

CAPITAL GOLD CORP  
Form 10-Q  
March 13, 2008

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT UNDER SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934  
For the quarterly period ended January 31, 2008

OR

TRANSITION REPORT UNDER SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 0-13078

CAPITAL GOLD CORPORATION  
(Exact name of registrant as specified in its charter)

DELAWARE  
(State or other jurisdiction of  
incorporation or organization)

13-3180530  
(I.R.S. Employer  
Identification No.)

76 Beaver Street, 14<sup>th</sup> floor, New York, NY 10005  
(Address of principal executive offices)

Registrant's telephone number, including area code: (212) 344-2785

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(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).  
Yes  No

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Indicate the number of shares outstanding of each of the issuer's classes of common equity as of the latest practicable date.

| Class                                     | Outstanding at March 13, 2008 |
|---|-------------------------------|
| Common Stock, par value \$.0001 per share | 175,638,646                   |

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**PART I. FINANCIAL INFORMATION**

**Item 1. Financial Statements**

The accompanying financial statements are unaudited for the interim periods, but include all adjustments (consisting only of normal recurring adjustments), which we consider necessary for the fair presentation of results for the three and six months ended January 31, 2008.

Moreover, these financial statements do not purport to contain complete disclosure in conformity with U.S. generally accepted accounting principles and should be read in conjunction with our audited financial statements at, and for the fiscal year ended July 31, 2007.

The results reflected for the three and six months ended January 31, 2008 are not necessarily indicative of the results for the entire fiscal year.

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CAPITAL GOLD CORPORATION  
CONDENSED CONSOLIDATED BALANCE SHEET  
JANUARY 31, 2008  
(in thousands, except for share and per share amounts)

|   | (Unaudited)<br>January 31,<br>2008 | July 31,<br>2007 |
|---|------------------------------------|------------------|
| <b>ASSETS</b>   |                                    |                  |
| Current Assets:   |                                    |                  |
| Cash and Cash Equivalents   | \$ 4,997                           | \$ 2,225         |
| Stockpiles and Ore on Leach Pads (Note 4)   | 6,770                              | 2,997            |
| Material and Supply Inventories   | 669                                | 174              |
| Deposits (Note 5)   | 268                                | 879              |
| Marketable Securities (Note 3)  | 75                                 | 90               |
| Prepaid Expenses (Note 18)  | 541                                | 72               |
| Loans Receivable – Affiliate (Note 10 and 13)   | 40                                 | 47               |
| Other Current Assets (Note 6)   | 1,923                              | 1,675            |
| <b>Total Current Assets</b>   | <b>15,283</b>                      | <b>8,159</b>     |
| Mining Concessions (Note 9)   | 63                                 | 68               |
| Property & Equipment – net (Note 7)   | 19,535                             | 18,000           |
| Intangible Assets – net (Note 8)  | 320                                | 577              |
| Other Assets:   |                                    |                  |
| Other Investments   | 28                                 | 28               |
| Deferred Financing Costs  | 503                                | 581              |
| Mining Reclamation Bonds  | 82                                 | 36               |
| Other   | -                                  | 42               |
| Security Deposits   | 60                                 | 60               |
| <b>Total Other Assets</b>   | <b>673</b>                         | <b>747</b>       |
| <b>Total Assets</b>   | <b>\$ 35,874</b>                   | <b>\$ 27,551</b> |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                                    |                  |
| Current Liabilities:  |                                    |                  |
| Accounts Payable  | \$ 1,070                           | \$ 617           |
| Accrued Expenses  | 1,451                              | 603              |
| Derivative Contracts (Note 16)  | 972                                | 596              |
| Current Portion of Long-term Debt (Note 15)   | 2,040                              | -                |
| <b>Total Current Liabilities</b>  | <b>5,533</b>                       | <b>1,816</b>     |
| Reclamation and Remediation Liabilities (Note 11)   | 1,323                              | 1,249            |
| Long-term Debt (Note 15)  | 10,460                             | 12,500           |
| <b>Total Long-term Liabilities</b>  | <b>11,783</b>                      | <b>13,749</b>    |
| Commitments and Contingencies   | -                                  | -                |
| Stockholders' Equity:   |                                    |                  |
| Common Stock, Par Value \$.0001 Per Share;<br>Authorized 300,000,000 shares; Issued and<br>Outstanding 175,588,648 and 168,173,148 shares, respectively | 18                                 | 17               |
| Additional Paid-In Capital  | 57,162                             | 54,016           |
| Accumulated Deficit   | (34,988)                           | (38,861)         |

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|  |           |           |
|--|-----------|-----------|
| Deferred Financing Costs (Note 15)               | (2,973)   | (3,438)   |
| Deferred Compensation                            | (716)     | (52)      |
| Accumulated Other Comprehensive Income (Note 12) | 55        | 304       |
| Total Stockholders' Equity                       | 18,558    | 11,986    |
| Total Liabilities and Stockholders' Equity       | \$ 35,874 | \$ 27,551 |

The accompanying notes are an integral part of the financial statements.

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CAPITAL GOLD CORPORATION  
CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS  
(UNAUDITED)  
(in thousands, except for share and per share amounts)

|  | For The Three Months Ended<br>January 31, |             |
|--|---|-------------|
|  | 2008                                      | 2007        |
| <b>Revenues</b>                                    |   |             |
| Sales – Gold, net                                  | \$ 8,043                                  | \$ -        |
| <b>Costs and Expenses:</b>                         |   |             |
| Costs Applicable to Sales                          | 2,419                                     | -           |
| Depreciation and Amortization                      | 881                                       | 273         |
| General and Administrative                         | 1,321                                     | 549         |
| Exploration  | 496                                       | 301         |
| Equity Based Compensation                          | 50  | 101         |
| Total Costs and Expenses                           | 5,167                                     | 1,224       |
| Income (Loss) from Operations                      | 2,876                                     | (1,224)     |
| <b>Other Income (Expense):</b>                     |   |             |
| Interest Income                                    | 31  | 12          |
| Interest Expense                                   | (288)                                     | (175)       |
| Other Income (Expense)                             | 14  | -           |
| Loss on change in fair value of derivative         | (342)                                     | (286)       |
| Total Other Income (Expense)                       | (585)                                     | (449)       |
| Income (Loss) before Income Taxes                  | 2,291                                     | (1,673)     |
| Income Tax Expense                                 | (165)                                     | -           |
| Net Income (Loss)                                  | \$ 2,126                                  | \$ (1,673)  |
| <b>Income (Loss) Per Common Share</b>              |   |             |
| Basic  | \$ 0.01                                   | \$ (0.01)   |
| Diluted  | \$ 0.01                                   | \$ -        |
| Basic Weighted Average Common Shares Outstanding   | 174,764,787                               | 138,074,015 |
| Diluted Weighted Average Common Shares Outstanding | 196,191,405                               | -           |

The accompanying notes are an integral part of the financial statements.

CAPITAL GOLD CORPORATION  
CONDENSED CONSOLIDATED STATEMENT OF OPERATIONS  
(UNAUDITED)  
(in thousands, except for share and per share amounts)

|  | For The Six Months Ended<br>January 31, |             |
|--|---|-------------|
|  | 2008                                    | 2007        |
| <b>Revenues</b>                                    |   |             |
| Sales – Gold, net                                  | \$ 14,569                               | \$ -        |
| <b>Costs and Expenses:</b>                         |   |             |
| Costs Applicable to Sales                          | 4,568                                   | -           |
| Depreciation and Amortization                      | 1,830                                   | 346         |
| General and Administrative                         | 2,172                                   | 1,181       |
| Exploration  | 631                                     | 514         |
| Equity Based Compensation                          | 108                                     | 101         |
| Total Costs and Expenses                           | 9,309                                   | 2,142       |
| Income (Loss) from Operations                      | 5,260                                   | (2,142)     |
| <b>Other Income (Expense):</b>                     |   |             |
| Interest Income                                    | 51                                      | 34          |
| Interest Expense                                   | (569)                                   | (198)       |
| Other Income (Expense)                             | (1)                                     | -           |
| Loss on change in fair value of derivative         | (703)                                   | (528)       |
| Total Other Income (Expense)                       | (1,222)                                 | (692)       |
| Income (Loss) before Income Taxes                  | 4,038                                   | (2,834)     |
| Income Tax Expense                                 | (165)                                   | -           |
| Net Income (Loss)                                  | \$ 3,873                                | \$ (2,834)  |
| <b>Income (Loss) Per Common Share</b>              |   |             |
| Basic  | \$ 0.02                                 | \$ (0.02)   |
| Diluted  | \$ 0.02                                 | \$ -        |
| Basic Weighted Average Common Shares Outstanding   | 172,809,806                             | 133,811,028 |
| Diluted Weighted Average Common Shares Outstanding | 194,594,693                             | -           |

The accompanying notes are an integral part of the financial statements.

CAPITAL GOLD CORPORATION  
 CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY  
 (UNAUDITED)  
 (in thousands, except for share and per share amounts)

|   | Common Stock<br>Shares | Common Stock<br>Amount | Additional<br>paid-in-<br>capital | Accumulated<br>Deficit | Accumulated<br>Other<br>Comprehensive<br>Income/(Loss) | Deferred<br>Financing<br>Costs | Deferred<br>Compensation | Total<br>Stockholders'<br>Equity |
|---|------------------------|------------------------|-----------------------------------|------------------------|--|--------------------------------|--------------------------|----------------------------------|
| Balance at July 31,<br>2007   | 168,173,148            | \$ 17                  | \$ 54,016                         | \$ (38,861)            | \$ 304   | \$ (3,438)                     | \$ (52)                  | \$ 11,986                        |
| Amortization of<br>deferred finance costs                             | -                      | -                      | -                                 | -                      | -  | 465                            | -                        | 465                              |
| Equity based<br>compensation  | -                      | -                      | 301                               | -                      | -  | -                              | 26                       | 327                              |
| Common stock issued<br>upon the exercising of<br>options and warrants | 6,321,500              | 1                      | 2,155                             | -                      | -  | -                              | -                        | 2,156                            |
| Issuance of restricted<br>common stock                                | 1,095,000              | -                      | 690                               | -                      | -  | -                              | (690)                    | -                                |
| Change in fair value<br>on interest rate swaps                        | -                      | -                      | -                                 | -                      | (261)  | -                              | -                        | (261)                            |
| Unrealized loss on<br>marketable securities                           | -                      | -                      | -                                 | -                      | (15)   | -                              | -                        | (15)                             |
| Equity adjustment<br>from foreign currency<br>translation             | -                      | -                      | -                                 | -                      | 27   | -                              | -                        | 27                               |
| Net income for the six<br>months ended January<br>31, 2008            | -                      | -                      | -                                 | 3,873                  | -  | -                              | -                        | 3,873                            |
| Balance at January 31,<br>2008  | 175,588,648            | \$ 18                  | \$ 57,162                         | \$ (34,988)            | \$ 55  | \$ (2,973)                     | \$ (716)                 | \$ 18,558                        |

The accompanying notes are an integral part of the financial statements.



CAPITAL GOLD CORPORATION  
CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS  
(UNAUDITED)  
(in thousands, except for share and per share amounts)

|  | For The<br>Six Months Ended<br>January 31, |            |
|--|--|------------|
|  | 2008                                       | 2007       |
| <b>Cash Flow From Operating Activities:</b>                  |  |            |
| Net Income (Loss)  | \$ 3,873                                   | \$ (2,834) |
| Adjustments to Reconcile Net Loss to                         |  |            |
| Net Cash Provided by (Used in) Operating Activities:         |  |            |
| Depreciation and Amortization                                | 1,830                                      | 347        |
| Accretion of Reclamation Obligation                          | 73   | -          |
| Loss on change in fair value of derivative, net              | 703  | 528        |
| Equity Based Compensation                                    | 327  | 135        |
| Changes in Operating Assets and Liabilities:                 |  |            |
| Decrease in Prepaid Expenses                                 | (468)                                      | (34)       |
| Increase in Inventory  | (3,888)                                    | -          |
| (Increase) Decrease in Other Current Assets                  | (248)                                      | 3,873      |
| Decrease (Increase) in Other Deposits                        | 611  | (349)      |
| (Increase) Decrease in Other Assets                          | -  | -          |
| Increase in Mining Reclamation Bond                          | (46)                                       | -          |
| Increase in Accounts Payable                                 | 452  | (25)       |
| Decrease in Derivative Liability                             | (587)                                      | -          |
| Increase in Accrued Expenses                                 | 848  | 37         |
| Net Cash Provided By Operating Activities                    | 3,480                                      | 1,678      |
| <b>Cash Flow From Investing Activities:</b>                  |  |            |
| (Increase) in Other Investments                              | -  | (6)        |
| Purchase of Mining, Milling and Other Property and Equipment | (2,809)                                    | (10,872)   |
| Purchase of Intangibles                                      | (90)                                       | (500)      |
| Net Cash Used in Investing Activities                        | (2,899)                                    | (11,378)   |

The accompanying notes are an integral part of the financial statements.

