

## Chairman's Address

Since announcing our intention to acquire certain coal assets in Colombia in September 2005, things have happened very quickly. We completed an equity financing in February 2006, raising C\$208 million to fund the property acquisitions and provide funds to start developing our own export infrastructure.

The initial acquisition involved the La Francia and Caypa mines, as well as interests in a rail line and port to be developed, as well as land and a licence for a second port, and an application for an attractive exploration concession. Subsequent to closing, we have worked quickly to install new management at the mines, acquire nine additional exploration concessions or applications, enter into attractive sales contracts for the majority of calendar 2006 and 2007 production at attractive prices and carried out most of the preliminary engineering work for the various infrastructure projects.

These projects include an ocean port located near Cartagena as well as a river port at Capulco. The plan is to initially build the port and river transport system to handle 10 million tonnes per year, although we intend to 'overbuild' certain portions of the port facility to make it relatively easy to expand the ocean port to 20 million tonnes per year. These two port projects are estimated to cost US\$70 million.

In addition, our partners in the Propuerto port consortium and the Fenoco rail consortium are moving quickly to build or expand their operations. Propuerto will soon break ground on a 20-million tonne per year ocean port at Santa Marta and our 14% ownership will ensure access of approximately three million tonnes per year at a cost well below the amount we currently pay. Fenoco has started upgrading the existing rail line to Santa Marta which currently handles 28 million tonnes per year. The partners intend to invest US\$230 million over the next two years to increase the capacity to 63 million tonnes per year and our 8.4% ownership will provide us with guaranteed access of up to 3.5 million tonnes per year at a cost substantially below current trucking rates. In order to take advantage of this, we also need to invest in rolling stock to connect La Francia with the Fenoco line. Collectively, these investments amount to another US\$55 million.

To enable us to move forward quickly, we recently completed a US\$115 million debt offering.

## Coal Markets and Production Outlook

We believe that the market for high quality thermal coal will remain firm for some time, as the tightening of emissions standards globally will ensure high demand and a premium price for high calorific, low sulfur coal such as we produce. We also intend to increase our coal production from 3.0 million tonnes in calendar 2006 to 4.8 million tonnes by 2010 from our two existing mines.

In addition, we have acquired a number of additional concessions and have commenced exploration on number of them. And we are always on the lookout for further acquisition opportunities.

We also plan to significantly increase our operating margins - in two ways – considerable cost savings from utilizing our own export infrastructure plus the contribution from selling excess capacity to other producers whose expansion plans are currently constrained by limited infrastructure.

Coalcorp's strategy to become a mid-sized coal producer is advancing even faster than we imagined only a year ago and hope to be able to report larger reserves, production, earnings and cash flow next year.

I am very proud of what we achieved in 2006. I am proud of the speed in which we acquired our portfolio of properties. I am grateful to our investors who have provided us with the funds necessary to build this company. But most of all, I am proud and grateful for the amazing job all of our employees did in making all this happen so quickly.

Serafino Iacono  
Chairman & Chief Executive Officer

*Auditors' Report and Consolidated Financial Statements of*

**COALCORP MINING INC.**  
**(formerly Adobe Ventures Inc.)**

*May 31, 2006 and 2005*

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## **Auditors' Report**

To the Shareholders of  
Coalcorp Mining Inc.  
(formerly Adobe Ventures Inc.)

We have audited the consolidated balance sheets of Coalcorp Mining Inc. (formerly Adobe Ventures Inc.) as at May 31, 2006 and 2005 and the consolidated statements of operations and deficit and cash flows for the two years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at May 31, 2006 and 2005 and the results of its operations and its cash flows for the two years then ended in accordance with Canadian generally accepted accounting principles.

***(Signed) Deloitte & Touche LLP***

Chartered Accountants  
Vancouver, British Columbia  
August 29, 2006

# COALCORP MINING INC.

(formerly Adobe Ventures Inc.)

## Consolidated Balance Sheets

May 31, 2006 and 2005

(Expressed in thousands of dollars)

	<u>2006</u>	<u>2005</u>
<b>ASSETS</b>		
<b>CURRENT</b>		
Cash	\$ 5,299	\$ 3,371
Short-term investments	62,617	-
Accounts receivable	15,972	25
Inventories (Note 4)	7,202	-
Prepaid expenses and deposits	1,789	-
	<u>92,879</u>	<u>3,396</u>
LONG-TERM INVESTMENTS	8,412	-
RESTRICTED CASH (Note 5)	12,667	-
PROPERTY, PLANT AND EQUIPMENT (Note 6)	175,735	314
INTANGIBLE ASSET (Note 3(c))	37,926	-
	<u>\$ 327,619</u>	<u>\$ 3,710</u>
<b>LIABILITIES</b>		
<b>CURRENT</b>		
Accounts payable and accrued liabilities	\$ 23,553	\$ 584
Current portion of long-term debt (Note 8)	2,967	-
	<u>26,520</u>	<u>584</u>
LONG-TERM DEBT (Note 8)	14,804	-
ASSET RETIREMENT OBLIGATIONS (Note 9)	1,228	-
OTHER LIABILITIES (Note 3 (a))	4,729	-
FUTURE INCOME TAXES (Note 13)	60,022	-
	<u>107,303</u>	<u>584</u>
COMMITMENTS AND CONTINGENCIES (Notes 3, 6 and 17)		
<b>SHAREHOLDERS' EQUITY</b>		
Share capital (Note 10 (b))	184,499	17,405
Contributed surplus (Note 10 (b))	53,592	274
Cumulative translation adjustment	175	-
Deficit	(17,950)	(14,553)
	<u>220,316</u>	<u>3,126</u>
	<u>\$ 327,619</u>	<u>\$ 3,710</u>

APPROVED BY THE DIRECTORS

(Signed) Miguel de la Campa

Miguel de la Campa, Director

(Signed) Neil Woodyer

Neil Woodyer, Director

See accompanying notes to the consolidated financial statements.

# COALCORP MINING INC.

(formerly Adobe Ventures Inc.)

## Consolidated Statements of Operations and Deficit

Years ended May 31, 2006 and 2005

(Expressed in thousands of dollars, except for share and per share amounts)

	<u>2006</u>	<u>2005</u>
REVENUES	\$ 29,790	\$ -
COST OF OPERATIONS		
Production costs	23,866	-
Depletion and depreciation	3,674	-
	<u>27,540</u>	<u>-</u>
INCOME BEFORE UNDERNOTED ITEMS	<u>2,250</u>	<u>-</u>
EXPENSES		
Business development	1,254	-
Consulting	1,154	61
Office and administration	2,777	189
Professional fees	602	-
Salaries and benefits	698	-
Stock-based compensation (Note 10)	6,334	-
Write-off of deferred acquisition costs (Note 11)	-	11,667
	<u>12,819</u>	<u>11,917</u>
OPERATING LOSS	<u>(10,569)</u>	<u>(11,917)</u>
OTHER INCOME (EXPENSE)		
Interest income	1,132	107
Bridge loan interest and financing costs (Note 7)	(707)	-
Interest on long-term debt (Note 8)	(474)	-
Foreign exchange gain (loss)	6,272	(22)
LOSS BEFORE INCOME TAXES	<u>(4,346)</u>	<u>(11,832)</u>
(PROVISION FOR) RECOVERY OF INCOME TAXES (Note 13)		
Current	(52)	-
Future	1,001	-
	<u>949</u>	<u>-</u>
NET LOSS	<u>(3,397)</u>	<u>(11,832)</u>
DEFICIT, BEGINNING OF YEAR	<u>(14,553)</u>	<u>(2,721)</u>
DEFICIT, END OF YEAR	<u>\$ (17,950)</u>	<u>\$ (14,553)</u>
BASIC AND DILUTED LOSS PER SHARE	<u>\$ (0.02)</u>	<u>\$ (0.48)</u>
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING	<u>139,391,236</u>	<u>24,901,378</u>

See accompanying notes to the consolidated financial statements.

# COALCORP MINING INC.

(formerly Adobe Ventures Inc.)

