

**XTIERRA INC.**

**CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

*Unaudited – prepared by management*

**First quarter**

**For the three month period ended March 31, 2012**

(Expressed in US\$000's)

**XTIERRA INC.**

**CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS**

*Unaudited – prepared by management*

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**For the three month period ended March 31, 2012**

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**XTIERRA INC.****Condensed Interim Consolidated Statements of Financial Position***Unaudited - prepared by management***As at March 31, 2012**

(Expressed in US\$000's)	Note	March 31, 2012 \$	December 31, 2011 \$
<b>ASSETS</b>			
Current assets			
Cash and cash equivalents	6	5,530	7,782
Amounts receivable and other	7	202	195
Prepaid expenses	7	17	15
		<u>5,749</u>	<u>7,992</u>
Non-current assets			
Exploration and evaluation assets	9	22,106	19,826
Property, plant and equipment	8	122	99
Prepaid expenses and other non-current assets	10	91	109
		<u>22,319</u>	<u>20,034</u>
		<u>28,068</u>	<u>28,026</u>
<b>LIABILITIES</b>			
Current			
Accounts payable and accruals	11	260	233
Derivative financial liabilities (warrants)	13	545	358
Other financial instruments (convertible notes)	13	568	623
		<u>1,373</u>	<u>1,214</u>
Non-current liabilities			
Property acquisition obligations	12	1,512	1,457
Other financial instruments (convertible notes)	13	682	627
		<u>2,194</u>	<u>2,084</u>
<b>SHAREHOLDERS' EQUITY</b>			
Capital stock	14	33,594	33,594
Share-based payment reserve	16	2,780	2,780
		<u>36,374</u>	<u>36,374</u>
Deficit		<u>(11,873)</u>	<u>(11,646)</u>
		<u>24,501</u>	<u>24,728</u>
		<u>28,068</u>	<u>28,026</u>

**COMMITMENTS AND CONTINGENCIES** (Notes 1, 9, 12 and 19)

The financial statements were approved by the Board of Directors on May 24, 2012 and signed on its behalf by:

Signed "John F. Kearney" , Director

Signed "Terence N. McKillen" , Director

See accompanying notes to the condensed interim consolidated financial statements

**XTIERRA INC.****Condensed Interim Consolidated Statements of Operations and Comprehensive Loss***Unaudited - prepared by management***For the three month period ended March 31,**

(Expressed in US\$000's, except for per share amounts)	2012	2011
	\$	\$
Expenses		
Foreign exchange gain	(42)	(121)
General and administrative expenses	48	26
Corporate expenses	41	95
Professional fees	51	52
Loss from operations	<u>98</u>	<u>52</u>
Other items		
Interest income	(3)	(1)
Change in fair value of convertible notes	12 (55)	(513)
Change in fair value of warrants	12 187	3,323
<b>Net loss and comprehensive loss for the period</b>	<b><u>227</u></b>	<b><u>2,861</u></b>
<b>Net loss per share – basic and diluted</b>	0.002	0.033
<b>Weighted average common shares outstanding</b>		
– basic and diluted	103,358,412	86,767,284

See accompanying notes to the condensed interim consolidated financial statements

**XTIERRA INC.****Condensed Interim Consolidated Statements of Changes in Equity***Unaudited - prepared by management*

	Share Capital	Share-based payment reserve	Retained losses	Total
(Expressed in US\$000's)	\$	\$	\$	\$
<b>Balance as at January 1, 2011</b>	<b>24,630</b>	<b>1,062</b>	<b>(10,381)</b>	<b>15,311</b>
Proceeds on share issue	1,496	-	-	1,496
Value of warrants granted on private placement	(426)	-	-	(426)
Exercise of warrants	3,977	-	-	3,977
Valuation allocation on exercise of warrants	3,929	-	-	3,929
Share issue costs	(71)	-	-	(71)
Recognition of share-based payments	-	1,729	-	1,729
Exercise of stock options	48	-	-	48
Valuation allocation on exercise of stock options	11	(11)	-	-
Total loss for year	-	-	(1,265)	(1,265)
<b>Balance as at December 31, 2011</b>	<b>33,594</b>	<b>2,780</b>	<b>(11,646)</b>	<b>24,728</b>
Total loss for the period	-	-	(227)	(227)
<b>Balance as at March 31, 2012</b>	<b>33,594</b>	<b>2,780</b>	<b>(11,873)</b>	<b>24,501</b>

See accompanying notes to the condensed interim consolidated financial statements

**XTIERRA INC.****CONDENSED INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS***Unaudited - prepared by management***For the three month period ended March 31,**

