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SILVANA MINES INC. - ANNUAL REPORT 1977

SILVANA MINES INC.
(formerly Silmonac Mines Limited (N.P.L.))

To The Shareholders

At a general meeting of the shareholders held on 29 July, 1977 in Vancouver, Silmonac shareholders approved the following - 1) Conversion from a special limited company to a limited company, and amending the Memorandum to comply with the new Companies Act, 2) consolidation of the share capital on the basis of one new share for each four (4) shares previously issued, 3) changing the company's name to Silverado Mines Ltd., or some similar name acceptable to the Registrar of Companies. Silvana Mines Inc. was approved by the Registrar, 4) purchase of mine plant and equipment from Kam-Kotia for 300,000 new shares, 5) approving the issue of 550,000 new shares to Kam-Kotia in consideration of Kam-Kotia surrendering its rights in the lease agreement of September 3, 1968 and, 6) purchased the mill from Carnegie Mining Corporation Limited for 600,000 new shares.

Effective August 1, your company took over complete control of the operation.

Production for 1977 totalled 17,499 tons, with an average grade of 19.34 ounces silver per ton, 7.41% lead and 6.13% zinc. Of this tonnage 11,782 tons, grading 18.45 ounces silver per ton, 6.93% lead and 6.22% zinc, was produced under Kam-Kotia's management from January to July 31 and 5,717 tons grading 21.18 ounces of silver per ton, 8.41% lead and 5.85% zinc was produced by Silvana from August 1 to December 31.

Total payable production of metals was as follows, 323,875 ounces of silver, 2,459,296 pounds of lead, 1,968,734 pounds of zinc and 12,290 pounds of cadmium.

For the past few years, production rates have been controlled by the accessibility and availability of ore reserves and the production capacity of the mine plant, which also controlled the amount of exploration and development work that could be done. A plan was developed that would greatly increase mine production capacity, provide access to allow exploration and development to proceed at a much faster rate and ultimately provide production at the mill's capacity, about 40,000 to 45,000 tons per year. The cost of the program is estimated at a minimum of $1.1 million. To finance the program, a line of bank credit to $750,000 was arranged, and 450,000 shares and 375,000 share purchase warrants were sold to underwriters for distribution to the public to net the company $845,156. The warrants are exercisable on or before February 9, 1979 and if all were exercised would provide a further $750,000 for the Company's treasury. The issue was completed in February, 1978, at which time your company's shares were listed for trading on the Vancouver Stock Exchange.

The program involves rehabilitating the 4,000 ft. level and setting up a mining plant at the portal. Work started in late 1977, but, no major commitments were made until the underwriting was completed. At the time of writing, the plant has been set up, and the necessary equipment to rehabilitate the level is on the site and actual rehabilitation of the level will be in progress by the end of March and all required equipment will be ordered by April. The program should be completed by the end of 1978 or early 1979.

Until the program is completed, no major increase in production will be possible. For 1978, some increase in production over 1977 may be possible, but it will be necessary to increase the rate of exploration and development as well so that, when the program is completed, production can be quickly increased. This need will tend to restrict production increase, unless early results are very favourable. The ore deposits occur along a major fault system, and are controlled by specific geological environmental factors. The fault system has been traced over a six mile length and mined extensively at each end over about a 2 mile length since the first discoveries were made in the Slocan late in the 19th century. Silvana controls the centre third of the system and to date has tested less than 10% of the total potential. Experience has shown that the reserves located increase as the scale of exploration increases. However, exploration programs must be constantly monitored and adjusted as geological data becomes available. As exploration rates increase with capability, ore reserves should be quickly built up allowing increased production.

Metal prices

While several factors control profits and cash flows e.g. production rates, costs, and ore grades, the most significant factor is probably metal prices.

The average price received for silver during 1977 ranged from $4.45 per ounce in January to $5.30 per ounce in December, in Canadian funds with the monthly average being $4.957 per ounce. To date in 1978, silver prices have continued to move up to $6.00 per ounce and higher and prospects are that this price will be maintained in 1978. Part of the increase has been due to the reduced value of the Canadian dollar in U.S. funds, and also the world price for silver has increased over the past year (1977) with a substantial increase in 1978 to date.

The price received for lead increased from 25 cents per pound in January to 35 cents per pound in December with some of the increase due to the weaker Canadian dollar. It is doubtful if the 35 cents price will be maintained in 1978.

The demand for zinc weakened during the year and the price dropped from a high of 37 cents to 28.5 cents per pound in U. S. funds. The average price received was 33.25 cents per pound in Canadian funds. Zinc prices are expected to be at current levels during the balance of 1978.

