

SKYE RESOURCES INC.

CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2004

SKYE RESOURCES INC.

Consolidated Balance Sheets

As at December 31, 2004 and August 31, 2004

	December 31	August 31
	2004	2004
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 7,206,580	\$ 4,769,539
Receivables	442,915	54,565
Prepaid expenses	31,897	23,657
	<u>7,681,392</u>	<u>4,847,761</u>
Equipment (note 5)	25,203	29,387
Mineral properties (note 7)	9,189,909	-
	<u>\$ 16,896,504</u>	<u>\$ 4,877,148</u>

LIABILITIES AND SHAREHOLDERS' EQUITY

Current liabilities:

Accounts payable and accrued liabilities	\$ 1,390,524	\$ 749,249
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Shareholders' equity:

Share capital (note 8)	23,364,610	8,675,751
Contributed surplus (note 8)	1,967,261	3,719,338
Deficit	(9,825,891)	(8,267,190)
	<u>15,505,980</u>	<u>4,127,899</u>

	<u>\$ 16,896,504</u>	<u>\$ 4,877,148</u>
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Commitments and contingencies (note 11)

Subsequent events (note 14)

Approved by the Board of Directors:

Signed: "Ian G. Austin" Director

Signed: "Brian E. Bayley" Director

See notes to the consolidated financial statements

SKYE RESOURCES INC.

Consolidated Statements of Loss and Deficit
For the four months ended December 31, 2004 and
the year ended August 31, 2004

	Four month period ended December 31 2004	Year ended August 31 2004
Revenue:		
Interest and other Income	\$ 26,056	\$ 71,946
Expenses:		
Amortization	4,912	14,090
Consulting	194,673	243,693
Exploration and development	296,829	20,604
General and administrative expenses	110,359	153,088
Investor relations	5,762	14,478
Process technology	102,105	369,819
Professional fees	138,026	300,522
Salaries and employee benefits	445,348	928,103
Stock-based compensation (note 8)	219,723	1,676,024
Transfer agent, listing and filing fees	10,673	42,772
Travel	56,347	154,305
	1,584,757	3,917,498
Loss for the period	1,558,701	3,845,552
Deficit, beginning of period	8,267,190	4,421,638
Deficit, end of period	\$ 9,825,891	\$ 8,267,190
Basic and diluted loss per share	\$ 0.13	\$ 0.38
Weighted average number of common shares outstanding	11,811,553	10,060,464

See notes to the consolidated financial statements

SKYE RESOURCES INC.

Consolidated Statements of Cash Flow
For the four months ended December 31, 2004 and
the year ended August 31, 2004

	Four month period ended December 31 2004	Year ended August 31 2004
Cash provided by (used for):		
Operating activities:		
Loss for the period	\$ (1,558,701)	\$ (3,845,552)
Items not affecting cash		
Amortization	4,912	14,090
Stock-based compensation	219,723	1,676,024
Shares issued for services	74,250	-
Changes in non-cash working capital balances:		
Receivables	(388,350)	(52,265)
Prepaid expenses	(8,240)	(22,187)
Accounts payable and accrued liabilities	641,275	709,340
	<u>(1,015,131)</u>	<u>(1,520,550)</u>
Financing activities:		
Exercise of warrants	4,792,000	593,000
Exercise of options	-	10,000
Private placement	-	6,000,000
Share issue costs	-	(396,450)
	<u>4,792,000</u>	<u>6,206,550</u>
Investing activities:		
Equipment	(728)	(43,477)
Purchase of mineral properties	(1,339,100)	-
	<u>(1,339,828)</u>	<u>(43,477)</u>
Increase in cash and cash equivalents	2,437,041	4,642,523
Cash and cash equivalents, beginning of period	4,769,539	127,016
Cash and cash equivalents, end of period	<u>\$ 7,206,580</u>	<u>\$ 4,769,539</u>

Supplementary Cash Flow Information (note 13)

See notes to the consolidated financial statements

SKYE RESOURCES INC.

Notes to Consolidated Financial Statements
(Expressed in Canadian dollars, unless otherwise stated)

1. Nature of Operations

The Company is in the business of exploring and developing mineral properties. On September 30, 2004, the Company entered into a Share Purchase Master Agreement ("Master Agreement"), as described in note 6, with Inco Limited ("Inco") for the acquisition of the 70% interest held by Inco in Exmibal (as defined in Note 3(a)). Exmibal held certain nickel licenses located in Guatemala. The Company is currently at the stage of exploring and developing the nickel licenses that it has now called its Fenix property.