(Expressed in US\$000's)	2012	2011
	\$	\$
<b>CASH FLOWS USED IN OPERATING ACTIVITIES:</b>		
Net loss for the period	(227)	(2,861)
Depreciation	11	-
Change in fair value of convertible notes	(55)	(513)
Change in fair value of warrants	187	3,323
Foreign exchange	(26)	-
Interest income	(3)	(1)
Operating cash flow before movements in working capital	<u>(113)</u>	<u>(52)</u>
Movements in working capital		
Decrease (increase) in amounts receivable and other and prepaids	8	(27)
Increase (decrease) in accounts payable and accruals	27	(217)
Net cash used in operating activities	<u>(78)</u>	<u>(296)</u>
<b>FINANCING ACTIVITIES:</b>		
Private placements	-	1,496
Exercise of warrants	-	3,732
Issue costs	-	(58)
Net cash generated by financing activities	<u>-</u>	<u>5,170</u>
<b>INVESTING ACTIVITIES:</b>		
Interest income	3	1
Investment in exploration and evaluation assets	(2,169)	(380)
Expenditures on property, plant and equipment	(34)	(20)
Net cash used in investing activities	<u>(2,200)</u>	<u>(399)</u>
Effect of exchange rate changes on cash and cash equivalents	<u>26</u>	<u>-</u>
Change in cash and cash equivalents	(2,252)	4,475
Cash and cash equivalents, beginning of period	<u>7,782</u>	<u>5,269</u>
Cash and cash equivalents, end of period	<u><u>5,530</u></u>	<u><u>9,744</u></u>
<b>Cash and cash equivalents consist of:</b>		
Cash	1,185	1,973
Cash equivalents	<u>4,345</u>	<u>7,771</u>
	<u><u>5,530</u></u>	<u><u>9,744</u></u>

See accompanying notes to the condensed interim consolidated financial statements

## **XTIERRA INC.**

### **Notes to the Condensed Interim Consolidated Financial Statements**

**(Expressed in US\$000's)**

**For the three month period ended March 31, 2012**

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#### **1. NATURE OF OPERATIONS**

Xtierra Inc. (the "Company" or "Xtierra") has interests in exploration and evaluation properties located in Mexico. Substantially all of the Company's efforts are devoted to financing and developing these properties. There has been no determination whether the Company's interests in exploration properties contain mineral reserves which are economically recoverable.

The Company's head office is located at 220 Bay Street, Suite 700, Toronto, Ontario M5J 2W4.

The business of mining and exploring for minerals involves a high degree of risk and there can be no assurance that current exploration programs will result in profitable mining operations. The recoverability of the carrying value of mineral property interests and the Company's continued existence is dependent upon the preservation of its interests in the underlying properties, the discovery of economically recoverable reserves, the achievement of profitable operations, or the ability of the Company to raise additional financing, if necessary, or alternatively upon the Company's ability to dispose of its interests on an advantageous basis. Changes in future conditions could require material write downs of the carrying values. All of the Company's mining assets are located outside of Canada and are subject to the risk of foreign investment, including increases in taxes and royalties, renegotiation of contracts, currency exchange fluctuations and restrictions, and political uncertainty.

Although the Company has taken steps to verify title to the properties on which it is conducting exploration and in which it has an interest, in accordance with industry standards for the current stage of exploration of such properties, these procedures do not guarantee the Company's title. The Company's properties may be subject to unregistered prior agreements, unregistered claims, aboriginal claims and regulatory and environmental requirements.

#### **Basis of measurement and going concern**

These condensed interim consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") applicable to a going concern. The application of the going concern basis is dependent upon the Company achieving profitable operations to generate sufficient cash flows to fund continuing operations, or in the absence of adequate cash flows from operations, obtaining additional financing to support operations for the foreseeable future. It is not possible to predict whether financing efforts will be successful or if the Company will attain profitable levels of operations.

These condensed interim consolidated financial statements do not give effect to adjustments that would be necessary should the Company be unable to continue as a going concern and therefore be required to realize its assets and liquidate its liabilities and commitments in other than the normal course of business and at amounts different from those in the accompanying consolidated financial statements. Such adjustments could be material.

#### **2. BASIS OF PREPARATION**

These condensed interim consolidated financial statements of the Company were prepared in accordance with International Accounting Standard 34, *Interim Financial Reporting* ("IAS 34") using accounting policies consistent with International Financial Reporting Standards ("IFRS"), as issued by the International Accounting Standards Board ("IASB").

These condensed interim consolidated financial statements do not include all of the information required for full annual financial statements and should be read in conjunction with the Company's audited consolidated financial statements for the year ended December 31, 2011 prepared in accordance with IFRS.

These condensed interim consolidated financial statements have been prepared on a historical cost basis except for financial instruments classified as fair value through profit and loss which are stated at their fair value. In addition, these consolidated financial statements have been prepared using the accrual basis of accounting, except cash flow information. These condensed interim financial statements are expressed in United States Dollars ("US\$").

The standards and interpretations within IFRS are subject to change and accordingly, the accounting policies for the annual report that are relevant to these condensed interim financial statements will be finalized only when the annual IFRS financial statements are prepared for the year ending December 31, 2012. The accounting policies chosen by the Company have been applied consistently to all periods presented.

