



2006 ANNUAL REPORT

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CONTENTS:

CORPORATE DIRECTORY	3
CHAIRMAN'S REPORT.....	4
CEO REPORT	5
EXPLORATION REPORT	9
OPERATIONS REPORT	12
BACKGROUND TO THE EVOLUTION OF THE CORPORATION, AND LISTING DETAILS...	15
DIRECTORS' REPORT	17
REPORT OF THE REMUNERATION COMMITTEE	21

AUDITED FINANCIAL STATEMENTS FOR THE FISCAL YEAR ENDED MAY 31, 2006

The Annual Report is designed to present a balanced and understandable view of the group's activities and prospects. The Chairman's statement and the Chief Executive's review provide an assessment of the group's affairs and position.

The Corporation's website (www.uruguayminerals.com) gives access to the share price of the ordinary shares, and to other information about the group.

CORPORATE DIRECTORY

DIRECTORS

Christopher John Clark (President),
Puntas de Santiago 1604
Montevideo 11500, Uruguay
urumin@adinet.com.uy

William Bill Francis Lindquist (Non-executive)
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USA

Tony Patrick Shearer (Non-executive Chairman)
15 Addison Crescent
London W14 8JR, England
tonyshearer@btinternet.com

SECRETARY AND GENERAL COUNSEL

Patricia Rodriguez
Puntas de Santiago 1604
Montevideo 11.500 Uruguay

LAWYERS TO THE CORPORATION

Fasken Martineau
Toronto Dominion Bank Tower
Box 20, Suite 4200
66 Wellington Street West
Toronto, ON M5K1N6

AUDITORS

PriceWaterhouseCoopers
Suite 3000 Box 82
Royal Trust Tower TD Centre
Toronto, Ontario, Canada M5K 1G8

SHARE CAPITAL ISSUED AS AT 23 AUGUST 2006

48,054,930 shares

John Christopher Morris (Non-executive)
25 Bay Road
Claremont, W. Australia 6010, Australia

Julio Cesar Porteiro Dobal (Non-executive)
Mario Casinoni 1383 Bis
Montevideo - Uruguay

David Thomas Fowler (Chief Executive Officer)
Puntas de Santiago 1604
Montevideo 11.500, Uruguay
urumin@adinet.com.uy

REGISTERED OFFICE

Anton, Campion, Macdonald, Phillips, Oyler &
Buchan (Barristers and Solicitors)
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Whitehorse, Yukon Territory Y1A 3T2, Canada

SHARE REGISTRARS

Computershare Trust Company of Canada
9th Floor, 100 University Avenue,
Toronto, Ontario M5J 2Y1, Canada

BANKERS

Macquarie Bank Limited, Canada
Canadian Imperial Bank of Commerce
ABN Amro, Uruguay

OPTIONS AS AT 23 AUGUST 2006

2,893,333 stock options exercisable up to 13 June
2011 at prices between C\$.40 and C\$ 5.50

CONVERTIBLE NOTES AS AT 23 AUGUST 2006

500,000 convertible notes exercisable up to July 30
2008 at \$US 4.20 per share.

CHAIRMAN'S REPORT



The excellent financial results for the year ended 31st May 2006 are set out in this annual report show a profit after tax of \$ 10.6 million, and a cash balance at the year end of \$ 9 million. The Board is proposing that a dividend of C\$ 3.5 cents a share costing approximately of US\$ 1.5 million is paid to shareholders on 27 October 2006. This policy allows us to return earnings to our shareholders at a level that can be sustained as prices fluctuate, while still maintaining our ability to finance our future growth.

During the year we generated gold sales of US\$48 million by selling 100,395 ounces of gold at an average price of \$ 482 per ounce after allowing for the sale of 21,400 ounces hedged at \$ 436 per ounce. The gold market improved late in the year and has continued this trend with the current market price sustaining a level of more than \$600 per ounce. At 31 May 2006 we had 3,589 ounces hedged at 436 per ounce and a further 10,000 ounces hedged at 486 per ounce. These hedges will be finished in the first half of 2006/07.

In his Chief Executive's report, David Fowler sets out our strategy and objectives, and the steps we are taking to achieve those objectives. For the next few years our focus will be on gold production, and expanding our reserves and resources. Our intention is to have reserves that are greater than five years production, and to target through successful exploration an increase in annual production to 250,000 ounces. While exploration success is never guaranteed, it is the Board's belief that the 110 kilometres Isla Crystalina belt is sufficiently promising to deliver these objectives. There are clearly also many high potential gold projects on the Florida and Dom Feliciano belts.

Over the past year we have invested significantly on completing an airborne geophysical survey of the very large geophysical anomaly* at Lascano in north eastern Uruguay and on the two zinc prospects along the Dom Feliciano mobile belt. To do these and our other base metals projects justice we believe that it is time for us to deliver value to shareholders by investigating the possibility of joint venturing these base metals prospects on which we have been working..

Our employees have worked very hard for us during the year under review, and I thank them for all their efforts. David Fowler is proving to be a fine leader, and has stepped in to the role of Chief Executive with enthusiasm, skill and commitment. In July 2006, we recruited George Schroer as Vice President Exploration thus filling a key vacancy in the management team. In August 2006 we also appointed Julio Porteiro, a Uruguayan, as a non Executive Director to provide important input on how the Company develops its business in Uruguay. All shareholders will join me in thanking Chris Clark for his vision in establishing the company, and for all the hard work and skill that he has put into building the company into the production and exploration company that it is today. Chris will be stepping down from the Board and ceasing to be President at the shareholders meeting in London on 12th October 2006. We usually have a very good turnout for the meeting, and I hope to see many of you there this year.

Tony Shearer
August 2006

*= The geophysical anomaly at Lascano is a very large gravity high, and is over 70 kilometres long and up to 40 kilometres wide, with a series of very strong, offset, magnetic highs on the western end. This anomaly, which was discovered in the late 1980's during a search for petroleum, has no surface expression

CEO REPORT



The 2006 financial year saw the results of the hard work and commitment over the past 3 years come to fruition with the first full year's production from San Gregorio at the target rate of 100,000 ounces, the best ever performance.

