

**PREMIUM EXPLORATION INC.**  
**Report to Shareholders and**  
**Management Discussion and Analysis**  
**Of the Financial Position and Results of Operations**  
**For the Year Ended December 31, 2006**

**Dated May 3, 2007**

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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 year ended December 31, 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 year ended December 31, 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 and Nayarit, Mexico. Our principal business activities have been the exploration of the mineral properties known as the Montana Property, located in the Stillwater Complex, the State of Montana, United States of America, the Cucurpe Property located in the State of Sonora, Mexico and the Nueva Galicia Property, located in the State of Nayarit, 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 and 60 additional claims staked by the Company during 2006.

The Company's Cucurpe Property located in Mexico consisted 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. During the fourth quarter of 2006, the Company reached an agreement with the optionor of the Cucurpe Property and terminated the agreement. The Company abandoned all interest in the 19 mining concessions covered by the agreement and agreed to transfer one of its staked concessions in the area. The Company recorded a write-off of \$318,084 being the costs of acquisition and exploration of the concessions abandoned on the settlement of the dispute on the Cucurpe agreement. The Company has retained 12 concessions staked by the Company in the first quarter of 2005.

The Montana Property, Cucurpe Property and the Nueva Galicia Property are the primary exploration properties held by the Company – see *Mineral Exploration*. The Company has also recently entered into several other letters of intent on other Mexican properties - see *Mineral Exploration*.

### **SIGNIFICANT EVENTS AND TRANSACTIONS**

During the quarter ended December 31, 2006, the Company conducted the following significant events or transactions:

- Announced a letter of intent whereby the Company entered into an agreement with Beartooth Platinum Corporation (“Beartooth”) to jointly explore and share data on the Company’s properties in Montana, U.S.A. Under the terms of the agreement, Beartooth will be the operator and will pay all costs of the exploration activities, except the Company will pay the assaying costs. Contingent upon the results, Beartooth may negotiate a joint venture with the Company on the platinum group metals component of these properties. The Company may at its option include any silver or gold metals in the joint venture.
- Announced the appointment of Robert McLeod, M.Sc., P.Geo., as a member of the Board of Directors. Mr. McLeod has worked extensively in various tectonic and orogenic environments throughout North America with an emphasis on epigenetic gold, volcanogenetic massive sulphide and magmatic Cu-Ni-PGM exploration projects, which are similar to the Company’s exploration targets.
- The Company completed a private placement of 2,750,000 units at C\$0.20 per unit for gross proceeds of \$475,080 (C\$550,000). Each unit consisted of one common share and one-half of one common share purchase warrant. Each whole warrant allows the holder to acquire one additional common share for one year, to November 9, 2007, at C\$0.25 per share. The agent received a cash commission of \$37,315 (C\$43,200) and 275,000 share purchase warrants. Each agent’s warrant allows the agent to acquire one additional common share for one year, to November 9, 2007, at C\$0.25 per share.
- Announced the grant of 1,025,000 share purchase options at C\$0.20 per share, expiring November 15, 2011.

### **MINERAL EXPLORATION**

#### ***Montana Property***

The Company’s Initial Public Offering (“IPO”) indicated a Phase I exploration budget on the Montana Property of \$192,025. During the year ended December 31, 2006, the Company only expended \$137,719 due to the forest fire delays and the cost-savings generated by the strategic alliance with Beartooth.

At December 31, 2006, the Company controls 197 mining claims at a combined carrying value of \$503,326.

### ***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 \$246,117 on the program during 2006. The results of the 2006 exploration program did not meet management criteria to continue with the option agreement and accordingly the Company entered into negotiations to terminate the agreement.

As previously discussed, the Company reached a settlement and terminated the Cucurpe option agreement. The Company did not earn any interest in the related 19 mining concessions and also agreed to transfer one of its own staked mining concessions in the area. The Company has recorded a write-down of \$318,084 in the period ended December 31, 2006 related to the termination of the agreement.

At December 31, 2006, the Company still controls 12 exploration concessions in the area at a carrying value of \$157,539.

### ***Nueva Galicia Property***

During 2006, the Company expended \$110,533 on the project, made \$30,000 of required cash payments and issued 50,000 shares. The Company also staked an additional 1,910 hectares adjacent to and within the area of influence of the property. The Company initiated a program of sampling and mapping to develop drill targets for testing in the spring of 2007.

At December 31, 2006, the Company has an option on 6 mining exploitation concessions in the area at a carrying value of \$152,252.

### ***Other Mexican Properties***

During 2006, the Company paid \$10,000 under two letters of intent to conduct due diligence to investigate two potential option agreements. On January 11, 2007, the Company entered into an option agreement on the San Pedro de Anasco Property. The option agreement requires cash payments of \$875,000, the issuance of 250,000 shares and the completion of \$1,800,000 of exploration expenditures in stages over a three-year term to January 11, 2010.

The second property, the Guadalupe Property, was evaluated by the Company and in early 2007, a decision was reached to not pursue this property. Accordingly, all costs will be written-off in the first quarter of 2007.

