X·TERRA

RESOURCES CORPORATION

ANNUAL REPORT 2008

X-TERRA RESOURCES CORPORATION
(the "Company" or "X-Terra")

MANAGEMENT DISCUSSION AND ANALYSIS
("MD&A")
(FORM 51-102F1)

FOR THE YEAR ENDED DECEMBER 31, 2008
(the "Period")

The Company prepares its financial statements in accordance with Canadian generally accepted auditing standards ("GAAP"). The following management's analysis of X-Terra's operating results and financial position should be read in conjunction with the audited consolidated financial statements of the Company for the years ended December 31, 2008 and 2007 and the related notes thereto. It was prepared in accordance with Regulation 51-102, *Continuous Disclosure Obligations*, and was approved by our Company's Board of Directors. Unless otherwise indicated, all amounts in this MD&A are in Canadian dollars. Management is responsible for the preparation of the consolidated financial statements and other financial information relating to the Company included in this report.

The Board of Directors is responsible for ensuring that management fulfills its responsibilities for financial reporting. In furtherance of the foregoing, the Board has appointed an Audit Committee composed of three directors, who are independent and not members of management. The Committee meets with management and the auditors in order to discuss results of operations and the financial condition of the Company prior to making recommendations and submitting the financial statements to the Board of Directors for its consideration and approval for issuance to shareholders. On the recommendation of the Audit Committee, the Board of Directors has approved the Company's financial statements.

DATE

This MD&A is prepared as at April 30, 2009.

OVERALL PERFORMANCE

Description of Business

X-Terra, an exploration stage company, is in the business of acquiring, exploring and developing mining and energy properties. It has interests in properties at the exploration stage located in Canada. The Company is in the process of exploring its mining property interests and has not yet determined whether they contain mineral deposits that are economically recoverable.

The Company capitalizes property acquisition and exploration expenditures relating to mineral and oil and gas properties in which it has an active interest. In the event that such properties become inactive or prove uneconomic, they are written-off. Any reference in this document to "properties" means any mineral resources and oil and gas properties in which the Company has earned or in the future may earn an interest.

X-Terra has been very active in 2008, the new management in place brought;

- A 5M$ private financing at a price of 1.00$ per unit;
- Three shale gas projects and one uranium project in the Company's portfolio of properties;
- Farm out deal with Brownstone Ventures;
- Experienced members on board (Richard Patricio and Martin Dallaire in 2008 and Sheldon Inwentash by the beginning of 2009);
- A senior financial officer in the management team - Mr. Sylvain Champagne as member on board and the CFO; and ;
- The institution of a normal course issuer bid – share buyback program.

The Company is a reporting issuer in British Columbia, Alberta, Manitoba and Ontario and is traded on the TSX Venture Exchange ("TSX-V"), under the symbol XT. It also trades on the Frankfort and Berlin Exchanges in Europe under the symbol DFUA. At the annual and special meeting of shareholders held on August 27, 2008 in Rouyn-Noranda, Québec, shareholders approved a special resolution authorizing the continuance of X-Terra under the Canada Business Corporations Act. On September 4, 2008, X-Terra obtained a Certificate and Articles of Continuance under the Canada Business Corporations Act, rendering the continuance effective.

X-Terra has instituted a normal course issuer bid through the facilities of the TSX Venture Exchange. Under the normal course issuer bid, which is effective from September 15, 2008 to September 14, 2009, X-Terra may repurchase for cancellation a maximum of 612,250 common shares over a 12-month period, representing approximately 5% of the "public float" of X-Terra's shares outstanding as at September 3, 2008. Purchases of common shares under the normal course issuer bid have been made at market prices and otherwise in accordance with the policies of the TSX Venture Exchange. X-Terra did not purchase any common shares during the twelve months preceding the normal course issuer bid.

The normal course issuer bid has been instituted in that X-Terra considers that the repurchase of common shares at certain market prices is beneficial to X-Terra. The normal course issuer bid is conducted through Desjardins Securities Inc. To the knowledge of X-Terra, no director or senior officer of X-Terra or their associates or affiliates currently intends to sell shares of X-Terra during the course of the normal course issuer bid.

For the year ended December 31, 2008, X-Terra purchased 291,500 common shares pursuant to the normal course issuer bid for a total amount of $116,110. As at December 31, 2008, 50,000 of these repurchased shares are still considered issued but not outstanding.

Shareholders may, upon request to X-Terra, obtain at no cost a copy of the "Notice of Intention to Make a Normal Course Issuer Bid" filed by X-Terra with the TSX Venture Exchange.

PROPERTIES

1. Energy Properties

Lindsay Property

The 100% owned Lindsay property comprises ther former Villedieu and Lindsay properties which have been combined because they are contiguous.

The Lindsay gold-uranium-rare earth element project is located approximately 125 kilometres south of Rouyn-Noranda, Quebec and 70 kilometres east-northeast of North Bay, Ontario, along the provincial border, halfway between the Elliot Lake uranium camp and the Abitibi gold belt, within the Grenville front. The project consists of 26 unpatented mining claims (1,534 hectares) in Villedieu Township. The Lindsay project is an early stage exploration project with historical uranium and rare-earth-element occurrences and economic potential for these commodities.

The property is underlaid by gneiss derived from a mature sequence of detrital and chemical metasedimentary rocks called the Kipawa formation that has been metamorphosed to upper amphibolite facies (Rive 1973b). The Kipawa alkaline intrusive complex is situated immediately north of the property and this plutonic mass could extend to the south of the property. The composition and texture of the complex is heterogeneous. Three principal internal units are present: a syenitic-monzonite facies; a banded mafic gneiss facies; and a peralkaline granite facies. The discovery of uranium and gold mineralization at Hunter's Point in 1957 increased uranium exploration in the Kipawa region. Since then, several mining companies have sporadically undertaken exploration work in the region. The increased price of uranium over the last several years (presently around $42US/pound; http:www.uxc.com/review/uxc_prices.aspx) has reinvigorated interest in uranium exploration in this region. Many companies are currently active in this sector. More recently, many mining companies have undertaken major exploration work in the region. The gold producer, Aurizon Mines Ltd.(TSX:ARZ), has carried out a magnetic, electromagnetic and airborne radiometric survey, covering a vast territory of this sector. In addition, a till sampling survey was conducted by Aurizon Mines in the regions considered most favourable for gold mineralization. This survey has defined four trends of gold dispersion utilizing the analysis of heavy mineral concentrates. The northeast dispersion trend of gold in heavy mineral concentrate is located immediately to the northwest of the property and is evident along the length of a major geological structure in a northwest direction that covers the property at its centre. The heavy mineral concentrates have yielded analyses of more than 0.1 g/T of gold in 27% of samples, including analyses of 1.3 g/T and 2.0 g/T of gold. On February 2009, Aurizon reports encouraging rare earth frilling results, they drilled 104 meters of 0.063% REE+Y at Kipawa. The company spent close $300,000 in exploration work on this property in 2008.

The 2008 exploration program has consisted of exploration and 76 till samples on a 1,000-metre-by-500-metre grid, conducted on a portion of the area covered by the government airborne survey. The objective of the till sampling was to delineate isolated heavy mineral concentrate gold anomalies.

Gold:

- One sample returned 1.22 grams per tonne (g/t);
- Four samples over 0.2 g/t or 200 parts per billion;

- One sample between 100 to 200 ppb;
- Eighteen samples between 21 to 50 ppb.

To view a location map of the 1,490-hectare claim blocks, please visit the Company's website. The 2009 exploration program will consist of MMI (Mobile Metal Ion) work. The MMI is a totally integrated geochemical approach to precious metal, base metal and kimberlite exploration. The 2008 exploration program was carried out under the supervision of Laurent Hallé, geologist and qualified person as per National Instrument 43-101.

Cool Lake Property (39 claims)
This 100% owned project area occurs within sedimentary and granitoid-dominated parts of the Pontiac subprovince in the eastern Superior Province of the Canadian Shield. Approximately 15-20 km south-southwest of the project area, a large Archean supracrustal belt, the Belleterre-Anglier greenstone belt (BAG) also occurs within the Pontiac subprovince. The BAG is the most southerly greenstone belt in the Superior Province, lying approximately 100 kilometres south of Abitibi greenstone belt of Rouyn-Noranda-Val d'Or area and immediately north of Grenville Front (Proterozoic Grenville Province). Both volcano-sedimentary and various granitoid rocks are present but volumetrically, the latter are dominant, especially in the western-half of the property. The granitic rocks, which host the uranium and other associated rare-elements, are widely distributed in this area. Granitoid rocks mainly comprise monzonite, monzodiorite, pegmatite granite, pegmatite dikes, syenite and granodiorite, in the decreasing order of abundance.

Although main focus of this project is to find economic grade uranium, there is also high potential for rare-element minerals that contain tantalum, niobium and possibly cesium. Tantalum, in particular, is a valuable commodity with a wide variety of industrial applications, most notably in the computer and steel sectors. The Cool Lake property is a still a "grass root" property and the 2008 exploration program has consisted mainly of prospection and geophysics. The data accumulated over the summer will be compiled during fall and then a map will be published on the Company website. Exploration works of approximately $30,000 have been done on the Cool Lake property in 2008. A ground radiometric survey is planned for summer 2009.

2. Shale gas properties

Rimouski, Rimouski North and Shawinigan Properties (8 permits)
Oil and gas exploration in Québec has been ongoing for the last 140 years. Notable gas discoveries include the Quaternary Pointe-du-Lac Gas Field, the Ordovician age St. Flavien Gas Field, and the Devonian Silurian Galt gas discovery near the town of Gaspé. Oil discoveries include the Port-au-Port oil discovery in Newfoundland and minor oil accumulation at Haldimand, near Gaspé. While the province is known to be petroliferous, the discoveries have been modest. Reservoirs can be found in the Cambrian, Ordovician, Silurian, Devonian and the Quaternary. Up until the "discovery" of the Utica Shale plays, most oil and gas accumulations in the area were conventional.

