X·TERRA

RESOURCES CORPORATION

ANNUAL REPORT 2010

X-TERRA RESOURCES CORPORATION
(an exploration stage company)
(the "Company" or "X-Terra")

MANAGEMENT DISCUSSION AND ANALYSIS ("MD&A")

FOR THE YEAR ENDED DECEMBER 31, 2010 (the "Period")

The Company prepares its financial statements in accordance with Canadian generally accepted accounting principles ("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, 2010 and 2009 and the related notes thereto. 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 29, 2011.

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 expenses 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.

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 Frankfurt, Munich and Berlin Exchanges in Europe under the symbol DFUA.

During the first quarter of 2010, the Company with its partner Brownstone Ventures applied to acquire approximately 150,000 hectares of additional land in the St-Laurent Lowlands between Rimouski and Riviere-du-Loup. Area participants, like Questerre Energy Corp., continue to make progress confirming the potential for significant oil and gas in Quebec. X-Terra Resources and Brownstone Ventures' Québec Oil and Gas Licenses, with this new acquisition, cover a total of over 300,000 hectares in Quebec.

In June 2010, X-Terra Resources Corp. has released the results of its annual and special meeting of shareholders held on June 25, 2010, in Rouyn-Noranda, Québec. At the meeting, shareholders elected Martin Dallaire, Sylvain Champagne, Sebastien Plouffe, Xin Zhao, Richard Patricio and Sheldon Inwentash as members of the board of directors of X-Terra Resources. The shareholders also reappointed PricewaterhouseCoopers LLP, chartered accountants, as the auditors of X-Terra Resources. At the meeting, shareholders also approved a resolution ratifying and confirming X-Terra Resources' stock option plan.

In July 2010, the Company received the approval of the TSX Venture Exchange for the extension of 5,000,000 warrants

and the new expiry date became July 11, 2013 instead of July 11, 2011.

In September 2010, the department of the Quebec Natural Resources officially approved X-Terra and Brownstone's license's application for a total of 157,570 hectares. This exploration project has been named Trois-Pistoles and is shared on a ratio 50%-50% with Brownstone Ventures.

PROPERTIES

1. Mining Properties

Lindsay Property (25 claims)

The 100% owned Lindsay rare earth elements (REE) 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 25 unpatented mining claims (1,534 hectares) in Villedieu Township. A total of $207,075 has been spent on the property in 2010. The Lindsay project is a mid-stage exploration project with historical uranium and rare-earth-elements 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 $57US/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. In February 2009, Aurizon reports encouraging rare earth results, they drilled 104 metres of 0.063% REE+Y north of the Lindsay property. In 2010, a total of three diamond drill holes totalling 358 metres have been done on the Lindsay property. More than 110 samples were sent to a lab for assaying; however, no economic results were obtained from this drilling campaign. The maps are available on the Company's website at www.xterraresources.com.

Cool Lake Property (40 claims)

A total of $34 999 has been spent on the property so far. The exploration program on the Cool Lake property has been completed and no target that justifies a drilling program has been identified. The Company decided to not renew the claims and wrote-off the property for an amount of $2,172 and deferred explorations expenses for an amount of $34,955.

Other projects

The Company is continuously looking to add resources base projects in the Company.

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.

A compilation has been completed and a 50/50 farm out deal has been finalized with well known oil and gas networked partner/operator named Brownstone Ventures Inc ("Brownstone"). In 2008, X-Terra entered into agreement with

Brownstone pursuant to which Brownstone acquired a 50% interest in the exploration licenses in exchange for the issuance to X-Terra of 2,000,000 common shares and 2,000,000 common shares purchase warrants. X-Terra still owns theses shares but all warrants have expired on October 28, 2010.

X-Terra and its partner Brownstone Ventures Inc. have made a 5,543-kilometre airborne magnetic survey on the Rimouski, Rimouski North and Shawinigan projects in the St. Laurent Lowlands, Quebec. The survey is composed of 5,543 kilometres of 300-metre-spacing flight lines and 3,000-metre-spacing control lines and was completed by Geophysics GPR International-KalusAir Services Inc. (KASI). Preliminary results from this last study suggest structural fabrics, which could generate targets on the three projects. These structural fabrics have been investigated by a geological field survey in August and September, 2010, in order to renew the permits of Rimouski and Rimouski North properties which have good potential targets. The Shawinigan permits have not been renewed and the Company wrote-off the property for an amount of $6,763 and deferred exploration expenses for an amount of $20,436. The maps are available on the Company's website at www.xterraresources.com.

Trois-Pistoles property (8 permits)

The Company with its partner Brownstone Ventures Inc. have acquired 157,570 hectares of additional land in the St-Laurent Lowlands between Rimouski and Riviere-du-Loup for the potential in oil and gas. An airborne magnetic survey flew over the Trois-Pistoles project by the Quebec Natural Resources department is now available and will be used for the technical compilation currently in progress.

SUMMARY OF ANNUAL AND QUARTERLY INFORMATION

Selected Annual Information and Operation Results

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

	Fiscal year ended December 31,		
	2010	**2009**	**2008**
	($)	**($)**	**($)**
Interest income	62,542	28,480	76,555
Income (loss)	(1,336,448)	(146,993)	153,212
Income (loss) per share	(0.11)	(0.01)	0.02

	As at December 31,		
	2010	**2009**	**2008**
	($)	**($)**	**($)**
Total assets	6,960,516	7,351,778	6,612,230

Operating activities

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 2010, the Company registered a net loss of $1,336,448 in comparison with a net loss registered for the fiscal year 2009 at $146,993. The Company has recorded interest income of $62,542 ($28,480 in 2009) and the increase in mainly due to interest rates which were higher. The Company also recorded a loss on investments held for trading of $275,600 (gain in 2009 - $198,284). The Company has recorded an expenses of $660,000 regarding the extension of 5,000,000 warrants (2009 – $60,198 regarding the extension of 650,000 warrants). There is a future income tax recovery of $29,590 in 2010 (2009 - $130,817). The Company wrote-off mining properties for an amount of $8,935 and deferred exploration expenses for $55,391 in 2010 against no amount in 2009. The Company's administrative expenses for 2010 are at $428,654 (2009 - $438,658) and include stock-based compensation of $58,500 (2009 - $69,020). Insurance fees have increased from $8,133 in 2009 to $8,228 in 2010. Professional fees have increased from $44,492 in 2009 to $51,075 in 2010 mainly due to the cost for the professional evaluation of a proposed acquisition. General administrative expenses have decreased and went from $285,606 in 2009 to $280,186. General administrative expenses are composed of bank charges to $513 ($5,246 in 2009), advertising and promotion to $5,113 ($4,980 in 2009), office operations to $28,410 ($29,206 in 2009), website to $12,220 ($12,000 in 2009), travelling expenses to $13,911 ($18,654 in 2009) and management and administrative services to $220,019 ($215,520 in 2009). Allocated sums for shareholders' communication went from $8,187 in 2009 to $6,526 in 2010. Allocated sums for transfer agent and regulatory fees have increased from $19,553 in 2009 to $19,795 in 2010. The other administrative expenses remained relatively stable, are cyclical and may fluctuate according to the events, which are not always predictable.