## Consolidated Statements of Cash Flows

Years ended May 31, 2006 and 2005

(Expressed in thousands of dollars)

	<u>2006</u>	<u>2005</u>
<b>OPERATING ACTIVITIES</b>		
Net loss for the year	\$ (3,397)	\$ (11,832)
Items not involving cash		
Accretion	99	-
Depletion, depreciation and amortization	3,674	-
Stock-based compensation	6,334	-
Write-off of deferred acquisition costs	-	11,667
Bridge loan financing costs	339	-
Foreign exchange gain	(8,911)	-
Future income tax recovery	(1,001)	-
Net change in non-cash working capital items (Note 15 (a))	(9,707)	516
	<u>(12,570)</u>	<u>351</u>
<b>INVESTING ACTIVITIES</b>		
Acquisition of César (Note 3 (a))	(49,015)	-
Acquisition of Neo Coal (Note 3 (b))	(638)	-
Acquisition of Panamerican (Note 3 (c))	(16,547)	-
Acquisition of Cerrejón (Note 3 (d))	(37,207)	-
Property, plant and equipment expenditures, net of accounts payable and accrued liabilities	(1,496)	-
Restricted cash	(12,667)	-
(Increase) decrease in short-term investments	(61,435)	10,000
Acquisition of long-term investments	(8,307)	-
Deferred acquisition costs	-	(7,208)
	<u>(187,312)</u>	<u>2,792</u>
<b>FINANCING ACTIVITIES</b>		
Issue of common shares, net of issue costs	194,811	-
Recovery of share issuance costs	-	1
Proceeds from debt financing	21,446	-
Repayment of debt financing	(14,447)	-
	<u>201,810</u>	<u>1</u>
<b>INCREASE IN CASH DURING THE YEAR</b>	<b>1,928</b>	<b>3,144</b>
<b>CASH, BEGINNING OF YEAR</b>	<b>3,371</b>	<b>227</b>
<b>CASH, END OF YEAR</b>	<b>\$ 5,299</b>	<b>\$ 3,371</b>

SUPPLEMENTARY INFORMATION (Notes 15 (b) and (c))

# COALCORP MINING INC.

(formerly Adobe Ventures Inc.)

## Notes to the Consolidated Financial Statements

Years ended May 31, 2006 and 2005

(Tabular amounts expressed in thousands of dollars except for shares and per share amounts)

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### 1. NATURE OF OPERATIONS

Coalcorp Mining Inc. (the “Company”) is a Canadian-based coal mining and development company that is focused on the exploration, development and exploitation of coal and coal-related assets. These consolidated financial statements reflect the acquisition of Americoal Corporation Ltd. (“Americoal”), Neo Coal Corporation Ltd. (“Neo Coal”), Panamerican Ports Corporation Ltd. (“Panamerican”) and Andean Coal Corporation (“Andean”) by the Company on February 8, 2006 (Note 3). Prior to the acquisition of Americoal, Neo Coal, Panamerican and Andean, the Company’s principal business activity was the acquisition and exploration of mineral properties. On October 27, 2005, the Company changed its name to Coalcorp Mining Inc. from Adobe Ventures Inc.

### 2. BASIS OF PRESENTATION

These consolidated financial statements have been prepared by the Company in accordance with Canadian generally accepted accounting principles (“Canadian GAAP”) and are expressed in Canadian dollars.

(a) *Basis of consolidation*

These consolidated financial statements include the accounts of the Company and all its subsidiaries. All significant intercompany transactions and balances have been eliminated.

Variable interest entities (“VIE’s”), which include, but are not limited to, special purpose entities, trusts, partnerships, and other legal structures, as defined by Canadian Institute of Chartered Accountants (“CICA”) Accounting Guideline 15, *Consolidation of Variable Interest Entities*, are entities in which equity investors do not have the characteristics of a “controlling financial interest” or there is not sufficient equity at risk for the entity to finance its activities without additional subordinated financial support. VIE’s are subject to consolidation by the primary beneficiary who will absorb the majority of the entities’ expected losses and/or expected residual returns. The Company does not have any entities that qualify for treatment under this guidance.

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# COALCORP MINING INC.

(formerly Adobe Ventures Inc.)

## Notes to the Consolidated Financial Statements

Years ended May 31, 2006 and 2005

(Tabular amounts expressed in thousands of dollars except for shares and per share amounts)

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### 2. BASIS OF PRESENTATION (Continued)

(b) *Measurement uncertainty*

The preparation of financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant accounts that require estimates as the basis for determining the stated amounts include accounting for doubtful accounts, inventories, property, plant and equipment, asset retirement obligations, stock-based compensation, allocation of purchase price of acquisitions and income and mining taxes.

Depreciation and depletion of property, plant and equipment assets are dependent upon estimates of useful lives and reserves estimates, both of which are determined with the exercise of judgement. The assessment of any impairment of property, plant and equipment is dependent upon estimates of fair value that take into account factors such as reserves, economic and market conditions and the useful lives of assets. Asset retirement obligations are recognized in the period in which they arise and are stated as the fair value of estimated future costs. These estimates require extensive judgement about the nature, cost and timing of the work to be completed, and may change with future changes to costs, environmental laws and regulations and remediation practices.

(c) *Functional and reporting currency*

The Company's reporting currency is the Canadian dollar. The Company and its subsidiaries operate in Canada and Colombia.

Where a subsidiary is self-sustaining, the financial results have been translated into Canadian dollars using the current rate method. The current rate method provides that all assets and liabilities are translated at the year-end rate of exchange and all revenue and expense items are translated at the average rate of exchange prevailing during the period. Exchange gains and losses arising from this translation, representing the net unrealized foreign currency translation gain (loss) on the Company's net investment in these foreign operations, are recorded in the cumulative translation account component of shareholders' equity.

Where a subsidiary is integrated, the financial results have been translated into Canadian dollars using the temporal method. The temporal method provides for foreign currency denominated monetary assets and liabilities to be translated into Canadian dollars at rates of exchange in effect at the balance sheet date. Non-monetary items are translated at historical exchange rates and revenues and expenses at average rates of exchange during the period. Exchange gains and losses arising on translation are included in the statement of operations and deficit.

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# COALCORP MINING INC.

(formerly Adobe Ventures Inc.)

## Notes to the Consolidated Financial Statements

Years ended May 31, 2006 and 2005

(Tabular amounts expressed in thousands of dollars except for shares and per share amounts)

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### 2. BASIS OF PRESENTATION (Continued)

(c) *Functional and reporting currency (continued)*

Other foreign currency transactions included in these consolidated financial statements are translated into Canadian dollars at the rates of exchange in effect at the consolidated balance sheet dates in the case of monetary assets and liabilities and at the rates of exchange in effect on the date of transaction in the case of non-monetary assets and income and expenses. All gains and losses on translation of these foreign currency transactions are included in the consolidated statement of operations and deficit.

(d) *Short-term investments*

Short-term investments include short-term money market instruments with terms to maturity at the date of issue of between three and twelve months. The carrying value of short-term investments consists of cost and accrued interest.

(e) *Inventories*

Coal inventory is valued at the lower of average production cost and net realizable value. Production costs include direct labour, benefits, direct material and other direct product costs including depletion and amortization. Cost is determined on the first-in, first-out basis.

Materials and supplies are valued at the lower of cost or replacement cost.

(f) *Long-term investments*

Long-term investments are carried at cost. The Company reviews the carrying value of each investment whenever events or changes in circumstances indicate that its carrying value may exceed its estimated net recoverable amount. An impairment loss is recognized when the carrying value of the investment exceeds its fair value.

(g) *Property, plant and equipment*

Property, plant and equipment are recorded at cost less accumulated depreciation and depletion. Maintenance, repairs and renewals are charged to operations.

Mining properties and mining and process facility assets are amortized on a units-of-production basis which is measured by the portion of the mine's economically recoverable and proven ore reserves recovered during the period.

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# COALCORP MINING INC.

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## Notes to the Consolidated Financial Statements

Years ended May 31, 2006 and 2005

(Tabular amounts expressed in thousands of dollars except for shares and per share amounts)

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### 2. BASIS OF PRESENTATION (Continued)

(g) *Property, plant and equipment (continued)*

Other assets are depreciated using the straight-line method based on their estimated useful lives, which generally range from 5 to 20 years.

All direct costs related to the acquisition, exploration and development of mineral properties are capitalized until the properties to which they relate are placed into production, sold, abandoned or management has determined there to be an impairment. If economically recoverable ore reserves are developed, capitalized costs of the related property are reclassified as mining assets and amortized using the units-of-production method following commencement of production.

