

**Franconia Minerals**  
**C O R P O R A T I O N**

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**Notice to Reader**

The accompanying unaudited interim consolidated financial statements of Franconia Minerals Corporation for the three months ended December 31, 2006 have been prepared by management and approved by the Audit Committee and Board of Directors of the Corporation. These statements have not been reviewed by the Corporation's external auditors.

Dated March 1, 2007



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Brian Gavin  
President

**Franconia Minerals Corporation**

(an exploration stage company)

**Consolidated Balance Sheet**

U.S. Dollars

*(Unaudited - Prepared by Management)*

	<u>December 31</u> <u>2006</u>	<u>September 30</u> <u>2006</u>
<b>ASSETS</b>		
<b>Current</b>		
Cash and equivalents	\$ 3,943,163	\$ 857,741
Prepaid expense	<u>241,614</u>	<u>86,365</u>
	4,184,777	944,106
Deferred acquisition and exploration costs (Note 5)	6,851,418	4,845,029
	<u>\$ 11,036,195</u>	<u>\$ 5,789,135</u>
 <b>LIABILITIES</b>		
<b>Current</b>		
Accounts payable and accrued liabilities	\$ 532,755	\$ 372,488
Asset retirement obligations	<u>25,000</u>	<u>25,000</u>
	<u>557,755</u>	<u>397,488</u>
 <b>SHAREHOLDERS' EQUITY</b>		
Share capital (Note 6)	13,805,667	8,915,822
Contributed surplus (Note 6)	2,146,797	539,026
Deficit accumulated during exploration stage	<u>(5,474,023)</u>	<u>(4,063,201)</u>
	<u>10,478,440</u>	<u>5,391,647</u>
	<u>\$ 11,036,195</u>	<u>\$ 5,789,135</u>

**Approved on behalf of the Board:**

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*/s/ Brian Gavin*

Brian Gavin

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*/s/ Allan Marter*

Allan Marter

*These financial statements should be read in conjunction with the most recent annual audited financial statements. The accompanying notes are an integral part of these consolidated financial statements.*

**Franconia Minerals Corporation**

(an exploration stage company)

**Consolidated Statements of Operations and Deficit**

for the three months ended December 31, 2006 and December 31, 2005

U.S. Dollars

*(Unaudited - Prepared by Management)*

	<b>December 31</b>	December 31
	<b>2006</b>	2005
<b>Expenses</b>		
General administration	\$ (1,397,992)	\$ (86,765)
General exploration	(131)	(53,107)
Write off deferred acquisition and exploration costs	(12,700)	(25,089)
Stock-based compensation expense	-	(346,023)
<b>Loss from operations</b>	<b>(1,410,822)</b>	(510,984)
<b>Other income (expenses)</b>	-	1,590
<b>Net loss for period</b>	<b>(1,410,822)</b>	(509,394)
<b>Deficit accumulated during exploration stage</b>		
Beginning of period	(4,063,201)	(1,871,044)
End of period	\$ <u>(5,474,023)</u>	\$ <u>(2,380,438)</u>
<b>Loss per share</b>	<b>(\$0.03)</b>	(\$0.02)
<b>Weighted average common shares outstanding</b>	<b>40,585,367</b>	22,614,923

*These financial statements should be read in conjunction with the most recent annual audited financial statements.  
The accompanying notes are an integral part of these consolidated financial statements.*

**Franconia Minerals Corporation**

(an exploration stage company)

**Consolidated Interim Statements of Cash Flows**

for the three months ended December 31, 2006 and December 31, 2005

U.S. Dollars

	<u>December 31</u> <u>2006</u>	<u>December 31</u> <u>2005</u>
<b>Cash flows from (used in) operating activities</b>		
Net (loss) for the period	\$ (1,410,822)	\$ (509,394)
Items not involving cash:		
Write off deferred costs	12,700	25,089
Non-cash services		
Stock-based compensation expense	-	346,023
Changes in non-cash working capital balances:		
Prepaid expenses	(155,249)	13,846
Accounts payable	160,268	48,404
	<u>(1,393,104)</u>	<u>(76,032)</u>
<b>Cash flows from (used in) financing activities</b>		
Funds held in trust	-	211,250
Issue of share capital, net of share issue costs	6,497,616	(245,558)
	<u>6,497,616</u>	<u>(34,308)</u>
<b>Cash flows from (used in) investing activities</b>		
Payments for deferred acquisition and exploration costs	(2,019,090)	109,631
	<u>(2,019,090)</u>	<u>109,631</u>
<b>Increase (decrease) in cash and equivalents</b>	<b>3,085,422</b>	<b>(709)</b>
Cash and equivalents, beginning of period	857,741	98,384
<b>Cash and equivalents, end of period</b>	<b>\$ <u>3,943,163</u></b>	<b>\$ <u>97,675</u></b>

*These financial statements should be read in conjunction with the most recent annual audited financial statements. The accompanying notes are an integral part of these consolidated financial statements.*

## **Franconia Minerals Corporation**

(an exploration stage company)

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

for the three months ended December 31, 2006

U.S. Dollars

*(Unaudited - Prepared by Management)*

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*These interim consolidated financial statements should be read in conjunction with the most recent audited consolidated financial statements. The significant policies and methods of computation follow that of the most recent audited consolidated financial statements. The disclosures provided in the notes below are incremental to those included in the most recent audited consolidated financial statements.*

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#### **1. Nature of Operations**

Franconia Minerals Corporation ("Franconia" or the "Company") was incorporated on August 7, 1998 under the Alberta *Business Corporations Act*. The Company is a public company and, effective January 12, 2005, the Company was listed on the TSX Venture Exchange. The Company is in the exploration stage devoting substantially all of its efforts to exploring mineral properties.

The Company continues to develop and explore its mineral properties and has not yet determined whether these properties contain mineral resources that are economically recoverable. The recoverability of amounts shown for mineral properties is dependent upon the existence of economically recoverable reserves, securing and maintaining title and beneficial interest in the properties, the ability of the Company to obtain necessary financing to complete the development, and upon future profitable production or proceeds from disposition of the mineral properties. There are no guarantees that such conditions will be met. The amounts shown as mineral properties represent net costs to date, less amounts written off and do not necessarily represent present or future values.

Although the Company has taken steps to verify the title to resource properties in which it has an interest, in accordance with industry standards for the current stage of exploration of such properties, these procedures do not guarantee the Company's title. Property titles may be subject to unregistered prior agreements, transfers or native land claims and title may be affected by unasserted claims.

#### **2. Going-Concern Assumption**

These consolidated financial statements have been prepared on a going-concern basis, which assumes the Company will be able to realize its assets and discharge its liabilities in the normal course of business for the foreseeable future.

The Company reported net losses of \$1,410,822 for the three months ended December 31, 2006 and \$509,394 for the three months ended December 31, 2005, and has an accumulated deficit of \$5,474,023 at December 31, 2006 (\$4,063,201 at September 30, 2006). These recurring losses and the need for continued funding, as discussed below, raise substantial doubt about the Company's ability to continue as a going-concern. These consolidated financial statements do not include any adjustments that would be necessary should the Company be unable to continue as a going concern.

#### **3. Significant Accounting Policies**

These consolidated financial statements have been prepared by management in accordance with generally accepted accounting principles in Canada. The preparation of consolidated financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. The consolidated financial statements have, in management's opinion, been properly prepared using careful judgment with reasonable limits of materiality and within the framework of the significant accounting policies summarized below.

##### (a) Principles of consolidation

The consolidated financial statements include the accounts of the Company and its integrated wholly-owned subsidiary, Franconia Minerals Corporation (US) Inc. All significant inter company transactions have been eliminated.

## **Franconia Minerals Corporation**

(an exploration stage company)

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

for the three months ended December 31, 2006

U.S. Dollars

*(Unaudited - Prepared by Management)*

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### **3. Significant Accounting Policies (continued)**

#### **(b) Deferred acquisition and exploration costs**

The Company is engaged in the acquisition, exploration and development of mineral properties. Deferred acquisition costs include amounts paid under option and agreements, as well as lease payments under property leases. Deferred exploration costs such as topographical, geochemical, geophysical studies and costs for drill testing are capitalized and carried at cost until the properties to which they relate are placed into production, sold or where management has determined there to be a permanent impairment in value. The Company expenses all general explorations costs as incurred.