### **SELECTED ANNUAL INFORMATION**

Fiscal Year Ended	December 2006	December 2005	December 2004
Total revenues	\$Nil	\$Nil	\$Nil
Net loss from continuing operations	\$975,356	\$195,799	\$110,912
Net loss	\$975,356	\$195,799	\$110,912
Basic and diluted loss per share	\$(0.06)	\$(0.02)	\$(0.03)
Total assets	\$1,348,169	\$796,302	\$537,203
Long-term financial liabilities	\$15,073	\$28,454	\$30,298
Cash dividends declared	\$Nil	\$Nil	\$Nil

## **RESULTS OF OPERATIONS**

The loss for the year ended December 31, 2006 was \$975,356, which compares to a loss of \$195,799 in 2005. The increase in the loss for the current year is due to a number of factors including the \$318,084 write-down of the Cucurpe property, significant increases in wages and fees, stock-based compensation, travel costs, professional fees, transfer agent and filing fees and shareholder relations. These increases were budgeted to increase substantially upon the Company completing its Initial Public Offering in March 2006. The current year loss includes wages, fees and benefits of \$122,383 (2005 - \$59,928), which includes \$56,000 (2005 - \$36,000) in management fees to Delbert W. Steiner, the President of the Company. The amount also increased due to a full year of wages and benefits for our Idaho office personnel and a portion of the year for staff at our new Vancouver offices. The loss also includes an increase in travel costs to \$99,590 (2005 - \$31,431), which was due to a number of factors including attendance at conferences and trade shows, and a number of trips by management and directors related to their general and administrative duties. Professional fees increased to \$101,709 from \$18,688 due to the legal fees related to the annual meeting, new management fee contracts and new property agreements. Also, a substantial portion of the prior year professional fees were deferred and deducted from share capital as issuance costs. Shareholder relations increased to \$76,223 (2005 - \$4,094) due to the costs associated with the annual meeting materials and being a public company. Transfer agent and filing fees also increased as a result of the March 1, 2006 IPO.

During the year ended December 31, 2006, the Company incurred resource property costs of \$491,659 (2005 - \$176,731) 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, the additional Mexican properties investigated 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	Dec-06	Sep-06	Jun-06	Mar-06	Dec-05	Sep-05	Jun-05	Mar-05
Total Revenues	\$Nil	\$Nil	\$Nil	\$Nil	\$Nil	Nil	\$Nil	\$Nil
Loss from continuing operations	\$322,125	\$445,596	\$113,369	\$94,266	\$47,737	\$30,472	\$71,053	\$46,537
Loss for the period	\$322,125	\$445,596	\$113,369	\$94,266	\$47,737	\$30,472	\$71,053	\$46,537
Loss per share	\$(0.02)	\$(0.02)	\$(0.01)	\$(0.01)	\$(0.00)	\$(0.00)	\$(0.01)	\$(0.00)

The quarterly losses for 2006 have increased due to the completion of the IPO in March 2006 and the resultant ramp up of activity. The loss for the quarter ended September 30, 2006 is also higher than prior quarters due to the \$318,084 write-down related to the termination of the Cucurpe option agreement.

## **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 December 31, 2006, the Company had a working capital of \$162,402 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, the December 2006 private placement less the increased exploration and general and administrative activity.

At December 31, 2006, the Company had cash on hand of \$432,290 compared to \$12,084 at December 31, 2005. Management believes that additional financing will be needed to fund ongoing expenses as required for its mineral property agreements and its general and administrative activities for the current exploration season, including additional funds for the Nueva Galicia and San Pedro de Analco option agreements and for the continued exploration of the Montana properties.

Subsequent to December 31, 2006, the Company raised approximately C\$750,000, after share issuance costs, on the completion of two private placements.

### **CAPITAL RESOURCES AND COMMITMENTS**

During 2006, the Company has paid the annual claim rental fees of approximately \$27,500 in order to maintain its Montana properties in good standing. The Company will be required to pay approximately \$25,000 in August 2007 to maintain the Montana claims.

The Company entered into a property agreement known as the Nueva Galicia property. The Company has made a \$40,000 cash payment and has issued 50,000 shares pursuant to the agreement and must make additional cash payments totalling \$110,000, issue a further 100,000 common shares and incur approximately a further \$300,000 in qualifying exploration expenditures in the next 12 months in order to maintain this option.

The Company entered into a property agreement known as the San Pedro de Analco property. The Company has made a \$20,000 cash payment and has issued 10,000 shares pursuant to this agreement and must make additional cash payments totalling \$100,000, issue a further 30,000 common shares and incur approximately \$300,000 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. This contract may be cancelled upon the Company providing six months advance notice.

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. This contract may be cancelled upon the Company providing three months advance notice.

It will be necessary for the Company to arrange for additional financing 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 and other equity financings, 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 December 31, 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 year of \$56,000 (2005 - \$36,000) paid or accrued to a director of the Company in his capacity as President. The Company also paid or accrued accounting fees for the year of \$22,300 (2005 - \$13,198) to a professional partnership in which a former director is a partner and incurred \$12,914 (2005 - \$2,498)

in interest expense on notes payable to directors and to a company controlled by a former director in the year.

