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FORM 51-102F1  
**MANAGEMENT DISCUSSION & ANALYSIS**  
FOR THE SIX MONTHS ENDED JUNE 30, 2006  
As of August 1, 2006

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## SKYE RESOURCES INC.

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### INTRODUCTION

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This Management Discussion and Analysis (the “MD&A”) contains references to Skye Resources Inc. and its subsidiaries (“Skye” or the “Company”) using words like “we” “us” and “our” and similarly we refer to the reader using words like “you” and “your”.

We have prepared the MD&A with reference to National Instrument 51-102 “Continuous Disclosure Obligations” of the Canadian Securities Administrators (“NI 51-102”). This MD&A covers the six months ended June 30, 2006, is prepared as of August 1, 2006, and should be read in conjunction with our consolidated financial statements for the year ended December 31, 2005 (audited) and the six months ended June 30, 2006 (unaudited). Unless otherwise stated, all amounts in this MD&A and in the audited and unaudited financial statements are expressed in Canadian dollars. We report our financial position, results of operations and cash flows in accordance with Canadian generally accepted accounting principles. Please also refer to the Cautionary Statement at the end of this MD&A.

At the date of this MD&A, our shares are listed on the TSX under the symbol “SKR”.

Additional information about Skye, including our continuous disclosure materials such as our annual and quarterly financial statements, is available through the SEDAR website at <http://www.sedar.com>.

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### OVERVIEW

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We are a development stage resource company with the objective of building a profitable nickel company. Our strategy is to:

- Assemble a seasoned, technically sophisticated management team;
- Acquire, evaluate and develop the Fenix Project in Guatemala;
- Acquire the rights to other good quality lateritic nickel deposits;
- Develop an improved leaching process; and
- Apply best practices in community relations and environmental management.

Skye is making excellent progress in implementing this strategy. The management team was initially assembled in early 2004, and we continue to strengthen it to meet the expanding needs of the Company. After entering into a letter of intent with Inco Limited (“Inco”) in November 2003 and a definitive Master Share Purchase Agreement with Inco in September 2004 (the “Master Agreement”), we closed in December 2004 our conditional acquisition from Inco of a 70% interest in Exploraciones y Explotaciones Mineras Izabal S.A., which changed its name effective January 2005 to Compañía Guatemalteca de Níquel, S.A. (referred to throughout this text as “CGN”). At the date of this MD&A, we own 92.4% of CGN – see the “Results of Operations” section below.

CGN is a Guatemalan company which holds an exploration license and an exploitation license covering certain nickel properties in eastern Guatemala and also owns a pyrometallurgical nickel

processing plant and related facilities that have been closed for approximately 25 years, but continuously maintained over that period. In April 2006, substantially all of its then Niquegua Norte exploration licence was converted into a 25-year renewable exploitation licence - see the "Results of Operations" section below. Built at a cost of US\$238 million in 1977, CGN operated the pyrometallurgical plant at the site over a period of approximately 40 months to 1980 producing a nickel matte for export. Since the plant shutdown, no mining activity has taken place on the CGN property.

Upon signing the Master Agreement with Inco, we initiated preparation of the preliminary assessment of CGN's nickel laterite project (hereinafter referred to as "Fenix") by Hatch Ltd. ("Hatch") and other consultants. On February 28, 2005 we received their preliminary assessment report investigating both smelting and atmospheric leaching process options for Fenix. Based on that report, we initiated in the second quarter of 2005 a feasibility study for a ferro-nickel operation at Fenix involving the refurbishment and expansion of the existing plant to produce about 50 million pounds of nickel annually in a ferro-nickel product. In April 2005, we began a drilling program on Fenix with the aim of validating selected existing resource data as well as conducting in-fill drilling to bring other saprolite material to at least the indicated category of resource classification. - see the "Results of Operations" section below. We are also undertaking a preliminary assessment of a further 50 million pound expansion using high pressure acid leaching. We have created and are providing initial funding to a community association which is focused on initiating sustainable community development in the region which would be impacted by the Fenix Project.

On March 24, 2005 we completed a private placement of 7,820,000 Units at \$4.10 each to realize gross proceeds of \$32,062,000. A further financing closed on February 21, 2006 with the issuance of 5,885,000 Common Shares of the Company at a price of \$4.25 per share, for total gross proceeds of approximately \$25,011,000. - see the "Liquidity and Capital Resources" section below. As a development stage resource company we earn no operating income and our only source of revenue is interest income.

