

# GFM RESOURCES LIMITED

(a development-stage company)

Form 51-102F1

## *Management's Discussion & Analysis*

For fiscal year 2005 - MD&A Dated April 25, 2006

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### **ITEM 1 - ANNUAL MD&A FOR THE FISCAL YEAR ENDED DECEMBER 31, 2005, AND TO THE DATE OF THIS REPORT.**

**1.- Date of this report: April 25, 2006.**

**2.- Overall Performance and events**

#### **a) Description of Business**

GFM Resources Limited (the "Company") is an emerging mineral exploration company focused on the acquisition and development of high-potential exploration properties in Mexico and Latin America. Its shares are listed on the NEX Board of the TSX Venture Exchange under the symbol **GFM.H**. The Company's majority shareholder, Grupo Ferrominero, S.A. de C.V. ("Grupo") is a private Mexican holding company that also controls Compañía Minera Autlán S.A. de C.V. ("Autlan"), a company listed on the Mexican Stock exchange and active in manganese and ferroalloy operations in Mexico and South America. Grupo also controls other companies in domains such as electronics and investment banking.

The Company was incorporated under the laws of British Columbia, Canada. During the year ended December 31, 2000, the Company continued its operation into the Yukon Territory, Canada, under the Business Corporation Act of Yukon, and registered as an extra-provincial company in British Columbia under the laws of British Columbia.

During the year, Management has continued to actively explore financing opportunities together with Grupo, whose portfolio of resource properties will be reviewed by Management of the Company for potential acquisition and exploration, assuming financing is available.

#### **b) Financings**

- (i) During the fiscal year, the Company received \$47,317 (US \$39,000) (2004: \$88,633 (US \$68,500)) from Grupo as a loan increase to meet its obligations. As at June 6, 2005, the total amount due to Grupo amounted to \$258,923, when an agreement was reached to settle this amount by the issuance of 2,589,230 common shares at a price of \$0.10 per share. This transaction was approved by the TSX Venture Exchange on June 27, 2005, and the shares issued on June 30, 2005. These shares had a hold period that expired on October 31, 2005.
- (ii) On June 30, 2005, the Company closed a non-brokered private placement with Grupo for gross proceeds of \$239,700 by issuing 2,397,000 units at a price of \$0.10 per unit. Each unit consisted of one common share and one half share purchase warrant; each complete warrant entitles Grupo to purchase one common share of the Company at an exercise price of \$0.20 per share until June 30, 2006. The units had a hold period expired on October 31, 2005. The proceeds will be used for working capital and to pursue the evaluation of resource properties for potential acquisition.
- (iii) Subsequent to the end of the fiscal year, on March 16, 2006, the Company issued 425,000 common shares at a price of \$0.40 for total proceeds of \$170,000 on closing of a non-brokered private placement with arm's length parties. The shares issued are subject to a four month hold period expiring on July 16, 2006. Proceeds from the Private Placement will be used to fund part of the exploration activities at the Atexcaco volcanogenic massive sulphide project (see (d), below).

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### **c) Board and Officers**

During the annual general meeting of shareholders held on June 30, 2005, a new Board of Directors was elected, as follows:

José Antonio Rivero (Chairman) (Mexico)  
Roman Friedrich III (Vancouver)  
Erik Jurgensen (Mexico)  
Lizardo Galván (Mexico)  
Pedro Reynoso (Mexico)  
James Robertson (Vancouver)

On February 1, 2006, Mr. Eduardo Baer (Toronto) was appointed to the Board of Directors

The following individuals were appointed by the Board as officers:

Eduardo Baer: President and Chief Executive Officer (appointed on February 1, 2006).  
Lizardo Galván: President and Chief Executive Officer to January 31, 2006, and Chief Operating Officer from February 1, 2006.  
Salvador Miranda: Chief Financial Officer (Vancouver)  
Stephen Wortley: Corporate Secretary. Mr. Wortley is Managing Partner of Vancouver law firm Lang Michener LLP.