**XTIERRA INC.**  
**Notes to the Condensed Interim Consolidated Financial Statements**  
**(Expressed in US\$000's)**  
**For the three month period ended March 31, 2012**

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**3. SIGNIFICANT ACCOUNTING POLICIES**

**(a) Basis of consolidation**

The condensed interim consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company (its subsidiaries). Control is achieved where the Company has the power to govern the financial and operating policies of an investee entity so as to obtain benefits from its activities.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated statement of operations from the effective date of acquisition or up to the effective date of disposal, as appropriate. Where necessary, adjustments are made to the financial statements of subsidiaries to bring the accounting policies used into line with those used by the Company. All material intra-Company transactions, balances, income and expenses are eliminated on consolidation.

**(a) Accounting Changes**

The Company did not adopt any new International Financial Reporting Standards (IFRSs) or Interpretations during the period that had a material impact on the Company's financial statements.

IFRS Standards issued but not yet effective:

IFRS 9	Financial Instruments
IAS 12 (Amendment)	Income Taxes
IFRS 10	Consolidated Financial Statements
IFRS 11	Joint Arrangements
IFRS 12	Disclosure of Interests in Other Entities
IFRS 13	Fair Value Measurement
IAS 27 (Amendment)	Separate Financial Statements
IAS 28	Investments in Associates and Joint Ventures

The Company has not yet determined the impact of these amendments on its financial statements.

**4. RELATED PARTY TRANSACTIONS**

Transactions between the Company and its subsidiaries, which are related parties, have been eliminated on consolidation and are not disclosed.

<b>Related Party Transactions</b>	<b>March 31 2012</b>	<b>March 31 2011</b>
	<b>\$</b>	<b>\$</b>
Office and general	10	49
Legal fees	2	19
Professional fees	109	68
	<u>121</u>	<u>136</u>
<b>Directors Remuneration</b>	<u>111</u>	<u>118</u>
<b>Capitalized as exploration assets</b>	<u>49</u>	<u>50</u>

No fees were paid by the Company to directors for their services as directors of the Company in the three month periods ended March 31, 2012 or March 31, 2011. Key management personnel remuneration comprises payments, including share based payments, for administration, geological, investor relations and legal services provided by persons or corporations controlled by persons who are directors or by any other person with the authority and responsibility for planning, directing and controlling the activities of the Company.

Included in accounts payable and accruals at March 31, 2012 is \$2 (2011 - \$19) due to related parties. These balances are due on demand, unsecured and non-interest bearing.



**XTIERRA INC.****Notes to the Condensed Interim Consolidated Financial Statements****(Expressed in US\$000's)****For the three month period ended March 31, 2012****4. RELATED PARTY TRANSACTIONS (continued)**

<b>Name of Subsidiary</b>	<b>Country of Incorporation</b>	<b>Percentage owned</b>	<b>Principal activity</b>
Orca Minerals Limited	Canada	100%	Orca Gold International Limited
Orca Gold International Limited	Bahamas	100%	Holding company for Mexican subsidiaries
Bilbao Resources S.A. de C.V.	Mexico	100%	Exploration
Golden Dust S.A. de C.V.	Mexico	100%	Exploration
Minera Orca S.A. de C.V.	Mexico	100%	Exploration
Orca Mining Exploration S.A. de C.V.	Mexico	100%	Exploration
Bilbao Mining S.A. de C.V.	Mexico	100%	Exploration

**5. SEGMENTAL ANALYSIS**

	<b>Segment result</b>	
	<b>March 31</b>	<b>March 31</b>
	<b>2012</b>	<b>2011</b>
	<b>\$</b>	<b>\$</b>
<b>Continuing Operations</b>		
Canada	(227)	(2,861)
Mexico	-	-
Total for continuing operations	<u>(227)</u>	<u>(2,861)</u>
Income tax	-	-
Loss for the period	<u><u>(227)</u></u>	<u><u>(2,861)</u></u>

**Segment assets and segment liabilities**

	<b>Assets</b>	
	<b>March 31</b>	<b>December 31</b>
	<b>2012</b>	<b>2011</b>
	<b>\$</b>	<b>\$</b>
Canada	5,498	7,825
Mexico	<u>22,570</u>	<u>20,201</u>
	<u><u>28,068</u></u>	<u><u>28,026</u></u>

**XTIERRA INC.**  
**Notes to the Condensed Interim Consolidated Financial Statements**  
**(Expressed in US\$000's)**  
**For the three month period ended March 31, 2012**

**5. SEGMENTAL ANALYSIS (continued)**

	<b>Additions to non-current assets</b>	
	<b>March 31</b>	<b>March 31</b>
	<b>2012</b>	<b>2011</b>
	<b>\$</b>	<b>\$</b>
Canada	-	-
Mexico	<u>2,304</u>	<u>501</u>
	<u><u>2,304</u></u>	<u><u>501</u></u>