X-Terra Resources' management has decided to position itself in the Shale gas play in Québec and acquired three (3) large properties. An exhaustive compilation is currently in progress and a 50/50 farm out deal has been finalized in October 2008 with a well known oil and gas networked partner/operator named Brownstone Ventures Inc ("Brownstone"). On October 28, 2008 X-Terra entered into agreement with Brownstone pursuant to which Brownstone acquired a 50% interest in the exploration licences in exchange for the issuance to X-Terra of 2,000,000 common shares and 2,000,000 common shares purchase warrants. The maps are available on the Company's website at www.xterraresources.com.

In the coming weeks and in collaboration with its partner Brownstone, the Company will put in place an exploration budget and strategy for 2009-2010.

SUMMARY OF ANNUAL AND QUARTERLY INFORMATION

Comparative figures
Certain comparative figures have been reclassified to conform to the presentation adopted for the year ended December 31, 2008.

Selected Annual Information and Operation Results

The following table sets forth a comparison of revenues and earnings (audited) for the previous three most recently completed financial years:

	December 31, 2008	December 31, 2007	December 31, 2006
	($)	($)	($)
Interest income	76,555	7,993	-
Income (loss)	153,212	(291,418)	54,332
Income (loss) per share	0.02	(0.06)	0.01
Total assets	6,612,230	1,511,778	14,097
Total long-term financial liabilities	-	-	-
Cash dividends declared	-	-	-

Due to its field of activity, the Company does not generate revenue on a regular basis and must continually issue shares in order to insure the financial means for mining and oil and gas projects and its everyday transactions. During the fiscal year 2008, the Company registered a net income of $153,212 in comparison with the net loss registered for the fiscal year 2007 at $291,418. The Company has recorded interest income of $76,555 ($7,993 in 2007), gain on sale of oil and gas properties of $835,766 (2007 - nil) and unrealized loss on short-term investments of $12,090 (2007 - nil). There is no future income tax recovery in 2008 (2007 - $86,000). The difference regarding the interest revenue is mainly due to the liquidity increasing. The gain on sale of oil and gas properties was calculated net of the book value of the 50% interest in the exploration licences sold to Brownstone. The Company's administrative expenses for 2008 are at $747,019 (2007 - $384,501) and include stock-based compensation of $256,520 (2007 - $71,940). Professional fees have decreased from $137,709 in 2007 to $93,214 in 2008 mainly due to the decreasing of the legal fees from $109,155 in 2007 to $54,821 in 2008. General administrative expenses have greatly increased and went from $114,909 in 2007 to $343,124 in 2008 mainly due to the consulting fees which went from nil in 2007 to $58,000 in 2008, and management and administrative fees which went from $70,314 in 2007 to $194,340 in 2008 and show more activities in the Company. Allocated sums for transfer agent and regulatory fees have decreased from $39,580 in 2007 to $27,580 in 2008. The other administrative expenses remained relatively stable, are cyclical and may fluctuate according to the events, which are not always predictable.

Summary of Quarterly Results and Fourth Quarter

The following table sets forth a comparison of selected quarterly financial information for the previous eight quarters:

Period	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Years	2008	2008	2008	2008	2007	2007	2007	2007
Current assets	5,233,450	4,898,577	618,524	457,584	488,484	238,055	357,382	8,385
Mining and oil and gas properties	988,074	996,034	989,757	976,521	975,864	975,500	544,500	-
Current liabilities	59,180	215,529	72,054	75,628	51,222	37,354	70,311	236,022
Shareholders' Equity (Deficiency)								
Share Capital	26,191,429	26,413,577	23,732,912	23,195,520	23,195,520	23,117,511	22,712,011	21,813,127
Deficit	(22,625,731)	(23,367,883)	(23,124,202)	(22,839,872)	(22,778,943)	(22,827,604)	(22,732,264)	(22,501,618)
Income (loss) for the period	742,152	(243,681)	(284,330)	(60,929)	48,661	(95,340)	(230,646)	(14,093)
Working capital (deficit)	5,174,270	4,683,048	546,470	381,956	437,262	200,701	287,071	(227,637)
Basic and diluted income (loss) per share	0.06	(0.02)	(0.04)	(0.00)	0.01	(0.02)	(0.06)	(0.00)

Fourth Quarter

During the three months period ended December 31, 2008, the Company registered a net income of $742,152 in comparison with the net income registered for the quarter ended December 31, 2007 at $48,661. The Company has recorded, for the quarter ended December 31, 2008, interest income of $34,982 ($4,429 for the quarter ended December 31, 2007), gain on sale of oil and gas properties of $835,766 (nil for the quarter ended December 31, 2007) and unrealized loss on short-term investments of $12,090 (nil for the quarter ended December 31, 2007). The Company registered no future income tax recovery for the last quarter of 2008 in comparison of $86,000 registered for the last quarter of 2007. The difference regarding the interest revenue is mainly due to the liquidity increasing. The Company's administrative expenses for the quarter ended December 31, 2008 are at $116,506 ($41,768 for the quarter ended December 31, 2007). Professional fees have increased from $2,754 for the quarter ended December 31, 2007 to $21,348 for the quarter ended December 31, 2008. General administrative expenses have greatly increased and went from $31,559 for the quarter ended December 31, 2007 to $85,452 for the quarter ended December 31, 2008 and is mainly due to the management and administrative fees which went from $22,905 for the quarter ended December 31, 2007 to $57,855 for the quarter ended December 31, 2008 and show more activities in the Company. The other administrative expenses for the last quarter of 2008 remained relatively stable, are cyclical and may fluctuate according to the events, which are not always predictable.

Stock-based compensation is a non-cash item, resulting from the application of the Black-Scholes option pricing model using assumptions for expected dividend yield, average risk-free interest rates, expected life of the options and expected volatility.

Mining and Oil and Gas Projects

For the year ended December 31, 2008, the Company has spent $330,021 in deferred exploration expenses.

Properties	Undivided interest	Deferred expenses as at December 31, 2007	Expenses for 2008	Future goals
	%	$	$	
Lindsay	100	47,430	299,435	Identify trends for gold dispersion and uranium prospection.
Cool Lake	100	-	29,993	Identify trends for gold dispersion and uranium prospection.
Rimouski	50	-	593	Put in place an exploration budget and strategy for oil and gas prospection and rare-element minerals for 2009-2010.

Liquidity and Capital Resources

As at December 31, 2008, the Company had a working capital of $5,174,270 (2007 – $437,262), which included cash and cash equivalents of $4,296,385 (2007 – $472,356). The Company has finished, as expected, to spend the entire amount of $320,000 before December 31, 2008 regarding the flow-through financing completed on October 3, 2007.

As at December 31, 2008, the Company had stock options outstanding allowing for the purchase of up to 115,000 common shares at $1.10 per share until June 2012, 437,500 common shares at $1.90 per share until June 2013 and 270,000 common shares at $1.00 per share until August 2013. The exercise of all the share purchase options represent an added potential financing of $1,227,750. The exercise of 6,609,999 warrants and brokers' options outstanding represent a potential financing of $8,881,665. These warrants and brokers' options expire in May and October 2009, and July 2010 and have an exercise price between $0.70 and $1.50.

During 2008, X-Terra has purchased 291,500 common shares for a total amount of $116,110 pursuant to the normal course issuer bid from which 241,500 have been cancelled as at December 31, 2008 and 50,000 by the beginning of January 2009.

On July 11, 2008 the Company has completed a private placement of 5,000,000 units at a deemed price of $1.00 per unit, for cash consideration of $5,000,000. Each unit consists of one common share and one common share purchase warrant. Each purchase warrant entitles its holder to purchase one additional common share of X-Terra at a price $1.50 for two years. PowerOne Capital Markets Limited acted as agent for the private placement. In connection with the private placement, X-Terra paid a cash commission to PowerOne in an amount equal to 8% of the gross proceeds of the private placement, and issued brokers' options to PowerOne, entitling it to purchase 400,000 units at a price of $1.00 per unit for a period of two years after the closing of the private placement. Each unit will be comprised of one common share and one common share purchase warrant. Each warrant will entitle its holder to purchase one additional common share of X-Terra at a price $1.50 for two years from the closing of the private placement.

Even if the Company has closed a private financing of $5,000,000 in July 2008, the Company has limited financial resources and its ability to continue operating is always dependent on management's ability to secure financing. Failure to obtain additional financing could result in limited exploration work. The Company is dependent on raising funds by the issuance of shares or disposing of interests in its mineral properties (by option, joint ventures or sales) in order to finance further acquisitions, undertake exploration and development of other mineral properties, and meet general and administrative expenses. There can be no assurance that the Company will be successful in raising the future required financing. The management team could pursue additional sources of financing, and while it has been successful in doing so in the past, there can be no assurance it will be able to do so in the future. Because of this uncertainty, there is substantial doubt about the ability of the Company to continue as a going concern. The consolidated financial statements do not include the adjustments that would be necessary should the Company be unable to continue as a going concern and these adjustments could be material.

Financing	Date	Purpose	Commercial objectives
Private financing $5,000,000	July 2008	Exploration work and working capital	The Company will continue its exploration program and will initiate a new one with its partner Brownstone on its shale gas properties (Rimouski, Rimouski-North and Shawinigan).

PROJECTED OPERATIONS

The Company does not foresee for the moment any important acquisition or disposal of property.

OFF-BALANCE SHEET ARRANGEMENT

X-Terra has not entered into any specialized financial agreements to minimize its investments, currency or commodity risk. There are no off balance sheet arrangements, such as a guarantee contract, contingent interest in assets transferred to an entity, derivative instruments obligations and or any obligations that trigger financing, liquidity, market or credit risk to the company.