Financing activities
No financing has been raised in 2010 and the Company does not expect anyone in the near future.

Investing activities
In 2010, the Company had cash outflow of $11,416 in acquisition of property, plant and equipment, $14,247 in acquisition of mining and oil and gas properties and $264,612 in deferred exploration expenses. In 2010, the Company received $90,404 in tax credits and mining duties and should receive the balance of $126,609 during 2011.

Liquidity and working capital
As at December 31, 2010, the Company had a working capital of $5,286,250 (December 31, 2009 - $5,817,717), including cash and cash equivalents of $2,133,942 (December 31, 2009 - $2,609,361). The Company's liquidity ($2,133,942) with investments and marketable securities ($3,002,970) represents $0.44 per share.

The exercise of the 1,175,000 shares purchase options as at December 31, 2010 and in date of this report represents an added potential financing of $1,256,500. These options expire between 2012 and 2020 and have an exercise price between $0.35 and $1.90.

As at December 31, 2010 the exercise of 5,150,000 warrants outstanding represented a potential financing of $7,725,000. However, 150,000 of these warrants expired in February 2011 (represented potential financing of $225,000) and 5,000,000 warrants expire in July 2013 (represents a potential financing of $7,500,000). They all have an exercise price of $1.50.

Summary of Quarterly Results
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**
Year	**2010**	**2010**	**2010**	**2010**	**2009**	**2009**	**2009**	**2009**
Revenues	71,758	70,195	62,689	78,561	35,482	74,387	30,796	45,304
Income (loss) for the period	(96,360)	(725,790)	(198,989)	(315,309)	145,308	(114,019)	(65,949)	(112,333)
Basic and diluted income (loss) per share	(0.01)	(0.06)	(0.02)	(0.03)	0.01	(0.01)	(0.01)	(0.01)
Total assets	6,960,516	6,104,903	5,983,187	6,519,548	7,351,778	6,662,876	6,434,284	6,280,121

Fourth Quarter
During the three month period ended December 31, 2010, the Company registered a net loss of $96,360 in comparison with the net income registered for the quarter ended December 31, 2009 at $145,308. The Company has recorded, for the quarter ended December 31, 2010, interest income of $21,528 ($2,778 for the quarter ended December 31, 2009), and unrealized gain on investments held for trading of $14,400 (unrealized gain of $160,600 for the quarter ended December 31, 2009). The Company registered $29,590 future income tax recovery for the last quarter of 2010 in comparison of $130,817 for the last quarter of 2009. The Company's administrative expenses for the quarter ended December 31, 2010 are at $97,552 ($82,971 for the quarter ended December 31, 2009). Professional fees have increased from $4,200 for the quarter ended December 31, 2009 to $15,695 for the quarter ended December 31, 2010 mainly due to the cost for the professional evaluation of a proposed acquisition. General administrative expenses have increased and went from $73,456 for the quarter ended December 31, 2009 to $76,973 for the quarter ended December 31, 2010. The Company wrote-off mining properties for an amount of $8,935 and deferred exploration expenses for $55,391 for the quarter ended December 31, 2010 against no amount for the quarter ended December 31, 2009. The other administrative expenses for the last quarter of 2010 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 Properties (All properties are located in Canada)

Deferred exploration expenses

						2010
Property	**Undivided interest %**	**Balance – Beginning of year $**	**Increase $**	**Writeoff $**	**Refundable tax credits and mining duties $**	**Balance – End of year $**
Lindsay	100	415,159	207,075	-	(103,063)	519,171
Cool Lake	100	34,892	107	(34,955)	(44)	-
Rimouski	50	14,434	27,034	-	(10,781)	30,687
Rimouski North	50	15,849	28,211	-	(11,247)	32,813
Shawinigan	50	12,002	14,100	(20,436)	(5,666)	-
Trois-Pistoles	50	-	585	-	(250)	335
		492,336	277,112	(55,391)	(131,051)	583,006

					2009
Property	**Undivided interest %**	**Balance – Beginning of year $**	**Increase $**	**Refundable tax credits and mining duties $**	**Balance – End of year $**
Lindsay	100	346,865	119,395	(51,101)	415,159
Cool Lake	100	29,993	8,564	(3,665)	34,892
Rimouski	50	593	24,197	(10,356)	14,434
Rimouski North	50	-	27,708	(11,859)	15,849
Shawinigan	50	-	20,983	(8,981)	12,002
		377,451	200,847	(85,962)	492,336

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 sheets 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 administrative expenses. These related party transactions were recorded at the exchange value, which is the consideration determined and agreed to by the related parties.

	2010 $	**2009 $**
Leasing contract*	24,000	24,000
Management consulting fees charged by a company controlled by a director of the Company	72,000	72,000
Administrative service fees charged by a company controlled by a director of the Company	144,690	143,520
	240,690	239,520

* 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.

GENERAL ADMINISTRATIVE EXPENSES AND PROFESSIONAL FEES

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

	$ 2010	$ 2009
Bank charges	513	5,246
Advertising and promotion	5,113	4,980
Office operations and facilities	28,410	29,206
Website	12,220	12,000
Traveling expenses	13,911	18,654
Management and administrative services	220,019	215,520
	280,186	285,606

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

	$ 2010	$ 2009
Audit and related services	32,020	32,673
Consulting fees	15,000	-
Legal	4,055	11,819
	51,075	44,492

CRITICAL ACCOUNTING ESTIMATES

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities as at the balance sheet date, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. A detailed summary of the Company's significant accounting policies is included in Note 3 of the Company's annual audited financial statements for the year ended December 31, 2010. Significant areas requiring the use of management estimates include:

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, it will test for impairment by comparing the fair value to the carrying amount, without first performing a test for recoverability.

Income Tax

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.

Stock Based Compensation and Other Stock Based Payments

The Company applies the fair value method to account for options granted to its directors, officers, employees and consultants. This method consists of recording expenses for the options granted over the vesting period for employees and over the period covered by the contracts for consultants. Any consideration paid on exercise of stock options is credited to share capital. Contributed surplus resulting from stock-based compensation is transferred to share capital when the options are exercised.

FUTURE ACCOUNTING CHANGES

International Financial Reporting Standards Implementation Plan

The Canadian Accounting Standards Board has confirmed that IFRS will replace current GAAP for publicly accountable

enterprises effective for fiscal years beginning on or after January 1, 2011. The Corporation will report interim and annual financial statements in accordance with IFRS beginning with the quarter ended March 31, 2011. The Company's fiscal 2011 interim and annual financial statements will include comparative fiscal 2010 financial statements, adjusted to comply with IFRS.