### **d) Investment in mineral property**

On November 18, 2005, the Company announced an option agreement with Grupo to earn an interest in Grupo's Atexcaco volcanogenic massive sulphide (VMS) project in the State of Puebla, in central Mexico. Details are as follows:

#### The property:

The Atexcaco VMS project, located at the intersection of Mexico's Eastern Sierra Madre and the Trans-Volcanic Belt, is comprised of 16 mining concessions totalling 15,964 Hectares. The project is divided into two distinct project areas, Aire Libre and Guadalupe. The Aire Libre VMS deposit was mined in the period between 1887 and 1939 by the Teziutlán Copper Company and then Asarco, with total historical production reported to have been about 2.3 million tonnes at a grade of 14% zinc, 3-10% copper, 5% lead, 100 grams silver per tonne and 2 grams gold per tonne. The Guadalupe project, located approximately 10 kilometres northwest of Aire Libre, includes an exploration drift within which a VMS-style massive sulphide horizon is exposed, although there is no recorded production.

Some five kilometres to the NW of Guadalupe, and also covered by Grupo's concessions, is "El Aretón" project area, covering approximately 400 hectares. El Aretón is a gold-bearing vein prospect located approximately 4.5 kilometres northwest of Guadalupe.

A project location is available on the Company's website at [www.gfm-resources.com](http://www.gfm-resources.com) under the "Projects" section.

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### The Option Agreement:

Under the terms of the option agreement, the Company will earn a 60% interest in Atexcaco by investing Cdn \$750,000 in exploration with the following investment schedule:

- Cdn \$200,000 by June 30, 2006
- An additional Cdn \$550,000 by June 30, 2007

If the Company invests amounts greater than the minimum for each year, the balance will be credited towards the amounts due the following year. The Company will have the right to earn the 60% interest at any time by completing its investment schedule.

Once the 60% interest has been earned, the Company has a second option to earn the remaining 40% interest in Atexcaco by paying Grupo US \$1,000,000 in the following manner:

- US \$500,000 in cash
- US \$500,000 in cash or issue to Grupo such number of common shares of the Company as is equal to US \$500,000 divided by the Discounted Market Price.

This agreement has received approval from the TSX Venture Exchange.

### Recent exploration work performed:

Grupo acquired the concessions in 1993 and has carried out exploration work during the past six years, including geochemistry, geophysics and detailed geology. A stream sediment sampling survey and reconnaissance geological mapping on Atexcaco was carried out in 1996, and in 1997 an airborne magnetic VLF-EM-radiometric survey was commissioned to Aerodat. During 1998 and 1999, Grupo carried out a grid-soil sampling and lithochemical rock sampling program.

In August 2002, the Company engaged consulting geologist C.F. Staargaard, P.Geo., to prepare a NI 43-101-compliant report on the Atexcaco VMS project as a precursor to GFM entering into an option agreement with Grupo to acquire the project. Mr. Staargaard's report found the Atexcaco VMS project to be of significant merit and recommended additional exploration in order to refine existing drill targets and locate new ones. However, market conditions did not allow the Company to contemplate seeking funding for the project at the time.

Between 1995 and 2005, Grupo and Autlan spent approximately US \$1.0 million on exploration of the Atexcaco VMS project.

### The Company's exploration program:

In November 2005, after signing the Option Agreement with Grupo, the Company, for the first time, carried out a complete compilation of all available information into a three dimensional model in order to define targets for drilling.

Prior to initiating the drilling, the Company secured the required land-access and environmental permits, and carried out preliminary work to facilitate access to the drill targets.

