

## **Management Discussion and Analysis**

All amounts are stated in Canadian Dollars unless otherwise noted  
SECOND QUARTER ended June 30, 2006.

August 25th, 2006

### **President's Message to Shareholders**

Dear Shareholder:

The most exciting event during the second quarter of 2006 for the Company was the start of work on the Silver Coin project near Stewart, BC. This year's program includes over 20,000 meters of drilling, substantial trenching, geological mapping and a new topographic survey. During the quarter, MineFill Services Inc. of Seattle, WA ("Minefill"), completed its 43-101 on the Silver Coin project. In addition, the Company visited and analyzed a number of projects that came to our attention, including some in China and Mexico. Subsequent to the end of the quarter the Company completed a financing in excess of \$3 million.

During the second quarter, the Company's main focus was on working with our joint venture partner, Mountain Boy Minerals, to get the 2006 exploration program underway. With a minimal amount of snow removal, we were able to begin working in early May. By the end of the 2006 exploration season the Company hopes to increase the overall resource on the property and also to improve the quality of the resource already defined as an inferred resource to an indicated resource. As results are received on the drilling and trenching programs they will be entered into a data base and the resource calculated on an ongoing basis. Pinnacle along with its partner Mountain Boy Minerals established a joint field office in Stewart where office duties, core logging, core splitting, core storage and management of all programs take place. Our Surprise Creek operations will also be headquartered from this office.

The Company is also planning increased exploration on its Surprise Creek property. A program of mapping, airborne geophysics and drilling of two holes, at least, is planned. Because of the location of the Surprise Creek property it is expected that this work will not begin until September. The Company now has approximately 25,000 hectares staked on the Surprise Creek property.

Over the last several months the Company has been working to get title transfer on its 25% interest on the Yang Wen Chong property in Yunnan Province. The Company's 25% interest in the property is recognized by the Chinese however title transfer has been a complex issue involving the Provincial government and other Chinese authorities. Subsequent to the end of the quarter, the Company was informed that the transfer is progressing and that the formal Sino-Joint Venture between the Company and its partner, Yunnan Geology and Mineral Resources Co., Ltd., would be granted approval during the third quarter.

Management continues working with Zijin, our Chinese partner, to have the Company become more involved in China including being a partner in production. This possibly could take the form of acquiring an operating mine or partnering production there. As well, Zijin will continue working with Pinnacle to advance the YWC project.

Subsequent to the end of the quarter the Company completed a private placement financing raising slightly in excess of \$3.2 million.

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## **Pinnacle Mines Ltd.**

During the quarter, the Company contracted with the investor relations firm, I Tell AG of Baar, Switzerland, to increase awareness of the Company in the European markets.

We believe that this year the Company will move one step closer to becoming a producer in Canada and possibly will acquire some production in China.

We wish to thank the shareholders for their continued interest and support.

Respectfully submitted,

Andrew Bowering  
President and CEO

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# **Pinnacle Mines Ltd.**

**August 25, 2006**

Management's Discussion and Analysis (MD&A) supplements, but does not form part of the unaudited interim financial statements of the Company and the notes thereto for the period ended June 30, 2006. Consequently, the following discussion and analysis of the financial condition and results of operations for Pinnacle Mines Ltd. should be read in conjunction with the unaudited interim financial statements for the period ended June 30, 2006 and related notes therein, which have been prepared in accordance with Canadian Generally Accepted Accounting Principals.

This discussion and analysis should also be read in conjunction with the audited financial statements of the Company for the year ended December 31, 2005, and the notes thereto. The audited financial statements for the year ended December 31, 2005 including the notes thereto, and other information issued by the Company, can be found on SEDAR at [www.sedar.com](http://www.sedar.com).

## **Forward-Looking Statements**

Certain statements contained in the following MD&A and elsewhere are considered forward-looking statements. Such statements include a number of unknown risks, uncertainties and other factors that may affect the performance of various programs underway and actual results of the programs may be materially different from any results expressed or implied. Readers are cautioned not to place undue reliance on the forward-looking statements put forward by the Company in light of the risks that are set out below.

## **Corporate Governance**

Management of the Company is responsible for the preparation and presentation of the annual and quarterly financial statements and notes thereto. Management is also responsible for the MD&A and other information contained in these reports. Additionally, it is Management's responsibility to ensure the Company complies with the laws and regulations applicable to its activities.