IFRS Transition Plan

The Company is in the process of executing a comprehensive IFRS transition plan and engaged third party advisors to assist with the planning and implementation of its transition to IFRS. The following summarizes the Company's expectations with respect to its IFRS transition plan:

Initial scoping and analysis of key areas for which accounting policies may be impacted by the transition to IFRS.	The Company has completed an initial scoping study to identify key areas that may be impacted by the transition to IFRS.
Detailed evaluation of potential changes required to accounting policies, information systems and business processes, including the application of IFRS 1 First-time Adoption of International Financial Reporting Standards.	The Company has completed an evaluation of the bulk of the potential changes and plans to complete this evaluation by the end of May 2011.
Final determination of accounting policies and the quantitative impact of adopting IFRS on key line items in the Company's financial statements	Key IFRS 1 exemption decisions and accounting policies changes will be approved by management and presented to the Audit Committee of the Board of Directors. Implementation of these accounting changes and required modifications to internal procedures, controls and systems will be made by the end of May 2011. The implementation will include a revised accounting policy manual and new internal financial reporting policies and controls, which will be monitored by management throughout the implementation process. It also includes the preparation of a January 1, 2010 opening balance sheet and 2010 comparative data under IFRS, with reconciliations from Canadian GAAP. The calculations to measure the impacts on the opening balance sheet are still ongoing; therefore, the Company is not able to reliably quantify the impacts expected on its consolidated financial statements for these differences at this time.
Resolution of the accounting policy change implications on information technology, business processes and contractual arrangements.	Based on the analysis performed to date, the Company is not expecting its information technology, business processes or contractual arrangements to be significantly impacted.

First-Time Adoption of IFRS

The adoption of IFRS requires the application of IFRS 1 First-time Adoption of International Financial Reporting Standards ("IFRS 1"), which provides guidance for an entity's initial adoption of IFRS. IFRS 1 generally requires retrospective application of IFRS as effective at the end of its first annual IFRS reporting period. However, IFRS 1 also provides certain optional exemptions and mandatory exceptions to this retrospective treatment.

IFRS 1 does not permit changes to estimates that have been made previously. Accordingly, estimates used in the preparation of the Corporation's opening IFRS statement of financial position will be consistent with those made when preparing the Company's financial statements under current GAAP.

Impact of Adopting IFRS on the Company's Financial Statements

The adoption of IFRS will result in some changes to the Company's accounting policies that are applied in the recognition, measurement and disclosure of balances and transactions in its financial statements. However, based on its evaluation to date, the Company does not expect any changes to its accounting policies that would result in material changes to line items within its financial statements.

The following provides a summary of the Company's evaluation of potential changes to accounting policies in key areas based on the current standards and guidance within IFRS. This is not intended to be a complete list of areas where the adoption of IFRS will require a change in accounting policies, but to highlight the areas the Company has identified as having the most potential for a significant change. The International Accounting Standards Board has a number of ongoing

projects, the outcome of which may have an effect on the changes required to the Company's accounting policies on adoption of IFRS. At the present time, however, the Company is not aware of any significant expected changes that would affect the summary provided below.

Mineral Property Interests, Exploration and Evaluation Costs (IFRS 6)
Subject to certain conditions, IFRS currently allows an entity to determine an accounting policy that specifies the treatment of costs related to the exploration for and evaluation of mineral properties. The Company's current policy for exploration and evaluation costs will be acceptable under IFRS.

Impairment of Assets
IFRS requires a write down of assets if the higher of the fair market value and the value in use of a group of assets is less than its carrying value. Value in use is determined using discounted estimated future cash flows. Current GAAP requires a write down to estimated fair value only if the undiscounted estimated future cash flows of a group of assets are less than its carrying value.

The Company's accounting policies related to impairment of non-financial assets will be changed to reflect these differences. The Company will perform impairment assessments in accordance with IFRS at the transition date.

Share-based Payments (IFRS 2)
In certain circumstances, IFRS requires a different measurement of stock-based compensation related to stock options than current GAAP.

The Company's accounting policies related to stock-based payments will be changed to reflect these differences.

Property and Equipment
IFRS contains different guidance related to recognition and measurement of property and equipment than current GAAP.

The Company does not expect any changes to its accounting policies related to property and equipment that would result in a significant change to line items within its financial statements.

Income Taxes
IFRS contains some different guidance related to recognition and measurement of future (deferred) income taxes. One of those differences relates to accounting for flow-through common shares, for which IFRS does not include the same level of specific guidance provided under current GAAP.

The Company has not completed its detailed evaluation of the differences between IFRS and current GAAP related to accounting for income taxes and for the accounting treatment of flow through shares. These differences could require changes to accounting policies that may impact the Company's financial statements and require adjustments to future (deferred) income taxes and shareholders' equity.

Impact of Adopting IFRS on the Company's Business
The Company may be required, during its conversion to IFRS, to make some changes to its accounting systems and business processes. The Company anticipates that such changes will be minimal and that its systems and processes can accommodate any necessary minimal changes.

The Board of Directors and Audit Committee have been regularly updated on the progress of the IFRS conversion plan, and are aware of the key aspects of IFRS affecting the Company.

The Company's first financial statements prepared in accordance with IFRS will be the interim financial statements for the three months ending March 31, 2011, which will include notes disclosing transitional information and disclosure of new accounting policies under IFRS. The interim financial statements for the three months ending March 31, 2011, will also include fiscal 2010 financial statements for the comparative period, adjusted to comply with IFRS, and the Company's transition date IFRS statement of financial position (as of January 1, 2010).

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.

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 cash and cash equivalents, marketable securities, investments and accounts receivable. Accounts receivable mainly consists of refundable tax credits and mining duties from the federal and Quebec governments, goods and services tax due from the federal government and provincial sales tax due from the Quebec government, amounts receivable from a partner and interest receivable from reputable institutions. 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 and the remainder in financial instruments guaranteed by Canadian chartered banks held with an independent investment dealer member of the Canadian Investor Protection Fund. The marketable securities are composed of bonds from reputable financial and corporate institutions.

Currency risk

It is management's opinion that the Company is not exposed to significant foreign exchange risk. As at December 31, 2010, 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 have insufficient cash resources to meet its financial obligations as they come due. The Company generates cash flows primarily from its financing activities. As at December 31, 2010, the Company had a cash and cash equivalents balance of $2,133,942 (2009 – $2,609,361) to settle current liabilities of $71,758 (2009 – $35,482). All of the Company's financial liabilities have contractual maturities of less than 30 days and are subject to normal trade terms. The Company regularly evaluates its cash position to ensure preservation and security of capital as well as maintenance of liquidity.

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.

Market risk

Market risk is the risk of loss that may arise from changes in market factors such as interest rates.

Interest rate risk

Interest rate risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate due to changes in market interest rates. The Company has cash balances, and its current policy is to invest excess cash in certificates of deposit or money market funds of major Canadian chartered banks. The bonds included in marketable securities bear interest at a fixed rate, and the Company is, therefore, exposed to the risk of changes in fair value resulting from interest rate fluctuations. The sensitivity of the Company to a variation of 1% in the interest rate would not have a significant impact. The Company's other financial assets and liabilities do not comprise any interest rate risk since they do not bear interest.

