

**PREMIUM EXPLORATION INC.**  
**Report to Shareholders and**  
**Management Discussion and Analysis**  
**Of the Financial Position and Results of Operations**  
**For the Quarter Ended June 30, 2006**

**August 28, 2006**

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**TO OUR SHAREHOLDERS:**

This Management's Discussion and Analysis ("MD&A") supplements, but does not form part of, the interim consolidated financial statements of the Company and the notes thereto for the quarter ended June 30, 2006. Consequently, the following discussion and analysis of the financial condition and results of operations for Premium Exploration Inc. ("Premium" or the "Company"), should be read in conjunction with the interim consolidated financial statements for the quarter ended June 30, 2006 and related notes therein, which have been prepared in accordance with Canadian generally accepted accounting principles, consistently applied.

Discussion of the Company, its operations and associated risks is further described in the Company's filings, available for viewing at [www.sedar.com](http://www.sedar.com). A copy of this MD&A will be provided to any applicant upon request.

**FORWARD-LOOKING STATEMENTS**

Certain statements contained in the following MD&A and elsewhere constitute forward-looking statements. Such forward-looking statements involve a number of known and unknown risks, uncertainties and other factors that may cause the actual results, performance or achievements of the Company to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date the statements were made, and readers are advised to consider such forward-looking statements in light of the risks set forth in the Company's filings and herein.

**GENERAL**

Premium is a mineral exploration company that has unproven mineral property interests in Montana, USA and Sonora Mexico. Our principal business activities have been the exploration of two mineral properties known as the Montana Property, located in the Stillwater Complex, the State of Montana, United States of America and the Cucurpe Property located in the State of Sonora, Mexico. The Company's Montana Property consists of 137 mining claims acquired through three separate acquisition agreements that were completed during the third and fourth quarters of 2004. The Company's property located in Mexico consists of 32 mining concessions and was acquired by staking 13 new concessions during the first quarter of 2005, and the completion of an acquisition agreement on July 17, 2005 for the balance of the 19 mining concessions. All property transactions have been conducted on an arm's length basis between the Company and the vendors.

The Montana Property and the Cucurpe Property are the primary exploration properties held by the Company – see *Mineral Exploration*.

## **SIGNIFICANT EVENTS AND TRANSACTIONS**

During the quarter ended June 30, 2006, the Company conducted the following significant events or transactions:

- Appointed a U.S. law firm to assist the Company in seeking a U.S. registration of its securities and to seek a listing of its securities on the OTC Bulletin Board or the Pink Sheets.
- Appointed Robert Coale and J. Peter Davies to its technical advisory board.
- Commenced its Phase I exploration program on the Cucurpe property in early May. This Phase includes soil sampling, trenching and a mapping program.
- Announced in mid-June that it had entered into an option agreement to acquire a 100% interest in the Nueva Galicia project, located near Nayarit, Mexico. The Company can earn its interest by making staged payments over 4 years totalling \$1 million, issuing 500,000 common shares and incurring exploration expenditures of \$1.8 million, of which \$150,000 must be spent in the first year. Should the project attain commercial production then the optionor will receive the lesser of \$1 million in cash or 500,000 common shares of the Company. The agreement is subject to regulatory approval, which is currently in progress.
- Announced the appointment of Nancy Reardon, M.Sc PGeol, SEG Fellow, as Chief Operating Officer and as a member of the Board of directors.
- Staked 60 additional claims, which are contiguous to the Montana claims. The filing fees and BLM fees for these new claims will be incurred in the third quarter of the year and will approximate \$18,000. These claims represent an extension to the south of the Pine claim shear zone.

## **MINERAL EXPLORATION**

### ***Montana Property***

During the quarter ended June 30, 2006, the expenditures on the Montana property, were very limited as the Company concentrated on its Mexican properties and awaited the planned July commencement of the summer 2006 exploration program.