The Company reviews and evaluates the recoverability of the carrying amounts of all its non-producing properties annually based on management's intentions and carrying amounts are written down when the long-term expectation is that the net carrying amount will not be recovered or when a decision to abandon the property is made. Proceeds from disposition of mineral properties are credited to the capitalized costs with no gain or loss being recognized until all costs are recovered.

#### **(c) Future income taxes**

The Company uses the asset and liability method for accounting for income taxes. Under this method of tax allocation, future income tax assets and liabilities are determined based on differences between the financial statement carrying values and their respective income tax basis (temporary differences). Future income tax assets and liabilities are measured using the tax rates expected to be in effect when the temporary differences are likely to reverse. The effect on future income tax assets and liabilities of a change in tax rates is included in operations in the period in which the change is enacted or substantially enacted. The amount of future income tax assets recognized is limited to the amount of the benefit that is more likely than not to be realized.

#### **(d) Foreign exchange**

Foreign currency balances, including those of foreign subsidiaries, are expressed in U.S. dollars on the following bases:

- (i) Monetary assets and liabilities, at the rate of exchange in effect as at the balance sheet date;
- (ii) Non-monetary assets and liabilities, at the exchange rates prevailing at the time of the acquisition of the assets or assumption of the liabilities; and
- (iii) Revenues and expenses, at the average rate of exchange for the year.

Gains and losses arising from the translation of foreign currency are included in net loss for the year.

#### **(e) Joint ventures**

The Company's exploration and development activities are conducted jointly with others. These consolidated financial statements reflect only the Company's proportionate interest in such activities.

#### **(f) Functional and reporting currency**

All of the Company's mining exploration operations are currently in the United States. Because only limited operations are conducted in Canadian dollars, the U.S. dollar is the functional and reporting currency. All numbers reported in these consolidated financial statements are stated in U.S. dollars unless otherwise denoted.

#### **(g) Stock-based compensation**

The Company accounts for stock-based compensation expense using the fair value based method with respect to all stock-based payments to directors, employees and non-employees, including awards that are direct awards of stock and call for settlement in cash or other assets, or stock appreciation rights that call for settlement by the issuance of equity instruments. Under this standard, stock-based payments are recorded as an expense over the vesting period or when the awards or rights are granted, with a corresponding increase to contributed surplus under shareholders' equity. When stock options are exercised, the corresponding fair value is transferred from contributed surplus to share capital

## **Franconia Minerals Corporation**

(an exploration stage company)

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

for the three months ended December 31, 2006

U.S. Dollars

*(Unaudited - Prepared by Management)*

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### **3. Significant Accounting Policies (continued)**

(h) Per share amounts

Basic loss per common share is computed by dividing loss from operations by the weighted average number of common shares outstanding for the period. Diluted per share amounts reflect the potential dilution that could occur if securities or other contracts to issue common shares were exercised or converted to common shares. The treasury stock method is used to determine the dilutive effect of stock options and other dilutive instruments.

(i) Asset retirement obligations

The fair value of a liability for an asset retirement obligation is recognized when a reasonable estimate of fair value can be made. The asset retirement obligation is recorded as a liability with a corresponding increase to the carrying amount of the related long-lived asset. Subsequently, the asset retirement cost is charged to earnings using a systematic and rational method and is adjusted to reflect period-to-period changes in the liability resulting from the passage of time and revisions to either the timing or the amount of the original estimate of undiscounted cash flow. The original undiscounted costs are based on engineering estimates using current cost and in accordance with statutory legislation and general industry practice.

The Company holds a tenement bond to ensure the Company has adequate resources to finance future rehabilitation costs. A provision has been made to reflect estimated costs for rehabilitation of claims.

(j) Measurement uncertainty

The amounts recorded for stock-based compensation, impairment of deferred acquisition and exploration costs, and asset retirement obligations are based on estimates. The Black-Scholes option pricing model is based on estimates of assumptions for expected volatility and risk-free interest rates. The recoverability of amounts shown for deferred acquisition, and exploration and development costs is dependent on the discovery of economically recoverable reserves, the ability of the Company to obtain financing to complete development of the properties and on future production or proceeds of disposition. The assumptions used to determine the asset retirement obligation are based on current market interest rates and future restoration expenditures. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods could be significant.

(k) Use of estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure 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 and would impact future results of operations and cash flows. Balances affected by estimates include deferred acquisition and exploration costs, accounts payable and accrued liabilities, asset retirement obligations and stock-based compensation.

### **4. Financial Instruments**

(a) Fair value

The carrying values of cash, and accounts payable and accrued liabilities approximate their fair values due to the short-terms to maturity of these financial instruments.

(b) Interest rate risk

The Company is not exposed to significant interest rate risk due to the short-term maturity of its monetary current assets and current liabilities.

(c) Credit risk

The Company is not exposed to significant credit risk on its financial assets due to cash being placed with major financial institutions.

**Franconia Minerals Corporation**

(an exploration stage company)

**Notes to Consolidated Financial Statements**

for the three months ended December 31, 2006

U.S. Dollars

*(Unaudited - Prepared by Management)***4. Financial Instruments** (continued)

## (d) Currency risk

The Company translates the results of foreign operations into U.S. currency using rates approximating the average exchange rate for the year. The exchange rate may vary from time to time. The Company does not use derivatives or similar instruments to manage currency risk.

**5. Deferred Acquisition and Exploration Costs**

		Total	Birch Lake	Mahoney	San Francisco	Red Knoll
September 30, 2005		\$ 2,569,025	\$ 1,975,494	\$ 178,483	\$ 389,483	\$ 25,565
	Expenditures					
	Acquisition	276,321	188,597	-	-	87,724
	Exploration	161,804	145,943	9,601	3,555	2,705
December 31, 2005		3,007,150	2,310,034	188,084	393,038	115,994
	Expenditures					
	Acquisition	633,707	287,027	241,295	27,000	78,385
	Exploration	2,432,069	1,875,624	7,166	371,314	177,965
	Abandoned	(1,227,897)	-	(436,545)	(791,352)	-
September 30, 2006		4,845,029	4,472,685	-	-	372,344
	Expenditures					
	Acquisition	310,105	260,034	-	-	50,071
	Exploration	1,708,984	1,428,126	3,291	9,409	268,158
	Abandoned	(12,700)	-	(3,291)	(9,409)	-
December 31, 2006		\$ <u>6,851,418</u>	\$ <u>6,160,845</u>	\$ <u>-</u>	\$ <u>-</u>	\$ <u>690,573</u>

**Property Commitments**(a) Birch Lake Option Agreement (Minnesota)

On November 12, 2002, the Company entered into the Birch Lake Option Agreement (BLOA) to hold the option to enter into an Earn-in and Joint Venture Agreement ("BLJV Agreement") with Beaver Bay Joint Venture (BBJV), an entity related by virtue of common shareholders and a common director. BBJV's property is known as the Duluth Complex in the state of Minnesota.

On October 27, 2003, the Company exercised its option to enter into the BLJV Agreement to acquire up to an 82% interest in BBJV. Under the terms of the option agreement, the Company made a payment of \$35,000 and issued 546,144 common shares at a deemed price of \$0.20 (Cdn. \$0.30) per share. In 2006, certain amendments to the BLOA expanded the area of interest to include the American Copper & Nickel Company Inc. ("ACNC") lands (see note 5(b)) and modified the terms of the BLJV Agreement.

To acquire an undivided 60% legal and beneficial interest in the project, the Company must have:

(i) Incurred \$10,000,000 in cumulative exploration expenditures as follows:

- a. Total of \$2,000,000 no later than January 2, 2008 (completed); and
- b. Total of \$10,000,000 no later than January 2, 2010.

**Franconia Minerals Corporation**

(an exploration stage company)

**Notes to Consolidated Financial Statements**

for the three months ended December 31, 2006

U.S. Dollars

*(Unaudited - Prepared by Management)***5. Deferred Acquisition and Exploration Costs (continued)**

(ii) Paid an aggregate of \$6,000,000 in cash and stock payments as follows:

<u>Dates</u>		<u>Cash</u>		<u>In Shares</u>	
October 27, 2003 (Effective Date)	\$	150,000	*	125,000	*
December 17, 2004/March 1, 2006		50,000	*	125,000	*
On/before April 15, 2006		100,000	*	-	*
On/before June 30, 2006		50,000	*	125,000	*
On/before January 2, 2007		175,000	*	150,000	*
On/before January 2, 2008		225,000		225,000	
On/before January 2, 2009		250,000		250,000	
On/before January 2, 2010		3,000,000		1,000,000	
Total	\$	<u>4,000,000</u>	\$	<u>2,000,000</u>	

\* Completed

The number of Company shares to be issued will be calculated using the weighted average trading price of the Company's shares converted to U.S. dollars for the month immediately preceding the month in which the payment is made.