Fair value

The fair value of financial instruments is summarized as follows:

	2010		2009	
	Carrying value $	Fair value $	Carrying value $	Fair value $
Financial assets				
Held for trading				
Cash and cash equivalents	2,133,942	2,609,361	2,609,361	2,609,361
Marketable securities	1,022,970	1,008,570	1,008,570	1,008,570
Investments	-	-	290,000	290,000
Available for sale				
Investments	1,980,000	1,980,000	1,760,000	1,760,000
Loans and receivables				
Receivable from a partner	62,370	62,370	67,718	67,718
Interest income receivable	5,506	5,506	-	-
Advance for shale gas permits	-	-	16,150	16,150
Financial liabilities				
Other liabilities				
Accounts payable and accrued liabilities	71,758	71,758	35,482	35,482

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

Fair value hierarchy

The following table summarizes the fair value hierarchy under which the Company's financial instruments are valued.

Level 1 includes unadjusted quoted prices in active markets for identical assets or liabilities. Level 2 includes inputs other than quoted prices included in Level 1 that are observable for the assets or liabilities, either directly or indirectly. And Level 3 includes inputs for the asset or liabilities that are not based on observable market data. For those fair value measurements included in Level 3 of the fair value hierarchy, a reconciliation from the opening balances to the closing balances has been provided.

				Assets measured at fair value As at December 31, 2010
	Level 1 $	Level 2 $	Level 3 $	Total $
Held for trading				
Cash on hand and bank balances	305,683	-	-	305,683
Money market funds	1,828,259	-	-	1,828,259
Marketable securities	-	1,022,970	-	1,022,970
Investments in warrants	-	-	-	-
	2,133,942	1,022,970	-	3,156,912
Available for sale				
Investments in common shares	1,980,000	-	-	1,980,000

	Assets measured at fair value As at December 31, 2009			
	Level 1 $	Level 2 $	Level 3 $	Total $
Held for trading				
Cash on hand and bank balances	608,168	-	-	608,168
Money market funds	2,001,193	-	-	2,001,193
Marketable securities	-	1,008,570	-	1,008,570
Investments in warrants	-	-	290,000	290,000
	2,609,361	1,008,570	290,000	3,907,931
Available for sale				
Investments in common shares	1,760,000	-	-	1,760,000

	Reconciliation of long-term investments measured at fair value based on Level 3 inputs	
	2010 $	2009 $
Balance – Beginning of year	290,000	91,716
Expiration of warrants	(290,000)	-
Change in fair value	-	198,284
Balance – end of year	-	290,000

Risk and Uncertainties

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 expenses 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 Regulations

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.

Also, no assurance can be made that Canada Revenue Agency and provincial agencies will agree with the Company's characterization of expenses as Canadian exploration expenses or Canadian development expense or the eligibility of such expenses as Canadian exploration expense under the Income Tax Act (Canada) or any provincial equivalent.

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.

Key Employees

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. The Company's properties are in the exploration stage and to date none of them have a proven ore body. The Company does not have a history of earnings or the provision of return on investment, and in future there is no assurance that it will produce revenue, operate profitably or provide a return on investment. 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.

Competition
The mining industry is intensely competitive in all its phases. The Company competes with many companies possessing greater financial resources and technical facilities than itself for the acquisition of mineral interests as well as for recruitment and retention of qualified employees.

Uninsured Hazards
Hazards such as unusual geological conditions are involved in exploring for and developing mineral deposits. The Company may become subject to liability for pollution or other hazards, which cannot be insured against or against which the Company may elect not to insure because of high premium costs or other reasons. The payment of any such liability could result in the loss of Company assets or the insolvency of the Company.

OTHER MD&A REQUIREMENTS

Share capital

As at April 29, 2011, the Company had the following:
Issued and outstanding- 11,783,069 shares

Warrants outstanding:

Expiry date	Number of warrants outstanding	Exercise price ($)
July 2013[1]	5,000,000	1.50

(1) In June 2010, the Company has extended the life of these warrants from July 11, 2010 to July 11, 2013.

Stock options outstanding:

Expiry date	Number of options outstanding	Exercise price ($)
June 2012	60,000	1.10
June 2013	375,000	1.90
August 2013	270,000	1.00
July 2014	290,000	0.50
June 2020	180,000	0.35
	1,175,000	

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, amended in 2010, the term of stock options granted may not exceed ten 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 2010 of $58,500 (2009 – $69,020) has been included in administrative expenses.

OTHER INFORMATION

The Company's web address is www.xterraresources.com. Further information regarding the Company and its operations are filed electronically on the System for Electronic Document Analysis and Retrieval (SEDAR) in Canada and can be obtained from www.sedar.com.

FORWARD-LOOKING STATEMENTS

Certain statements in this document that are not supported by historical facts are forward-looking, which means that they are subject to risks, uncertainties and other factors that may result in actual results differing from those anticipated or implied by such forward-looking statements. There are many factors that may cause such a disparity, notably unstable metals prices, the impact of fluctuations in foreign exchange markets and interest rates, poor reserves estimates, environmental risks (more stringent regulations), unexpected geological situations, unfavorable mining conditions, political risks arising from mining in developing countries, changing regulations and government policies (laws or policies), failure to obtain required permits and approval from government authorities, or any other risk related to mining and development. Even though the Company believes that the assumptions relating to the forward-looking statements are plausible, it is unwise to rely unduly on such statements, which were only valid as of the date of this document.

April 29, 2011.

(S) Martin Dallaire
Martin Dallaire, President and Chief Executive Officer

(S) Sylvain Champagne
Sylvain Champagne, Chief Financial Officer

X-Terra Resources Corporation

(an exploration stage company)

Consolidated Financial Statements

December 31, 2010 and 2009

PRICEWATERHOUSECOOPERS

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April 29, 2011

Independent Auditor's Report

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

We have audited the accompanying consolidated financial statements of X-Terra Resources Corporation, which comprise the consolidated balance sheets as at December 31, 2010 and 2009 and the consolidated statements of operations and deficit, comprehensive income (loss) and cash flows for the years then ended, and the related notes including a summary of significant accounting policies.

Management's responsibility for the consolidated financial statements
Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility
Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

"PricewaterhouseCoopers" refers to PricewaterhouseCoopers LLP/s.r.l./s.e.n.c.r.l., an Ontario limited liability partnership, which is a member firm of PricewaterhouseCoopers International Limited, each member firm of which is a separate legal entity.