On March 16, 2006, the Company announced that it had retained Canadian-based Energold Drilling Corp. to carry out approximately 3,000 meters of diamond drilling, and on April 6, 2006, the Company announced the start of diamond drilling in the immediate vicinity of the Aire Libre

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mine. Six targets representing potential extensions to historically mined mineralization, at depths ranging between 300 and 550 meters, were selected on the basis of detailed three dimensional modelling of the old mine workings, historical drilling and geological mapping. Core is being logged and split on site under the supervision of GFM Resources geologists. Samples are being prepared by ALS Chemex in Guadalajara, Mexico and then shipped to their facilities in Vancouver for analysis. The Company anticipates that this initial program of drilling will be completed by mid-June 2006.

Mr. Chris Staargaard, P.Geo. will serve as the Qualified Person as for this project.

### **e) Change of audit firm**

Since the Company's last audit, the Company's auditors Ellis Foster Chartered Accountants, have entered into a transaction with Ernst & Young LLP under which certain assets of Ellis Foster were sold to Ernst & Young, and the partners and professional staff of Ellis Foster joined Ernst & Young either as employees or partners of Ernst & Young and carried on practice as members of Ernst & Young, and as a result, Ernst & Young will appear as the Company's auditors of record on a going-forward basis.

### **3.- Selected Annual Information.**

The following are summary figures for the last three fiscal years and are based on audited financial statements:

	Years ended December 31		
	2005 \$	2004 \$	2003 \$
Revenues (interest income)	174	25	32
Loss before extraordinary items Per share, basic & diluted	(326,291) (0.04)	(75,734) (0.01)	(41,322) (0.01)
Net loss Per share, basic & diluted	(326,291) (0.04)	(75,734) (0.01)	(41,322) (0.01)
Total assets	196,163	8,921	2,818
Long term liabilities	Nil	Nil	Nil
Cash dividends declared	Nil	Nil	Nil

The increase in total assets is related to the financing operation described in Section 9(b). Details in results of operations affecting the net loss are explained in the following section:

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### 4.- Results of Operations

The following table summarizes the year's expenses, compared to the previous fiscal year's:

<u>Cash expenses</u>	<u>2005</u>	<u>% of expenses</u>	<u>2004</u>	<u>% change</u>
Administration and accounting	43,525	37.54%	29,925	45.45%
Audit expenses	6,850	5.91%	6,500	5.38%
Consulting fees	7,600	6.56%	-	n/a
Legal expenses	14,693	12.67%	15,741	-6.66%
Filing fees	2,847	2.46%	2,830	0.59%
Transfer agent fees	6,066	5.23%	5,591	8.49%
TSX sustaining fees	5,000	4.31%	5,000	0.00%
General prospecting	5,454	4.70%	8,000	-31.82%
Office rent	7,200	6.21%	7,200	0.00%
Other office expenses	3,005	2.59%	3,766	-20.21%
News dissemination	972	0.84%	725	34.05%
Travel and automobile	12,642	10.90%	4,506	180.56%
Training and development	75	0.06%	800	-90.63%
	<u>115,928</u>	<u>100.00%</u>	<u>90,584</u>	<u>27.98%</u>
<u>Non-cash expenses</u>				
Amortization expense	194		242	
Stock compensation expense	197,920		-	
Unrealized foreign exchange	12,423		(15,521)	
Write-off of equipment	-		454	
	<u>210,537</u>		<u>(14,825)</u>	
Total Expenses	<u>326,465</u>		<u>75,759</u>	

Loss from operations for the year was \$326,291 (2004: \$75,734). The main contributing differences were as follows:

- The stock compensation expense of \$197,920, which is a result of applying the *Black-Scholes Option Pricing Model* on the stock options granted during the year, is the greatest factor contributing to the increase in the net loss; however, this is a non-cash expense, recorded on the balance sheet as "Contributed surplus". The *Black-Scholes* model is an estimate of the *fair value* of the options granted, and is subject to assumptions such as the volatility of the market price of the Company's stock in the past, interest rates and expected life of the options.
- Administration fees of \$43,525 (2004: \$29,925) increased due to additional administration time required to implement new disclosure requirements and a higher monthly fee paid to the administrator, now Chief Financial Officer of the Company.
- The Company incurred consulting fees of \$7,600 (2004: \$ Nil) in assessment and evaluation of its financing options and alternatives for its exploration program.