  

	<b>Liabilities</b>	
	<b>March 31</b>	<b>December 31</b>
	<b>2012</b>	<b>2011</b>
	<b>\$</b>	<b>\$</b>
Canada	<u>(2,877)</u>	<u>(2,763)</u>
Mexico	<u>(690)</u>	<u>(535)</u>
	<u><u>(3,567)</u></u>	<u><u>(3,298)</u></u>

**6. CASH AND CASH EQUIVALENTS**

	<b>March 31</b>	<b>December 31</b>
	<b>2012</b>	<b>2011</b>
	<b>\$</b>	<b>\$</b>
Cash	1,185	1,233
Cash equivalents	<u>4,345</u>	<u>6,549</u>
Total	<u><u>5,530</u></u>	<u><u>7,782</u></u>

The currency profile of cash and cash equivalents is as follows:

Canadian Dollars	661	1,422
US Dollars	4,672	6,214
Mexican Pesos	<u>197</u>	<u>146</u>
	<u><u>5,530</u></u>	<u><u>7,782</u></u>

Cash and cash equivalents comprise cash balances held for the purposes of meeting short-term cash commitments and investments which are readily convertible to a known amount of cash and are subject to an insignificant risk of change in value. Where investments are categorised as cash equivalents, the related balances have a maturity of three months or less from the date of investment. Cash at bank earns interest at floating rates based on daily bank deposit rates. Short-term deposits are made for varying periods of between one day and three months, depending on the cash requirements of the Company, and earn interest at the respective short-term deposit rates at floating rates.

**XTIERRA INC.****Notes to the Condensed Interim Consolidated Financial Statements****(Expressed in US\$000's)****For the three month period ended March 31, 2012****7. AMOUNTS RECEIVABLE AND OTHER AND PREPAID EXPENSES**

	<b>March 31</b>	December 31
	<b>2012</b>	2011
	<b>\$</b>	<b>\$</b>
Trade receivables	21	17
Receivable sales taxes	181	178
Prepaid expenses	17	15
	<u>219</u>	<u>210</u>

**8. PROPERTY, PLANT AND EQUIPMENT**

	<b>March 31</b>	Additions	December 31
	<b>2012</b>	(depreciation)	2011
	<b>\$</b>	<b>\$</b>	<b>\$</b>
Equipment at cost	174	34	140
Accumulated depreciation	(52)	(11)	(41)
	<u>122</u>	<u>23</u>	<u>99</u>

**9. EXPLORATION AND EVALUATION ASSETS**

The following table shows the mineral property interests:

	<b>March 31</b>	Additions	December 31
	<b>2012</b>	(Write downs)	2011
	<b>\$</b>	<b>\$</b>	<b>\$</b>
Bilbao	16,923	2,164	14,759
Laguna	2,766	1	2,765
El Dorado	1,166	30	1,136
Other	1,251	85	1,166
	<u>22,106</u>	<u>2,280</u>	<u>19,826</u>

The Company has the following investments in exploration and development properties located in the States of Zacatecas and San Luis Potosi, Mexico:

**Bilbao**

The Company holds a 100% interest in the Bilbao zinc-silver-lead-copper project, subject to a 1.5% net smelter royalty.

Prior to August 2008, the Company was earning into a 75% interest in the Bilbao property. In August 2008, the Company acquired the outstanding 25% interest in the Bilbao property for total consideration of \$5,000 of which \$2,500 was paid on the closing date and a further \$500 was paid one year after the closing date and the balance of \$2,000 is payable on the following terms:

- \$500 at the time of commencement of construction of a mine or no later than August 2014;
- \$500 on the first anniversary of commencement of construction of a mine or no later than August 2018;

## **XTIERRA INC.**

### **Notes to the Condensed Interim Consolidated Financial Statements**

**(Expressed in US\$000's)**

**For the three month period ended March 31, 2012**

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#### **9. MINERAL PROPERTY INTERESTS (continued)**

##### **Bilbao (continued)**

- \$500 on the second anniversary of commencement of construction of a mine or no later than August 2018; and
- \$500 on the third anniversary of commencement of construction of a mine or no later than August 2018.

At the time of the agreement in 2008 the present value of the then outstanding future payments of \$2,500 was determined to be approximately \$1,023 based on a discount rate of 15%. This value was recorded as a liability and is being accreted to its face value over the estimated life of the payment obligations.

##### **Laguna**

The Company holds a 100% interest in the Laguna silver-gold-mercury tailings development project and has been granted a twenty year concession dated December 10, 2003 by the Comision Nacional del Agua ("Conagua") relating to the extraction rights to six million cubic metres of tailings material, subject to an amount payable to Conagua in the amount MX\$11.00 (approximately US\$1.00) per cubic metre of tailings.

