TALON METALS CORP.

Consolidated Financial Statements

December 31, 2012 and 2011

(Expressed in Canadian Dollars)

Management's Responsibility for Financial Information

Management has prepared the information and representations in these consolidated financial statements. The consolidated financial statements have been prepared in conformity with International Financial Reporting Standards ("IFRS"), and where appropriate, reflect management's best estimates and judgment.

Talon Metals Corp. maintains adequate systems of internal accounting and administrative controls, consistent with reasonable cost. Such systems are designed to provide reasonable assurance that relevant and reliable financial information is produced. Our independent auditors have the responsibility of auditing the consolidated financial statements and expressing an opinion on them.

The Board of Directors, through its Audit Committee, is responsible for ensuring that management fulfills its responsibilities for financial reporting and internal control. The Audit Committee is comprised of three directors. This Committee meets periodically with management and the independent auditors to review accounting, auditing, internal control and financial reporting matters.

"Henri van Rooyen" - CEO

"Vincent Conte" - CFO

INDEPENDENT AUDITOR'S REPORT

To the Shareholders of Talon Metals Corp.

Report to Consolidated Financial Statements
We have audited the accompanying consolidated financial statements of Talon Metals Corp. and its subsidiaries, which comprise the consolidated balance sheet as at December 31, 2012 and the consolidated statement of loss and comprehensive loss, consolidated statement of changes in equity and consolidated statement of cash flows for the year ended December 31, 2012, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements
Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility
Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion
In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of Talon Metals Corp. and its subsidiaries as at December 31, 2012, their financial performance and their cash flows for the year ended December 31, 2012 in accordance with International Financial Reporting Standards.

Other matters
The consolidated financial statements as at December 31, 2011 and for the year then ended, prior to the adjustments described in Note 17, Prior Year Adjustments, were audited by other auditors who expressed an opinion without reservation on those consolidated statements in their audit report dated March 27, 2012. We have audited the adjustments (as described in Note 17, Prior Year Adjustments) to the consolidated financial statements as at December 31, 2011 and for the year then ended and in our opinion, such adjustments, in all material respects, are appropriate and have been properly applied.

Signed: ***"MSCM LLP"***

Toronto, Canada
March 21, 2013

Chartered Accountants
Licensed Public Accountants

Talon Metals Corp.
Consolidated Balance Sheets

(Expressed in Canadian Dollars)

	Notes	December 31, 2012	December 31, 2011 (Adjusted - Note 17)
Assets			
Current assets			
Cash and cash equivalents		$ 16,485,729	$ 21,570,417
Investments	*5*	1,447,186	1,898,300
Prepayments		58,813	94,426
Accounts and other receivables		51,607	229,894
		18,043,335	23,793,037
Non-current assets			
Equipment		105,333	151,936
Resource properties and deferred expenditures	*6*	18,290,769	15,567,320
Investment in Tlou Energy	*5*	6,107,143	19,615,514
Assets held for sale	*7*	262,400	1,715,378
		$ 42,808,980	$ 60,843,185
Liabilities			
Current liabilities			
Accounts payable and accrued liabilities		$ 556,118	$ 1,100,003
Provision for distribution of Rio Verde shares to option holders	*4, 17*	516,000	510,000
		1,072,118	1,610,003
Shareholders' equity			
Share capital	*8*	74,106,555	68,501,013
Warrants	*8*	-	5,546,292
Contributed surplus		14,572,653	13,577,709
Accumulated other comprehensive loss		(873,821)	(723,363)
Deficit		(46,068,525)	(27,668,469)
		41,736,862	59,233,182
		$ 42,808,980	$ 60,843,185

The accompanying notes are an integral part of these consolidated financial statements.

Approved by the board of directors on March 21, 2013

Signed:

"Gregory S. Kinross" *"Jonathan M. Schneider"*

Talon Metals Corp.
Consolidated Statements of Loss and Comprehensive Loss
(Expressed in Canadian Dollars)

	Notes	2012	2011 (Adjusted - Note 17)
Revenue			
Interest income		$ 153,314	$ 405,199
Expenses			
Office and general		1,021,798	1,587,220
Professional fees		330,479	1,032,557
Stock option compensation payments	*9*	1,024,194	6,020,178
Salaries, benefits, consulting and management fees	*14*	2,918,293	1,662,358
Provision for distribution of Rio Verde shares to option holders	*4, 17*	30,375	510,000
Travel		278,916	1,101,331
Listing and filing expense		94,510	261,168
Depreciation of equipment		35,554	34,867
		5,734,119	12,209,679
Loss before the undernoted		(5,580,805)	(11,804,480)
Foreign currency translation (gain) loss		(788,983)	373,692
Share of loss in Tlou	*5*	2,102,070	2,192,199
Impairment loss on investment in Tlou	*5*	11,255,843	-
Loss on investments		1,208,738	1,072,996
Accretion of present value on long term assets	*7*	(47,022)	(252,978)
Gain on sale of projects		-	(1,089,158)
Sundry income		-	(196,282)
Write down of projects		-	636,973
Gain on disposal of assets held for sale	*7*	(911,395)	(471,740)
Gain on sale of investments	*5*	-	(262,185)
		12,819,251	2,003,517
Net loss from continuing operations		(18,400,056)	(13,807,997)
Net gain from discontinued operations including gain on distribution of non-cash asset to shareholders	*4, 17*	-	8,879,994
Net loss		(18,400,056)	(4,928,003)
Share of other comprehensive income (loss) - Tlou		(150,458)	(685,445)
Net loss and comprehensive loss		$ (18,550,514)	$ (5,613,448)
Net gain from discontinued operations attributable to:			
Shareholders of Talon		$ -	$ 10,077,688
Non-controlling interest in Rio Verde		-	(1,197,694)
		$ -	$ 8,879,994
Net loss attributable to:			
Shareholders of Talon		$ (18,400,056)	$ (3,730,309)
Non-controlling interest in Rio Verde		-	(1,197,694)
		$ (18,400,056)	$ (4,928,003)
Basic and diluted loss per share from:	*10*		
Continuing operations		$ (0.20)	$ (0.16)
Discontinued operations		$ -	$ 0.10
		$ (0.20)	$ (0.06)
Basic and diluted loss per share from discontinued operations attributable to:	*10*		
Shareholders of Talon		$ -	$ 0.116
Non-controlling interest in Rio Verde		$ -	$ (0.014)
		$ -	$ 0.102
Weighted averge shares outstanding		92,027,577	87,056,526