The Company's Management is held accountable to the Board of Directors ("Directors"), each member of which is elected annually by the shareholders of the Company. The Directors are responsible for reviewing and approving the annual audited financial statements and the MD&A. Responsibility for the review and approval of the Company's quarterly unaudited interim financial statements and the MD&A is delegated by the Directors to the Audit Committee, which is comprised of three directors, two of whom are independent of management. Additionally, the Audit Committee pre-approves the audit and other services provided by the Company's auditors.

The auditors are appointed annually by the shareholders to conduct an audit of the financial statements in accordance with generally accepted auditing standards. The external auditors have complete access to the Audit Committee to discuss audit, financial reporting and related matters resulting from the annual audit as well as assisting the members of the Audit Committee in discharging their corporate governance responsibilities.

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## **Pinnacle Mines Ltd.**

In January 2004, the Canadian Securities Administrators (CSA) released a draft of a proposed policy establishing 'best practices' for the boards of directors for public companies, covering: composition of the boards of directors; adoption of a board mandate; development of position descriptions for directors and chief executive officers; adoption of a written code of business conduct and ethics; orientation and continuing education for directors; board nominations; requiring appointment of a compensation committee composed entirely of independent directors; and the implementation of regular board assessments. While every reporting issuer is encouraged, but not yet required to adopt these practices, they are under active review by the Directors and such corporate governance practices, where appropriate, are considered to be essential to the effective operation of the company. The disclosure of Pinnacle Mines' corporate governance policies is contained in the Company's Information Circular prepared for the 2006 Annual General Meeting, which is available for review at [www.sedar.com](http://www.sedar.com).

### **General Corporate Review**

Pinnacle Mines is a Canadian-based junior resource exploration company engaged in the exploration and development of base and precious metal resource properties located in British Columbia, Canada, Yunnan, China and Puebla, Mexico.

Corporate activities during the second quarter 2006 were focused on starting the 2006 exploration program at the Silver Coin project, completing a 43-101 on the Silver Coin project and preparing for the 2006 exploration activities at its Surprise Creek properties near Stewart, BC. This is now the third year of exploration for the Company in the Stewart area. Subsequent to the end of the quarter the Company investigated a number of properties in Canada and Mexico and in July the Company signed an option agreement with Almaden Minerals Ltd. to acquire an interest in its Tuligtic property in Puebla, Mexico. This property is new to Almaden and has large gold and copper porphyry potential. The Company is looking to acquire a property or properties that can be explored year round. In addition Company personnel are keeping in constant contact with Yunnan Geology to have its 25% interest in the Yang Wen Chong property transferred to the Company as soon as possible. The Company will not be doing any exploration on the property until property title has been transferred.

### ***Use of Estimates***

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant areas requiring the use of management estimates relate to the determination of impairment of assets, and useful lives for depreciation and amortization. Financial results as determined by actual events could differ from those estimates.

### ***Accounting for Stock Options***

The fair value of stock options used to calculate compensation expense has been estimated using the Black-Scholes Option Pricing Model. Option pricing models require the input of highly subjective assumptions including the expected price volatility of the Company's shares. Changes in the subjective input assumptions can materially affect the fair value estimate, and therefore, the existing models do not necessarily provide a reliable measure of the fair value of the Company's stock options.

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## **Pinnacle Mines Ltd.**

### ***Asset Retirement Obligation***

The Company's reclamation and closure cost obligation is calculated using highly subjective assumptions that include the Company's long-term credit-adjusted risk-free interest rate, the long-term inflation rate, the year in which the reclamation obligation is expected to begin and the current estimate of the reclamation obligation. Any changes in these subjective assumptions could materially affect the Company's reclamation and closure cost obligation. The Company has two bonds in place for reclamation requirements, one at Silver Coin and the other at Surprise Creek.

### ***Resource Property Interests***

The Company's current business activity focus is on the exploration and development of precious metal properties. The cost of acquiring, exploring, and developing mineral properties is capitalized. In the event that the Company elects to proceed with the development of a project, capitalized acquisition, exploration and development expenditures will be amortized against future production upon commencement of commercial production, or written off if the properties are sold or abandoned.