With the foregoing conditions met, the Company will have the option to enter into a joint venture with BBJV. To comply with the terms of that future agreement, the Company will need to contribute to the joint venture its 60% of required expenditures plus an additional 20% of required expenditures. The additional 20% will be recoverable by payment to the Company of 70% of the cash flow from commercial production until 100% of such amounts, including interest, have been recovered by the Company.

To acquire an undivided 70% legal and beneficial interest in the project, the Company must incur an additional \$10,000,000 in work expenditures in a period of five years subsequent to initial conditions being met. The Company will be said to have a 70% interest in the project with a final payment of \$1,000,000 being made to BBJV. The Company will need to contribute to the joint venture its 70% of required expenditures plus an additional 15% of required expenditures. Again, the additional 15% paid will be recoverable by payment to the Company of 70% of the cash flow from commercial production until 100% of such amounts, including interest, have been recovered by the Company.

On completion of the additional \$10,000,000, the Company will have a one-time option period of 90 days to provide a guarantee that it will fund 100% of the costs associated with the project. The Company will then be said to have a vested 82% interest in the project. Similarly, additional costs paid on behalf of or related to BBJV will be recoverable by payment to the Company of 60% of the cash flow from commercial production until 100% of such amounts, including interest, have been recovered by the Company.

**(b) American Copper & Nickel Company Inc. - Birch Lake**

On December 22, 2003, Lehmann Exploration Management, a company controlled by a shareholder and officer, as operator of BBJV, entered into a binding letter of intent to acquire from ACNC, a wholly owned subsidiary of INCO, two federal leases covering 4,864.78 net mineral acres and ownership of 160 acres in fee, 74.11 acres of surface rights only and 328.88 net mineral acres of mineral rights. The federal leases are subject to a royalty to the U.S. government on production, and are also subject in part to overriding royalties to certain private parties not to exceed 1%. All the mineral rights acquired from ACNC are subject to payment to ACNC of a royalty of 7.5% of net distributable earnings from the subject rights. The annual holding costs for 2003 through 2013 are estimated to be approximately \$70,000 per year for lease rentals and real estate taxes. These lands were acquired in the name of Beaver Bay and are subject to the earn-in agreement in favor of the Company. In 2005, ACNC was reimbursed for land holding costs since acquisition by issuing 395,821 of the common shares of the Company for a deemed value of \$114,708 (Cdn. \$0.36 per common share).

**Franconia Minerals Corporation**

(an exploration stage company)

**Notes to Consolidated Financial Statements**

for the three months ended December 31, 2006

U.S. Dollars

*(Unaudited - Prepared by Management)***5. Deferred Acquisition and Exploration Costs (continued)****(c) Red Knoll Project**

In 2005, the Company signed a Property Acquisition Agreement with TCAI regarding the 8,000-acre Red Knoll property in Graham County, Arizona. Under the terms of the Agreement, the Company will earn a 100% interest in TCAI's unpatented mining claims by spending \$2,000,000 over four years on exploration. The Agreement calls for a minimum expenditure of \$200,000 by the Company in the first year. In addition, the Company will reimburse TCAI for land holding costs in 2004 and issue shares to TCAI (see Note 6). Upon the Company completing \$2,000,000 in expenditures on the property, TCAI will have a one-time option to elect to back-in to a 70% interest in the Red Knoll property by spending \$5,000,000. If TCAI does not exercise its back-in right, it will have no further rights to the property except for a 2% NSR. The Company will have the right to reduce the royalty to 1% by paying TCAI \$1,500,000. The Agreement calls for the Company to issue to TCAI 150,000 units of the Company at a deemed price of Cdn. \$0.40 per unit. Each unit will consist of one common share of the Company and one-half of one common share purchase warrant. Each whole warrant entitles the holder thereof to purchase one common share at a price of Cdn. \$0.60 at any time prior to the earlier of (a) 15 trading days after receiving notice from the Company that the weighted average price of the common shares has been equal to or greater than Cdn. \$0.70 for a period of 15 consecutive trading days; or (b) two years from the date of issue of the units (Note 6(c) (iii)). The Company will also issue an additional 100,000 units to TCAI on each anniversary date during the term of the option. Land holding costs are estimated to be \$48,000 per year.

In 2006, the Company complied with the requirement of a minimum expenditure of \$200,000 in the first year of the contract.

**6. Share Capital**

- (a) Authorized  
 Unlimited number of common shares  
 Unlimited number of preferred shares issuable in series
- (b) Issued

<b>Common Shares</b>	<b><u>Number</u></b>		<b><u>Amount</u></b>
Balance, December 31, 2005	23,279,385	\$	4,317,596
Warrants exercised	8,767,865		3,139,813
Private placement	195,000		1,071,250
Property acquisitions	-		264,495
Stock options exercised	-		52,380
Contributed surplus transfer	-		83,152
Share issue costs	-		(12,864)
			<hr/>
Balance, September 30, 2006	32,242,250		8,915,822
Warrants exercised	46,050		18,702
Private placement	3,579,140		5,280,001
Property acquisitions	-		-
Stock options exercised	-		-
Contributed surplus transfer	-		-
Share issue costs	-		(408,858)
			<hr/>
Balance, December 31, 2006	<u>35,867,440</u>	\$	<u>13,805,667</u>

## **Franconia Minerals Corporation**

(an exploration stage company)

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

for the three months ended December 31, 2006

U.S. Dollars

*(Unaudited - Prepared by Management)*

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#### **6. Share Capital (continued)**

##### (c) Issued common shares

##### (i) Prospectus offering

During December 2004, the Company completed a prospectus offering by issuing 3,750,000 units for gross proceeds of \$1,199,540 (Cdn. \$1,500,000). Each unit consisted of one common share and one-half of one common share purchase warrant (Note 6(d)). Each whole warrant entitles the holder to purchase one common share at a price of \$0.48 (Cdn. \$0.60) at any time prior to the earlier of (a) 15 trading days after receiving notice from the Company that the weighted average price of the common shares has been equal to or greater than \$0.56 (Cdn. \$0.70) for a period of 15 consecutive trading days; and (b) December 14, 2006 (Note 6(c) (iii)). Clarus Securities Inc. acted as agent in respect of the offering and received a commission of 7% of the gross proceeds of the offering and an option to acquire 375,000 of units at the offering price per unit for a period of 24 months.

During January 2005, the Company issued 27,500 additional units for gross proceeds of \$8,910 (Cdn. \$10,773) on the second closing of the prospectus offering. An additional 13,750 warrants were attached to these units. The agent in respect of the offering received an additional commission of 7% of the gross proceeds of the offering and an option to acquire 375,000 of units at the offering price per unit for a period of 24 months.

##### (ii) Private placements

The funds held in trust at December 31, 2005, consisting of a non-brokered private placement of \$211,250 (Cdn. \$250,000) 10% convertible unsecured note, were converted to 1,388,888 units at \$0.18 (Cdn. \$0.15), each unit consisting of one common share and one common share purchase warrant. Each warrant entitles the holder thereof to purchase one common share at a price of \$0.21 (Cdn. \$0.25) at any time prior to 5:00 p.m. Toronto time on May 3, 2008. However, if the weighted average price of the common shares of the Company is equal to or greater than \$0.63 (Cdn. \$0.75) per common share for a period of 15 consecutive trading days, and upon 15 trading days' notice in writing to the warrant holder of this fact, provided that the warrant holder has not otherwise exercised the warrants within the time prescribed by the notice, the warrants will expire (Note 6(c) (iii)). In February 2006, the Company completed a non-brokered private placement financing of \$850,000 (Cdn. \$1,000,000) through the issuance of 5,000,000 units at \$0.17 (Cdn. \$0.20) per unit. Each unit consists of one common share and one-half common share purchase warrant. Each whole warrant entitles the holder to purchase one additional common share at an exercise price of \$0.27 (Cdn. \$0.30) at any time prior to the earlier of (a) the date that is 15 trading days after receiving notice from the Company that the weighted average price of the common shares on the TSX Venture Exchange has been equal to or greater than \$0.54 (Cdn. \$0.60) for a period of 15 consecutive trading days; and (b) August 9, 2007.