In June 2005, we filed US and international non-provisional patent applications for our proprietary atmospheric sulfuric acid leaching process for nickel laterites. We completed pilot plant testing in 2005 to produce an intermediate nickel/cobalt product using samples from Fenix. The testing was successful. SGS Research Ltd's ("SGS") final report on the last phase of pilot plant testing was received on March 17, 2006, and the results were reported in a news release dated March 30, 2006. We have initiated discussions with major nickel industry participants regarding their interest in working with Skye to further develop this process through the funding of a demonstration plant and are considering how to proceed.

For the six months ended June 30, 2006 we reported a loss of \$14,651,000 (basic and diluted loss per share of \$0.53) compared to a loss of \$11,052,000 (basic and diluted loss per share of \$0.56) for the six months ended June 30, 2005. The loss for the six months in 2006 relates principally to exploration and development costs for the Fenix Project, the hydromet preliminary assessment, salaries and non-cash stock-based compensation expense. As at June 30, 2006, we had working capital of \$20,472,000, which includes a liability for accrued bonuses of \$858,000 payable at the discretion of the Board of Directors, and which was derived mainly from net proceeds of \$23,616,000 from the sale of the Company's Common Shares by private placement in February 2006. As at August 1, 2006 we had cash and cash equivalents of \$21,200,000.

Financial results are more fully described under "Summary of Quarterly Results".

At the Annual General Meeting of the Company's shareholders on May 16, 2006, three new Directors were elected to replace four who did not stand for re-election. The number of Directors now stands at five as reported in a press release dated April 19, 2006 and available on the SEDAR website at <http://www.sedar.com>.

On June 22, 2006, BHP Billiton PLC announced that their group of companies held 4,846,400 common shares representing a 16.5% interest in the then issued and outstanding common shares of the Company. On the same day, the Board of Directors of the Company issued a press release (available on the SEDAR website at <http://www.sedar.com>) which announced that they had approved the adoption of a Shareholder Rights Plan.

The following discussion, analysis and financial review comprise ten sections:

1. Results of operations
2. Summary of quarterly results
3. Liquidity and capital resources
4. Financial condition
5. Outlook
6. Risks
7. Transactions with related parties
8. Financial instruments
9. Outstanding shares, options and warrants
10. Cautionary statement

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## RESULTS OF OPERATIONS

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### *Conditional acquisition of the Fenix Project*

Under the terms of the Master Agreement and in consideration of conditionally acquiring Inco's 70% interest in CGN, we issued to Inco 1,888,101 Skye Common Shares, together with 198,665 common share purchase warrants exercisable at \$3 per share, and 5,098 common share purchase warrants exercisable at \$2 per share (all of which warrants expired on December 24, 2004 without being exercised). Pursuant to the Master Agreement we have a five year option period ("Fenix Option Period") to evaluate the technical and economic feasibility of CGN developing a nickel mining and processing project in the area covered by CGN's exploration and exploitation licenses (the "Fenix Option"). If we exercise the Fenix Option, a subsequent closing will occur at which time we will pay Inco U.S. \$3.5 million and issue approximately 1.75 million additional Common Shares (together the "Additional Consideration") to Inco in consideration for certain surface rights it holds through affiliates in Guatemala. The Additional Consideration is payable once we have fulfilled a number of conditions during the Fenix Option Period, including the preparation of a feasibility study and the completion of financings to raise an aggregate of \$20 million less the proceeds from the exercise of outstanding warrants (Note: this latter condition was satisfied on March 24, 2005 – see "Liquidity and Capital Resources" section below). In addition, Inco retained the right to receive certain payments based on the tonnages of ore mined from the concessions and, if a ferro-nickel plant is operated, will also receive certain payments on any ferro-nickel produced based on a net smelter return formula. Inco also agreed to market any finished nickel products, and will have certain rights to refine any intermediate nickel products of CGN. If certain conditions are not met by us during the Fenix Option Period or we elect not to exercise our Fenix Option, Inco will have the right to reacquire its interest in CGN for a nominal cost.

### *Funding and ownership of the Fenix Project*

Skye's interest in CGN has been increasing as the Government of Guatemala has to date elected not to fund its share of cash calls by CGN. Skye and the Guatemalan Government, as shareholders of CGN, are afforded the opportunity to receive *pro rata* additional shares in CGN by funding their proportionate share of cash calls and new shares are issued only to the shareholders that elect to provide such funding. At June 30, 2006 the Company's interest in CGN was 92.4%; an increase from the 90.9% ownership at December 31, 2005. The funds received by CGN from these cash calls have been expended on exploration and development which on consolidation are expensed as incurred.