## **DISCUSSION OF FOURTH QUARTER RESULTS**

The fourth quarter of 2005 saw the Company decrease its exploration expenditures due to the shortage of working capital as the Company awaited the completion of its IPO.

General and administrative costs of \$47,737 incurred in the fourth quarter were higher than costs of \$30,472 incurred in the third quarter. The increase is due to the accrual for our 2005 annual audit and the \$7,017 expended on general exploration in the quarter.

Cash flows used in operations, before changes in non-cash working capital items, of \$27,440 were higher than the \$17,605 use of cash for operations in the previous quarter of 2005, reflecting the increased amount expended on general exploration in the quarter.

## **CHANGES IN ACCOUNTING POLICIES**

Effective January 1, 2006, the Company determined that its functional currency had changed from the U.S. dollar to the Canadian dollar due to the IPO financing and anticipated future financings in Canadian funds and the establishment of a Canadian head office. The method of foreign currency translation was changed on a prospective basis from January 1, 2006 as described in Note 4 of the consolidated financial statements.

## **FINANCIAL INSTRUMENTS**

The Company's financial instruments consist of cash, receivables, accounts payable and accrued liabilities, 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 December 31, 2006 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 5).

## **OUTSTANDING SHARES**

As at December 31, 2006, the Company had 20,764,303 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 and a private placement completed in December 2006.

Issued and diluted shares outstanding as at the date hereof are 24,141,303 and 32,224,303 respectively. The increase from December 31, 2005 reflects the 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, 2,750,000 shares issued on a private placement in December 2006 and 50,000 shares issued pursuant to the Nueva Galicia exploration with purchase option agreement.

## **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**

- a) By a letter of intent dated January 23, 2007, the Company paid \$5,000 and was granted the right to enter into an option to explore and acquire certain concessions located in the State of Jalisco, Mexico. The letter of intent allows for a 120-day due diligence period to May 23, 2007 to enter into a definitive agreement whereby the Company would, at its option issue 250,000 shares from treasury, make cash payments of \$1,475,000 and complete \$1,650,000 of exploration expenditures in stages over a 36-month term. The property will be subject to a 1% net smelter return from commercial production.
- b) On March 5, 2007, the Company granted 1,500,000 stock options to directors, officers and consultants for 5 years, to March 5, 2012, at C\$0.23 per share.
- c) On March 12, 2007, the Company issued 3,300,000 units on two private placements at C\$0.25 per unit for gross proceeds of C\$825,000. Each unit consisted of one common share and one-half of one common share purchase warrant. Each whole warrant allows the holder to acquire one additional common share for one year at C\$0.35 per share. The agent received a commission of C\$42,000 and 210,000 warrants. Each agent's warrant allows the agent to acquire one additional common share for one year at C\$0.30 per share. A finder fee of C\$30,000 was also paid.

## **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.

### **Disclosure Controls and Procedures**

The Company has established disclosure controls and procedures to ensure that information disclosed in this MD&A and the related financial statements was properly recorded, processed, summarized and reported to the Company 's Board and Audit Committee. The Chief Executive Officer (CEO) and Chief Financial Officer (CFO) of the Company conducted an evaluation of the disclosure controls and procedures as required by Multilateral Instrument 52-109 issued by the Canadian Securities Administrators. They are satisfied that at December 31, 2006 the Company's disclosure controls and procedures were effective in providing reasonable assurance that material information regarding this annual report and other disclosures was made known to them on a timely basis.

It should be noted that while the Company's CEO and CFO believe that the Company's disclosure controls and procedures provide a reasonable level of assurance and that they are effective, they do not expect that the disclosure controls and procedures will prevent all errors and fraud. A control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

### **Internal Controls over Financial Reporting**

The CEO and CFO of the Company acknowledge that they are responsible for designing internal controls over financial reporting or causing them to be designed under their supervision in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP.

Management and the Board of Directors work to mitigate the risk of a material misstatement in financial reporting, however, there can be no assurance that this risk can be reduced to less than a remote likelihood of a material misstatement.

During the year ended December 31, 2006, there have been no changes in the Company's internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

In its evaluation, the Company identified certain material weaknesses in internal controls over financial reporting including:

- a) due to limited staff complements at the various operating locations, it is not feasible to achieve the complete segregation of incompatible duties;
- b) certain transactions do not possess evidence of supervisory approval for the related disbursement; and
- c) due to limited staff complements at the various operating locations, the Company relies upon third parties as participants in the Company's internal controls over financial reporting.

The Company believes that these weaknesses are mitigated by:

- a) the active involvement of senior management and the board of directors in all affairs of the Company;
- b) open lines of communication within the Company;

- c) the present levels of activity and the transactions being readily transparent; and
- d) the thorough review of the financial statements and management, discussion and analysis by management and the board of directors.

**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