RELATED PARTY TRANSACTIONS

Related party transactions occurred in the normal course of business and were recorded at the exchange values, which is the consideration determined and agreed to by the related parties. Unless indicated otherwise, the following transactions are included in general administrative expenses.

	2008 $	2007 $
Leasing contract*	24,000	-
Management consulting fees charged by a company controlled by a director of the Company	54,000	4,947
Administrative service fees charged by a company controlled by a director of the Company	81,225	-
Administrative service fees charged by a company controlled by a director of the Company (included in share issue expenses as a reduction of share capital)	13,680	-
Consulting fees charged by a company controlled by two directors of the Company	50,000	15,010
Consulting fees charged by a company controlled by a director of the Company	8,000	-
Legal services provided by a law corporation controlled by a director (included in professional fees)	-	22,202
	230,905	42,159

* The Company has entered into a leasing agreement for an office in Rouyn-Noranda with a company controlled by directors and officers of the Company.

SUBSEQUENT EVENTS

i) In connection with the transaction with Brownstone, X-Terra issued 150,000 units to PowerOne Capital Markets Limited ("PowerOne") as brokers' options on February 10, 2009. Each unit is comprised of one common share of the Company and one common share purchase warrant. Each warrant entitled PowerOne to purchase and additional common share of the Company.

ii) From January 1 to April 30, 2009, the Company had purchased 320,500 common shares at an average price of $0.29 in the course of the normal issuer bid program. From de beginning of this program in September 2008, the Company has repurchased a total of 612,000 shares on a possibility of 612,250 for a total amount of $209,990.

GENERAL ADMINISTRATIVE EXPENSES AND PROFESSIONAL FEES

This is the detail for general administrative expenses for the previous two most recently completed financial years:

	$ 2008	$ 2007
Bank charges	5,580	1,795
Advertising and promotion	5,033	2,226
Office operations and facilities	24,188	19,244
Website	17,280	4,875
Traveling expenses	28,781	16,455
Consulting fees	58,000	-
Management and administrative services	194,340	70,314
Part XII.6 taxes	9,922	-
	343,124	114.909

This is the detail for professional fees for the previous two most recently completed financial years:

	$ 2008	$ 2007
Audit and related services	38,393	28,554
Legal	54,821	109,155
	93,214	137,709

USE OF ESTIMATES

The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Significant areas where management judgment is applied are the useful life of assets for amortization purposes, the valuation of mining and oil and gas properties and deferred exploration expenses, valuation allowances for future income taxes and the valuation of stock-based compensation and warrants. Actual results could differ from those estimates and such differences could be material.

NEW ACCOUNTING POLICIES

Accounting standards newly adopted

On January 1, 2008, the Company adopted four new accounting standards related to general standards of financial statement presentation, capital disclosures and financial instruments issued by the Canadian Institute of Chartered Accountants ("CICA"). The new CICA standards are as follows.

Section 1400, "General Standards of Financial Statement Presentation"
This Section specifies the requirements for assessing an entity's ability to continue as a going concern and disclosing any material uncertainties that cast doubt on its ability to continue as such. The Company's disclosure presented in note 2 of the Company's Consolidated Financial Statements for the year ended December 31, 2008 reflects such assessment.

Section 1535, "Capital Disclosures"
This Section specifies the disclosure of information that enables users of an entity's financial statements to evaluate its objectives, policies and processes for managing capital, such as qualitative information about these objectives, policies and processes for managing capital, summary quantitative data about what the entity manages as capital, and whether it has complied with any capital requirements and, if not, the consequences of non-compliance. The disclosure requirements relating to this Section are described in note 11 of the Company's Consolidated Financial Statements for the year ended December 31, 2008.

Section 3862, "Financial Instruments – Disclosures", and Section 3863, "Financial Instruments – Presentation"
These sections replace Section 3861, "Financial Instruments – Disclosure and Presentation", revising and enhancing its disclosure requirements while carrying forward its presentation requirements. These new sections place increased emphasis on disclosures about the nature and extent of risk arising from financial instruments and how the entity manages those risks. The disclosure requirements relating to these sections are described in note 17 of the Company's Consolidated Financial

Statements for the year ended December 31, 2008.

New accounting standards not yet adopted

Section 3064, "Goodwill and Intangible Assets"
In February 2008, the CICA issued Section 3064, which replaces Section 3062, "Goodwill and Other Intangible Assets". This new Section provides guidance on the recognition, measurement, presentation and disclosure of goodwill and intangible assets. The new Section specifically excludes mining activities related to prospecting, acquisition of mineral rights, exploration, drilling and mineral development from being considered as intangible assets, as existing Section 3061, "Property, Plant and Equipment", contains standards for the measurement, presentation and disclosure of mining properties. The Section applies to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2008. The Company does not expect the adoption of this standard to have a material impact on its consolidated financial statements.

Section 1601, "Consolidated Financial Statements", and Section 1602, "Non-controlling Interests"
In January 2009, the CICA issued sections 1601 and 1602, which together replace Section 1600, "Consolidated Financial Statements". Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. It is equivalent to the corresponding provisions of International Accounting Standards 27 (Revised), "Consolidated and Separate Financial Statements". The sections apply to interim and annual consolidated financial statements relating to fiscal years beginning on or after January 1, 2011. The Company is evaluating the impact of the adoption of these new sections on its consolidated financial statements.

Section 1582, "Business Combinations"
In January 2009, the CICA issued Handbook Section 1582, which replaces Section 1581 of the same title. Section 1582 establishes standards for accounting for a business combination and provides the Canadian equivalent to International Financial Reporting Standards 3 (Revised), "Business Combinations". The Section applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011. Earlier application is permitted. The Company is evaluating the impact of the adoption of this new Section on the consolidated financial statements.

International Financial Reporting Standards ("IFRS")

In February 2008, the Canadian Accounting Standards Board ("AcSB") confirmed that the use of IFRS would be required for Canadian publicly accountable enterprises for years beginning on or after January 1, 2011. Management is presently working on a changeover plan to adopt IFRS by 2011. Management will start shortly the process of assessing accounting policy choices and elections that are allowed under IFRS and will also assess the impact of the conversion on its business activities including the effect on information technology and data systems, internal controls over financial reporting and disclosure controls. X-Terra's management will continually review and adjust its changeover plan to ensure its implementation process properly addresses the key elements of the plan.

FINANCIAL INSTRUMENTS

The Company is exposed to various financial risks resulting from both its operations and its investments activities. The Company's management manages its financial risks. The Company does not enter into financial instrument agreements including derivative financial instruments for speculative purposes. The Company's main financial risk exposure and its financial risk management policies are as follows.

Interest rate risk
Interest rate risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate as a result of changes in market interest rates. Cash equivalents bear interest at fixed rates.

Other current financial assets and financial liabilities are not exposed to interest rate risk because they are non-interest bearing.

The Company does not use derivative financial instruments to mitigate its exposure to interest rate risk.

Credit risk
Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. The Company is subject to concentrations of credit risk through its cash and cash equivalents and accounts receivable. The Company reduces its credit risk by maintaining part of its cash and cash equivalents in financial instruments guaranteed by and held with a Canadian chartered bank.

It is management's opinion that the Company is not exposed to significant credit risk.

Currency risk
It is management's opinion that the Company is not exposed to significant foreign exchange risk. As at December 31, 2008, all financial assets and financial liabilities are denominated in Canadian dollars, as are all its activities.

Liquidity risk
Liquidity risk is the risk that the Company will not be able to meet the obligations associated with its financial liabilities. As at December 31, 2008, the Company had enough funds available to satisfy its obligations under accounts payable and accrued liabilities. All of the Company's financial liabilities have contractual maturities of less than three months and are subject to normal trade terms.

In the past few years, the Company financed its liquidity needs primarily by issuing equity securities. As the Company currently incurs operating losses, additional capital will be required to continue exploration activities on the properties.

Fair value
The fair value of financial instruments is summarized as follows:

	2008		2007	
	Carrying amount $	**Fair value $**	**Carrying amount $**	**Fair value $**
Financial assets				
Held for trading				
Cash and cash equivalents	4,296,385	4,296,385	472,356	472,356
Short-term investments	91,716	91,716	-	-
Available for sale				
Short-term investments	760,000	760,000	-	-
Loans and receivables				
Interest income receivable	22,883	22,883	-	-
Financial liabilities				
Other liabilities				
Accounts payable and accrued liabilities	49,258	49,258	51,222	51,222

Fair value estimates are made at the balance sheet date, based on relevant market information and other information about financial instruments.

As at December 31, 2008, all financial instruments (cash and cash equivalents, interest income receivable, and accounts payable and accrued liabilities) have fair values which approximate their carrying values as a result of the relatively short period to maturity of the instruments. For short-term investments, refer to note 6 of the Company's Consolidated Financial Statements for the year ended December 31, 2008.

<u>Risk and Uncertainties</u>
The securities of the Company are highly speculative. In evaluating the Company, it is important to consider that it is a resources exploration enterprise in the exploratory stage of its operations. To date, the Company has had no revenues and there is no immediate expectation of revenues. A prospective investor or other person reviewing the Company should not consider an investment in it unless the investor is capable of sustaining an economic loss of the entire investment. All costs have been funded through equity. Certain risks are associated with the Company's business including:

Mineral Exploration and Development

The Company's properties are in the exploration stage and are without a known body of commercial ore. Development of any of its properties will only follow after obtaining satisfactory exploration results. Mineral exploration and development involve a high degree of risk and few properties which are explored are ultimately developed into producing mines. There is no assurance that the Company's mineral exploration and development activities will result in the discovery of a body of commercial ore on any of its properties. Several years may pass between the discovery and development of commercial mineable mineralized deposits.

Most exploration projects do not result in the discovery of commercially mineralized deposits. The commercial viability of exploiting any precious or base metal deposit is dependant on a number of factors including infrastructure and governmental regulation, in particular those relating to environment, taxes, and royalties. No assurance can be given that minerals will be discovered of sufficient quality, size and grade on any of the Company's properties to justify a commercial operation.

