

**SKYE RESOURCES INC.**

**CONSOLIDATED INTERIM FINANCIAL STATEMENTS**

**MARCH 31, 2006**

**(Unaudited)**

## SKYE RESOURCES INC.

Consolidated Balance Sheets  
As at March 31, 2006 and December 31, 2005  
(Expressed in thousands of Canadian Dollars)

	March 31	December 31
	2006	2005
	(unaudited)	(audited)
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 29,369	\$ 13,378
Receivables	310	460
Prepaid expenses	222	89
	29,901	13,927
Equipment (note 3)	352	335
Mineral properties (note 4)	9,815	9,790
	\$ 40,068	\$ 24,052

### LIABILITIES AND SHAREHOLDERS' EQUITY

Current liabilities:		
Accounts payable and accrued liabilities	\$ 4,704	\$ 5,204
Reclamation obligations (note 7)	425	400
Shareholders' equity:		
Share capital (note 5)	73,064	48,771
Contributed surplus (note 5)	8,325	7,971
Deficit	(46,450)	(38,294)
	34,939	18,448
	\$ 40,068	\$ 24,052

Commitments and Contingencies (note 7) and Subsequent Events (note 11)

Approved by the Board of Directors:

Signed: "Ian G. Austin"

Director

Signed: "David S. Smith"

Director

## SKYE RESOURCES INC.

Consolidated Statements of Operations and Deficit  
For the Three Months Ended March 31, 2006 and 2005  
(Expressed in thousands of Canadian Dollars, except per share amounts)

	Three months ended March 31	
	2006	2005
	(unaudited)	(unaudited)
Revenue:		
Interest and other income	\$ 154	\$ 52
Expenses:		
Fenix development costs	3,562	808
Exploration	2,261	169
Process technology	102	1,749
General and administrative	1,763	865
Project financing	104	-
Amortization	35	6
Stock-based compensation (note 5)	483	306
	8,310	3,903
Loss for the period	8,156	3,851
Deficit, beginning of period	38,294	9,826
Deficit, end of period	\$ 46,450	\$ 13,677
Basic and diluted loss per share	\$ 0.31	\$ 0.24
Weighted average number of common shares outstanding	26,014,161	16,008,316

See notes to the consolidated interim financial statements

## SKYE RESOURCES INC.

Consolidated Statements of Cash Flow  
For the Three Months Ended March 31, 2006 and 2005  
(Expressed in thousands of Canadian Dollars)

	Three months ended March 31	
	2006	2005
	(unaudited)	(unaudited)
Cash provided by (used for):		
Operating activities:		
Loss for the period	\$ (8,156)	\$ (3,851)
Items not affecting cash		
Amortization	35	6
Stock-based compensation-options (note 5)	483	306
Changes in non-cash working capital balances:		
Receivables	150	(9)
Prepaid expenses	(133)	(43)
Accounts payable and accrued liabilities	(500)	1,773
<b>Cash used in operating activities</b>	<b>(8,121)</b>	<b>(1,818)</b>
Financing activities: (note 5)		
Exercise of warrants	484	-
Exercise of options	63	-
Private placement	25,011	32,060
Share issue costs	(1,394)	(2,144)
<b>Cash provided by financing activities</b>	<b>24,164</b>	<b>29,916</b>
Investing activities:		
Equipment (note 3)	(52)	(26)
Increase in cash and cash equivalents	15,991	28,072
Cash and cash equivalents, beginning of period	13,378	7,207
<b>Cash and cash equivalents, end of period</b>	<b>\$ 29,369</b>	<b>\$ 35,279</b>

Supplementary Cash Flow Information (note 9)

## SKYE RESOURCES INC.

Notes to Consolidated Financial Statements

For the Three Months Ended March 31, 2006 and 2005 (unaudited)

(Expressed in thousands of Canadian dollars,

Except for share / unit / warrant amounts, unless otherwise stated)

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### 1. Basis of presentation

It is recommended that these unaudited interim financial statements be read in conjunction with the audited annual financial statements for the year ended December 31, 2005. The accounting policies applied to the preparation of the interim financial statements are consistent with those applied to the previous financial period ended December 31, 2005. These interim financial statements have been prepared in accordance with Canadian generally accepted accounting principles for interim financial information. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for audited financial statements. In the opinion of management, all adjustments (consisting of normal and recurring accruals) considered necessary for fair presentation have been included. Operating results for the three month period ended March 31, 2006 are not necessarily indicative of the results that may be expected for the year ended December 31, 2006. Certain comparative figures have been reclassified to conform with the presentation in the current period.