## **CHINA**

### **Yang Wen Chang ("YWC") Property**

On May 8<sup>th</sup>, 2004, Pinnacle Mines Ltd. announced that it had executed a formal purchase contract with Yunnan Geology and Mineral Resources Co., Ltd. ("YGM") to acquire, subject to regulatory approval, a 100% interest in the Yang Wen Chong ("YWC") gold property located in the highly prospective southeast region of Yunnan Province, PRC, as initially announced on April 21, 2004.

As consideration for YWC, Pinnacle was to pay YGM a total of 27,000,000 RMB (CDN\$4,437,000) over a two year period following the signing of the purchase contract. In addition, in connection with the purchase of YWC, Pinnacle agreed to pay a finder's fee of up to 700,000 shares. During 2004, Pinnacle advanced a total of 3,270,000 RMB (CDN\$512,011) to YGM towards the purchase price for YWC.

However, in late 2004, Pinnacle began renegotiating its relationship with YGM and subsequent to the end of the fourth quarter, reached an agreement with YGM to form a Sino-Foreign Joint Venture to further explore and develop YWC (the "Joint Venture"). Under the terms of a Letter of Agreement dated January 26, 2005, Pinnacle agreed to pay YGM a further 3,730,000 RMB (CDN\$568,599) on or before January 31, 2005 (paid) (the "January 2005 Payment") as consideration for a 25% interest in the Joint Venture. Subsequent to the end of the second quarter 2005, Pinnacle finalized the formal Joint Venture agreement with YWC. The Company is working to have its 25% title transferred from Yunnan Geology to itself.

In August 2006 personnel from the Company visited the offices of YGM in Kunming, Yunnan to get an update on the status of the transfer of the 25%. They were told that the process is underway and were given a timetable of events that had to occur before the interest was assigned to Pinnacle. It would appear that the process could take as little as a month and a half to complete but probably longer. Our personnel were assured that the process was underway.

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## **Pinnacle Mines Ltd.**

Initially YGM will own 75% of the Joint Venture but has granted Pinnacle the option to earn up to an additional 45% by spending 12,600,000 RMB (CDN\$1,960,560) on exploration and development of YWC over a five year period. Pursuant to the terms of the letter agreement, Pinnacle will earn, beyond its initial 25% ownership, an additional 1% of the Joint Venture for every 280,000 RMB (CDN\$43,568) spent on exploration at YWC. If, prior to the five year anniversary date of the letter agreement, Pinnacle has spent 12,600,000 RMB in exploration, it will own 70% and YGM will own 30% of the Joint Venture.

YGM has agreed to apply for all necessary business licenses and government approvals to form the Joint Venture which is anticipated to take approximately 9 months to complete. In the event regulatory approval for the Joint Venture is not received, YGM has agreed to refund the January 2005 Payment of 3,730,000 RMB (CDN\$568,599) to the Company; however the Company will forfeit its previous payments totalling 3,270,000 RMB (CDN\$512,011).

The YWC property is a 51.2 square kilometer mineral exploration license located in Funing County, Yunnan Province, PRC. During the period 1996-2000, YWC was part of a joint venture between YGM and BHP Exploration. Limited work carried out by the joint-venture and current field work by YGM, has identified several zones of mineralization of economic interest. To date, 12 holes have been drilled on the property; numerous trenches, test pits and tunnels have been completed. One hole is reported by the BHP/Yunnan Geological team to have a gold-mineralized intersection of 1.63 grams/tonne (g/t) over 83 meters. In addition, significant mineralization has been identified over a length of 3 kilometers in the contact/alteration zone between a Devonian siltstone/mudstone and a Cambrian limestone. Individual trenches that have been chip sampled have widths and grades varying from 3.25 g/t over 10.63 meters to 3.15 g/t over 98.15 meters. The mineralization is open along strike and dip. The contact zone is well defined.

These exploration results are not compliant with National Instrument 43-101, and have been obtained from BHP Exploration reports on YWC. Pinnacle management believes the results and calculations were generated using accepted and proven geologic and engineering practices and are reliable and relevant. However until such time as additional exploration work has been completed by Pinnacle, the potential quantity and grade of any mineral resource on YWC is conceptual in nature. There can be no assurances that further exploration will confirm the existence of any mineral resources on the property.

The first report completed for Pinnacle was by consulting geologist, Jeffrey Wilson, and subsequently filed with the regulatory authorities in early August. During the third quarter of 2004 personnel from the Yunnan Geology and Mineral Resource Company, Ltd were on site and completed some mapping and sampling. Soil and chip samples confirmed the wide spread nature of gold on the property. A far more aggressive and detailed work plan for the property is being formulated.