##### **El Dorado Gold Project**

In April 2010, the Company acquired a 100% interest in the El Dorado gold project located in the Pinos district of south-eastern Zacatecas State, Mexico, for payments totalling approximately \$930, of which \$126 has been paid and the balance is payable on the following terms:

- payment of \$268 on the earlier of January 15, 2014 or the date a feasibility study is completed;
- payment of \$268 on January 15, 2015; and
- payment of \$268 on January 15, 2016.

If the Company completes a feasibility study with gold reserves in excess of 250,000 ounces or 500,000 ounces, additional payments of \$500 or \$1,000 respectively, are required.

At the time of the agreement the present value of the outstanding future payments that totaled \$804 was determined to be approximately \$402 at based on a discount rate of 15%. This value has been recorded as a liability and is being accreted to its face value over the estimated life of the payment obligations.

##### **Other**

The Company holds a 100% interest in certain exploration concessions in the Panfilo Natera Mining District in Mexico in three claim groupings: (1) Galore; (2) El Morro; and (3) Milagros.

##### **Financing Option**

The Pacific Road Group of Funds ("Pacific Road") holds options negotiated in terms of the Initial Agreement dated September 19, 2007, to provide financing of up to \$15,000 and \$17,500 directly to the Laguna and Bilbao projects, respectively, to obtain interests of up to 35% and 25% of the Company's interests in such projects, respectively. Such project financings, if advanced, may be converted into common shares of the Company or a subsidiary of the Company based on the 30-day volume weighted average trading price at the time of conversion. A fee of 2.5% will be payable to the Manager/Advisor of Pacific Road on any project financing provided under these options. A director of the Company is an officer of the Manager/Advisor to Pacific Road. As of March 31, 2012, no financing has been provided to the Laguna or Bilbao projects under these options.

#### **10. PREPAID EXPENSES AND OTHER NON-CURRENT ASSETS**

	March 31 2012	December 31 2011
	\$	\$
Prepaid expenses and other non-current assets	<u>91</u>	<u>109</u>

**XTIERRA INC.****Notes to the Condensed Interim Consolidated Financial Statements****(Expressed in US\$000's)****For the three month period ended March 31, 2012****11. ACCOUNTS PAYABLE AND ACCRUALS**

	<b>March 31 2012</b>	December 31 2011
	<b>\$</b>	<b>\$</b>
Trade creditors	193	154
Payable to related parties	2	4
Accrued liabilities	65	75
	<u>260</u>	<u>233</u>

**12. NON CURRENT LIABILITIES**

	<b>March 31 2012</b>	December 31 2011
	<b>\$</b>	<b>\$</b>
<b>Property acquisition obligations (stated at net present cost) due as follows:</b>		
Between two and five years	893	860
After five years	619	597
	<u>1,512</u>	<u>1,457</u>

See Note 9.

**13. OTHER FINANCIAL LIABILITIES**

	<b>March 31 2012</b>	December 31 2011
	<b>\$</b>	<b>\$</b>
<b>Financial liabilities carried at fair value through profit and loss</b>		
Warrants	545	358
Conversion option component of convertible notes	568	623
	1,113	981
<b>Financial liabilities at amortized cost</b>		
Debt component of convertible notes (non-current)	682	627
	<u>1,795</u>	<u>1,608</u>

**Warrants**

As at March 31, 2012, the Company had the following outstanding share purchase warrants:

	<u>Warrants</u> (000's)	Value of Conversion <u>Option</u> \$	<u>Exercise Price</u> \$	<u>Expiry Date</u>
	9,000	329	Cdn\$0.40 per share	December 23, 2012
	5,331	216	Cdn\$0.40 per share	January 20, 2013
Total	<u>14,331</u>	<u>545</u>		

**XTIERRA INC.****Notes to the Condensed Interim Consolidated Financial Statements****(Expressed in US\$000's)****For the three month period ended March 31, 2012****13. OTHER FINANCIAL LIABILITIES (continued)****Warrants (continued)**

Warrants issued by the Company to purchase common shares, for a fixed price stated in Canadian dollars, a currency other than the Company's functional currency of US dollars, and not offered pro rata to all existing shareholders of the same class at the time of issuance, are considered derivative financial liabilities under IFRS. Such warrants are required to be measured and recognized at fair value with changes subsequent to initial recognition included in the Statement of Operations and Comprehensive Income (Loss). The Company has estimated fair value using the Black-Scholes option pricing model at each reporting date.

Share purchase warrant transactions for the respective periods were as follows:

	Warrants (000's)	Weighted Average Exercise Price Cdn\$	Value of Conversion Option \$
Balance, January 1, 2012	14,331	0.40	358
Change in fair value	-	-	187
Balance, March 31, 2012	<u>14,331</u>	0.40	<u>545</u>

The fair value of the warrants issued in December 2010 and January 2011 and remaining outstanding at March 31, 2012 increased to \$545 at March 31, 2012, as a result of an increase in the value of the warrant following an increase in the Company's share price during the quarter.