The amounts shown for mineral properties do not necessarily represent present or future values. Their recoverability is dependent upon the discovery of economically recoverable reserves, the ability of the Company to obtain the necessary financing to complete the development, and future profitable production or proceeds from the disposition thereof.

(h) *Intangible asset*

Intangible asset consists of a port license to operate a coal port in Colombia. The license will be amortized over its expected useful life upon issuance of the final authorization to begin construction of the port facility.

(i) *Impairment of long-lived assets*

Long-lived assets are tested for recoverability annually or whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. An impairment loss is recognized when their carrying value exceeds the total estimated future undiscounted cash flows. An impairment loss is measured and recorded based on discounted estimated future cash flows. Future cash flows are estimated based on expected future production, commodity prices, operating costs and capital costs.

(j) *Asset retirement obligation costs*

The Company recognizes liabilities for statutory, contractual or legal obligations associated with the retirement of property, plant and equipment, when those obligations result from the acquisition, construction, development or normal operation of the assets. Initially, the fair value of the liability for an asset retirement obligation is recognized in the period incurred. The net present value is added to the carrying amount of the associated asset and amortized over the asset's useful life. The liability is accreted over time through periodic charges to operations and it is reduced by actual costs of reclamation.

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# COALCORP MINING INC.

(formerly Adobe Ventures Inc.)

## Notes to the Consolidated Financial Statements

Years ended May 31, 2006 and 2005

(Tabular amounts expressed in thousands of dollars except for shares and per share amounts)

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### 2. BASIS OF PRESENTATION (Continued)

(j) *Asset retirement obligation costs (continued)*

The Company's estimates of reclamation costs could change as a result of changes in regulatory requirements and assumptions regarding the amount and timing of the future expenditures. A change in estimated discount rates is reviewed annually or as new information becomes available. Expenditures relating to ongoing environmental programs are charged against operations as incurred or capitalized and amortized depending on their relationship to future earnings.

(k) *Revenue recognition*

Revenue from the sale of coal is recognized on the date the product is loaded for shipment at the port or at the mine according with the conditions of the contract, as this coincides with the transfer of title, the risk of ownership, the determination of the amount due under the terms of sales contracts the Company has with its customer, and collection is reasonably assured.

(l) *Income taxes*

The Company uses the liability method of accounting for income and mining taxes. Under the liability method, future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and for tax losses and other deductions carried forward. Upon business acquisitions, the liability method results in a gross up of mining interests to reflect the recognition of the future tax liabilities for the tax effect of such differences.

Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply when the asset is realized or the liability settled. A reduction in respect of the benefit of a future tax asset (a valuation allowance) is recorded against any future tax asset if it is not likely to be realized. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period in which the change is substantively enacted.

(m) *Stock-based compensation*

The Company accounts for stock-based compensation using the Black-Scholes fair value option pricing model. Stock-based compensation is accrued and charged to operations, with a corresponding credit to contributed surplus, on a straight-line basis over the vesting period. If and when the stock options are ultimately exercised, the applicable amounts of contributed surplus are transferred to share capital.

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# COALCORP MINING INC.

(formerly Adobe Ventures Inc.)

## Notes to the Consolidated Financial Statements

Years ended May 31, 2006 and 2005

(Tabular amounts expressed in thousands of dollars except for shares and per share amounts)

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### 2. BASIS OF PRESENTATION (Continued)

(n) *Loss per share*

Loss per share is computed by dividing the net loss available to common shareholders by the weighted average number of shares outstanding during the reporting year. Diluted loss per share is computed similar to basic loss per share except that the weighted average shares outstanding are increased to include additional shares for the assumed exercise of stock options and warrants, if dilutive. The number of additional shares is calculated by assuming that outstanding stock options and warrants were exercised and that the proceeds from such exercises were used to acquire common stock at the average market price during the reporting years. Options and warrants as disclosed in Note 10 are anti-dilutive and, therefore, have not been taken into account in the per share calculations.

(o) *Comparative amounts*

Certain comparative information has been reclassified to conform to the current year's presentation.

### 3. ACQUISITIONS

(a) *Americoal Acquisition - Compania Carbones del César S.A. ("César")*

On September 27, 2005, the Company entered into an agreement (the "Blue Pacific Agreement") with Blue Pacific Assets Corp. ("Blue Pacific") pursuant to which the Company agreed to acquire certain interests in each of Americoal, Neo Coal and Panamerican.

Pursuant to the Blue Pacific Agreement, the Company acquired all of the issued and outstanding shares of Americoal, a BVI company, which held the right to indirectly acquire all of the issued and outstanding shares of César, a Colombian company that operates the La Francia mine located in the César region of Colombia. Americoal was incorporated on July 26, 2005 and has no operations or assets, other than its right to acquire César.

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# COALCORP MINING INC.

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## Notes to the Consolidated Financial Statements

Years ended May 31, 2006 and 2005

(Tabular amounts expressed in thousands of dollars except for shares and per share amounts)

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### 3. ACQUISITIONS (Continued)

(a) *Americoal Acquisition - Compania Carbones del César S.A. ("César") (continued)*

In consideration for the acquisition of César, the Company issued 12 million common shares to Blue Pacific and paid Blue Pacific \$1.5 million (US\$1.25 million). The Company also assumed all of Americoal's purchase obligations relating to César, including the payment of \$44.8 million (US\$38.8 million) to the beneficial shareholders of César (amount paid). Blue Pacific was also granted a royalty interest of \$1.17 (US\$1.00) per tonne on all of the La Francia mine's future production.

The common shares issued have been valued at a price of \$0.68 being the average closing price of the common shares of the Company for the two days before, the day of, and the two days after, the date of announcement of the acquisition on September 28, 2005.

The acquisition of César was completed on February 8, 2006 and the results of operations of César are included in the consolidated statement of operations since February 8, 2006.

The business combination has been accounted for as a purchase transaction, with the Company as the acquirer of César. The allocation of the purchase price based on the consideration paid and the preliminary estimate of the fair value of César's net assets acquired is as follows:

Purchase price		
Cash	\$	44,817
Shares issued on acquisition (12 million common shares)		8,112
Acquisition costs		4,198
	\$	57,127
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Net assets acquired		
Non-cash working capital	\$	721
Property, plant and equipment		110,498
Long-term debt		(10,906)
Asset retirement obligation		(58)
Other liabilities		(4,729)
Future income tax liabilities		(38,399)
	\$	57,127

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The Company assumed a contract for the sale of coal to a Chilean company for a total of 600,000 tonnes at US\$31.50 per tonne. As at February 8, 2006 and May 31, 2006, this contract was in a loss position of approximately \$4.7 million.

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# COALCORP MINING INC.

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## Notes to the Consolidated Financial Statements

Years ended May 31, 2006 and 2005

(Tabular amounts expressed in thousands of dollars except for shares and per share amounts)

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### 3. ACQUISITIONS (Continued)

(a) *Americoal Acquisition - Compania Carbones del César S.A. ("César") (continued)*

The preliminary determination of the fair value of César's assets acquired and liabilities assumed is based on the management of the Company's best estimate at the date of these financial statements. The Company is completing its assessment of the fair value of net assets acquired, including obtaining independent appraisals for certain assets, and expects to finalize its estimate prior to December 31, 2006. Any change to the preliminary allocation of the fair value of César's net assets acquired will be recorded in the period they are determined.

(b) *Neo Coal Acquisition - La Curubita concession application*

Pursuant to the Blue Pacific Agreement, the Company acquired from Blue Pacific a joint venture interest in Neo Coal, a corporation existing under the laws of Aruba. Neo Coal had an agreement with an unrelated third party ("Arboleda"), who had applied to the Colombian governmental authority responsible for granting mineral exploration concessions ("Ingeominas"), to acquire a 2,500 hectare coal exploration concession known as La Curubita (the "La Curubita concession"). Pursuant to this agreement, Neo Coal will acquire a joint venture interest in the La Curubita concession, when and if granted. The application is currently being reviewed by Ingeominas. If granted, Neo Coal will have a 90% interest, and Arboleda will have a 10% carried interest in the La Curubita concession. Neo Coal was incorporated on May 19, 2005 and has no operations or assets, other than its right to acquire an interest in the La Curubita concession application.

