

# Management Discussion and Analysis

All amounts are stated in Canadian Dollars unless otherwise noted

**May 28, 2004**

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 March 31, 2004. 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 March 31, 2004 and related notes therein, which have been prepared in accordance with Canadian Generally Accepted Accounting Principals.

This discussion and analysis should be read in conjunction with the audited financial statements of the Company for the year ended December 31, 2003, and the notes thereto. The audited financial statements for the year ended December 31, 2003, including the notes thereto, and other information issued by the Company, including an Annual Information Form, 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 cause the performance, actual results of the Company to materially be different from any future 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 Director's 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.

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 2004 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, and China.

Corporate activities during the period were focused on the investigation and acquisition of mineral prospects in China. Early in the quarter, management and directors of Pinnacle visited several areas of China, eventually deciding that the southwestern province of Yunnan presented the best opportunities.

In January, 2004, Pinnacle closed a \$660,000 private placement financing that was announced during the fourth quarter of 2003, thereby maintaining a good working capital position.

On February 17, 2004, Pinnacle announced it had entered into a letter of intent to acquire an 80% interest in a gold property called Yuen Jia Ping. The YJP property is located in the southeastern region of Yunnan province, 30 kilometers south of the city of Guangnan. The property is 7.4 square kilometers in size, consisting of a 3.7 sq. km. mining license and a 3.7 sq. km. exploration license. At YJP, sedimentary-rock-hosted "Carlin-type" gold mineralization is contained in zones of marine sedimentary rocks comprised of sandstone, siltstone, claystone and limestone that have been folded and faulted on a regional scale. It is uncertain if multiple stacked zones are present or if the gold is confined to one favourable horizon. Present mining is apparently focusing on the fine-grained sedimentary rocks that are being delivered to multiple active leach pads, and although production at YJP began during 2003, no production data is currently available.

Under the terms of the letter agreement, Pinnacle agreed to make staged payments totaling \$2.25 million Canadian to the owner of YJP for an 80% interest. Pinnacle advanced \$290,000 CDN to the owner on February 24<sup>th</sup>, 2004 and expected complete a formal agreement within three months. Prior to Pinnacle purchasing its 80% interest in YJP, the owner of YJP is permitted to carry on mining at its current rate of production.

Prior to the execution of a formal agreement, the owner of YJP unilaterally terminated the letter of intent and returned all monies advanced. Pinnacle withholds the right to seek damages and compensation, both within China and abroad, for its costs and losses in respect of this transaction.

Subsequent to the end of the quarter, on May 8, 2004, Pinnacle executed the formal Purchase Contract with Yunnan Geology and Mineral Resources Co., Ltd. ("YGM") to acquire a 100% interest in the Yang Wen Chong ("YWC") gold property, located in the highly prospective southeast region of Yunnan Province, PRC.

As consideration for YWC, Pinnacle will pay YGM 27,000,000 RMB (CDN \$4,437,000) as follows: 270,000 RMB on signing the Purchase Contract; 13,230,000 RMB on the latter of four months from the signing of the Purchase Contract or on receipt of regulatory approval; 5,400,000 RMB within twelve months; and 8,100,000 RMB within eighteen months of signing the Purchase Contract. YGM has agreed to transfer title to YWC upon completion of 70% of the required payments. In addition, Pinnacle has agreed to pay YGM 500,000 RMB for every tonne of gold that is added to the resource currently outlined on YWC (estimated at 10-11 tonnes by Yunnan Geology), prior to Pinnacle obtaining the property title. YGM is currently trenching and pit testing many of the mineralized zones on the property. In connection with the purchase of YWC, Pinnacle has agreed to pay a finder's fee of up to 700,000 shares.

In addition to the payments outlined above, Pinnacle has agreed to pay a further 1,000,000 RMB as consideration for current work being completed by Yunnan Geology on YWC, which has led to the discovery of two new zones of mineralization.

The YWC property is a 51.2 square kilometre mineral exploration license located in Fu Lin 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 an estimated mineral resource of 10-11 tonnes of gold. To date, 12 holes have been drilled on the property, numerous trenches, test pits and tunneling 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 metres. In addition, significant mineralization has been identified over a length of 3 kilometres 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 metres to 3.15 g/t over 98.15 metres. 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, Pinnacle will soon begin an exploration program to bring the current information to National Instrument 43-101 standards. Until such time, the potential quantity and grade of any mineral resource on YWC is conceptual in nature and there can be no assurances that further exploration will confirm the existence of any mineral resource on the property.

Also subsequent to the quarter, Pinnacle agreed with certain investors, subject to regulatory approval, to complete a private placement of up to 1.855 million units in the

Company at \$0.65 per unit, for total proceeds of \$1,205,750, each unit consisting of one common share and one share purchase warrant. The warrants are exercisable by the holder on the basis of two warrants and \$0.80 for one common share for a period of two years. Proceeds from the financing are to be used to cover a portion of the property payments for YWC, to evaluate other mining and exploration prospects in China and for general working capital.

Pinnacle anticipates completing and filing a qualifying report prepared to National Instrument 43-101 standards, during the second quarter of 2004.