The Company's common shares trade on the TSX-V exchange under the symbol "SKR". Prior to December 24, 2003, the Company's shares were on the NEX.

2. Changes in Accounting Policies

Stock-based compensation

Effective September 1, 2003, the Company recognizes compensation expense for stock options granted using the fair value based method of accounting for all options issued on or after September 1, 2003. Any cash paid on the exercise of stock options is added to the stated value of common shares and the fair values at the time the related grants are made previously added to contributed surplus are reallocated to the stated value of the common shares.

3. Significant Accounting Policies

a. Principles of consolidation

These financial statements include our accounts and those of our wholly-owned subsidiary, Skye de Guatemala, S.A. (a Guatemalan company) and our 70%-owned subsidiaries, Compañía Guatemalteca de Níquel, S.A. ("CGN") (formerly Exploraciones y Explotaciones Mineras Izabal S.A. ("Exmibal")) and Inversiones Arcadia, S.A. (both Guatemalan companies). All significant inter-company balances and transactions have been eliminated.

b. Use of estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires the Company's management to make estimates and assumptions about future events that affect the amounts reported in the financial statements and related notes. Actual results may differ from those estimates.

c. Cash and cash equivalents

Cash and cash equivalents consist of cash on hand and short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in value.

d. Equipment

Equipment is recorded at cost and amortized over three years on a straight line basis.

SKYE RESOURCES INC.

Notes to Consolidated Financial Statements

(Expressed in Canadian dollars, unless otherwise stated)

e. Mineral properties and exploration costs

The cost of acquiring mineral properties is capitalized and, when commercial production commences, will be charged to operations on a unit of production method based on estimated proven and probable reserves. Exploration and development expenditures, including those on capitalized mineral properties, are expensed as incurred. Exploration and development costs will be capitalized prospectively once it has been established that a mineral property is commercially mineable.

f. Realization of assets

The investment in and expenditures on mineral interests comprise a significant portion of our assets. Realization of our investment in these assets is dependent upon the attainment of successful production from the properties or from the proceeds of their disposal. If, after management review, it is determined that capitalized acquisition costs are not recoverable over the estimated economic life of the property, or the property is abandoned, the property is written down to its net realizable value.

g. Site closure and reclamation costs

The Company has adopted the Canadian Institute of Chartered Accountants Handbook Section 3110, "Asset Retirement Obligations" ("HB 3110"). HB 3110 requires that the fair value of a liability for an asset retirement obligation, such as site closure and reclamation costs, be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The Company is required to record the estimated present value of future cash flows associated with site closure and reclamation as a liability when the liability is incurred and increase the carrying value of the related assets for that amount. Subsequently, these asset retirement costs will be amortized to expense over the life of the related assets using the unit-of-production method. At the end of each period, the liability is increased to reflect the passage of time (accretion expense) and changes in the estimated future cash flows underlying any initial fair value measurements (additional asset retirement costs).

The Company's mineral properties were conditionally acquired under the terms of the Master Agreement and the Company's obligations, if any, to remediate the environmental condition and conduct the closure of the Minesite and smelter facilities are yet to be determined. (see note 6). The Company's obligations are dependent primarily upon the findings of an on-going baseline environmental review to determine the condition of the Fenix property at December 15, 2004 that is being undertaken jointly by the Company and Inco; by the terms with respect to site closure and mine reclamation to be established in an environmental impact study to be approved by the Ministry of the Environment and Natural Resources of the Government of Guatemala ("MARN"); and by the Company completing a bankable feasibility study before the end of the Option Period (defined in note 6) which is a condition to exercising the option, and following exercise of the option by the Company making a production decision to proceed with the development of the Fenix project (see note 6). No reasonable estimate of the fair value of site closure and mine reclamation costs can be made as at December 31, 2004. Accordingly, no provision has been established for the estimated future site closure and mine reclamation costs for the Company's mineral properties. As soon as a reasonable estimate of the potential obligations for site closure and mine reclamation costs can be made, such a provision will be made and the estimated cost will be added to the purchase cost of mineral properties in the manner described above.

SKYE RESOURCES INC.