No physical work took place on the YWC during the first six months of 2006.

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# **Pinnacle Mines Ltd.**

## **Canada**

### **Surprise Creek Property**

The Company acquired 40 claims units in 2003 in the Stewart area by staking an area covering several old reverted crown grants in the Bear River pass near Surprise Creek. Renamed the El Dorado, this property has had very little exploration in the last 30 years and sporadic work efforts since the early 1900s. A 1946 report indicates several silver-rich boulders assaying up to 10.3 g/t gold and 5,136 g/t silver were located but their source was not found. With the additional staking at Surprise Creek the El Dorado claims are now part of the Surprise Creek claim block.

The property is now roughly 25,000 hectares in size within one claim block. The property follows the contact zone between the Mt. Dilworth rhyolite and overlying Salmon River sedimentary formations, the same stratigraphic sequence that is host to numerous gold deposits including Eskay Creek, Snip and Premier-Big Missouri mines. The rhyolite horizon was traced along the entire north-south length of the Surprise Creek claim group.

Initially the property was only 15,000 hectares in size but as a result of a program of exploration on the property during August and September 2005 the Company staked additional 10,000 hectares to bring the total to the above noted number. Mapping and rock sampling work already completed in 2006 suggests that some of these hectares will be dropped later this year.

The 2005 exploration at Surprise Creek consisted of prospecting and reconnaissance geological mapping. Altogether 279 rock samples and 8 silt samples were collected during the program. As a result of this work the Company has planned an expanded program for 2006. As noted above some geological mapping and rock chip sampling has taken place. As well it is planned to drill two long holes from two locations to confirm the rock types at depth. Subsequent to the quarter ended June 30, 2006, one drill pad site has been prepared and the second is underway. The Company is currently talking to a number of drilling companies in order to obtain a drill for this small program.

### **Silver Coin Property**

On August 4, 2004 the Company entered into an option agreement with Mountain Boy Minerals Ltd. whereby Pinnacle could earn 51% of Mountain Boy's wholly-owned Silver Coin and FR claims and 55% owned Dauntless projects by spending \$1.75 million on exploration over a three year period. In addition, Pinnacle has the right to earn an additional 9% in the projects by bringing one of the projects to production. All claims are contiguous and are located 24 kilometers north of Stewart, BC.

The Silver Coin property includes the former producing Silbak Premier property from which approximately 100,000 tons of ore were mined and processed in the nearby Premier Mill. According to past published results, it appears that several thousand tonnes may remain in the zones.

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## **Pinnacle Mines Ltd.**

There are two styles of mineralization contained in a number of different zones on the property, a high sulphide, base metal lower gold mineralization style and a low sulphide gold rich mineralization style. These are consistent with the two types of mineralization at the nearby Silbak-Premier mine that yielded 4.7 million tons containing 1.8 million ounces of gold, 41 million ounces of silver, 4.2 million pounds of copper, 62 million pounds of lead and 20 million pounds of zinc.

On October 13, 2004 the Company signed a letter agreement with Tenajon Resources Corp. to earn up to a 70% interest in the Kansas property in the Stewart area of BC. The Kansas property is a 19.5 hectare crown grant and is surrounded by the Silver Coin property. A technical report by Westmin Resources Limited in 1995 calculated the uncut gold reserves on the Kansas at 1,774,000 tons grading 2.20 g/t (124,889 ounces of gold). This calculation was completed prior to National Instrument 43-101, is historic in nature and has not been reclassified to current categories; however management believes that the results and calculations were generated using accepted and proven geologic and engineering practices and are reliable and relevant.

During the latter part of 2004 the Company drilled 26 holes totaling 2,032 meters on the Silver Coin property. By the end of the 2005 exploration season, the Company had drilled approximately 8,000 meters in 50 holes, some of which were not completed due to poor ground conditions.

### **The 2005 Program at Silver Coin**

Initially 3,500 meters of drilling, as well as several kilometers of trenching, and over 1,000 soil samples were planned for the 2005 exploration season. However part way through the summer the Company completed a private placement of \$1,950,000. As a result of the new funding the drilling program was expanded and approximately 8,000 meters of drilling were completed. Mr. Alex Walus, P. Geol., Pinnacle senior geologist, supervised the exploration program on behalf of the Company. Pinnacle was still in an earn-in mode in 2005 and Mountain Boy Minerals was in charge of the exploration program. Mr. Ed Kruchkowski, of Mountain Boy, was the project manager. The 2005 drilling was designed to extend and better define the known mineralization in an area that contains the Perseverance zone, the Snowball zone, the Kansas and Kansas West zones and the 35 zone. Enough drilling was completed in 2005 to start constructing a mineral resource estimate according to 43-101 standards.