### *Exploration and Resource Confirmation*

In April 2005, the Company initiated a diamond drilling program on Fenix designed in two phases. The first was a twin hole phase which was completed in June 2005. The second, larger phase of drilling aimed at providing more detailed information in previously drilled areas and improving confidence in these resources, was completed in January 2006. Drilling results were reported by news releases as they became available and were filed on the Sedar website at <http://www.sedar.com> and have been incorporated into Snowden's estimates of saprolite (see the "Resources of the Fenix Project" section below) and limonite resources. The saprolite resources will form the basis of the Fenix Project feasibility study.

Since January 2006, we have continued drilling to infill previously drilled areas not included in the Snowden resources estimates to continue to raise the level of confidence and quality of resources assessed and measured by current standards.

The following table outlines exploration expenditure for the three and six months ended June 30, 2006 and 2005:

	Three months ended		Six months ended	
	June 30 2006	June 30 2005	June 30 2006	June 30 2005
Exploration (000's)				
Salaries and consulting	\$ 283	\$ 327	\$ 582	\$ 420
Drilling	513	1,404	1,467	1,404
Sample preparation and assaying	241	35	789	44
Supplies, roads, maintenance, other	269	296	729	363
	<u>\$ 1,306</u>	<u>\$ 2,062</u>	<u>\$ 3,567</u>	<u>\$ 2,231</u>

### *Resources of the Fenix Project*

On July 4, 2006 the Company reported that it has received new resource estimates from Snowden Mining Industry Consultants Inc. ("Snowden") in support of Skye's Fenix Project feasibility study. Snowden has re-evaluated the saprolite resources for five of the Fenix deposits which contain a measured and indicated resource of 27.6 million tonnes grading 1.85 % nickel (at a 1.5% cut-off) with additional inferred resources of 7.0 million tonnes grading 1.65% nickel. A further 10 Fenix saprolite deposits, not re-evaluated by Snowden, contain measured and indicated resources of 35.8 million tonnes grading 1.81% nickel (at a 1.6% cut-off) and inferred resources of 48.2 million tonnes grading 1.64% nickel.

Skye has also received Snowden's estimates of the limonite resources at these five deposits. Snowden reports measured and indicated limonite resources of 33.1 million tonnes grading 1.18% nickel and 0.12% cobalt (at a 1.25 % Ni equivalent cut-off) with additional inferred resources of 7.4 million tonnes grading 1.10% nickel and 0.10% cobalt. In addition, there are 17.3 million tonnes of inferred limonite resources grading 1.30% nickel and 0.10% cobalt in one deposit not included in the Snowden estimate. The limonite resources at the other nine deposits have not yet been estimated. Limonite, while not suitable for treatment in the pyrometallurgical project which is the subject of the feasibility study, is presently being evaluated in the separate hydromet preliminary assessment of a 50 million pound per year expansion of the feasibility study project using high pressure acid leaching ("HPAL").

#### *Development of the Fenix Project*

The Company retained Hatch as the prime contractor to prepare a feasibility study for the Fenix Project. We estimate that the feasibility study will cost approximately \$9,000,000 and will be completed in the third quarter of 2006. A positive result and a successful financing of the project are two of several essential steps in the process to achieve production from the operation of a nickel mine and associated mineral processing facilities on the Fenix property – see "Risks" section below. Hatch has also been retained to prepare a preliminary assessment of a 50 million pound per year expansion using HPAL. HPAL was compared initially with Skye's proprietary atmospheric leaching process. It was decided to proceed with HPAL in the hydromet preliminary assessment due to enhanced cobalt credits and overall limonite and saprolite processing rates which matched more closely the quantities of limonite and saprolite in the Fenix deposits.

The following table outlines Fenix development costs for the three and six months ended June 30, 2006 and 2005:

	Three months ended		Six months ended	
	June 30 2006	June 30 2005	June 30 2006	June 30 2005
Fenix Development Costs (000's)				
Feasibility study	\$ 601	\$ 1,323	\$ 2,353	\$ 1,323
Hydromet preliminary assessment	691	-	777	-
Social and environmental assessments	929	15	1,799	85
Community relations	203	95	489	182
Fenix project preliminary assessment	-	-	-	304
Other Guatemalan-based expenditures	592	923	1,160	1,270
	<u>\$ 3,016</u>	<u>\$ 2,356</u>	<u>\$ 6,578</u>	<u>\$ 3,164</u>

#### *Social and environmental assessments*

Generally under the Master Agreement, 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 has been set out in a baseline environmental site assessment ("ESA") that was prepared jointly by the Company and Inco. – see note 2 (g), "Site closure and reclamation costs", to the Company's audited

consolidated financial statements for the year ended December 31, 2005, and note 7 (a), "Commitments and contingencies" to the Company's unaudited consolidated financial statements for the period ended June 30, 2006.