### 2. Principles of consolidation

These financial statements include the accounts of the Company and those of:

(i) three wholly-owned subsidiaries

Skye Resources (B.V.I.) Inc.

incorporated in the British Virgin Islands

Skye Resources Guatemala (B.V.I.) Inc.

incorporated in the British Virgin Islands

Skye de Guatemala, S.A.

incorporated in Guatemala, and

(ii) two 92.4%-owned subsidiaries,

Compañía Guatemalteca de Níquel, S.A. ("CGN")

incorporated in Guatemala

(formerly Exploraciones y Explotaciones Mineras Izabal S.A. ("Exmibal"))

Inversiones Arcadia, S.A.

incorporated in Guatemala.

All significant inter-company balances and transactions have been eliminated.

### 3. Equipment

	Cost	Accumulated Amortization	March 31 2006 Net
Office furniture and equipment	\$ 141	\$ (40)	\$ 101
Computer equipment	209	(75)	134
Vehicles	134	(17)	117
	<u>\$ 484</u>	<u>\$ (132)</u>	<u>\$ 352</u>

  

	Cost	Accumulated Amortization	December 31 2005 Net
Office furniture and equipment	\$ 121	\$ (26)	\$ 95
Computer equipment	206	(57)	149
Vehicles	105	(14)	91
	<u>\$ 432</u>	<u>\$ (97)</u>	<u>\$ 335</u>

## SKYE RESOURCES INC.

Notes to Consolidated Financial Statements

For the Three Months Ended March 31, 2006 and 2005 (unaudited)

(Expressed in thousands of Canadian dollars,

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### 4. Mineral properties

Pursuant to a Share Purchase Master Agreement ("Master Agreement") with Inco Limited ("Inco"), the Company conditionally acquired a 70% indirect interest in CGN's Fenix Project ("Fenix Project") in Guatemala at a cost of \$9,190 in December 2004 through the purchase of shares in CGN. If the Company exercises the option to complete the acquisition (the "Fenix Option"), the Company will pay Inco US\$3,500,000 and issue approximately 1,750,000 Common Shares to Inco – see note 5 to the audited financial statements for the year ended December 31, 2005. The acquisition cost is subject to change as a result of exercising the Fenix Option and as the Company makes new estimates of the fair value of the liability for site closure and reclamation costs. The Fenix Project includes a former mine operation, a pyrometallurgical nickel processing plant, an oil-fired power plant and associated infrastructure that operated over a period of approximately 40 months and closed in 1980. Since then, the site has 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 Fenix Option and payment of the additional consideration. The Company determined that no write-down of the carrying value of its mining properties is required.

Until April 2006, the Company held two exploration licences, Niquegua Norte and Niquegua Montufar II, which entitled it to explore for nickel, cobalt, iron, chromium and magnesium. In April 2006, the Guatemalan Ministry of Energy and Mines ("MEM") issued an exploitation licence (the "Fenix Exploitation Licence") which converted substantially the entire Niquegua Norte exploration licence into a 25 year renewable exploitation licence covering an area of 248 square kilometres. The Fenix Exploitation Licence allows mining of nickel, cobalt, iron, chromium and magnesium to take place on the licensed area. The Niquegua Montufar II exploration licence granted in December 2004, remains in effect and has a three year term with two possible extensions of two years each, subject to a reduction in area unless justification can be shown why the scope of the project requires a greater area.

In the second half of 2005 the Company's indirect interest in the Fenix Project increased following a series of cash calls to the shareholders of CGN from 70.0% to approximately 90.9% and, during the three months ended March 31, 2006, further increased to 92.4% as a result of the Company funding certain costs associated with the Fenix Project. The aggregate costs funded for these cash calls were \$13,446. The remaining interest is owned by the Government of Guatemala which has elected not to contribute its proportionate share of this new funding. The funds received by CGN from these cash calls are expended on exploration and development which on consolidation are expensed as incurred.