PRICEWATERHOUSECOOPERS

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of X-Terra Resources Corporation as at December 31, 2010 and 2009 and the results of its operations and its 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, 2010 and 2009

	2010 $	2009 $
Assets		
Current assets		
Cash and cash equivalents (note 4)	2,133,942	2,609,361
Marketable securities (note 5)	1,022,970	1,008,570
Investments (note 6)	1,980,000	2,050,000
Accounts receivable (note 7)	215,352	179,525
Prepaid insurance	5,744	5,743
	5,358,008	5,853,199
Property, plant and equipment (note 8)	17,535	9,588
Mining and oil and gas properties (note 9)	1,001,967	996,655
Deferred exploration expenses (note 10)	583,006	492,336
	6,960,516	7,351,778
Liabilities		
Current liabilities		
Accounts payable and accrued liabilities	71,758	35,482
Shareholders' Equity		
Share capital (note 11)	25,440,232	25,440,232
Warrants and brokers' options (note 11)	1,848,627	1,736,775
Contributed surplus (note 13)	2,676,860	2,070,212
Deficit	(24,109,172)	(22,772,724)
Accumulated other comprehensive income	1,032,211	841,801
	6,888,758	7,316,296
	6,960,516	7,351,778

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, 2010 and 2009

	2010 $	2009 $
Administrative expenses		
Insurance	8,228	8,133
Professional fees	51,075	44,492
General administrative expenses	280,186	285,606
Shareholders' communication	6,526	8,187
Transfer agent and regulatory fees	19,795	19,553
Stock-based compensation (note 12)	58,500	69,020
Amortization of property, plant and equipment	4,344	3,667
	428,654	438,658
Other expenses (income)		
Interest income	(62,542)	(28,480)
Extension of warrants (note 11)	660,000	60,198
Loss (gain) on investment held for trading (notes 5 and 6)	275,600	(198,284)
Transaction costs on investment held for trading	-	5,718
Writeoff of mining and oil and gas properties	8,935	-
Writeoff of deferred exploration expenses	55,391	-
	937,384	(160,848)
Loss before income taxes	(1,366,038)	(277,810)
Future income tax recovery (note 16)	(29,590)	(130,817)
Net loss for the year	(1,336,448)	(146,993)
Deficit – Beginning of year	(22,772,724)	(22,625,731)
Deficit – End of year	(24,109,172)	(22,772,724)
Basic and diluted net loss per share	(0.11)	(0.01)
Weighted average number of shares outstanding		
Basic	11,783,069	11,725,116
Diluted	11,783,069	11,725,116

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

X-Terra Resources Corporation

(an exploration stage company)

Consolidated Statements of Comprehensive Income (Loss)

For the years ended December 31, 2010 and 2009

	2010 $	2009 $
Net loss for the year	(1,336,448)	(146,993)
Other comprehensive income		
Unrealized gain on available-for-sale investment, net of related income taxes of $29,590 (2009 – $130,817) (note 6)	190,410	841,801
Comprehensive income (loss) for the year	(1,146,038)	694,808

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, 2010 and 2009

	2010 $	2009 $
Cash flows from		
Operating activities		
Net loss for the year	(1,336,448)	(146,993)
Adjustments for		
Stock-based compensation (note 12)	58,500	69,020
Extension of warrants	660,000	60,198
Amortization of property, plant and equipment	4,344	3,667
Unrealized gain on investment held for trading (notes 5 and 6)	(14,400)	(198,284)
Realized loss on investment held for trading (note 6)	290,000	-
Writeoff of mining and oil and gas properties	8,935	-
Writeoff of deferred exploration expenses	55,391	-
Transaction costs on investments held for trading	-	5,718
Future income taxes	(29,590)	(130,817)
	(303,268)	(337,491)
Changes in non-cash operating working capital items (note 14)	27,720	(45,485)
	(275,548)	(382,976)
Financing activities		
Purchase of shares under normal course issuer bid	-	(93,880)
Investing activities		
Net acquisition of marketable securities	-	(1,008,570)
Acquisition of property, plant and equipment	(11,416)	-
Acquisition of mining and oil and gas properties	(14,247)	(8,581)
Tax credits and mining duties received	90,404	-
Deferred exploration expenses	(264,612)	(193,017)
	(199,871)	(1,210,168)
Decrease in cash and cash equivalents during the year	(475,419)	(1,687,024)
Cash and cash equivalents – Beginning of year	2,609,361	4,296,385
Cash and cash equivalents – End of year (note 4)	2,133,942	2,609,361

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 oil and gas properties. It has interests in properties at the exploration stage located in Canada and has not yet determined whether they contain mineral deposits that are economically recoverable.

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 obtaining certain government approvals and future profitable production or proceeds from the disposal of properties. Changes in future conditions could require material writedowns of the carrying value of mining and oil and gas properties.

Although the Company has taken steps to verify title to a certain property on which it is conducting exploration and in which it is acquiring an interest, in accordance with industry standards for the current stage of exploration of such property, these procedures do not guarantee the Company's title. Property title may be subject to unregistered prior agreements, and non-compliance with regulatory requirements.

As at December 31, 2010, the Company had working capital of $5,286,250 (2009 – $5,817,717) including cash and cash equivalents of $2,133,942 (2009 – $2,609,361) and accumulated deficit of $24,109,172 (2009 – $22,772,724), and had incurred a loss of $1,336,448 (2009 – $146,993) for the year then ended.

Management of the Company believes that it has sufficient funds to pay its ongoing general and administrative expenses, to pursue its 2011 budgeted exploration expenditures and to meet its liabilities, obligations and existing commitments for the ensuing 12 months as they fall due. In assessing whether the going concern assumption is appropriate, management takes into account all available information about the future, which is at least, but not limited to, 12 months from the end of the reporting period. The Company's ability to continue future operations beyond 2011 and fund its exploration expenditures is dependent on management's ability to secure additional financing in the future, which may be completed in a number of ways, including but not limited to, the issuance of debt or equity instruments. Management will pursue such additional sources of financing when required, and while management has been successful in securing financing in the past, there can be no assurance it will be able to do so in the future or that these sources of funding or initiatives will be available for the Company or that they will be available on terms which are acceptable to the Company.

2 Future accounting changes

The Company will cease to prepare its consolidated financial statements in accordance with Canadian generally accepted accounting principles ("GAAP") as set out in Part V of the Canadian Institute of Chartered Accountants ("CICA") Handbook – Accounting for the periods beginning on January 1, 2011, when it will start to apply as its primary basis of accounting International Financial Reporting Standards as published by the International Accounting Standards Board and as set out in Part I of the CICA Handbook – Accounting. Consequently, future accounting changes to Canadian GAAP are not discussed in these consolidated financial statements as they will never be applied by the Company.

3 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. All intercompany transactions and balances have been eliminated.

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 as at the consolidated balance sheet date and the reported amounts of revenues and expenses during the reporting period. Significant areas where management judgment is applied are assumptions and estimates relating to the useful life of assets for amortization purposes and for evaluation of their net recoverable amount, the determination of potential impairments of mining and oil and gas properties and deferred exploration expenses, valuation allowances for future income taxes and the fair value 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 consist of cash on hand, bank balances, and highly liquid short-term investments with original maturities of three months or less from the date of purchase and which are readily convertible to known amounts of cash.

Investments

Investments consist of investments in shares and warrants of a public company.

The investment that consists of shares of a public company is classified as available-for-sale investment. The investment in warrants of a public company is classified as investment 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 the available-for-sale investment or in net income for the investment held for trading. When the available-for-sale investment is disposed of or impaired, the 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 using the following method and rates:

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

Amortization of property, plant and equipment not related to exploration and development activities is recognized as an expense in the consolidated statement of operations. 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.

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. They 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 properties are placed into production, sold or abandoned. 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 or that it results from exploration work not warranting further investment.