The change in fair value of warrants, as recorded in the consolidated Statement of Operations and Comprehensive Loss, is a result of the fair value adjustment of the warrants. The warrants are carried on the Statement of Financial Position as financial liabilities at their estimated fair value as a result of their exercise price being denominated in Canadian dollars, being a currency other than the Company's functional currency of US dollars. This \$545 derivative financial liability is an accounting treatment only under IFRS and does not represent a cash liability of the Company. The change in fair value recorded is a non-cash adjustment that has had no cash effect on the Company.

The key assumptions used in determining the fair value of the warrants were:

	<b>March 31 2012</b>	December 31 2011	January 1 2011
Market value of one ordinary share	Cdn\$0.22	Cdn\$0.16	Cdn\$0.43
Exercise price	Cdn\$0.40	Cdn\$0.40	Cdn\$0.34
Term	0.76 years	1.01 years	0.94 year
Risk free rate	1.66%	1.66%	1.66%
Volatility	103%	103%	103%
Dividend	0%	0%	0%
Warrants outstanding	14,331,210	14,331,210	22,010,000
Value per warrant	\$ 0.04	\$ 0.02	\$ 0.19
Fair value of warrants	\$ 545	\$ 358	\$ 4,128

**Convertible Notes**

On April 14, 2009, the Company and Pacific Road entered into an agreement, whereby Pacific Road subscribed for an aggregate principal amount of \$1,250 in non-interest bearing convertible notes (the "Notes") issued by Orca Minerals Limited ("Orca Minerals"), a subsidiary of the Company. The Notes have a term of five years and are convertible, at the holders' option, into a number of common shares of Orca Minerals which will equal ten percent (10%) of the issued shares of Orca Minerals on a fully diluted basis. A director of the Company is an officer of the Manager/Advisor to Pacific Road.

**XTIERRA INC.**  
**Notes to the Condensed Interim Consolidated Financial Statements**  
**(Expressed in US\$000's)**  
**For the three month period ended March 31, 2012**

**13. OTHER FINANCIAL LIABILITIES (continued)**

**Convertible Notes (continued)**

Pacific Road has a further right to exchange its holdings in Orca Minerals into either: (i) a number of shares of Bilbao Resources, S.A. de C.V. ("Bilbao Resources"), an indirectly-owned Mexican subsidiary of Orca Minerals which holds the Company's interest in the Bilbao project, which will equal ten percent (10%) of the issued shares of Bilbao Resources on a fully diluted basis or (ii) a number of common shares of Xtierra equal to the value of Pacific Road's equity interest in Orca Minerals at the time of exchange divided by the volume-weighted average trading price of Xtierra's shares during a 30-day period prior to such exchange.

If exchanged into shares of Bilbao Resources, the Bilbao Resources shares are further exchangeable into a number of common shares of Xtierra equal to the value of Pacific Road's equity interest in Bilbao Resources at the time of exchange divided by the volume-weighted average trading price of Xtierra's shares during a 30-day period prior to such exchange.

Pacific Road also has a put right, exercisable at its option at any time prior to maturity, to require Xtierra to purchase the Notes for a number of common shares equal to the principal amount of the Notes divided by the volume weighted average trading price of Xtierra's common shares during the 30 day period prior to the exercise of such right.

The Notes provide for a minimum conversion price of Cdn\$0.10 per Xtierra common share.

On issuance of the convertible notes, the Company determined the debt component of the convertible notes to be a financial liability at amortized cost, and the conversion option component to be a financial liability at fair value through profit or loss.

Subsequent to initial recognition, the debt component is measured at amortized cost using the effective interest method and is accreted to its fair value over the expected life of the obligation. The conversion option component is recorded at its estimated fair value at each reporting date, with changes in fair value being included in the Statement of Operations and Comprehensive Income (Loss).

	Conversion option component	Debt component	Total
	\$	\$	\$
Convertible Notes - Face Value			1,250
Balance, January 1, 2011	1,254	453	1,707
Change in fair value (i)	(631)	-	(631)
Accretion	-	174	174
Balance, December 31, 2011 (i)	<u>623</u>	<u>627</u>	<u>1,250</u>
Change in fair value (i)	(55)	-	(55)
Accretion	-	55	55
Balance, March 31, 2012 (i)	<u><u>568</u></u>	<u><u>682</u></u>	<u><u>1,250</u></u>

(i) The fair value of the conversion option component at March 31, 2012 was calculated as \$577, implying a change in fair value of \$64, however, as the total value of the notes cannot be less than face value, a change of \$55 was recorded, resulting in a recorded fair value of the conversion option component of \$568, which together with the accreted value of \$682 of the debt component, equals the face value of \$1,250.

The change in fair value of convertible notes, as recorded in the consolidated Statement of Operations and Comprehensive Income (Loss), is a result of the fair value adjustment of the conversion option component of the convertible notes. The conversion option component of the convertible notes is carried on the Statement of Financial Position as financial liabilities at its estimated fair value. The change in fair value recorded is a non-cash adjustment that has had no cash effect on the Company.