Total consideration for the acquisition of Neo Coal was \$3.3 million; the Company issued to Blue Pacific 4 million common shares and the Company paid \$0.6 million (US\$0.5 million) to Arboleda. The 4 million common shares will be held in escrow until and if the La Curubita concession is granted. Blue Pacific was also granted a royalty interest of \$1.17 (US\$1.00) per tonne on all production in respect of the La Curubita concession.

The common shares issued have been valued at a price of \$0.68 being the average closing price of the common shares of the Company for the two days before, the day of, and the two days after, the date of announcement on September 28, 2005.

The acquisition is considered to be an asset acquisition and the purchase price has been allocated to other mineral property within property, plant and equipment.

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# COALCORP MINING INC.

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## Notes to the Consolidated Financial Statements

Years ended May 31, 2006 and 2005

(Tabular amounts expressed in thousands of dollars except for shares and per share amounts)

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### 3. ACQUISITIONS (Continued)

#### (c) *Panamerican Acquisition - Cartagena Coal Port Assets*

Pursuant to the Blue Pacific Agreement, the Company acquired from Blue Pacific all of the issued and outstanding shares in Panamerican, a BVI company. Panamerican's only operations and assets consist of the existing option to acquire: (i) 57 hectares of land on the coast of the Caribbean Sea near the industrial zone of Cartagena, Colombia (the "Port Land"), which land is capable of being used as a coal port; and (ii) all of the issued and outstanding shares of Carbones del Carare, S.A. ("Carare"), a company existing under the laws of Colombia (the shares of Carare and the Port Land being referred to, collectively, as the "Port Assets"). Carare was previously licensed to operate and retains rights to a public coal port located near the city of Cartagena. Panamerican was incorporated on August 11, 2005 and has no operations or assets, other than its right to acquire the Port Assets.

Total consideration for the acquisition of the Port Assets was \$24.7 million; the Company issued to Blue Pacific 12 million common shares, paid a finder's fee of \$0.3 million (US\$0.25 million) to an unrelated third party and is committed to paying to Blue Pacific a royalty of US\$0.30 per tonne shipped through the Port Assets. The Company also assumed all of Panamerican's purchase obligations relating to the Port Assets, consisting of the payment of \$16.2 million (US\$13.9 million), \$16.1 million paid for the value of the lapsed permit held by Carare to operate a coal port and \$0.1 million (US\$0.1 million) for all of the issued and outstanding shares of Carare (less any accrued liabilities of Carare).

The common shares issued have been valued at a price of \$0.68 being the average closing price of the common shares of Coalcorp for the two days before, the day of, and the two days after, the date of announcement on September 28, 2005.

The acquisition is considered to be an asset acquisition and the purchase price has been allocated to the port license.

As of May 31, 2006, the Company has been granted a temporary authorization permit to begin basic site clearing and preparation for the construction of the port facility while awaiting the issuance of final authorization to begin construction.

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# COALCORP MINING INC.

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## Notes to the Consolidated Financial Statements

Years ended May 31, 2006 and 2005

(Tabular amounts expressed in thousands of dollars except for shares and per share amounts)

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### 3. ACQUISITIONS (Continued)

(d) *The Andean Acquisition - Carbones Colombianos del Cerrejón, S.A. ("Cerrejón")*

Pursuant to an agreement with Next Com Limited ("Next Com"), the Company acquired all of the issued and outstanding shares of Andean, a BVI company that held the right to acquire all of the issued and outstanding shares of Cerrejón, the operator of the Caypa Mine. Cerrejón is a company existing under the laws of Colombia. Andean was incorporated on August 24, 2005, and has no other operations or assets other than its right to acquire Cerrejón.

In consideration for the acquisition of Andean, the Company paid \$1.2 million (US\$1.0 million) to Next Com. The Company further assumed all of Andean's purchase obligations relating to the acquisition of the shares of Cerrejón, consisting of the payment of \$37.6 million (US\$32.6 million). Andean is also required to make a working capital adjustment payment of approximately \$3.8 million. The working capital adjustment payable has been recorded in accounts payable and accrued liabilities as at May 31, 2006.

The acquisition of Cerrejón was completed on February 8, 2006 and the results of operations of Cerrejón are included in the consolidated statement of operations since February 8, 2006.

The business combination has been accounted for as a purchase transaction, with the Company as the acquirer of Andean. The allocation of the purchase price based on the consideration paid and the preliminary estimate of the fair value of Cerrejón's net assets acquired is as follows:

Purchase price		
Cash (including working capital adjustment)	\$	41,459
Acquisition costs		2,851
	\$	44,310
<hr/>		
Net assets acquired		
Cash	\$	3,288
Non-cash working capital		1,153
Property, plant and equipment		57,196
Asset retirement obligation		(1,071)
Future income tax liabilities		(16,256)
	\$	44,310

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# COALCORP MINING INC.

(formerly Adobe Ventures Inc.)

## Notes to the Consolidated Financial Statements

Years ended May 31, 2006 and 2005

(Tabular amounts expressed in thousands of dollars except for shares and per share amounts)

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### 3. ACQUISITIONS (Continued)

(d) *The Andean Acquisition - Carbones Colombianos del Cerrejón, S.A. ("Cerrejón")*  
(continued)

The preliminary determination of the fair value of Cerrejón's assets acquired and liabilities assumed is based on the management of the Company's best estimate at the date of these financial statements. The Company is completing its assessment of the fair value of net assets acquired, including obtaining independent appraisals for certain assets, and expects to finalize its estimate prior to December 31, 2006. Any change to the preliminary allocation of the fair value of Cerrejón's net assets acquired will be recorded in the period they are determined.

### 4. INVENTORIES

	<u>2006</u>	<u>2005</u>
Coal inventory	\$ 3,622	\$ -
Materials and supplies	3,580	-
	<u>\$ 7,202</u>	<u>\$ -</u>

### 5. RESTRICTED CASH

Restricted cash is comprised of term deposits being held as security against certain long-term debt balances (Note 8).

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# COALCORP MINING INC.

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### 6. PROPERTY, PLANT AND EQUIPMENT

The following table summarizes the Company's property, plant and equipment:

	2006			2005
	Cost	Accumulated depreciation/ depletion	Net book value	Net book value
Mining properties				
Caypa (Note 3 (d))	\$ 46,447	\$ 1,488	\$ 44,959	\$ -
La Francia (Note 3 (a))	109,713	1,827	107,886	-
Mining plant and equipment				
Caypa (Note 3 (d))	10,749	344	10,405	-
La Francia (Note 3 (a))	785	11	774	-
Other mineral properties				
Francia concessions (Note 6 (ii))	5,397	-	5,397	-
Curubita concessions (Notes 3 (b) and 6 (ii))	5,974	-	5,974	-
Other plant and equipment	357	17	340	314
	<b>\$ 179,422</b>	<b>\$ 3,687</b>	<b>\$ 175,735</b>	<b>\$ 314</b>

- (i) The Company has acquired rights to four additional coal exploration properties located near the Company's La Francia mine (the "Francia concessions") from Corte Nova Ltd. in May 2006. The Francia concessions were acquired for aggregate consideration of \$5.4 million (\$0.8 million paid as of May 31, 2006). Each of the agreements provide for varying additional acquisition payments based on additional measured resources or indicated resources upon completion of a twelve month exploration program.
- (ii) The Company has acquired rights to four additional coal exploration properties located near the Company's La Curubita concession (the "Curubita concessions") from Corte Nova Ltd. in May 2006. The Curubita concessions were acquired for aggregate consideration of \$0.8 million (\$0.7 million paid as of May 31, 2006). Each of the agreements provides for varying additional acquisition payments based on additional proven, measured or superior resources upon completion of a twelve month exploration program.

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

Years ended May 31, 2006 and 2005

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### **7. BRIDGE LOAN**

In September 2005, the Company completed a bridge loan financing for a total of \$8.5 million (US\$7.5 million). The unsecured loans were for a period of up to one year, bearing interest at 1% per month, payable monthly. US\$2.5 million of this loan was financed by a company in which a director of the Company is an officer (Note 12). The Company issued an aggregate of 1.5 million warrants to the lenders as a drawdown fee, with each warrant giving the lender the right to acquire one share of the Company at an exercise price of \$0.60 for a period of 2 years. The fair value of these warrants of \$339,250 was determined using the Black-Scholes option pricing model assuming no dividends are to be paid, a weighted average volatility of 62%, an average annual risk free rate of 6% and an estimated life of 2 years.