Financial performance

Net profits after tax increased from \$ 1.5 million in 2004/05 to \$ 10.6 million in 2005/06 or basic earnings per share of 23 cents. This increase in earnings came from the increase in production at a higher average grade of ore processed in a market where the price of gold was rising.

The group finished the year with \$ 8.9 million in cash after spending \$17.7 million on capital expenditure, loan repayments and exploration. Debt at year end was \$ 4.2 million, including \$ 2.9 million in convertible notes from the purchase of the net profit interest in Arenal and surrounding tenements. This puts the group in a sound financial position from which it can invest in exploration and development while providing a return to shareholders.

The company generated a gross operating margin from operations of \$29.2 million. The majority of this has been re-invested into the business to deliver the future potential of the company. Table 1 below shows how profits generated have been used.

Operations

The Arenal mine has been rapidly developed to provide the majority of the mill feed for the year. This has been a significant achievement in that it has required a flexible phased approach to waste development (rather than opening up the full extent of the pit) and the requirement to limit the pit extent due to the adjacent river. The Arenal deposit is performing to expectation with cumulative tonnes and grade mined to the end of May 31 2006 reconciling closely to the reserve model. The pit wall slip in the last quarter of 2006 and a re-evaluation, by external consultants, of the geotechnical parameters used to model the pit has led to the conclusion that the waste to ore ratio for the defined reserve will change from an original ratio of 4.36:1 to 4.75:1.

Table 1 Operating profits generated and what they were used for	2006 \$US million
Profits generated from operations	
Sales	51.2
Operating costs	(22.0)
Operating margin	29.2
Operating margin was spent on the following	
Property plant and equipment	(12.0)
Exploration	(5.5)
Corporate costs	(3.5)
Interest	(.3)
Working capital and deferred stripping	(5.7)
Cash income taxes	(.7)
Surplus of cash from operating activities after deducting investing activities	1.5
Financing activities	1.9
Net cash movement for year	3.4

The investment and effort that have gone into refurbishing the plant, hiring key staff and implementing a formal maintenance program have allowed average monthly throughput to increase from an average of 83,500 tonnes in 2003/04 (design

capacity) to 105,000 tonnes in 2005/06. Considerable work continues to be done in training operators and maintenance staff and developing standard operating procedures to maintain the consistency of plant performance in the coming year.

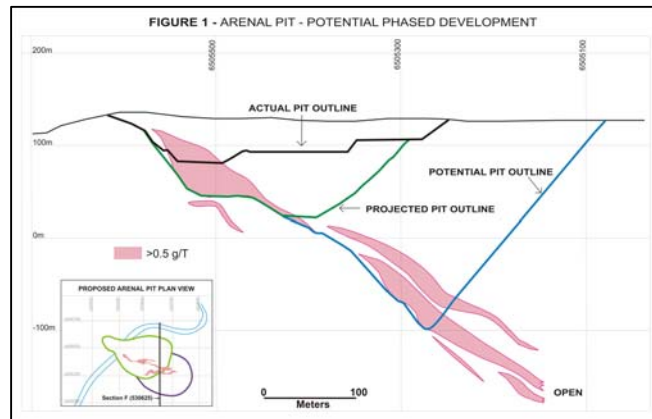
The development and retention of key employees are critical to the future growth potential of the company. A Human Resources Manager has been appointed to focus on this issue in the coming year with emphasis on development and training. The Company is looking to appoint a Safety Manager to bring the same level of focus to improving safety performance that continues to be below the required level.

Cash operating costs were \$ 210 per ounce for the full year, 5% higher than targeted in our prior year outlook. Approximately \$3 per ounce relates to repairs as a result of the pit wall slip with the balance due to other cost increases.

While quarterly gold production will vary due to the pit constraints discussed above the yearly target for 2007 is 100,000 ounces. We have made all of the necessary studies, and submissions to the Government for the expansion of the Arenal pit and the diversion of the Corrales River. We expect to get this critical approval by the end of 2006.

Development

While progress has been made during the year reserves and resources, net of production, are largely unchanged from the prior year. With the appointment of a new Vice President of Exploration reserves and resources will be reviewed and updated concurrently with the publication of the Company's half year report in January 2007. The focus of near mine drilling during the year has been Arenal, San Gregorio and Argentinita .

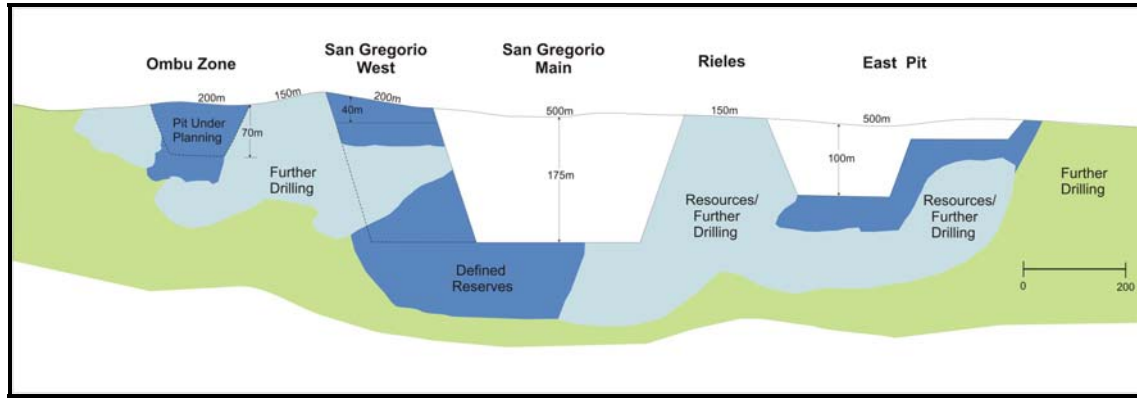


Our target at the beginning of the year for Arenal was to define additional open pit reserves to the south east and to test depth extensions. We invested approximately 14,500 meters in these targets. This drilling showed that the mineralised zones to the south east widen but become more defuse and therefore lower grade. A conceptual expansion of the Arenal pit at depth to the south east as shown in the above figure would potentially provide an additional 2,000,000 tonnes of material at a grade of 1.46 g/t. However, at this stage, the higher strip ratio means that this mineralization is only potentially economic with open pit mining at a gold price of \$ 600 per ounce. Within the broader zone of mineralization there are however higher grade lenses and there is additional open extension of mineralization at depth to the south east. Studies have begun to evaluate the economics and practicality of underground mining at depth. This work is planned to be completed during the 2006/07 financial year.