CAPITAL GOLD CORPORATION  
CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS – CONTINUED  
(UNAUDITED)  
(in thousands, except for share and per share amounts)

|   | For The<br>Six Months Ended<br>January 31, |          |
|---|--|----------|
|   | 2008                                       | 2007     |
| <b>Cash Flow From Financing Activities:</b>                         |  |          |
| Advances to Affiliate   | 8  | (3)      |
| Proceeds from Borrowing on Credit Facility                          | -  | 8,750    |
| Proceeds From Issuance of Common Stock                              | 2,156                                      | 4,413    |
| Deferred Finance Costs  | -  | (257)    |
| Net Cash Provided By Financing Activities                           | 2,164                                      | 12,903   |
| Effect of Exchange Rate Changes                                     | 27   | 162      |
| Increase (Decrease) In Cash and Cash Equivalents                    | 2,772                                      | 3,365    |
| Cash and Cash Equivalents - Beginning                               | 2,225                                      | 2,741    |
| Cash and Cash Equivalents - Ending                                  | \$ 4,997                                   | \$ 6,106 |
| <b>Supplemental Cash Flow Information:</b>                          |  |          |
| Cash Paid For Interest  | \$ 598                                     | \$ 216   |
| Cash Paid For Income Taxes  | \$ 1                                       | \$ 1     |
| <b>Non-Cash Financing Activities:</b>                               |  |          |
| Issuance of common stock and warrants as payment of financing costs | \$ -                                       | \$ 3,665 |
| Change in Fair Value of Derivative Instrument                       | \$ 261                                     | \$ 33    |

The accompanying notes are an integral part of the financial statements.

CAPITAL GOLD CORPORATION  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
JANUARY 31, 2008  
(UNAUDITED)

NOTE 1 - Basis of Presentation

Capital Gold Corporation ("Capital Gold", "the Company", "we" or "us") owns rights to property located in the State of Sonora, Mexico and the California Mining District, Lake County, Colorado. The Company is engaged in the production of gold and other minerals from its properties in Mexico as well as exploration for additional mineral properties. All of the Company's mining activities are being performed in Mexico.

On June 29, 2001, the Company exercised an option and purchased from AngloGold North America Inc. and AngloGold (Jerritt Canyon) Corp. 100% of the issued and outstanding stock of Minera Chanate, S.A. de C.V., a subsidiary of those two companies ("Minera Chanate"). Minera Chanate's assets consisted of certain exploitation and exploration concessions in the States of Sonora, Chihuahua and Guerrero, Mexico. These concessions are sometimes referred to as the El Chanate Concessions.

Pursuant to the terms of the agreement, on December 15, 2001, the Company made a \$50,000 payment to AngloGold. AngloGold is entitled to receive the remainder of the purchase price by way of an ongoing percentage of net smelter returns of between 2% and 4% plus 10% net profits interest (until the total net profits interest payment received by AngloGold equals \$1,000,000). AngloGold's right to a payment of a percentage of net smelter returns and the net profits interest will terminate at such point as they aggregate \$18,018,355. In accordance with the agreement, the foregoing payments are not to be construed as royalty payments. Should the Mexican government or other jurisdiction determine that such payments are royalties, the Company could be subject to and would be responsible for any withholding taxes assessed on such payments.

Under the terms of the agreement, the Company has granted AngloGold the right to designate one of its wholly-owned Mexican subsidiaries to receive a one time option (the "Option") to purchase 51% of Minera Chanate (or such entity that owns the Minera Chanate concessions at the time of option exercise) (the "Back-In Right"). That Option is exercisable over a 180 day period commencing at such time as the Company notifies AngloGold that it has made a good faith determination that it has gold-bearing ore deposits on any one of the identified group of El Chanate Concessions, when aggregated with any ore that the Company has mined, produced and sold from such concessions, of in excess of 2,000,000 troy ounces of contained gold. The exercise price would equal twice the Company's project costs on the properties during the period commencing on December 15, 2000 and ending on the date of such notice.

In January 2008, pursuant to the terms of the agreement, the Company made a good faith determination and notified AngloGold that the drill indicated resources at the El Chanate gold mine exceeded two million ounces of contained gold. The term "drill indicated resources" is defined in the agreement. A drill indicated resource number does not rise to the level of, and should not be considered proven and probable reserves as those terms are defined under SEC guidelines. AngloGold has 180 days from the date of notification to determine whether or not it will choose to exercise the Option for the Back-In Right.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of the Company's management, the accompanying condensed consolidated financial statements reflect all adjustments (which include only normal recurring adjustments) necessary to present fairly the condensed consolidated financial position and results of operations and cash flows for the periods presented. They include the accounts of Capital Gold Corporation and its wholly owned and majority owned subsidiaries, Leadville Mining and Milling Holding Corporation, Minera Santa Rita, S.A de R.L. de C.V. ("MSR") and Oro de Altar S. de R. L. de C.V. ("Oro") as well as the accounts within Caborca Industrial S.A. de C.V. ("Caborca Industriale"), a Mexican corporation 100% owned by two of the Company's officers and directors for mining support services. These services include, but are not limited to, the payment of mining salaries and related costs. Caborca Industrial bills the Company for these services at slightly above cost. This entity is considered a variable interest entity under accounting rules provided under FIN 46, "Consolidation of Variable Interest Entities". All significant intercompany accounts and transactions are eliminated in consolidation. Certain items in these financial statements have been reclassified to conform to the current period presentation. These reclassifications had no impact on the Company's results of operations, stockholders' equity or cash flows

Results of operations for interim periods are not necessarily indicative of the results of operations for a full year.

#### NOTE 2 - Equity Based Compensation

In connection with offers of employment to the Company's executives as well as in consideration for agreements with certain consultants, the Company issues options and warrants to acquire its common stock. Employee and non-employee awards are made at the discretion of the Board of Directors.

Such options and warrants may be exercisable at varying exercise prices currently ranging from \$0.24 to \$0.63 per share of common stock with certain of these grants becoming exercisable immediately upon grant. Certain grants vested or are vesting for a period of five years, respectively. Also, certain grants contain a provision whereby they become immediately exercisable upon a change of control.

Effective February 1, 2006, the Company adopted the provisions of SFAS No. 123R. Under FAS 123R, share-based compensation cost is measured at the grant date, based on the estimated fair value of the award, and is recognized as expense over the requisite service period. The Company adopted the provisions of FAS 123R using a modified prospective application. Under this method, compensation cost is recognized for all share-based payments granted, modified or settled after the date of adoption, as well as for any unvested awards that were granted prior to the date of adoption. Prior periods are not revised for comparative purposes. Because the Company previously adopted only the pro forma disclosure provisions of SFAS 123, it will recognize compensation cost relating to the unvested portion of awards granted prior to the date of adoption, using the same estimate of the grant-date fair value and the same attribution method used to determine the pro forma disclosures under SFAS 123, except that forfeitures rates will be estimated for all options, as required by FAS 123R.

The cumulative effect of applying the forfeiture rates is not material. FAS 123R requires that excess tax benefits related to stock option exercises be reflected as financing cash inflows instead of operating cash inflows.

The fair value of each option award is estimated on the date of grant using a Black-Scholes option valuation model. Expected volatility is based on the historical volatility of the price of the Company stock. The risk-free interest rate is based on U.S. Treasury issues with a term equal to the expected life of the option. The Company uses historical data to estimate expected dividend yield, expected life and forfeiture rates. The estimated per share weighted average grant-date fair values of stock options and warrants granted during the six months ended January 31, 2008 and 2007, were \$0.60 and \$0.32, respectively. The fair values of the options and warrants granted were estimated based on the

following weighted average assumptions:

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|                         | Six months ended January 31, |           |
|-------------------------|------------------------------|-----------|
|                         | 2008                         | 2007      |
| Expected volatility     | 47.60 – 58.69%               | 66%       |
| Risk-free interest rate | 3.74%                        | 6.25%     |
| Expected dividend yield | -                            | -         |
| Expected life           | 6.3 years                    | 2.0 years |

Stock option and warrant activity for employees during the six months ended January 31, 2008 is as follows:

|  | Number of<br>Options | Weighted<br>Average<br>exercise<br>price | Weighted<br>average<br>remaining<br>contracted<br>term (years) | Aggregate<br>intrinsic<br>value |
|--|----------------------|--|--|---------------------------------|
| Outstanding at July 31, 2006                         | 5,570,454            | \$ .16                                   | 1.17   | \$ 702,250                      |
| Options granted                                      | 1,050,000            | .36                                      |  |                                 |
| Options exercised                                    | (3,570,909)          | .08                                      | -  | -                               |
| Options expired                                      | (549,545)            | .22                                      | -  | -                               |
| Warrants and options outstanding at July 31, 2007    | 2,500,000            | \$ .34                                   | 1.20   | \$ 255,000                      |
| Options granted*                                     | 2,500,000            | .63                                      | -  | -                               |
| Options exercised                                    | (250,000)            | .32                                      | -  | -                               |
| Options expired                                      | -                    | -  | -  | -                               |
| Warrants and options outstanding at January 31, 2008 | 4,750,000            | \$ .49                                   | 3.15   | \$ 985,000                      |
| Warrants and options exercisable at January 31, 2008 | 2,850,000            | \$ .39                                   | 3.32   | \$ 788,000                      |

\* Issuances under 2004 Equity Incentive Plan.

Unvested stock option and warrant balances for employees at January 31, 2008 are as follows:

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|   | Number of<br>Options | Weighted<br>Average<br>Exercise<br>price | Weighted<br>average<br>remaining<br>contracted<br>term (years) | Aggregate<br>Intrinsic<br>value |
|---|----------------------|--|--|---------------------------------|
| Outstanding at August 1, 2007                       | 150,000              | \$ .32                                   | 0.67   | \$ 18,000                       |
| Options granted                                     | 2,500,000            | \$ .63                                   | -  | -                               |
| Options vested                                      | (500,000)            | \$ .63                                   | -  | -                               |
| Unvested Options outstanding at<br>January 31, 2008 | 2,150,000            | \$ .61                                   | 6.17   | \$ 197,000                      |

Stock option and warrant activity for non-employees during the six months ended January 31, 2008 is as follows:

|   | Number of<br>Options | Weighted<br>Average<br>Exercise<br>price | Weighted<br>average<br>remaining<br>contracted<br>term (years) | Aggregate<br>Intrinsic<br>value |
|---|----------------------|--|--|---------------------------------|
| Warrants and options outstanding at July<br>31, 2006    | 25,561,000           | \$ .29                                   | 1.33   | \$ 1,939,530                    |
| Options granted   | 16,982,542           | .33                                      | -  | -                               |
| Options exercised                                       | (18,633,000)         | .29                                      | -  | -                               |
| Options expired   | (1,375,000)          | .31                                      | -  | -                               |
| Warrants and options outstanding at July<br>31, 2007    | 22,535,542           | \$ .33                                   | 1.48   | \$ 2,577,734                    |
| Options granted*  | 1,115,000            | \$ .55                                   | -  | -                               |
| Options exercised                                       | (6,070,500)          | .34                                      | -  | -                               |
| Options expired   | (680,000)            | .30                                      | -  | -                               |
| Warrants and options outstanding at<br>January 31, 2008 | 16,900,042           | \$ .34                                   | 2.33   | \$ 6,154,900                    |
| Warrants and options exercisable at<br>January 31, 2008 | 16,380,042           | \$ .33                                   | 2.33   | \$ 6,118,500                    |

\* Issuances under 2004 Equity Incentive Plan.

Unvested stock option and warrant balances for non-employees at January 31, 2008 are as follows:

|   | Number of<br>Options | Weighted<br>Average<br>Exercise<br>price | Weighted<br>average<br>remaining<br>contracted<br>term (years) | Aggregate<br>Intrinsic<br>value |
|---|----------------------|--|--|---------------------------------|
| Outstanding at August 1, 2007                       | -                    | -  | -  | -                               |
| Options granted                                     | 650,000              | \$ .63                                   | -  | -                               |
| Options vested                                      | (130,000)            | \$ .63                                   | -  | -                               |
| Unvested Options outstanding at<br>January 31, 2008 | 520,000              | \$ .63                                   | 6.99   | \$ 36,000                       |

The impact on the Company's results of operations of recording equity based compensation for the six months ended January 31, 2008, for employees and non-employees was approximately \$327,000 and reduced earnings per share by \$0.00 per basic and diluted share.

As of January 31, 2008, there was approximately \$716,000 of unrecognized equity based compensation cost related to options granted to executives and employees which have not yet vested.

#### NOTE 3 - Marketable Securities

Marketable securities are classified as current assets and are summarized as follows:

|   | (in thousands)      |                  |
|---|---------------------|------------------|
|   | January 31,<br>2008 | July 31,<br>2007 |
| Marketable equity securities, at cost                           | \$ 50               | \$ 50            |
| Marketable equity securities, at fair value (See Notes 10 & 13) | \$ 75               | \$ 90            |

#### NOTE 4 - Stockpiles, Ore on Leach Pads and Inventories ("In-Process Inventory")

|                                | (in thousands)      |                  |
|--------------------------------|---------------------|------------------|
|                                | January 31,<br>2008 | July 31,<br>2007 |
| <b>Current:</b>                |                     |                  |
| Stockpiles & Ore on leach pads | \$ 6,770            | \$ 2,997         |
| Total                          | \$ 6,770            | \$ 2,997         |



Costs that are incurred in or benefit the productive process are accumulated as stockpiles, ore on leach pads and inventories. Stockpiles, ore on leach pads and inventories are carried at the lower of average cost or net realizable value. Net realizable value represents the estimated future sales price of the product based on current and long-term metals prices, less the estimated costs to complete production and bring the product to sale. Write-downs of stockpiles, ore on leach pads and inventories, resulting from net realizable value impairments, will be reported as a component of *Costs applicable to sales*. The current portion of stockpiles, ore on leach pads and inventories is determined based on the expected amounts to be processed within the next 12 months. Stockpiles, ore on leach pads and inventories not expected to be processed within the next 12 months will be classified as long-term.