The Company is currently carrying out an environmental and social impact program that includes an environmental impact evaluation ("Evaluación de Impacto Ambiental" or "EIA") that must be approved by the Ministry of Environment and Natural Resources (Ministerio de Ambiente y Recursos Naturales or MARN) of the Government of Guatemala for the refurbishment and expansion of the ferro-nickel processing plant. The EIA was submitted to MARN in the second quarter of 2006 to comply with Guatemalan regulatory requirements. In addition to the EIA, the Company is gathering additional study information pertaining to public consultation and other policy and performance standards requirements of the World Bank Group and/or Equator-Principle-subscribing financial institutions (the "social environmental assessments" or "SEA"). The assessments are being overseen by Klohn Crippen Berger Ltd (supported by Consultoría y Tecnología Ambiental, S.A., a Guatemalan environmental consulting company). The estimated SEA (including the EIA) cost is approximately \$4,500,000.

Skye has focused on understanding and responding to community issues and concerns in enhancing relationships with the communities adjacent to the mining area. We have also created and are providing initial funding to a community association which is focused on initiating sustainable community development in the region which would be impacted by the Fenix Project.

#### *Technology*

We have made significant progress in developing an atmospheric leach process which could treat CGN's mineralized material at the Fenix Project and similar material elsewhere. Extensive laboratory pilot testing has been completed at SGS for the process to produce an intermediate nickel/cobalt product from nickel laterites and the Company has filed USA and international patent applications. Skye's proprietary process is capable of recovering nickel and cobalt from both limonite and saprolite nickel laterites which occur together in many deposits such as Fenix. The process takes place at atmospheric pressure and at relatively low temperatures, meaning that the conditions are quite benign relative to other process technologies. Under the Master Agreement, we have agreed to grant Inco certain rights to use at its own facilities on commercial terms, any process developed by us and used at the Fenix Project.

The two-phase pilot program to develop Skye's proprietary atmospheric leaching process for the production of a mixed nickel-cobalt hydroxide intermediate product has been completed. The work was carried out at SGS with encouraging results. The second phase of pilot tests on new bulk samples from the Fenix Project culminated in the integrated operation of the pilot plant through to the targeted intermediate product. The testing was successful. SGS's final report on the last phase of pilot plant testing was received on March 17, 2006 and the results were reported in a news release dated March 30, 2006.

In the six months ended June 30, 2006 \$113,000 (June 30, 2005 - \$2,701,000) was incurred on process technology – see the “Outlook” section below. The following table outlines process technology expenditure for the three and six months ended June 30, 2006 and 2005:

	Three months ended		Six months ended	
	June 30 2006	June 30 2005	June 30 2006	June 30 2005
Process Technology (000's)				
Pilot plant operations	\$ 9	\$ 871	\$ 96	\$ 2,620
Intellectual property costs	2	81	17	81
	<u>\$ 11</u>	<u>\$ 952</u>	<u>\$ 113</u>	<u>\$ 2,701</u>

#### *General and administration*

The following table outlines general and administrative costs for the three and six months ended June 30, 2006 and 2005:

	Three months ended		Six months ended	
	June 30 2006	June 30 2005	June 30 2006	June 30 2005
General and Administrative (000's)				
Salaries and employee benefits	\$ 921	\$ 1,194	\$ 1,938	\$ 1,651
Consulting	20	46	146	82
Professional fees	301	152	525	314
Investor relations	46	87	113	107
Office and other costs	294	162	623	352
	<u>\$ 1,582</u>	<u>\$ 1,641</u>	<u>\$ 3,345</u>	<u>\$ 2,506</u>

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#### SUMMARY OF QUARTERLY RESULTS

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We continued to work on the feasibility study for the mine/smelter project, the SEA, the exploration program, community relations initiatives and the preliminary assessment for the hydromet expansion of the Fenix Project.