During the year 9,000 meters was drilled in the area of the old San Gregorio pits. This drilling was focused on testing depth extensions of the San Gregorio East pit, the potential to define additional

mineralization at Rieles to merge the East Pit and main pit and depth extensions of the main pit. Drilling is continuing on this and on the western end of the San Gregorio pit. Modelling of these resources has started with phase 1 results to be available to be release concurrently with the half year results in January 2007.

FIGURE 2 – SAN GREGORIO SYSTEM – REDEVELOPEMT POTENTIAL



Argentinita is a new deposit 3 km South South West along the same major regional structure that is adjacent to the Zapucay deposit mined in the prior year. Drilling to date has defined mineralization along strike for 700 meters with an average width of 1 to 6 meters. The average grade of the intercepts above .5 g/t is 1.3 g/t. Significant additional drilling needs to be done to infill and extend mineralization however we confident that a low grade deposit will be defined. Reserves and resources will be released in January 2007.

Exploration

The Company recruited George Schroer as Vice President of Exploration during July 2006. George is an experienced geologist with the ability to meet the challenge of turning our exploration potential into reserves. With this appointment, and after many years of valuable service, Mike Schwabe steps down as Exploration Director. Mike will continue in the geology team as a consultant.

During the year we spent \$ 6 million on exploration of which \$ 2 million was invested in airborne gravity and magnetic surveys for 7 project areas including Lascano. The Lascano survey has been successful in resolving the gravity and magnetic characteristics of the underlying rocks and drill targets have been identified for drilling before December 2006. .

The acquisition of the new DM45 drill rig and additional geologists during 2006 allowed us to expand our exploration efforts on the Isla Crystalina belt in the second half of the year. Positive results have been achieved at the Argentinita gold prospect where we have likely identified our next gold deposit.

As we go forward our strategy will be to ensure that we have sufficient resources to pursue both regional and near mine projects concurrently. At May 31, 2005 the company had 12 geologists dedicated to exploration. Within 6 months the company plans to have 24 geologists with strength being added at all levels of experience. A new diamond drill rig, capable of drilling to 1,000 meters will arrive in August 2006 and a second DM45 RC rig capable of drilling to 400 meters will be available by December 2006. A Drilling Superintendent has been added to focus on productivity and cost and train new employees. A Geophysics Supervisor has also been employed to co-ordinate data collection,

processing and interpretation of geophysical data. Importantly the addition of these two people frees our geologists to focus on geology.

Our exploration program continues to be viewed as the priority for the future growth and wealth creation of the company. We were successful in discovering Arenal and are focused on repeating this success.

Strategy

Since inception nearly 10 years ago, UME has followed a strategy of exploring for gold, base metals and diamonds in Uruguay. This strategy has led to the acquisition and development of a significant number of prospects and information and the development of an operating gold mine. Strategically it makes sense for us to grow our gold business, and to focus the majority of our resources on this objective.

We have spent considerable time and effort developing our base metals and diamonds assets to their current point and we want to realize their potential. We have therefore decided to look for partners who are prepared to work with us in joint ventures, or spin these businesses off as separate public companies. Data on all key base metals projects will be prepared by September 2006 and will be available for due diligence by third parties from September 2006. Our intention is to sign agreements with interested parties during the 2006/2007 financial year and for them to commence work on the ground immediately. We will continue to invest in these projects until we have suitably attractive investment propositions.

Outlook

Our key objectives for 2006/2007 are to

- Produce 100,000 ounces of gold at a cost of less than \$US 250 per ounce
- Obtain permission to divert the Corrales river to allow ongoing development of the Arenal pit.
- Define additional reserves at San Gregorio, Argentinita and Arenal
- Prepare scoping studies on underground mining, incremental plant expansion options, and heap leach processing.
- Identify and drill exploration targets that can convert into gold reserves within 2 years
- Find partners to work with us to advance our base metals prospects
- Work towards an IPO of our diamond assets.

I would like to thank all of those who have and continue to commit to the success of UME. Our employees and consultants, shareholders, the local communities in which we operate and the Uruguayan Government have all supported the company over the last year and we look forward to building on this in the coming year.

David Fowler
Chief Executive Officer

EXPLORATION REPORT

Isla Crystalina Gold Project

In the past twelve months the Company continued to place the majority of its exploration effort on the Isla Crystalina belt. This belt is an inlier of Proterozoic rocks approximately 110km in length and 40 km in width. It is located in the north of Uruguay approximately 450 km from Montevideo. The San Gregorio processing plant and existing San Gregorio mining operations are located on the western end of the belt.

The primary focus of exploration activities over the past year on the Minas de Corrales Gold Project was further drill evaluation and definition of gold resources close to the San Gregorio mill facility. This is an ongoing program with the emphasis on upgrading the resource categories and defining additional proven and probable reserves. The areas tested included Arenal depth and strike extensions, Rieles, Santa Teresa, San Gregorio West, Zapucay, and Argentinita.

The Arenal program continued with in-fill and step out holes testing the mineralized structure to a vertical depth of more than 200 meters and along strike for 700 meters. Further work is being undertaken to fully assess the extent and tenor of the mineralized body

At Rieles depth extensions to the mineralized zone were tested together with definition drilling for reserve modeling. On these two main projects 19,020 meters of reverse circulation and 4,390 meters of diamond drilling were completed.

Exploration in the Minas de Corrales district is increasingly directed towards definition and testing of new targets, particularly in the San Gregorio and the Zapucay districts. The most advanced prospects in this program are Argentinita and Laurales in the Zapucay district where mapping and geophysical surveys show a geological package and alteration characteristics with similarities to the Arenal shear zone.