Notes to Consolidated Financial Statements
(Expressed in Canadian dollars, unless otherwise stated)

h. Foreign currency translation

The Canadian dollar is the reporting currency of the Company. Amounts recorded in foreign currencies and the financial statements of the Company's subsidiaries are translated into Canadian dollars as follows:

- (i) Monetary assets and liabilities at the rate of exchange in effect as at the balance sheet date;
- (ii) Non-monetary assets and liabilities at the exchange rates prevailing at the time of the acquisition of the assets or assumption of the liabilities; and
- (iii) Income and expenses at the average rate of exchange for the period.

Gains and losses arising from this translation of foreign currency are included in the determination of net loss.

i. Revenue recognition

Interest on cash and cash equivalents is recorded on an as earned basis.

j. Process technology

Process technology expenditures are expensed as incurred.

k. Stock-based compensation

The Company recognizes compensation expense for stock options granted in the statements of loss using the fair value based method of accounting for all options issued on or after September 1, 2003. Any cash paid on the exercise of stock options is added to the stated value of common shares.

l. Income taxes

The Company follows the asset and liability method of accounting for income taxes. Future income tax assets and liabilities are recognized for the temporary differences between the financial statement carrying values of assets and liabilities and their income tax bases. Future income tax assets and liabilities are measured using enacted income tax rates expected to apply to taxable income in the years in which temporary differences are expected to be recovered or settled. The effect on future income tax assets and liabilities of a change in tax rate is included in income in the period in which the change occurs. The amount of future income tax assets recognized is limited to the amount that is more likely than not to be realized.

m. Loss per share

The Company uses the treasury stock method to compute the dilutive effect of options, warrants and similar instruments. Under this method the dilutive effect on earnings per share is recognized on the use of the proceeds that could be obtained upon exercise of options, warrants and similar instruments. It assumes that the proceeds would be used to purchase common shares at the average market price during the period. Diluted loss per share has not been presented separately as it proved to be anti-dilutive for the periods presented.

Basic loss per share is calculated using the weighted-average number of common shares outstanding during the year.

SKYE RESOURCES INC.

Notes to Consolidated Financial Statements

(Expressed in Canadian dollars, unless otherwise stated)

4. Financial Instruments

Financial instruments consist of cash and cash equivalents, receivables and accounts payable. The carrying values of these financial instruments approximate their fair values because of their short maturity. Cash and cash equivalents are exposed to credit risk and these amounts are placed with a major Canadian bank. The Company is not exposed to interest rate risk due to the short term maturity of the financial instruments.

5. Equipment

	Cost	Accumulated Amortization	December 31 2004 Net
Office furniture and equipment	\$ 2,452	\$ (445)	\$ 2,007
Computer equipment	41,753	(18,557)	23,196
	<u>\$ 44,205</u>	<u>\$ (19,002)</u>	<u>\$ 25,203</u>

	Cost	Accumulated Amortization	August 31 2004 Net
Office furniture and equipment	\$ 1,724	\$ (172)	\$ 1,552
Computer equipment	41,753	(13,918)	27,835
	<u>\$ 43,477</u>	<u>\$ (14,090)</u>	<u>\$ 29,387</u>

6. Acquisition of CGN

On the initial closing under the Master Agreement on December 15, 2004, the Company conditionally acquired Inco's 70% interest in Exmibal and the Fenix project mineral exploration licenses held by Exmibal (see note 7). At that time, the Company issued to Inco 1,888,101 common shares of the Company at a deemed price of \$3.26 per share, together with 198,665 common share purchase warrants exercisable at \$3.00 per share, and 5,098 common share purchase warrants exercisable at \$2.00 per share, resulting in Inco holding 13.93% of the issued and outstanding common shares and warrants of the Company immediately following the initial closing. All of these warrants expired on December 24, 2004 without having been exercised. (see note 8) The Government of Guatemala owns 30% of CGN.

Under the Master Agreement, the Company has a five year option period from December 15, 2004 (the "Option Period") to evaluate the technical and economic feasibility of developing an integrated nickel mining and processing facility in the area covered by the exploration licenses referred to in Note 7. If the Company exercises the option to proceed with such a project, a subsequent closing will occur where the Company will pay Inco U.S.\$3,500,000 and issue to Inco approximately an additional 1,750,000 common shares (together, the "Additional Consideration") and Inco will transfer to the Company or its subsidiaries two wholly-owned subsidiaries in Guatemala, Bocanueva S.A. and Tampico S.A., which hold certain surface rights and dock facilities and other assets. The Additional Consideration would be payable once the Company has fulfilled a number of conditions during the option period, including the preparation of a feasibility study, and the completion of financings to raise an aggregate of \$20,000,000 (less the proceeds from the exercise of the above-mentioned warrants that expired on December 24, 2004) (see notes 14 and 15).