In February 2006, the Company repaid the outstanding balance and accrued interest of \$367,953 from the proceeds of the equity offering (Note 10).

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# COALCORP MINING INC.

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Years ended May 31, 2006 and 2005

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### 8. LONG-TERM DEBT

Long-term debt consists of the following:

	<u>2006</u>	<u>2005</u>
Loan maturing in June 2006 for up to \$1.5 million (3,000 million Colombian pesos), unsecured, interest at Colombian market weekly average of fixed-term deposits ("DTF") plus 5% payable bi-annually and principal payable at the end of the loan term	\$ 1,274	\$ -
Loan maturing in January 2007 for up to \$0.5 million (826 million Colombian pesos), unsecured, interest at DTF plus 4.75%, amortized monthly blended payments of \$50,700 (100 million Colombian pesos)	366	-
Loan maturing in January 2007 for up to \$1.5 million (2,687 million Colombian pesos), unsecured, interest at DTF plus 4.75%, amortized monthly blended payments of \$181,675 (358.3 million Colombian pesos)	1,327	-
Loan maturing in January 2008 for up to \$2.5 million (4,813 million Colombian pesos), unsecured, interest at DTF plus 4.5%, amortized monthly blended payment of \$116,188 (229.2 million Colombian pesos)	2,137	-
Loan maturing in February 2010 for up to \$4.6 million (US\$4 million), interest at LIBOR plus 1.25% payable bi-annually and principal payable at the end of the loan, guaranteed by a term deposit in the same amount issued by the Company (see Note 5)	4,406	-
Loan maturing in March 2010 for up to \$8.3 million (US\$7.5 million), interest at LIBOR plus 2.41% payable bi-annually and principal payable at the end of the loan, guaranteed by a term deposit in the same amount issued by the Company (see Note 5)	8,261	-
	<u>17,771</u>	-
Less: Portion due within one year	2,967	-
	<u>\$ 14,804</u>	<u>\$ -</u>

As of May 31, 2006, the DTF rate was 5.98%.

# COALCORP MINING INC.

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Years ended May 31, 2006 and 2005

(Tabular amounts expressed in thousands of dollars except for shares and per share amounts)

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### 8. LONG-TERM DEBT (Continued)

As of May 31, 2006, the principal maturities of long-term debt are as follows for the years ended May 31:

2007	\$	2,967
2008		2,137
2009		-
2010		12,667
	\$	<u>17,771</u>

### 9. ASSET RETIREMENT OBLIGATIONS

Although the ultimate amount of the asset retirement obligation is uncertain, the fair value of these obligations is based on information currently available, including closure plans and applicable regulations. Significant closure activities include land rehabilitation, demolition of buildings and mine facilities and other costs.

The total undiscounted amount of the estimated cash flows required to settle the Company's asset retirement obligations is approximately \$10 million (US\$9 million) (2005 - \$Nil) which has been discounted using a discount rate of 12% to total approximately \$1.2 million (2005 - \$Nil). These obligations will be funded from operating cash flows, reclamation deposits and cash on hand. Future changes to these estimates, due to changes in closure plans or applicable regulations, will be made prospectively, with a corresponding charge to the asset's carrying value.

The following table summarizes the effect to the Company's asset retirement obligations:

Balance, May 31, 2005	\$	-
Additions during the year upon acquisitions (Notes 3 (a) and (d))		1,129
Accretion		99
Balance, May 31, 2006	\$	<u>1,228</u>

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# COALCORP MINING INC.

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Years ended May 31, 2006 and 2005

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### 10. SHARE CAPITAL

(a) *Authorized*

Unlimited number of common shares without par value  
Unlimited number of preferred shares without par value

(b) *Issued and fully paid common shares*

	<u>Number of common shares</u>	<u>Amount</u>	<u>Contributed surplus</u>
Balance, May 31, 2004	24,901,378	\$ 17,404	\$ 274
Recovery of share issuance costs	-	1	-
Balance, May 31, 2005	24,901,378	17,405	274
Bridge financing (Note 7)	-	-	339
Issued on private placement, net of issue costs	345,000,000	148,157	46,649
Issued for acquisitions of			
Americoal (Note 3 (a))	12,000,000	8,112	-
Neo Coal (Note 3 (b))	4,000,000	2,704	-
Panamerican (Note 3 (c))	12,000,000	8,112	-
Options exercised	10,000	9	(4)
Stock-based compensation	-	-	6,334
Balance, May 31, 2006	397,911,378	\$ 184,499	\$ 53,592

On February 8, 2006, the Company issued 345,000,000 subscription receipts at \$0.60 per subscription receipt for net proceeds of \$194.8 million in a private placement. Each subscription receipt was converted into one common share and one-half of one warrant for no additional consideration. Each warrant entitles the holder to acquire one common share of the Company at \$0.80 until February 8, 2011.

The Company has allocated a fair value to these warrants of \$46.6 million, which was determined using the Black-Scholes option pricing model assuming no dividends are to be paid, a weighted average volatility of 54%, an average annual risk free rate of 6% and an estimated life of 2.5 years.

# COALCORP MINING INC.

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### 10. SHARE CAPITAL (Continued)

#### (c) Incentive stock option plan

Under the Company's stock option plan, the Company may grant options to its directors, officers and employees not to exceed 10% of the issued common shares of the Company. At May 31, 2006, 12,758,638 common shares remain available for grant under the plan. Under the plan, the exercise price of each option equals the market price of the Company's shares on the date of grant and an option's maximum term is five years. Options are granted from time to time by the Board of Directors and vest immediately upon grant.

A summary of the changes in the Company's incentive share option plan for the years ended May 31, 2006 and 2005 are as follows:

	2006		2005	
	Number of options	Weighted average exercise price	Number of options	Weighted average exercise price
Balance outstanding, June 1	257,500	\$ 0.55	270,000	\$ 0.55
Granted	26,875,000	0.75	-	-
Exercised	(10,000)	0.55	-	-
Cancelled	(90,000)	0.55	(12,500)	0.55
Balance outstanding, May 31	27,032,500	\$ 0.75	257,500	\$ 0.55

The following table summarizes information concerning outstanding and exercisable options at May 31, 2006:

Outstanding and exercisable		
Number of options	Weighted average remaining contractual life (years)	Weighted average exercise price per share
157,500	2.40	\$ 0.55
26,875,000	4.04	0.75
27,032,500	4.03	\$ 0.75

# COALCORP MINING INC.

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Years ended May 31, 2006 and 2005

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### 10. SHARE CAPITAL (Continued)

(c) *Incentive stock option plan (continued)*

The fair value of options granted by the Company in 2006 (no options were granted in 2005) was determined using the Black-Scholes option pricing model assuming no dividends are to be paid, a weighted average volatility of 63%, an average annual risk free rate of 6% and an estimated life of 2.5 years. The weighted average grant date fair value of stock options granted during the year ended May 31, 2006 was \$0.24.

(d) *Warrants*

During the year ended May 31, 2006, no warrants were exercised and 6,911,500 non-broker warrants with an exercise price of \$1.15 and 1,382,300 broker warrants with an exercise price of \$0.90 expired unexercised.

As at May 31, 2006, the following warrants were outstanding and exercisable:

	<u>Outstanding and exercisable</u>	<u>Exercise price</u>	<u>Expiry date</u>
Non-broker warrants (Note 7)	1,500,000	\$ 0.60	September 22, 2007
Non-broker warrants (Note 10 (b))	172,500,000	0.80	February 8, 2011

### 11. WRITE-OFF OF DEFERRED ACQUISITION COSTS

During the year ended May 31, 2004, the Company entered into an arm's length letter of intent with Sardegna Energy Limited ("SEL"), pursuant to which the Company and SEL agreed to jointly conduct due diligence investigations in respect of the proposed acquisition of the Carbosulcis coal mine in Sardegna, Italy.

The Company advanced funds to SEL in stages as required to fund SEL's due diligence investigations in respect of the proposed Carbosulcis Acquisition. As at May 31, 2006, total costs of \$12,105,480 had been incurred, comprising mostly of feasibility studies, professional fees, consulting fees, and travel and accommodation. Of this total, \$11,667,075 was written off during the year ended May 31, 2005, as a result of continuing political and administrative barriers and delays, and the balance of \$438,405 was expensed as incurred (during the three months ended August 31, 2005) and is included in business development expenses in the consolidated statement of operations and deficit.