All of the drill results can be found in the 2005 year end report and on the Company's website. During the last quarter of 2005 and first quarter of 2006 all of the drilling data (including verifiable assays), trenching information, geological mapping that was available from all exploration programs on the property from 1988 onwards were given to Minefill Services, Inc. to complete an estimate of resources under the strict controls and guidelines of National Instrument 43-101. This report was completed in early May 2006. The Silver Coin property is estimated, at this time, to contain approximately 500,000 ounces of gold and 2,100,000 ounces of silver in the inferred resource category. The 2006 exploration program is planned to explore nearby areas to add to this total and improve the resource estimation to a category higher than inferred. The 43-101 report has been filed with SEDAR and is also on our website.

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## **Pinnacle Mines Ltd.**

The 2006 exploration program involves significant amounts of drilling and trenching. An initial 20,000 meters of drilling has been planned with associated amounts of surface trenching. The overall plan is to substantially add to the resource that has been outlined in 2005, in areas outside the present resource limits. To August 20, 2006, there have been 15,625 meters of drilling completed in 72 holes on the Kansas, Big Missouri and Indi claims. The drilling is along the northern boundary of the Kansas claim and the southern boundary of the Big Missouri claim. While substantial drilling has been completed since May, assay results are at least five weeks behind, which seems to be the norm for the industry this year.

This year accurate survey of all the drill holes is underway. New survey control points are being established and it is also planned to establish accurate specific gravity measurements for various rock types. This work is now getting underway. In addition a program of environmental base line studies is planned to commence before the end the year. An environmental group has yet to be chosen.

The Company is also planning a small exploration program on the FR claims that lie nearby to the Silver Coin claim block. A program of about six short holes is planned.

### **MEXICO**

#### **Tuligtic**

Subsequent to the end of the quarter on July 24, 2006, Pinnacle entered into an option agreement with Almaden Minerals Ltd. on the Tuligtic property in Puebla State, Mexico. Pinnacle can earn a 60% interest in the Tuligtic project by making property expenditures of US\$6 Million and issuing 1,000,000 shares of Pinnacle to Almaden within 6 years.

The approximately 11,000 hectare Tuligtic project covers an area of intensely altered rocks over an area 5 by 5 kilometers in size. Within this area a field program carried out by Almaden identified both a porphyry copper and an epithermal gold target. The copper porphyry target occurs within K-silicate altered intrusive rocks that intrude deformed limestone which is overlain by intensely altered volcanic rocks and geologically recent, post-mineralization ash deposits. Calc-silicate altered limestone occurs in proximity to the intrusive contacts and is associated with skarn-type copper mineralization, identified in boulders. Multiple phases make up the intrusive body which has been altered and veined. Stockwork quartz pyrite veining dominates the alteration and is associated with minor copper mineralization. This alteration is observed to overprint earlier potassic alteration. An IP geophysical survey was carried out and indicated that the exposed mineralization represents a portion of a much larger intrusive hosted system characterized by an elevated chargeability response anomaly which is open in three directions and increasing in tenor with depth. Soil sampling has returned highly anomalous copper, molybdenum, silver and gold in soil samples over areas where the altered and mineralized intrusive rocks are exposed, and elevated chargeability responses have been recorded at surface.

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## **Pinnacle Mines Ltd.**

The epithermal gold-silver target area, which is exposed roughly one kilometer to the south of the outcropping intrusive is also characterized by extensively clay altered and silicified volcanic rocks. The alteration is indicative of the upper parts of an epithermal system and includes replacement silicification and sinter, the precipitate or sediment that was deposited from a hot spring. Quartz-calcite veins with textural evidence of boiling have been identified outcropping in limestone roughly 100 meters beneath the exposed sinter. Initial sampling of these veins and from float boulders of breccia containing quartz vein fragments have returned anomalous values in gold and silver as high as 600 g/t Ag and 6.1 g/t Au. The sinter and the overlying altered volcanic rocks are highly anomalous in Hg, As and Sb.