Economics of Developing Mineral Properties

Substantial expenditures are required to establish ore reserves through drilling, to develop metallurgical processes to extract metal from ore and to develop the mining and processing facilities and infrastructure at any site chosen for mining. No assurance can be given that minerals will be discovered in sufficient quantities to justify commercial operation or that the funds required for development can be obtained on a timely basis.

The marketability of any minerals acquired or discovered may be affected by numerous factors which are beyond the Company's control and which cannot be predicted, such as market fluctuations, the proximity and capacity of milling facilities, mineral markets and processing equipment, and such other factors as government regulations, including regulations relating to royalties, allowable production, importing and exporting of minerals, and environmental protection. Depending on the price of minerals produced, the Company may determine that it is impractical to commence or continue commercial production.

Environmental Factors

The Company proposes to conduct exploration activities in various parts of Canada. Such activities are subject to laws, rules and regulations governing the protection of the environment, including, in some cases, posting of reclamation bonds. In Canada, extensive environmental legislation has been enacted by federal, provincial and territorial governments. All phases of the Company's operations are subject to environmental regulation in the jurisdictions in which it operates. Environmental legislation is evolving in a manner which requires stricter standards and enforcement, increased fines and penalties for non-compliance, more stringent environmental assessments of proposed properties and a heightened degree of responsibility for companies and their officers, directors and employees. There is no assurance that future changes in environmental regulations, if any, will not adversely affect the Company's operations. The cost of compliance with changes in governmental regulations has the potential to reduce the profitability of operations or to preclude entirely the economic development of a property. Environmental hazards may exist on the Company's properties, which hazards are unknown to the Company at present, which may have been caused by previous or existing owners or operators of the properties. The Company is not aware of any environmental hazards on any of the properties held by the Company.

The Company has adopted environmental practices designed to ensure that it continues to comply with or exceed all environmental regulations currently applicable to it. All of the Company's activities are in compliance in all material respects with applicable environmental legislation. The Company is currently engaged in exploration with nil to minimal environmental impact.

Uncertainty of Ownership Rights and Boundaries of Resource Properties

There is no assurance that the rights of ownership and other rights in concessions held by the Company are not subject to loss or dispute particularly because such rights may be subject to prior unregistered agreements or transfers or other land claims and may be affected by defects and adverse laws and regulations which have not been identified by the Company. Notwithstanding that the exploration and operating concessions in respect of which the Company may hold various interests have been surveyed, the precise boundary locations thereof may be in dispute. Although the Company has exercised the usual due diligence with respect to title to properties in which it has a material interest, there is no guarantee that title to the properties will not be challenged or impugned. The Company's mineral property interest may be subject to prior unregistered agreements or transfers or native land claims and title may be affected by undetected defects. In addition, certain of the mining claims in which the Company has an interest are not recorded in its name and cannot be recorded until certain steps are taken by other parties. Before a number of claims under option can be recorded in the Company's name, the underlying title holder has to assign title to the Company once the Company satisfies its option agreement obligations. There are no assurances that the underlying title holder will assign title.

Potential Conflicts of Interest
The directors of the Company serve as directors of other public and private companies and devote a portion of their time to manage other business interests. This may result in certain conflicts of interest. To the extent that such other companies may participate in ventures in which the Company is also participating, such directors and officers of the Company may have a conflict of interest in negotiating and reaching an agreement with respect to the extent of each company's participation. The Canada Business Corporations Act, to which the Company is subject, requires the directors and officers of the Company to act honestly and in good faith with a view to the best interests of the Company. However, in conflict of interest situations, directors of the Company may owe the same duty to another company and will need to balance the competing obligations and liabilities of their actions. There is no assurance that the needs of the Company will receive priority in all cases. From time to time, several companies may participate together in the acquisition, exploration and development of natural resource properties, thereby allowing these companies to: (i) participate in larger programs; (ii) acquire an interest in a greater number of programs; and (iii) reduce their financial exposure with respect to any one program. A particular company may assign, at its cost, all or a portion of its interests in a particular program to another affiliated company due to the financial position of the company making the assignment. In determining whether or not the Company will participate in a particular program and the interest therein to be acquired by it, it is expected that the directors of the Company will primarily consider the degree of risk to which the Company may be exposed and its financial position at the time.

Governmental Regulation
Operations, development and exploration on the Company's properties are affected to varying degrees by: (i) government regulations relating to such matters as environmental protection, health, safety and labor; (ii) mining law reform; (iii) restrictions on production, price controls, and tax increases; (iv) maintenance of claims; (v) tenure; and (vi) expropriation of property. There is no assurance that future changes in such regulation, if any, will not adversely affect the Company's operations. Changes in such regulation could result in additional expenses and capital expenditures, availability of capital, competition, reserve uncertainty, potential conflicts of interest, title risks, dilution, and restrictions and delays in operations, the extent of which cannot by predicted.

The Company is at the exploration stage on all of its properties. Exploration on the Company's properties requires responsible best exploration practices to comply with Company policy, government regulations, and maintenance of claims and tenure. The Company is required to be registered to do business and have a valid prospecting license (required to prospect or explore for minerals on crown Mineral land or to stake a claim) in any Canadian province in which it is carrying out work. Mineral exploration primarily falls under provincial jurisdiction. However, the Company is also required to follow the regulations pertaining to the mineral exploration industry that fall under federal jurisdiction, such as the Fish and Wildlife Act.

If any of the Company's projects are advanced to the development stage, those operations will also be subject to various laws and regulations concerning development, production, taxes, labor standards, environmental protection, mine safety and other matters. In addition, new laws or regulations governing operations and activities of mining companies could have a material adverse impact on any project in the mine development stage that the Company may possess.

Precious and base metal prices
The price of precious and base metal prices can fluctuate widely and is affected by numerous factors including demand, inflation, strength of the US dollar and other currencies, interest rates, gold sales by the central banks, forward sales by producers, global or regional political or financial events, and production and cost levels in major producing regions. In addition, prices are sometimes subject to rapid short-term changes because of speculative activities.

Even if the Company discovers commercial amounts of metals on its properties, it may not be able to place the property into commercial production if precious and base metal prices are not at sufficient levels

Need for Additional Financing
Currently, exploration programs are pursued by the Company with the objective of establishing mineralization of commercial quantities. The Company may fund the proposed programs through equity financing and the possible exercise of outstanding options. Such funding would be dilutive to current shareholders. Should sources of equity financing not be available to the Company, the Company would seek a joint venture relationship in which the funding source could become entitled to a shared, negotiated interest in the property or the projects. If exploration programs carried out by the Company are successful in establishing ore of commercial quantities and/or grade, additional funds will be required to develop the properties and reach commercial production. In that event, the Company may seek capital through further equity funding, debt instruments, by offering an interest in the property being explored and allowing the party or parties carrying out further exploration or development thereof to earn an interest, or through a combination of funding arrangements. There can be no

assurance of such funding sources. Furthermore, if the Company is not able to obtain the capital resources necessary to meet property payments or exploration or development obligations which now apply or which would apply in joint ventures with others, its potential as a "going concern" could be seriously affected.

Management and Directors

The Company is dependent on a relatively small number of key directors and officers: Martin Dallaire and Sylvain Champagne. Loss of any one of these persons could have an adverse affect on the Company. The Company does not maintain "key-man" insurance in respect of any of its management.

Lack of operating profit

The Company was incorporated on February 24, 1987 and since incorporation, has not realized net income except for 2008 nor paid dividends. Variations in annual and quarterly loss and loss per shares are affected by administration costs and the write-down or write-off of mineral property carrying costs. It is anticipated that the Company will continue to experience operating losses for the foreseeable future. There can be no assurance that the Company will ever achieve significant revenues or profitable operations.

OTHER MD&A REQUIREMENTS

Share data

As at April 30, 2009, the Company had the following:

Issued and outstanding- 11,783,069 shares

The Company defines its capital as the shareholder's equity.

The Company's capital management objectives are to:

- have sufficient capital to be able to meet the Company's mining properties exploration and mining development plan in order to ensure the growth of the activities.
- have sufficient cash to fund the exploration expenses and investing activities and the working capital requirements.

Warrants and brokers' options outstanding:

Expiry date	Number of warrants and brokers' options outstanding	Exercise price ($)
May 2009	650,000	0.70
October 2009	133,333	0.75
October 2009	426,666	1.00
July 2010 *	5,400,000	1.50
February 2011	150,000	1.50
	6,759,999	

* These include 400,000 brokers' options which expire in July 2010. Each brokers' option entitles the holder to subscribe for an equal number of units in consideration of $1.00, composed of one share and one warrant at a price of $1.50.

Stock options outstanding:

Expiry date	Number of options outstanding	Exercise price ($)
June 2012	115,000	1.10
June 2013	437,500	1.90
August 2013	270,000	1.00
	822,500	

OTHER INFORMATION
The Company's web address is www.xterraresources.com. Other information relating to the Company may be found on the SEDAR website (www.sedar.com).

FORWARD-LOOKING STATEMENTS
This discussion includes certain statements that may be deemed "forward-looking statements". Other than statements of historical facts, statements in this discussion include, but are not limited to, the Company's expectations as to, future production, reserve potential, exploration drilling, exploration activities and events or developments, commodities market prices, timetables, costs, capital expenditures, work programs, and budgets. Although the Company believes the expectations expressed in such forward-looking statements are based on reasonable assumptions, the risks, hazards, uncertainties. Factors that could cause actual results to differ materially from those in forward-looking statements include, but are not limited to, operating, exploration and geological successes, continued availability of capital and financing, and general economic, environmental, industry, market or business conditions, volatility and sensitivity to market metal prices. Such statements are not guarantees of future performance and actual results or developments may differ materially from those in the forward-looking statements.