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# COALCORP MINING INC.

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### 12. RELATED PARTY TRANSACTIONS

During the year ended May 31, 2006, the Company incurred the following expenses with companies and individuals related by way of directors and/or officers in common:

	<u>2006</u>	<u>2005</u>
Business development costs	\$ 118	\$ -
Consulting fees	1,123	30
Rent	5	12
Interest on bridge loan (Note 7)	123	-
	<u>\$ 1,369</u>	<u>\$ 42</u>

As at May 31, 2006, property, plant and equipment included an amount of \$1,269,900 (2005 - \$Nil) paid to a company related by way of a common director.

These transactions, occurring in the normal course of operations, are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

### 13. INCOME TAXES

The provision for income taxes reported differs from the amounts computed by applying the cumulative Canadian federal and provincial income tax rates to the loss before tax provision due to the following:

	<u>2006</u>	<u>2005</u>
Loss before income taxes	\$ 4,346	\$ 11,832
Statutory tax rate	<u>36.12%</u>	<u>36.12%</u>
Expected income tax recovery	\$ 1,569	\$ 4,274
Difference in tax rates between Colombia and Canada	(56)	-
Non-deductible expenses	(2,454)	(1,039)
Future income tax recovery on reduction of cost base differences on assets	1,001	-
Valuation allowance on future tax assets	-	(3,117)
Benefit of income tax losses not recognized	(880)	(118)
Foreign exchange differences	2,200	-
Other	(431)	-
Recovery of income taxes	<u>\$ 949</u>	<u>\$ -</u>

# COALCORP MINING INC.

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### 13. INCOME TAXES (Continued)

The approximate tax effect of each type of temporary difference that gives rise to the Company's future income tax assets are as follows:

	<u>2006</u>	<u>2005</u>
Future income tax assets		
Mineral property exploration and development	\$ 478	\$ 511
Eligible capital expenditures	2,891	3,117
Share issues costs	3,219	-
Non-capital loss carryforwards	3,767	322
Other	5	5
	<u>10,360</u>	3,955
Valuation allowance	<u>(10,360)</u>	(3,955)
Future income tax asset	\$ -	\$ -
Future income tax liability		
Accumulated cost base differences on assets	\$ 60,022	\$ -

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At May 31, 2006, the Company had Canadian non-capital losses carried forward of approximately \$3,670,000 for income tax purposes. The losses may be utilized to reduce future years' taxable income and expire between 2007 and 2016. The Company had Colombian non-capital losses carried forward of approximately \$7,296,000. These losses may be utilized to reduce future years' taxable income and expire between 2007 and 2014. The Company also had Canadian exploration and development expenditures of approximately \$1,434,000 and eligible capital expenditures of approximately \$8,761,000. These expenditures may be utilized to reduce future years' taxable income and do not expire.

### 14. FINANCIAL INSTRUMENTS

The fair values of cash and cash equivalents, short-term investments, accounts receivable and accounts payable approximate their carrying values due to the short-term to maturity of these financial instruments.

Long-term investments consist of interests in two privately held Colombian companies. The fair value of these investments cannot be measured reliably. The Company reviewed the carrying value of these investments and determined that no impairment should be recorded as at May 31, 2006.

The fair value of long-term debt was determined using discounted cash flows at prevailing market rates and the fair value is considered to approximate carrying value.

The Company minimizes credit risk by reviewing the credit risk of the counterparty to the arrangement and has made any necessary provisions related to credit risk at May 31, 2006.

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# COALCORP MINING INC.

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Years ended May 31, 2006 and 2005

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### 14. FINANCIAL INSTRUMENTS (Continued)

The Company is exposed to fluctuations in interest rates, foreign currency exchange rates and commodity prices. The Company has not entered into any derivative financial instruments to manage exposure to fluctuations in these rates.

### 15. CASH FLOW INFORMATION

(a) *Net change in non-cash working capital items*

	Years ended May 31,	
	2006	2005
(Increase) decrease in		
Accounts receivable	\$ (4,666)	\$ 31
Inventories	(1,835)	-
Prepaid expenses	(537)	-
Accounts payable and accrued liabilities	(2,669)	485
	<u>\$ (9,707)</u>	<u>\$ 516</u>

(b) *Supplementary information regarding other non-cash transactions*

During the year ended May 31, 2006, the Company issued 28 million common shares with a value of \$18.9 million with respect to the acquisitions described in Note 3.

(c) *Other supplementary information*

	Years ended May 31,	
	2006	2005
Interest paid	\$ 652	\$ -
Income taxes paid	-	-

### 16. SEGMENTED INFORMATION

(a) Operating segment - The Company's operations are primarily directed towards the acquisition, exploration and production of coal in the natural resources sector.

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# COALCORP MINING INC.

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### 16. SEGMENTED INFORMATION (Continued)

- (b) Geographic segments - The Company's assets, revenues and expenses by geographic areas for the year ended May 31, 2006 are as follows:

	2006		
	Colombia	Canada	Total
Property, plant and equipment	\$ 175,717	\$ 18	\$ 175,735
Total assets	\$ 251,227	\$ 76,392	\$ 327,619
Property, plant and equipment expenditures	\$ 1,496	\$ -	\$ 1,496
Revenues	\$ 29,790	\$ -	\$ 29,790
Production costs	(23,866)	-	(23,866)
Depletion and depreciation	(3,673)	(1)	(3,674)
Expenses	(2,758)	(10,061)	(12,819)
Other income (expense)	8,750	(2,527)	6,223
Income (loss) before income taxes	\$ 8,243	\$ (12,589)	\$ (4,346)

Prior to the acquisitions (Note 3) all of the Company's assets and operations were located in Canada.

For the year ended May 31, 2006, 44% of revenue was to one customer, 37% of revenue was to one customer and 70% of accounts receivable are from 3 customers.

### 17. COMMITMENTS AND CONTINGENCIES

- (a) The Company has entered into various contracts to deliver 3.5 million tonnes of coal at prices of between US\$38 and US\$56 per tonne by December 31, 2007, in addition to the contract assumed on acquisition (Note 3 (a)).
- (b) The Company is from time to time involved in various claims, legal proceedings and complaints arising in the ordinary course of business. The Company does not believe that adverse decisions in any pending or threatened proceedings related to any matter, or any amount which it may be required to pay by reason thereof, will have a material effect on the financial conditions or future results of operations of the Company.
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# **COALCORP MINING INC.**

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### **18. SUBSEQUENT EVENTS**

- (a) On August 17, 2006, the Company closed a \$129 million (US\$115 million) financing that consisted of 115,000 units. Each unit consisted of US\$1,000 principal amount senior secured guaranteed note and 210 common share purchase warrants. The notes will mature on August 31, 2011, with an annual interest rate of 12%. Each warrant entitles the holder to purchase one common share of the Company at a price of \$1.20 per common share any time on or before August 17, 2011.
  
  - (b) On August 24, 2006, the Company entered into an agreement to acquire the rights to 25 additional coal exploration concessions in the César and Santander departments representing in excess of 85,000 hectares. The concessions were acquired for an aggregate consideration of approximately \$10.7 million (US\$9.5 million). The agreement provides for varying additional acquisition payments based on additional indicated resources.
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## Management's Discussion & Analysis

The financial statements present the results of Coalcorp Mining Inc. for the year ended May, 2006 with 2005 comparatives and accompanying notes in accordance with Canadian generally accepted accounting principles. Unless otherwise specified, references to years are to the fiscal year of the company ended May 31. The following comments analyze the factors which affected the company's operations during 2006, as well as the factors that reasonably may be expected to affect future operations and financial results.

This document should be read in conjunction with the financial statements. Certain statements included in this report are forward looking and are subject to important risks and uncertainties. The results or events forecast in these statements may differ materially from actual results or events. Factors which could cause results or events to differ from current expectations are described in the risks and uncertainties section of the company's Annual Information Form. Readers should note that some assumptions, although reasonable at the time of publication, are not guarantees of future performance.

