debt | - | - | (2,105,905) |
| Proceeds from convertible debt | 9,710,603 | - | 10,150,603 |
| Issuance of common shares for cash | - | - | 28,871,618 |
| Share issuance costs | - | - | (733,866) |
| Issuance of special warrants | - | - | 18,091,667 |
| Issuance of common shares upon exercise of stock options | 81,413 | - | 1,615,718 |
| Issuance of common shares upon exercise of warrants | - | - | 14,295,118 |
| Cash provided by financing activities | 9,792,016 | - | 74,103,140 |
| Net change in cash and cash Equivalents | 4,058,540 | (2,477,145) | 8,089,943 |
| Cash and cash equivalents, beginning balance | 4,031,403 | 7,922,255 | - |
| Cash and cash equivalents, ending balance | $ 8,089,943 | $ 5,445,510 | $ 8,089,943 |

Supplementary Disclosures of Cash Flow Information (Note 7)

***Nature of Business*** Golden Queen Mining Co. Ltd. ("Golden Queen" or the "Company") is engaged in maintaining a gold and silver mining property for exploration, future development and production. The Company was formed on November 21, 1985. Since its inception, the Company has been in the exploration stage but moved into the development stage in 2012. Planned activities involve bringing to production a gold and silver mine, the Soledad Mountain Project (the "Project"), located in the Mojave Mining District, Kern County, California.

These unaudited, condensed consolidated interim financial statements reflect all adjustments, consisting of normal recurring adjustments, which in the opinion of management are necessary for fair presentation of the information contained herein. The interim results are not necessarily indicative of the operating results expected for the fiscal year ending on December 31, 2013 and should be read in conjunction with the audited consolidated financial statements for the year ended December 31, 2012. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the disclosures herein are adequate to make the information presented not misleading. In the opinion of management, the information furnished herein reflects all known accruals and adjustments necessary for a fair statement of the results for the periods reported herein. All such adjustments are of a normal recurring nature. The financial results of the periods reported herein are not necessarily indicative of future financial results.

***Principles of Consolidation*** These unaudited, condensed, consolidated interim financial statements include the accounts of Golden Queen, a British Columbia corporation, and its wholly-owned subsidiary, Golden Queen Mining Co., Inc. (the "Subsidiary"), a US (State of California) corporation.

***Generally Accepted Accounting Principles*** These unaudited, condensed, consolidated interim financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America and the instructions to Form 10-Q.

***Recent Accounting Pronouncements*** There are no new accounting pronouncements that the Company recently adopted or are pending the Company's adoption that are expected to have a material impact on the Company's results of operations, financial position or cash flows.

***Cash and Cash Equivalents*** For purposes of balance sheet classification and the statements of cash flows, the Company considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

The Company places its cash and cash equivalents with high quality financial institutions. At times, such cash deposits may be in excess of Federal Deposit Insurance Corporation insurance limits. To date, the Company has not experienced a loss or lack of access to its cash and cash equivalents. However, no assurance can be provided that access to the Company's cash and cash equivalents will not be impacted by adverse economic conditions in the financial markets.

***Property and Equipment*** Property and equipment are stated at the lower of cost or net realizable value less accumulated depreciation. Depreciation is provided by the straight-line method over the estimated service lives of the respective assets, which range from 3 to 30 years, as follows:

| | |
|---|---|
| Buildings | 20 years |
| Furniture and Fixtures | 5 years |
| Automobiles | 3 to 5 years |
| Rental Properties | 30 years |

***Mineral Properties*** Costs related to the development of our mineral reserves are capitalized when it has been determined an ore body can be economically developed. The development stage begins when an ore body is determined to be economically minable based on proven and probable reserves and appropriate permits are in place, and ends when the production stage or exploitation of reserves begins. Major mine development expenditures are capitalized, including primary development costs such as costs of building access roads, heap leach pads, and infrastructure development.

Costs for exploration, pre-production development, if and when applicable, and maintenance and repairs on capitalized property, plant and equipment are charged to operations as incurred. Exploration costs include those relating to activities carried out (a) in search of previously unidentified mineral deposits, or (b) at undeveloped concessions. Pre-production development activities involve costs incurred in the exploration stage that may ultimately benefit production that are expensed due to the lack of evidence of economic development, which is necessary to demonstrate future recoverability of these expenses. Secondary development costs are incurred for preparation of an ore body for production in a specific ore block, stope or work area, providing a relatively short-lived benefit only to the mine area they relate to, and not to the ore body as a whole.