#### NOTE 5 – Deposits

Deposits are classified as current assets and represent advance payments made on the Company's mining contract and on mining equipment regarding the El Chanate Project in Sonora, Mexico. Deposits are summarized as follows:

|                                     | (in thousands)      |                  |
|-------------------------------------|---------------------|------------------|
|                                     | January 31,<br>2008 | July 31,<br>2007 |
| Advance payments on mining contract | \$ 250              | \$ 684           |
| Equipment deposits                  | -                   | 193              |
| Other                               | 18                  | 2                |
| Total Deposits                      | \$ 268              | \$ 879           |

#### NOTE 6 – Other Current Assets

Other current assets consist of the following:

|                                | (in thousands)      |                  |
|--------------------------------|---------------------|------------------|
|                                | January 31,<br>2008 | July 31,<br>2007 |
| Value added tax to be refunded | \$ 1,622            | \$ 1,475         |
| Asset held for resale          | 166                 | 166              |
| Other                          | 135                 | 34               |
| Total Other Current Assets     | \$ 1,923            | \$ 1,675         |

## NOTE 7 – Property and Equipment

Property and Equipment consist of the following:

|                                  | (in thousands)      |                  |
|----------------------------------|---------------------|------------------|
|                                  | January 31,<br>2008 | July 31,<br>2007 |
| Process equipment and facilities | \$ 17,309           | \$ 16,285        |
| Asset retirement obligation      | 1,218               | 1,218            |
| Mining equipment                 | 973                 | 863              |
| Mineral properties               | 141                 | 141              |
| Construction in progress         | 1,625               | -                |
| Computer and office equipment    | 249                 | 212              |
| Improvements                     | 16                  | 16               |
| Furniture                        | 31                  | 23               |
| Total                            | 21,562              | 18,758           |
| Less: accumulated depreciation   | (2,027)             | (758)            |
| Property and equipment, net      | \$ 19,535           | \$ 18,000        |

Expenditures for new facilities or equipment and expenditures that extend the useful lives of existing facilities or equipment are capitalized and depreciated using the Units of Production (“UOP”) and straight-line method at rates sufficient to depreciate such costs over the estimated productive lives, which do not exceed the related estimated mine lives, of such facilities based on proven and probable reserves.

Mineral exploration costs are expensed as incurred. When it has been determined that a mineral property can be economically developed as a result of establishing proven and probable reserves, costs incurred prospectively to develop the property are capitalized as incurred and are amortized using the UOP method over the estimated life of the ore body based on estimated recoverable ounces or pounds in proven and probable reserves.

Depreciation expense for the six months ended January 31, 2008 and 2007 was approximately \$1,274,000 and \$22,000, respectively.

## NOTE 8 - Intangible Assets

Intangible assets consist of the following:

|  | (in thousands)      |                  |
|--|---------------------|------------------|
|  | January 31,<br>2008 | July 31,<br>2007 |
| Repurchase of Net Profits Interest from FG | \$ 500              | \$ 500           |
| Water Rights                               | 134                 | -                |
| Mobilization Payment to Mineral Contractor | 70                  | 70               |
| Investment in Right of Way                 | 18                  | 18               |
| Total                                      | 722                 | 588              |
| Accumulated Amortization                   | (402)               | (11)             |
| Intangible assets, net                     | \$ 320              | \$ 577           |

Purchased intangible assets consisting of rights of way, water rights, easements and net profit interests are carried at cost less accumulated amortization. Amortization is computed using the straight-line method over the economic lives of the respective assets, generally five years or using the UOP method. It is the Company’s policy to assess

periodically the carrying amount of its purchased intangible assets to determine if there has been an impairment to their carrying value. Impairments of other intangible assets are determined in accordance with SFAS 144. There was no impairment at January 31, 2008.

Amortization expense for the six months ended January 31, 2008 and 2007 was approximately \$391,000 and \$2,000, respectively.

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## NOTE 9 - Mining Concessions

Mining concessions consist of the following:

|                                | (in thousands)      |                  |
|--------------------------------|---------------------|------------------|
|                                | January 31,<br>2008 | July 31,<br>2007 |
| El Chanate                     | \$ 45               | \$ 45            |
| El Charro                      | 25                  | 25               |
| <b>Total</b>                   | <b>70</b>           | <b>70</b>        |
| Less: accumulated amortization | (7)                 | (3)              |
| <b>Total</b>                   | <b>\$ 63</b>        | <b>\$ 67</b>     |

The El Chanate concessions are carried at historical cost and are being amortized using the UOP method. They were acquired in connection with the purchase of the stock of Minera Chanate (see Note 1).

MSR acquired an additional mining concession – El Charro. El Charro lies within the current El Chanate property boundaries. MSR is required to pay 1 1/2% net smelter royalty in connection with the El Charro concession.

Amortization expense for the six months ended January 31, 2008 and 2007 was approximately \$4,000 and \$0, respectively.

## NOTE 10 - Loans Receivable - Affiliate

Loans receivable - affiliate consist of expense reimbursements due from a publicly-owned corporation in which the Company has an investment. The Company's president and chairman of the board of directors is an officer and director of that corporation. These loans are non-interest bearing and due on demand (see Notes 3 & 13).

## NOTE 11 - Reclamations and Remediation Liabilities (“Asset Retirement Obligations”)

In accordance with SFAS No. 143, Accounting for Asset Retirement Obligations, reclamation costs are allocated to expense over the life of the related assets and are periodically adjusted to reflect changes in the estimated present value resulting from the passage of time and revisions to the estimates of either the timing or amount of the reclamation and abandonment costs. The Asset Retirement Obligation is based on when the spending for an existing environmental disturbance and activity to date is expected to occur. The Company reviews, on an annual basis, unless otherwise deemed necessary, the Asset Retirement Obligation at each mine site.

The following is a reconciliation of the liability for long-term Asset Retirement Obligation:

|   | (in thousands) |
|---|----------------|
| Balance at July 31, 2007                  | \$ 1,249       |
| Additions, changes in estimates and other | -              |
| Liabilities settled                       | -              |
| Accretion expense                         | 74             |
| Balance at January 31, 2008               | \$ 1,323       |

#### NOTE 12 - Other Comprehensive Income (Loss)-Supplemental Non-Cash Investing Activities

Other comprehensive income (loss) consists of changes in the fair value of derivatives, accumulated foreign translation gains and losses and unrealized gains and losses on marketable securities and is summarized as follows:

|  | (in thousands) |
|--|----------------|
| Balance at July 31, 2007                             | \$ 304         |
| Equity Adjustments from Foreign Currency Translation | 27             |
| Change in fair value of derivative instrument        | (261)          |
| Unrealized Gains (loss) on Marketable Securities     | (15)           |
| Balance at January 31, 2008                          | \$ 55          |

#### NOTE 13 - Related Party Transactions

In August 2002, the Company purchased marketable equity securities of a related company (see Note 3). The Company recorded approximately \$3,250 and \$4,500, respectively, in expense reimbursements including office rent from this entity for the six months ended January 31, 2008 and 2007, respectively (see Notes 10).

The Company utilizes a Mexican Corporation 100% owned by two officers/Directors and stockholders of the Company for mining support services. These services include but are not limited to the payment of mining salaries and related costs. The Mexican Corporation bills the Company for these services at slightly above cost. Mining expenses charged by the Mexican Corporation and eliminated upon consolidation amounted to approximately \$1,522,000 and \$181,000 for the six months ended January 31, 2008 and 2007, respectively.

#### NOTE 14 - Stockholders' Equity

##### Common Stock

At various stages in the Company's development, shares of the Company's common stock have been issued at fair market value in exchange for services or property received with a corresponding charge to operations, property and equipment or additional paid-in capital depending on the nature of the services provided or property received.

During the six months ended January 31, 2008, the Company received proceeds of approximately \$2,156,000 from the exercising of an aggregate of 6,321,500 warrants issued in past private placements.

The Board of Directors recommended an amendment to the Company's Certificate of Incorporation to increase the Company's authorized shares of capital stock from 250,000,000 to 300,000,00 shares. This amendment was approved by the stockholders on January 24, 2008 and the Company effected the authorized share increase on January 25, 2008.

#### 2006 Equity Incentive Plan

The 2006 Equity Incentive Plan (the "Plan"), approved by stockholders on February 21, 2007, is intended to attract and retain individuals of experience and ability, to provide incentive to the Company's employees, consultants, and non-employee directors, to encourage employee and director proprietary interests in the Company, and to encourage employees to remain in the Company's employ.

The Plan authorizes the grant of non-qualified and incentive stock options, stock appreciation rights and restricted stock awards (each, an "Award"). A maximum of 10,000,000 shares of common stock are reserved for potential issuance pursuant to Awards under the Plan. Unless sooner terminated, the Plan will continue in effect for a period of 10 years from its effective date.

The Plan is administered by the Company's Board of Directors which has delegated the administration to the Company's Compensation Committee. The Plan provides for Awards to be made to such of the Company's employees, directors and consultants and its affiliates as the Board may select. As of January 31, 2008, 6,260,000 options and shares have been granted under the Plan leaving 3,740,000 available for issuance.

In August 2007, the Company issued two year options to purchase the Company's common stock at exercise prices ranging from \$0.38 to \$0.50 per share for professional services rendered. These options are for the purchase of 465,000 shares and were issued under the 2006 Equity-Incentive Plan. The Company utilized the Black-Scholes Method to fair value these options and recorded approximately \$58,000 as equity based compensation expense.

On December 20 2007, the Company's executive officers and directors were granted stock options and restricted stock under the Plan. Executive officers and directors were granted an aggregate of 3,000,000 stock options and executive officers were granted an aggregate 1,075,000 shares of restricted stock. All of the stock options have a term of seven years and vest as follows: 20% vested upon issuance and the balance vest 20% annually thereafter. The exercise price of the stock options is \$0.63 per share (per the Plan, the closing price on the Toronto Stock Exchange on the trading day immediately prior to the day of determination converted to U.S. Dollars). The restricted shares granted vest equally over three years from the date of grant. In the event of a termination of continuous service (other than as a result of a change of control), as defined in the Plan, unvested stock options and unvested restricted stock grants shall terminate and, with regard to vested stock options, the exercise period shall be the lesser of the original expiration date or one year from the date continuous service terminates. Upon the happening of a change of control, all unvested stock options and unvested restricted stock grants immediately vest. The Company utilized the Black-Scholes Pricing Model to fair value the stock options and recorded approximately \$231,000 as Equity Based Compensation during the period. The Company also recorded approximately \$690,000 as deferred compensation expense within the Company's statement of stockholders equity upon the issuance of the restricted stock. Approximately \$26,000 of this restricted stock vested in the current period.

## NOTE 15 - Debt

Long term debt consists of the following:

|                      | (in thousands)      |                  |
|----------------------|---------------------|------------------|
|                      | January 31,<br>2008 | July 31,<br>2007 |
| Total long-term debt | \$ 12,500           | \$ 12,500        |
| Less current portion | 2,040               | -                |
| Long-term debt       | \$ 10,460           | \$ 12,500        |

The Company entered into a credit facility (the "Credit Facility") in 2006 involving its wholly-owned subsidiaries MSR and Oro, as borrowers, us, as guarantor, and Standard Bank plc ("Standard Bank"), as the lender and the offshore account holder. Under the Credit Facility, MSR and Oro borrowed money in an aggregate principal amount of US\$12,500,000 (the "Loan") for the purpose of constructing, developing and operating the Company's El Chanate Project (the "Mine"). The Company guaranteed the repayment of the loan and the performance of the obligations under the Credit Facility. The Loan is scheduled to be repaid in fourteen quarterly payments with the first principal payment due after certain Mine start-up production and performance criteria are satisfied, which the Company believes will occur in the first calendar quarter of 2008. The Loan bears interest at LIBOR plus 4.00%, with LIBOR interest periods of 1, 2, 3 or 6 months and with interest payable at the end of the applicable interest period. As of January 31, 2008, the outstanding amount on the credit facility was \$12,500,000 and accrued interest on this facility was approximately \$74,000 (see Note 21)

The Credit Facility contains covenants customary for a project financing loan, including but not limited to restrictions (subject to certain exceptions) on incurring additional debt, creating liens on its property, disposing of any assets, merging with other companies and making any investments. The Company will be required to meet and maintain certain financial covenants, including (i) a debt service coverage ratio of not less than 1.2 to 1.0, (ii) a projected debt service coverage ratio of not less than 1.2 to 1.0, (iii) a loan life coverage ratio of at least 1.6 to 1.0, (iv) a project life coverage ratio of at least 2.0 to 1.0 and (v) a minimum reserve tail. The Company also is required to maintain a certain minimum level of unrestricted cash, and upon meeting certain Mine start-up production and performance criteria, MSR and Oro are required to maintain a specified amount of cash as a reserve for debt repayment. The Loan is secured by all of the tangible and intangible assets and property owned by MSR and Oro.