As silver production accounts for about 70% of cash flow depending on grades and metal prices, higher silver prices have substantial leverage on cash flow and profits.

A strike at the zinc concentrate buyers plants from early May to the middle of November caused zinc production to be stockpiled from May until the end of November, when shipments were resumed. The stockpiled material should be all shipped by April, 1978 and payment received by July or August, 1978. The lack of income from zinc production increased working capital requirements which had to be borrowed, and this increased interest expense. Some additional expense was incurred in stockpiling. These costs were more than offset by higher silver prices received for the stockpiled zinc concentrates.

Financial Statements

The Company's year end has been changed from October 31 to December 31. Attached are statements for the periods November 1, 1976 to September 30, 1977, and October 1, 1977 to December 31, 1977.

Respectfully submitted on behalf of the Board of Directors.

G. W. Walkey
President

March, 1978.

SILVANA MINES INC.

(Formerly Silmonac Mines Limited (N.P.L.))
Executive Office - Suite 1402, 390 Bay Street,
Toronto, Ontario. M5H 2Y2.

NOTICE OF ANNUAL GENERAL MEETING OF MEMBERS

NOTICE is hereby given that the Annual General Meeting of the Members of Silvana Mines Inc. (hereinafter called the "Company") will be held in the Tudor Room, Hotel Georgia, 801 West Georgia Street in the City of Vancouver, British Columbia, on

Monday, April 24, 1978

at the hour of 10:00 o'clock in the forenoon (Vancouver time) for the following purposes:

(a) to receive and consider the Annual Report of the Company including report of the Directors, the financial statements as at September 30, 1977 and the three month period ended December 31, 1977, and the reports of the Auditors, Thorne Riddell & Co.;

(b) to elect directors for the ensuing year;

(c) to appoint auditors for the ensuing year;

(d) generally to transact such further and other business as may be properly brought before the meeting and any adjournment or adjournments thereof.

Copies of the aforementioned reports and financial statements to be submitted to the meeting are forwarded herewith and the Information Circular is attached hereto. A form of Proxy is enclosed herewith.

DATED at TORONTO, this 31st day of March, 1978.

By Order of the Board of Directors,

J. GEDDES
SECRETARY

MEMBERS ARE ENTITLED TO VOTE AT THE MEETING EITHER IN PERSON OR BY PROXY. IF YOU ARE UNABLE TO BE PRESENT AT THE MEETING, YOU ARE REQUESTED TO READ, COMPLETE, SIGN, DATE AND RETURN THE ENCLOSED PROXY.

NOTE: A Proxy, to be effective, must be received, by mail or otherwise at the Executive Office of the Company at Suite 1402, 390 Bay Street, Toronto, Ontario or at the Records Office of the Company, P. O. Box 189, New Denver, B.C. within 48 hours before the time for holding the said Annual General Meeting.

SILVANA MINES INC.
(Formerly Silmonac Mines Limited (N.P.L.))
INFORMATION CIRCULAR

AS AT

MARCH 31, 1978

SOLICITATION OF PROXIES

This Information Circular is furnished in connection with the solicitation of Proxies by the Management of SILVANA MINES INC., ("the Company") for use at the Annual General Meeting of the Members of the Company to be held on the 24th day of April, 1978, at the time and place for the purposes set forth in the Notice of Meeting. The cost of this solicitation will be borne directly by the Company.

APPOINTMENT AND REVOCATION OF PROXY

The persons named in the accompanying Form of Proxy are Directors and Officers of the Company. A member desiring to appoint some other person to represent him at the Meeting may do so by striking out the printed names and inserting the desired person's name in the blank space provided in the form of Proxy and depositing the completed Proxy at the Executive Office of the Company, Suite 1402, 390 Bay Street, Toronto, Ontario via the enclosed addressed envelope or at the Records Office of the Company, P. O. Box 189, New Denver, British Columbia.

A Proxy may be revoked either by (a) signing a Proxy bearing a later date and depositing it at the place and within the time aforesaid; or (b) signing and dating a written notice of revocation (in the same manner as the Proxy is required to be executed as set out in the Notes to the Proxy) and either depositing the same at the place and within the time aforesaid or with the Chairman of the Meeting on the day of the Meeting or on the day of any adjournment thereof; or (c) attending the Meeting or any adjournment thereof, and registering with the Scrutineer thereat as a member present in person, whereupon such Proxy shall be deemed to have been revoked.