Drilling and related costs are either classified as exploration or secondary development, as defined above, and charged to operations as incurred, or capitalized, based on the following criteria:

- Whether the costs are incurred to further define mineralization at and adjacent to existing reserve areas or intended to assist with mine planning within a reserve area;
- Whether the drilling costs relate to an ore body that has been determined to be commercially mineable, and a decision has been made to put the ore body into commercial production; and
- Whether, at the time that the cost is incurred, the expenditure: (a) embodies a probable future benefit that involves a capacity, singly or in combination, with other assets to contribute directly or indirectly to future net cash inflows, (b) we can obtain the benefit and control others' access to it, and (c) the transaction or event giving rise to our right to or control of the benefit has already occurred.

If all of these criteria are met, drilling and related costs are capitalized. Drilling costs not meeting all of these criteria are expensed as incurred. The following factors are considered in determining whether or not the criteria listed above have been met, and capitalization of drilling costs is appropriate:

- Completion of a favourable economic study and mine plan for the ore body targeted;
- Authorization of development of the ore body by management and/or the Board of Directors; and
- All permitting and/or contractual requirements necessary for us to have the right to or control of the future benefit from the targeted ore body have been met.

Once production has commenced, capitalized costs will be depleted using the units-of-production method over the estimated life of the proven and probable reserves. If mineral properties are subsequently abandoned or impaired, any capitalized costs will be charged to the Condensed Consolidated Statements of Loss and Comprehensive Loss in that period.

We assess the carrying cost of our mineral properties for impairment whenever information or circumstances indicate the potential for impairment. Such evaluations compare estimated future net cash flows with our carrying costs and future obligations on an undiscounted basis. If it is determined that the future undiscounted cash flows are less than the carrying value of the property, a write down to the estimated fair value is charged to the Condensed Consolidated Statements of Loss and Comprehensive Loss for the period. Where estimates of future net cash flows are not available and where other conditions suggest impairment, management assesses if the carrying value can be recovered.

Proceeds received under option agreements and/or earn-in agreements are recorded as a cost recovery against the carrying value of the underlying project until the carrying value is reduced to zero. Any proceeds received in excess of the carrying value of the project are recorded as a realized gain in the Condensed Consolidated Statements of Loss and Comprehensive Loss.

***Valuation of Long-lived Assets*** Accounting standards require recognition of impairment of long-lived assets in the event the carrying value of such assets may not be recoverable. It requires that those long-lived assets to be disposed of by sale are to be measured at the lower of carrying amount or fair value less cost of sale whether reported in continuing operations or in discontinued operations. In accordance with the provisions of the accounting standard, the Company reviews the carrying value of its mineral properties on a regular basis. Reductions to the carrying value, if necessary, are recorded to the extent the carrying value of the property exceeds the assets' recoverable amount.

***Foreign Currency Translation*** The Company's functional and reporting currency is the US dollar. Assets and liabilities in foreign currencies are generally translated into US dollars at the exchange rates on the balance sheet date. Revenues and expenses are translated at exchange rates on the date of the transaction. Where amounts denominated in a foreign currency are converted into US dollars by remittance or repayment, the realized exchange differences are included in other income. The exchange rates prevailing at September 30, 2013 and December 31, 2012 were $1.03 and $0.99 stated in Canadian dollars per one US dollar, respectively. The average rates of exchange during the three months ended September 30, 2013 and the year ended December 31, 2012 were $1.04 and $1.00, stated in Canadian dollars per one US dollar, respectively.

***Earnings (Loss) Per Share*** The Company computes and discloses earnings (loss) per share in accordance with ASC 260, "Earnings per Share", which requires dual presentation of basic earnings (loss) per share and diluted earnings (loss) per share on the face of all income statements presented for all entities with complex capital structures. Basic earnings (loss) per share is computed as net income (loss) divided by the weighted average number of common shares outstanding for the period. Diluted earnings (loss) per share reflects the potential dilution that could occur from common shares issuable through stock options, warrants and convertible instruments.

***Reclamation and remediation costs (Asset Retirement Obligations)*** The Company accrues the estimated costs associated with environmental remediation obligations in the period in which the liability is incurred or becomes determinable. Until such time that a project life is established, the Company records the corresponding cost as an expense. The costs of future expenditures for environmental remediation are not discounted to their present value unless subject to a contractually obligated fixed payment schedule.