April 30, 2009.

(S) Martin Dallaire
Martin Dallaire, President and CEO

(S) Sylvain Champagne
Sylvain Champagne, CFO

X-Terra Resources Corporation
(an exploration stage company)

Consolidated Financial Statements
December 31, 2008 and 2007

PricewaterhouseCoopers LLP/s.r.l./s.e.n.c.r.l.
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Montréal, Quebec
Canada H3B 2G4
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April 30, 2009

Auditors' Report

To the Shareholders of
X-Terra Resources Corporation
(an exploration stage company)

We have audited the consolidated balance sheets of **X-Terra Resources Corporation** as at December 31, 2008 and 2007 and the consolidated statements of operations and deficit, comprehensive income (loss) and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2008 and 2007 and the results of its operations and its comprehensive income (loss), deficit and cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP[1]

[1] Chartered accountant auditor permit No. 14707

X-Terra Resources Corporation

(an exploration stage company)
Consolidated Balance Sheets
As at December 31, 2008 and 2007

	2008 $	2007 $
Going concern assumption (note 2)		
Assets		
Current assets		
Cash and cash equivalents (note 5)	4,296,385	472,356
Restricted cash	-	500
Short-term investments (note 6)	851,716	-
Accounts receivable (note 7)	78,721	15,628
Prepaid insurance	6,628	-
	5,233,450	488,484
Property, plant and equipment (note 8)	13,255	-
Mining and oil and gas properties (note 9)	988,074	975,864
Deferred exploration expenses (note 10)	377,451	47,430
	6,612,230	1,511,778
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	49,258	51,222
Part XII.6 taxes payable	9,922	-
	59,180	51,222
Shareholders' Equity		
Share capital (note 11)	26,191,429	23,195,520
Warrants and brokers' options (note 11)	1,814,247	511,185
Contributed surplus (note 13)	1,153,105	532,794
Deficit	(22,625,731)	(22,778,943)
Accumulated other comprehensive income	20,000	-
	6,553,050	1,460,556
	6,612,230	1,511,778

The accompanying notes are an integral part of these consolidated financial statements.

Approved by the Board of Directors

Martin Dallaire (signed) Director
Martin Dallaire

Sylvain Champagne (signed) Director
Sylvain Champagne

X-Terra Resources Corporation

(an exploration stage company)
Consolidated Statements of Operations and Deficit
For the years ended December 31, 2008 and 2007

	2008 $	2007 $
Going concern assumption (note 2)		
Administrative expenses		
Insurance	14,921	16,000
Professional fees	93,214	137,709
General administrative expenses	343,124	114,909
Shareholders' communication	9,523	4,363
Transfer agent and regulatory fees	27,580	39,580
Stock-based compensation (note 12)	256,520	71,940
Amortization of property, plant and equipment (note 8)	2,137	-
	747,019	384,501
Other expenses (income)		
Interest income	(76,555)	(7,993)
General exploration expenses	-	910
Gain on sale of mining and oil and gas properties (note 9)	(835,766)	-
Unrealized loss on short-term investments held for trading (note 6)	12,090	-
	(900,231)	(7,083)
Income (loss) before income taxes	153,212	(377,418)
Future income tax recovery (note 16)	-	86,000
Net income (loss) for the year	153,212	(291,418)
Deficit – Beginning of year	(22,778,943)	(22,487,525)
Deficit – End of year	(22,625,731)	(22,778,943)
Basic and diluted net income (loss) per share	0.02	(0.06)
Weighted average number of shares outstanding		
Basic	9,344,727	5,178,930
Diluted	9,344,727	5,178,930

The accompanying notes are an integral part of these consolidated financial statements.

X-Terra Resources Corporation

Consolidated Statements of Comprehensive Income (Loss)

For the years ended December 31, 2008 and 2007

	2008 $	2007 $
Net income (loss) for the year	153,212	(291,418)
Other comprehensive income		
Unrealized gain on available-for-sale short-term investments (note 6)	20,000	-
Comprehensive income (loss) for the year	173,212	(291,418)

The accompanying notes are an integral part of these consolidated financial statements.

X-Terra Resources Corporation

(an exploration stage company)
Consolidated Statements of Cash Flows
For the years ended December 31, 2008 and 2007

	2008 $	2007 $
Going concern assumption (note 2)		
Cash flows from		
Operating activities		
Net income (loss) for the year	153,212	(291,418)
Adjustments for		
Gain on sale of mining and oil and gas properties (note 9)	(835,766)	-
Unrealized loss on short-term investments held for trading (note 6)	12,090	-
Stock-based compensation (note 12)	256,520	71,940
Amortization of property, plant and equipment (note 8)	2,137	-
Future income tax recovery (note 16)	-	(86,000)
	(411,807)	(305,478)
Changes in non-cash operating working capital items (note 14)	(88,024)	2,879
	(499,831)	(302,599)
Financing activities		
Issuance of common shares and warrants and brokers' options	5,350,199	959,999
Share issue expenses	(571,325)	(114,455)
Purchase of shares under normal course issuer bid	(116,110)	-
Due to directors and officers	-	(11,782)
	4,662,764	833,762
Investing activities		
Acquisition of property, plant and equipment	(15,392)	-
Acquisition of mining and oil and gas properties	(20,250)	(25,364)
Deferred exploration expenses	(303,262)	(47,430)
	(338,904)	(72,794)
Increase in cash and cash equivalents during the year	3,824,029	458,369
Cash and cash equivalents (note 5) – **Beginning of year**	472,356	13,987
Cash and cash equivalents (note 5) – **End of year**	4,296,385	472,356

The accompanying notes are an integral part of these consolidated financial statements.

1 Nature of operations

X-Terra Resources Corporation (the "Company"), an exploration stage company, is in the business of acquiring, exploring and developing mining and energy properties. It has interests in properties at the exploration stage located in Canada.

The Company is in the process of exploring its mining and oil and gas property interests and has not yet determined whether they contain mineral deposits that are economically recoverable. The Company will periodically have to find additional funds to continue its exploration activities, and while it has been successful in doing so in the past, there can be no assurance it will be able to do so in the future.

Until it is determined that properties contain mineral reserves or resources that can be economically mined, they are classified as exploration properties. The recoverability of deferred exploration expenses is dependent on the discovery of economically recoverable reserves and resources; securing and maintaining title and beneficial interest in the properties; the ability to obtain necessary financing to continue the exploration and development of its properties; and future profitable production or proceeds from the disposal of properties.

At the annual and special meeting of shareholders held on August 27, 2008 in Rouyn-Noranda, Quebec, shareholders approved a special resolution authorizing the continuance of the Company under the Canada Business Corporations Act. On September 4, 2008, the Company obtained a Certificate and Articles of Continuance under the Act, rendering the continuance effective.

As at December 31, 2008, the Company holds the Lindsay, Cool Lake, Rimouski, Rimouski North and Shawinigan properties and has cash and cash equivalents totalling $4,296,385 and working capital of $5,174,270.

2 Going concern assumption

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP") on a going concern basis whereby it is assumed that the Company will realize its assets and assume its liabilities in the normal course of business.

The Company is in the process of exploring its mining and oil and gas properties and has not yet determined whether these properties contain ore reserves. The recoverability of the amounts shown for mining and oil and gas properties and related deferred exploration expenses is dependent on the ability of the Company to obtain the necessary financing to complete exploration and development and on future profitable production or proceeds from the disposal of properties. The Company will have to raise additional funds to complete the development phase of its programs, and while it has been successful in doing so in the past, there can be no assurance that it will be able to do so in the future. The application of GAAP on a going concern basis may be inappropriate since there is a significant doubt as to the going concern assumption.

The consolidated financial statements do not reflect the adjustments to the carrying value of assets and liabilities, the reported amounts of revenues and expenses and the classification of balance sheet items if the going concern assumption were inappropriate, and these adjustments could be material. Management did not take these adjustments into account as it believes in the validity of the going concern assumption.

3 New accounting policies

Accounting standards newly adopted

On January 1, 2008, the Company adopted four new accounting standards related to general standards of financial statement presentation, capital disclosures and financial instruments issued by the Canadian Institute of Chartered Accountants ("CICA"). The new CICA standards are as follows.

a) Section 1400, "General Standards of Financial Statement Presentation"

This Section specifies the requirements for assessing an entity's ability to continue as a going concern and disclosing any material uncertainties that cast doubt on its ability to continue as such. The Company's disclosure presented in note 2 reflects such assessment.

b) Section 1535, "Capital Disclosures"

This Section specifies the disclosure of information that enables users of an entity's financial statements to evaluate its objectives, policies and processes for managing capital, such as qualitative information about these objectives, policies and processes for managing capital, summary quantitative data about what the entity manages as capital, and whether it has complied with any capital requirements and, if not, the consequences of non-compliance. The disclosure requirements relating to this Section are described in note 11.

c) Section 3862, "Financial Instruments – Disclosures", and Section 3863, "Financial Instruments – Presentation"

These sections replace Section 3861, "Financial Instruments – Disclosure and Presentation", revising and enhancing its disclosure requirements while carrying forward its presentation requirements. These new sections place increased emphasis on disclosures about the nature and extent of risk arising from financial instruments and how the entity manages those risks. The disclosure requirements relating to these sections are described in note 17.