Drilling at Argentinita has begun to return some better intersections and a revised model for the emplacement of mineralization is in process of being tested. 161 RC drill holes for 10,890 meters and 3 diamond drill holes for 717 meters have been

Highlights of Fiscal Year 2005/06:
<ul style="list-style-type: none"> • New low grade gold deposit discovered and being drilled out at Argentinita • Lascano survey completed and drill targets identified • Airborne gravity and magnetic surveys completed for Retamosa, Casupa, Zapucay, Arenal and Rivera Diamonds • Key recruits to re-organise and renew geology team
Drilling Resources
<ul style="list-style-type: none"> • UDR650 diamond/RC rig • DM45 RC rig capable of drilling to 400 meters. A second DM45 is expected to be commissioned by Dec 31 2006 • Longyear 44 diamond rig • UDR200 diamond rig • Three contract RC and 1 diamond rigs

Table 2 Argentinita drill intercepts

Hole No.	Co- ordinates	Intercept
RCARG71	499.47E 3541.84N	8m@2.29g/t Au from14m
RCARG74	Not Surveyed	14m@1.97g/t Au from 4m
RCARG94	698.34E 3351.43N	6m@2.36 g/t Au from 36m
RCARG101	694.45E 3676.45N	10m@3.29g/t Au from 20m
RCARG05	486.93E 3499.61N	12m@2.30g/t from 0m
RCARG23	664.46E 3374.64N	20m@2.81 from 10m
RCARG24	635.01E 3418.02N	23m@2.37 from14m

drilled on this prospect to date. Better intersections from this program in the past year are shown in Table 2.

Other Gold Projects

The Company has gold projects and targets in the Florida Greenstone Belt and the Dom Feliciano Mobile Belt. The Florida belt covers an area of approximately 200 km in length by 20 km in width and runs along the south western corner of the country. The group has a number of gold prospects on this belt including Chamizo and Cruzera.

The Chamizo prospect comprises shear hosted gold mineralisation in a fine grained acid volcanic tuff. Previous drilling by UME in 2002 intercepted 6 meters at 3 g/t Au. There are a number of interesting soil anomalies in the district that need to be followed up. An airborne magnetic and gravity survey of the Casupa district was performed late in the current year. Re-evaluation of the Crucera project, located in the Casupa district commenced during the year and drilling will be performed in the 2007 year. A quartz vein approximately 500 meters in length with widths of 2-3 meters and grades averaging 5 g/t was previously drilled at Crucera. Whilst the vein itself represents a small to modest target there are widespread gold occurrences of similar vein hosted mineralization in the area, suggesting potential for larger, bulk mining targets. Limited work has been done on Casupa or Chamizo however both will be advanced in 2006/2007.

The Dom Feliciano mobile belt runs in a north south direction in the east of Uruguay. It comprises an extensive package of gold, copper and base metal anomalous rock units extending for more than 70 kilometers along strike and up to 20 kilometers wide. The belt is principally made up of volcano-sedimentary units and syntectonic intrusives Two key projects on this belt are Presidente Terra where the target is shear hosted gold mineralization and the Texas district which is prospective for massive sulphide deposits.

Base Metals

Mal Abrigo

This project comprises a large gabbro/norite complex, where disseminated nickel/copper mineralization has been noted in outcrops at several localities. Reconnaissance prospecting also located disseminated sulphides in the nearby Cerro Negro complex which may be part of the same intrusive event. Ground surveys including soil sampling and HLEM geophysical surveys have continued late in 2006 with the aim of defining new drill targets which may represent massive sulphide accumulations. From drilling conducted previously a number of zones of disseminated sulphides from 4 to 20 meters in thickness were intersected at Mal Abrigo The sulphides comprise pyrrhotite with exsolution of pentlandite and minor chalcopyrite.

Carpinteria

The rock package at Carpinteria comprises a complex sequence of structurally deformed granitic rocks, serpentinised ultramafics, mafic units and graphitic and sulphidic black shales. Drilling of coincident geochemical and geophysical targets has encountered variable amounts of disseminated sulphides in a number of the rock units. Pentlandite has been identified from petrographic work. Exploration is continuing with further drill targets to be defined for 2007.

Paso de Lugo

The rock package comprises ultramafic flow rocks in contact with a sedimentary sequence, granites and volcanics. Geophysical surveys have defined a target zone interpreted to coincide with the basal contact of the ultramafic sequence. A follow up drill programme is proposed for the latter part of the year.

Retamosa and Maria Albina North

The Retamosa and Maria Albina North prospects represent targets for Mississippi Valley style lead, zinc deposits. Gossans and minor outcrops of mineralization have been identified in a number of locations within carbonate host rocks of the Lavalleja Formation. An airborne gravity and magnetic survey was completed over these areas during the year and evaluation of the data is in process to identify targets for further detailed work or drill testing.

Lascano

The Lascano project is located in north east Uruguay and comprises a very large gravity anomaly with a strong magnetic signature. A detailed airborne gravity and magnetic survey of approximately 10,400 line km was completed during the year to allow for better definition of the geophysical features which will enable appropriate drill targets to be located and tested.

Initial interpretation has identified 3 ring shaped gravity and magnetic highs. The modelling suggests that the gravity high is caused by medium density rocks surrounded by non magnetic lower density rocks. Depths to the top of the gravity source are estimated to be 400 meters in some locations.

Three targets have been defined for drilling at Lascano during 2006.

Diamond Project

The Rivera Diamond Project is located on the Archean – Paleoproterozoic Rio de la Plata Craton, which is a component of the southern part of the Brazilian Shield. This craton hosts kimberlites, related rocks and diamonds in Brazil. The Company is exploring a structurally active area of northern Uruguay, from which micro-diamonds, chrome spinels and G9 and G10 garnets have been recovered by previous explorers.