During the third quarter, the Company will establish a Mexican operating subsidiary. Once this has been done Company geologists will visit the site and organize the work program for the latter part of 2006 and the early part of 2007. Because of the heat of the summer in this part of Mexico it has been decided to delay intensive exploration until the fall period. An initial program of topographic and geologic mapping and an expanded rock chip and soils sampling program are planned to better define the copper and gold system and help focus on the targets.

### **Financial Results**

All of the financial information referenced below has been prepared in accordance with Canadian generally accepted accounting principals, applied on a consistent basis.

#### **Financial Data for last eight Quarters (in CDN\$)**

Three months end	Jun - 06	Mar-06	Dec-05	Sep-05	Jun-05	Mar-05	Dec-04	Sep-04
Total Revenues	\$ -	\$ -	\$ -	\$ -	\$ -		\$ -	\$ -
Loss before extraordinary items	\$300,271	\$241,331	522,325	266,068	417,154	200,814	219,867	150,291
Loss	\$304,882	\$242,119	522,325	260,101	414,594	40,062	233,344	194,831
Loss per share	\$0.02	\$0.01	\$0.04	\$0.02	\$0.04	\$0.00	\$0.04	\$0.03

The Company's operations during the three month period ended June 30, 2006 produced a net loss of \$304,882 or \$0.02 per share compared to a net loss of \$414,594 or \$0.04 per share for the same period in 2005. As the Company does not own any revenue-producing resource properties, no mining revenues have been recorded to date. The decrease in net loss over the same period last year is mainly due to the slower start in exploration activity during the quarter and no stock-based compensation was paid as it was in 2005. However there was an increase in consulting services, investor relations costs and salaries and benefits. Office fees associated with running the Vancouver operation stayed about the same.

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## **Pinnacle Mines Ltd.**

During the quarter ended June 30, 2006, the Company had lower exploration expenditures. The reduction in exploration costs was associated with a slower start this year. It is expected that these costs will increase significantly for the next quarter. As well this year costs are being shared by all partners whereas for part of last year Pinnacle was still earning in its position. Shareholder service costs increased slightly in the period ended June 30, 2006 to \$17,422 from \$10,918 in 2005. The small change was primarily due to slightly increased amounts of work being performed in 2006. Shareholder service costs include such things as regulatory fees, and shareholder costs associated with the Transfer Agent. Management fees /service costs in 2006 stayed the same as in the previous year at \$39,000. This all reflects on an exploration and development company that is now becoming very active and is now looking at projects in Canada, Mexico and China. Costs were up significantly in travel and for salaries and benefits from the previous year. This reflects a more active period in 2006 including travel to eastern Canada, China, and Mexico to investigate properties being offered to the Company. Investor relations costs were up considerably to \$92,912 in 2006 from \$26,582 in 2005. This represents a more active investor relations campaign this year in terms of mail-outs, shows and promotional materials. In addition the IR department was reorganized and a new individual was hired.

### **Liquidity and Capital Resources**

The Company had a working capital surplus at June, 30 2006 of \$2,500,915 compared to \$594,880 at June 30, 2005. The reason for the change was due mainly to the funding of the company during 2006, specifically the \$3,224,624 private placement and partial brokered financing completed in July 2006. At December 31 of 2005 the Company had a working capital surplus of \$1,736,492. As of June 30, 2006 the Company had 17,623,596 common shares issued (fully diluted 22,151,421 shares) compared to 11,039,918 common shares (fully diluted 15,644,734 shares) as of June 30, 2005. As of the time of writing of this report there are 19,508,596 shares issued and outstanding as a result of the private placement in July. A number of share issues have taken place in the Company since its reorganization in 2003. The timing of the most recent issuances was as follows:

On July 9, 2003, the common shares of the Company were consolidated on a one new for five old basis, resulting in 1,186,035 common shares being issued and outstanding. Subsequent to the consolidation, 600,000 common shares were issued at a deemed price of \$0.16 per share in settlement of certain outstanding liabilities. In addition, 606,000 common shares were issued at a deemed price of \$0.16 per share as payment for the 100% interest in the Surprise Creek property. At the same time, 1,180,000 units of the Company were issued through a private placement to raise gross proceeds of \$188,000. Each unit consisted of one common share and one share purchase warrant, each warrant being exercisable into an additional common share at \$0.21 for a two year period.