Fenix development costs of \$3,016,000, exploration costs of \$1,306,000 and General and Administrative costs of \$1,582,000 this quarter are the major components of the loss of \$6,495,000. In the comparable quarter ended June 30, 2005, development was just getting underway following the acquisition of the Fenix Project and was \$660,000 lower at \$2,356,000. Exploration in the three months ending June 30, 2006 was \$756,000 lower than comparable quarter of 2005 due to reduced drilling activity at Fenix. The General and administrative expenses for the second quarter of 2005 were comparable to the current quarter at \$1,641,000. Process technology costs were lower in the current quarter at \$11,000 versus costs of \$952,000 in the same period a year earlier as the pilot program was substantially complete at the end of 2005.

The following table summarizes our quarterly results for the last eight financial quarters:

(\$000's except per share data)	Year Ended December 31 2006		Year Ended December 31 2005				Transition December 31 2004	Year Ended August 31 2004
	Q2	Q1	Q4	Q3	Q2	Q1		Q4
	Total Revenue	246	154	63	113	185	52	26
Expenses								
Fenix development	3,016	3,562	3,933	3,666	2,356	808	-	-
Exploration	1,306	2,261	3,706	1,899	2,062	169	297	21
Process technology	11	102	1,554	343	952	1,749	102	206
General and administrative	1,582	1,763	1,018	881	1,641	865	961	821
Project financing	194	104	-	-	-	-	-	-
Amortization	49	35	33	31	8	6	5	5
Stock-based compensation	583	483	382	146	367	306	220	628
Loss for the period	6,495	8,156	10,563	6,853	7,201	3,851	1,559	1,657
Per share	\$0.22	\$0.31	\$0.49	\$0.29	\$0.31	\$0.24	\$0.13	\$0.15

During each quarter in 2005 we worked on the exploration program, the environmental and social assessments program, the feasibility study for the mine/smelter project, community relations initiatives and continued the development of our proprietary atmospheric leach process. In the first six months of 2005, we completed a financing and the preliminary assessment of the Fenix Project.

During the four month Transition Period to December 31, 2004, we acquired a 70% conditional interest in CGN, initiated the preliminary assessment, raised additional financing through the exercise of outstanding warrants and continued development of our atmospheric leach process.

During the quarter ended August 31, 2004, we were incurring expenditures to reach agreement with Inco on CGN. We also initiated development of the hydromet technology and applied for provisional patents.

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## LIQUIDITY AND CAPITAL RESOURCES

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On March 24, 2005 we completed a private placement of 7,820,000 Units at \$4.10 each to realize gross proceeds of \$32,062,000 and net proceeds of \$29,883,000. Each Unit consisted of one common share and one-half of one common share purchase warrant. Each whole warrant entitles the holder to purchase one additional common share at a price of \$5.75 per share until March 24, 2007 – see “Outstanding Shares, Options and Warrants” section below.

On February 21, 2006 we completed a private placement of 5,885,000 Common Shares at \$4.25 each to realize gross proceeds of \$25,011,000 and net proceeds of approximately \$23,616,000. The proceeds will be used for the Fenix Project on exploration drilling, environmental and community relations expenditures, basic engineering, land purchases, early establishment of the

owner's project management team and other expenses to permit implementation of the Fenix Project following completion of the feasibility study, a preliminary assessment for the hydrometallurgical expansion and general and administrative including project financing costs.

In the six months ended June 30, 2006 a total of 272,600 warrants were exercised and \$1,568,000 received in cash leaving 3,637,400 warrants outstanding at June 30, 2006. No change has occurred since that date to the date of this MD&A. If all the outstanding warrants are exercised prior to expiry, we will receive an additional \$20,915,050.

As at the date of this MD&A, our contractual obligations are summarized as follows.

Contractual Obligations (000's)	Payments due by period				
	Total	< 1 year	1 - 3 years	4 - 5 years	> 5 years
Long-term debt	\$ -	\$ -	\$ -	\$ -	\$ -
Capital lease obligations	22	5	17	-	-
Operating leases	61	61	-	-	-
Purchase obligations	4,592	4,558	34	-	-
Other long term obligations <sup>1</sup>	22,942	-	-	22,942	-
	<u>\$ 27,617</u>	<u>\$ 4,624</u>	<u>\$ 51</u>	<u>\$ 22,942</u>	<u>\$ -</u>

<sup>1</sup> Obligations are contingent upon a positive decision to exercise the Fenix Option – see “Conditional acquisition of the Fenix Project” above.