UME's stream sampling programs during the past 5 years have confirmed the presence of micro-diamonds, and chemically high interest chrome spinels and garnets in the Rivera region. During 2005, electron microprobe analysis at UWA in Perth, has identified several kimberlitic garnets, including one G10 garnet from a location which is approximately 3 kilometres south of a previously recovered micro-diamond. The chemistry of several of the chrome spinels is indicative of derivation from the diamond stability field (DSF). These results confirm the potential for the presence of diamondiferous kimberlites in the Rivera region.

In May 2006 a gravity gradiometer and magnetic survey was performed over prospective areas in Rivera. The results of this survey have been incorporated into the follow-up program which is ongoing.

The information presented in this report has been reviewed and verified by Mr George Schroer Vice President Exploration and a Certified Professional Geologist. Mr. Schroer is the Qualified Person for the purposes of the AIM Guidance Note on Mining, Oil and Gas Companies dated March 2006. Mr. Schroer has a Bachelor of Science in Geology from Colorado State University and is a member of SEG and AIPG. He has over 20 years of international experience in exploration.

OPERATIONS REPORT

Safety and Environment

The lost time Injury rate for the San Gregorio operations was 15 for the 2005/06 financial year compared to 11 for 2004/05 with a reduction in severity of 27%. Whilst safety management has improved, the level of performance is still below international industry standards. Recruiting of key, experienced mine safety professionals will be undertaken to continue improvements in this area.

No environmental incidents were recorded during the year. Studies by the Company and third parties were completed during the year to divert the Corrales River. These studies indicate that the diversion can occur without long term, significant impacts. The submissions to request the diversion were made in April 2006 and the Company requires approval by December 2006 to maintain its mine plan at proposed grades.

Major safety and environmental audits were performed at the end of the fiscal year by independent experts to international industry standards. Whilst performance in these areas was seen to be good, the need to formalise and improve management systems was highlighted. These audits have given the operation clearly defined action plans to implement corrective measures.

Mining

Mining production was focused at Arenal utilising the owner-operated mobile mining fleet plus additional contract hauling capacity where appropriate. Small contractor fleets were engaged to rehandle stockpiled material and high-grade vein material as encountered.

The heavy vehicle river crossing over Arroyo Corrales was commissioned during January 2006 – 4 months later than budgeted due to delayed ministerial approval. The mining fleet can now deliver Arenal ore directly to the ROM Pad and costs associated with rehandling by small contracted equipment has been eliminated.

In February 2006, a relatively large wedge failure (40kt) occurred on the western wall of Arenal. Although this failure posed no threat to the safety of personnel and equipment, it represented a risk to the integrity of a 50m section of the Flood Protection Dyke. Following geomechanical consultation, the affected section of the Flood Protection Dyke was reinstated and inter-phase wall parameters modified directly below the failure. As a result, approximately 3-months of ore has been deferred to the final cut-back of the Arenal open pit.

Highlights of Fiscal Year 2005/06:

- 27% improvement in safety indices – LTF and Severity
- Continued exemplary environmental performance
- Gold production target met – greater than 100koz
- Operating cash cost of US\$210 per ounce
- Process plant throughput 30% above design
- Major process plant refurbishment
- Mining production 20% above plan
- Constructed and commissioned Phase 6 of the Tailings Storage Facility (TSF)
- Establishment of heavy vehicle crossing of Arroyo Corrales
- Establishment of standardised supply and service contracts
- Assume control of MSG laboratory

Much extension drilling was performed at Arenal during the 2005/06 period. Infill drilling on the western limit has confirmed the geological model and drilling to the immediate east returned thin, low grade intersections. The south-east, down dip extension has been better defined along strike but remains open at depth. As currently defined, this extension falls within an optimised pit shape using today's gold prices, but the economics are not especially robust. Additional drilling and evaluation of mining alternatives will be performed in 2007 with the aim of converting resources to reserves .

As a complement to ongoing exploration, initial engineering and evaluation has commenced in two major projects. Firstly, the feasibility of upgrading the process plant throughput capacity is being investigated. Secondly, initial laboratory testing has commenced with respect to heap leaching of ores from various sources. The objective of each of these initiatives is to evaluate the potential to lower unit production costs and increase reserves. It is envisaged that these evaluations will be ongoing throughout the next year.

Processing

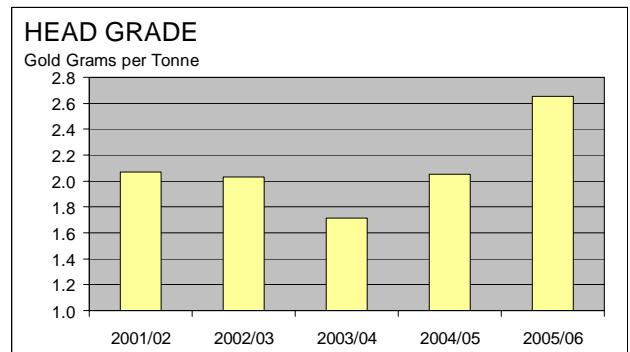
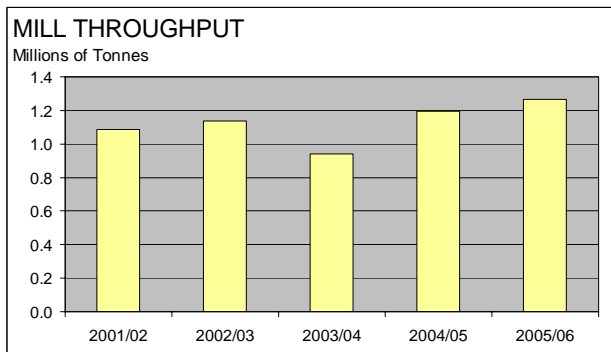
During the 2005/06 period, Arenal provided 65% of plant feed. Other feed sources included medium and low grade stocks from San Gregorio as well as high grade vein material.. The feed strategy was designed to maintain the gold production target whilst reducing the quantity of relatively high work index Arenal ore.