The Company has concluded that, at this time, it appears that the Montana Property has several interesting occurrences of PGM mineralization associated with the chromitites and gold associated with the fault zone that warrant further investigation. The Company has developed a two phase exploration program that it will begin in 2006 to further explore the Montana Property. Phase I is budgeted to cost \$174,900 with Phase II having a budget of \$352,275. The details for the second phase of the 2006 exploration program should be finalized based on the results of first phase, as the information generated during first phase will influence and refine the geological model and further refine the exploration targets. The exploration targets that need to be further defined are the gold, PGM mineralization associated with the north trending fault zone and the PGM mineralization associated with the chromitite layers. Phase 2 of the work program on the Montana properties is contingent upon the Company raising additional equity from subsequent offerings of its shares or from the exercise of warrants from the IPO and is not included in the Use of Proceeds from the IPO.

## ***Cucurpe Property***

The exploration program on the Cucurpe property was amended in the first quarter of 2006 to provide for a Phase I budget of \$200,000 and a Phase II budget of \$55,900. The program was commenced in early May and the Company expended approximately \$33,000 on the program to June 30, 2006, thereby completing its \$200,000 expenditure requirement.

## **RESULTS OF OPERATIONS**

The loss for the quarter ended June 30, 2006 was \$113,369, which compares to a loss of \$47,303 for the comparable quarter of 2005. The increase in the loss for the current quarter is due to a number of factors including significant increases in wages, fees and benefits, travel costs, professional fees, transfer agent and filing fees and shareholder relations. The current quarter loss includes wages, fees and benefits of \$25,810 (2005 - \$14,086), which includes \$15,000 (2005 - \$9,000) in management fees to Delbert W. Steiner, the President of the Company. The amount also increased due to a full quarter of wages and benefits for our Montana office accountant and certain one-time fees related to potential additional exploration projects. The loss also includes an increase in travel costs to \$31,079 (2005 - \$11,767), which was due to a number of factors including attendance at several conferences and trade shows, and a number of trips by management and directors indirectly related to fund raising, the IPO process and general and administrative duties. Professional fees increased to \$14,540 from \$1,501 due to the majority of the 2005 costs being capitalized as deferred financing costs. The 2006 costs included costs, which were not related to the IPO process. Shareholder relations increased to \$26,631 (2005 - \$1,927) due to printing costs, costs of preparing and investor package and the mail-out of annual meeting materials. Transfer agent and filing fees also increased as a result of the March 1, 2006 IPO.

The Company incurred resource property costs of \$130,107 (2005 - \$98,921) during the year to June 30, as a result of exploration work completed on its Montana and Mexican properties. The increase was due to the lack of cash curtailing activity in 2005 and the commencement of the 2006 work program in Mexico and the completion of the 2005 program during 2006 in Montana.

## **SUMMARY OF QUARTERLY RESULTS**

### **Financial Data for the Last Eight Quarters**

Three Months Ended	Jun-06	Mar-06	Dec-05	Sep-05	Jun-05	Mar-05	Dec-04	Sep-04
Total Revenues	\$Nil	\$Nil	\$Nil	Nil	\$Nil	\$Nil	\$Nil	\$Nil
Loss from continuing operations	\$113,369	\$94,266	\$47,737	\$30,472	\$71,053	\$46,537	\$47,085	\$63,827
Loss for the period	\$113,369	\$94,266	\$47,737	\$30,472	\$71,053	\$46,537	\$47,085	\$63,827
Loss per share	\$(0.01)	\$(0.01)	\$(0.00)	\$(0.00)	\$(0.01)	\$(0.00)	\$(0.01)	\$(0.03)

The quarterly losses for the year ended December 31, 2005 reflect a lower level of exploration activity and a higher level of administrative activity than in fiscal 2004. The quarterly losses for 2006 have increased due to the completion of the IPO in March 2006 and the resultant ramp up of activity..

## **FINANCIAL POSITION AND LIQUIDITY**

Premium has no history of profitable operations and its mineral projects are at an early stage. Therefore, it is subject to many risks common to comparable companies, including under-capitalization, cash shortages and limitations with respect to personnel, financial and other resources as well as a lack of revenues.

At the end of the quarter under review, the Company had a working capital of \$422,732 as compared to a working capital deficiency of \$379,313 at December 31, 2005. The change during the period primarily reflects the proceeds of the IPO less the increased exploration and general and administrative activity.