Proceeds from the sale of exploration properties, including the payments received for options on mining and oil and gas properties, are applied by property 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. Governmental assistance, mining duties credits and other credits related to exploration work are applied against the deferred exploration expenses.

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, it 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 finances 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 share capital when the resource 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 the exchange rates in effect at the consolidated balance sheet dates. 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 consolidated balance sheet dates. 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 reflected in the consolidated statements of operations and deficit and comprehensive income (loss).

Loss per share

The calculation of loss per share is based on the weighted average number of shares outstanding for the year. Basic loss per share is calculated by dividing the net loss for the year by the weighted average number of common shares outstanding during the year. The computation of diluted 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 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 accounted for in the year in which they are incurred and are recorded as a decrease of the share capital in the year in which the shares are issued.

Stock-based compensation and other stock-based payments

The Company applies the fair value method to account for options granted to its directors, officers, employees and consultants. This method consists of recording expenses for the options granted over the vesting period for employees and over the period covered by the contracts for consultants. Any consideration paid on exercise of stock options is credited to share capital. 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 the consolidated statements of operations and deficit and comprehensive 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 of amortization.
- Available-for-sale financial assets are required to be measured at fair value, with unrealized gains and losses recognized in other comprehensive income. Fair value is based on the quoted market price at the reporting date. Investments in equity instruments classified as available for sale that do not have a quoted market price in an active market are measured at cost.

The Company has implemented the following financial instrument classifications:

Financial instrument	**Classification**
Cash on hand and bank balances	Held for trading
Money market funds	Held for trading
Marketable securities – Bonds	Held for trading
Investments	
Common shares of a public company	Available for sale
Warrants of a public company	Held for trading
Interest income receivable, receivable from a partner and advance for shale gas permits	Loans and receivables
Accounts payable and accrued liabilities	Other liabilities

4 Cash and cash equivalents

	2010 **$**	**2009** **$**
Cash on hand and bank balances	305,683	608,168
Money market funds	1,828,259	2,001,193
	2,133,942	2,609,361

5 Marketable securities

	2010		2009	
	Carrying value $	**Fair value $**	**Carrying value $**	**Fair value $**
Bonds				
Corporate	514,030	514,030	499,925	499,925
Financial institutions	508,940	508,940	508,645	508,645
Total	1,022,970	1,022,970	1,008,570	1,008,570

a) Allocation of bonds by maturity date

			2010
	2 Years $	**4 Years $**	**Total $**
Carrying value	508,940	514,030	1,022,970
Fair value	508,940	514,030	1,022,970

			2009
	3 Years $	**5 Years $**	**Total $**
Carrying value	508,645	499,925	1,008,570
Fair value	508,645	499,925	1,008,570

b) Interest rate

The bonds bear interest at fixed rates ranging from 3.27% to 4.90% (from 3.27% to 4.90% in 2009).

c) Fair value

For the year ended December 31, 2010, the Company recognized in net loss for the year an unrealized gain of $14,400 (2009 – nil) on marketable securities classified as held for trading.

6 Investments

	2010		2009	
	Carrying value $	**Fair value $**	**Carrying value $**	**Fair value $**
Available-for-sale investment				
Common shares of a public company*	1,980,000	1,980,000	1,760,000	1,760,000
Investment held for trading				
Warrants of a public company*	-	-	290,000	290,000
	1,980,000	1,980,000	2,050,000	2,050,000

* 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 entitled the Company to purchase one common share of Brownstone at a price of $2 until October 28, 2010. These warrants expired unexercised. 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, 2010, the Company recognized an unrealized gain of $220,000 (2009 – $972,618) on common shares of a public company designated as available for sale in other comprehensive income, and a $290,000 realized loss (2009 – unrealized gain of $198,284) on warrants of a public company classified as held for trading was included in net loss for the year. In 2009, transaction costs of $47,382 and $5,718 were recorded for the available-for-sale investment in common shares and held-for-trading investment in warrants, respectively.

7 Accounts receivable

	2010 $	2009 $
Refundable tax credits and mining duties	126,609	85,962
Sales taxes	20,867	9,695
Receivable from a partner	62,370	67,718
Interest income receivable	5,506	-
Advance for shale gas permits	-	16,150
	215,352	179,525

8 Property, plant and equipment

			2010
	Cost $	Accumulated amortization $	Net $
Computer equipment/software	13,875	7,263	6,612
Office furniture	6,008	1,715	4,293
Exploration equipment	7,800	1,170	6,630
	27,683	10,148	17,535

			2009
	Cost $	Accumulated amortization $	Net $
Computer equipment/software	11,952	4,841	7,111
Office furniture	3,440	963	2,477
	15,392	5,804	9,588

All property, plant and equipment are located in Canada.

9 Mining and oil and gas properties

			2010			
Property	**Number of claims/ permits**	**Undivided interest %**	**Balance – Beginning of year $**	**Net acquisitions $**	**Writeoff $**	**Balance – End of year $**
Lindsay[1]	25	100	978,444	1,745	-	980,189
Cool Lake[3]	40	100	2,172	-	(2,172)	-
Rimouski[2]	2	50	4,004	1,995	-	5,999
Rimouski North[2]	3	50	5,272	2,628	-	7,900
Shawinigan[2][3]	3	50	6,763	-	(6,763)	-
Trois-Pistoles	8	50	-	7,879	-	7,879
			996,655	14,247	(8,935)	1,001,967

			2009		
Property	**Number of claims/ permits**	**Undivided interest %**	**Balance – Beginning of year $**	**Net acquisitions $**	**Balance – End of year $**
Lindsay[1]	25	100	977,863	581	978,444
Cool Lake	40	100	2,172	-	2,172
Rimouski[2]	2	50	2,010	1,994	4,004
Rimouski North[2]	3	50	2,643	2,629	5,272
Shawinigan[2]	3	50	3,386	3,377	6,763
			988,074	8,581	996,655

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 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.

(3) As at December 31, 2010, the Company has re-evaluated its portfolio of properties and is writing off the Cool Lake and Shawinigan properties for an amount of $2,172 and $6,763, respectively, and deferred exploration expenses for an amount of $34,955 and $20,436, respectively, since the Company does not intend to renew its claims and permits.