Future reclamation and environmental-related expenditures are difficult to estimate due to the early stage nature of the Project, the uncertainties associated with defining the nature and extent of environmental disturbance, the application of laws and regulations by regulatory authorities and changes in reclamation for remediation technology. The Company periodically reviews the provision for such reclamation and remediation costs as evidence indicating that the liabilities have potentially changed. Changes in estimates are reflected in the condensed consolidated interim statement of operations in the period an estimate is revised.

The Company is in the developmental stage and is unable to determine the estimated timing of expenditures relating to reclamation accruals. It is reasonably possible that the ultimate cost of reclamation and remediation could change in the future and that changes to these estimates could have a material effect on future operating results as new information becomes known.

***Estimates*** The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Significant estimates have been made by management in several areas including the recoverability of mineral properties, reclamation reserves and valuation of stock options. Actual results could differ from those estimates.

***Fair Value of Financial Instruments*** The carrying amounts reported in the balance sheets for cash and cash equivalents, receivables, accounts payable and accrued liabilities approximate fair values because of the immediate or short-term maturity of these financial instruments. The carrying amount of the convertible debt instrument is being recorded at amortized cost using the effective interest rate method. The fair value of the reclamation financial assurance approximates the carrying value because the stated interest rates reflect recent market conditions or because the rates are variable in nature.

***Income Taxes*** The Company follows the asset and liability method of accounting for income taxes whereby the deferred tax assets and liabilities are recognized for the future tax consequences of differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis. If it is determined that the realization of the future tax benefit is not more likely than not, the Company establishes a valuation allowance.

***Stock Option Plan*** The Company's current stock option plan (the "Plan") was adopted by the Company in 2013 and approved by shareholders of the Company in 2013. The Plan provides a fixed number of 7,200,000 common shares of the Company that may be issued pursuant to the grant of stock options. The exercise price of stock options granted under the Plan shall be determined by the Company's board of directors (the "Board"), but shall not be less than the volume-weighted, average trading price of the Company's shares on the TSX for the five trading days immediately prior to the date of the grant. The expiry date of a stock option shall be the date so fixed by the Board subject to a maximum term of five years. The Plan provides that stock options will terminate on the earlier of the expiry of the term and (i) 12 months from the date an option holder dies, (ii) 12 months from the date from the date the option holder ceases to act as a director or officer of the Company, or (iii) 12 months from the date the option holder ceases to be employed, or engaged as a consultant, by the Company. All options granted under the 2013 Plan will be subject to such vesting requirements as may be prescribed by the Exchange, if applicable, or as may be imposed by the Board.

***Derivative Financial Instruments*** The Company reviews the terms of its equity instruments and other financing arrangements to determine whether or not there are embedded derivative instruments that are required to be accounted for separately as a derivative financial instrument. Also, in connection with the issuance of financing instruments, the Company may issue options or warrants that may, depending on their terms, be accounted for as derivative instrument liabilities, rather than as equity. The Company may also issue options or warrants to non-employees in connection with consulting or other services.

Derivative financial instruments are measured at their fair value. For derivative financial instruments that are accounted for as liabilities, the derivative instrument is initially recorded at its fair value and is then re-valued at each reporting date, with changes in the fair value reported as charges or credits to income. For options or warrant-based derivative financial instruments, the Company uses the Black-Scholes option pricing model to estimate fair value of the derivative instruments. For complex financial instruments, such as convertible debt instruments, the Company uses an acceptable option pricing model commensurate with the complexity of the embedded derivative to estimate fair value. To the extent that the initial fair values of the freestanding and/or bifurcated derivative instrument liabilities exceed the total proceeds received, an immediate charge to income is recognized, in order to initially record the derivative instrument liabilities at their fair value.

The classification of derivative instruments, including whether or not such instruments should be recorded as liabilities or as equity, is reassessed at the end of each reporting period. If reclassification is required, the fair value of the derivative instrument, as of the determination date, is reclassified. Any previous charges or credits to income for changes in the fair value of the derivative instrument are not reversed. Derivative instrument liabilities are classified in the balance sheet as current or non-current based on whether the remaining maturity of the instrument is more than 12 months and it is not expected to be settled within twelve months. Other derivatives are presented as current liabilities.