At June 30, 2006, the Company had cash on hand of \$665,546 compared to \$12,084 at December 31, 2005. Management believes the cash balance is adequate to fund ongoing expenses as required for its mineral property agreements and its general and administrative activities for the current exploration season but will need to raise additional funds for the Nueva Galicia option agreement and for the continued exploration of the Montana and Cucurpe properties.

### **CAPITAL RESOURCES AND COMMITMENTS**

The Company has mineral expenditure requirements under its East-West property agreement of \$50,000 by December 31, 2006. The Company also has annual claim rental fees of approximately \$17,125 in order to maintain its Montana properties in good standing.

The Company has to expend an additional \$400,000 on the Mexican concessions covered by the Acuna Option Agreement by May 20, 2007. In addition, the Company must pay duties twice yearly to the Mexican Government Department of Mines. The estimated duties on the 32 Concessions are \$5,400 per year.

The Company has recently entered into a new property agreement known as the Nueva Galicia project. The Company must make cash payments totalling \$120,000, issue 150,000 common shares and incur \$150,000 in qualifying exploration expenditures in the next 12 months in order to maintain this option.

The Company has an agreement, with Delbert W. Steiner, President and Director, which calls for monthly payments of \$5,000 and a term of five years to 1 March 2011.

The Company also has an agreement with Nancy Reardon, Chief Operating Officer and Director, which calls for monthly payments of C\$6,000 and a term of two years to 1 September 2008.

It will be necessary for the Company to arrange for additional financing following the completion of the coming 12 month-period to meet its ongoing exploration and overhead requirements.

Management believes it will be able to raise equity capital as required in the long term, but recognizes the risks attached thereto. Although the Company has successfully completed its IPO, there can be no assurance that it will be able to obtain adequate financing in the future or that the terms of such financing may be favourable.

### **OFF-BALANCE SHEET ARRANGEMENTS**

The Company had no off-balance sheet arrangements as at June 30, 2006 and as at the date hereof.

### **RELATED PARTY TRANSACTIONS**

Transactions with related parties are disclosed in the financial statements and include management fees for the six-month period of \$26,000 (2005 - \$18,000) paid or accrued to a director of the Company in his capacity as President. The Company also paid or accrued accounting fees for the six-month period of \$10,135 (2005 - \$6,614) to a professional partnership in which a former director is a partner and incurred \$9,179 (2005 - \$1,081) in interest expense on a note payable to a director and to a company controlled by a former director in the six-month period.

### **CHANGES IN ACCOUNTING POLICIES**

There were no changes in accounting policies in the period under review.

## **FINANCIAL INSTRUMENTS**

The Company's financial instruments consist of cash, receivables, GST receivable, accounts payable, due to related parties and notes payable. The Company maintains most of its cash in Canadian dollars. However, amounts are converted into U.S. dollars and Mexican pesos and are therefore subject to changes in fair value due to fluctuations in exchange rates. It is management's opinion that the Company is not exposed to significant interest, currency or credit risks arising from these financial instruments.

## **DISCLOSURE FOR VENTURE ISSUERS WITHOUT SIGNIFICANT REVENUE**

Consistent with other companies in the mineral exploration industry, Premium has no source of operating revenue. The Company's June 30, 2006 interim consolidated financial statements provide a breakdown of the general and administrative expenses for the year under review (Statement 2) and an analysis of the capitalized and expensed exploration and development costs incurred on its mineral properties (Schedule and Note 3a).

## **OUTSTANDING SHARES**

As at June 30, 2006, the Company had 17,964,303 common shares issued and outstanding versus 12,914,303 common shares issued and outstanding at December 31, 2005. The increase over 2005 reflects the success of the Company in completing its IPO during the first quarter of 2006.

Issued and diluted shares outstanding as at the date hereof are 17,964,303 and 20,989,303 respectively. The increase from December 31, 2005 reflects the subsequent issuance of 5,000,000 shares on the closing of the IPO and a further 50,000 shares related to the broker's corporate finance fee.

## **INVESTOR RELATIONS ACTIVITIES**

With respect to public relations, the Company's policy is to provide information from its corporate offices to investors and brokers directly.