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- Legal expenses of \$14,693 (2004: \$15,741) increased in relation to the additional legal work required for examination of reactivation alternatives; in addition, legal fees directly related to the private placement and shares for debt transactions were recorded as cost of issuance of the shares..
- Travel expenses of \$12,642 (2004: \$4,506) were in connection to the a trip of two directors and the administrator to Toronto during March 2005, in connection to the examination of possible financial opportunities, a trip to Grupo's offices in Mexico of a consultant analyzing exploration and financial alternatives, and a trip to the Atexcaco project by this consultant and the Company's Chief Financial Officer to examine the property.
- All other expenses were comparable with those of the previous year.

The Company has no revenues other than interest from an interest-bearing chequing account and a bank term deposit.

### 5.- Summary of quarterly results:

	Quarter ended (three-month unaudited figures) (\$)							
	Dec 31 2005	Sep 30 2005	Jun 30 2005	Mar 31 2005	Dec 31 2004	Sep 30 2004	Jun 30 2004	Mar 31 2004
Revenues	0	0	4	10	5	2	5	14
Loss before extraordinary items	(176,255)	(27,141)	(102,764)	(25,572)	(22,823)	(7,534)	(22,851)	(22,526)
Per share, basic & diluted	(0.02)	(0.00)	(0.02)	0.00	0.00	0.00	(0.01)	0.00
Loss	(176,255)	(27,141)	(102,764)	(25,572)	(22,823)	(7,534)	(22,851)	(22,526)
Per share, basic & diluted	(0.02)	(0.00)	(0.02)	0.00	0.00	0.00	(0.01)	0.00
Total assets	196,163	212,862	241,457	4,639	8,921	15,038	16,008	19,295
Long term liabilities	Nil	Nil	Nil	Nil	Nil	Nil	Nil	Nil
Cash dividends declared	Nil	Nil	Nil	Nil	Nil	Nil	Nil	Nil

As indicated above, the significant increase in net loss incurred during the June 2005 quarter, was mainly due to the "stock compensation expense" resulting from the application of the *Black-Scholes Option Pricing Model* on the stock options granted on June 30, 2005.

The increase in total assets in June 2005 is due to the private placement of \$239,700 indicated in Section 9(b) under "transactions with related parties".

### 6.- Liquidity and Working Capital

At December 31, 2005, the Company had cash and cash equivalents and GST receivables of approximately \$185,000 (December 31, 2004: \$7,400), and a working capital of \$146,923 (December 31, 2004: working capital deficiency of \$209,497). During the first half of the fiscal year, the

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Company received \$47,317 from Grupo (2004: \$88,633) as a loan increase to enable the Company to meet its obligations. However, the full amount of the loan of \$258,923 was settled by issuing shares of the Company as described under section 9(a) (transactions with related parties), below. The company also received \$239,700 from a private placement from Grupo, also described under section 9(b), below. These two transactions are the cause for the increased liquidity of the Company.

Receivables of \$3,627 include Canadian Goods and Services (GST) tax of \$2,061 (Dec. 31 2004: \$1,299), Mexican Value Added Tax of \$1,406 (2004: \$Nil), and interest income accrued of \$160. Both the GST and interest accrued were received by the Company subsequent to the end of the fiscal year.

Accounts payable and accrued liabilities of \$39,385 (Dec. 31, 2004: \$17,771) include amounts accrued for the 2005 audit, income tax preparation costs and annual filing fees, in addition to current payables both in Canada and Mexico.

Amounts due to related parties decreased substantially after the shares for debt settlement explained in Section 9(a). The remaining amounts are detailed in Section 9(e).

Given the present level of ongoing obligations and expenses, the Company must rely on the continued financial support from Grupo in order to meet its operational obligations for the foreseeable future.