As part of the fee for entering into and closing the Credit Facility, the Company issued to Standard Bank 1,150,000 shares of its restricted common stock and a warrant for the purchase of 12,600,000 shares of its common stock at an exercise price of \$0.317 per share, expiring on the earlier of (a) December 31, 2010 or (b) the date one year after the repayment of the Credit Facility. Previously, pursuant to the mandate and commitment letter for the facility, the Company issued to Standard Bank 1,000,000 shares of its restricted common stock and a warrant for the purchase of 1,000,000 shares of its common stock at an exercise price of \$0.32 per share, expiring on the earlier of (a) December 31, 2010 or (b) the date one year after the repayment of the Credit Facility. The Company recorded the issuance of the shares of common stock and warrants as deferred financing costs as a reduction of stockholders' equity on its balance sheet. The issuance of these shares was recorded at the fair market value of the Company's common stock at the commitment letter date or \$0.27 per share. In addition, the warrants were valued using the Black-Scholes option pricing model and were reflected as deferred financing costs as a reduction of stockholders' equity on the Company's balance sheet in 2006. The Company registered for public resale the 2,150,000 shares issued to Standard Bank and the 13,600,000 shares issuable upon exercise of warrants issued to Standard Bank.





Amortization of deferred financing costs related to these issuances was \$465,000 and \$284,000 for the six months ended January 31, 2008 and 2007, respectively.

#### NOTE 16 - Sales Contracts, Commodity and Financial Instruments

In March 2006, in conjunction with the Company's credit facility, the Company entered into two identically structured derivative contracts with Standard Bank (See Note 15). Each derivative consisted of a series of forward sales of gold and a purchase gold cap. The Company agreed to sell a total volume of 121,927 ounces of gold forward to Standard Bank at a price of \$500 per ounce on a quarterly basis during the period from March 2007 to September 2010. The Company also agreed to a purchase gold cap on a quarterly basis during this same period and at identical volumes covering a total volume of 121,927 ounces of gold at a price of \$535 per ounce. While the period of the derivative contracts has commenced, the Company does not anticipate any material adverse effect from the fact that it has not commenced to sell gold because the price of gold is substantially above \$535 per ounce. Under FASB Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("FAS 133"), these contracts must be carried on the balance sheet at their fair value, with changes to the fair value of these contracts reflected as Other Income or Expense. These contracts were not designated as hedging derivatives; and therefore, special hedge accounting does not apply.

The following is a reconciliation of the derivative contracts regarding the Company's Gold Price Protection agreement:

|  | (in thousands) |       |
|--|----------------|-------|
| Balance as of July 31, 2007                | \$             | 548   |
| Loss on change in fair value of derivative |                | 703   |
| Net cash settlements                       |                | (591) |
| Balance as of January 31, 2008             | \$             | 660   |

Rather than modifying the original Gold Price Protection agreement with Standard Bank to satisfy these forward sale obligations, the Company has opted for a net cash settlement between the call option purchase price of \$535 and the forward sale price of \$500, or \$35.00 per oz. The Company has paid Standard Bank approximately \$1,051,000 on the settlement of 30,021 ounces with corresponding reductions in the Company's derivative liability (\$591,000 or 16,895 ounces of gold during the six months ended January 31, 2008). The remaining ounces to settle with regard to this agreement amounted to 91,906 as of January 31, 2008.

On October 11, 2006, prior to the Company's initial draw on the Credit Facility, the Company entered into interest rate swap agreements in accordance with the terms of the Credit Facility, which requires that the Company hedge at least 50 percent of the Company's outstanding debt under this facility. The agreements entered into cover \$9,375,000 or 75% of the outstanding debt. Both swaps covered this same notional amount of \$9,375,000, but over different time horizons. The first covered the six months commencing October 11, 2006 and terminated on March 31, 2007 and the second covering the period from March 30, 2007 with a termination date of December 31, 2010. The Company intends to use discretion in managing this risk as market conditions vary over time, allowing for the possibility of adjusting the degree of hedge coverage as the Company deems appropriate. However, any use of interest rate derivatives will be restricted to use for risk management purposes.

The Company uses variable-rate debt to finance a portion of the El Chanate Project. Variable-rate debt obligations expose the Company to variability in interest payments due to changes in interest rates. As a result of these arrangements, the Company will continuously monitor changes in interest rate exposures and evaluate hedging opportunities. The Company's risk management policy permits it to use any combination of interest rate swaps, futures, options, caps and similar instruments, for the purpose of fixing interest rates on all or a portion of variable rate debt, establishing caps or maximum effective interest rates, or otherwise constraining interest expenses to minimize the variability of these effects.

The interest rate swap agreements are accounted for as cash flow hedges, whereby "effective" hedge gains or losses are initially recorded in other comprehensive income and later reclassified to the interest expense component of earnings coincidentally with the earnings impact of the interest expenses being hedged. "Ineffective" hedge results are immediately recorded in earnings also under interest expense. No component of hedge results will be excluded from the assessment of hedge effectiveness. The amount expected to be reclassified from other comprehensive income to earnings during the year ending July 31, 2008 from these two swaps was determined to be immaterial.

The following is a reconciliation of the derivative contract regarding the Company's Interest Rate Swap agreement:

|  | (in thousands) |     |
|--|----------------|-----|
| Balance as of July 31, 2007            | \$             | 48  |
| Change in fair value of swap agreement |                | 265 |
| Net cash settlements                   |                | (1) |
| Balance as of January 31, 2008         | \$             | 312 |

The Company is exposed to credit losses in the event of non-performance by counterparties to these interest rate swap agreements, but the Company does not expect any of the counterparties to fail to meet their obligations. To manage credit risks, the Company selects counterparties based on credit ratings, limits its exposure to a single counterparty under defined guidelines, and monitor the market position with each counterparty as required by SFAS 133.

#### NOTE 17 - Employee and Consulting Agreements

On August 29, 2007, the Board increased the salaries of the Company's executive officers to be commensurate with industry standards as follows: Gifford A. Dieterle, President, Treasurer and Chairman of the Board, \$250,000; John Brownlie, Chief Operating Officer, \$225,000; Christopher Chipman, Chief Financial Officer, \$175,000 (consulting fee); Jeffrey W. Pritchard, Vice President - Investor Relations and Secretary, \$195,000; Roger A. Newell, Vice President - Development, \$135,000; and J. Scott Hazlitt, Vice President - Mine Development, \$135,000. The salary increase for Mr. Brownlie and the consulting fee increase for Mr. Chipman were retroactive to May 1, 2007 and the salary increase for Mr. Pritchard was retroactive to August 1, 2007. The Board also increased directors' compensation to the Company's independent directors and to Robert Roningen by \$1,000 per month.

On September 10, 2007, Roger A. Newell resigned as our Vice President of Development.

NOTE 18 – Income Taxes

On October 1, 2007, the Mexican Government enacted legislation which introduces certain tax reforms as well as a new minimum flat tax system. This new flat tax system integrates with the regular income tax system and is based on cash-basis net income that includes only certain receipts and expenditures. The flat tax is set at 17.5% of cash-basis net income as determined, with transitional rates of 16.5% and 17.0% in 2008 and 2009, respectively. If the flat tax is positive, it is reduced by the regular income tax and any excess is paid as a supplement to the regular income tax. If the flat tax is negative, it may serve to reduce the regular income tax payable in that year or can be carried forward for a period of up to ten years to reduce any future flat tax.

Companies are required to prepay income taxes on a monthly basis based on the greater of the flat tax or regular income tax as calculated for each monthly period. Accordingly, the Company recorded a prepayment requirement of \$475,000 for the month of January 2008 based on the flat tax regulations. This amount is greater than the anticipated regular income tax of approximately \$165,000. Annualized income projections indicate that the Company will not be liable for any excess flat tax for the year 2008 and, accordingly, has recorded a \$165,000 Mexican income tax provision for January 2008.

As the new legislation was recently enacted, it remains subject to ongoing varying interpretations. There is the possibility of implementation amendments by the Mexican Government and the estimated future income tax liability recorded at the balance date may change.

NOTE 19 - Concentrations of Credit Risk

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of cash and cash equivalents and marketable securities. The Company maintains cash balances at financial institutions which exceed the Federal Deposit Insurance Corporation limit of \$100,000 at times during the year.

NOTE 20 – Recently Issued Accounting Pronouncements

The Company adopted the provisions of FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48") effective January 1, 2007. The purpose of FIN 48 is to clarify and set forth consistent rules for accounting for uncertain tax positions in accordance with Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes". The cumulative effect of applying the provisions of this interpretation are required to be reported separately as an adjustment to the opening balance of retained earnings in the year of adoption. The adoption of this standard did not have an impact on the financial condition or the results of the Company's operations.

On February 15, 2007, the FASB issued FASB Statement No. 159, The Fair Value Option for Financial Assets and Financial Liabilities - Including an Amendment of FASB Statement No. 115. This standard permits an entity to choose to measure many financial instruments and certain other items at fair value. This option is available to all entities. Most of the provisions in Statement 159 are elective; however, the amendment to FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities, applies to all entities with available-for-sale and trading securities. Some requirements apply differently to entities that do not report net income. The FASB's stated objective in issuing this standard is as follows: "to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions".

The fair value option established by Statement 159 permits all entities to choose to measure eligible items at fair value at specified election dates. A business entity will report unrealized gains and losses on items for which the fair value option has been elected in earnings (or another performance indicator if the business entity does not report earnings) at each subsequent reporting date. The fair value option: (a) may be applied instrument by instrument, with a few exceptions, such as investments otherwise accounted for by the equity method; (b) is irrevocable (unless a new election date occurs); and (c) is applied only to entire instruments and not to portions of instruments.

Statement 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. The Company does not anticipate this statement having a material impact on its financial statements.

On December 4, 2007, the FASB issued FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements - An Amendment of ARB No. 51*. Statement 160 establishes new accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. Specifically, this statement requires the recognition of a noncontrolling interest (minority interest) as equity in the consolidated financial statements and separate from the parent's equity. The amount of net income attributable to the noncontrolling interest will be included in consolidated net income on the face of the income statement. Statement 160 clarifies that changes in a parent's ownership interest in a subsidiary that do not result in deconsolidation are equity transactions if the parent retains its controlling financial interest. In addition, this statement requires that a parent recognize a gain or loss in net income when a subsidiary is deconsolidated. Such gain or loss will be measured using the fair value of the noncontrolling equity investment on the deconsolidation date. Statement 160 also includes expanded disclosure requirements regarding the interests of the parent and its noncontrolling interest.

Statement 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. Like Statement 141R discussed above, earlier adoption is prohibited. The Company does not anticipate this statement having a material impact on its financial statements.

#### Note 21 – Subsequent Events

The Company received a mandate letter, dated February 27, 2008, from Standard Bank to refinance the existing project finance facility on the El Chanate mine. The key anticipated amendments to the refinance include: 1) removal of cash restrictions and covenants, 2) reduction of the finance interest rate by 1.5%, 3) addition of a five million dollar line of credit at an interest rate of LIBOR + 2%, 4) Exercise of a portion of the warrants currently held by Standard Bank to provide additional support for El Chanate expansion plans and to fully fund the debt service reserve account. The Company anticipates a closing date for this refinance by the end of April 2008.

## **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

### **Cautionary Statement on Forward-Looking Statements**

Certain statements in this report constitute “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities and Exchange Act of 1934. Certain, but not necessarily all, of such forward-looking statements can be identified by the use of forward-looking terminology such as “believes,” “expects,” “may,” “will,” “should,” or “anticipates” or the negative thereof or other variations thereon or comparable terminology, or by discussions of strategy that involve risks and uncertainties. All statements other than statements of historical fact, included in this report regarding our financial position, business and plans or objectives for future operations are forward-looking statements. Without limiting the broader description of forward-looking statements above, we specifically note that statements regarding exploration, costs, grade, production and recovery rates, permitting, financing needs and the availability of financing on acceptable terms or other sources of funding are all forward-looking in nature.

Such forward-looking statements involve known and unknown risks, uncertainties and other factors, including but not limited to, the factors discussed below in Part II; Item 1A. “Risk Factors,” which may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements and other factors referenced in this report. We do not undertake and specifically decline any obligation to publicly release the results of any revisions which may be made to any forward-looking statement to reflect events or circumstances after the date of such statements or to reflect the occurrence of anticipated or unanticipated events.

### **General**

Through wholly-owned subsidiaries, Capital Gold Corporation owns 100% of 16 mining concessions located in the Municipality of Altar, State of Sonora, Republic of Mexico totaling approximately 3,544 hectares (8,756 acres or 13.7 square miles). We commenced mining operations on two of these concessions in late March 2007 and achieved gold production and revenue from operations in early August 2007. We sometimes refer to the operations on these two concessions as the El Chanate Project. Our results of operations differ from preceding periods because we now are realizing revenue from operations.