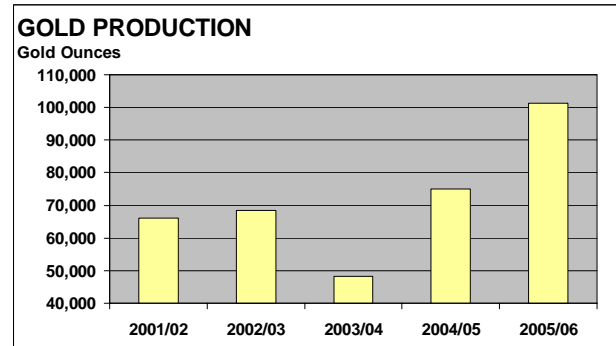
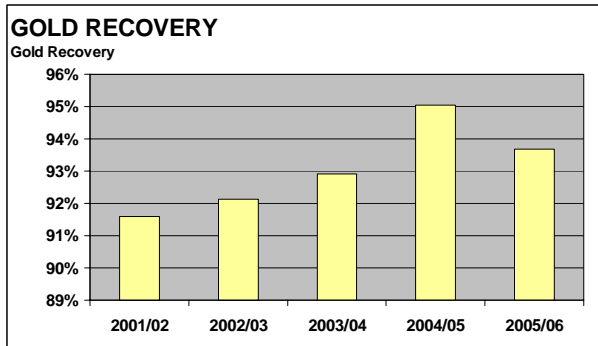
The yearly performance of the process plant was extremely good, despite simultaneous refurbishment being undertaken. For more than half the year, the plant operated on 6 of the 7 tanks whilst each tank was consecutively repaired including modification improvements to the agitators. Other major repairs were carried out in the secondary crushing circuit, elution circuit and gold room.

Table 3 2005/06 Ore feed to Process Plant

Feed Source	Tonnes	Grade (g/t)
Santa Teresa	1,864	0.50
Arenal	821,435	3.36
Veta A	64,177	2.92
Zapucay	10,502	1.80
San Gregorio Stock	368,550	1.06
Total Feed	1,266,528	2.65

Towards the end of the fiscal year problems were encountered with respect to higher than anticipated silver content in the Arenal ore. With the plant operating at its limit, the additional silver concentration overloaded the capacity of the elution circuit and high gold recoveries could not be maintained. A loss of several percentage points of gold recovery was suffered. Metallurgical consultants have worked with us to resolve the issue by installing additional capacity in key plant areas by September 2006.





Construction of Phase 6 of the tailings storage facility was completed and commissioned in April 2006. This 3m vertical lift represents a 24-month tailings storage capacity plus freeboard to contain contingent storm events. Continued construction of internal dykes ensures that safety parameters significantly exceed regulatory limits. It is recognised that good management of the tailings storage facility is a fundamental component of the operations social licence and appropriate measures will continue to ensure this.

Commercial

Throughout the year UME made progress in the formalisation of commercially sound supply and service contracts. These contracts included fuel, cyanide, carbon, lime, LPG, ammonium nitrate, crushing supplies, specialist maintenance provision and contract mining services.

From October 2005, UME assumed management control of the MSG laboratory. The Company is well advanced in the installation of new laboratory equipment and the implementation of standardised procedures with appropriate third party cross checking and industry proficiency testing.

The Company now has 300 employees in operations, exploration and administration. Depending upon intermittent civil works, up to 200 additional contractors are also utilised. The non-existence of a Uruguayan mining industry presents significant challenges with respect to safety, personnel training and community awareness. This is being overcome through the use of key expatriate personnel, implementation of international training schemes and the development of relationships with Government and community bodies. The Company recognises that continued success in these areas is essential to business health and growth.

BACKGROUND TO THE EVOLUTION OF THE CORPORATION, AND LISTING DETAILS

Uruguay Mineral Exploration Inc. (UME) was incorporated on October 16, 1996 as 713257 Alberta Inc. pursuant to the Business Corporations Act (Alberta). On January 31, 1997, the Corporation changed its name to Uruguay Goldfields Inc (“UGI”). On February 13, 1998, the Corporation amalgamated with Canadian Black River Petroleum Ltd., continuing as UGI. This amalgamation enabled the Corporation to list on the Canadian Dealing (over-the counter) Network in Toronto, Ontario.

On March 29, 2000, the common shares of UME were admitted for listing on the Canadian Venture Exchange (CDNX).

On February 8, 2002, the Corporation changed its name to Uruguay Mineral Exploration Inc., and continued from the Province of Alberta to the Yukon Territory to be governed by the corporate laws of the Yukon Territory.

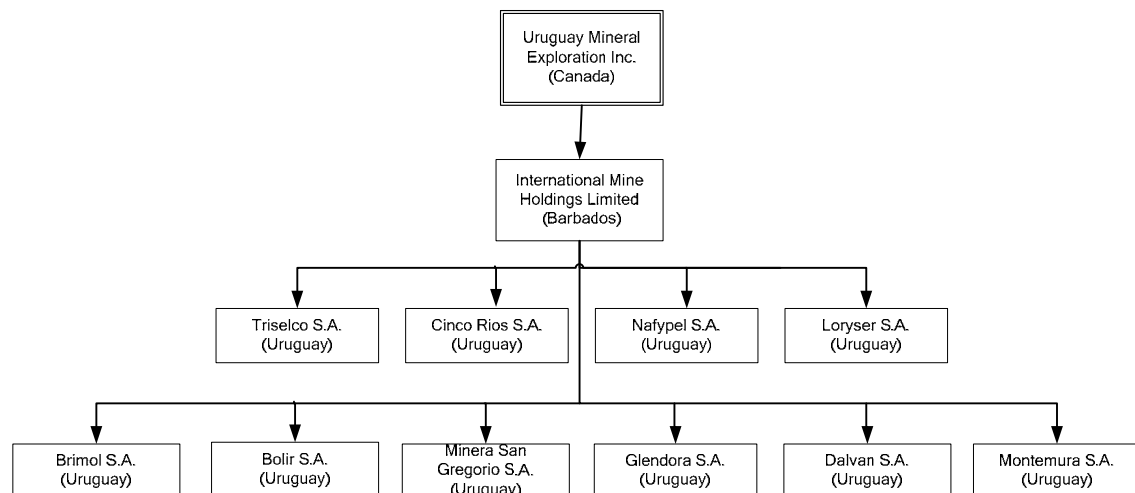
During June 2002, the CDNX was acquired by The Toronto Stock Exchange as a wholly owned subsidiary. Accordingly the name of the CDNX was changed to the TSX Venture Exchange, where the Corporation’s common shares trade under the symbol UME.