SKYE RESOURCES INC.

Notes to Consolidated Financial Statements
(Expressed in Canadian dollars, unless otherwise stated)

Concurrently with the above acquisition the Company agreed to a Production Interest Agreement, Sales Agency Agreement, a Net Smelter Returns (NSR) Agreement, an Off-take Agreement, and a Technology Agreement with Inco.

The Production Interest Agreement provides for a variable payment tied to production and certain LME cash nickel prices to Inco based on 70% of the number of dry tonnes of ore that would be mined at the Fenix project.

The Sales Agency Agreement provides for Inco to market all ferro-nickel or other finished nickel products produced from the Fenix project and sold to third party end-users that do not require further refining in return for a 2.75% commission to Inco.

If the Company develops the Fenix project by building a ferro-nickel plant, then Inco and the Company will enter into a Net Smelter Return Agreement providing for payment to Inco of a sliding scale royalty (based on certain LME average cash nickel prices and increasing after the end of the payback period referred to below) calculated on 70% of Net Smelter Returns from the sale of ferro-nickel products produced from a ferro-nickel plant built at the Fenix Project.

If the Company develops the Fenix project to include a mine and processing facility using an atmospheric leach process producing an intermediate product, then Inco and the Company will enter into an Off-take Agreement on commercially reasonable terms, the initial duration of which will be at least equal to the payback period for the mine and processing facility to be financed.

Under the Technology Agreement and upon the Company exercising the aforementioned option during the Option Period, Inco has the non-exclusive, non-transferable, limited perpetual license to use the Company's proprietary knowledge and any improvements used at the Fenix project at any Inco-managed or controlled facility in return for certain fees and a variable annual royalty tied to the Inco facility's recovery rates and product sales values.

Inco has certain other rights under the Master Agreement, including (1) as long as Inco retains at least a 10% equity interest in the Company, the right to appoint one director to the Company's board following exercise of the option; (2) the right to become the operator if the Company fails to secure financing to put the Fenix property into production within a certain period following receipt of a positive feasibility study; (3) the right to re-activate shut-down operations under limited circumstances; (4) a one-time right to re-acquire the Fenix project for the then fair market value if the Company ceases to make good faith efforts to advance the construction of a mine on the Fenix property for reasons unrelated to force majeure within a certain period following receipt of a positive feasibility study; (5) a pre-emptive right for five and a half years after December 15, 2004 to participate in the Company's equity and derivative security financings up to certain prescribed limits as long as Inco retains at least a 7.5% equity interest in the Company; and (6) certain pre-emptive sale interest rights.

The Company also issued 500,000 shares in connection with the completion of the Master Agreement to Geostar (see note 10 (a) (i)) and incurred other acquisition costs of \$1,339,100 comprising:

- (i) a total of \$963,600 to the Government of Guatemala and the Municipality of El Estor in connection with the granting of the exploration licenses to settle certain claims for royalties levied on previous operations, and
- (ii) other costs of \$375,500 including \$75,000 to Geostar (see note 10 (a) (i)).

The acquisition has been accounted for using the purchase method of accounting and the results of operations have been consolidated since the date of acquisition.

SKYE RESOURCES INC.

Notes to Consolidated Financial Statements

(Expressed in Canadian dollars, unless otherwise stated)

Purchase price	\$	9,189,909
Fair market value of net assets acquired:		
Mineral properties		9,189,909
Purchase price discrepancy	\$	-
Consideration:		
Issuance of 2,388,101 shares	\$	7,785,209
Issuance of 203,763 warrants		65,600
Other acquisition costs		1,339,100
	\$	9,189,909

7. Mineral properties

The Company conditionally acquired the Fenix project mineral properties in Guatemala at a cost of \$9,189,909 as described in note 6. The acquisition cost is subject to change if and when the Company establishes a reasonable estimate of the fair value of the liability for site closure and reclamation costs (see note 3 (g)) and if and when Additional Consideration becomes payable to Inco (see note 6). The mineral properties have located on them a former mine operation and a plant producing nickel matte that operated for three years and closed in 1981. Since then, the sites have been held on a continuous care and maintenance basis by CGN. There are certain surface rights held by Inco subsidiaries that are a part of any viable Fenix project that the Company will acquire upon exercise of the option described in note 6 and payment of the Additional Consideration. The Company determined that no write-down of the carrying value of its mining properties is required.