In May 2007, we completed an expanded 72-hole reverse circulation drilling campaign to identify additional proven and probable gold reserves at the El Chanate Project. The 72 holes totaled approximately 8,300 meters, and were positioned to fill in gaps in the ore body and test the outer limits of the currently known ore zones. We updated the assay database and digital geologic model and contracted Independent Mining Consultants, Inc. (“IMC”) of Tucson, AZ to update our ore reserve and our mine plan. On August 30, 2007, IMC delivered to us an updated resource block model and an updated mine plan and mine production schedule (the “2007 Report”). The original feasibility study (the “2003 Study”) on the El Chanate Project was prepared by M3 Engineering of Tucson in August 2003. M3 updated the 2003 Study in October 2005 (the “2005 Study”). An August 2006 technical report from SRK Consulting, Denver, Colorado (the “2006 Update”) further updated the feasibility study.

According to the 2007 Report, our proven and probable reserve tonnage has increased by approximately 98 percent from 19.9 million to 39.5 million metric tonnes with a gold grade of 0.66 grams per tonne (43.5 million US short tons at 0.019 ounces per ton). The open pit stripping ratio is 0.6:1 (0.6 tonnes of waste to one tonne of ore). The updated pit design for the revised plan in the 2007 Report is based on a plant recovery of gold that varies by rock types, but is expected to average 66.8%. A gold price of US\$550 (three year average as of July 31, 2007 as determined by IMC) per ounce was used to re-estimate the reserves compared with a gold price of \$450 per ounce used in the previous estimate.



The following Summary is extracted from the 2007 Report. Please note that the reserves as stated are an estimate of what can be economically and legally recovered from the mine and, as such, incorporate losses for dilution and mining recovery. The 832,280 ounces of contained gold represents ounces of gold contained in ore in the ground, and therefore does not reflect losses in the recovery process. Total gold produced is estimated to be 555,960 ounces, or approximately 66.8% of the contained gold. The gold recovery rate is expected to average approximately 66.8% for the entire ore body. Individual portions of the ore body may experience varying recovery rates ranging from about 73% to 48%. Oxidized and sandstone ore types may have recoveries of about 73%; fault zone ore type recoveries may be about 64%; siltstone ore types recoveries may be about 48% and latite intrusive ore type recoveries may be about 50%.

### El Chanate Project

#### **Production Summary**

|                             | <u>Metric</u>                                     | <u>U.S.</u>                                   |
|-----------------------------|---|---|
| <b>Materials</b>            |   |   |
| <b>Reserves</b>             |   |   |
| Proven                      | 26.7 Million Tonnes @ 0.68 g/t*                   | 29.4 Million Tons @ 0.0198 opt*               |
| Probable                    | <u>12.8 Million Tonnes @ 0.61 g/t*</u>            | <u>14.1 Million Tons @ 0.0179 opt*</u>        |
| Total Reserves              | 39.5 Million Tonnes @ 0.66 g/t*                   | 43.5 Million Tons @ 0.0192 opt*               |
| <b>Waste</b>                |   |   |
| Total                       | <u>24.1 Million Tonnes</u><br>63.6 Million Tonnes | <u>26.6 Million Tons</u><br>70.1 Million tons |
| Contained Gold              | 25.89 Million grams                               | 832,280 Oz                                    |
| <b>Production</b>           |   |   |
| Ore Crushed**               | 2.6 Million Tonnes /Year<br>7,500 Mt/d            | 2.87 Million Tons/Year<br>8,267 t/d           |
| Operating Days/Year         | 365 Days per year                                 | 365 Days per year                             |
| Gold Plant Average Recovery | 66.8 %  | 66.8 %  |
| Average Annual Production** | 1.35 Million grams                                | 43,414 Oz                                     |
| Total Gold Produced         | 17.29 Million grams                               | 555,960 Oz                                    |

\* “g/t” means grams per metric tonne, “opt” means ounces per ton, “Mt/d” means metric tonnes per day and “t/d” means tons per day. The reserve estimates are based on a recovered gold cutoff grade of 0.17 to 0.21 grams per metric tonne, depending on the operating year, and as described below.

\*\* Based on mining rate of 7,500 metric tonnes per day of ore. It does not take into account the anticipated increase to 10,000 metric tonnes per day or more.

Through January 31, 2008, approximately 2.37 million tonnes of ore had been placed on the leach pad containing an estimated 63,627 ounces of gold. As of January 31, 2008, we estimate that we have 24,333 recoverable ounces on the leach pad. Gold production for the six months ended January 31, 2008, totaled approximately 19,433 ounces of Gold.

Gold production at El Chanate is currently near the feasibility study rate of 4,000 ounces per month. We have started to ramp up daily tonnage levels from 7,500 tonnes per day ("tpd") to 10,000 tpd. This should boost our gold production toward 5,000 ounces per month (60,000 ounces per year). Initially, we anticipate that the increased plant throughput will not require any capital since an additional ore crushing and stacking capacity was factored into the original design.

With the recent reserve increase, we are analyzing what steps are necessary to effectively increase production rates to a range of 70,000 to 80,000 ounces per year by 2009 and improve gold recoveries by conducting further metallurgical test work at our laboratory facilities at the mine. We will continue our ongoing studies to possibly increase production levels to 100,000 ounces per year thereafter. To this end, we have engaged Golder Engineering and its Mexican associates to supply engineering services for leach pad expansion and to study the impact of the planned mining increase. Golder previously successfully completed the construction management of our existing leach pads. In addition, we are discussing options available with the crusher manufacturer, Excel Machinery, with regards to adding an additional secondary crusher into the crushing circuit, to enable the system to handle increased tonnage. We anticipate that another crusher should move daily tonnage up closer to 15,000 tpd. The estimated cost to achieve these increased production rates will be approximately \$7,000,000 over a two year period. Management has been and will continue to fund these expansion costs through revenues from gold sales, additional bank financing and/or the sale of our securities; however, we cannot assure that adequate additional funding, if needed, will be available to fund this expansion activity.

The leach pad expansion is estimated to be completed by the end of April 2008. For the six months ended January 31, 2008, our capital expenditure cost related to this leach pad expansion totaled approximately \$1,625,000 which was fully funded from cash flow from operations. In addition, based on the studies noted above, specifically our ADR plant capacity, we have identified certain restrictions in the amount of solution that can be processed that are in the process of being addressed. Recently, we doubled the installed pumping capacity to increase solution flow to the leach pad and added additional carbon capacity to the system. We have purchased an additional set of carbon columns and a strip vessel to process an additional two tonnes of carbon per strip. We believe that this project will be completed by the end of our current fiscal year (July 30), thereby lifting the limitations on our current gold production. We anticipate remaining capital expenditures to amount to approximately \$1,200,000 to complete the leach pad expansion and the ADR plant upgrade.

In December 2007, we completed an additional 26 hole reverse circulation drilling program amounting to 4,912 meters. The drill holes were mainly positioned to test the outer limits of the currently known ore zones. The results of this drilling campaign have not yet been included in our resource model as we continue to receive assay results.

We are actively investigating other exploration projects in northern Mexico.

### **Results of Operations**

You should read the following discussion and analysis of our financial condition and results of operations in conjunction with our unaudited interim financial statements and related notes included elsewhere in this report.



Three months ended January 31, 2008 compared to Three months ended January 31, 2007

Net income for the three months ended January 31, 2008 was approximately \$2,126,000 compared to a net loss, of approximately \$1,673,000 for the three months ended January 31, 2007. The principal reason for this transition was our realizing revenue from operations during the current quarter. Net income per common share was \$0.01 for the three months ended January 31, 2008, on both a basic and diluted basis. The net loss per share for the same period in 2006 was \$0.01 on a basic basis.

Revenues & Costs Applicable to Sales

Gold sales in the current period totaled approximately \$8,043,000. We sold 9,550 ounces at an average realizable price per ounce of \$843 (the London Bullion Market Association average gold PM fix was \$835 for the current period). Costs applicable to sales were approximately \$2,419,000 for the current period. There were no metal sales in 2006. Our cash cost and total cost per ounce sold was \$252 and \$315, respectively, for the current period.

Depreciation and Amortization

Depreciation and amortization expense during the three months ended January 31, 2008 and 2007 was approximately \$ 881,000 and \$273,000, respectively. The primary reason for the increase of approximately \$608,000 was primarily due to depreciation and amortization charges related to the El Chanate development and equipment costs being incurred in the current period. There were no such charges for the same period in the prior year as these assets were placed in service in April 2007. Depreciation and amortization also represents deferred financing costs resulting from the Credit Facility entered into in August 2006 with Standard Bank Plc. This accounted for approximately \$272,000 of the amortization expense during the three months ended January 31, 2008 and 2007, respectively.

General and Administration Expense

General and administrative expenses during the three months ended January 31, 2008 were approximately \$1,321,000, an increase of approximately \$772,000 or 141% from the three months ended January 31, 2007. The increase in general and administrative expenses resulted primarily from: 1) higher salaries and wages including the awarding of cash bonuses to officers and employees of approximately \$315,000 and the granting of stock options and restricted stock to our officers and employees under our 2006 Equity Incentive Plan amounting to approximately \$219,000, 2) higher investor relations and travel fees, and 3) an increase in insurance costs versus the same period a year earlier as we were not yet in production in the prior period. The above mentioned increases in compensation were granted based upon recommendations from an independent report on executive compensation. This independent report, requested by our Compensation Committee, was obtained in order to assist us in attracting and retaining individuals of experience and ability, to provide incentive to our employees and directors, to encourage employee and director proprietary interests in the Company, and to encourage employees to remain in our employ.

Exploration Expense

Exploration expense during the three months ended January 31, 2008 and 2007 was approximately \$496,000 and \$301,000, respectively, or an increase of \$195,000 or 65%. The primary reason for the increase in exploration expenses was the result of our drilling program implemented during the current quarter.

### Equity Based Compensation

Equity based compensation during the three months ended January 31, 2008 was approximately \$50,000 as compared to \$101,000 in costs for the same period a year earlier. These costs primarily represent the equity compensation expense from the issuance of stock options for professional services provided to non-employees during the current and prior period.

### Other Income and Expense

Our loss on the change in fair value of derivative instruments during the three months ended January 31, 2008 and 2007, was approximately \$342,000 and \$286,000, respectively, and was reflected as an other expense. This was primarily due to the change in fair value of our two identically structured derivative contracts with Standard Bank which correlates to fluctuations in the gold price. These contracts were not designated as hedging derivatives; and therefore, special hedge accounting does not apply.

Interest expense was approximately \$288,000 for the three months ended January 31, 2008 compared to approximately \$175,000 for the same period a year earlier. This increase was mainly due to higher interest charges incurred during the current period related to our fully outstanding Credit Facility with Standard Bank. As of January 31, 2008 and 2007, there was \$12,500,000 and \$8,750,000 outstanding, respectively, on this credit facility.

### Six months ended January 31, 2008 compared to Six months ended January 31, 2007

Net income for the six months ended January 31, 2008 was approximately \$3,873,000 compared to a net loss, of approximately \$2,834,000 for the six months ended January 31, 2007. The principal reason for this transition was our realizing revenue from operations during the six months ended January 31, 2008. The Company's first gold sale occurred in August 2007. Net income per common share was \$0.02 for the six months ended January 31, 2008, on both a basic and diluted basis. The net loss per share for the same period in 2006 was \$0.02 on a basic basis.

### Revenues & Costs Applicable to Sales

Gold sales for the six months ended January 31, 2008 totaled approximately \$14,569,000. We have sold 18,744 ounces at an average realizable price per ounce of \$779 (the London Bullion Market Association average gold PM fix was \$772 for this period). Costs applicable to sales were approximately \$4,568,000 for the current period. There were no metal sales in the prior period. Our cash cost and total cost per ounce sold was \$246 and \$314, respectively, for the six months ended January 31, 2008.

### Depreciation and Amortization

Depreciation and amortization expense during the six months ended January 31, 2008 and 2007 was approximately \$1,830,000 and \$346,000, respectively. The increase of approximately \$1,484,000 was primarily due to depreciation and amortization charges related to the El Chanate development and equipment costs being incurred in the current period. There were no such charges for the same period in the prior year as these assets were placed in service in April 2007. Depreciation and amortization also represents deferred financing costs resulting from the Credit Facility. This accounted for approximately \$544,000 and \$332,000 of the amortization expense during the six months ended January 31, 2008 and 2007, respectively.

General and Administration Expense

General and administrative expenses during the six months ended January 31, 2008 were approximately \$2,172,000, an increase of approximately \$991,000 or 84% from the six months ended January 31, 2007. See commentary contained in "General and Administrative Expense" within the "Three months ended January 31, 2008 compared to Three months ended January 31, 2007" section above for more detail on this increase.

Exploration Expense

Exploration expense during the six months ended January 31, 2008 and 2007 was approximately \$631,000 and \$514,000, respectively, or an increase of \$117,000 or 23%. The primary reason for the increase in exploration expenses was the result of our drilling program implemented during the current period.

Equity Based Compensation

Equity based compensation during the six months ended January 31, 2008 was approximately \$108,000 as compared to \$101,000 in costs for the same period a year earlier. These costs primarily represent the equity compensation expense from the issuance of stock options for professional services provided to non-employees during the current and prior period.

Other Income and Expense

Our loss on the change in fair value of derivative instruments during the six months ended January 31, 2008 and 2007, was approximately \$700,000 and \$528,000, respectively, and was reflected as an other expense. This was primarily due to the change in fair value of our two identically structured derivative contracts with Standard Bank which correlates to fluctuations in the gold price. These contracts were not designated as hedging derivatives; and therefore, special hedge accounting does not apply.