On the date of the accompanying Notice of Meeting, the Company had 2,641,250 common shares outstanding without par value, and 375,000 warrants which entitle the holders to one common share per warrant if exercised on or before February 9, 1979. At the date of this Circular no warrants have been exercised. All shares in the capital of the company are of the same class and each carries the right to one vote. The warrants have no voting rights.

Members registered prior to the time of the Meeting are entitled to attend and vote thereat. Members desiring to be represented by Proxy at the Meeting must, to entitle the person appointed by the Proxy to attend and vote thereat, deposit their Proxies at the place and within the time set forth in the Notes to the Proxy.

To the knowledge of the Directors and Senior Officers of the Company, the following Members beneficially own directly or indirectly, shares carrying more than 10% of the voting rights attached to all shares of the Company.

Name of Shareholder	No. of Shares	Percentage of Outstanding Shares
Kam-Kotia Mines Limited Suite 1402, 390 Bay Street Toronto, Ontario	1,172,357	53.50%
Carnegie Mining Corporation Limited (subsidiary of Kam-Kotia Mines Limited) Suite 1402, 390 Bay Street Toronto, Ontario	600,000	27.38%

PROVISIONS RELATING TO VOTING

The shares represented by Proxy in the form enclosed will, on any poll, be voted by the designated holder thereof in accordance with the direction of the Member appointing him. In the absence of such direction it is intended that such shares will be voted in the affirmative for all proposals set out in the accompanying Form of Proxy and for the election of Directors and the appointment of Auditors as set out under those respective headings in this Circular.

The enclosed Form of Proxy confers discretionary authority on the persons named therein with respect to amendments or variations to matters identified in the Notice of Meeting, and with respect to other matters which may properly come before the Meeting. At the time of printing this Circular, the Management of the Company knows of no such amendments, variations or other matters to come before the Meeting other than the matters referred to in the Notice of Meeting.

ELECTION OF DIRECTORS

The Directors of the Company are elected annually and hold office until the next Annual General Meeting of the Members or until their successors in office are duly elected. The Management of the Company proposes to nominate the persons listed below for election as Directors of the Company to serve until their successors are elected or appointed. In the absence of instructions to the contrary, Proxies given pursuant to the solicitation by the Management of the Company will be voted for on any poll by the nominees listed in this Circular. THE MANAGEMENT DOES NOT CONTEMPLATE THAT ANY OF THE NOMINEES WILL BE UNABLE TO SERVE AS A DIRECTOR. IN THE EVENT THAT PRIOR TO THE MEETING ANY VACANCIES OCCUR IN THE SLATE OF NOMINEES HEREIN LISTED, IT IS INTENDED THAT DISCRETIONARY AUTHORITY SHALL BE EXERCISED BY MANAGEMENT TO VOTE THE PROXY ON ANY POLL FOR THE ELECTION OF ANY OTHER PERSON OR PERSONS AS DIRECTOR(S).

The following table sets out the names of the persons to be nominees for election as Directors, the positions and offices which they hold with the Company, their respective principal occupation or employments, the period during which they have served as Directors of the Company, and the number of shares of the Company and its subsidiaries which each beneficially owns directly or indirectly as of the date of the accompanying Notice of Meeting:

Name of Nominee	Principal Occupation	No. of Shares of Company beneficially owned, directly or indirectly	Date first Elected to the Board
G. W. Walkey	Mining Engineer Vice-President, Kam-Kotia Mines Limited	1	1969
H. Vance White	Mining Executive Vice-President Dickenson Mines Limited	1,501	1977
James Geddes	Chartered Accountant with Mid-North Engineering Services Limited	1	1977
William Hogg	Mine Manager Silvana Mines Inc. formerly Mine Manager Kam-Kotia Mines Limited (New Denver Division)	1	1977

The management has relied on information furnished by each respective nominee as to his beneficial ownership of shares in the Company at the date hereof. Each of the above named persons has held the principal occupation indicated for at least five years.

REMUNERATION OF MANAGEMENT AND OTHERS

The aggregate direct remuneration paid by the Company to Directors and Senior Officers (including the five highest paid employees) during the year ended December 31, 1977, amounted to $88,340 of which Directors' fees as such amounted to $1,650.

Kam-Kotia Mines Limited (Kam-Kotia) is the parent Company of Silvana and since August 1, 1977 has provided engineering and management services at the rate of $11,500 per month or a total of $57,500 for the 5 month period. Included in the Kam-Kotia fee are the services of G. W. Walkey, President of Silvana, W. Hogg, Mine Manager of Silvana, and three senior staff personnel at the mine. No salaries are paid to the above five persons by Silvana.