On December 13, 2004, the Government of Guatemala issued new exploration licenses to CGN covering the Fenix project to replace CGN's Niquegua exploitation concession (originally granted in 1965 for an initial 40 year term) and two smaller concessions granted in 1974. The new licenses (called Niquegua Norte and Montufar II) are for an initial three-year period and they are renewable on application for up to two additional periods of two years each. Upon approval of an environmental impact study by MARN, the licenses would, subject to the filing of an application and receipt of approval from the Guatemalan Ministry of Energy and Mines (MEM), be converted into exploitation licenses that would have a 25 year term, with a right of renewal for an additional 25 year period. (see note 15).

SKYE RESOURCES INC.

Notes to Consolidated Financial Statements
(Expressed in Canadian dollars, unless otherwise stated)

8. Share Capital:

a) Share Capital:	Number of Shares	Share Capital	Contributed Surplus
Authorized:			
100,000,000 common shares without par value			
Issued:			
Balance, August 31, 2003	4,680,104	\$ 4,491,601	\$ 5,914
Exercise of warrants	3,500,000	525,000	-
Exercise of options	10,000	10,000	-
Private placement - net of issue costs (4)	3,000,000	3,566,150	2,037,400
Shares issued for debt	27,500	15,000	-
Exercise of agents warrants	34,000	68,000	-
Stock option expense	-	-	1,676,024
Balance, August 31, 2004	11,251,604	\$ 8,675,751	\$ 3,719,338
Exercise of warrants (1)	1,646,000	4,792,000	-
Contributed surplus on warrants exercised (2)	-	2,037,400	(2,037,400)
Warrants issued for property acquisition (3)	-	-	65,600
Shares issued for mineral properties (3)	2,388,101	7,785,209	-
Shares issued for services	27,500	74,250	-
Stock option expense	-	-	219,723
Balance, December 31, 2004	15,313,205	\$ 23,364,610	\$ 1,967,261

- (1) During the four months ended December 31, 2004 there were 1,500,000 share purchase warrants exercised at a price of \$3.00 per share for proceeds of \$4,500,000 and 146,000 brokers warrants exercised at a price of \$2.00 per share for proceeds of \$292,000. The total proceeds of \$4,792,000 were added to the common share account and \$2,037,400 was allocated from the contributed surplus account to common shares on behalf of the warrants.
- (2) During the four months ended December 31, 2004 a reduction of contributed surplus originated from an exercise of warrants in item (1). The contributed surplus account was increased by this amount during the year ended August 31, 2004 when the warrants were issued - see item (4).
- (3) On December 15, 2004 upon initial closing under the Master Agreement, the Company issued 2,388,101 Skye common shares together with 198,665 common share purchase warrants exercisable at \$3.00 per share, and 5,098 common share purchase warrants exercisable at \$2.00 per share. All such warrants expired on December 24, 2004. The 2,388,101 Skye common shares comprised 1,888,101 issued to Inco (see note 6) and 500,000 to Geostar Metals Inc. ("Geostar") (see note 10 (a) (i)).
- (4) On December 24, 2003, the Company issued 3,000,000 units at a price of \$2.00 per unit for net proceeds of \$5,603,550 (net of \$396,450 in share issuance costs). Each unit is comprised of one common share and one half of a share purchase warrant. Each full warrant entitles the holder to purchase one common share at a price of \$3.00 per share expiring December 24, 2004. An additional 146,000 warrants exercisable at \$2.00 until December 24, 2004 were issued to agents in connection with the placement. Of the total net consideration of \$5,603,550, \$3,566,150 was allocated to the common shares and \$2,037,400 was allocated to the warrants and added to contributed surplus.

SKYE RESOURCES INC.