There was no work completed on Pinnacle's 100% owned Surprise Creek and El Dorado properties in northwest British Columbia due to inclement weather. Work programs are scheduled for the summer months of July and August. The Surprise Creek property is roughly 15,000 hectares within three separate claim groups. 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.

During the 2003 season, the Company acquired 40 claims units by staking an area covering several old reverted crown grants in the Bear River pass. Renamed the El Dorado, this property has had very little exploration in the last 30 years and sporadic work efforts since the early 1900s. There has been considerable tunnelling on the property but no documented drilling. The *BC Minister of Mines Annual Reports*, over several decades, document numerous gold and silver showings. In 1928, a sample across 1.5 metres, from a cut 27 metres above the Frenchman Tunnel, assayed 27.4 g/t gold, 68.6 g/t silver and 2.3% copper. 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.

## 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								
Three months ended	Mar - 04	Dec - 03	Sep - 03	Jun - 03	Mar - 03	Dec - 02	Sep - 02	Jun - 02
Total Revenues	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Loss before extra-ordinary items	\$114,165	\$90,146	\$15,852	\$13,972	\$4,312	\$45,650	\$2,053	\$11,578
Loss	\$114,165	\$90,146	\$15,852	\$13,972	\$4,312	\$45,650	\$2,053	\$11,578
Loss per share	\$0.02	\$0.02	\$0.01	\$0.01	\$0.02	\$0.01	\$0.01	\$0.01

The Company's operations during the period ended March 31, 2004 produced a net loss of \$114,165 or \$0.02 per share compared to a net loss of \$4,312 or \$0.01 per share for 2003. As Pinnacle does not own any revenue-producing resource properties, no mining revenues have been recorded to date. The significant increase in net loss from 2003 is primarily due to management fees, travel, professional fees and regulatory fees, all associated with Pinnacle's increased activity in 2004.

During the quarter ended March 31, 2004, Pinnacle did not have exploration expenditures related to its British Columbia properties due to winter conditions.

Administrative expenses increased in the period ended March 31, 2004 to \$114,165 from \$4,312 in 2003. The increase was primarily due to increases in professional fees to \$37,074 (2003 – nil), travel and entertainment to \$35,287 (2003 – nil), office overhead costs to \$21,597 (2003 - \$232), management fees to \$11,500 (2003 – nil) and regulatory fees to \$8,707 (2003 - \$4,080).

During the period ended March 31, 2004, \$11,500 in management and consulting fees were paid to related parties (2003 – nil). The Chairman and COO, the President and CEO, and one director, have been paid consulting fees associated with the management and/or development of the Company.

### **Liquidity and Capital Resources**

Working capital at March 31, 2004 was \$563,984 compared to \$(66,371) at March 31, 2003. The increase in 2004 is due to cash received from the Company's 2003 and 2004 private placements and the settlement of accounts payable through the issuance of shares.

As of March 31, 2004 the Company had 5,342,135 common shares issued (fully diluted 7,847,635 shares) compared to 5,930,177 common shares (fully diluted 5,930,177 shares) as of March 31, 2003. The increase reflects the reorganization of the company on a 5 to 1 rollback in July 2003 and subsequent issuances of shares for property acquisition, settlement of debt and private placement financings. The timing of each of these events 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 of the Company 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.

The working capital at March 31, 2004 is sufficient for the Company to complete the basic YWC property examination in China and to carry out corporate administrative details for the next funding which will be carried out over the next 2 to 3 months.

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.

<b>Financial Data for Last Three Fiscal</b>			
<b>Fiscal period ended</b>	<b>Dec 31 – 03</b>	<b>Dec 31 – 02</b>	<b>Dec 31 – 01</b>
Total Revenues (000's)	\$ 0	\$ 0	\$ 0
Loss before extraordinary items	\$ 90,146	\$ 45,650	\$ 198,215
Net loss	\$ 90,146	\$ 45,650	\$ 198,215
Weighted average number of shares outstanding	3,572,035	5,930,177	5,930,177
Loss per share	\$ 0.02	\$ 0.01	\$ 0.03
Cash and cash equivalents	\$ 80,422	\$ 333	\$ 516
Current assets	\$ 82,022	\$ 2,978	\$ 23,908
Total assets	\$ 260,261	\$ 47,518	\$ 63,448
Current liabilities	\$ 45,971	\$ 124,842	\$ 95,122
Total long-term financial liabilities	\$ 0	\$ 0	\$ 0
Total shareholders' equity	\$ 214,289	\$ (77,325)	\$ (31,675)
Cash dividends declared per share	\$0.00	\$0.00	\$0.00

## **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.

### **Political Risk**

The Company is actively pursuing properties in Canada and China. Both countries are considered politically stable and to have minimal risk. Pinnacle may consider the 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.

## 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 two active projects, one in central British Columbia and another in Yunnan Province, China.

This year's exploration program in central BC on the Surprise Creek and El Dorado properties will be carried out in July, August and September. Mapping and sampling of the properties and the areas highlighted by last year's exploration program are a priority in order to identify the most prospective areas for subsequent detailed exploration.

In China, exploration efforts over the next few months will focus on setting up an exploration camp and beginning exploration on the Yang Wen Chong property. In June, Pinnacle's geology team will be preparing a detailed property report to National Instrument 43-101 guidelines.

Pinnacle continues to look at and investigate other projects that are brought to its attention.