## **MANAGEMENT**

Premium is very dependent upon the personal efforts and commitments of its existing management. To the extent that management's services would be unavailable for any reason, a disruption to the operations of Premium could result, and other persons would be required to manage and operate the Company.

## **SUBSEQUENT EVENTS**

- Announced the resignation of Ken Scott as Chief Financial Officer and as a director due to personal reasons. Mr. Scott was recently named as a partner of PricewaterhouseCoopers, LLP.
- In late July announced the commencement of the Phase I exploration program in Montana upon receipt of required approvals of the 2006 program from the Gallatin National Forest Service.
- Announced the results of the completion of the suspended 2005 exploration, which was completed in the second quarter of 2006 and led to the staking of the additional 60 claims, as previously discussed.
- In mid-August announced the status of the Cucurpe program including the progress in the areas of soil sampling and the compilation of data from the airborne magnetic data and regional geochemistry data obtained from the Servicio Geologico Mexicano, which covers the entire Cucurpe project. It is anticipated that phase I will be completed in the fourth quarter of 2006.
- ***Nueva Galicia Property***

The Company completed its initial assessment of the new property in Mexico and based on this assessment executed a definitive agreement to acquire a 100% interest in the property. The definitive agreement gives the Company the option to acquire certain 50 year concessions on the property, which expire between 2050 and 2055. The definitive agreement requires the Company, in order to maintain its purchase option, to conduct the following:

	Make Cash Payments (ii)	Issue Common Shares (ii)	Incur Exploration Expenditures (ii)
On signing the agreement	\$30,000(i)	50,000	
6 months from the date of the agreement	\$40,000	50,000	
12 months from the date of the agreement	\$50,000	50,000	\$150,000
18 months from the date of the agreement	\$60,000	50,000	\$150,000
24 months from the date of the agreement	\$70,000	75,000	\$400,000
36 months from the date of the agreement	\$250,000	100,000	\$500,000
48 months from the date of the agreement	\$500,000	125,000	\$600,000
	\$1,000,000	500,000	\$1,800,000

- (i) A deposit of \$7,500 was given to the licensee at the time the letter of understanding was completed.
- (ii) Subject to regulatory approval.

Should the property attain commercial production, the Company must complete the preceding option commitments and issue the licensee the lesser of \$1,000,000 or 500,000 additional common shares.

## **RISK FACTORS**

Companies operating in the mining industry face many and varied kinds of risks. While risk management cannot eliminate the impact of all potential risks, the Company strives to manage such risks to the extent possible and practical. Following are the risk factors most applicable to the Company:

Exploring and developing mineral resource projects bears a high potential for all manner of risks. Additionally, few exploration projects successfully achieve development due to factors that cannot be predicted or foreseen. Moreover, even one such factor may result in the economic viability of a project being detrimentally impacted such that it is neither feasible nor practical to proceed. The Company

closely monitors its activities and those factors that could impact them, and employs experienced consulting, engineering, insurance and legal advisors to assist in its risk management reviews.

Although the Company has taken steps to verify the title to mineral properties 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. Property title may be subject to unregistered prior agreements or transfers and title may be affected by undetected defects.

At present the principal activity of the Company is the exploration and development of gold resource properties. The feasible development of such properties is highly dependent upon the price of gold. A sustained and substantial decline in commodity gold prices could result in the write-down, termination of exploration and development work or loss of its interests in identified resource properties. Although such prices cannot be forecasted with certainty, the Company carefully monitors factors that could affect gold commodity prices in order to assess the feasibility of its resource projects.

Exploration and development projects are subject to the environmental laws and regulations of the country within which the Company is conducting its operations. As such laws are subject to change, the Company carefully monitors proposed and potential changes, and ensures that it is and will be in strict compliance.

Various non-governmental organizations dedicated to environmental protection monitor, amongst others, the mining industry. These organizations have in the past commenced actions with the regulatory agencies or the courts to prevent or delay mining activities.

#### **APPROVAL**

The Board of Directors of the Company has approved the disclosure contained in this Annual Management Discussion and Analysis.

Respectfully submitted  
On Behalf of the Board of Directors

*"Delbert W. Steiner"*

Delbert W. Steiner  
President