Notes to Consolidated Financial Statements
(Expressed in Canadian dollars, unless otherwise stated)

(b) Stock purchase options

The Company has a stock option plan under which the Board of Directors may grant stock options to directors, officers, employees and consultants. Under the plan, the exercise price is the closing price on the day immediately preceding the date of granting the option. As long as the Company is listed on Tier 2 of the TSX Venture Exchange options granted shall vest over 18 months and each option shall expire not later than five years from the date the option is granted. The maximum number of shares which may be set aside for issuance pursuant to options granted is 2,241,520. Subject to shareholder approval at the Company's Annual and Special Shareholders' Meeting scheduled for May 26, 2005, this number will be increased to 4,626,641, being 20% of the current 23,133,205 shares issued and outstanding.

Stock option transactions are summarized below:

	Number of Shares	Exercise Price	Weighted Average Exercise Price
Balance, August 31, 2003	20,000	\$ 1.00	\$ 1.00
Granted during the year	1,335,000	0.68 - 5.25	3.56
Exercised during the year	(10,000)	1.00	1.00
Expired/cancelled during the year	(10,000)	1.00	1.00
Outstanding August 31, 2004	1,335,000	\$ 0.68 - 5.25	\$ 3.56
Granted during the period	250,000	3.24 - 3.60	3.53
Outstanding December 31, 2004	1,585,000	\$ 0.68 - 5.25	\$ 3.55

The weighted average fair value of options granted in the four month period ending December 31, 2004 is \$1.65 (August 31, 2004, \$1.67). The related stock-based compensation of \$219,723 (August 31, 2004 - \$1,676,024) is expensed in the same period based on the fair value method of accounting for options, and added to Contributed Surplus in Shareholders Equity on the Balance Sheet

Stock options outstanding at December 31, 2004 are summarized below:

Expiry Date	Number Outstanding	Number Exercisable	Exercise Price
November 27, 2008	100,000	100,000	\$ 0.68
December 9, 2008	690,000	690,000	3.30
January 2, 2009	235,000	197,500	4.25
January 28, 2009	75,000	37,500	5.25
March 4, 2009	185,000	97,500	4.65
July 12, 2009	50,000	12,500	3.05
December 1, 2009	50,000	12,500	3.24
December 17, 2009	200,000	50,000	3.60
	1,585,000	1,197,500	

The weighted average exercise price of the options exercisable at December 31, 2004 is \$3.42.

SKYE RESOURCES INC.

Notes to Consolidated Financial Statements

(Expressed in Canadian dollars, unless otherwise stated)

The fair value of stock options is estimated using the Black-Scholes option pricing model with the following assumptions:

	Four month period ended December 31 2004	Year ended August 31 2004
Risk free interest rate	3.05%	3.00%
Annual dividends	—	—
Expected stock price volatility	75%	75%
Expected life	2.5 years	2.5 years

(c) Share purchase warrants:

	Number of Shares	Exercise price	Expiry Date
Balance August 31, 2004			
Warrants	1,500,000	\$3.00	December 24, 2004
Agents warrants	146,000	\$2.00	December 24, 2004
Four months ended December 31, 2004			
Warrants exercised	(1,500,000)	\$3.00	December 24, 2004
Agents warrants exercised	(146,000)	\$2.00	December 24, 2004
Warrants issued	198,665	\$3.00	December 24, 2004
Warrants issued	5,098	\$2.00	December 24, 2004
Warrants expired	(203,763)		December 24, 2004
Balance December 31, 2004	—	—	

During the four months ended December 31, 2004 there were 198,665 share purchase warrants issued at a price of \$3.00 per share which were valued at \$59,300 and there were 5,098 share purchase warrants issued at a price of \$2.00 per share that were valued at \$6,300 (see note 8 (a)), the value of which was recorded in contributed surplus. These 203,763 warrants expired on December 24, 2004.

The outstanding warrants at August 31, 2004 were issued as part of the private placement of 3,000,000 units that closed December 24, 2003 for net proceeds of \$5,603,550. The estimated fair value of the warrants was used to allocate the net proceeds from sale of units between share capital (\$3,566,150) and contributed surplus (\$2,037,400).

SKYE RESOURCES INC.