The Company completed a non-brokered private placement financing for gross proceeds of \$5,379,719 (Cdn. \$6,000,001) through the issuance of units at \$1.30 (Cdn. \$1.45) per unit. Each unit consisted of one common share and one-half of one common share purchase warrant. Each whole warrant entitles the holder to purchase one additional common share at an exercise price of \$1.66 (Cdn. \$1.85) at any time prior to the earlier of (a) the date that is 15 trading days after receiving notice from the Company that the weighted average price of the common shares on the TSX Venture Exchange or TSX Exchange has been equal to or greater than \$2.69 (Cdn. \$3.00) for a period of 15 consecutive trading days commencing at least 120 days after the date of issuance of the warrants; and (b) May 20, 2008. The common shares and warrants to be issued on exercise of the warrants are subject to a four month and one day hold period expiring March 21, 2007. The Company paid finder's fees in cash equal to 6% of the gross proceeds and issued brokers warrants equal to 6% of the units issued. The broker warrants have terms identical to the warrants issued pursuant to the unit offering and are subject to the same hold period.

##### (iii) Warrant Exercises

In April 2006, the weighted average price of the common shares on the TSX Venture Exchange were equal to or greater than \$0.50 (Cdn. \$0.60) for a period of 15 consecutive trading days. In accordance with several financing agreements, the Company gave notice to various warrant holders that they had 15 days after receipt of the notice to exercise their warrants or they would expire.

During the three months ended December 31, 2006, 46,050 warrants were exercised and 238,770 expired.

**Franconia Minerals Corporation**

(an exploration stage company)

**Notes to Consolidated Financial Statements**

for the three months ended December 31, 2006

U.S. Dollars

*(Unaudited - Prepared by Management)***6. Share Capital (continued)**(iv) Property acquisition

In February 2005, the Company issued 355,571 shares to BBJV, an entity managed and operated by a company controlled by a director and shareholder, at \$0.26 (Cdn. \$0.31) per share for total costs of \$91,220 (Cdn. \$110,295) in accordance with the terms of agreement on the Birch Lake properties.

The Company issued 395,671 shares to ACNC at \$0.29 (Cdn. \$0.36) per share for total costs of \$114,308 (Cdn. \$142,442), as consideration for payment of lease costs on the Birch Lake property.

Under the terms of the amended Birch Lake agreement, the Company agreed in October 2005 to issue 664,472 shares at a fair value price of \$0.18 (Cdn. \$0.22) to BBJV, an entity controlled by a shareholder and director (Note 7(a)). These shares were issued in January 2006 but included as a 2005 transaction.

Under the terms of the Red Knoll property agreement, in June 2005, the Company was to issue 150,000 units consisting of one common and one-half of one share purchase warrant. Each whole warrant entitles the holder thereof to purchase one common share at a price of \$0.50 (Cdn. \$0.60) at any time prior to 5:00 p.m. Toronto time on the earlier of (a) 15 trading days after receiving notice from the Company that the weighted average price of the common shares has been equal to or greater than \$0.58 (Cdn. \$0.70) for a period of 15 consecutive trading days; or (b) two years from the date of issue of the units (Note 6(c)(iii)). These shares were issued subsequent to the 2005 year-end; however, their issue was recorded as a 2005 transaction.

The Company will also issue an additional 100,000 units to TCAI on each anniversary date during the term of the option. During 2006, 100,000 units were issued. The project was subsequently abandoned.

The Company concluded a Property Acquisition Agreement (the "Acquisition Agreement") entered into in 2005 with TCAI regarding Franconia's Mahoney property. In accordance with the Acquisition Agreement, the Company issued to TCAI 250,000 units of the Company during 2006. Each unit consists of one common share of the Company and one-half of one common share purchase warrant. Each whole warrant will entitle TCAI to purchase one common share of the Company at an exercise price of \$0.50 (Cdn. \$0.60) on the earlier of (a) 15 trading days after receiving notice from the Company that the weighted average price of the common shares of the Company has been equal to or greater than \$0.58 (Cdn. \$0.70) for a period of 15 consecutive trading days; and (b) the second anniversary of the date of issuance (Note 6(c)(iii)). The project was subsequently abandoned.

(d) Escrow shares

As a result of prospectus financing in 2004, 1,982,301 shares of the Company were placed in escrow. Of this amount, 25% was released on the date the Company was listed on the TSX Venture Exchange and the remaining shares were released at 25% thereof every six months commencing July 2005. At December 31, 2005, the Company had 991,151 shares in escrow and the final release occurred July 11, 2006.

(e) Warrants

The following table summarizes information about warrants outstanding at September 30, 2006 and December 31, 2006:

Expiry Date	Price	Outstanding September 30			Outstanding December 31	
		2006	Issued	Exercised	Expired	2006
December 14, 2006	\$ 0.24-0.48	284,820	-	(46,050)	(238,770)	-
January 10, 2007	\$ 0.32	4,125	-	-	-	4,125
June 9, 2007	\$ 0.54	50,000	-	-	-	50,000
January 20, 2008	\$ 0.54	75,000	-	-	-	75,000
April 12, 2008	\$ 0.51	125,000	-	-	-	125,000
May 20, 2008	\$ 1.57	-	2,281,043	-	-	2,281,043
		538,945	2,281,043	(46,050)	(238,770)	2,535,168

**Franconia Minerals Corporation**

(an exploration stage company)

**Notes to Consolidated Financial Statements**

for the three months ended December 31, 2006

U.S. Dollars

*(Unaudited - Prepared by Management)***6. Share Capital** (continued)(f) Options

The Company has granted stock options to directors, officers and consultants of the Company as follows:

Date Granted	Expiry Date	September 30 2006	Granted	Exercised	Expired	December 31 2006	Exercise Price
19-Aug-04	19-Aug-09	735,000	-	-	-	735,000	\$ 0.32
15-Apr-05	15-Apr-07	50,000	-	-	-	50,000	\$ 0.34
15-Apr-05	15-Apr-10	1,670,000	-	-	-	1,670,000	\$ 0.34
23-Nov-06	23-Nov-11	-	1,530,500	-	-	1,530,500	\$ 1.23
		<u>2,455,000</u>	<u>1,530,500</u>	<u>-</u>	<u>-</u>	<u>3,985,500</u>	<u>\$ 0.68</u>

Date Granted	Expiry Date	December 31 2005	Granted	Exercised	Expired	September 30 2006	Exercise Price
19-Aug-04	19-Aug-09	750,000	-	(15,000)	-	735,000	\$ 0.32
15-Apr-05	15-Apr-07	50,000	-	-	-	50,000	\$ 0.34
15-Apr-05	15-Apr-10	1,670,000	-	-	-	1,670,000	\$ 0.34
2-Aug-05	2-Aug-10	180,000	-	(180,000)	-	-	
		<u>2,650,000</u>	<u>-</u>	<u>(195,000)</u>	<u>-</u>	<u>2,455,000</u>	<u>\$ 0.33</u>

The Company has a stock option plan available to employees, directors, officers and consultants with grants under the Plan approved from time to time by the board of directors. Under the Plan, the Company is authorized to issue options to purchase in aggregate up to 20% of the Company's issued and outstanding common shares, up to a maximum of 4,412,820 shares. Each option can be exercised to acquire one common share of the Company. The term of the options and vesting provisions are determined by the board of directors, subject to applicable stock exchange rules. The exercise price for an option granted under the Plan may not be less than the price permitted by the applicable stock exchange and generally vest at the time of granting and have a term of five years.

The fair value of stock options is determined at the date of grant and the amount is charged to operations over the vesting period of the options.

The Company has recorded \$1,484,064 compensation expense for the stock options granted to directors, officers and consultants in the three months ended December 31, 2006 using the fair value method with the following assumptions: volatility of 122%; risk-free interest rate of 3.89%; dividend yield of Nil; and expected life of five years. Of this amount, \$394,523 has been recorded as part of deferred acquisition and exploration costs.