New accounting standards not yet adopted

d) Section 3064, "Goodwill and Intangible Assets"

In February 2008, the CICA issued Section 3064, which replaces Section 3062, "Goodwill and Other Intangible Assets". This new Section provides guidance on the recognition, measurement, presentation and disclosure of goodwill and intangible assets. The new Section specifically excludes mining activities related to prospecting, acquisition of mineral rights, exploration, drilling and mineral development from being considered as intangible assets, as existing Section 3061, "Property, Plant and Equipment", contains standards for the measurement, presentation and disclosure of mining properties. The Section applies to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2008. The Company does not expect the adoption of this standard to have a material impact on its consolidated financial statements.

e) Section 1601, "Consolidated Financial Statements", and Section 1602, "Non-controlling Interests"

In January 2009, the CICA issued sections 1601 and 1602, which together replace Section 1600, "Consolidated Financial Statements". Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. It is equivalent to the corresponding provisions of International Accounting Standard 27 (Revised), "Consolidated and Separate Financial Statements". The sections apply to interim and annual consolidated financial statements relating to fiscal years beginning on or after January 1, 2011. The Company is evaluating the impact of the adoption of these new sections on its consolidated financial statements.

f) Section 1582, "Business Combinations"

In January 2009, the CICA issued Handbook Section 1582, which replaces Section 1581 of the same title. Section 1582 establishes standards for accounting for a business combination and provides the Canadian equivalent to International Financial Reporting Standard 3 (Revised), "Business Combinations". The Section applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011. Earlier application is permitted. The Company is evaluating the impact of the adoption of this new Section on the consolidated financial statements.

4 Significant accounting policies

Basis of accounting

These consolidated financial statements have been prepared in accordance with Canadian GAAP. The Canadian dollar is the functional and reporting currency used to measure the Company's operations.

Basis of consolidation

These consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, Minera Reina Isabel, S.A. de C.V. ("Minera Reina") and Minera Tatemas, S.A. de C.V. ("Minera Tatemas"), which are currently inactive.

Use of estimates

The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of income and expenses during the reporting period. Significant areas where management judgment is applied are the useful life of assets for amortization purposes, the valuation of mining and oil and gas properties and deferred exploration expenses, valuation allowances for future income taxes and the valuation of stock-based compensation and warrants and brokers' options. Actual results could differ from those estimates and such differences could be material.

Cash and cash equivalents

Cash and cash equivalents comprise cash on hand, bank balances and short-term liquid investments with original maturities of three months or less.

Short-term investments

Short-term investments consist of investments in a public company.

In accordance with the requirements of CICA Handbook Section 3855, "Financial Instruments – Recognition and Measurement", adopted by the Company as of January 1, 2007, short-term investments that are shares of a public company are classified as available-for-sale investments. Warrants held by the Company are classified as investments held for trading. Transactions are recorded on the settlement date, and investments are recognized at fair value. Unrealized gains and losses are recorded, net of income taxes if any, in comprehensive income (loss) in the case of available-for-sale investments or in net income (loss) for investments held for trading. When available-for-sale investments are disposed of or impaired, these gains or losses are reclassified to net income (loss).

Property, plant and equipment

Property, plant and equipment are recorded at cost. Amortization is calculated to amortize the cost of the property, plant and equipment less their residual values over their estimated useful lives as follows:

	Method	Rate
Computer equipment/software	Declining balance	30%
Office furniture	Declining balance	20%

Amortization of property, plant and equipment related to exploration and development activities is capitalized to mining and oil and gas properties and deferred exploration expenses and are recognized in the consolidated statement of operations through amortization of mining and oil and gas properties when they are put into production. For those which are not related to exploration and development activities, amortization expense is recognized in the consolidated statement of operations.

Mining and oil and gas properties and deferred exploration expenses

Mining and oil and gas properties and deferred exploration expenses include rights in mining and oil and gas properties and deferred exploration costs and are recorded at acquisition cost less option payments received and other recoveries or at their fair value in the case of a devaluation caused by an impairment in value.

Exploration costs are deferred until the economic viability of the project has been established, at which time costs are added to mining properties. Costs are written off when properties are abandoned or when cost recovery is uncertain. Management has defined uncertainty as either there being no financial resources available from the Company or its joint venture partners for development of a mining or oil and gas property over a three-year period or results from exploration work not warranting further investment.

Proceeds from the sale of exploration properties are applied in reduction of related carrying costs, and any excess is recorded as a gain in the consolidated statement of operations. In the case of a partial sale, if carrying costs exceed the proceeds, only the losses are recorded.

Although management takes steps to verify title to mining and oil and gas properties in which the Company may have an interest, in accordance with industry standards for the current stage of exploration of such properties, these procedures do not guarantee the Company's title. Property title may be subject to unregistered prior agreements and be in non-compliance with regulatory requirements.

Mining and oil and gas property option agreements

Option payments are made at the discretion of the optionee and, accordingly, are accounted for when received. Option payments received are treated as a reduction of the carrying value of the related mining or oil and gas property and as deferred costs until the Company's costs are recovered. Option payments received in excess of costs incurred are credited to income.

Impairment of long-lived assets

Long-lived assets are reviewed for impairment upon the occurrence of events or changes in circumstances indicating that the carrying value of the assets may not be recoverable, as identified by comparing their net book value to the estimated undiscounted future cash flows generated by their use and eventual disposal. Impairment is measured as the excess of the carrying value over the fair value, determined principally by discounting the estimated net future cash flows expected to be generated from the use and eventual disposal of the related asset. In the event that the Company has insufficient information about its exploration properties to estimate future cash flows to test the recoverability of the capitalized costs, the Company will test for impairment by comparing the fair value to the carrying amount, without first performing a test for recoverability.

Income taxes

The Company provides for income taxes using the liability method of tax allocation. Under this method, future income tax assets and liabilities are determined based on deductible or taxable temporary differences between the accounting values and tax values of assets and liabilities using enacted or substantively enacted income tax rates expected to be in effect for the year in which the differences are expected to reverse. The Company establishes a valuation allowance against future income tax assets if, based on available information, it is more likely than not that some or all of the income tax assets will not be realized.

Flow-through shares

The Company may finance a portion of its exploration expenses through the issuance of flow-through common shares. Under the terms of the flow-through share agreements, the resource expense deductions for income tax purposes are renounced to investors in accordance with the appropriate income tax legislation. The Company recognizes future income tax liability and reduces shareholders' equity when the expenses are renounced and when the renunciation forms are filed with the tax authorities.

Foreign currency transactions and integrated foreign subsidiaries

The financial statements of integrated foreign operations and transactions denominated in currencies other than the functional currency are translated into the functional currency using the temporal method. Under this method, monetary assets and liabilities in foreign currencies are translated into the functional currency at exchange rates in effect at the balance sheet date. Non-monetary assets and liabilities are translated at historical rates, unless such assets and liabilities are carried at market value, in which case, they are translated at the exchange rate in effect at the balance sheet date. Income and expenses denominated in foreign currencies are translated at the rate of exchange prevailing on each transaction date. Gains and losses on translation are included in the consolidated statement of operations.

Income (loss) per share

The calculation of income (loss) per share is based on the weighted average number of shares outstanding for the year. Basic income (loss) per share is calculated by dividing the net income (loss) for the year by the weighted average number of common shares outstanding during the year. The computation of diluted income (loss) per share assumes the conversion, exercise or contingent issuance of securities only when such conversion, exercise or issuance would have a dilutive effect on income (loss) per share. The treasury stock method is used to determine the dilutive effect of the warrants, brokers' options and stock options. When the Company reports a loss, the diluted net loss per common share is equal to the basic net loss per common share because of the anti-dilutive effect of the outstanding warrants, brokers' options and stock options.

Share, warrant and brokers' option issue expenses

Share, warrant and brokers' option issue expenses are recorded as a decrease in share capital and warrants and brokers' options on the consolidated balance sheet in the year in which they are incurred.

Stock-based compensation

The Company applies the fair value method to account for options granted to its directors, officers, employees and consultants. Any consideration paid on exercise of stock options is credited to share capital. The stock compensation cost is stated as per the periods of option acquisition. Contributed surplus resulting from stock-based compensation is transferred to share capital when the options are exercised.

Financial instruments – Recognition and measurement

All financial instruments are required to be measured at fair value on initial recognition, except for certain related party transactions. Measurement in subsequent periods depends on whether the financial instrument has been classified as held for trading, available for sale, held to maturity, loans and receivables, or other liabilities.

- Financial assets and financial liabilities classified as held for trading are required to be measured at fair value, with changes in fair value recognized in net income (loss).
- Financial assets classified as held to maturity, loans and receivables, and financial liabilities (other than those held for trading) are required to be measured at amortized cost using the effective interest method.
- Available-for-sale financial assets are required to be measured at fair value, with unrealized gains and losses recognized in other comprehensive income (loss). Investments in equity instruments classified as available for sale that do not have a quoted market price in an active market are required to be measured at cost.

The Company has adopted the following financial instrument classifications:

Financial instrument	**Classification**
Cash and cash equivalents	Held for trading
Interest income receivable	Loans and receivables
Short-term investments (common shares of a public company)	Available for sale
Short-term investments (warrants of a public company)	Held for trading
Accounts payable and accrued liabilities	Other liabilities

5 Cash and cash equivalents

	2008 $	2007 $
Cash on hand and bank balances	796,385	472,356
Guaranteed investment certificates, bearing interest at a rate of 3.14%, maturing in January 2009	3,500,000	-
	4,296,385	472,356

As at December 31, 2008, cash and cash equivalents include no amount (2007 – $273,170) reserved for new exploration activities to be conducted in Canada before December 31, 2008.

6 Short-term investments

The portfolio investments consist of common shares of a publicly held company that are available for sale and are recorded at fair value and warrants of a publicly held company that are held for trading and are recorded at fair value.

	2008 $	2007 $
Available for sale		
Common shares of a public company*		
2,000,000 Common shares, quoted market value of $760,000	740,000	-
Unrealized gain	20,000	-
Fair value of short-term investments	760,000	-
Held for trading		
Warrants of a public company*	91,716	-
	851,716	-

* These investments are the result of a transaction completed on October 28, 2008 between the Company and Brownstone Ventures Inc. ("Brownstone") to which the Company sold a 50% interest in exploration licences in exchange for 2,000,000 common shares and 2,000,000 common share purchase warrants. Each purchase warrant entitles the Company to purchase one common share of Brownstone at a price of $2.00 until October 28, 2010. The exploration licences sold are related to the Rimouski, Rimouski North and Shawinigan mining and oil and gas properties (note 9).