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**13. OTHER FINANCIAL LIABILITIES (continued)**

**Convertible Notes (continued)**

The key assumptions used in determining the fair value of the non interest bearing loan were:

	<b>March 31</b>	December 31	January 1
	<b>2012</b>	2011	2011
Market value of one ordinary share	Cdn\$0.22	Cdn\$0.16	Cdn\$0.43
Face value of convertible notes	1,250,000	1,250,000	1,250,000
Term	2.04 years	2.29 years	3.29 years
Risk free rate	2.77%	2.77%	2.77%
Volatility	103%	103%	103%

**14. CAPITAL STOCK**

**Common shares**

**Authorized**

Unlimited number of common shares

**Issued**

	Shares (000's)	Amount \$
Balance at January 1, 2011	84,867	24,630
Private placement	5,331	1,496
Warrant valuation	-	(426)
Share issue costs	-	(71)
Exercise of warrants	12,999	3,977
Grant date fair value adjustment of warrants exercised	-	3,929
Exercise of stock options	229	48
Exercise of stock options - value reallocation	-	11
	<u>103,426</u>	<u>33,594</u>
Balance, December 31, 2011 and March 31, 2012	<u>103,426</u>	<u>33,594</u>

**15. STOCK OPTIONS**

The board of directors has approved a Stock Option Plan for directors, officers, management, employees and other persons who perform ongoing services for the Company or any of its subsidiaries. The purpose of the plan is to attract, retain and motivate these parties by providing them with the opportunity, through share options, to acquire a proprietary interest in the Company and to benefit from its growth.

The maximum number of common shares reserved for issuance upon the exercise of options is not to exceed 10% of the total number of common shares outstanding immediately prior to such an issuance. The options are exercisable over a period not exceeding ten years. The options are non-assignable and may be granted for a term not exceeding ten years. The exercise price of the options is fixed by the board of directors at the market price of the shares at the time of grant, subject to all applicable regulatory requirements.



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**15. STOCK OPTIONS (continued)**

On April 27, 2011, the Company granted 4,225,000 stock options to directors, officers and employees pursuant to its Stock Option Plan. These options vested on the date of the grant. The grant fair value of these options is \$1,729 which has been recorded to stock-based compensation and share-based payment reserve. The following assumptions were used in calculating the fair value of options granted, using the Black-Scholes option pricing model: expected dividend yield of 0%, expected volatility of 103%, risk-free interest rate of 2.5% and expected life of five years. Directors and officers were granted 2,700,000 stock options.

As at March 31, 2012, the Company had the following outstanding stock options:

	Number of Options Granted and Exercisable at March 31, 2012 (000's)	Estimated Grant Date Fair Value \$	<u>Exercise Price</u>	<u>Expiry Date</u>
	2,250	683	Cdn\$0.50	May 23, 2013
	2,351	368	Cdn\$0.21	February 15, 2015
	<u>4,225</u>	<u>1,729</u>	Cdn\$0.51	April 27, 2016
Total	<u><u>8,826</u></u>	<u><u>2,780</u></u>		

Stock option transactions for the respective periods were as follows:

	Number of Options (000's)	Weighted Average Exercise Price Cdn\$
Balance, January 1, 2011	4,830	0.34
Granted	4,225	0.51
Exercised	<u>(229)</u>	<u>0.20</u>
Balance, December 31, 2011 and March 31, 2012	<u><u>8,826</u></u>	<u><u>0.43</u></u>

The weighted average remaining contractual life of options outstanding at March 31, 2012 is 2.7 years.

The weighted average exercise price for options that are exercisable at March 31, 2012 amounted to \$0.43 per option.

**16. SHARE-BASED PAYMENT RESERVE**

	March 31 2012 \$
Balance, January 1, 2011	1,062
Value attributed to stock options granted during the period - employees	1,729
Exercise of stock-based compensation options	<u>(11)</u>
Balance, December 31, 2011 and March 31, 2012	<u><u>2,780</u></u>

## **XTIERRA INC.**

### **Notes to the Condensed Interim Consolidated Financial Statements**

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#### **17. FINANCIAL INSTRUMENTS**

The Company may be exposed to risks of varying degrees of significance which could affect its ability to achieve its strategic objectives. The main objectives of the Company's risk management processes are to ensure that the risks are properly identified and that the capital base is adequate in relation to those risks. There have been no significant changes in the risks or the Company's objectives, policies and procedures related to risk management.

The principal risks to which the Company is exposed to are described below.

##### **Fair value**

The carrying amounts for cash and cash equivalents, amounts receivable and other, prepaid expenses and accounts payable and accrued liabilities on the consolidated balance sheets approximate fair value because of the limited term of these instruments.

##### **Capital Risk:**

The Company manages its capital to ensure that there are adequate capital resources for the Company to maintain and explore its mineral properties. The capital structure of the Company consists of cash, cash equivalents and capital stock.