Interest expense was approximately \$569,000 for the six months ended January 31, 2008 compared to approximately \$198,000 for the same period a year earlier. This increase was mainly due to higher interest charges incurred during the current period related to our fully outstanding credit facility with Standard Bank. As of January 31, 2008 and 2007, there was \$12,500,000 and \$8,750,000 outstanding, respectively, on this credit facility.

Changes in Foreign Exchange Rates

During the six months ended January 31, 2008, we recorded equity adjustments from foreign currency translations of approximately \$27,000. These translation adjustments are related to changes in the rates of exchange between the Mexican Peso and the US dollar and are included as a component of other comprehensive income.

Summary of Quarterly Results

(000's except per share Data)

|                                     | For the three<br>Months ended<br>January 31,<br>2008 | For the three<br>Months ended<br>January 31,<br>2007 | For the Six<br>Months ended<br>January 31,<br>2008 | For the Six<br>Months ended<br>January 31,<br>2007 |
|-------------------------------------|--|--|--|--|
| Revenues                            | 8,043  | -  | 14,569   | -  |
| Net Income (loss)                   | 2,126  | (1,673)  | 3,873  | (2,834)  |
| Basic net income (loss) per share   | 0.01   | (0.01)   | 0.02   | (0.02)   |
| Diluted net income (loss) per share | 0.01   | -  | 0.02   | -  |

Liquidity and Capital Resources

As of January 31, 2008, we had approximately \$4,997,000 in cash and cash equivalents, an increase of \$2,772,000 over July 31, 2007. Working capital was approximately \$9,750,000, an increase of \$3,407,000 over July 31, 2007. Cash provided by operating activities during the six months ended January 31, 2008 was approximately \$3,480,000, which primarily represents cash flows resulting from our realization of revenue from operations during the six months ended January 31, 2008. Cash used in investing activities during the six months ended January 31, 2008, amounted to approximately \$2,899,000, primarily from the leach pad expansion and the acquisition of equipment, including additional conveyors and ADR plant equipment, as well as additional water rights related to our El Chanate Project. Cash provided by financing activities during the six months ended January 31, 2008 amounted to approximately \$2,164,000, primarily from the exercising of 6,321,500 warrants for gross proceeds of approximately \$2,156,000. We believe that our available funds in conjunction with anticipated revenues from gold sales will be adequate to cover operating activities at El Chanate for the life of mine as well as our leach pad and ADR plant expansion activities. We anticipate remaining capital expenditures to amount to approximately \$1,200,000 to complete the leach pad expansion and the ADR plant upgrade.

In March 2006, we entered into a gold price protection arrangement with Standard Bank to protect us against future fluctuations in the price of gold. We agreed to a series of gold forward sales and call option purchases in anticipation of entering into the Credit Facility. Under the price protection agreement, we have agreed to sell a total volume of 121,927 ounces of gold forward to Standard Bank at a price of \$500 per ounce on a quarterly basis during the period from March 2007 to September 2010. We will also purchase call options from Standard Bank on a quarterly basis during this same period covering a total volume of 121,927 ounces of gold at a price of \$535 per ounce. To date, rather than modifying the original Gold Price Protection agreement with Standard Bank to satisfy these forward sale obligations, we have opted for a net cash settlement between the call option purchase price of \$535 and the forward sale price of \$500, or \$35.00 per oz. We have paid Standard Bank approximately \$1,051,000 on the settlement of 30,021 ounces with corresponding reductions in our derivative liability (\$591,000 or 16,895 ounces of gold) during the six months ended January 31, 2008. The remaining ounces to settle with regard to this agreement amounted to 91,906 as of January 31, 2008.

On October 11, 2006, prior to our initial draw on the Credit Facility, we entered into interest rate swap agreements in accordance with the terms of the Credit Facility, which requires that we hedge at least 50 percent of our outstanding debt under this facility. The agreements entered into cover \$9,375,000 or 75% of the outstanding debt. Both swaps covered this same notional amount of \$9,375,000, but over different time horizons. The first covered the six months that commenced on October 11, 2006 and terminated on March 31, 2007 and the second covers the period from March 30, 2007 through December 31, 2010. We intend to use discretion in managing this risk as market conditions vary over time, allowing for the possibility of adjusting the degree of hedge coverage as we deem appropriate. However, any use of interest rate derivatives will be restricted to use for risk management purposes.



We received a mandate letter, dated February 27, 2008, from Standard Bank to refinance the existing project finance facility on the El Chanate mine. The key anticipated amendments to the refinance include: 1) removal of cash restrictions and covenants, 2) reduction of the finance interest rate by 1.5%, 3) addition of a five million dollar line of credit at LIBOR + 2%, and 4) exercise of a portion of the warrants currently held by Standard Bank to provide additional support for El Chanate expansion plans and to fully fund the debt service reserve account. We anticipate a closing date by the end of April 2008.

While we believe that our available funds in conjunction with anticipated revenues from gold sales will be adequate to cover operating activities at El Chanate and general and administrative expenses for the life of the mine as well as the remaining capital costs associated with the leach pad and ADR plant expansion, if we encounter unexpected problems we may need to raise additional capital. We also may need to raise additional capital for significant property acquisitions and/or exploration activities. To the extent that we need to obtain additional capital, management intends to raise such funds through the sale of our securities and/or joint venturing with one or more strategic partners. We cannot assure that adequate additional funding, if needed, will be available. If we need additional capital and we are unable to obtain it from outside sources, we may be forced to reduce or curtail our operations or our anticipated exploration activities. Please see *"We just recently started to receive cash flow from operations and, historically, have relied on external funding sources. While we believe that we will continue to generate cash flow and profits from operations, if we encounter unexpected problems, we may need to raise additional capital. If additional capital is required and we are unable to obtain it from outside sources, we may be forced to reduce or curtail our operations or our anticipated exploration activities."* In Part II; Item 1A. "Risk Factors" below.

### **Environmental and Permitting Issues**

Management does not expect that environmental issues will have an adverse material effect on our liquidity or earnings. In Mexico, although we must continue to comply with laws, rules and regulations concerning mining, environmental, health, zoning and historical preservation issues, we are not aware of any significant environmental concerns or existing reclamation requirements at the El Chanate concessions. We received the required Mexican government permits for construction, mining and processing the El Chanate ores in January 2004. The permits were extended in June 2005. Pursuant to the extensions, once we file a notice that work has commenced, we have one year to prepare the site and construct the mine and seven years to mine and process ores from the site. We filed the notice on June 1, 2006. Once we revise our new mine plan based on the 2007 Report, we will work to extend the permits for mining and processing for the new life of mine. We received the original explosive permit from the government in August 2006. This permit, as extended, expires on December 31, 2008 and is renewable annually.

We own properties in Leadville, Colorado for which we have previously recorded an impairment loss. Part of the Leadville Mining District has been declared a federal Superfund site under the Comprehensive Environmental Response, Compensation and Liability Act of 1980, and the Superfund Amendments and Reauthorization Act of 1986. Several mining companies and one individual were declared defendants in a possible lawsuit. We were not named a defendant or Principal Responsible Party. We did respond in full detail to a lengthy questionnaire prepared by the Environmental Protection Agency ("EPA") regarding our proposed procedures and past activities in November 1990. To our knowledge, the EPA has initiated no further comments or questions. The Division of Reclamation, Mining and Safety of the State of Colorado (the "Division") conducted its most recent inspection of our Leadville Mining properties in August 2007. The Division concluded that based upon 2007 equipment prices and labor costs, an additional \$46,000 was necessary to be bonded with the Division to reclaim the site to achieve the approved postmining land use. The total amount of the bond sufficient to perform reclamation as of January 31, 2008, is approximately \$82,000. We have met this bonding requirement.

We do include in all our internal revenue and cost projections a certain amount for environmental and reclamation costs on an ongoing basis. This amount was determined at a fixed amount of \$0.13 per metric tonne of material to be mined on a continual, ongoing basis to provide primarily for reclaiming tailing disposal sites and other reclamation requirements. No assurance can be given that environmental regulations will not be changed in a manner that would adversely affect our planned operations. We estimated the reclamation costs for the El Chanate site to be approximately \$2,300,000. Reclamation costs are allocated to expense over the life of the related assets and are periodically adjusted to reflect changes in the estimated present value resulting from the passage of time and revisions to the estimates of either the timing or amount of the reclamation and abandonment costs. The asset retirement obligation is based on when the spending for an existing environmental disturbance and activity to date will occur. We review, on an annual basis, unless otherwise deemed necessary, the asset retirement obligation at each mine site.

### **New Accounting Pronouncements**

We adopted the provisions of FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48") effective January 1, 2007. The purpose of FIN 48 is to clarify and set forth consistent rules for accounting for uncertain tax positions in accordance with Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes". The cumulative effect of applying the provisions of this interpretation are required to be reported separately as an adjustment to the opening balance of retained earnings in the year of adoption. The adoption of this standard did not have an impact on the financial condition or the results of our operations.

On February 15, 2007, the FASB issued FASB Statement No. 159, The Fair Value Option for Financial Assets and Financial Liabilities - Including an Amendment of FASB Statement No. 115. This standard permits an entity to choose to measure many financial instruments and certain other items at fair value. This option is available to all entities. Most of the provisions in Statement 159 are elective; however, the amendment to FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities, applies to all entities with available-for-sale and trading securities. Some requirements apply differently to entities that do not report net income. The FASB's stated objective in issuing this standard is as follows: "to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions".

The fair value option established by Statement 159 permits all entities to choose to measure eligible items at fair value at specified election dates. A business entity will report unrealized gains and losses on items for which the fair value option has been elected in earnings (or another performance indicator if the business entity does not report earnings) at each subsequent reporting date. The fair value option: (a) may be applied instrument by instrument, with a few exceptions, such as investments otherwise accounted for by the equity method; (b) is irrevocable (unless a new election date occurs); and (c) is applied only to entire instruments and not to portions of instruments.

Statement 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. Early adoption is permitted as of the beginning of the previous fiscal year provided that the entity makes that choice in the first 120 days of that fiscal year and also elects to apply the provisions of FASB Statement No. 157, Fair Value Measurements. We do not anticipate this having a material impact on our financial statements.

On December 4, 2007, the FASB issued FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements - An Amendment of ARB No. 51*. Statement 160 establishes new accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. Specifically, this statement requires the recognition of a noncontrolling interest (minority interest) as equity in the consolidated financial statements and separate from the parent's equity. The amount of net income attributable to the noncontrolling interest will be included in consolidated net income on the face of the income statement. Statement 160 clarifies that changes in a parent's ownership interest in a subsidiary that do not result in deconsolidation are equity transactions if the parent retains its controlling financial interest. In addition, this statement requires that a parent recognize a gain or loss in net income when a subsidiary is deconsolidated. Such gain or loss will be measured using the fair value of the noncontrolling equity investment on the deconsolidation date. Statement 160 also includes expanded disclosure requirements regarding the interests of the parent and its noncontrolling interest.

Statement 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. Like Statement 141R discussed above, earlier adoption is prohibited. We do not believe this statement will have a material impact on our financial statements.

#### **Disclosure About Off-Balance Sheet Arrangements**

We do not have any transactions, agreements or other contractual arrangements that constitute off-balance sheet arrangements.

#### **Critical Accounting Policies**

Our financial statements and accompanying notes are prepared in accordance with accounting principles generally accepted in the United States of America. Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses. These estimates and assumptions are affected by management's application of accounting policies. Critical accounting policies for us include inventory, revenue recognition, property, plant and mine development, impairment of long-lived assets, accounting for equity-based compensation, environmental remediation costs and accounting for derivative and hedging activities.

#### Stockpiles, Ore on Leach Pads and Inventories ("In-Process Inventory")

Costs that are incurred in or benefit the productive process are accumulated as stockpiles, ore on leach pads and inventories. Stockpiles, ore on leach pads and inventories are carried at the lower of average cost or net realizable value. Net realizable value represents the estimated future sales price of the product based on current and long-term metals prices, less the estimated costs to complete production and bring the product to sale. Write-downs of stockpiles, ore on leach pads and inventories, resulting from net realizable value impairments, are reported as a component of *Costs applicable to sales*. The current portion of stockpiles, ore on leach pads and inventories is determined based on the expected amounts to be processed within the next 12 months. Stockpiles, ore on leach pads and inventories not expected to be processed within the next 12 months are classified as long-term. The major classifications are as follows:

##### *Ore on Leach Pads*

The recovery of gold from certain gold ores is achieved through the heap leaching process. Under this method, oxide ore is placed on leach pads where it is treated with a chemical solution, which dissolves the gold contained in the ore. The resulting "pregnant" solution is further processed in a plant where the gold is recovered. Costs are added to ore on leach pads based on current mining costs, including applicable depreciation, depletion and amortization relating to mining operations. Costs are removed from ore on leach pads as ounces are recovered based on the average cost per



estimated recoverable ounce of gold on the leach pad.

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The estimates of recoverable gold on the leach pads are calculated from the quantities of ore placed on the leach pads (measured tons added to the leach pads), the grade of ore placed on the leach pads (based on assay data) and a recovery percentage (based on ore type). In general, leach pads recover approximately 50% to 95% of the recoverable ounces in the first year of leaching, declining each year thereafter until the leaching process is complete.