### *1. Basis of Presentation and Ability to Continue as a Going Concern*

The Company has had no revenues from operations since inception and as at September 30, 2013 had a deficit of $67,197,286 (December 31, 2012 - $67,953,626) accumulated during the exploration and development stage.

The Company has not as yet made a production decision. The Company is evaluating various financing options for the construction of the Project, including debt and equity.

The ability of the Company to obtain financing for its ongoing activities and thus maintain solvency, or to fund construction of the Project, is dependent on equity market conditions, the market for precious metals or the willingness of other parties to lend the Company money. While the Company has been successful at certain of these efforts in the past, there can be no assurance that future efforts will be successful. This raises substantial doubt about the Company's ability to continue as a going concern.

These condensed consolidated interim financial statements do not include any adjustments to the recoverability and classification of recorded asset amounts and classification of liabilities that might be necessary should the Company be unable to continue as a going concern.

### *2. Mineral Properties*

The Company received notice that it had met all the remaining major conditions of the conditional use permits for development of the Project in July 2012. As a result, management made the decision to begin capitalizing all development expenditures directly related to the Project. Prior to July 2012, all acquisition costs were written off due to uncertainties around obtaining the necessary permits. Development expenditures for the nine month period ended September 30, 2013 are as follows:

| | | |
|---|---|---|
| Balance, December 31, 2012 | $ | 1,799,301 |
| Acquisition costs: | | |
| Mineral properties | | 1,340,138 |
| Deferred costs: | | |
| Property rent payments | | 94,021 |
| Road construction | | 962,828 |
| Site infrastructure development | | 798,277 |
| Water supply and distribution | | 136,153 |
| Engineering/consulting | | 890,855 |
| Geology/drilling | | 5,320 |
| Permitting/environmental | | 401,726 |
| Site maintenance | | 166,215 |
| Leach pad construction | | 528,401 |
| Other direct costs | | 174,837 |
| | | 5,498,771 |
| Asset retirement obligation | | - |
| Balance, September 30, 2013 | $ | 7,298,072 |

There are multiple third party landholders and the royalty amount due to each landholder over the life of the project varies with each property. The royalty payments become payable upon commencement of commercial production and are paid over the life of the Project. The estimated royalty payable over the life of the mine is $86,000,000, including all state royalties. As of September 30, 2013, the Company has not incurred any royalty payments as the Project has not been in production.

### *3. Share capital*

*Common shares - 2013*

In September 2013, 20,000 stock options were exercised for total proceeds of $5,017. As a result of the exercise, $24,723 was transferred from the derivative liability to additional paid up capital.

In May 2013, 100,000 stock options were exercised for total proceeds of $25,722. As a result of the exercise, $90,496 was transferred from the derivative liability to additional paid up capital.

In April 2013, 200,000 stock options were exercised for total proceeds of $50,674. As a result of the exercise, $132,012 was transferred from the derivative liability to additional paid up capital.

In March 2013, the Company issued 15,000 common shares for mineral property interests with a total fair value of $22,568 (C$23,250).

*Common shares - 2012*

In November 2012, the Company issued 20,000 common shares for mineral property interests with a total fair value of $52,852 (C$52,000).

*Stock options*

The Company has elected to use the Black-Scholes option pricing model to determine the fair value of stock options granted. In accordance with the accounting standard for employees, the compensation expense is amortized on a straight-line basis over the requisite service period, which approximates the vesting period. Compensation expense for stock options granted to non-employees is amortized over the contract services period or, if none exists, from the date of grant until the options vest. Compensation associated with unvested options granted to non-employees is re-measured on each balance sheet date using the Black-Scholes option pricing model.

The following is a summary of stock option activity during the nine month period ended September 30, 2013 and the year ended December 31, 2012:

| | Shares | Weighted Average Exercise Price per Share |
|---|---|---|
| Options outstanding and exercisable: January 1 and December 31, 2012 | 1,800,000 | C$0.29 |
| Stock options issued | 800,000 | C$1.32 |
| Stock options exercised | (320,000) | C$0.26 |
| Options outstanding, September 30, 2013 | 2,280,000 | C$0.65 |
| Options exercisable, September 30, 2013 | 1,780,000 | C$0.49 |

During the nine months ended September 30, 2013, there were 800,000 stock options issued for a stock based compensation expense of $378,228 (2012 - $Nil). Of the options issued, 50,000 were issued to a consultant and vested immediately while an additional 150,000 options were issued to directors and also vested immediately. The remaining 600,000 stock options were issued to two employees of which 100,000 vested immediately. The remaining 500,000 stock options had vesting conditions as follows:

- 300,000 options - 100,000 vesting every 6 months from grant date for a total vesting period of 18 months; and
- 200,000 options - 100,000 vesting every 6 months from grant date for a total vesting period of 12 months.