We have entered into certain employment contracts with eight of our officers resulting in an aggregate annual compensation of approximately \$1,600,000. In addition to their annual remuneration payable under these contracts, bonuses and stock options may be paid or granted at the sole discretion of the Board of Directors. Also, on achieving certain milestones, three of these officers may be issued up to 660,000 shares issuable if and when certain milestones are achieved. At June 30, 2006 \$272,000 has been accrued to cover the cost of certain of the grants of Common Shares.

At August 1, 2006, there were 3,171,250 stock options to purchase shares outstanding with a weighted average exercise price of \$4.49 per share. The stock options expire between November 16, 2007 and July 24, 2011 (see “Outstanding Shares, Options and Warrants” below for more details).

Our cash and cash equivalents balance as of August 1, 2006 was approximately \$21,200,000 compared with \$13,378,000 at December 31, 2005. The significant increase relates to the financing we closed on February 21, 2006 mentioned above.

Our current cash balance is adequate until the end of 2006 to fund planned corporate and administrative expenses and expenses related to the feasibility study, the preliminary assessment for a hydromet expansion of Fenix – see the “Outlook” section below, the exploration program and certain project implementation costs. Thereafter, to continue development of the Fenix Project, we will need to raise additional funds. However, the availability of these funds is not guaranteed and will be contingent upon a number of factors including the condition of the equity and debt markets at the time they are required.

We do not have any off-balance sheet arrangements except that the Company has the benefit of an indemnity from Inco under the terms of the Master Agreement in respect of the Company's site closure and reclamation obligations incurred by CGN prior to December 15, 2004 – see note 10 (a) to the Company's consolidated audited statements for the year ended December 31, 2005 and note 7 (a) to the Company's consolidated unaudited statements for the period ended June 30, 2006.

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## FINANCIAL CONDITION

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The Company's financial condition at the date of this MD&A improved substantially over the most recently completed financial year end, December 31, 2005, due to the receipt of net proceeds of approximately \$23,616,000 from the private placement of its Common Shares on February 21, 2006 – see "Liquidity and Capital Resources" section above. Our working capital of \$20,472,000 at June 30, 2006, including the net proceeds of \$23,616,000, is sufficient to meet the Company's known obligations at the date of this MD&A.

In 2005, the Company and its subsidiaries entered into contracts for the SEA, the exploration drilling program, the feasibility study and the process technology pilot plant research program. In 2006, Skye has entered into an agreement for the preliminary assessment of the expansion of Fenix using HPAL and 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. We have also entered into an agreement with an energy consultancy firm to develop a strategic approach to the pursuit of a long-term contract(s) aimed at achieving a cost-competitive electricity supply for the Fenix Project – see the "Liquidity and Capital Resources" section above for more information on commitments and contingencies.

The Company holds mineral properties with a cost of \$9,840,000 at the date of this MD&A (\$9,790,000 at December 31, 2005) representing the conditional acquisition of the 70% indirect interest in the mineral properties owned by CGN plus a provision of \$610,000 (\$600,000 at December 31, 2005) to cover the estimated present value of reclamation obligations. Since December 2004, the Company's indirect interest in the mineral properties has increased to 92.4%. However, no cost of the increased ownership has been capitalized as the funds invested indirectly in CGN that gave rise to the increased ownership were used by CGN for its corporate purposes (for example, exploration costs for the Fenix Project) and expensed on consolidation of the group's combined financial statements. The additional interest was acquired by the Company after June 30, 2005 and is owned by it without any obligation to Inco and is not subject to the Master Agreement nor does it form a part of the Fenix Option. If the Company fails to meet all the conditions for the exercise of the Fenix Option under the terms of the Master Agreement or fails to exercise the Fenix Option, the value of the mineral properties to the Company will be severely impaired or zero – see the "Outlook" and "Risks" sections below.

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## OUTLOOK

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The Company is working to complete the Fenix Project feasibility and companion studies in the third quarter of 2006 to establish the economic and technical viability of the Fenix Project. This will allow us to consider strategic options including evaluating a production decision and also a decision on the exercise of the Company's Fenix Option under the terms of the Master

Agreement with Inco – see “Results of Operations” section above where the conditional acquisition of CGN and the Company’s Fenix Option to complete the acquisition are more fully described, and the “Risks” and “Cautionary Statement” sections below. Skye has engaged a project finance advisor and is initiating its efforts to identify the means to finance the required capital to carry out the Fenix Project development program and subsequent operations in the event a positive production decision is made.

In 2006 we initiated a preliminary assessment study to double the capacity of the Fenix Project beyond that contemplated in the Fenix feasibility study by utilizing hydrometallurgy to process the limonite. The estimated cost of the preliminary assessment study is \$2 million and it should be completed in the third quarter of 2006.