Mid-North Engineering Services Limited ("Mid-North"), Suite 1402, 390 Bay Street, Toronto provides administrative, accounting and secretarial services including Executive Office facilities and during the 5 month period $5,000 was paid to Mid-North for its services.

The insiders of Mid-North are: A. W. White, H. R. Heard, J. Geddes, H. I. Miller, H. V. White, and H. S. Dolson, all with the same address as the Company.

The insiders of Kam-Kotia Mines Limited are Dickenson Mines Limited, A. W. White, G. W. Walkey, H. R. Heard, H. V. White, H. I. Miller, H. S. Dolson, J. Geddes and F. A. Fell, all of Suite 1402, 390 Bay Street, Toronto, Ontario; R. P. Tapper, J. W. Nichol, E. Crull, H. Hessner and C. MacKinnon, all of Balmertown, Ontario; W. Hogg, K. Gordon, L. Olsen and E. Heichert all of New Denver, British Columbia; J. N. Cram, R. R. #1, Cobalt, Ontario; D. F. Burt, Burt, Burt, Wolfe & Bowman, Suite 315, 85 Richmond Street West, Toronto, Ontario; C. R. Diebold, Diebold & Millonzi, Suite 600, 15 Court Street, Buffalo, N. Y., 14202; F. R. Graham, Graymont Limited, 2nd Floor, 360 St. James St. W., Montreal, P.Q.; C. A. Billings, 2100 Cabot Street, Ottawa, Ontario; R. A. Halet, H.B. & O. Engineering Limited, Suite 1010, 360 Bay Street, Toronto, Ontario; G. H. Scott, 66 Arjay Crescent, Willowdale, Ontario; David Johnston, 93 Salisbury Ave., Galt/Cambridge, Ontario.

INTEREST OF MANAGEMENT & OTHERS IN MATERIAL TRANSACTIONS

No Director, Senior Officer or proposed nominee for election as a Director of the Company herein named, no shareholder holding greater than 10% of the issued capital of the Company and no associate or affiliate of the foregoing persons has or has had any material interest, direct or indirect, in any transaction since the commencement of the Company's last completed financial year, or in any proposed transaction which in either such case, has materially affected or will materially affect the Company.

APPOINTMENT OF AUDITORS

It is proposed that Messrs. Thorne Riddell & Co., will be nominated as auditors of the Company until the next Annual General Meeting of Members. Forms of Proxy given pursuant to the solicitation of the management of the Company, will, on any poll, be voted as directed and in the event of no direction, for the appointment of the said firm, at a remuneration to be fixed by the Directors. Thorne Riddell & Co. were first appointed by Directors October 6, 1977.

ADVANCE NOTICE OF THE MEETING

Advance Notice of the Meeting was published in the Vancouver Sun and Province on the 8th day of February, 1978, in accordance with Section 133 of the Companies Act. No nominations for Directors have been received from the members of the Company.

PARTICULARS OF ANY OTHER MATTERS TO BE ACTED UPON

The Management of the Company knows of no matters to come before the said Meeting other than the matters referred to in the Notice of the said Meeting. However, if any other matters which are not known to the Management of the Company shall properly come before the said Meeting the Forms of Proxy given pursuant to this solicitation by the management of the Company will be voted on such matters in accordance with the best judgement of the person voting the proxy.

DATED at Toronto, Ontario, this 31st day of March, 1978.

Thorne
Riddell
& Co.

CHARTERED ACCOUNTANTS

AUDITORS' REPORT

To the Shareholders of
Silvana Mines Inc.

We have examined the balance sheet of Silvana Mines Inc. as at September 30, 1977 and the statements of income, deficit and changes in financial position for the eleven months then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these financial statements present fairly the financial position of the company as at September 30, 1977 and the results of its operations and the changes in its financial position for the eleven months then ended in accordance with generally accepted accounting principles which, after giving retroactive effect to the change in recording of exploration and development costs as described in note 6, and, except for the change to the accrual method of accounting for royalty production revenue as described in note 1(c), have been applied on a basis consistent with that of the preceding year.

The figures for the previous five years ended October 31, 1976 are based on financial statements which were reported on by other auditors.