In addition, during the quarter, the Company extended the expiry date of 650,000 stock options issued to non-employees from January 28, 2014 to May 30, 2014. All other stock options remain unchanged.

*Stock options - Continued*

The stock options issued during the quarter were measured using the Black-Scholes option pricing model with the following assumptions:

| | September 30, 2013 | September 30, 2012 |
|---|---|---|
| Risk-free interest rate | 2.01 - 2.03% | - |
| Expected life | 5 years | - |
| Expected volatility | 96.25% - 97.04% | - |
| Dividend rate | 0.00% | - |

As at September 30, 2013, the aggregate intrinsic value of the outstanding exercisable options was approximately $1,381,067 (December 31, 2012 - $3,515,000; September 30, 2012 - $4,783,421). There were 320,000 stock options exercised during the nine months ended September 30, 2013 and they had a total intrinsic value of $245,305. There were no stock option exercised during the comparable period in 2012.

As of September 30, 2013, there was $418,682 of unamortized stock based compensation expense as there were 500,000 stock options that had not vested as of September 30, 2013. There was no unamortized stock based compensation expense as at December 31, 2012 and September 30, 2012, as all the outstanding options had vested on those dates.

The following table summarizes information about stock options outstanding and exercisable at September 30, 2013:

| Expiry Date | Number Outstanding and Exercisable | Weighted Average Remaining Contractual Life (Years) | Weighted Average Exercise Price |
|---|---|---|---|
| January 28, 2014 | 800,000 | 0.33 | C$0.26 |
| May 30, 2014 | 630,000 | 0.66 | C$0.26 |
| April 18, 2015 | 50,000 | 1.55 | C$1.24 |
| June 3, 2018 | 300,000 | 4.68 | C$1.19 |
| June 3, 2018 | 50,000 | 4.68 | C$1.19 |
| September 3, 2018 | 150,000 | 4.93 | C$1.67 |
| September 18, 2018 | 300,000 | 4.97 | C$1.30 |
| Outstanding, September 30, 2013 | 2,280,000 | 2.03 | C$0.65 |
| Exercisable, September 30, 2013 | 1,780,000 | 1.25 | C$0.49 |

### 4. Commitments and Contingencies

*Property rent payments (Advance minimum royalties)*

The Company has acquired a number of mineral properties outright and has acquired exclusive rights to explore, develop and mine on the property under various mining lease agreements with landowners.

The Company is required to make property rent payments related to its mining lease agreements with landowners. The total property rent payments for the nine months ended September 30, 2013 were $94,020 (December 31, 2012 - $204,792). The Company is expected to make approximately a total of $170,000 in property rent payments to various landowners with current mining lease agreements in 2013.

### *4. Commitments and Contingencies (Continued)*

*Finder's fee*

The Company has agreed to issue 100,000 common shares as a finder's fee in connection with certain property acquisitions upon commencement of commercial production of the Project. As of September 30, 2013, commercial production has not commenced and no shares have been issued.

*Management agreements*

In 2004, the Company entered into an agreement with the President of the Company to issue 300,000 bonus shares upon completion of certain milestones. Upon receipt by the Company of a bankable feasibility study and the decision to place the Property into commercial production, a bonus of 150,000 common shares would be issued. Upon commencement of commercial production on the Property, a further bonus of 150,000 common shares would be issued. In May 2010, the Company entered into an amendment to the agreement whereby the 300,000 bonus shares would alternatively be issuable upon a change of control transaction, or upon a sale of all or substantially all of the Company's assets, having a value at or above C$1.00 per share of the Company, with a further 300,000 bonus shares being issuable in the event the change of control transaction or asset sale occurred at a value at or above C$1.50 per share. This amended agreement is for a term of three years and shall automatically renew for two years. As at September 30, 2013, none of the milestones had been reached and no commitment to issue the common shares has been recorded in connection with these arrangements.