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## RISKS

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Mineral exploration, mining and processing activities involve a high degree of risk. There are several factors that may cause actual results to differ materially from the forward looking information included herein, including the following:

*Exploration and Development Risk.* The exploration and development business is inherently risky and few projects actually become operating mines. CGN does not have proven or probable mineral reserves and substantial expenditures on exploration and a feasibility study are required to prove mineral reserves. It is not certain that the feasibility study will support a positive decision to develop and operate a nickel mine and associated mineral processing facilities on the Fenix property and, consequently, may not support a decision to exercise the Company’s Fenix Option to complete the purchase of the CGN shares or a minimum realizable value of the Company’s mineral properties of \$9,840,000 at June 30, 2006.

*Master Agreement with Inco.* There is no guarantee that we will satisfy all the conditions during the Fenix Option Period of the Master Agreement entered into as of December 15, 2004 and thereafter be in a position to exercise the Fenix Option and complete the acquisition of a 70% interest in the Fenix Project.

*Development Stage Company.* We are a development stage company with no history of operating revenues or pre-tax profits. There can be no assurance that our operations will be profitable in the future. We may not be able to complete the engineering and construction of the facility at the costs and in the time frames estimated in the preliminary assessment and later in the feasibility study, and we may not be able to operate that facility at the design throughput and at unit costs of production estimated in those studies.

*Permits.* There is no guarantee that we will obtain all the required permits. (see “Foreign Property” below) Without the necessary permits the Fenix Project would not proceed.

*Financing.* Exercising the Fenix Option, constructing the mine and beginning operations will require substantial financial resources that, in part, will be denominated in foreign currencies. There is no guarantee that we will find the necessary financial resources to construct and operate the Fenix Project and there is no assurance that adverse changes in currency exchange rates will not degrade those resources prior to spending.

*Nickel Prices.* The future price of nickel dictates the economics of any nickel project. Nickel prices have historically fluctuated widely and there is no guarantee that future nickel prices will be sufficiently high to allow for an adequate return on Fenix or justify its development – see the sub-paragraph entitled “The Nickel Market” in the “Overview” section of the Company’s MD&A for the year ended December 31, 2005.

*Foreign Property.* CGN is located in Guatemala and as such is susceptible to certain risks including currency fluctuations, political or financial instability, exchange controls, changes in taxation, aboriginal issues, third party land claims, property title defects, changes in mining and labour regulations, import and export controls, changes in permit and licensing requirements, delays in the issuance of permits, embargos, expropriation, and environmental issues all of which may adversely impact our business.

*Environmental Risk.* Mining and minerals processing activities have a potential impact on the quality of land, air and water and on the current and future use of land and water resources. We will demonstrate leadership in the protection of the environment and employ best practices but there is no guarantee of success. There is no guarantee that the Company will receive the necessary environmental permits and approvals from the Government to proceed with the construction and operation of the Fenix Project.

*Community Risk.* Our exploration, mining and processing operations will have an impact on the communities in which they are situated and depend for their success on the support of those communities. We are committed to consulting and working constructively with local communities on such issues as safety and health, opportunities for local people and long term sustainability but there is no guarantee of receiving the support of these communities.

*Property, Equipment and Personnel.* Due to market conditions, the availability and cost of suitable personnel, land and equipment with which to conduct the exploration, construction and operation of a nickel mine and associated mineral processing facilities may cause exploration and construction costs to rise and could delay the start of construction and operations. The Company’s property, equipment and personnel may also be subject to earthquake, fire, heavy wind and extreme rain conditions from time to time and the possibility of damage and associated costs arising from such adverse conditions and associated developments. The Company’s Fenix Project and its related property and equipment are uninsured.

*Competition.* We compete with many other resource companies that are engaged in the search for and acquisition of mineral resource properties and experienced personnel to explore, construct and operate these properties. Most of our competitors are more established and better financed than we are and therefore there is no guarantee that we will be successful in acquiring other properties and capable personnel necessary to develop a successful operation.

*Technical Risk.* There is no certainty that the hydrometallurgical process we have been developing will work or that we will use it at Fenix or elsewhere. We have filed US and international patent applications for our hydrometallurgical processes but there is no guarantee that these patents will be granted and that implementation of such processes will not infringe, or be alleged to infringe, an existing patent. Financing of development utilizing Skye’s hydrometallurgical process is not guaranteed.

*Energy Cost.* Mining and processing operations are energy intensive and sensitive to the high cost of energy. The economics of Fenix could be compromised as a result of high energy costs.