##### **Credit Risk:**

Credit risk is the risk that a client or vendor will be unable to pay or receive any amounts owed or owing by the Company. Management's assessment of the Company's risk is low as it is primarily attributable to funds held in Canadian banks, government sales taxes recoverable from the Government of Canada, and IVA taxes recoverable from the Mexican government, which are included in amounts receivable and other. Management expects the IVA taxes recorded in amounts receivable to be fully recoverable.

##### **Liquidity Risk:**

The Company's approach to managing liquidity risk is to ensure that it will have sufficient liquidity to meet liabilities when due. At March 31, 2012, the Company had cash and cash equivalents of \$5,530 to settle current liabilities of \$260. Accordingly, the Company is able to meet its current obligations.

##### **Market Risk:**

Market risk incorporates a range of risks. Movements in risk factors, such as market price risk and currency risk, affect the fair values of financial assets and liabilities. The Company is exposed to these risks as the ability of the Company to develop or market its properties and the future profitability of the Company is related to the market price of certain minerals.

##### **Price Risk:**

The Company is exposed to price risk with respect to commodity prices. The Company closely monitors commodity prices to determine the appropriate course of action to be taken by the Company. Price risk is remote since the Company is not a producing entity.

##### **Interest Rate Risk:**

The Company has cash balances and no interest-bearing debt. The Company's current policy is to invest excess cash in investment-grade short-term deposit certificates issued by major Canadian banks. The Company periodically monitors the investments it makes and is satisfied with the credit ratings of its banks.

##### **Foreign Currency Risk:**

The Company is subject to foreign exchange risk as some of its operating, investing and financing activities are transacted in currencies other than the United States ("US") dollar. The Company is therefore subject to gains and losses due to fluctuations in these currencies relative to the U.S. dollar. As at March 31, 2012, the Company held Canadian monetary assets and liabilities totalling approximately Cdn\$631,000 (\$633), and Mexican monetary assets and liabilities totalling approximately MXN\$2,359,000 (\$185).

##### **Sensitivity Analysis:**

The Company has designated its cash equivalents, warrants and other financial liabilities as held-for-trading, which are measured at fair value. Financial instruments included in cash and amounts receivable and other are classified as loans and receivables, which are measured at amortized cost. Accounts payable and accruals are classified as other financial liabilities, which are measured at amortized cost.

The carrying and fair value amounts of the Company's financial instruments are approximately the same at the statement of financial position dates.

## **XTIERRA INC.**

### **Notes to the Condensed Interim Consolidated Financial Statements**

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#### **17. FINANCIAL INSTRUMENTS (continued)**

The Company holds approximately Cdn\$631,000 (\$633) in financial assets and liabilities. A one percent change in the Canadian - US foreign exchange rates could result in a foreign exchange impact of approximately \$6 based on monetary assets and liability balances existing at March 31, 2012.

The Company holds approximately Mxn\$2,359,000 (\$185) in financial assets and liabilities. A one percent change in the Mexican - US foreign exchange rates could result in a foreign exchange impact of approximately \$2 based on monetary assets and liability balances existing at March 31, 2012.

A one percent change in interest rates will result in a corresponding change in interest income of approximately \$55 based on cash and cash equivalent balances existing at March 31, 2012.

#### **Fair Value Hierarchy and Liquidity Risk Disclosure:**

The fair value hierarchy have the following levels: (a) quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1); (b) inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices) (Level 2); and (c) inputs for the asset or liability that are not based on observable market data (unobservable inputs) (Level 3). At March 31, 2012, the Company's financial instruments that are carried at fair value, consisting of cash equivalents have been classified as Level 2 within the fair value hierarchy.

#### **18. CAPITAL MANAGEMENT**

The Company's capital structure consists of its capital stock, convertible notes, property acquisition obligation, warrants and share-based payment reserve.

The Company manages its capital structure and makes adjustments to it, based on the funds available to the Company, in order to support the acquisition, exploration and development of mineral properties. The board of directors does not establish quantitative return on capital criteria for management, but rather relies on the expertise of the Company's management to sustain future development of the business.

The properties in which the Company currently has an interest are in the exploration and development stages; as such the Company is dependent on external financing to fund its activities. In order to carry out the planned exploration and pay for administrative costs, the Company will utilize its existing working capital and seek to raise additional amounts as needed through the issue of common shares or other securities.

The Company will continue to assess new properties and seek to acquire an interest in additional properties if it feels there is sufficient geologic or economic 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 reasonable.

There have been no changes to the Company's capital management during 2012.

#### **19. COMMITMENTS AND CONTINGENCIES**

The Company's mining and exploration activities are subject to various federal, provincial and international laws and regulations governing the protection of the environment. These laws and regulations are continually changing and generally becoming more restrictive. The Company believes its operations are materially in compliance with all applicable laws and regulations. The Company has made, and expects to make in the future, expenditures to comply with such laws and regulations.