During the nine months ended September 30, 2013, the Company entered into employment agreements with a new Chief Financial Officer ("CFO") and a Chief Operating Officer ("COO'). Included in the agreement with the CFO is a provision that if the CFO's position is lost upon change of control or within six months of a change of control the CFO would be entitled to a one-time payment equal to twice the annual salary, $300,000 total, plus twice the annual bonus. The annual bonus is determined by the Board subsequent to a review of the CFO's performance. Included in the agreement with the COO is a provision that if the COO's position is lost upon a change of control or within six months of a change of control the COO would be entitled to a onetime payment equal to 100% of the annual base salary of $150,000.

*Compliance with Environmental Regulations*

The Company's exploration and development activities are subject to laws and regulations controlling not only the exploration and mining of mineral properties, but also the effect of such activities on the environment. Compliance with such laws and regulations may necessitate additional capital outlays or affect the economics of a project, and cause changes or delays in the Company's activities.

### *5. Related Party Transactions*

Except as noted elsewhere in these unaudited, condensed, consolidated interim financial statements, related party transactions are disclosed as follows:

**Consulting Fees**

For the three months and nine months ended September 30, 2013, the Company paid $40,047 and $114,570 (2012 - $37,300 and $105,700) to Mr. H. L. Klingmann for services as President of the Company of which $14,763 is payable as at September 30, 2013 (2012 - $Nil), paid $4,334 and $17,622 (2012 - $6,800 and $20,200) to Mr. Chester Shynkaryk, for his consulting services to the Company while also serving as Director of the Company and paid $7,224 and $21,987 (2012 - $7,500 and $22,400) to Mr. Ross Macdonald for his CFO services during his tenure with the Company.

***5. Related Party Transactions (Continued)***

For the three months and nine months ended September 30, 2013, the Company paid $12,172 and $19,505 (2012 - $Nil and $Nil) to three of the Company's directors for compensation in their roles as directors of the Company.

**Convertible Debentures**

On July 26, 2013, the Company entered into agreements to issue convertible debentures for aggregate proceeds of C$10,000,000 (the "Placement"). The convertible debentures are unsecured, and bear interest at 2% per annum, calculated on the outstanding principal balance, payable annually. The principal amounts of the debentures are convertible into shares of the Company at a price of C$1.03 per share for a period of two years. If the debentures have not been converted by the holder prior to the maturity date, then the Company may convert them at the lower of C$1.03 or the market price as at the maturity date. The market price on the maturity date will be determined based on the volume weighted average price of the shares as traded on the Toronto Stock Exchange for the five trading days preceding the maturity date. A total of C$7,500,000 of the offering has been subscribed for by an investment vehicle managed by Thomas M. Clay, a Director and insider of the Company.

The conversion feature of the debentures meets the definition of a derivative liability instrument because the conversion feature is denominated in a currency other than the Company's functional currency and the conversion rate is variable and therefore does not meet the "fixed-for-fixed" criteria outlined in ASC 815-40-15. As a result, the conversion feature of the debentures is required to be recorded as a derivative liability recorded at fair value and marked-to-market each period with the changes in fair value each period being charged or credited to income.

On inception of the debentures, the fair value of the derivative liability related to the conversion feature was $5,741,520 and as of September 30, 2013, was $4,991,522. The derivative liability was calculated using an acceptable option pricing valuation model with the following assumptions:

| | |
|---|---|
| Risk-free interest rate | 1.15% - 1.19% |
| Expected life of derivative liability | 1.82 - 2 years |
| Expected volatility | 73.43% - 76.61% |
| Dividend rate | 0.00% |

The changes in the derivative liability related to the conversion feature are as follows:

| | September 30, 2013 |
|---|---|
| Balance, beginning of the period | $ - |
| Fair value at inception | 5,741,520 |
| Change in fair value of derivative liability including foreign exchange | (749,998) |
| Balance, end of the period | $ 4,991,522 |

With the conversion feature initially being valued at $5,741,520, the resulting residual value allocated to the host debentures was $3,975,480, being the difference between the face value of the convertible debentures and the fair value of the conversion feature derivative liability.