In the first quarter of 2004, the Company completed a private placement of 1,650,000 units to raise gross proceeds of \$660,000. Each unit consisted of one common share and one share purchase warrant, two warrants being exercisable for a period of one year into an additional common share at \$0.50. The Company also issued 120,100 units in finders' fees in conjunction with the private placement.

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## **Pinnacle Mines Ltd.**

There were no shares issued, no warrants exercised and no options exercised in the second quarter of 2004.

During the third quarter 47,343 warrants were exercised ranging in price from 21 cents to 50 cents. Escrow shares that were returned totaled 1,402 and 4 shares were transferred to Computershare.

On September 23, 2004 the Company completed a flow through financing of 678,000 units at \$0.65 per unit for gross proceeds of \$440,700. Each unit consisted of one common flow through share and one share purchase warrant. Two of these warrants entitle the holder to purchase one non-flow-through share at a price of \$0.75 per share on or before September 23, 2005. The Company also issued 23,680 agent units to Canaccord Capital in conjunction with the private placement.

On November 8, 2004 the company closed a private placement of 1,040,000 units at \$0.60 per unit for gross proceeds of \$624,000. Each unit consisted of one common flow through share and one share purchase warrant, with two warrants entitling the holder to purchase one non-flow-through share for a two year period from the date of offering at a price of \$0.75 per share in the first year and \$0.85 per share in the second year.

On November 30, 2004 the Company closed a private placement of 2,600,000 units at \$0.60 per unit for gross proceeds of \$1,560,000. Each unit consisted of one common flow through share and one share purchase warrant, with two warrants entitling the holder to purchase one non-flow-through share for a two year period from the date of offering at a price of \$0.75 per share in the first year and \$0.85 per share in the second year. The agent in the private placement received Agent's warrants to acquire that number of common shares equal to 15% of the number of units sold under the offering. The agent also received a corporate finance fee of 60,000 units and 30,000 warrants.

During the first quarter of 2005, 741,457 full share equivalent warrants were exercised at a price of 21 cents for net proceeds of \$370,729.

During the second quarter of 2005, 40,000 full share equivalent warrants were exercised at a price of 21 cents for net proceeds of \$8,400. During the second quarter of 2005 the Company completed a private placement. The private placement consisted of 93,000 units at a price at a price of \$0.60 per unit for net proceeds of \$55,800. Each unit consisted of one common share and one share purchase warrant, every two warrants being exercisable into one additional common share for a period of two years at a price of \$0.60 per share for the first year and \$0.75 per share in the second year.

During the third quarter of 2005 the Company completed a private placement. The private placement consisted of 3,000,000 units at a price of \$0.65 per unit for net proceeds of \$1,950,000. Each unit consisted of one common share and one-half share purchase warrant with one whole warrant being exercisable into one additional common share for a period of two years at a price of \$0.83 per share.

At the beginning of the 2005 there were 4,347,269 warrants outstanding. During the year a total of 1,546,500 were issued, part of the private placement, 2,323,423 were exercised, and 62,496 warrants expired leaving a total of 3,507,850 warrants outstanding at the end of the third quarter. During the first quarter of 2006, the Company

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## **Pinnacle Mines Ltd.**

closed a private placement consisting of 353,117 units at a price of \$0.85 per unit. The unit also contained a warrant. Two warrants can purchase a share for 2 years at \$1.00 during the first year and \$1.20 during the second year.

At the beginning of 2006 the number of issued shares stood at 15,984,531 and by the end of the second quarter 2006 the number was 17,623,596.

The working capital at June 30, 2006 is sufficient to complete the 2006 drill program at the Silver Coin, to start the exploration of the Surprise Creek, to drill the FR, to start the exploration programs in Mexico and to carry out corporate administrative details for the next 6 months. To cover the cost of drilling at Silver Coin in 2007, the exploration at Surprise Creek in 2007, a feasibility study for Silver Coin, any future exploration in China, the acquisition of new projects, exploration into 2007 in Mexico and have enough money for administrative costs for the next 12 months the Company will need to raise a minimum of \$3 to \$4 million.

Funding requirements may vary from those planned for a number of reasons, including but not limited to exploration progress and interim development advancement as well as foreign capital exchange rates. The Company is looking at various means to reduce its dependency on raising equity capital to finance its exploration and development expenses. The financial data for the last three years is shown below.