## SKYE RESOURCES INC.

Notes to Consolidated Financial Statements

For the Three Months Ended March 31, 2006 and 2005 (unaudited)

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### 5. Share Capital:

a) Share Capital:	Number of Shares	Share Capital	Contributed Surplus
Authorized:			
Unlimited common shares without par value			
Issued:			
Balance, December 31, 2004	15,313,205	\$ 23,365	\$ 1,967
Shares and warrants issued for private placement <sup>(5)</sup>	7,820,000	27,259	4,803
Share issue costs <sup>(5)</sup>	-	(2,179)	-
Shares issued for services <sup>(4)</sup>	101,800	326	-
Stock-based compensation expense	-	-	1,201
Balance, December 31, 2005	23,235,005	48,771	7,971
Shares issued for private placement <sup>(3)</sup>	5,885,000	25,011	-
Share issue costs <sup>(3)</sup>	-	(1,394)	-
Exercise of warrants <sup>(1)</sup>	84,100	484	-
Contributed surplus on warrants exercised <sup>(1)</sup>	-	103	(103)
Exercise of share options <sup>(2)</sup>	18,400	63	-
Contributed surplus on share options exercised <sup>(2)</sup>	-	26	(26)
Stock-based compensation expense	-	-	483
Balance, March 31, 2006	29,222,505	\$ 73,064	\$ 8,325

(1) During the three months ended March 31, 2006 there were 84,100 share purchase warrants exercised at a price of \$5.75 per share for proceeds of \$484. The proceeds were added to the common share account and \$103 was allocated from the contributed surplus account to common shares for the warrants exercised.

(2) During the three months ended March 31, 2006 there were 18,400 share purchase options exercised at an average exercise price of \$3.41 for proceeds of \$63. The proceeds were added to the common share account and \$26 was allocated from the contributed surplus account to common shares for the share options exercised.

(3) On February 21, 2006, the Company closed a private placement of 5,885,000 Common Shares at a price of \$4.25 per common share. The equity financing raised gross proceeds of \$25,011 and net proceeds of \$23,617 after issue costs of \$1,394. Inco acquired 731,150 Common Shares in the financing. Following the closing of the financing, Inco held an aggregate of 3,619,251 Common Shares and 250,000 share purchase warrants of the Company representing approximately 12.4% of the issued and outstanding shares of the Company (approximately 14.8% on a fully diluted basis – see note 5 to the audited consolidated financial statements for the year ended December 31, 2005).

(4) 101,800 Common Shares were issued at \$3.20 per share (\$326) to three Officers in respect of incentive stock grants contained in their employment contracts. Pursuant to these contracts the Company was obligated to issue 160,000 Common Shares. The obligation to issue 58,200 of those shares was cancelled in consideration of the Company making cash payments for income-tax-withheld.

## **SKYE RESOURCES INC.**

Notes to Consolidated Financial Statements

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- <sup>(5)</sup> 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, thereby satisfying the financing condition relating to the Fenix Option held by the Company under the Master Agreement. 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.

(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. Options may be granted for up to 10 years subject to such vesting terms and conditions as may be specified by the Board of Directors. At March 31, 2006, the maximum number of shares set aside for issuance pursuant to options granted is 4,608,241, being 20% of the 23,133,205 (i.e. 4,626,641) shares issued and outstanding at the time of the Annual and Special Shareholders' Meeting of the Company on May 26, 2005 less options of 18,400 that have been exercised subsequently.

**SKYE RESOURCES INC.**

Notes to Consolidated Financial Statements

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Stock option transactions are summarized below:

	Number of Shares	Exercise Price	Weighted Average Exercise Price
Outstanding December 31, 2004	1,585,000	\$ 0.68 - 5.25	\$ 3.55
Granted during 2005	940,000	2.90 - 4.38	3.18
Outstanding December 31, 2005	2,525,000	0.68 - 5.25	3.42
Granted during the period	455,000	6.65 - 7.45	6.78
Cancelled during the period	(8,750)	2.90 - 4.38	3.75
Exercised during the period	(18,400)	2.90 - 4.65	3.41
Expired during the period	(10,050)	2.90 - 4.65	4.64
Outstanding March 31, 2006	2,942,800	\$ 0.68 - 7.45	\$ 3.93

The weighted average fair value of options granted in the three months ended March 31, 2006 is \$3.56 (year ended December 31, 2005 is \$1.33).