The company maintains accounting and internal control systems to provide reasonable assurance that its financial information is complete, reliable and accurate and that its assets are adequately protected. The Board of Directors, in conjunction with the Audit Committee, has an oversight role to ensure the integrity of the reported information.

This report, dated August 29, 2006, has been reviewed by the company's Audit Committee and approved by its Board of Directors. All dollar amounts are expressed in Canadian dollars unless stated otherwise.

### Overview

As a result of the acquisition of coal assets in Colombia on February 8, 2006 the company is engaged in the business of operating coal mines and the development of other coal mining related assets. The company operates the La Francia coal mine located in the César region of Colombia and the Caypa coal mine located in the Guajira region of Colombia, as well as a number of additional exploration concessions and applications.

The company also holds a 14.2% interest in Propuerto S.A., a consortium of coal producers developing a new port facility at Santa Marta and an 8.4% interest in Ferrocarriles del Norte de Colombia, S.A. (Fenoco), which operates a railroad from the Cesar area to Santa Marta. The company is also planning the development of a wholly-owned port facility near Cartagena, as well as a river transport system to provide access to the Cartagena facility.

The purchase price of the assets acquired is summarized as follows:

\$millions	Cash Consideration	Value of Shares	Acquisition Costs	Total
La Francia	44.8	8.1	4.2	57.1
Caypa	41.5	-	2.8	44.3
Cartagena port	16.2	8.2	0.3	24.7
La Curubita	0.6	2.7	-	3.3
Total	103.1	19.0	7.3	129.4

Coalcorp's goal is to become a leading intermediate-sized, vertically-integrated coal company. In order to achieve its goal, the company recognized that access to, or ownership in, export infrastructure would be as important as finding or acquiring suitable coal deposits, as there is very little, if any, excess capacity available to Colombian coal exporters at the current time.

Until the acquisition of the company's coal assets in Colombia on February 8, 2006, the Company had no meaningful assets, liabilities revenues or income. The 2006 financial statements include 20 days of operations for its coal business in the third quarter and the fourth quarter of 2006 reflects the first full quarter of the operation of its coal business. Accordingly, comparisons to previous periods have been omitted where not relevant, with an increased emphasis on providing forward-looking information to assist in the understanding of the company's business.

### Overall Performance

Operating results in 2006 include 112 days of the company's ownership of the Colombian coal assets and approximately \$2 million of costs for the period prior to the acquisition in which no revenue was generated. The company raised gross proceeds of \$207 million in its February 2006 equity financing, of which \$129 million was used to finance the acquisition of the operating assets. At May 31, 2006 the company was in excellent financial condition, with cash and investments in excess of \$68 million, and working capital of \$66 million. Subsequent to the year end, the company raised an additional US\$115 million through the sale of 5-year secured notes, further enhancing its financial position.

The company is changing its fiscal year end from May 31 to June 30 and accordingly, the first fiscal period in 2007 will be the four months ending September 30, 2006 and fiscal 2007 will include 13 months ending June 30, 2007. For fiscal 2007, the company expects to produce approximately 3.5 million tonnes of coal. Essentially all of fiscal 2007 production has already been sold to customers, with 2.4 million tonnes FOT mine and 1.1 million tonnes FOB port at average prices of US\$38 and US\$56 per tonne respectively.

In addition to these sales contracts, the company has a pre-existing commitment to deliver approximately 600,000 tonnes of coal at a price of US\$31.50 per tonne FOB port for which the company is currently in negotiations regarding a potential deferment of this contract.

### Selected Annual Information

\$000	2006	2005	2004
Total revenues	29,790	-	-
Net income (loss)	(3,397)	(11,832)	(262)
Per share	(0.02)	(0.48)	(0.03)
Total assets	327,619	3,710	15,057
Total long-term liabilities	80,703	-	-

The 2006 results largely reflect approximately four months of operating results, with the preceding eight months comprising mainly corporate and administrative costs. The 2005 results include a write-off for an unsuccessful attempt to acquire coal assets in Sardegna, Italy. The company was largely dormant in 2004.

## Results of Operations

In the fourth quarter, the company sold 328,000 tonnes to customers FOT the mine and 235,000 tonnes to customers FOB port at net realized prices of US\$32 and US\$53 per tonne respectively. Mine operating costs in the same period amounted to US\$27 per tonne, with transport and handling costs for FOB sales incurring additional costs of US\$17 per tonne. Including the previous 20 days included in the third quarter, the company sold a total of 405,000 tonnes FOT the mine and 303,000 tonnes FOB port in fiscal 2006 at similar prices and costs.

This resulted in a cash operating margin (revenue less production costs) of \$5.6 million in the quarter and \$6.0 million for the year. After depreciation and net non-operating costs of \$7.9 million in the quarter and \$10.3 million for the year, the company recorded a loss before taxes of \$2.3 million and \$4.3 million for the fourth quarter and year respectively. The major components of these costs were a non-cash charge for stock option expense of \$6.3 million included in the fourth quarter and year-to-date for stock options granted in the quarter, \$5.5 million for administrative and corporate costs in the fourth quarter and \$6.5 million for the year, offset by non-cash foreign exchange gains of \$6.0 million in the fourth quarter and \$6.3 million for the year. After provision for income tax recoveries, the company reported net income of \$3.0 million or \$0.00 per share in the fourth quarter and a net loss of \$3.3 million or \$0.02 per share for the year.

## Summary of Quarterly Results

\$000	May 31 2006	Feb. 28 2006	Nov. 30 2005	Aug. 31 2005
Total revenues	22,905	6,885	-	-
Net income (loss)	(1,128)	(314)	(1,502)	(453)
Per share	(0.00)	0.00	(0.06)	(0.02)
	May 31 2005	Feb. 28 2005	Nov. 30 2004	Aug. 31 2004
Net income (loss)	(11,730)	(57)	2	(47)
Per share	(0.47)	0.00	0.00	0.00

## Liquidity and Capital Resources

With substantial cash resources at May 31, 2006, the operations generating positive operating margins and no material capital investment plans related to the existing mines, the company has more than adequate resources to carry out its current mine operating plans, as well as fund investments in additional mining properties.

A US\$115 million debt financing completed in August 2006 was intended to provide the majority of funding for the company's development plans with respect to export infrastructure. The components of this plan include:

Cartagena Port – awaiting final permitting and detailed engineering, the Phase I program expected to cost US\$55 million to be incurred over the balance of calendar 2006 and 2007 with start-up expected sometime in calendar 2008. No material financial commitments have been made to date.

Fenoco – the company is required to fund its share of a US\$230 million upgrading and expansion program (US\$20 million) to be spent over the next two years. In addition, the company has budgeted US\$20 million to connect its La Francia mine to the Fenoco line, with no material financial commitments made to date.

Propuerto - the company is required to fund its share of development costs, currently estimated at \$US15 million, over the next two years. No material commitments have been made to date.

River transport – the company is planning on spending US\$15 million on the development of a river port, the majority of which will be incurred over the next twelve months, although no material financial commitments have been made to date.

The company expects to make a number of material financial commitments with respect to these projects over the next six months.

### Contractual Obligations

\$000	Less than 1 year	1 – 3 years	4 - 5 years	After 5 years	Total
Long term debt <sup>1</sup>	2,967	2,137	12,667	-	17,771
Purchase obligations <sup>2</sup>	8,030	24,641	27,362	30,498	90,531
Total obligations	10,997	26,778	40,029	30,498	108,302

<sup>1</sup> Represents five-year terms loans made by a financial institution with which the company holds certificates of deposit of a like amount used as collateral for the loans (back-to-back loans) which are used to providing funding for the company's operations in Colombia.

<sup>2</sup> Represents take-or pay contracts with respect to i) 1.6 million tonnes per annum at a third-party port facility until 2012 and ii) up to 2.45 million tonnes per annum of capacity on the Fenoco rail line for a period of 7 years.

### Transactions with Related Parties

All transactions with related parties have occurred in the normal course of operations and are measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties. During the years ended May 31, 2006 and 2005, the company paid the following amounts to related parties:

(a) business development costs of \$118,000 (2005 – nil) to a company in which a director of the company is an officer;

(b) consulting fees of \$1,123,000 (2005 - \$30,000) to a company in which a director of the company is an officer;

(c) rent of \$5,000 (2005 - \$12,000) to a company of which a director of the company is an officer; and

(d) interest on the bridge loans of \$123,000 (2005 – nil) to a company of which two directors of the company are directors.