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## TRANSACTIONS WITH RELATED PARTIES

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During the six months ended June 30, 2006, the Company had the following transactions with related parties:

- (i) paid or accrued \$nil (six months ended June 30, 2005 - \$24,000) for office administrative expenses to Quest Management Corp., a company which had directors in common;
- (ii) paid or accrued \$nil (six months ended June 30, 2005 - \$13,000) for office rent to Quest Management Corp., a company which had directors in common;
- (iii) paid or accrued \$75,000 (six months ended June 30, 2005 - \$119,000) 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 (six months ended June 30, 2005 - \$63,000) to a company the principal of which is an officer of the Company for legal consulting services provided to the Company;

As at June 30, 2006, accounts payable include \$13,000 (December 31, 2005 - \$17,000) currently due to related parties. As at the date of this MD&A, accounts payable include \$37,000 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. The contract with Quest Management Corp. has been terminated.

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**FINANCIAL INSTRUMENTS**


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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 but these amounts are placed with a major Canadian bank where the risk is minimal; however they are exposed to a decline in purchasing power outside Canada. The Company is not exposed to interest rate risk due to the short term maturity of the financial instruments.

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**OUTSTANDING SHARES, OPTIONS AND WARRANTS**


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As of the date of this MD&A we had the following Common Shares, share purchase options and share purchase warrants outstanding:

**Common Shares Outstanding** 29,454,955  
 (Does not include 660,000 incentive stock grants to three officers of the company - see Liquidity and Capital Resources)

Options: Expiry Date	August 1, 2006		Exercise Price
	Outstanding	Exercisable	
November 16, 2007	100,000	100,000	\$ 2.90
November 16, 2007	280,000	280,000	3.30
November 16, 2007	10,000	10,000	4.25
November 30, 2007	25,000	25,000	3.30
November 30, 2007	15,000	15,000	4.38
November 27, 2008	100,000	100,000	0.68
December 9, 2008	385,000	385,000	3.30
January 2, 2009	225,000	225,000	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	50,000	3.24
December 17, 2009	200,000	200,000	3.60
February 25, 2010	20,000	15,000	4.38
April 19, 2010	601,250	450,000	3.20
August 11, 2010	20,000	10,000	3.20
November 30, 2010	50,000	25,000	3.01
March 8, 2011	380,000	95,000	6.65
March 20, 2011	75,000	18,750	7.45
May 17, 2011	200,000	50,000	8.28
July 10, 2011	65,000	16,250	8.90
July 24, 2011	75,000	18,750	10.30
	<b>3,171,250</b>	<b>2,383,750</b>	
<b>Warrants:</b>			
March 24, 2007	3,637,400		\$ 5.75

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## CAUTIONARY STATEMENT

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This document may contain or refer to certain forward-looking statements relating but not limited to our expectations, intentions, plans and beliefs. Forward-looking information can often be identified by forward-looking words such as “anticipate”, “believe”, “expect”, “goal”, “plan”, “intend”, “estimate”, “may” and “will” or similar words suggesting future outcomes, or other expectations, beliefs, plans, objectives, assumptions, intentions or statements about future events or performance. Forward-looking information may include reserve and resource estimates, estimates of future production, unit costs, costs of capital projects and timing of commencement of operations, and is based on current expectations that involve a number of business risks and uncertainties. Factors that could cause actual results to differ materially from any forward-looking statement include, but are not limited to, failure to establish estimated resources and reserves, the grade and recovery of ore which is mined varying from estimates, capital and operating costs varying significantly from estimates, delays in obtaining or failures to obtain required governmental, environmental or other project approvals, inflation, changes in exchange rates, fluctuations in commodity prices, delays in the development of projects and other factors. Forward-looking statements are subject to risks, uncertainties and other factors that could cause actual results to differ materially from expected results. You should be aware that these statements are subject to known and unknown risks, uncertainties and other factors that could cause actual results to differ materially from those suggested by the forward-looking statements. You are cautioned not to place undue reliance on forward-looking information. By its nature, forward-looking information involves numerous assumptions, inherent risks and uncertainties, both general and specific, that contribute to the possibility that the predictions, forecasts, projections and various future events will not occur. We are under no obligation to publicly update or otherwise revise any forward-looking information whether as a result of new information, future events or other such factors which affect this information, except as required by law.

All subsequent written and oral forward looking statements attributable to the Company or persons acting on its behalf are expressly qualified in their entirety by this notice.