Stock options vested immediately, except 38,805 options that vest over a one-year period, with one-quarter vesting immediately, and one-quarter every three months thereafter.

As at December 31, 2006, there were 3,985,500 options were outstanding:

(g) Agent and other options

In the three months ended December 31, 2006, the Company recorded \$123,707 in share issue costs for options granted to agents using the fair value method with the following assumptions: volatility of 122%; risk-free interest rate of 3.89%; dividend yield of Nil; and expected life of two years.

The outstanding balances have been included in the schedule of warrants outstanding

**Franconia Minerals Corporation**  
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for the three months ended December 31, 2006  
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**6. Share Capital** (continued)

(h) Contributed surplus

Contributed surplus increased in connection with the recognition of compensation cost relating to stock options.

Contributed surplus is decreased when those stock options are exercised.

	Three months ended December 31 2006	Nine months ended September 30 2006
Contributed surplus, beginning	\$ 539,026	\$ 521,993
Stock-based compensation expense	1,607,771	100,185
Reallocated on exercise of options	<u>-</u>	<u>(83,152)</u>
Contributed surplus, ending	<u>\$ 2,146,797</u>	<u>\$ 539,026</u>

**7. Related Party Transactions**

Except as disclosed elsewhere in these consolidated financial statements, the Company had the following related party transactions:

(a) Transactions with a director and companies controlled by that director

The Company has entered into various agreements with a director and companies controlled by that director, regarding the Birch Lake properties, and consulting and administration services. This director holds certain mining claims and leases in respect of the Birch Lake properties in trust for the Company.

Transactions between the Company and the director and companies controlled by that director were as follows:

- (i) Consulting fees charged in the three months totaled \$23,477 (three months ended December 31, 2005 - \$7,824). These fees have been included in deferred acquisition and exploration costs.
- (ii) Land costs reimbursed in respect of Birch Lake totaled \$85,034 (three months ended December 31, 2005 - \$24,505).
- (iii) Administrative costs reimbursed totaled \$21,184 (three months ended December 31, 2005 - \$12,166).

Of the above amounts, a total of \$19,685 (2005 - \$42,908) is included in accounts payable at December 31, 2006.

(b) Other transactions

- (i) Legal fees paid to a director's law firm totaled \$14,189 during the three months (three months ended December 31, 2005 - \$12,750). With the exception of legal costs included in share issue costs, these fees are included in general administration.
- (ii) Consulting fees paid to the Company's president totaled \$27,000 during the three months (three months ended December 31, 2005 - \$7,200). These costs have been included in general administration.

Transactions in the normal course of operations have been recorded at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

## **Franconia Minerals Corporation**

(an exploration stage company)

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

for the three months ended December 31, 2006

U.S. Dollars

*(Unaudited - Prepared by Management)*

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## **8. Loss per Share**

The loss per share figures have been calculated using the weighted average number of common shares outstanding during the respective periods, which amounted to 40,585,367 for the three months ended December 31, 2006 (three months ended December 31, 2005 - 22,614,923). The effect of the conversion of all outstanding options and warrants would be anti-dilutive.

## **9. Consultant Contracts and Ongoing Commitments**

### (a) Consulting contracts

The Company has entered into one-year consulting contracts, automatically renewable annually, with five consultants who are also shareholders or directors of the Company. These agreements provide for a consulting fee of \$450 per day and reimbursement of expenses. If these agreements are terminated by the Company without cause the consultants will receive severance pay from the Company in amounts ranging from \$50,000 to \$100,000 to a maximum of \$400,000 in total. In addition, the Company will cancel any previously issued share options held by the consultants that are not exercised within 30 days of termination by payment to the consultants of the amount equal to the difference between the exercise price of the options and the average closing price of the common shares on the relevant stock exchange or trading platform during the previous 30 days.

### (b) Other

In the ordinary course of business, the Company enters into contracts that contain indemnification provisions, such as loan agreements, purchase contracts, service agreements, licensing agreements, asset purchase and sale agreements, operating agreements, leasing agreements and asset use agreements. In such contracts, the Company may indemnify counterparties to the contracts if certain events occur. These indemnification provisions vary on an agreement-by-agreement basis. In some cases, there are no pre-determined amounts or limits included in the indemnification provisions and the occurrence of contingent events that will trigger payment under them is difficult to predict. Therefore, the maximum potential future amount that the Company could be required to pay cannot be estimated.

## **10. Subsequent Events**

- (a) Subsequent to December 31, 2006, the Company announced that, effective January 15, 2007, CIBC Mellon Trust Company ("CIBC Mellon") had become the Company's principal transfer agent and registrar of the Company's common shares in Canada and the United Kingdom. As part of the Company's withdrawal from the PLUS Market (formerly OFEX) in the United Kingdom (last trading day December 29, 2006.), CIBC Mellon replaces and takes over the role of Capita IRG Plc.
- (b) Subsequent to December 31, 2006, Franconia announced that George D. Tikkanen was formally appointed as Chairman of the Company's Board of Directors. Mr. Tikkanen, who has been a director of the Company since 2001, replaces Ernest K. Lehmann. Mr. Lehmann will remain as a director and will continue to assist Franconia as a technical, political and community affairs consultant. Mr. Tikkanen has been active in the mining and mineral exploration industry since 1956, including more than 22 years at senior corporate and Board levels. He retired in 1999 from Cominco Ltd. as Vice President of Exploration and was President of Cominco Resources International from 1987 to 1995. Since that time, he has been active as a consultant in the mining and mineral exploration industry and has held directorships of many companies worldwide.
- (c) Subsequent to December 31, 2006, the Company provided a fourth progress report on the on-going 2006-2007 core-drilling program at Birch Lake where the latest drilling intercepted mineralization considerably thicker than the average 75 foot thickness of the deposit. Ongoing drilling continued to reveal mineralization that is generally similar to or higher than the average 0.59% copper, 0.19% nickel and 0.65g/t palladium, 0.32g/t platinum, and 0.14g/t gold values already found in this 100.4 million tonne inferred resource.
- (d) Subsequent to December 31, 2006, the Company issued 113,359 shares (\$150,000 value) to the Beaver Bay Joint Venture in accordance with the terms of the agreement.

**Franconia Minerals Corporation**  
**Management Discussion and Analysis**  
**for the three months ended December 31, 2006**

This management discussion and analysis (MD&A) of results of operations and financial condition of Franconia Minerals Corporation (an exploration stage company) (Franconia or the Company) describes the operating and financial results of the Company for the three months ended December 31, 2006. The MD&A supplements, but does not form part of the financial statements of the Company and should be read in conjunction with Franconia's unaudited consolidated financial statements and related notes for the three months ended December 31, 2006 as well as the audited consolidated financial statements and related notes for the nine month period ended September 30, 2006 and the audited consolidated financial statements for fiscal 2005. The Company prepares and files its financial statements in accordance with Canadian generally accepted accounting principles.

**The Company reports its financial results in U.S. dollars.**

**Forward-looking Statements**

Some statements contained in this MD&A are forward-looking, and therefore involve uncertainties or risks that could cause actual results to differ materially. Such statements include comments regarding mining and milling operations, mineral resources and exploration program performance. Factors that could cause actual results to differ materially include metal price volatility, economic and political events affecting metal supply and demand, fluctuations in mineralization grade, geological, technical, mining or processing problems, future profitability and production. The Company disclaims any obligation to update forward-looking statements.

**Date of MD&A**

This MD&A was prepared on February 28, 2007.

**Overview of Operations**

Franconia was incorporated on August 7, 1998 under the Alberta *Business Corporations Act*. The Company is a public company listed on the TSX Venture Exchange and, until December 29, 2006, was listed on the PLUS market in London (formerly known as Ofex).

Franconia is an exploration stage Company, which devotes substantially all of its efforts to exploring mineral properties. Commercial operations have not commenced. Most of the Company's efforts are related to activities such as raising capital for the purpose of acquiring and exploring mineral properties.

The Company currently has interest in mineral lands covering approximately 9,300 ha (23,000 acres) in two projects, in Minnesota and Arizona. The land interests comprise earn-in and joint venture agreements, exploration and mining agreements and direct interests through the Company's filings for unpatented claims, state mineral leases and federal prospecting permits. The Company's Birch Lake Project in Minnesota is an advanced-stage exploration project with an inferred mineral resource and its Red Knoll Project in Arizona is an early-stage exploration prospect.