Although the quantities of recoverable gold placed on the leach pads are reconciled by comparing the grades of ore placed on pads to the quantities of gold actually recovered (metallurgical balancing), the nature of the leaching process inherently limits the ability to precisely monitor inventory levels. As a result, the metallurgical balancing process needs to be constantly monitored and estimates need to be refined based on actual results over time. Our operating results may be impacted by variations between the estimated and actual recoverable quantities of gold on its leach pads. Variations between actual and estimated quantities resulting from changes in assumptions and estimates that do not result in write-downs to net realizable value will be accounted for on a prospective basis.

#### *In-process Inventory*

In-process inventories represent materials that are currently in the process of being converted to a saleable product. Conversion processes vary depending on the nature of the ore and the specific processing facility, but include mill in-circuit, leach in-circuit, flotation and column cells, and carbon in-pulp inventories. In-process material are measured based on assays of the material fed into the process and the projected recoveries of the respective plants. In-process inventories are valued at the average cost of the material fed into the process attributable to the source material coming from the mines, stockpiles and/or leach pads plus the in-process conversion costs, including applicable depreciation relating to the process facilities incurred to that point in the process.

#### *Precious Metals Inventory*

Precious metals inventories include gold doré and/or gold bullion. Precious metals that result from our mining and processing activities are valued at the average cost of the respective in-process inventories incurred prior to the refining process, plus applicable refining costs.

#### *Materials and Supplies*

Materials and supplies are valued at the lower of average cost or net realizable value. Cost includes applicable taxes and freight.

#### Property, Plant and Mine Development

Expenditures for new facilities or equipment and expenditures that extend the useful lives of existing facilities or equipment are capitalized and depreciated using the UOP and straight-line method at rates sufficient to depreciate such costs over the estimated productive lives, which do not exceed the related estimated mine lives, of such facilities based on proven and probable reserves.

Mineral exploration costs are expensed as incurred. When it has been determined that a mineral property can be economically developed as a result of establishing proven and probable reserves, costs incurred prospectively to develop the property will be capitalized as incurred and are amortized using the UOP method over the estimated life of the ore body based on estimated recoverable ounces or pounds in proven and probable reserves.

### Impairment of Long-Lived Assets

We review and evaluate our long-lived assets for impairment when events or changes in circumstances indicate that the related carrying amounts may not be recoverable. An impairment is considered to exist if the total estimated future cash flows on an undiscounted basis are less than the carrying amount of the assets, including goodwill, if any. An impairment loss is measured and recorded based on discounted estimated future cash flows. Future cash flows are estimated based on quantities of recoverable minerals, expected gold and other commodity prices (considering current and historical prices, price trends and related factors), production levels and operating costs of production and capital, all based on life-of-mine plans. Existing proven and probable reserves and value beyond proven and probable reserves, including mineralization other than proven and probable reserves and other material that is not part of the measured, indicated or inferred resource base, are included when determining the fair value of mine site reporting units at acquisition and, subsequently, in determining whether the assets are impaired. The term “recoverable minerals” refers to the estimated amount of gold or other commodities that will be obtained after taking into account losses during ore processing and treatment. Estimates of recoverable minerals from such exploration stage mineral interests are risk adjusted based on management’s relative confidence in such materials. In estimating future cash flows, assets are grouped at the lowest level for which there are identifiable cash flows that are largely independent of future cash flows from other asset groups. Our estimates of future cash flows are based on numerous assumptions and it is possible that actual future cash flows will be significantly different than the estimates, as actual future quantities of recoverable minerals, gold and other commodity prices, production levels and operating costs of production and capital are each subject to significant risks and uncertainties.

### Reclamation and Remediation Costs (Asset Retirement Obligations)

Reclamation costs are allocated to expense over the life of the related assets and are periodically adjusted to reflect changes in the estimated present value resulting from the passage of time and revisions to the estimates of either the timing or amount of the reclamation and abandonment costs. The asset retirement obligation is based on when the spending for an existing environmental disturbance and activity to date will occur. We review, on an annual basis, unless otherwise deemed necessary, the asset retirement obligation at our mine site in accordance with FASB FAS No. 143, “Accounting for Asset Retirement Obligations.”

### Deferred Financing Costs

Deferred financing costs which were included in other assets and a component of stockholders’ equity relate to costs incurred in connection with bank borrowings and are amortized over the term of the related borrowings.

### Intangible Assets

Purchased intangible assets consisting of rights of way, easements and net profit interests are carried at cost less accumulated amortization. Amortization is computed using the straight-line method over the economic lives of the respective assets, generally five years or using the UOP method. It is our policy to assess periodically the carrying amount of our purchased intangible assets to determine if there has been an impairment to their carrying value. Impairments of other intangible assets are determined in accordance with SFAS 144. There was no impairment at January 31, 2008.

### Fair Value of Financial Instruments

The carrying value of our financial instruments, including cash and cash equivalents, accounts receivable, loans receivable and accounts payable approximated fair value because of the short maturity of these instruments.

### Revenue Recognition

Revenue is recognized, net of treatment and refining charges, from a sale when the price is determinable, the product has been delivered, the title has been transferred to the customer and collection of the sales price is reasonably assured.

### Equity Based Compensation

In connection with offers of employment to our executives as well as in consideration for agreements with certain consultants, we issue options and warrants to acquire our common stock. Employee and non-employee awards are made in the discretion of the Board of Directors.

Effective February 1, 2006, we adopted the provisions of SFAS No. 123R. Under FAS 123R, share-based compensation cost is measured at the grant date, based on the estimated fair value of the award, and is recognized as expense over the requisite service period. We adopted the provisions of FAS 123R using a modified prospective application. Under this method, compensation cost is recognized for all share-based payments granted, modified or settled after the date of adoption, as well as for any unvested awards that were granted prior to the date of adoption. Prior periods are not revised for comparative purposes. Because we previously adopted only the pro forma disclosure provisions of SFAS 123, we will recognize compensation cost relating to the unvested portion of awards granted prior to the date of adoption, using the same estimate of the grant-date fair value and the same attribution method used to determine the pro forma disclosures under SFAS 123, except that forfeitures rates will be estimated for all options, as required by FAS 123R.

### Accounting for Derivatives and Hedging Activities

We entered into two identically structured derivative contracts with Standard Bank in March 2006. Each derivative consisted of a series of forward sales of gold and a purchase gold cap. We agreed to sell a total volume of 121,927 ounces of gold forward to Standard Bank at a price of \$500 per ounce on a quarterly basis during the period from March 2007 to September 2010. We also agreed to a purchase gold cap on a quarterly basis during this same period and at identical volumes covering a total volume of 121,927 ounces of gold at a price of \$535 per ounce. Although these contracts are not designated as hedging derivatives, they serve an economic purpose of protecting us from the effects of a decline in gold prices. Because they are not designated as hedges, however, special hedge accounting does not apply. Derivative results are simply marked to market through earnings, with these effects recorded in *other income* or *other expense*, as appropriate under FASB Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("FAS 133").

On October 11, 2006, prior to our initial draw on the Credit Facility, we entered into interest rate swap agreements in accordance with the terms of the Credit Facility, which requires that we hedge at least 50 percent of our outstanding debt under this facility. The agreements entered into cover \$9,375,000 or 75% of the outstanding debt. Both swaps covered this same notional amount of \$9,375,000, but over different time horizons. The first covered the six months that commenced on October 11, 2006 and terminated on March 31, 2007 and the second covers the period from March 30, 2007 through December 31, 2010. We intend to use discretion in managing this risk as market conditions vary over time, allowing for the possibility of adjusting the degree of hedge coverage as we deem appropriate. However, any use of interest rate derivatives will be restricted to use for risk management purposes.



We use variable-rate debt to finance a portion of the El Chanate Project. Variable-rate debt obligations expose us to variability in interest payments due to changes in interest rates. As a result of these arrangements, we will continuously monitor changes in interest rate exposures and evaluate hedging opportunities. Our risk management policy permits us to use any combination of interest rate swaps, futures, options, caps and similar instruments, for the purpose of fixing interest rates on all or a portion of variable rate debt, establishing caps or maximum effective interest rates, or otherwise constraining interest expenses to minimize the variability of these effects.

The interest rate swap agreements will be accounted for as cash flow hedges, whereby "effective" hedge gains or losses are initially recorded in other comprehensive income and later reclassified to the interest expense component of earnings coincidentally with the earnings impact of the interest expenses being hedged. "Ineffective" hedge results are immediately recorded in earnings also under interest expense. No component of hedge results will be excluded from the assessment of hedge effectiveness.

We are exposed to credit losses in the event of non-performance by counterparties to these interest rate swap agreements, but we do not expect any of the counterparties to fail to meet their obligations. To manage credit risks, we select counterparties based on credit ratings, limit our exposure to a single counterparty under defined guidelines, and monitor the market position with each counterparty as required by SFAS 133.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk.**

Not applicable.

**Item 4. Controls and Procedures.**

The term "disclosure controls and procedures" is defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). This term refers to the controls and procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files under the Exchange Act is recorded, processed, summarized, and reported within the required time periods. In designing and evaluating the disclosure controls and procedures, management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Our Chief Executive Officer and our Chief Financial Officer have evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this quarterly report. They have concluded that, as of that date, our disclosure controls and procedures were effective at ensuring that required information will be disclosed on a timely basis in our reports filed under the Exchange Act.

No change in our internal control over financial reporting occurred during the period covered by this report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## PART II - OTHER INFORMATION

### Item 1. Legal Proceedings.

None.

### Item 1A. Risk Factors

We are subject to various risks that may materially harm our business, financial condition and results of operations. If any of these risks or uncertainties actually occur, our business, financial condition or operating results could be materially harmed. In that case, the trading price of our common stock could decline and you could lose all or part of your investment.

#### Risks related to our business and operations

*We have just begun generating operating revenues. If we are unable to sustain operating revenues, we will not be able to generate profits and our business may fail.*

Until recently, we had no producing properties and, historically, have operated at a loss. We only commenced gold producing activities and started to generate revenues in August 2007. Our ultimate success will depend on our ability to generate profits from our properties. Our viability is largely dependent on the successful commercial development of our El Chanate gold mining project in Sonora, Mexico. While we have commenced revenue producing mining operations, we cannot assure that revenues will continue to cover cash flow or continue to generate profits.

*We just recently started to receive cash flow from operations and, historically, have relied on external funding sources. While we believe that we will continue to generate cash flow and profits from operations, if we encounter unexpected problems, we may need to raise additional capital. If additional capital is required and we are unable to obtain it from outside sources, we may be forced to reduce or curtail our operations or our anticipated exploration activities.*

Prior to the first fiscal quarter of 2008, we were not able to generate cash flow from operations. While we now are generating positive cash flow and profits, if we encounter unexpected problems and we are unable to continue to generate positive cash flow and profits, we may need to raise additional capital. We also may need to raise additional capital for property acquisition and new exploration. To the extent that we need to obtain additional capital, management intends to raise such funds through the sale of our securities and/or joint venturing with one or more strategic partners. We cannot assure that adequate additional funding, if needed, will be available. If we need additional capital and we are unable to obtain it from outside sources, we may be forced to reduce or curtail our operations or our anticipated exploration activities.

*Our Credit Facility with Standard Bank plc imposes restrictive covenants on us.*

Our Credit Facility with Standard Bank requires us, among other obligations, to meet certain financial covenants including (i) a debt service coverage ratio of not less than 1.2 to 1.0, (ii) a projected debt service coverage ratio of not less than 1.2 to 1.0, (iii) a loan life coverage ratio of at least 1.6 to 1.0, (iv) a project life coverage ratio of at least 2.0 to 1.0 and (v) a minimum reserve tail. We are also required to maintain a certain minimum level of unrestricted cash. In addition, the Credit Facility restricts, among other things, our ability to incur additional debt, create liens on our property, dispose of any assets, merge with other companies or make any investments. A failure to comply with the restrictions contained in the Credit Facility could lead to an event of default thereunder which could result in an acceleration of such indebtedness.





***We are using reconditioned equipment which could adversely affect our cost assumptions and our ability to economically and successfully mine the project.***

We are using reconditioned carbon column collection equipment to recover gold and Sinergia, our mining contractor, is using equipment that is not new. Such equipment is subject to the risk of more frequent breakdowns and need for repair than new equipment. If the equipment that we or Sinergia uses breaks down and needs to be repaired or replaced, we will incur additional costs and operations may be delayed resulting in lower amounts of gold recovered. In such event, our capital and operating cost assumptions may be inaccurate and our ability to economically and successfully mine the project may be hampered, resulting in decreased revenues and, possibly, a loss from operations.

***The gold deposit we have identified at El Chanate is relatively low-grade. If our estimates and assumptions are inaccurate, our results of operation and financial condition could be materially adversely affected.***

The gold deposit we have identified at our El Chanate Project is relatively low-grade. If the estimates of ore grade or recovery rates turn out to be lower than the actual ore grade and recovery rates, if costs are higher than expected, or if we experience problems related to the mining, processing, or recovery of gold from ore at the El Chanate Project, our results of operation and financial condition could be materially adversely affected. Moreover, it is possible that actual costs and economic returns may differ materially from our best estimates. It is not unusual in the mining industry for new mining operations to experience unexpected problems during the initial production phase and to require more capital than anticipated. There can be no assurance that our operations at El Chanate will continue to be profitable.