10 Deferred exploration expenses

						2010
Property	**Undivided interest %**	**Balance – Beginning of year $**	**Increase $**	**Writeoff $**	**Refundable tax credits and mining duties $**	**Balance – End of year $**
Lindsay (note 9(1))	100	415,159	207,075	-	(103,063)	519,171
Cool Lake (note 9(3))	100	34,892	107	(34,955)	(44)	-
Rimouski (note 9(2))	50	14,434	27,034	-	(10,781)	30,687
Rimouski North (note 9(2))	50	15,849	28,211	-	(11,247)	32,813
Shawinigan (note 9(2)(3))	50	12,002	14,100	(20,436)	(5,666)	-
Trois-Pistoles	50	-	585	-	(250)	335
		492,336	277,112	(55,391)	(131,051)	583,006

					2009
Property	**Undivided interest** **%**	**Balance – Beginning of year** **$**	**Increase** **$**	**Refundable tax credits and mining duties** **$**	**Balance – End of year** **$**
Lindsay (note 9[1])	100	346,865	119,395	(51,101)	415,159
Cool Lake	100	29,993	8,564	(3,665)	34,892
Rimouski (note 9[2])	50	593	24,197	(10,356)	14,434
Rimouski North (note 9[2])	50	-	27,708	(11,859)	15,849
Shawinigan (note 9[2])	50	-	20,983	(8,981)	12,002
		377,451	200,847	(85,962)	492,336

	2010 $	2009 $
Deferred exploration expenses		
Accommodations	15,640	14,000
Maps, printing and drafting	1,275	1,500
Assay and geochemical analyses	6,161	2,177
Geology	119,390	106,298
Geophysics	22,427	71,409
Drilling	101,008	-
Project management fees	11,211	5,463
	277,112	200,847
Deductions		
Writeoff of deferred exploration expenses	(55,391)	-
Refundable tax credits and mining duties	(131,051)	(85,962)
Increase in deferred exploration expenses	90,670	114,885
Balance – Beginning of year	492,336	377,451
Balance – End of year	583,006	492,336

11 Share capital and warrants and brokers' options

Capital management

The capital of the Company consists of the items included in shareholders' equity of $6,888,758 as at December 31, 2010 (2009 – $7,316,296). The Company's objectives when managing capital are to safeguard its ability to continue its operations as well as its acquisition and exploration programs. As needed, the Company raises funds through private placements; it does not incur long-term debt since the Company does not generate operating revenues. There is no dividend policy. The Company does not have any externally imposed capital requirements or any regulatory or contractual requirements to which it is subject, unless the Company closes a flow-through private placement, in which case the funds are restricted in use for exploration expenses.

In light of the above, the Company will continue to assess new properties and seek to acquire an interest in additional properties if it believes there is sufficient potential and if it has adequate financial resources to do so.

Management reviews its capital management approach on an ongoing basis and believes that this approach, given the relative size of the Company, is appropriate.

There were no changes in the Company's approach to capital management during year ended December 31, 2010.

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, 2008	12,003,569	26,191,429
Cancelled[1]	(50,000)	(97,205)
Purchased and cancelled[1]	(320,500)	(698,992)
Finder's fee[2]	150,000	45,000
Balance – December 31, 2009 and 2010	11,783,069	25,440,232

Warrants and brokers' options

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

	2010		
	Number of warrants	**Number of brokers' options**	**Amount $**
Balance – Beginning of year	5,800,000	400,000	1,736,775
Extension of warrants[3]	-	-	660,000
Expired[4]	(650,000)	(400,000)	(548,148)
Balance – End of year	5,150,000	-	1,848,627

	2009		
	Number of warrants	**Number of brokers' options**	**Amount $**
Balance – Beginning of year	6,209,999	400,000	1,814,247
Finder's fee[2]	150,000	-	8,100
Extension of warrants[3]	-	-	60,198
Expired[4]	(559,999)	-	(145,770)
Balance – End of year	5,800,000	400,000	1,736,775

(1) For the year ended December 31, 2009, the Company purchased 320,500 of its own shares for cancellation for a cash consideration of $93,880, in connection with its normal course issuer bid. During 2009, 50,000 of the shares repurchased in 2008 were cancelled. Share capital has been reduced by the average issue price per share before buyback of $2.18 totalling $796,197, of which $702,317 has been charged to contributed surplus.

(2) On February 10, 2009, the Company issued 150,000 units to PowerOne Capital Markets Limited. Each unit consists of one common share and one common share purchase warrant representing transaction costs (note 6). Each purchase warrant entitles the holder to purchase one common share at a price of $1.50 until February 10, 2011. A value of $53,100 was assigned to the issuance of the units. Of this amount, $45,000 was assigned to the common shares and $8,100 to the warrants.

(3) On June 14, 2010, the Company extended the life of 5,000,000 existing warrants entitling the holder to acquire one common share at a price of $1.50 until July 11, 2013. The fair value of the extended warrants was estimated to be $660,000, considering the fair value of the original warrants left at the date of the modification, using the Black-Scholes pricing model with the following assumptions: risk-free interest rate of 1.93%, average expected volatility of 110% and no amount of expected dividend per share.

On May 19, 2009, the Company extended the life of 650,000 existing warrants entitling the holder to acquire one common share at a price of $0.70 until May 28, 2010. The fair value of the extended warrants was estimated to be $60,198, considering the fair value of the original warrants left at the date of the modification, using the Black-Scholes pricing model with the following assumptions: risk free interest rate of 1.73%, average expected volatility of 106% and no amount of expected dividend per share.

(4) In 2010, 650,000 warrants and 400,000 brokers' options expired without being exercised (2009 – 559,999 warrants and no brokers' options).

Information relating to warrants outstanding as at December 31, 2010 is as follows:

Expiry date	Number of warrants outstanding	Exercise price $
February 2011	150,000	1.50
July 2013	5,000,000	1.50
	5,150,000	

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:

	2009
Average dividend per share	Nil
Volatility	110%
Risk-free interest rate	1.18%
Weighted average expected life	2 years
Weighted average fair value of warrants granted	$0.054

No grant of warrants occurred in 2010.

Normal course issuer bid

The Company instituted a normal course issuer bid through the facilities of the TSX Venture Exchange. Under the normal course issuer bid, which was effective from September 15, 2008 to September 14, 2009, the Company could repurchase for cancellation a maximum of 612,250 common shares over a 12-month period, which represented 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 were 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 had been instituted because the Company considered the repurchase of common shares at certain market prices to be beneficial to the Company. The normal course issuer bid was conducted through Desjardins Securities Inc. To the best of the Company's knowledge, no director or senior officer of the Company or their associates or affiliates sold shares of the Company during 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 amended in 2010, the term of stock options granted may not exceed ten years following the date of grant, while the term was five years before the amendment.

The Company applies the fair value method of accounting for stock options and, accordingly, the fair value of the stock options granted in 2010 amounts to $58,500 (2009 – $69,020) and has been included in administrative expenses.