**Operational Activities**

**Birch Lake Project - Minnesota**

On November 12, 2002, the Company entered into the Birch Lake Option Agreement (BLOA) to hold the option to enter into an Earn-in and Joint Venture Agreement (BLJV Agreement) with the Beaver Bay Joint Venture (BBJV), an entity related by virtue of common shareholders and a common director. BBJV's property is known as the Duluth Complex in the state of Minnesota. In 2006, certain amendments to the BLOA expanded the area of interest to include the American Copper & Nickel Company Inc. (ACNC) lands and modified the terms of the BLJV Agreement.

Under the terms of the amended agreement Franconia may earn up to an 82% interest in the Birch Lake and Maturi properties by making payments in cash and common shares to the BBJV, by completing work expenditures on the properties and by funding a project to commercial production. The term of the BLOA extends to January 2, 2010.

The cash payments to the BBJV total \$4,000,000 of which \$350,000 has been paid to date and the remaining \$3,650,000 is payable no later than January 2, 2010. The Company issued a total of \$375,000 in shares to the BBJV to December 31, 2006. A further

\$150,000 in shares was deemed issued on January 2, 2007 counting towards the total deemed value of \$2,000,000 of shares to be issued by January 2, 2010. The Company has to complete cumulative work expenditures of \$2,000,000 by no later than January 2, 2008 (completed) and a total of \$10,000,000 by no later than January 2, 2010. Franconia has expended approximately \$6,160,845 to December 31, 2006 on acquisition and exploration at Birch Lake.

With the foregoing conditions met, the Company will have the option to enter into a joint venture with BBJV. To comply with the terms of that future agreement, the Company will need to contribute to the joint venture its 60% of required expenditures plus an additional 20% of required expenditures. The additional 20% will be recoverable by payment to the Company of 70% of the cash flow from commercial production until 100% of such amounts, including interest, have been recovered by the Company.

To acquire an undivided 70% legal and beneficial interest in the project, the Company must incur an additional \$10,000,000 in work expenditures in a period of five years subsequent to initial conditions being met. The Company will be said to have a 70% interest in the project with a final payment of \$1,000,000 being made to BBJV. The Company will need to contribute to the joint venture its 70% of required expenditures plus an additional 15% of required expenditures.

Again, the additional 15% paid will be recoverable by payment to the Company of 70% of the cash flow from commercial production until 100% of such amounts, including interest, have been recovered by the Company.

On completion of the additional \$10,000,000, the Company will have a one-time option period of 90 days to provide a guarantee that it will fund 100% of the costs associated with the project. The Company will then be said to have a vested 82% interest in the project. Similarly, additional costs paid on behalf of or related to BBJV will be recoverable by payment to the Company of 60% of the cash flow from commercial production until 100% of such amounts, including interest, have been recovered by the Company.

On June 26, 2006, the Company announced an 11,000 to 15,000-foot core drilling program at Birch Lake, the first phase of a two-phase program. In addition to providing data to improve the metallurgical processing, including the recovery of nickel from ore to concentrate, the program is helping to move the project towards final feasibility determination and with the State's environmental review and permitting process. Approximately 15% of the total 23-hole program was completed by December 31, 2006 and Franconia noted this drilling achieved the highest grade intercepts the Company had seen at Birch Lake to date and appeared to represent a higher grade core to the resource. This drilling has also further confirmed the thickness and grade of mineralization in the southern portion of the deposit.

### **Birch Lake Resource Estimate**

On October 3, 2006, the Company announced the completion of an independent updated resource estimate and preliminary economic assessment of the combined Birch Lake and Maturi inferred resources in Minnesota. Scott Wilson Roscoe Postle Associates, which prepared the estimate to NI 43-101 standards, considered:

- Development of a 100.4 million tonne resource at Birch Lake and development of an 83.1 million tonne resource at Maturi, 3 miles northeast of Birch Lake, both containing recoverable copper, nickel, cobalt, gold, platinum and palladium.
- Underground room and pillar mining (10,000 tonnes per day) at Birch Lake and underground long-hole transverse open stoping mining (8,000 tpd) at Maturi, flotation concentration and hydrometallurgical recovery with a combined annual production of 74 million lbs copper, 19 million lbs nickel, 2.9 million lbs cobalt, 7,400 oz gold, 33,000 oz platinum and 68,000 oz palladium over a 26-year mine life at Birch Lake and a 24-year mine life at Maturi. Material from Maturi would be transported to the Birch Lake site for concentration and hydrometallurgical recovery.
- Pre-production capital of \$616 million.
- Average operating cost of \$25.87/tonne.

All technical data have been reviewed by Brian Gavin, Franconia's president and an appropriately qualified person as defined by National Instrument 43-101.

### **Red Knoll Copper Project – Arizona**

On May 15, 2006, Franconia reported that it had begun a Titan 24 geophysical survey on the 8,000 acre Red Knoll property (Red Knoll) in Graham County, Arizona, adjacent to and northeast of Phelps Dodge's porphyry copper deposits in the Safford District. Franconia was targeting concealed porphyry-style copper mineralization buried beneath post-mineral volcanic cover.

Red Knoll is subject to a Property Acquisition Agreement with Teck Cominco American Incorporated (TCAI) whereby Franconia can earn a 100% interest in the unpatented mining claims by spending \$2,000,000 in exploration expenditures over four years and issuing shares to TCAI. Upon Franconia completing expenditures on the property, TCAI has a one-time option to elect to back-in to a 70% interest in the property by spending \$5,000,000 over four years.

In 2006, the Company complied with the requirement of a minimum expenditure of \$200,000 in the first year of the contract and during December 2006, the Company commenced a core drilling program at Red Knoll, with four holes totaling 10,000 feet planned.

### **Financing Activities**

On May 2, 2006, the Company announced it had received a Letter of Intent (LOI) from the State of Minnesota, which would provide a loan of between \$1.5- and 2.5-million to help develop the Company's Birch Lake Project. On June 21, 2006, the Company announced that this loan had been approved. All of these funds would be earmarked primarily for infill drilling to further define the Birch Lake resource as well as to provide metallurgical samples for improving nickel recoveries to concentrate and conducting feasibility level metallurgical testing of both concentrate production and hydrometallurgical treatment of concentrates to produce saleable nickel-cobalt and PGM intermediates for refining and SX/EW cathode copper on site. A small part of the funds would be utilized for related environmental review and permitting along with conceptual mine design for the Birch Lake project.

On October 2, 2006, the Company reported that it had signed the final documentation with regard to this loan of up to \$2.5 million to be used for a two-phase technical development program aimed at advancing Birch Lake towards becoming a producing mine. Under the terms of the loan, the State – through its two economic development entities, Iron Range Resources and the Department of Employment and Economic Development – will first lend \$0.2 million for work to be completed in 2006. Franconia will contribute matching funds of \$0.6 million for the same period. Further State funding of \$2.3 million will be matched against \$6.9 million from Franconia for work to be completed late in 2007 or the first quarter of 2008. In addition to the previously announced cash repayment terms, Franconia will issue the lender warrants to purchase one share of common stock of Franconia for each dollar advanced by the lender under the terms of the loan, at an exercise price equal to Cdn\$1.13. The warrants will have a term of three years.

On November 21, 2006, the Company announced that it had completed a non-brokered private placement financing of Cdn\$6,000,001 through the issuance of units at Cdn\$1.45 per unit. Each unit consists of one common share and one-half common share purchase warrant. Each whole warrant entitles the holder to purchase one additional common share at an exercise price of Cdn\$1.85 at any time prior to the earlier of: a) the date which is the 15th trading day after receiving notice from the Corporation that the weighted average price of the Common Shares on the TSX Venture Exchange or TSX Exchange has been equal to or greater than Cdn\$3.00 for a period of 15 consecutive trading days commencing 120 days after the date of issuance of the warrants; and b) eighteen months from the date of issue. The net proceeds from the offering will be used for drilling at the Corporation's Red Knoll, Arizona copper target, a pre-feasibility study on Maturi-Birch Lake combined operation, and for general corporate purposes. The units were subject to a 4 month and one day hold period. The Corporation paid a finder's fee in cash equal to 6% of the gross proceeds and issue brokers warrants equal to 6% of the units issued. The broker warrants have terms identical to the warrants issued pursuant to the unit offering.