***We have only one project. As a result, our chances of conducting viable mining operations are dependent upon the success of that project.***

Our only current properties are the El Chanate concessions. Accordingly, we are dependent upon the success of the El Chanate concessions.

***Gold prices can fluctuate on a material and frequent basis due to numerous factors beyond our control. If and when we commence production, our ability to generate profits from operations could be materially and adversely affected by such fluctuating prices.***

The profitability of any gold mining operations in which we have an interest will be significantly affected by changes in the market price of gold. Gold prices fluctuate on a daily basis. During the month of January 2008, the spot price for gold on the London Exchange has fluctuated between \$846.75 and \$924.50 per ounce. During calendar 2007, the spot price for gold on the London Exchange fluctuated between \$608.40 and \$841.10 per ounce. Gold prices are affected by numerous factors beyond our control, including:

- the level of interest rates,
- the rate of inflation,
- central bank sales,
- world supply of gold and
- stability of exchange rates.

Each of these factors can cause significant fluctuations in gold prices. Such external factors are in turn influenced by changes in international investment patterns and monetary systems and political developments. The price of gold has historically fluctuated widely and, depending on the price of gold, revenues from mining operations may not be sufficient to offset the costs of such operations.

***We may not be successful in hedging against gold price and interest rate fluctuations and may incur mark to market losses and lose money through our hedging programs.***

We have entered into metals trading transactions to hedge against fluctuations in gold prices, using call option purchases and forward sales, and have entered into various interest rate swap agreements. The terms of our Credit Facility with Standard Bank require that we utilize various price hedging techniques to hedge a portion of the gold we plan to produce at the El Chanate Project and hedge at least 50% of our outstanding loan balance. There can be no assurance that we will be able to successfully hedge against gold price and interest rate fluctuations.

Further, there can be no assurance that the use of hedging techniques will always be to our benefit. Hedging instruments that protect against metals market price volatility may prevent us from realizing the full benefit from subsequent increases in market prices with respect to covered production, which would cause us to record a mark-to-market loss, decreasing our revenues and profits. Hedging contracts also are subject to the risk that the other party may be unable or unwilling to perform its obligations under these contracts. Any significant nonperformance could have a material adverse effect on our financial condition, results of operations and cash flows.

To date, rather than modifying the original Gold Price Protection agreement with Standard Bank to satisfy these forward sale obligations, we have opted for a net cash settlement between the call option purchase price of \$535 and the forward sale price of \$500, or \$35.00 per oz. We have paid Standard Bank approximately \$1,051,000 on the settlement of 30,021 ounces with corresponding reductions in our derivative liability (\$591,000 or 16,895 ounces of gold during the six months ended January 31, 2008). The remaining ounces to settle with regard to this agreement amounted to 91,906 as of January 31, 2008. We believe we will be able to deliver the quantity of gold required by our forward sales on a going forward basis; however, we may continue to opt to net cash settle these forward sale obligations if it remains the most cost effective option for us. If we are unable for any reason to produce the quantity of gold required by our forward sales and generate sufficient cash flow to settle these forward sales in gold or cash, it could have a material adverse effect on our financial condition and cash flows.

***Our material property interests are in Mexico. Risks of doing business in a foreign country could adversely affect our results of operations and financial condition.***

We face risks normally associated with any conduct of business in a foreign country with respect to our El Chanate Project in Sonora, Mexico, including various levels of political and economic risk. The occurrence of one or more of these events could have a material adverse impact on our efforts or operations which, in turn, could have a material adverse impact on our cash flows, earnings, results of operations and financial condition. These risks include the following:

labor disputes,  
invalidity of governmental orders,  
uncertain or unpredictable political, legal and economic environments,  
war and civil disturbances,  
changes in laws or policies,  
taxation,

delays in obtaining or the inability to obtain necessary governmental permits,  
governmental seizure of land or mining claims,  
limitations on ownership,  
limitations on the repatriation of earnings,  
increased financial costs,  
import and export regulations, including restrictions on the export of gold, and  
foreign exchange controls.

These risks may limit or disrupt the project, restrict the movement of funds or impair contract rights or result in the taking of property by nationalization or expropriation without fair compensation.

***We sell gold in U.S. dollars; however, we incur a significant amount of our expenses in Mexican pesos. If applicable currency exchange rates fluctuate, our revenues and results of operations may be materially and adversely affected.***

We sell gold in U.S. dollars. We incur a significant amount of our expenses in Mexican pesos. As a result, our financial performance would be affected by fluctuations in the value of the Mexican peso to the U.S. dollar.

***Changes in regulatory policy could adversely affect our exploration and future production activities.***

Any changes in government policy may result in changes to laws affecting:

ownership of assets,  
land tenure,  
mining policies,  
monetary policies,  
taxation,  
rates of exchange,  
environmental regulations,  
labor relations,  
repatriation of income and/or  
return of capital.

Any such changes may affect our ability to undertake exploration and development activities in respect of future properties in the manner currently contemplated, as well as our ability to continue to explore, develop and operate those properties in which we have an interest or in respect of which we have obtained exploration and development rights to date. The possibility, particularly in Mexico, that future governments may adopt substantially different policies, which might extend to expropriation of assets, cannot be ruled out.

***Compliance with environmental regulations could adversely affect our exploration and future production activities.***

With respect to environmental regulation, future environmental legislation could require:

stricter standards and enforcement,  
increased fines and penalties for non-compliance,

more stringent environmental assessments of proposed projects and a heightened degree of responsibility for companies and their officers, directors and employees.

There can be no assurance that future changes to environmental legislation and related regulations, if any, will not adversely affect our operations. We could be held liable for environmental hazards that exist on the properties in which we hold interests, whether caused by previous or existing owners or operators of the properties. Any such liability could adversely affect our business and financial condition.

***We have insurance against losses or liabilities that could arise from our operations. If we incur material losses or liabilities in excess of our insurance coverage, our financial position could be materially and adversely affected.***

Mining operations involve a number of risks and hazards, including:

- environmental hazards,
- industrial accidents,
- metallurgical and other processing,
- acts of God, and/or
- mechanical equipment and facility performance problems.

Such risks could result in:

- damage to, or destruction of, mineral properties or production facilities,
- personal injury or death,
- environmental damage,
- delays in mining,
- monetary losses and /or
- possible legal liability.

Industrial accidents could have a material adverse effect on our future business and operations. We currently maintain general liability, auto and property insurance coverage. We cannot be certain that the insurance we have in place will cover all of the risks associated with mining or that we will be able to maintain insurance to cover these risks at economically feasible premiums. We also might become subject to liability for pollution or other hazards which we cannot insure against or which we may elect not to insure against because of premium costs or other reasons. Losses from such events may have a material adverse effect on our financial position.

***Calculation of reserves and metal recovery dedicated to future production is not exact, might not be accurate and might not accurately reflect the economic viability of our properties.***

Reserve estimates may not be accurate. There is a degree of uncertainty attributable to the calculation of reserves, resources and corresponding grades being dedicated to future production. Until reserves or resources are actually mined and processed, the quantity of reserves or resources and grades must be considered as estimates only. In addition, the quantity of reserves or resources may vary depending on metal prices. Any material change in the quantity of reserves, resource grade or stripping ratio may affect the economic viability of our properties. In addition, there can be no assurance that mineral recoveries in small scale laboratory tests will be duplicated in large tests under on-site conditions or during production.

***We are dependent on the efforts of certain key personnel and contractors to develop our El Chanate Project. If we lose the services of these personnel and contractors and we are unable to replace them, our planned operations at our El Chanate Project may be disrupted and/or materially adversely affected.***

We are dependent on a relatively small number of key personnel, including but not limited to John Brownlie, Chief Operating Officer, who oversees the El Chanate Project, the loss of any one of whom could have an adverse effect on us. We are also dependent upon Sinergia to provide mining services. Sinergia commenced mining operations on March 25, 2007, and transitioned from the pre-production to production phase of the mining contract in July 2007. Sinergia has mobilized its mining fleet to the site; however, its mining fleet is not new. If we lose the services of our key personnel, or if Sinergia is unable to effectively maintain its fleet, our planned operations at our El Chanate Project may be disrupted and/or materially adversely affected.

***There are uncertainties as to title matters in the mining industry. We believe that we have good title to our properties; however, any defects in such title that cause us to lose our rights in mineral properties could jeopardize our planned business operations.***

We have investigated our rights to explore, exploit and develop our concessions in manners consistent with industry practice and, to the best of our knowledge, those rights are in good standing. However, we cannot assure that the title to or our rights of ownership in the El Chanate concessions will not be challenged or impugned by third parties or governmental agencies. In addition, there can be no assurance that the concessions in which we have an interest are not subject to prior unregistered agreements, transfers or claims and title may be affected by undetected defects. Any such defects could have a material adverse effect on us.

***Our ability to remain profitable long-term eventually will depend on our ability to find, explore and develop additional properties. Our ability to acquire such additional properties will be hindered by competition. If we are unable to acquire, develop and economically mine additional properties, we most likely will not be able to be profitable on a long-term basis.***

Gold properties are wasting assets. They eventually become depleted or uneconomical to continue mining. The acquisition of gold properties and their exploration and development are subject to intense competition. Companies with greater financial resources, larger staffs, more experience and more equipment for exploration and development may be in a better position than us to compete for such mineral properties. If we are unable to find, develop and economically mine new properties, we most likely will not be able to be profitable on a long-term basis.

***Our ability on a going forward basis to discover additional viable and economic mineral reserves is subject to numerous factors, most of which are beyond our control and are not predictable. If we are unable to discover such reserves, we most likely will not be able to be profitable on a long-term basis.***

Exploration for gold is speculative in nature, involves many risks and is frequently unsuccessful. Few properties that are explored are ultimately developed into commercially producing mines. As noted above, our long-term profitability will be, in part, directly related to the cost and success of exploration programs. Any gold exploration program entails risks relating to

the location of economic ore bodies,  
development of appropriate metallurgical processes,

receipt of necessary governmental approvals and construction of mining and processing facilities at any site chosen for mining.

The commercial viability of a mineral deposit is dependent on a number of factors including:

the price of gold,  
the particular attributes of the deposit, such as its  
size,  
grade and  
proximity to infrastructure,  
financing costs,  
taxation,  
royalties,  
land tenure,  
land use,  
water use,  
power use,  
importing and exporting gold and  
environmental protection.

The effect of these factors cannot be accurately predicted.

#### **Risks related to ownership of our stock**

*We do not intend to pay cash dividends in the near future.*

Our board of directors determines whether to pay cash dividends on our issued and outstanding shares. The declaration of dividends will depend upon our future earnings, our capital requirements, our financial condition and other relevant factors. Our board does not intend to declare any dividends on our shares for the foreseeable future. We anticipate that we will retain any earnings to finance the growth of our business and for general corporate purposes.

*Provisions of our Certificate of Incorporation, By-laws and Delaware law could defer a change of our management which could discourage or delay offers to acquire us.*

Provisions of our Certificate of Incorporation, By-laws and Delaware law may make it more difficult for someone to acquire control of us or for our stockholders to remove existing management, and might discourage a third party from offering to acquire us, even if a change in control or in management would be beneficial to our stockholders. For example, our Certificate of Incorporation allows us to issue different series of shares of common stock without any vote or further action by our stockholders and our Board of Directors has the authority to fix and determine the relative rights and preferences of such series of common stock. As a result, our Board of Directors could authorize the issuance of a series of common stock that would grant to holders the preferred right to our assets upon liquidation, the right to receive dividend payments before dividends are distributed to the holders of other common stock and the right to the redemption of the shares, together with a premium, prior to the redemption of other series of our common stock.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

We received proceeds of approximately \$2,156,000 during the quarter ended January 31, 2008 from the exercising of an aggregate of 6,321,500 warrants issued in past private placements. We issued 465,000 two year options to purchase our common stock at an exercise prices ranging from \$0.38 to \$0.50 per share for professional services rendered. We also issued 3,150,000 options to purchase our common stock at an exercise price of \$0.63 to our officers, directors and employees as part of our Equity Incentive program. All of the stock options have a term of seven years and vest as follows: 20% vested upon issuance and the balance vest 20% annually thereafter. In addition, we issued 1,095,000 shares of restricted common stock to our officers and employees that vest over a three year period.

All of the foregoing securities were issued pursuant to exemptions from registration provided by Section 4(2) of the Securities Act of 1933.

**Item 3. Defaults Upon Senior Securities.**

None.

**Item 4 Submission of Matters to a Vote of Security Holders.**

We held our Annual Meeting of Stockholders on January 24, 2008. For information on the matters voted upon and the results of voting, you are referred to Item 8.01 "Other Events" in our current report on Form 8-K filed with the Commission on January 30, 2008.

**Item 5. Other Information.**

None.

**Item 6. Exhibits.**

- 31.1 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 from the Company's Chief Executive Officer.
- 31.2 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 from the Company's Chief Financial Officer.
- 32.1 Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 from the Company's Chief Executive Officer.
- 32.2 Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 from the Company's Chief Financial Officer.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereto duly authorized.

**CAPITAL GOLD CORPORATION**

Registrant

By: /s/ Gifford A. Dieterle  
Gifford A. Dieterle  
President/Treasurer

Date: March 13, 2008

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