A summary of the information relating to the share purchase options for the year ended December 31 is as follows:

	2010		**2009**	
	Options outstanding and exercisable	**Weighted average exercise price $**	**Options outstanding and exercisable**	**Weighted average exercise price $**
Balance – Beginning of year	995,000	1.20	822,500	1.49
Granted	180,000	0.35	290,000	0.50
Cancelled	-	-	(117,500)	1.53
Balance – End of year	1,175,000	1.07	995,000	1.20

Information relating to options outstanding and exercisable as at December 31, 2010 is as follows:

Exercise price $	Options outstanding and exercisable	Weighted average remaining contracted life (years)
1.10	60,000	1.45
1.90	375,000	2.42
1.00	270,000	2.66
0.50	290,000	3.50
0.35	180,000	9.50
	1,175,000	3.78

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:

	2010	2009
Average dividend per share	Nil	Nil
Volatility	110%	100%
Risk-free interest rate	3.08%	2.34%
Weighted average expected life	10 years	5 years
Weighted average fair value of options granted	$0.325	$0.238

13 Contributed surplus

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

	2010 $	2009 $
Balance – Beginning of year	2,070,212	1,153,105
Stock-based compensation	58,500	69,020
Warrants expired	290,948	145,770
Brokers' options expired	257,200	-
Shares cancelled	-	97,205
Shares purchased and cancelled	-	605,112
Balance – End of year	2,676,860	2,070,212

14 Cash flow information

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

	2010 $	2009 $
Decrease (increase) in accounts receivable	4,820	(14,842)
Decrease (increase) in prepaid insurance	(1)	885
Increase (decrease) in accounts payable and accrued liabilities	22,901	(21,606)
Decrease in Part XII.6 taxes payable	-	(9,922)
	27,720	(45,485)

For the year ended December 31, 2010, the Company's investments in deferred exploration expenses and property, plant and equipment amounted to $277,112 and $12,291 respectively (2009 – $200,847 and nil respectively), of which $264,612 and $11,416 respectively (2009 – 193,017 and nil respectively) have been paid. Also, the Company accrued refundable tax credits and mining duties of $110,943 (2009 – $85,962).

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:

	2010 $	2009 $
Leasing contract*	24,000	24,000
Management consulting fees charged by a company controlled by a director of the Company	72,000	72,000
Administrative service fees charged by a company controlled by a director of the Company	144,690	143,520
	240,690	239,520

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

As at December 31, 2010, the balance due to the related parties amounts to $38,383 (2009 – $26,955). This amount is subject to the same conditions as those of non-related parties.

16 Income taxes

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

	2010 $	2009 $
Income taxes at the statutory rate	(408,445)	(85,843)
Permanent difference	41,202	-
Non-deductible expense	211,560	6,195
Taxable capital gain on warrants	73,726	22,521
Effect of tax rate changes on future income taxes	11,904	246,331
Loss carryforwards expired	12,269	81,408
Other	3,716	(40,531)
Change in valuation allowance	24,478	(360,898)
Future income tax recovery	(29,590)	(130,817)

The components of future income tax assets are as follows:

	2010 $	2009 $
Resource assets	198,573	176,347
Non-capital loss carryforwards	506,283	386,491
Capital losses	1,477,797	1,539,187
Unrealized gain	(159,638)	(156,717)
Financing fees	95,867	147,160
	2,118,882	2,092,468
Less: Valuation allowance	(2,118,882)	(2,092,468)
Future income tax recovery	-	-

As at December 31, 2010, the Company has accumulated non-capital losses for income tax purposes amounting to approximately $1,882,000. These losses will expire as follows:

		$
Years ending December 31,	2014	65,000
	2015	85,000
	2026	91,000
	2027	348,000
	2028	349,000
	2029	453,000
	2030	491,000

The Company's balance of capital losses amounts to approximately $10,987,000 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 $356,000 is deductible over the next four years.

17 Financial risk factors

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.

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 cash and cash equivalents, marketable securities, investments and accounts receivable. Accounts receivable consists mainly of refundable tax credits and mining duties from the federal and Quebec governments, goods and services tax due from the federal government and provincial sales tax due from the Quebec government, amounts receivable from a partner and interest receivable from reputable institutions. 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 and the remainder in financial instruments guaranteed by Canadian chartered banks held with an independent investment dealer member of the Canadian Investor Protection Fund. The marketable securities are composed of bonds from reputable financial and corporate institutions.

Liquidity risk

Liquidity risk is the risk that the Company will have insufficient cash resources to meet its financial obligations as they come due. The Company generates cash flows primarily from its financing activities. As at December 31, 2010, the Company had a cash and cash equivalents balance of $2,133,942 (2009 – $2,609,361) to settle current liabilities of $71,758 (2009 – $35,482). All of the Company's financial liabilities have contractual maturities of less than 30 days and are subject to normal trade terms. The Company regularly evaluates its cash position to ensure preservation and security of capital as well as maintenance of liquidity.

Market risk

Market risk is the risk of loss that may arise from changes in market factors such as interest rates.

i) Interest rate risk

Interest rate risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate due to changes in market interest rates. The Company has cash balances, and its current policy is to invest excess cash in certificates of deposit or money market funds of major Canadian chartered banks. The bonds included in marketable securities bear interest at a fixed rate, and the Company is, therefore, exposed to the risk of changes in fair value resulting from interest rate fluctuations. The sensitivity of the Company to a variation of 1% in the interest rate would not have a significant impact. The Company's other financial assets and financial liabilities do not comprise any interest rate risk since they do not bear interest.

ii) Fair value

The fair value of financial instruments is summarized as follows:

	2010		**2009**	
	Carrying value $	**Fair value $**	**Carrying value $**	**Fair value $**
Financial assets				
Held for trading				
Cash and cash equivalents	2,133,942	2,133,942	2,609,361	2,609,361
Marketable securities	1,022,970	1,022,970	1,008,570	1,008,570
Investments	-	-	290,000	290,000
Available for sale				
Investments	1,980,000	1,980,000	1,760,000	1,760,000
Loans and receivables				
Receivable from a partner	62,370	62,370	67,718	67,718
Interest income receivable	5,506	5,506	-	-
Advance for shale gas permits	-	-	16,150	16,150
Financial liabilities				
Other liabilities				
Accounts payable and accrued liabilities	71,758	71,758	35,482	35,482

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

iii) Fair value hierarchy

The following table summarizes the fair value hierarchy under which the Company's financial instruments are valued.

Level 1 includes unadjusted quoted prices in active markets for identical assets or liabilities. Level 2 includes inputs other than quoted prices included in Level 1 that are observable for the assets or liabilities, either directly or indirectly. And Level 3 includes inputs for the assets or liabilities that are not based on observable market data. For those fair value measurements included in Level 3 of the fair value hierarchy, a reconciliation from the opening balances to the closing balances has been provided.

				Assets measured at fair value As at December 31, 2010
	Level 1 $	**Level 2 $**	**Level 3 $**	**Total $**
Held for trading				
Cash on hand and bank balances	305,683	-	-	305,683
Money market funds	1,828,259	-	-	1,828,259
Marketable securities	-	1,022,970	-	1,022,970
Investment in warrants	-	-	-	-
	2,133,942	1,022,970	-	3,156,912
Available for sale				
Investment in common shares	1,980,000	-	-	1,980,000

				Assets measured at fair value As at December 31, 2009
	Level 1 $	**Level 2 $**	**Level 3 $**	**Total $**
Held for trading				
Cash on hand and bank balances	608,168	-	-	608,168
Money market funds	2,001,193	-	-	2,001,193
Marketable securities	-	1,008,570	-	1,008,570
Investment in warrants	-	-	290,000	290,000
	2,609,361	1,008,570	290,000	3,907,931
Available for sale				
Investment in common shares	1,760,000	-	-	1,760,000

	Reconciliation of long-term investments measured at fair value based on Level 3 inputs	
	2010 **$**	**2009** **$**
Balance – Beginning of year	290,000	91,716
Expiration of warrants	(290,000)	-
Change in fair value	-	198,284
Balance – End of year	-	290,000