The fair value of warrants is determined through the use of Black-Scholes pricing models as they are not traded on any public stock exchange.

For the year ended December 31, 2008, the Company recognized an unrealized gain of $20,000 on common shares of a public company designated as available for sale in other comprehensive income and a $12,090 unrealized loss on warrants of a public company classified as held for trading was included in net income for the year.

7 Accounts receivable

	2008 $	2007 $
Sales taxes	55,838	15,628
Interest income receivable	22,883	-
	78,721	15,628

8 Property, plant and equipment

			2008
	Cost $	Accumulated amortization $	Net $
Computer equipment/software	11,952	1,793	10,159
Office furniture	3,440	344	3,096
	15,392	2,137	13,255

			2007
	Cost $	Accumulated amortization $	Net $
Computer equipment/software	-	-	-
Office furniture	-	-	-
	-	-	-

All property, plant and equipment are located in Canada.

9 Mining and oil and gas properties

Property	Number of claims/ Number of permits	Undivided interest %	Balance – December 31, 2007 $	Net additions $	Balance – December 31, 2008 $
Lindsay[(1)]	26	100	975,864	1,999	977,863
Cool Lake	39	100	-	2,172	2,172
Rimouski[(2)]	2	50	-	2,010	2,010
Rimouski North[(2)]	3	50	-	2,643	2,643
Shawinigan[(2)]	3	50	-	3,386	3,386
			975,864	12,210	988,074

All mining and oil and gas properties are located in Canada.

(1) The Lindsay property comprises the former Villedieu and Lindsay properties, which have been combined because they are contiguous.

(2) On October 28, 2008, the Company entered into an agreement with Brownstone Ventures Inc. ("Brownstone") whereby Brownstone acquired a 50% interest in the exploration licences of the Rimouski, Rimouski North and Shawinigan properties in exchange for the issuance to the Company of 2,000,000 common shares valued at $740,000 and 2,000,000 common share purchase warrants valued at $103,806, for a total of $843,806. The gain on sale of mining and oil and gas properties of $835,766 was calculated net of the book value of the assets sold of $8,040. Pursuant to an operating agreement to be entered into by the Company and Brownstone, Brownstone will be the operator of an exploration program for the territories covered by the licences.

10 Deferred exploration expenses

Property	Percentage interest %	Balance – December 31, 2007 $	Net additions $	Balance – December 31, 2008 $
Lindsay (note 9[(1)])	100	47,430	299,435	346,865
Cool Lake	100	-	29,993	29,993
Rimouski (note 9[(2)])	50	-	593	593
		47,430	330,021	377,451

	2008 $	2007 $
Exploration costs		
Accommodations	23,832	2,920
Maps, printing and drafting	350	-
Consulting	-	600
Assay and geochemical analysis	8,135	13,368
Geology	217,757	24,115
Geophysics	62,966	3,660
Project management fees	16,981	2,767
Increase in deferred exploration expenses	330,021	47,430
Balance – Beginning of year	47,430	-
Balance – End of year	377,451	47,430

11 Share capital and warrants and brokers' options

Capital management

The Company defines its capital as shareholders' equity. Its capital management objectives are to:

- have sufficient capital to be able to complete the Company's mining and oil and gas property exploration and mining development plan in order to ensure the growth of its activities; and
- have sufficient cash to fund exploration expenses, investing activities and working capital requirements.

Share capital

Authorized

Unlimited common shares without par value

Issued

Changes in the Company's share capital are as follows:

	Number of shares	Amount $
Balance – December 31, 2006	3,638,933	21,813,127
Private placement(4)	1,000,000	205,000
Flow-through and non-flow-through private placement(5)	559,999	254,228
Mining properties(6)	1,250,000	950,500
Debt settlement(7)	327,739	183,534
Share issue expenses(8)	-	(210,869)
Balance – December 31, 2007	6,776,671	23,195,520
Private placement(1)	5,000,000	2,990,947
Purchased and cancelled(2)	(241,500)	(532,430)
Exercise of warrants(3)	377,999	390,251
Exercise of brokers' options(3)	27,999	27,213
Exercise of options (note 12)	62,400	119,928
Balance – December 31, 2008	12,003,569	26,191,429

Warrants and brokers' options

The following table details the changes in the Company's warrants and brokers' options:

	Number of warrants	Number of brokers' options	Amount $
Balance – Beginning of year	1,587,998	27,999	511,185
Private placement(1)	5,000,000	400,000	1,437,728
Exercised(3)	(377,999)	(27,999)	(134,666)
Balance – End of year	6,209,999	400,000	1,814,247

On February 23, 2007, the Company changed its name from Canadian Empire Exploration Corp. to X-Terra Resources Corporation and consolidated its share capital as to ten shares of Canadian Empire Exploration Corp. for one share of X-Terra Resources Corporation. All the opening figures relating to the number of common shares, warrants and brokers' options outstanding have been modified to reflect this consolidation.

(1) On July 11, 2008, the Company completed a private placement of 5,000,000 units at a deemed price of $1 per unit for cash consideration of $5,000,000. Each unit consists of one common share and one common share purchase warrant. Each purchase warrant entitles the holder to purchase one common share at a price of $1.50 until July 11, 2010. From the total compensation received, $1,415,000 was assigned to warrants and $3,585,000 to share capital according to their estimated fair values.

Share issue expenses of $828,526 were incurred, of which $234,473 has been allocated to warrants and $594,053 to share capital. These share issue expenses include a fair value of $257,200 for 400,000 brokers' options, entitling the brokers to purchase 400,000 units at a price of $1 per unit until July 11, 2010. Each unit consists of one common share and one common share purchase warrant. Each purchase warrant entitles the holder to purchase one common share at a price of $1.50 until July 11, 2010.

The fair value of the brokers' options was estimated using a binomial pricing model based on the following assumptions: dividend yield of nil, volatility of 100%, risk-free interest rate of 3.18% and an expected life of two years. As a result, the fair value of the brokers' options was estimated at $257,200.

(2) For the year ended December 31, 2008, the Company purchased 291,500 of its own shares for cancellation for a cash consideration of $116,110, in connection with its normal course issuer bid. As at December 31, 2008, 50,000 of the repurchased shares had not yet been cancelled. As a result, those shares are still considered issued but not outstanding for the purpose of earnings per share calculations. Share capital has been reduced by the average issue price per share before buy-back of $2.16 totalling $522,430, of which $416,320 has been charged to contributed surplus. For the shares not yet cancelled, share capital has been reduced by the amount paid for the shares totalling $10,000.

(3) In 2008, 377,999 warrants and 27,999 brokers' options were exercised for cash consideration of $265,999 and $16,799 respectively, and a fair value of $124,252 and $10,414 respectively from these warrants and brokers' options has been reclassified on the balance sheet from warrants and brokers' options to share capital.

(4) On May 10, 2007, the Company completed a private placement of 1,000,000 units at a deemed price of $0.56 per unit for cash consideration of $560,000. Each unit consists of one common share and one common share purchase warrant. Each purchase warrant entitles the holder to purchase one common share at a price of $0.70 until May 10, 2009. From the total compensation received, $355,000 was assigned to warrants and $205,000 to share capital according to their estimated fair values.

(5) On October 3, 2007, the Company closed a private placement of 133,333 non-flow-through units and 426,666 flow-through units at a price of $0.60 and $0.75 per unit respectively for cash consideration of $400,000. Each non-flow-through unit consists of one non-flow-through common share and one common share purchase warrant. Each purchase warrant entitles the holder to purchase one non-flow-through common share at a price of $0.75 until October 3, 2009.

Each flow-through unit consists of one flow-through common share and one common share purchase warrant. Each purchase warrant entitles the holder to purchase one non-flow-through common share at a price of $1 until October 3, 2009.

From the total compensation received, $156,185 was assigned to warrants and $254,228 to share capital according to their estimated fair values.

Share issue expenses include 27,999 brokers' options. Each brokers' option consists of one non-flow-through common share and one non-transferable common share purchase warrant. Each brokers' option entitles the holder to purchase one non-flow-through common share at a price of $0.60 and one non-transferable common share purchase warrant at a price of $0.75 until October 3, 2009.

(6) On May 10, 2007 and August 24, 2007, the Company issued a total of 1,250,000 common shares at a fair value of $950,500 and a cash payment of $25,000 in connection with the Villedieu and Lindsay properties.

(7) On May 14, 2007, the Company issued 327,739 common shares at a deemed price of $0.56 per share in settlement of $183,534 of indebtedness comprising promissory notes entered into in 2006 with private companies owned by certain individuals who were directors and/or senior officers of the Company until June 14, 2007.

(8) Share issue expenses were not allocated on each individual transaction but on an aggregated basis. These include $86,000 for the future effect on income taxes related to flow-through shares when the renunciation forms have been filed (note 16).

Information relating to warrants and brokers' options outstanding as at December 31, 2008 is as follows:

Expiry date	Number of warrants outstanding	Number of broker's options outstanding	Exercise price $
May 2009	650,000	-	0.70
October 2009	426,666	-	1.00
October 2009	133,333	-	0.75
July 2010	-	400,000	1.00
July 2010	5,000,000	-	1.50
	6,209,999	400,000	

Except for the brokers' options, the warrants, when granted, are accounted for at their fair value determined by the Black-Scholes pricing model, based on the vesting period and on the following weighted average assumptions:

	2008	2007
Average dividend per share	Nil	Nil
Volatility	100%	94.87%
Risk-free interest rate	3.18%	4.33%
Weighted average expected life	2 years	2 years
Weighted average fair value of warrants granted	$0.28	$0.32

Normal course issuer bid

The Company has instituted a normal course issuer bid through the facilities of the TSX Venture Exchange. Under the normal course issuer bid, which is effective from September 15, 2008 to September 14, 2009, the Company may repurchase for cancellation a maximum of 612,250 common shares over a 12-month period, representing approximately 5% of the "public float" of the Company's shares outstanding as at September 3, 2008. Purchases of common shares under the normal course issuer bid have been made at market prices and otherwise in accordance with the policies of the TSX Venture Exchange. The Company did not purchase any common shares during the 12 months preceding the normal course issuer bid.