Toronto, Canada
November 15, 1977

Chartered Accountants

SILVANA MINES INC. (note 7)
(Incorporated under the laws of British Columbia)

BALANCE SHEET AS AT SEPTEMBER 30, 1977

ASSETS

CURRENT ASSETS		
Cash	$ 32	
Receivable from parent company - Kam-Kotia Mines Limited	35,625	
Concentrates on hand and in transit	323,635	
Prepaid expenses	24,521	$ 383,813
OIL AND GAS INTERESTS (note 2)		
Non-producing leaseholds		982
FIXED ASSETS (notes 3 and 4)		
Buildings, machinery and equipment, at cost	900,000	
Less accumulated depreciation	7,559	
	892,441	
Mining claims and properties, at cost less depletion	849,744	1,742,185
OTHER ASSETS		
Funds held by third party (note 8)	33,045	
Supplies, at average cost	27,447	60,492
		$2,187,472

LIABILITIES

CURRENT LIABILITIES		
Accounts payable and accrued liabilities		$ 119,603

SHAREHOLDERS' EQUITY

CAPITAL STOCK (notes 4 and 5)		
Authorized		
5,000,000 shares without par value		
Issued		
2,191,250 shares	2,122,500	
DEFICIT	54,631	2,067,869
		$2,187,472

Approved by the Board

Director G. W. WALKEY

Director J. GEDDES

SILVANA MINES INC.

STATEMENT OF INCOME

	Eleven months ended September 30, 1977	Eleven months ended September 30, 1976 (unaudited)	1976	1975	1974	1973	1972
			Years ended October 31				
Revenue							
Metal recovery, gross value	$473,537						
Transportation and treatment costs	154,940						
	318,597						
Royalty production revenue	205,160	$ 48,898	$ 48,898	$ 6,000	$ 6,000	$ 6,000	$ 6,000
	523,757						
Expenses							
Exploration	68,935						
Extraction	55,932						
Milling	54,375						
Mine management	43,732						
Drilling costs, oil and gas interests	5,997						
	228,971						
Operating income before undernoted items	294,786	48,898	48,898	6,000	6,000	6,000	6,000
Depreciation and depletion	14,865						
Income from mining operations	279,921	48,898	48,898	6,000	6,000	6,000	6,000
Head office, administration and general expenses	23,319	7,743	8,202	6,936	5,148	6,188	3,904
Equipment and incorporation expenses written off							17,253
	256,602	41,155	40,696	(936)	852	(188)	(15,157)
Other income							
Interest	3,101	2,368	2,730	708	756	483	291
NET INCOME (LOSS)	$259,703	$ 43,523	$ 43,426	$ (228)	$ 1,608	$ 295	$(14,866)

STATEMENT OF DEFICIT

	Eleven months ended September 30, 1977	Eleven months ended September 30, 1976 (unaudited)	1976	1975	1974	1973	1972
			Years ended October 31				
DEFICIT AT BEGINNING OF PERIOD (note 6)	$314,334	$357,760	$357,760	$357,532	$359,140	$359,435	$344,569
Net income (loss)	259,703	43,523	43,426	(228)	1,608	295	(14,866)
DEFICIT AT END OF PERIOD	$ 54,631	$314,237	$314,334	$357,760	$357,532	$359,140	$359,435

SILVANA MINES INC.

STATEMENT OF CHANGES IN FINANCIAL POSITION

	Eleven months ended September 30, 1977	Eleven months ended September 30, 1976 (unaudited)	Years ended October 31 1976	1975	1974	1973	1972
WORKING CAPITAL DERIVED FROM							
Operations	$ 274,570	$43,523	$43,426	$ (228)	$1,608	$ 295	$2,387
Common shares exchanged for fixed assets (note 4)	900,000						
Common shares exchanged for termination of lease rights to mining claims and properties (note 4)	550,000						
	1,724,570	43,523	43,426	(228)	1,608	295	2,387
WORKING CAPITAL APPLIED TO							
Acquisition of fixed assets in exchange for common shares	900,000						
Addition to mining claims and properties in exchange for common shares	550,000						
Funds held by third party (note 8)	33,045						
Acquisition of mining supplies	27,447						
Acquisition of oil and gas interest		982	982				
	1,510,492	982	982				
INCREASE (DECREASE) IN WORKING CAPITAL	214,078	42,541	42,444	(228)	1,608	295	2,387
WORKING CAPITAL AT BEGINNING OF PERIOD	50,132	7,688	7,688	7,916	6,308	6,013	3,626
WORKING CAPITAL AT END OF PERIOD	$ 264,210	$50,229	$50,132	$7,688	$7,916	$6,308	$6,013

SILVANA MINES INC.