Effective October 1 2004 UME acquired the Uruguayan subsidiaries of Crystallex International Inc including Minera San Gregorio S.A. that owned and operated the San Gregorio Gold Project in northern Uruguay.

On 18 December 2004 the Corporation listed it’s common shares on the London AIM market.

Corporate structure

The Corporation’s corporate structure is shown in figure 1 below. All entities are 100% owned.



Commercial structure

UME controls (or has the rights to control) 100% of the interests in all the projects in which it is involved, except as set out in Notes 12 (Commitments) to the Financial Statements for the year ended 31st May 2006.

Shareholder's Timetable

Year end:	31st May
Annual report circulated to shareholders	by 13th September 2006
Shareholders meetings in London, England	12th October 2006
Circulation of the report for the quarter ending	
31st August 2006	by 13th October 2006
30th November 2006	by 12th January 2006
28th February 2007	by 13h April 2007

DIRECTORS' REPORT

Officers as at 23th August 2006

Chris Clark (aged 62, President, appointed 1996),

Chris is a mining industry professional with over 25 years experience in the international mining industry. He had fifteen years experience with Rio Tinto group in Australia, New Guinea and Europe, principally in both technical and corporate management aspects of the copper, iron ore and gold industries. He was Operations Director of Ramsgate Resources Ltd, a listed Australian medium scale gold producer with exploration activities in Papua New Guinea and Argentina, and is one of the two joint founders of UME. Chris has been President of UME since its inception in 1996.. Chris was Chief Executive Officer until June 2006

David Fowler (aged 39, Chief Executive Officer, appointed to Board October 2005).

David joined UME in 2004 as Chief Financial Officer. He became Finance Director in October 2005 and was appointed Chief Executive Officer in June 2006. David is a Chartered Accountant and has a Graduate Diploma in Finance and Investment. He has over 15 years experience in the mining industry in South America, Australia, and Asia. He was previously Chief Financial officer of Western Metals Limited.

William Lindqvist (aged 64, Non Executive Director Appointed October 2005; A,CG,R)

Bill is an Independent Consulting Geologist, with 30 years of international experience in exploration. He was previously Vice President Exploration for Home Stake Mining Company and Executive General Manager for Newcrest Mining Ltd. Bill has a PHD in applied Geology from the Royal London School of Mines and is a member of Aus IMM,SEG and AIME. Bill is currently a Director of Plutonic Power Corporation and Solomon Resources Limited.

John Morris (62, Non-executive Director, appointed May 2002; A, CG, R)

John has over 30 years experience in exploration, mining and the management of public companies. John has held various directorships with Australian public companies, including the Forsyth group of companies, which he grew to be the seventh largest gold producer in Australia, and Ramsgate Resources NL, which developed the Mount Monger Gold Project. He is a Director of Chaco Resources PLC.

Julio Porteiro (aged 67, Non Executive Director, appointed July 2006)

Julio is the main partner of the Uruguay consulting firm Julio C Porteiro & Associates a consulting firm specializing in the formulation and evaluation of investment projects and company and human resource development in Uruguay. He was the President of Nuevo Banco Comercial S.A. the largest private bank in Uruguay until July 2006, leading its restructure and sale to international investors in June 2006. He has also served as President of the Association of Certified Public Accountants, Economists and Managers of Uruguay and was reappointed in November 2005 for a three year period as a member of the Development Nations Committee of the International Federation of Accountants.

Tony Shearer (aged 57, Non-executive chairman, appointed February 2002; A, CG, R)

Tony spent over 20 years with Deloitte Haskins & Sells, chartered accountants, in London, Johannesburg, and Edinburgh, qualifying as a chartered accountant in 1971 and becoming a partner in 1980. In 1988 Tony joined M&G Group (the leading UK listed mutual funds group) as their finance director and became Chief Operating Officer. He has worked within the City of London since then, as Chief Executive of Singer & Friedlander Group PLC, Deputy Chief Executive of Old Mutual International, and Chief Executive of two other financial services companies. Currently Tony is a director of Wogen Group plc, and a number of other companies.

* = Member of the following Committees of the Board:

A = Audit Committee

CG = Corporate Governance Committee

R = Remuneration Committee

Principal Activities

Since inception, the principal activity of the entities within the consolidated entity has been the acquisition, exploration and development of mineral properties, either directly or through joint ventures, in Uruguay. Effective October 1, 2003 the company acquired the San Gregorio Gold Project in Uruguay and the scope of its operations now cover the mining and processing of precious metals as well as exploration.

Dividends

UME has not paid any dividends to date. The Board has proposed that a dividend of \$ 3.5 Cents per share is paid to shareholders on 27 October 2006.

Likely Developments and Expected Results

In the opinion of the Directors there are no matters that would affect the future operations and expected results of the consolidated entity that have not been referred to in this Annual Report.

Deeds of Indemnity and Officers' Insurances

The Corporation contracted Directors and Officers insurance with effect from August 10, 2006 .

Corporate Governance Statement

The Board of Directors currently comprises a Non-Executive chairman, three other Non-Executive Directors, and two Executive Directors. The chairman is responsible for the running of the Board. The Board is responsible to the shareholders for the overall direction and control of the Company and its subsidiaries (collectively the "Group"), as well as for the corporate governance of the consolidated entity. It guides and monitors the business and affairs of the Corporation on behalf of the shareholders by whom the directors are elected, and to whom they are accountable.