Stock options outstanding at March 31, 2006 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	235,000	4.25
January 28, 2009	75,000	75,000	5.25
March 4, 2009	170,000	170,000	4.65
July 12, 2009	50,000	50,000	3.05
December 1, 2009	50,000	37,500	3.24
December 17, 2009	200,000	150,000	3.60
February 25, 2010	45,000	35,000	4.38
April 19, 2010	602,800	300,300	3.20
May 31, 2010	200,000	100,000	2.90
August 11, 2010	20,000	10,000	3.20
November 30, 2010	50,000	12,500	3.01
March 8, 2011	380,000	95,000	6.65
March 20, 2011	75,000	18,750	7.45
see <sup>(1)</sup> below	2,942,800	2,079,050	\$ 3.93

<sup>(1)</sup> Weighted average exercise price of the options exercisable at March 31, 2006 is \$3.65

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

	Three months ended March 31 2006	Year ended December 31 2005
Risk free interest rate	3.9%	3.9%
Annual dividends	\$ -	\$ -
Expected stock volatility	86.0%	65.0%
Expected life	2.5 years	2.5 years

(c) Share purchase warrants:

	Number of Shares	Exercise price	Expiry Date
Outstanding December 31, 2004	-	-	n/a
Warrants issued during 2005	3,910,000	\$5.75	March 24, 2007
Outstanding December 31, 2005	3,910,000	\$5.75	March 24, 2007
Warrants exercised during 2006	(84,100)	\$5.75	March 24, 2007
Outstanding March 31, 2006	3,825,900	\$5.75	March 24, 2007

During the year ended December 31, 2005 there were 3,910,000 share purchase warrants issued at a price of \$5.75 per share which were valued at \$4,803, the value of which was recorded in contributed surplus. During the three months ended March 31, 2006 a total of 84,100 share purchase warrants were exercised at a price of \$5.75 and cash of \$484 was received. As a result, \$103 was transferred from contributed surplus to share capital representing the value of the exercised warrants that was recorded in the year ended December 31, 2005.

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

	Three months ended March 31 2006	Year ended December 31 2005
Risk free interest rate	n/a	3.3%
Annual dividends	\$ -	\$ -
Expected stock volatility	n/a	81.0%
Expected life	n/a	2.0 years

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### 6. Related party transactions:

During the three months ended March 31, 2006, the Company had the following transactions with related parties:

- (i) paid or accrued \$nil (three months ended March 31, 2005 - \$13) for office administrative expenses to Quest Management Corp., a company with directors in common;
- (ii) paid or accrued \$nil (three months ended March 31, 2005 - \$13) for office rent to Quest Management Corp., a company with directors in common;
- (iii) paid or accrued \$38 (three months ended March 31, 2005 - \$50) to an officer (two officers prior to December 31, 2005) of the company for financial consulting services provided to the Company;
- (iv) paid or accrued \$nil (three months ended March 31, 2005 - \$63) to a company the principal of which is an officer of the Company for legal consulting services provided to the Company;

The transactions for services provided were in the normal course of operations and at commercial rates. The contract with Quest Management Corp. has been terminated.

As at March 31, 2006, accounts payable include \$13 (December 31, 2005 - \$17) currently due to related parties.

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 business and at commercial rates.

### 7. Commitments and contingencies

- (a) Generally under the Master Agreement (but subject to Amendment No. 1 referred to below), Inco is obligated to indemnify the Company for liabilities relating to environmental clean-up, remediation, and reclamation arising out of activities prior to December 15, 2004, provided no notice of claim may be given more than seven years after December 15, 2004. The condition of the existing mine and facilities will be set out in a baseline environmental site assessment ("ESA") that is being undertaken jointly by the Company and Inco.