NOTES TO FINANCIAL STATEMENTS

SEPTEMBER 30, 1977

1. ACCOUNTING POLICIES

(a) Concentrates on hand and in transit

Shipments for which a settlement has not been received are included as concentrates on hand and are carried at net realizable value. At September 30, 1977 there were 537 tons of concentrate for which settlement had not been received. The estimated net realizable value of this concentrate is $323,635.

(b) Depreciation, amortization and depletion

Depreciation of buildings, machinery and equipment, and depletion of mining claims and properties is provided on the units of production method to amortize the cost over the mine life based on the estimated ore reserves.

Exploration and development expense related to the company's mining property will be deferred and will be amortized on the units of production method.

Oil and gas lease costs will be deferred and will be amortized by charges against income from future operations. Unproductive oil and gas lease costs and applicable deferred exploration and development expenditures are written off when it is determined that the lease area is of no further interest to the company.

(c) Royalty production revenue

In prior years, the company followed a practice of recording on a cash basis production royalties received under the lease agreement (note 4). This policy had been adopted because of the uncertainty as to the amount receivable, if any, at the company's fiscal year end since in the past the date of computation had been December 31. In the current period, and on having assumed the role of operator of the mine (note 4), the company deemed it appropriate to recognize as at September 30, 1977 accrued income related to this lease agreement. The effect of this change is to increase income by $199,160.

2. OIL AND GAS INTERESTS

The company owns a 5% working interest in 960 acres of Alberta Crown Petroleum and Natural Gas leases covering three claims in the Berry Area of Southern Alberta. Under an agreement with Keness Explorations Ltd. dated August 11, 1976, the company agreed to pay 9.375% of the cost of drilling any wells on these claims to the casing point or through to abandonment, and 5% of drilling costs beyond the casing point, in return for 5% of any revenue from the wells. A well drilled on one of these claims was found to be non-commercial and was abandoned December 13, 1976. The company's share of drilling costs has been charged to operations in the current year. As of September 30, 1977 no decision had been made as to whether drilling would resume on the property.

3. MINING CLAIMS AND PROPERTIES

The company's mineral claims in the Kootenay District of British Columbia were subject to a royalty of $500,000 payable to a third party and is secured by a mortgage on those mineral claims. This royalty is payable out of production at .25 times the net smelter return per ton of ore, expressed in dollars up to but not exceeding $3 per ton until the full $500,000 has been paid. The royalty agreement provided that payment of this royalty be deferred until the operators' advances had been retired. By July 31, 1977 the royalty payable had been reduced to $372,605. On August 1, 1977 Silvana Mines Inc. assumed the role of operator of the mine. A royalty of $7,559 was paid respecting the two months of operations under this new arrangement. As of September 30, 1977, the royalty balance was $365,046.

4. COMMENCEMENT OF MINING OPERATIONS

On June 30, 1977 Silvana Mines Inc. entered into an agreement with Kam-Kotia Mines Limited and Carnegie Mining Corporation Limited to assume the operation of the mining property owned by Silvana and previously leased by Kam-Kotia. The terms of the agreement were approved at a general meeting of the shareholders on July 29, 1977.

As part of this agreement, Kam-Kotia agreed to terminate effective July 31, 1977 the lease agreement of September 3, 1968 between Kam-Kotia Mines Limited and the company. In consideration for the termination of this lease agreement Kam-Kotia received 550,000 fully paid new common shares of the company (note 5).

Under the terms of this lease agreement the company was entitled to a share of the cash flow from the mine while it was being operated by Kam-Kotia. For the period from January 1, 1977 to July 31, 1977 the company's share of this cash flow is estimated to be $199,000. Two-thirds of this balance has been advanced as at September 30, 1977.

Kam-Kotia further agreed to provide an operating loan of up to $100,000, bearing interest at Kam-Kotia's bank prime rate plus 1%. The loan is to be repaid prior to May 31, 1978 out of earnings. As of September 30, 1977, $28,000 has been advanced to the company. The operating loan is secured by an assignment to Kam-Kotia of Silvana's marketing contracts for concentrates.

The shareholders of the company also approved on July 29, 1977 the purchase from Kam-Kotia of mining equipment valued at $300,000, the consideration for which was the issuance of 300,000 new common shares. A mill valued at $600,000 was also purchased from Carnegie Mining Corporation Limited for the issuance of 600,000 new common shares.

Kam-Kotia has also agreed to carry out a development program up to $750,000 or to provide, or cause to be provided, funds for such, in order to complete Stage 1 of the development of the mine property. If Kam-Kotia does not complete this undertaking respecting these development funds by July 31, 1980 then Kam-Kotia shall surrender 225,000 new shares to the treasury.