### **Corporate Changes**

On November 17, 2006, the Company announced it had filed a notice in accordance with National Instrument 51-102 and had elected to change the ending date of its financial year end from December 31 to September 30 starting with the financial period January 1, 2006 to September 30, 2006.

On November 20, 2006, Franconia announced its intention to withdraw from the PLUS market (formerly Ofex) in United Kingdom. Since no objection was received from shareholders, under the PLUS rules, the Company withdrew from this market on December 29, 2006.

## Deferred Acquisition and Exploration Costs

		Total	Birch Lake	Mahoney	San Francisco	Red Knoll
September 30, 2005	\$	2,569,025	\$ 1,975,494	\$ 178,483	\$ 389,483	\$ 25,565
Expenditures	Acquisition	276,321	188,597	-	-	87,724
	Exploration	161,804	145,943	9,601	3,555	2,705
December 31, 2005		3,007,150	2,310,034	188,084	393,038	115,994
Expenditures	Acquisition	633,707	287,027	241,295	27,000	78,385
	Exploration	2,432,069	1,875,624	7,166	371,314	177,965
Abandoned		(1,227,897)	-	(436,545)	(791,352)	-
September 30, 2006		4,845,029	4,472,685	-	-	372,344
Expenditures	Acquisition	310,105	260,034	-	-	50,071
	Exploration	1,708,984	1,428,126	3,291	9,409	268,158
Abandoned		(12,700)	-	(3,291)	(9,409)	-
December 31, 2006	\$	<u>6,851,418</u>	<u>\$ 6,160,845</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 690,573</u>

## Results of Operations

### Three months ended December 31, 2006

Franconia's operations in the three months to December 31, 2006 were focused on exploration (focused mainly on the Birch Lake Project) and financing. The Company did not generate any operating revenue in the quarter. The Company's net loss for the quarter was \$(1,410,822) compared with a net loss of \$(509,394) for the quarter ended December 31, 2005. The increase in the loss was primarily due to stock-based compensation expense of \$1,089,541 in the current quarter compared with an expense of \$346,023 in the same quarter a year earlier.

### Summary of Results

The following tables, prepared in accordance with Canadian GAAP, set out financial performance highlights for the last eight quarters:

	1 <sup>st</sup> Quarter December 31, 2006	3 <sup>rd</sup> Quarter* September 30, 2006	2 <sup>nd</sup> Quarter June 30, 2006	1 <sup>st</sup> Quarter March 31, 2006
General administration	\$1,397,992	\$ 214,695	\$ 109,486	\$ 127,973
General exploration	131	0	713	0
Stock-based compensation expense (now included in general administration)	0	0	0	0
Net income/(loss)	\$(1,410,822)	\$(1,451,121)	\$(103,669)	\$(127,973)

	<b>4<sup>th</sup> Quarter December 31, 2005</b>	<b>3<sup>rd</sup> Quarter September 30, 2005</b>	<b>2<sup>nd</sup> Quarter June 30, 2005</b>	<b>1<sup>st</sup> Quarter March 31, 2005</b>
General administration	\$ 86,766	\$ 118,198	\$ 92,760	\$ 141,783
General exploration	53,107	0	0	0
Stock-based compensation expense	346,023	0	0	0
Net income (loss)	\$(509,396)	\$(107,578)	\$(71,711)	\$(175,457)

### **Liquidity and Capital Resources**

At December 31, 2006, Franconia had working capital of \$3,627,022 (\$571,618 at September 30, 2006 and a working capital deficit of \$(323,280) at December 31, 2005. Cash was \$ 3,943,163 at December 31, 2006 (\$857,741 at September 30, 2006).

### **Off-Balance Sheet Arrangements**

The Company has no off-balance sheet arrangements.

### **Transactions with Related Parties**

The Company had the following related party transactions:

#### **(a) Transactions with a director and companies controlled by that director**

The Company has entered into various agreements with a director and companies controlled by that director, regarding the Birch Lake properties, and consulting and administration services. This director holds certain mining claims and leases in respect of the Birch Lake properties in trust for the Company.

Transactions between the Company and the director and companies controlled by that director were as follows:

(i) Consulting fees charged in the three months totaled \$23,477 (three months ended December 31, 2005 - \$7,284). These fees have been included in deferred acquisition and exploration costs.

(ii) Land costs reimbursed in respect of Birch Lake totaled \$85,034 (three months ended December 31, 2005 - \$24,505).

(iii) Administrative costs reimbursed totaled \$21,184 (three months ended December 31, 2005 - \$12,166).

Of the above amounts, a total of \$19,685 (three months ended December 31, 2005 - \$42,908) is included in accounts payable at December 31, 2006.

#### **(b) Other transactions**

(i) Legal fees paid to a director's law firm totaled \$14,189 during the three months (three months ended December 31, 2005 - \$12,750). With the exception of legal costs included in share issue costs, these fees are included in general administration.

(ii) Consulting fees paid to the Company's president totaled \$27,000 in the quarter (three months ended December 31, 2005 - \$7,200). These costs have been included in general administration.

Transactions in the normal course of operations have been recorded at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

### **Costs Related to Issuance of Stock Options**

The Company has a stock option plan available to employees, directors, officers and consultants with grants under the Plan approved from time to time by the Board of Directors. Under the Plan, the Company is authorized to issue options to purchase in aggregate up to 20% of the Company's issued and outstanding common shares, up to a maximum of 4,412,820 common shares. Each option can be exercised to acquire one common share of the Company. The term of the options and vesting provisions are determined by the board of directors, subject to applicable stock exchange rules. The exercise price for an option granted under the

plan may not be less than the price permitted by the applicable stock exchange and generally vest at the time of granting and have a term of 5 years.

The fair value of stock options is determined at the date of the grant and the amount is charged to operations over the vesting period of the options. During the quarter ended December 31, 2006 the Company recorded \$1,484,064 of compensation expense for the stock options granted to directors, officers and consultants using the fair-value method with the following assumptions: volatility of 122%; risk-free interest rate of 3.89%; dividend yield of nil; and expected life of five years. Of this amount, \$394,523 has been recorded as part of deferred acquisition and exploration costs.

### **Subsequent Events**

On January 15, 2007, the Company announced that, effective January 15, 2007, CIBC Mellon Trust Company had become the Company's principal transfer agent and registrar of the Company's common shares in Canada and the United Kingdom. As part of the withdrawal from the PLUS Market in the United Kingdom, CIBC Mellon replaces and takes over the role of Capita IRG Plc.

On January 31, 2007, Franconia announced that Mr. George D. Tikkanen was formally appointed as Chairman of the Company's Board of Directors. Mr. Tikkanen, who has been a director of the Company since 2001, replaces Ernest K. Lehmann. Mr. Lehmann will remain as a director and will continue to assist Franconia as a technical, political and community affairs consultant.

### **Proposed Transactions**

There are no material decisions by the board of directors of the Company with respect to any imminent or proposed transactions that have not been disclosed.

### **Critical Accounting Estimates**

#### **Interests in Mining Properties and Deferred Exploration Expenditures**

In accordance with the Company's accounting policies, acquisition costs and exploration expenditures relating to mineral properties are deferred until the properties are brought into commercial production or disposed.

Amortization will commence when a property is put into commercial production. As the Company does not currently have any properties in commercial production, no amortization has been recorded.

Mineral reserve and mineral resource estimates are not precise and also depend on statistical inferences drawn from drilling and other data, which may prove to be unreliable. Future production could differ from mineral resource estimates for the following reasons:

- (a) mineralization or formation could be different from those predicted by drilling, sampling and similar tests;
- (b) the grade of mineral resources may vary from time to time and there can be no assurance that any particular level of recovery can be achieved from the mineral resources; or
- (c) declines in the market prices of contained minerals may render the mining of some or all of the Company's mineral resources uneconomic.

Any of these factors may result in impairment of the carrying amount of interests in mining properties or deferred exploration expenditures.

### **Summary of Significant Accounting Policies**

*The significant policies and methods of computation follow that of the most recent audited consolidated financial statements. The disclosures provided below are incremental to those included in the audited consolidated financial statements.*

The Company's unaudited consolidated financial statements for the quarter ended December 31, 2006 have been prepared by management in accordance with generally accepted accounting principles in Canada. The preparation of consolidated financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results

could differ from those estimates. The consolidated financial statements have, in management's opinion, been properly prepared using careful judgment with reasonable limits of materiality and within the framework of the significant accounting policies summarized below. The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, Franconia Minerals Corporation (US) Inc.