Notes to Consolidated Financial Statements

(Expressed in Canadian dollars, unless otherwise stated)

The fair value of warrants issued during the periods were estimated using the Black-Scholes option pricing model with the following assumptions:

	Four month period ended December 31 2004	Year ended August 31 2004
Risk free interest rate	3.00%	3.00%
Annual dividends	—	—
Expected stock price volatility	75%	75%
Expected life	1 year	1 year

9. Income taxes

The income taxes shown on the consolidated statements of loss and deficit differ from the amounts obtained by applying statutory rates due to the following:

	Four month period ended December 31 2004	Year ended August 31 2004
Statutory tax rate	35.6%	35.6%
Loss for the period	\$ (1,558,701)	\$ (3,845,552)
Recovery of income taxes based on the statutory rate	554,898	1,369,016
Stock based compensation	(78,221)	(596,665)
Unrecognized benefit of non-capital losses	(476,320)	(772,351)
Difference due to foreign tax rate	(357)	-
	\$ -	\$ -

The significant components of the Company's Canadian income tax assets are as follows:

	December 31 2004	August 31 2004
Future income tax assets:		
Non-capital loss carry forwards	\$1,289,804	\$957,672
Share issue costs	116,967	116,967
Excess of undepreciated capital cost over net book value of equipment	6,766	5,016
Cumulative Canadian exploration expense	42,534	42,534
Cumulative Canadian development expense	59,060	59,060
Foreign exploration and development expense	857,923	752,251
	2,373,054	1,933,500
Less valuation allowance	(2,373,054)	(1,933,500)
	\$ -	\$ -

SKYE RESOURCES INC.

Notes to Consolidated Financial Statements

(Expressed in Canadian dollars, unless otherwise stated)

The future income tax assets have been offset by a valuation allowance because it is more likely than not that the Company will not realize these assets.

Non-capital losses for tax purposes which may be carried forward to reduce taxable income in future years expire at the end of the following years:

2006	\$ 119,940
2007	32,012
2008	20,211
2009	71,206
2010	111,664
2011	2,238,528
2011	1,029,483
	<hr/>
	\$ 3,623,044

10. Related party transactions:

(a) During the four months ended December 31, 2004, the Company had the following transactions with related parties:

- (i) paid \$75,000 in cash and issued 500,000 of the Company's common shares with a value of \$1,630,000 to Geostar in connection with the completion of the Master Agreement with Inco (see note 6) that at the time of the contractual arrangement was not a related party but which, on December 31, 2004, became a related party with a director in common. The Company originally entered into an agreement with Geostar whereby Geostar would receive \$100,000 and 500,000 common shares of the Company. On December 14, 2004 that agreement was amended to lower the cash component to \$75,000. The agreement and the amendment were made in recognition of Geostar introducing the Company to Inco and providing assistance and support in negotiating the acquisition of the CGN shares and its Fenix property.
- (ii) paid or accrued \$14,000 (year ended August 31, 2004 - \$42,000) for office and administrative expenses to a company with directors in common; and \$17,600 (year ended August 31, 2004 - \$52,900) for rent to a company with directors in common;

The transactions for services provided were in the normal course of operations and at commercial rates.

(b) As at December 31, 2004, accounts payable includes \$8,805 (August 31, 2004 - \$8,614) due to companies with directors in common; and the prepaid deposit includes \$5,250 (August 31, 2004 - \$5,250) paid to a company with directors in common.

The amounts payable by the Company for the services provided have been determined by negotiation between the parties. The transactions were in the normal course of operations and at commercial rates.

SKYE RESOURCES INC.

Notes to Consolidated Financial Statements
(Expressed in Canadian dollars, unless otherwise stated)

11. Commitments and contingencies

- (a) Under the Master Agreement a two-member committee (the "Liaison Committee"), chaired by an Officer of the Company is responsible for determining the potential environmental reclamation or closure liability or costs for any actions or activities the Company carries out on CGN's mineral properties during the Option Period, and to fix the initial amount and the terms and conditions, including the effective life of, and any change in such amount and the terms and conditions, including the effective life of, a "clean" irrevocable bond or letter of credit or such other mutually agreed form of financial assurance to be posted by the Company in favour of Inco or its designee securing such liability or costs (the "Environmental Reclamation Bond"), provided, however, that no Environmental Reclamation Bond is to be posted until the Liaison Committee determines in good faith that such potential liability or cost is at least US\$100,000.