To ensure that the Board is well equipped to discharge its responsibilities it has established guidelines for the operation of the Board. It has delegated to the Chief Executive Officer the management, operation and administration of the consolidated entity within parameters set by the Board, and has delegated certain matters to Committees of the Board. The Board ensures that the executive management is appropriately qualified and experienced to discharge their responsibilities, and regularly monitors the performance of the executive team. In addition the Board reserves to itself the setting of the strategy including any change in the nature of the Group's business, all decisions relating to the issue of shares, options and warrants, dividend policy, any decisions in respect of the acquisition or disposal of fixed assets, companies, businesses, properties and titles, any partnerships, joint ventures or "farm-in" arrangements, the approval of the Corporation's financial statements, and the approval of all circulars and listing particulars required by the authorities.

At each scheduled meeting, directors are apprised of the group's current performance, financial position, and any significant strategic issues. The Corporate Secretary is responsible for ensuring that Board procedures are followed, and all directors have access to her advice and services. The Board is satisfied that it is provided with information in an appropriate form and quality to enable it to discharge its duties. Directors may, in the furtherance of their duties, seek independent professional advice, at the Corporation's expense if considered appropriate.

All directors are required to submit themselves for election at each annual general shareholders' meeting. Any appointment is until the next meeting (which must be held within 15 months of the prior annual general shareholders meeting). The composition of the Board is reviewed on a regular basis to ensure that its make up and the diversity of skills and experience are appropriate for the Corporation. The directors bring to the Board a wide range of experience and skills, and participate fully in decisions on key issues facing the group. The directors hold regular meetings with shareholders and their representatives to discuss the Corporation's strategy and financial performance. These discussions could encompass strategy, performance management and corporate governance issues.

The Board meets at least quarterly, in person or by phone, and has regular contact between the directors during the year. Between 1st June 2005 and 31st May 2006 the Board met by phone or by written resolution on 13 occasions.

The Audit Committee comprises three Non-Executive Directors and is chaired by Tony Shearer. It is responsible for nominating the external auditors, for ensuring that there are appropriate internal controls, and for reviewing the adequacy and scope of the annual statutory audit, and the annual and quarterly financial statements. The Committee meets throughout the year to review a wide range of issues including the Corporation's published financial statements, internal control issues, regulatory compliance, and the oversight of the objectivity and effectiveness of the auditors.

The Board of Directors, although retaining ultimate responsibility for their operation, has delegated the review of the effectiveness of the system of internal controls to the Audit Committee. However, such a system is designed to manage rather than eliminate the risk of failure to achieve business objectives, and can only provide reasonable, and not absolute, assurance against material misstatement or loss, including the safeguarding of assets, the maintenance of proper accounting records, the reliability of financial information, compliance with appropriate legislation, regulation and best practice, and the identification and management of business risk. The Board has delegated detailed implementation of the system of internal financial control throughout the group to executive management. These controls include financial controls that assist the Board in meeting its responsibilities for the integrity and

accuracy of the group's accounting records. The Group's financial statements, prepared from these records, comply with accounting principles generally accepted in Canada.

Between 1st June 2005 and 31st May 2006 the Committee met by phone or by written resolution on 4 occasions, and all the Members were present at each meeting.

The Corporate Governance Committee comprises three Non-Executive Directors (chaired by Tony Shearer). It is responsible for the Corporation's approach to, and reporting in respect of, corporate governance, for ensuring that all members of the Board understand their duties and responsibilities, and for the mandate given to the President. Between 1 June 2005 and 31 May 2006, the Committee met on 2 occasions, and all members were present.

The Remuneration Committee, comprises the Non-Executive Directors (chaired by Tony Shearer). It is responsible for reviewing the remuneration policy, for determining and reviewing compensation arrangements of the executive directors and officers, and for ensuring compliance with all requirements relating to executive remuneration (including the annual report on it). The Committee meets as required to consider all aspects of remuneration paid to executive directors, and to make recommendations to the Board on the remuneration framework and strategy for the senior employees. The remuneration packages, and the benefits paid to each director, are subject to continual monitoring, and are reviewed by the Committee. The Board is responsible for determining the level of fees paid to Non-Executive directors following consideration of recommendations from the executive directors. Between 1 June 2005 and 31 May 2006, the Committee met by phone on 2 occasions, and all members were present at each meeting.

Directors' Responsibilities

The directors are required to prepare financial statements for each financial period, or year, which present fairly the financial position of the Corporation and the group and of the results for the period. In preparing those financial statements, the directors are required to select suitable accounting policies and apply them consistently, and make judgments and estimates that are reasonable and prudent. They are also required to follow applicable accounting standards, disclosing and explaining any material departure there from. The accounts are required to be prepared on a going concern basis, so long as that remains appropriate. The directors are responsible for ensuring that proper accounting records are kept, which disclose with reasonable accuracy at any time the financial position of the Corporation, and enable them to ensure that the accounts comply with relevant legislation. The directors also have a general responsibility to safeguard the assets of the group, and to prevent and detect fraud and other irregularities.

Going Concern

After making appropriate enquiries, the directors have a reasonable expectation that the group has adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the accounts.

REPORT OF THE REMUNERATION COMMITTEE

Remuneration Policy

The Corporation's executive remuneration program is administered by the Remuneration Committee.

The Corporation's overall policy regarding compensation of the Corporation's executive officers is structured to provide a competitive compensation package that supports both the short-term and long-term goals of the Corporation, attracts and retains suitable and qualified executive management, and establishes a compensation framework which is industry competitive.

The executive compensation program comprises two elements, namely a base salary, and participation in the Corporation's incentive stock option plan.

Executive base salaries are determined having reference to the salary levels in the industry in which the Corporation operates. Criteria included in the determination of salary levels includes the scope, skills, responsibilities, working conditions, and complexity of the position held, and salaries being paid for similar positions in other companies of similar size and business.

The share scheme has been established for directors, executive officers contractors and employees of the Corporation and its subsidiaries. The Board of Directors is responsible for the administration of any share schemes, and determines the number of Common share under option, the date each option is to be effective, the exercise price of Common Shares issuable under each option and any and all terms and conditions of each particular option.

The Remuneration Committee considers the annual participation in the Corporation's share schemes, and considers it to be the primary ingredient in relating the total executive compensation to the Corporation's performance.

Further details are provided in the Management's 2006 Information Circular.