The change in the convertible debentures is as follows:

| | September 30, 2013 |
|---|---|
| Balance, beginning of the period | $ - |
| Discounted convertible debentures | 3,975,480 |
| Interest expense including foreign exchange | 317,597 |
| Balance, end of the period | $ 4,293,077 |

### *5. Related Party Transactions (Continued)*

As at September 30, 2013, $3,219,808 of the convertible debentures is due to an investment vehicle managed by Thomas M. Clay, a director and insider of the Company. In addition, $22,647 of the $30,196 interest payable as at September 30, 2013 is due to the same investment vehicle. Total interest expense includes the amortization of the convertible debenture discount as well as the interest expense at the stated interest rate on the convertible debenture.

### *6. Derivative Liability – Stock options*

As at January 1, 2009, the date on which the guidance of ASC 815-40-15 became effective for the Company, the Company's stock options and warrants met the criteria of a derivative instrument liability because they were exercisable in a currency other than the functional currency of the Company and thus did not meet the "fixed-for-fixed" criteria of that guidance. As a result, the Company was required to separately account for the stock options and warrants as derivative instrument liabilities recorded at fair value and marked-to-market each period with the changes in the fair value each period charged or credited to income.

During the nine months ended September 30, 2013, 320,000 stock options that were treated as derivative liabilities were exercised. A total of $247,231, representing the fair value of the stock options exercised, was transferred from the derivative liability to additional paid-up capital. For the year ended December 31, 2012, no stock options that were treated as derivative liabilities were exercised. In addition, during the nine period ended September 30, 2013, 200,000 stock options were issued that met the definition of a derivative liability as described above. As a result, a total of $204,126 was added to the derivative liability representing the liability related to the newly issued stock options to non-employees.

As of September 30, 2013 and December 31, 2012, the Company had re-measured the remaining outstanding options and determined the fair value of the derivative liability to be $1,468,292 and $3,522,071, respectively, using the Black-Scholes option pricing model with the following assumptions:

| | September 30, 2013 | December 31, 2012 |
|---|---|---|
| Risk-free interest rate | 1.19% - 1.86% | 1.14% |
| Expected life of derivative liability | 0.33 to 4.93 years | 1.08 to 2.30 years |
| Expected volatility | 79.11% - 103.25% | 57.15% - 63.01% |
| Dividend rate | 0.00% | 0.00% |

The changes of derivative liability for options and warrants are as follows:

| | September 30, 2013 | December 31, 2012 |
|---|---|---|
| Balance, beginning of the period | $ 3,522,071 | $ 4,552,502 |
| Fair value of options granted | 204,126 | - |
| Fair value of warrants issued | - | - |
| Fair value of options exercised | (247,231) | - |
| Fair value of warrants exercised | - | - |
| Change in fair value of options and warrants including foreign exchange | (2,010,674) | (1,030,431) |
| Balance, end of the period | $ 1,468,292 | $ 3,522,071 |

### *7. Supplementary Disclosures of Cash Flow Information*

| | Nine Months Ended September 30, 2013 | Nine Months Ended September 30, 2012 | Amounts from Date of Inception (November 21, 1985) through September 30, 2013 |
|---|---|---|---|
| Cash paid during the period for: | | | |
| Interest | $ - | $ - | $ 1,192,911 |
| Income taxes | $ - | $ - | $ - |
| Non-cash financing and investing activities: | | | |
| Reclassification of derivative liability for exercised stock options and warrants | $ 247,231 | $ - | $ 5,681,452 |
| Stock option compensation | $ 378,228 | $ - | $ 1,794,676 |
| Financing charges related to modification of warrant's term | $ - | $ - | $ 889,117 |
| Exchange of notes for common shares | $ - | $ - | $ 1,727,282 |
| Exchange of note for future royalty payments | $ - | $ - | $ 150,000 |
| Common shares issued for mineral property | $ 22,568 | $ - | $ 380,231 |
| Mineral property acquired through the issuance of long-term debt | $ - | $ - | $ 1,084,833 |
| Common shares issued upon conversion of convertible debt | $ - | $ - | $ 414,917 |
| Mineral property expenditures included in accounts payable | $ 1,029,233 | $ 162,197 | $ 1,029,233 |
| Asset retirement cost charged to mineral property | $ - | $ 8,416 | $ 124,363 |
| Interest expense on discounted convertible debentures | $ 349,586 | $ - | $ 349,586 |
| Accretion expense | $ - | $ 16,832 | $ 227,212 |

### *8. Subsequent Events*

Two directors of the Company exercised stock options during the month of October as follows:

- 500,000 options for proceeds of C$130,000
- 300,000 options for proceeds of C$78,000