The normal course issuer bid has been instituted in that the Company considers that the repurchase of common shares at certain market prices is beneficial to the Company. The normal course issuer bid is being conducted through Desjardins Securities Inc. To the knowledge of the Company, no director or senior officer of the Company or their associates or affiliates currently intends to sell shares of the Company during the course of the normal course issuer bid.

12 Stock options

In 2002, the Company adopted a stock option plan (the "Option Plan"), as amended, authorizing the granting of stock options to qualified optionees to purchase a total maximum of 10% of the number of outstanding issued common shares of the Company at any time. This is referred to as a "rolling plan". Under the Option Plan, the term of stock options granted may not exceed five years following the date of grant.

The Company applies the fair value method of accounting for stock options, and accordingly the fair value of the vested portion of stock options granted in 2008 of $256,520 (2007 – $71,940) has been included in administrative expenses.

The following table summarizes information relating to the share purchase options for the year ended December 31, 2008:

	Options outstanding	Weighted average exercise price $
Balance – December 31, 2007	184,900	1.11
Granted	770,000	1.58
Exercised	(62,400)	1.08
Cancelled	(62,500)	1.90
Expired	(7,500)	1.50
Balance – December 31, 2008	822,500	1.49

Information relating to options outstanding and exercisable as at December 31, 2008 is as follows:

Exercise price $	Options outstanding	Weighted average remaining contracted life (years)	Options exercisable	Weighted average remaining contracted life (years)
1.00	270,000	4.66	270,000	4.66
1.10	115,000	3.45	115,000	3.45
1.90	437,500	4.42	437,500	4.42
	822,500	4.36	822,500	4.36

The options, when granted, are accounted for at their fair value determined by the Black-Scholes option pricing model based on the vesting period and on the following weighted average assumptions:

	2008	2007
Average dividend per share	Nil	Nil
Volatility	98%	111%
Risk-free interest rate	3.17%	4.71%
Weighted average expected life	5 years	5 years
Weighted average fair value of options granted	$0.24	$0.87

13 Contributed surplus

The following are the changes in the Company's contributed surplus:

	2008 $	2007 $
Balance – Beginning of year	532,794	460,854
Stock-based compensation	256,520	71,940
Exercise of options	(52,529)	-
Shares purchased and cancelled	416,320	-
Balance – End of year	1,153,105	532,794

14 Cash flow information

The changes in non-cash operating working capital items are as follows:

	2008 $	2007 $
Increase in prepaid insurance	(6,628)	-
Increase in accounts receivable	(63,093)	(15,518)
Decrease (increase) in restricted cash	500	(500)
Increase (decrease) in accounts payable and accrued liabilities	(28,725)	18,897
Increase in taxes payable	9,922	-
	(88,024)	2,879

For the year ended December 31, 2008, the Company's investments in deferred exploration expenses amounted to $330,021 (2007 – $47,430), of which $303,262 (2007 – $47,430) has been paid.

15 Related party transactions

Related party transactions occurred in the normal course of business and were recorded at the exchange values, which is the consideration determined and agreed to by the related parties. Unless indicated otherwise, the following transactions are included in general administrative expenses:

	2008 $	2007 $
Leasing contract*	24,000	-
Management consulting fees charged by a company controlled by a director of the Company	54,000	4,947
Administrative service fees charged by a company controlled by a director of the Company	81,225	-
Administrative service fees charged by a company controlled by a director of the Company (included in share issue expenses as a reduction of share capital)	13,680	-
Consulting fees charged by a company controlled by two directors of the Company	50,000	15,010
Consulting fees charged by a company controlled by a director of the Company	8,000	-
Legal services provided by a law firm controlled by a director of the Company (included in professional fees)	-	22,202
	230,905	42,159

* The Company has entered into a lease for an office in Rouyn-Noranda with a company controlled by directors and officers of the Company.

16 Income taxes

A reconciliation of the combined Canadian federal and provincial income taxes at statutory rate and the Company's effective income tax expense are as follows:

	2008 $	2007 $
Income taxes at statutory rate	(47,343)	(120,850)
Non-deductible expense	80,470	23,255
Reduction in federal tax rates and other	98,430	321,363
Loss carryforwards expired	70,870	-
Change in valuation allowance	(202,427)	(309,768)
Future income tax recovery	-	(86,000)

Under the provisions of CICA EIC-146, "Flow-Through Shares", a future income tax liability must be recognized and shareholders' equity reduced on the date that the entity renounces the tax credits associated with flow-through expenditures, provided that there is reasonable assurance that the expenditures will be made.

Where the entity has unrecognized future tax assets and the taxable temporary differences relating to the flow-through shares are expected to reverse during the loss carryforward period, these tax assets can be applied against the full taxable temporary difference. The recognition of the benefits results in a future income tax recovery.

In 2007, the Company issued flow-through units for gross proceeds of $320,000 (2008 – nil). Under the flow-through share agreements, the Company agreed to renounce $320,000 of qualifying expenditures to the investors effective December 31, 2007, although, under Canadian tax law, the expenditures have been incurred up to December 31, 2008.

The Company is required to record a provision at the time the renunciation is filed with tax authorities, by an increase in the share and warrant issue expenses relating to the flow-through shares, for future income taxes related to the tax deductions the Company has foregone. The Company filed its renunciation with the authorities in 2007; therefore, estimated future income taxes of $86,000 were recorded as at December 31, 2007 (2008 – nil). Consequently, the Company has recognized such expenses as share and warrant issue expenses in 2007 (2008 – nil).

The components of future income tax assets are as follows:

	2008 $	2007 $
Resource assets	169,129	694,175
Non-capital loss carryforwards	349,212	241,830
Capital losses	1,788,089	1,539,187
Unrealized gain	(1,236)	-
Financing fees	148,172	26,916
	2,453,366	2,502,108
Less: Valuation allowance	(2,453,366)	(2,502,108)
Future income tax recovery	-	-

As at December 31, 2008, the Company has accumulated non-capital losses for income tax purposes amounting to approximately $1,298,000. These losses will expire as follows:

		$
Years ending December 31,	2010	46,000
	2014	65,000
	2015	85,000
	2026	91,000
	2027	348,000
	2028	663,000

The Company's balance of capital losses amounts to approximately $11,500,000 and can be carried forward indefinitely to be used against future capital gains.

The unamortized balance for tax purposes of share and warrant issue expenses amounting to approximately $551,000 is deductible over the next four years.

17 Financial instruments

The Company is exposed to various financial risks resulting from both its operations and its investment activities. The Company's management manages its financial risks. The Company does not enter into financial instrument agreements including derivative financial instruments for speculative purposes. The Company's main financial risk exposure and its financial risk management policies are as follows.

Interest rate risk

Interest rate risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate as a result of changes in market interest rates. Cash equivalents bear interest at fixed rates.

Other current financial assets and financial liabilities are not exposed to interest rate risk because they are non-interest bearing.

The Company does not use derivative financial instruments to mitigate its exposure to interest rate risk.

Credit risk

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. The Company is subject to concentrations of credit risk through its cash and cash equivalents and accounts receivable. The Company reduces its credit risk by maintaining part of its cash and cash equivalents in financial instruments guaranteed by and held with a Canadian chartered bank.

It is management's opinion that the Company is not exposed to significant credit risk.

Currency risk

It is management's opinion that the Company is not exposed to significant foreign exchange risk. As at December 31, 2008, all financial assets and financial liabilities are denominated in Canadian dollars, as are all its activities.

Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet the obligations associated with its financial liabilities. As at December 31, 2008, the Company had enough funds available to satisfy its obligations under accounts payable and accrued liabilities. All of the Company's financial liabilities have contractual maturities of less than three months and are subject to normal trade terms.

In the past few years, the Company has financed its liquidity needs primarily by issuing equity securities. As the Company has currently incurred operating losses, additional capital will be required to continue exploration activities on its properties (notes 1 and 2).

Fair value

The fair value of financial instruments is summarized as follows:

	2008		2007	
	Carrying amount $	**Fair value $**	**Carrying amount $**	**Fair value $**
Financial assets				
Held for trading				
Cash and cash equivalents	4,296,385	4,296,385	472,356	472,356
Short-term investments	91,716	91,716	-	-
Available for sale				
Short-term investments	760,000	760,000	-	-
Loans and receivables				
Interest income receivable	22,883	22,883	-	-
Financial liabilities				
Other liabilities				
Accounts payable and accrued liabilities	49,258	49,258	51,222	51,222

Fair value estimates are made at the balance sheet date, based on relevant market information and other information about financial instruments.

As at December 31, 2008, all financial instruments (cash and cash equivalents, interest income receivable, and accounts payable and accrued liabilities) have fair values which approximate their carrying values as a result of the relatively short period to maturity of the instruments. For short-term investments, refer to note 6.

18 Comparative figures

Certain comparative figures have been reclassified to conform to the presentation adopted for the year ended December 31, 2008.

19 Subsequent events

a) In **connection with the transaction with Brownstone, the Company issued 150,000 units to PowerOne Capital Markets** Limited ("PowerOne") as brokers' options on February 10, 2009. Each unit is comprised of one common share of the Company and one common share purchase warrant. Each purchase warrant entitles PowerOne to purchase an additional common share of the Company.

b) From January 1 to April 30, 2009, the Company purchased 320,500 common shares at an average price of $0.29 in the course of the normal course issuer bid.