### **7.- Capital resources**

As at the end of the fiscal year 2005 the Company has not initiated active exploration, and therefore no capital investments are recorded. Amounts shown as equipment, valued at \$777, consists entirely of furniture and equipment.

### **8.- Off-Balance Sheet Arrangements**

There are no off-balance sheet arrangements, and no contingent liabilities or other obligations.

### **9.- Transactions with Related Parties**

- a) During the fiscal year, the Company received \$47,317 (US \$39,000) (2004: \$88,633 (US \$68,500)) from Grupo as a loan increase to meet its current obligations. As at June 6, 2005, the total amount due to Grupo amounted to \$258,923, when an agreement was reached to settle this amount by the issuance of 2,589,230 common shares at a price of \$0.10 per share. This transaction was approved by the TSX Venture Exchange on June 27, 2005, and the shares issued on June 30, 2005. This settlement eliminated all of the outstanding debt with Grupo. These shares had a hold period that expired on October 31, 2005.
- b) On June 30, 2005, the Company closed a non-brokered private placement with Grupo that raised \$239,700 by issuing 2,397,000 units at a price of \$0.10 per unit. Each unit consisted of one common share and one half share purchase warrant; each complete warrant entitles Grupo to purchase one common share of the Company at an exercise price of \$0.20 per share until June 30, 2006. The units had a hold period that expired on October 31, 2005. The proceeds will be used for working capital and to pursue the evaluation of resource properties for potential acquisition.

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- c) From June 30, 2005 to December 31 2005, a company controlled by Mr. Salvador Miranda, Chief Financial Officer was paid \$25,525 (2004: \$Nil) in office administration and accounting, and \$4,200 (2004: \$Nil) in office rent. Mr. Miranda was appointed to this position on June 30, 2005.
- d) From June 30, 2005 to December 31 2005 legal expenses of \$6,117 (2004: \$Nil) and share issuance costs of \$5,441 (2004: \$Nil) were paid to a law firm where Mr. Stephen Wortley, the Company's Corporate Secretary, is Managing Partner. Mr. Wortley was appointed Secretary on June 30, 2005.
- e) Accounts payable and accrued liabilities as at December 31, 2005 include \$5,738 (2004: \$Nil) due to a company controlled by Mr. Miranda in administration expenses, office rent and other reimbursable expenses, inclusive of GST. An amount of \$1,262 (2004: \$Nil) was due to a law firm where Mr. Wortley is its managing partner. Amounts due to related parties as at December 31, 2005 consists of \$493 due to Grupo as a result of a foreign exchange variation on the amount sent by Grupo in US dollars to complete the private placement referenced in Section 9(b). These amounts were repaid subsequent to the end of the fiscal year.

### **10.- Fourth quarter 2005**

The relevant event during the last quarter of 2005 was the signing of the Option Agreement for the Atexcaco massive sulphide property described in Section 2. In December 2005, Mr. Eduardo Baer, now President & CEO of the Company, was initially retained as consultant to examine financing opportunities and to determine possible alternatives for the Company's exploration project.

### **11.- Proposed Transactions**

There are no specific proposed transactions as at the date of this MD&A

### **12.- Critical Accounting Estimates**

Not applicable, as the Company is a venture issuer.

### **13.-Changes in Accounting Policies, including Initial Adoption**

There were no changes in accounting policies during the year ended December 31, 2005.

### **14.-Financial Instruments and other Instruments**

The Company is not presently using any financing instruments other than an interest-bearing chequing account and short term interest-bearing bank instruments.

### **15.-Other MD&A requirements**

- a) The Company, as a "venture issuer", is not required to prepare an Annual Information Form (AIF) at this stage.