The Company is engaged in the acquisition, exploration and development of mineral properties. Deferred acquisition costs include amounts paid under option and farm in agreements as well as lease payments under property leases. Deferred exploration costs such as topographical, geochemical, geophysical studies, and costs for drill testing are capitalized and carried at cost until the properties to which they relate are placed into production, sold or where management has determined there to be a permanent impairment in value. These costs may also include indirect administrative fees and office costs being incurred for these properties. The Company expenses all general explorations costs as incurred.

The Company reviews and evaluates the recoverability of the carrying amounts of all its non-producing properties annually based on management's intentions and are written down when the long-term expectation is that the net carrying amount will not be recovered. The costs relating to a property are written off when the decision to abandon the property is made. Proceeds from disposition of mineral properties are normally credited to the capitalized costs with no gain or loss being recognized unless the sale is significant to the capitalized property costs. For such significant dispositions, a gain or loss would be recognized. In addition, if there has been a delay in development activity for several successive years, a write-down of those project-capitalized costs will be charged to income.

Most of the Company's mining operations are in United States Dollars. The Company's operations outside of the United States are primarily in Canada conducted in Canadian Dollars. Because only limited operations are conducted in Canadian Dollars, the Company adopted the United States Dollar as its reporting currency.

Accordingly, the consolidated financial statements have been prepared on that basis. All numbers reported in these consolidated financial statements are stated in United States Dollars unless otherwise denoted.

### **Changes in Accounting Policies**

There were no changes to accounting policies in the most recent period.

### **Financial and Other Instruments**

The Company has not made use of any hedging or other financial instruments, and is not exposed to significant interest rate nor credit risks arising from its financial instruments.

### **Risk Considerations**

Franconia's business of exploring for mineral resources involves a variety of operational, financial and regulatory risks that are typical in the natural resource industry. The Company continues to develop and explore its mineral properties and has not yet determined whether these properties contain mineral resources that are economically recoverable. The recoverability of amounts shown for mineral properties is dependent upon the existence of economically recoverable reserves, securing and maintaining title and beneficial interest in the properties, the ability of the Company to obtain necessary financing to complete the development, and upon future profitable production of proceeds from disposition of the mineral properties. There are no guarantees that such conditions will be met. The amounts shown as mineral properties represent net costs to date, less amounts written off and do not necessarily represent present or future values.

Although the Company has taken steps to verify the title to resource properties in which it has an interest, in accordance with industry standards for the current stage of exploration of such properties, these procedures do not guarantee the Company's title. Property titles may be subject to unregistered prior agreements, transfers or native land claims and title may be affected by unasserted claims.

### **Going Concern Assumption**

The Company's consolidated financial statements have been prepared on a going concern basis, which assumes the Company will be able to realize its assets and discharge its liabilities in the normal course of business for the foreseeable future. The Company will require additional funds to enable the Company to continue to acquire and explore mineral properties. At December 31, 2006, Franconia reported working capital of \$3,627,022. While management has been successful in the past attracting financing, there is

no assurance that sufficient funds will be raised in the future. These consolidated financial statements do not include any adjustments that would be necessary should the Company be unable to continue as a going concern

During the latest three month period and subsequent to December 31, 2006, the Company raised net proceeds of \$5,280,001 from a private placement and \$18,702 from the exercise of warrants, which will be used to fund the Company's mineral property acquisition and exploration commitments and working capital requirements.

The consolidated financial statements do not include any adjustments that would be necessary should the Company be unable to continue as a going concern.

### **Disclosure Controls and Procedures**

Disclosure controls and procedures are designed to provide reasonable assurance that all relevant information is gathered and reported to senior management, including the Company's President and Chief Executive Officer and Chief Financial Officer, on a timely basis so that appropriate decisions can be made regarding public disclosure.

As at December 31, 2006, the end of the period covered by this management's discussion and analysis, management of the Company, with the participation of the President and Chief Executive Officer and the Chief Financial Officer, evaluated the effectiveness of the Company's disclosure controls and procedures as required by Canadian securities laws. Based on that evaluation, the President and Chief Executive Officer and the Chief Financial Officer have concluded that, as of the end of the period covered by this management's discussion and analysis, the disclosure controls and procedures were effective to provide reasonable assurance that material information required to be disclosed in the Company's annual filings and interim filings (as such terms are defined under Multilateral Instrument 52-109 – Certification of Disclosure in Issuers' Annual and Interim Filings) and other reports filed or submitted under Canadian securities laws is recorded, processed, summarized and reported within the time periods specified by those laws and that material information is accumulated and communicated to management of the Company, including the President and Chief Executive Officer and the Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

### **Other**

#### **Deferred Acquisition and Exploration Costs**

For a break-down of Deferred Acquisition and Exploration Costs, refer to the unaudited consolidated financial statements of operations and deficit and cash flows and related notes for the three month period ended December 31, 2006.

Deferred acquisition costs include amounts paid under option and farm in agreements as well as lease payments under property leases. Deferred exploration costs such as topographical, geochemical, geophysical studies, and costs for drill testing are capitalized and carried at cost until the properties to which they relate are placed into production, sold or where management has determined there to be a permanent impairment in value. These costs may also include indirect administrative fees and office costs being incurred for these properties. The Company expenses all general explorations costs as incurred.

The Company reviews and evaluates the recoverability of the carrying amounts of all its non-producing properties annually based on management's intentions and are written down when the long-term expectation is that the net carrying amount will not be recovered. The costs relating to a property are written off when the decision to abandon the property is made. Proceeds from disposition of mineral properties are normally credited to the capitalized costs with no gain or loss being recognized unless the sale is significant to the capitalized property costs. For such significant dispositions, a gain or loss would be recognized. In addition, if there has been a delay in development activity for several successive years, a write-down of those project-capitalized costs will be charged to income.

### Capitalized Deferred Acquisition and Exploration Costs

For each of the quarters ended December 31, 2006 and 2005, the material components of capitalized deferred acquisition and exploration costs were as follows:

	<u>Three months ended December 31, 2006</u>			<u>Three months ended December 31, 2005</u>		
	Total	Birch Lake	Red Knoll	Total	Birch Lake	Red Knoll
Analytical services	\$ 39,721	\$ 39,721	\$ -	\$ -	\$ -	\$ -
Office and general	164,769	159,035	5,734	15,449	15,449	-
Travel and promotion	9,020	3,185	5,835	3,369	664	2,705
Land payments	310,105	260,034	50,071	276,321	188,597	87,724
Drilling	150,304	12,663	137,641	-	-	-
Vehicle	10,400	7,226	3,175	1,022	1,022	-
Consultants and contractors	1,322,070	1,206,297	115,774	126,103	126,103	-
	<u>\$ 2,006,389</u>	<u>\$ 1,688,160</u>	<u>\$ 318,229</u>	<u>\$ 422,264</u>	<u>\$ 331,835</u>	<u>\$ 90,429</u>

For each of the quarters ended December 31, 2006 and 2005, the material components of general administration expenses were as follows:

<u>Three Months Ended</u>	
<u>December 31</u>	
<u>2006</u>	<u>2005</u>
\$ 135,462	\$ 558
1,221,848	500,684
11,764	6,195
14,889	9,627
<u>14,029</u>	<u>6,989</u>
<u>\$ 1,397,992</u>	<u>\$ 524,053</u>

**Disclosure of Outstanding Share Data**

The Company is a public company listed on the TSX Venture Exchange. Effective December 29, 2006, the Company's shares were no longer listed on the PLUS market in the United Kingdom.

As at December 31, 2006, the Company had 42,606,328 common shares issued, warrants to purchase 2,535,168 common shares at \$0.32 (Cdn\$0.38) to \$1.57 (Cdn\$1.85) and options to purchase 3,985,500 common shares at \$0.32 (Cdn\$0.40) to \$1.23 (Cdn\$1.45).

**Additional Information**

Additional information relating to the Company is available on the Internet at the SEDAR website located at [www.sedar.com](http://www.sedar.com) and at [www.franconiaminerals.com](http://www.franconiaminerals.com).