The company commenced operation of its mine on August 1, 1977.

5. CAPITAL STOCK

At the annual general meeting held on July 29, 1977, the shareholders approved a special resolution to consolidate the capital stock of the company to reduce the number of shares authorized from 5,000,000 shares with a par value of 50¢ each, to 1,250,000 shares without par value, and to reduce issued and fully paid shares from 2,965,000 shares to 741,250, every four shares previously issued being consolidated into one share. The shareholders approved a second resolution to increase the authorized capital of the company from 1,250,000 shares without par value to 5,000,000 shares without par value. During the year, 1,450,000 of these new shares were issued in consideration for assets received from Kam-Kotia Mines Limited and Carnegie Mining Company Limited and the termination of a lease agreement with Kam-Kotia Mines Limited (note 4). There were no changes in the issued share capital during the five years ended October 31, 1976.

6. PRIOR PERIOD ADJUSTMENT

Prior to 1972 exploration and development costs had been deferred in the accounts. In the fiscal years ended October 31, 1972 through October 31, 1976 net head office and administrative charges were netted against this balance which was carried in the accounts as a deferred charge. In the current period while preparing for the operating changes as set out in notes 3 and 4, the company concluded that any value attributed to these costs would have expired prior to 1972. As a result the balance carried as a deferred charge has been removed and recorded as a prior period adjustment. This deferred charge in the amount of $314,101 has been written off to deficit.

7. CHANGE OF NAME

At the annual meeting on July 29, 1977 the shareholders approved a resolution to change the name of the company from Silmonac Mines Ltd. (N.P.L.) to Silvana Mines Inc. On September 6, 1977 the company received approval under the Companies Act for the change in name.

8. FUNDS HELD BY THIRD PARTY

On July 29, 1977 a Garnishing Order Before Judgment was issued by the Supreme Court of British Columbia on a claim filed by Silver Standard Mines Limited for an amount of $33,000 representing the balance of consideration payable by Silvana Mines Inc. related to the purchase on March 31, 1964 of certain mining claims. The company acknowledges its indebtedness to Silver Standard Mines Limited but disputes the timing of the payment. Under the Order, an amount of $33,000 is on deposit with the court. In the opinion of the company's legal counsel, it has a good defence against the action.

9. FINANCING

On August 5, 1977, the Royal Bank of Canada agreed to provide a line of credit of up to $250,000 for operating purposes and up to $500,000 as a term loan. The interest rate on the $250,000 will be the bank's prime rate plus 1% and on the $500,000 the bank's prime rate plus 1 3/4% as well as 1/2% stand-by fee on the unused portion of the term loan. Security for the loans will be a debenture for $750,000, a general assignment of accounts receivable, an assignment of Section 88 security and the provision by Kam-Kotia Mines Limited of a letter of comfort. As well, before drawing down the $500,000 term loan, the company must receive at least $400,000 of new equity funds.

SILVANA MINES INC.

NOTES TO FINANCIAL STATEMENTS (Continued)

SEPTEMBER 30, 1977

10. INCOME TAXES

There is no provision for income taxes in the current period due to the application of a portion of exploration and development expenditures deductible under the Income Tax Act.

The company has exploration and development expenditures available for tax purposes at September 30, 1977 of approximately $38,000.

Thorne
Riddell
& Co.

CHARTERED ACCOUNTANTS

AUDITORS' REPORT

To the Shareholders of
Silvana Mines Inc.

We have examined the balance sheet of Silvana Mines Inc. as at December 31, 1977 and the statements of income, deficit and changes in financial position for the three months then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these financial statements present fairly the financial position of the company as at December 31, 1977 and the results of its operations and the changes in its financial position for the three months then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding period.

Toronto, Canada
February 22, 1978

Thorne Riddell & Co.
Chartered Accountants

SILVANA MINES INC.
(Incorporated under the laws of British Columbia)

BALANCE SHEET AS AT DECEMBER 31, 1977

ASSETS

CURRENT ASSETS		
Cash	$ 103,000	
Accounts receivable	27,000	
Concentrates on hand and in transit	509,000	
Prepaid expenses	14,000	$ 653,000
FIXED ASSETS		
Buildings, machinery and equipment, at cost	919,000	
Less accumulated depreciation	17,000	
	902,000	
Mining claims and properties, at cost less depletion (note 2)	873,000	1,775,000
OTHER ASSETS		
Supplies, at average cost	46,000	
Deferred development costs	36,000	82,000
		$2,510,000

LIABILITIES

CURRENT LIABILITIES		
Accounts payable and accrued liabilities	$ 190,000	
Demand note payable to parent company, 9 1/4%, subsequently paid	237,000	$ 427,000

SHAREHOLDERS' EQUITY

CAPITAL STOCK		
Authorized		
5,000,000 Common shares without par value		
Issued		
2,191,250 Common shares	2,123,000	
DEFICIT	40,000	2,083,000
		$2,510,000

Subsequent event (note 4)

Approved by the Board

Director G. W. WALKEY

Director J. GEDDES

SILVANA MINES INC.