## **Subsequent Events**

On August 17, 2006, the company closed a \$129 million (US\$115 million) financing that consisted of 115,000 units. Each unit consisted of US\$1,000 principal amount senior secured guaranteed note and 210 common share purchase warrants. The notes will mature on August 31, 2011, with an annual interest rate of 12%. Each warrant entitles the holder to purchase one common share of the company at a price of \$1.20 per common share any time on or before August 17, 2011.

On August 24, 2006, the Company entered into an agreement to acquire the rights to 25 additional coal exploration concessions in the Cesar and Santander departments representing in excess of 85,000 hectares. The concessions were acquired for an aggregate consideration of US\$9.5 million. The agreement provides for varying additional acquisition payments based on additional indicated resources.

## **Critical Accounting Policies and Estimates**

The preparation of financial statements in conformity with generally accepted accounting principles in Canada requires the Company to establish accounting policies and to make estimates that affect both the amount and timing of the recording of assets, liabilities, revenues and expenses. Some of these estimates require judgments about matters that are inherently uncertain.

A detailed summary of all of the Company's significant accounting policies and the estimates derived therefrom is included in Note 2 to the annual consolidated financial statements for the year ended May 31, 2006. While all of the significant accounting policies are important to the Company's consolidated financial statements, the following accounting policies and the estimates derived therefrom, have been identified as being critical:

- Impairment of long-lived assets;
- Depletion and Depreciation of Property, Plant and Equipment;
- Asset Retirement Obligations;
- Stock-based compensation;
- Income Taxes.

### *Impairment of long-lived assets*

The Company undertakes a review, at least annually, to evaluate the carrying values of operating mines and other mineral property interests. Preparation of a life-of-mine's cash flow for each remaining year is based on management's estimates of remaining mine reserves and grade, future production and sale volumes, unit sales prices, future operating and capital costs and reclamation costs to the end of mine life. For each mining project, the carrying value is compared to the estimated future discounted cash flows and any excess is written down against operations.

The estimates used by management are subject to various risks and uncertainties. It is reasonably possible that changes in estimates could occur which may affect the expected

recoverability of the Company's investments in mining projects and other mineral property interests.

#### *Depletion and depreciation of property, plant and equipment*

Property, plant and equipment comprises the largest component of the Company's assets and, as such, the amortization of these assets has a significant effect on the Company's financial statements.

On the commencement of commercial production, depletion of each mining property is provided on the unit-of-production basis using estimated proven and probable reserves as the depletion basis. The mining plant and equipment and other capital assets are depreciated, following the commencement of commercial production, over their expected economic lives using either the unit-of-production method or the straight-line method.

Capital projects in progress are not depreciated until the capital asset has been put into operation.

The proven and probable reserves are determined based on a professional evaluation using accepted international standards for the assessment of mineral reserves. The assessment involves the study of geological, geophysical and economic data and the reliance on a number of assumptions. The estimates of the reserves may change, based on additional knowledge gained subsequent to the initial assessment. This may include additional data available from continuing exploration, results from the reconciliation of actual mining production data against the original reserve estimates, or the impact of economic factors such as changes in the price of commodities or the cost of components of production. A change in the original estimate of reserves would result in a change in the rate of depletion and depreciation of the related mining assets, or could result in impairment, resulting in a write-down of the assets.

#### *Asset retirement obligations*

The Company has obligations for site restoration and decommissioning related to its mining properties. The Company, using mine closure plans or other similar studies that outline the requirements planned to be carried out, estimates the future obligations for mine closure activities. Because the obligations are dependent on the laws and regulations of the country in which the mines operate, the requirements could change — resulting from amendments in those laws and regulations relating to environmental protection and other legislation affecting resource companies.

The Company recognizes liabilities for statutory, contractual or legal obligations associated with the retirement of mining property, plant and equipment when those obligations result from the acquisition, construction, development or normal operation of the assets. Initially, a liability for an asset retirement obligation is recognized at its fair value in the period in which it is incurred. Upon initial recognition of the liability, the corresponding asset retirement cost is added to the carrying amount of the related asset and the cost is amortized as an expense over the economic life of the asset using either the unit-of-production method or the straight-line method, as appropriate. Following the initial recognition of the asset retirement obligation, the carrying amount of the liability is increased for the passage of time and adjusted for changes to the amount or timing of the underlying cash flows needed to settle the obligation.

Because the estimate of obligations is based on future expectations in the determination of closure provisions, management makes a number of assumptions and judgments. The closure provisions are more uncertain the further into the future the mine closure activities are to be carried out. Actual costs incurred in future periods in relation to the remediation of Company's existing assets could differ materially from the \$2.6 million undiscounted future value of the Company's estimated asset retirement obligations at May 31, 2006.

#### *Stock-based compensation*

The Company uses the Black-Scholes Option Pricing Model in determining the fair value of options granted for stock-based compensation. Option pricing models require the input of highly subjective assumptions including the expected price volatility. Changes in the subjective price assumptions can materially affect the fair value estimate, and therefore the existing models do not necessarily provide a reliable single measure of the fair value of the Company's stock options granted/vested during the year.

#### *Income taxes*

The Company must make significant estimates in respect of the provision for income taxes and the composition of its future income tax assets and future income tax liabilities. The Company's operations are, in part, subject to foreign tax laws where interpretations, regulations and legislation are complex and continually changing. As a result, there are usually some tax matters in question which may, on resolution in the future, result in adjustments to the amount of future income tax assets and future income tax liabilities, and those adjustments may be material to the Company's financial position and results of operations.

Future income tax assets and liabilities are computed based on differences between the carrying amounts of assets and liabilities on the balance sheet and their corresponding tax values, using the enacted or substantially enacted, as applicable, income tax rates at each balance sheet date. Future income tax assets also result from unused loss carry-forwards and other deductions. The valuation of future income tax assets is reviewed quarterly and adjusted, if necessary, by use of a valuation allowance to reflect the estimated realizable amount.

The determination of the ability of the Company to utilize tax loss carry-forwards to offset future income taxes payable requires management to exercise judgment and make assumptions about the future performance of the Company. Management is required to assess whether the Company is "more likely than not" to be able to benefit from these tax losses. Changes in economic conditions, commodity prices and other factors could result in revisions to the estimates of the benefits to be realized or the timing of utilizing the losses.

#### **Changes in Accounting Policies including Initial Adoption**

Certain of the company's accounting policies were changed or initially adopted in the year, primarily as a result of its acquisition of the coal-producing assets. Please see the headings "Inventories", "Property, Plant and Equipment", "Intangible Assets", "Asset Retirement Obligations" and "Revenue Recognition" in Note 2 to the annual financial statements for the year ended May 31, 2006 for a complete description of these new or changed policies.

## Outstanding Share Data

At August 29, 2006 the company has the following securities outstanding:

	TSX Symbol	Number Outstanding	Shares issuable on Exercise	Exercise price	Expiry date	Proceeds if exercised
Common shares	CCJ	397,918,878	-	-	-	-
Warrants	-	1,500,000	1,500,000	0.60	9/22/07	900,000
Warrants	CCJ.WT	172,000,000	172,500,000	0.80	2/8/11	138,000,000
Warrants	CCJ.WT.A	21,000,000	21,000,000	1.20	8/17/11	25,000,000

Additionally, the company has 27,062,500 stock options outstanding, which if exercised, would result in proceeds of \$20.2 million.

## Financial and Disclosure Controls and Procedures

The company maintains accounting and internal control systems to provide reasonable assurance that its financial information is complete, reliable and accurate and that its assets are adequately protected. The Board of Directors, in conjunction with the Audit Committee, has an oversight role to ensure the integrity of the reported information.

The company evaluated the effectiveness of its disclosure controls and procedures as at May 31, 2006. Based on the results of this evaluation, the company's Chief Executive Officer and its Chief Financial Officer concluded that the design and operation of the disclosure controls were effective and that its disclosure controls and procedures provide reasonable assurance that material information relating to Coalcorp and its subsidiaries is made known to the company by others within those entities, particularly during the period in which the annual filings are being prepared.

Additional information relating to Coalcorp Mining Inc., including the company's Annual Information Form, is available on SEDAR at [www.sedar.com](http://www.sedar.com).