Under the terms of amendment number 1 to the Master Agreement dated December 15, 2004, if, any one or more of,

- (i) without Inco's agreement acting reasonably, the Company removes five (5) tonnes or more of ore from the Fenix property during any calendar year (counted from December 15, 2004) for purpose of carrying out processing tests or running pilot or demonstration plants (see note 15),
- (ii) the Company in any way conducts any activities other than normal exploration activities, or
- (iii) any sediment ponds or dams on the mineral property are measurably and adversely affected by any of the Company's activities or there is a physical breach of any such ponds or dams, which in either case is not attributable to any joint responsibility of the Liaison Committee or any several responsibility of the Company or Inco in accordance with the Master Agreement,

which have the effect of measurably and adversely disturbing any area within the properties owned or controlled by CGN, then the Company shall assume full responsibility for any and all environmental claims, liabilities, remediation and reclamation relating to any such disturbed areas and the Company shall indemnify Inco in respect thereof.

- (b) The Company has entered into employment contracts with four officers with aggregate annual base compensation of \$700,000. In addition to the remuneration payable under the contracts, bonuses and stock options may be paid or granted at the discretion of the Board of Directors. Under certain conditions of terminations, these officers will receive two times their annual compensation as severance. On achieving certain milestones three of these officers will also earn up to 900,000 common shares of the Company (subsequently reduced to 740,000 shares on April 18, 2005 by the issue of 101,800 shares and the cancellation of 58,200 incentive stock grants) at no additional cost.

12. Segmented Information

The Company primarily operates in one reportable operating segment, being the acquisition and development of mineral properties. The Company's operations and assets are in Canada and Guatemala as follows:

	<u>Canada</u>	<u>Guatemala</u>
Loss from operations	\$ 1,550,947	\$ 7,754
Total assets	\$ 7,493,090	\$ 9,403,414

The loss from operations in Guatemala represents only 15 days under company ownership.

SKYE RESOURCES INC.

Notes to Consolidated Financial Statements
(Expressed in Canadian dollars, unless otherwise stated)

13. Supplementary Cash Flow Information

	Four months ended December 31 2004	Year ended August 31 2004
(a) Cash and cash equivalents consist of:		
Cash	\$ 512,586	\$ 175,427
Cash equivalents	6,693,994	4,594,112
	<u>\$ 7,206,580</u>	<u>\$ 4,769,539</u>
(b) Non-cash financing activities consist of:		
Shares issued for debt	\$ -	\$ 15,000
Shares issued for services	74,250	-
Shares issued for property acquisition	7,785,209	-
Warrants issued for property acquisition	65,600	-
Fair value of stock options granted	219,723	1,676,024
	<u>\$ 8,144,782</u>	<u>\$ 1,691,024</u>
(c) Non-cash investing activities consist of:		
Shares issued for property acquisition	\$ (7,785,209)	\$ -
Warrants issued for property acquisition	(65,600)	-
	<u>\$ (7,850,809)</u>	<u>\$ -</u>

14. Subsequent events

On March 24, 2005, the Company closed a private placement of 7,820,000 units at a price of \$4.10 per unit. The equity financing raised gross proceeds of approximately \$32,000,000, thereby satisfying the financing condition relating to the option held by the Company under the Master Agreement (see note 6). Inco acquired 500,000 units in the financing. Each unit consisted of one common share and one-half of one common share purchase warrant, with each whole warrant entitling the purchaser to acquire one additional common share of the Company at a price of \$5.75 for a period of two years from the date of issuance. Following the closing of the financing Inco held an aggregate of 2,388,101 common shares and 250,000 share purchase warrants of the Company representing approximately 10.3% of the issued and outstanding shares of the Company (approximately 9.2% on a fully diluted basis). The net proceeds of the financing will be used to fund further development of the Fenix Project, including a feasibility study, an environmental impact study, exploration of the Fenix project area licenses, and for general corporate purposes.

On April 18, 2005, the Company entered into a contract with Boart Longyear Ltd. for a 45,000 meter diamond drilling program on the Fenix project in Guatemala at an estimated cost of \$9,000,000.

15. Risk

The Company's rights to own the 70% interest in CGN and through CGN, the right to own and operate the Fenix project are held under the terms of the Master Agreement and recorded as mineral properties in these financial statements. There is no guarantee that the newly issued exploration licenses for the Fenix project can be converted into exploitation licenses and Inco has the right to re-acquire the Company's interests in CGN for nominal consideration if the feasibility study on the Fenix project is not completed during the Option Period or the Company elects not to exercise its option to proceed with an integrated mining and processing facility at the Fenix project (see notes 6 and 7).