STATEMENT OF INCOME

THREE MONTHS ENDED DECEMBER 31, 1977

Revenue		
Metal recovery, gross value		$660,000
Transportation and treatment costs		213,000
		447,000
Expenses		
Exploration	$177,000	
Mining	64,000	
Milling	61,000	
Mine management	79,000	381,000
Operating income before undernoted items		66,000
Depreciation and depletion		19,000
Income from mining operations		47,000
Head office, administration and general expenses		35,000
		12,000
Other income		
Interest		3,000
NET INCOME (note 5)		$ 15,000

STATEMENT OF DEFICIT

THREE MONTHS ENDED DECEMBER 31, 1977

DEFICIT AT BEGINNING OF PERIOD	$ 55,000
Net income	15,000
DEFICIT AT END OF PERIOD	$ 40,000

SILVANA MINES INC.

STATEMENT OF CHANGES IN FINANCIAL POSITION

THREE MONTHS ENDED DECEMBER 31, 1977

WORKING CAPITAL DERIVED FROM		
Operations	$34,000	
Reduction in funds held by third party	33,000	$ 67,000
WORKING CAPITAL APPLIED TO		
Acquisition of fixed assets	19,000	
Addition to mining claims and properties	33,000	
Increase in supplies	18,000	
Deferred development costs	35,000	105,000
DECREASE IN WORKING CAPITAL		38,000
WORKING CAPITAL AT BEGINNING OF PERIOD		264,000
WORKING CAPITAL AT END OF PERIOD		$226,000

SILVANA MINES INC.

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 1977

1. ACCOUNTING POLICIES

   (a) Concentrates on hand and in transit

   Shipments for which a final settlement has not been received are included as concentrates on hand and in transit and are valued at net realizable value of $785,000. Payments received in advance of final settlement are deducted from concentrates on hand and in transit and amounted to $276,000.

   (b) Depreciation and depletion

   Depreciation of buildings, machinery and equipment, and depletion of mining claims and properties is provided on the unit of production method based on estimated ore reserves.

2. MINING CLAIMS AND PROPERTIES

   The company's mineral claims in the Kootenay District of British Columbia were subject to a royalty of $500,000 payable to Kam-Kotia Mines Limited and to a third party. The royalty is secured by a mortgage on those mineral claims and is payable out of production at .25 times the net smelter return per ton of ore, expressed in dollars up to but not exceeding $3 per ton until the full $500,000 has been paid.

   As of December 31, 1977, the balance outstanding under the royalty agreement was $355,000.

3. FINANCING

   On August 5, 1977, the Royal Bank of Canada agreed to provide a line of credit of up to $250,000 for operating purposes and up to $500,000 as a term loan. The interest rate on the $250,000 will be the bank's prime rate plus 1% and on the $500,000 the bank's prime rate plus 1 3/4% as well as 1/2% stand-by fee on the unused portion of the term loan. Security for the loans will be a debenture for $750,000, a general assignment of accounts receivable, an assignment of Section 88 security and the provision by Kam-Kotia Mines Limited of a letter of comfort. As well, before drawing down the $500,000 term loan, the company must receive at least $400,000 of new equity funds (see note 4).

4. SUBSEQUENT EVENT

   Subsequent to the year end the company issued 450,000 common shares from treasury and 375,000 warrants for proceeds of $845,000. In the event that the warrants are exercised, the company would receive $750,000. These warrants expire on February 9, 1979.

5. INCOME TAXES

   There is no provision for income taxes in the current period due to the application of a portion of exploration and development expenditures deductible under the Income Tax Act.

   As at December 31, 1977, the company has exploration and development expenditures available for tax purposes amounting to approximately $573,000.

6. CHANGE OF YEAR END AND COMPARATIVE FIGURES

   The company changed its year end from September 30 to December 31 in order to coincide with the year end of its parent, Kam-Kotia Mines Limited.

   Comparative figures for the eleven months ended September 30, 1977 have not been included with these financial statements as they are included elsewhere in this report.