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Copies of all previously published financial statements, management discussions, meeting materials, etc., are available on the SEDAR website at [www.sedar.com](http://www.sedar.com). Other Company information is available on its website at [www.gfm-resources.com](http://www.gfm-resources.com).

b) Information pursuant to sections of National Instrument 51-102:

- i) Section 5.3: Please refer to Note #1 to the annual audited financial statements for this fiscal year.
- ii) Section 5.4: Share Capital: please refer to Note #6 to the annual audited financial statements for the year.

Common Shares	Shares	Amount
Balance, December 31, 2003 and 2004	6,185,016	\$1,572,452
Issued June 30, 2005 pursuant to settlement of debt of \$258,923 due to Grupo at \$0.10 per share.	2,589,230	\$258,923
Issued June 30, 2005 pursuant to a private placement with Grupo at \$0.10 per unit. <sup>(i)</sup>	2,397,000	\$174,827
Balance, December 31, 2005:	11,171,246	\$2,006,202
Pursuant to non-brokered private placement with arm's length parties at \$0.40 per share:	425,000	170,000
Balance, date of this MD&A	11,596,246	2,176,202

<sup>(i)</sup> As per Note 6(b), to the audited financial statements for the fiscal year, the private placement done during the year carried share purchase warrants. The fair value of the warrants has been estimated using the Black Scholes pricing option model with the following assumptions: risk-free rate of 3.2%, dividend yield 0%, volatility of 151.7%, and expected life of approximately 1 year. The value assigned to the 1,198,500 share purchase warrants was \$59,432, a value credited to contributed surplus. In addition, \$ 5,441 of legal fees directly attributable to these transactions was recorded as a cost of issuance of the shares.

As per Note 6(c) of the annual audited financial statements for the year outlining the escrow release calendar, 600,000 shares remained in escrow as at December 31, 2005. On February 20, 2005, and August 20, 2005, 37,500 shares were released from escrow each time (for a total for the year of 75,000 shares). A further 75,000 shares were released from escrow on February 20, 2006

Warrants	No. warrants	Exercise Price	Expiry Date
Balance, December 31, 2003 and 2004	NIL		
Issued June 30, 2005 pursuant to a private placement with Grupo at \$0.10 per unit	1,198,500	\$0.20	June 30, 2006
Balance, Dec. 31, 2005 and date of this MD&A:	1,198,500	\$0.20	

Each warrant entitles the holder to purchase one common share of the Company

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Options	No. options	Exercise price	Expiry date
Balance, December 31, 2003 and 2004	270,000	\$0.25	June 25, 2005
Expired on June 25, 2005	(270,000)	\$0.25	
Granted on June 30, 2005	618,500	\$0.10	June 30, 2010
Outstanding, Dec. 31, 2005 and date of this report	618,500	\$0.10	

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The outstanding and exercisable options are allocated as follows:

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Name	Position	No. of options	Exercise Price	Expiration Date
José Antonio Rivero	Director (Chairman)	106,500	\$0.10	June 30, 2010
Lizardo Galván	Director and Officer (COO)	80,000	\$0.10	June 30, 2010
Roman Friedrich III	Director	80,000	\$0.10	June 30, 2010
James Robertson	Director	80,000	\$0.10	June 30, 2010
Erik Jurgensen	Director	80,000	\$0.10	June 30, 2010
Pedro Reynoso	Director	80,000	\$0.10	June 30, 2010
Salvador Miranda	Officer (CFO)	64,000	\$0.10	June 30, 2010
Stephen Wortley	Officer (Corporate Secretary)	16,000	\$0.10	June 30, 2010
Sergio Hernández	Consultant (Exploration Mgr.)	32,000	\$0.10	June 30, 2010
TOTAL		618,500	\$0.10	June 30, 2010

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Each stock option entitles the holder to purchase one common share of the Company

The fully diluted capital of the Company as at the date of this MD&A is integrated as follows:

Shares issued and outstanding	11,596,246
Warrants outstanding and exercisable	1,198,500
Options outstanding and exercisable	618,500
<b>Fully diluted</b>	<b>13,413,246</b>

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