Under the terms of Amendment Number 1 to the Master Agreement dated December 15, 2004 (supplemented by a Limited Mining Activities Protocol reached in 2005), if any one or more of the following occur at or on the Fenix Project:

- (i) Skye conducts any activities, without Inco's consent, acting reasonably, other than normal exploration activities or 'limited mining activities' (the removal of less than five tonnes of ore from the Fenix Project during any calendar year for the purpose of carrying out processing tests or running pilot or demonstration plants (in 2005, Skye was allowed to remove up to 25 tonnes pursuant to the Protocol)) which have the effect of measurably and adversely disturbing any area within the properties owned or controlled by CGN; or
- (ii) any sediment ponds or dams on the Fenix Project are measurably and adversely affected by any of Skye's activities or there is a physical breach of any such ponds or dams, which is not attributable to any joint responsibility of the Liaison Committee or any several responsibility of Skye or Inco in accordance with the Master Agreement,

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then Skye shall assume full responsibility for any and all environmental claims, liabilities, remediation and reclamation relating to any such disturbed areas and Skye shall indemnify Inco in respect thereof.

An estimate of the fair value of site closure and reclamation costs was made as at March 31, 2006 for land disturbed by exploration activities. Accordingly, a provision of \$625 (March 31, 2005 - \$Nil) (\$200 of which is included in accounts payable and accrued liabilities) has been established for reclamation obligations in respect of the estimated future site closure and mine reclamation costs for the Company's mineral properties. As soon as further reasonable estimates of the potential obligations for site closure and mine reclamation costs can be made, additional provisions or reductions will be made and the estimated change in net present value of future cash flows will be included with the purchase cost of mineral properties in the manner described above.

The following table presents the reconciliation of the beginning and ending aggregate carrying amount of the obligation associated with the retirement of the properties.

	Three months ended March 31 2006	Three months ended March 31 2005
Asset retirement obligation-beginning of period	\$ 600	\$ -
Liabilities incurred	22	-
Accretion expense	3	-
Asset retirement obligation-end of period	\$ 625	\$ -

The undiscounted amount of cash flows required over the estimated life of the underlying assets, to settle the obligation, adjusted for inflation, is estimated at \$700 (March 31, 2005 - \$Nil). The obligation was calculated using a credit-adjusted risk free discount rate of 4% and an inflation rate of 2%. It is expected that this obligation will be funded from general Company resources at the time the costs are incurred. Accretion expense for the three months ended March 31, 2006 was \$3 (March 31, 2005 - \$Nil). The Company has the benefit of an indemnity for its asset retirement obligation incurred prior to December 15, 2004 under the Master Agreement – see this note above - and has determined that for the period ended December 31, 2004 its asset retirement obligation was not significant.

- (b) The Company has entered into employment contracts with seven officers with aggregate annual base salary of \$1,325 (December 31, 2005 - \$925 for five officers). 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 termination the officers will receive two times their annual base salary as severance. On achieving certain milestones three of these officers will also earn up to 740,000 Common Shares of the Company at no additional cost.
- (c) The Company has entered into agreements with financial advisors that require, on the occurrence of certain future events, the payment of fees that will vary depending on the success achieved.

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### 8. 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:

	Three months ended March 31 2006	Three months ended March 31 2005
Canada		
Loss from operations	\$ 5,266	\$ 3,318
Equipment	86	45
Total assets	29,778	35,463
Guatemala		
Loss from operations	2,890	533
Equipment	266	-
Mineral property	9,815	9,190
Total assets	\$ 10,290	\$ 9,578

### 9. Supplementary Cash Flow Information

	Three months ended March 31 2006	Three months ended March 31 2005
Cash and cash equivalents consist of:		
Cash	\$ 369	\$ 15,886
Cash equivalents	29,000	19,393
	<u>\$ 29,369</u>	<u>\$ 35,279</u>

### 10. Risk

The Company's right to own the 70% interest in CGN acquired from Inco 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. Inco has the right to re-acquire the 70% interest it conditionally sold Skye 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 Fenix Option to proceed with an integrated mining and processing facility at the Fenix Project (see note 4).

### 11. Subsequent Events

As announced by the Company on April 21, 2006, the Fenix Exploitation Licence with an initial 25-year term plus a right of renewal for up to an additional 25-year period was issued to CGN by the Guatemalan Government in April 2006.

The Company's Common Shares were approved for listing on the TSX and commenced trading on May 09, 2006 under the symbol "SKR". As of the market close on May 8<sup>th</sup>, 2006, Skye's Common Shares no longer trade on the TSX Venture Exchange.