During the three months ended June 30, 2006, the Company incurred fees of \$39,000 (2005 - \$37,000) with directors for management consulting services. This amount has been included in management services expense on the statement of operations and deficit.

The Company is owed \$4,000 from a director of the Company and the amount due bears interest at 5% per annum and has no set terms or repayment schedule.

All related party transactions have been recorded at the exchange amount, which is the amount of consideration established and agreed to between the parties.

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## **Pinnacle Mines Ltd.**

### **Financial Data for Last Three Fiscal Years**

Selected annual Information for the fiscal year ended	December 31, 2005	December 31, 2004	December 31, 2003
Total revenue	16,213	990	nil
Loss before Mineral Property Write Downs Per Share Basis*	(1,237,082) (0.10)	(802,174) (0.14)	(90,146) (0.02)
Loss after Mineral Property Write Downs Per Share Basis*	(1,237,082) (0.10)	(846,714) (0.15)	(90,146) (0.02)
Total assets	5,416,160	2,839,836	260,261
Total long-term liabilities	nil	nil	nil
Cash dividends declared	nil	nil	nil

### **Risk Factors**

Mineral exploration and operations in the mining industry face a variety of risks. There is no certainty that money invested in mineral exploration will result in a profitable mining operation. Many risks, such as interest rate fluctuations, metal price changes and monetary exchange rates are beyond the control of any one company. Management tries to reduce the impact of these and other risks as much as possible. Property titles may be affected by prior agreements and other undetectable defects.

### **Metal Prices**

The principal activity of the Company is exploration of resource properties for various metals. The feasibility of finding and then developing a profitable operation is highly dependent on the price of metals.

### **Industry**

Exploration and development of mining projects is inherently risky. Few exploration projects ever proceed beyond basic exploration and fewer still are taken to development. Moreover even when projects are good enough to be taken to feasibility there are various factors that may negatively affect the viability of such projects. The Company has to continually monitor the various factors that might affect mining projects and as such hires professional consulting groups to advise the Company. These professional groups include, but are not limited to, engineering companies, legal advisors, financial experts and environmental consultants.

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## **Pinnacle Mines Ltd.**

### **Political Risk**

The Company is actively pursuing properties in Canada, China and Mexico. In China, the Company has to deal with government policies that can change quickly with no prior warning. The country is improving its investment climate but it still remains difficult to transfer funds. Legal problems can be a concern as there is generally limited recourse to the foreign companies that may have problems that need legal remedies. The Company may consider exploration of projects in other parts of the world and will evaluate the political risk as required. The Company does not maintain political risk insurance for its foreign exploration projects. Although the legal system in Mexico is different than in Canada, mining law is well established and the Company does not expect any political risk.

### **Environmental**

The Company has studied the environmental rules and regulations of all countries that it is actively involved in and ensures that it conducts its operations according to those rules. The Company or its consultants, keep up to date on such regulations as they are subject to change.

### **Outlook**

General increases in the prices of precious metals have raised investor interest in exploration projects. Pinnacle now has four active projects, two in central British Columbia, one in Mexico and another in Yunnan Province, China.

This year's exploration program in central BC on the Silver Coin property got underway in May. In 2005 a total of 50 holes were drilled for a total of just less than 8,000 meters on the Silver Coin property before winter conditions stopped the work. Already in 2006 there have been almost 16,000 meters of drilling completed in 72 holes. Much more work is planned before the end of the year and the total amount of drilling could pass 25,000 meters. Trenching, mapping and sampling of the property will increase in 2006 compared to 2005. As drilling and trenching is completed in 2006 all the data will be collected and a new resource calculation will be completed. The exploration program for 2007 has not been planned yet and will depend on the success of the 2006 program.

In China efforts will focus on acquiring title to our 25% interest in the Yang Wen Chong and once this is accomplished the Company will set up a camp and beginning the exploration program outlined in the Company's technical report on the Yang Wen Chong property, which is available for review on the Company's website or at [www.sedar.com](http://www.sedar.com).

In Mexico Company personnel will start its exploration program later in the fall so as to avoid the summer heat. The initial program of mapping and sampling is needed to better define targets for a drill program.

Pinnacle continues to look at and investigate other projects that are brought to its attention. In China a number of exploration properties have been brought to the Company's attention and it is expected that the Company will Joint Venture one or two properties next year. As well, the Company plans to expand into other areas in Mexico.