The accompanying notes are an integral part of these consolidated financial statements.

Talon Metals Corp.

Consolidated Statements of Changes in Equity

(Expressed in Canadian Dollars)

	Notes	Common shares – Number of shares	Common shares – Amount	Common share purchase warrants	Subscription receipts	Contributed surplus	Accumulated other comprehensive loss	Deficit (Restated - Note 17)	Sub-total equity	Non-controlling interest in Rio Verde	Total equity
Balance at January 1, 2012		92,001,687	$68,501,013	$ 5,546,292	$ -	$13,577,709	$ (723,363)	$ (27,668,469)	$ 59,233,182	$ -	$59,233,182
Options exercised		75,000	59,250			(29,250)			30,000		30,000
Warrants cancelled			5,546,292	(5,546,292)							
Stock option compensation payments	*9*					1,024,194			1,024,194		1,024,194
Share of other comprehensive income - Tlou							(150,458)		(150,458)		(150,458)
Net loss								(18,400,056)	(18,400,056)		(18,400,056)
Balance at December 31, 2012	*8*	92,076,687	$74,106,555	$ -	$ -	$14,572,653	$ (873,821)	$ (46,068,525)	$ 41,736,862	$ -	$41,736,862
Balance at January 1, 2011		74,609,275	$41,990,775	$ 1,388,815	$ -	$ 7,864,955	$ (37,918)	$ (12,763,346)	$ 38,443,281	$ 13,355,970	$51,799,251
Options exercised		794,650	623,276			(307,424)			315,852		315,852
Warrants exercised		5,323,162	4,582,712	(1,388,815)					3,193,897		3,193,897
Equity financing		11,274,600	23,500,171	5,250,038					28,750,209		28,750,209
Broker warrants issued on financing			(643,150)	643,150					-		-
Compensation									-	481,100	481,100
Subscription receipts issued on financing					10,414,261				10,414,261		10,414,261
Share of other comprehensive income - Tlou							(685,445)		(685,445)		(685,445)
Broker fees and other costs on financing			(1,552,771)	(346,896)					(1,899,667)		(1,899,667)
Share based payment						6,020,178			6,020,178		6,020,178
Share issuance by Rio Verde								285,977	285,977	1,169,023	1,455,000
Net loss								(3,730,309)	(3,730,309)	(1,197,694)	(4,928,003)
Distribution of Rio Verde shares:											
Dividend								(11,460,791)	(11,460,791)		(11,460,791)
Net deconsolidation effect on equity					(10,414,261)			-	(10,414,261)	(13,808,399)	(24,222,660)
Balance at December 31, 2011		92,001,687	$68,501,013	$ 5,546,292	$ -	$13,577,709	$ (723,363)	$ (27,668,469)	$ 59,233,182	$ -	$59,233,182

The accompanying notes are an integral part of these consolidated financial statements.

Talon Metals Corp.
Consolidated Statements of Cash Flows

(Expressed in Canadian Dollars)

	2012	2011 '(Adjusted - Note 17)
Cash flows from operating activities		
Net loss and comprehensive loss for the year from continuing operations	$ (18,550,514)	$ (5,613,448)
Non-cash adjustments:		
Share-based payments	1,024,194	6,020,178
Write down of projects	-	636,973
Share of net loss and comprehensive loss in Tlou	2,252,528	2,877,644
Decrease in unrealized appreciation on investments	1,208,738	810,811
Impairment loss on investment in Tlou	11,255,843	-
Provision for distribution of Rio Verde shares to option holders	6,000	510,000
Gain on sale of projects	-	(1,089,158)
Net gain from discontinued operations including gain on distribution of non-cash asset to shareholders	-	(8,879,994)
Gain on sale of equipment	(911,395)	-
Gain on sale and disposal of assets held for sale	-	(471,740)
Accretion of present value on long term assets	(47,022)	(252,978)
Foreign currency translation (gain) loss	(439,896)	373,692
Depreciation of equipment	35,554	34,867
	(4,165,970)	(5,043,153)
Working capital adjustments:		
Decrease in prepayments	35,613	197,308
Decrease in accounts and other receivables	178,287	388,249
(Decrease) in accounts payables and accrued liabilities	(543,885)	(698,516)
Cash flows from continuing operations	(4,495,955)	(5,156,112)
Cash flows from discontinued operations	-	(1,398,732)
Net cash flows used in operating activities	(4,495,955)	(6,554,844)
Cash flows from investing activities		
Proceeds on sale (acquisition) of equipment	911,395	(150,212)
Proceeds from sale of assets held for sale	-	1,931,754
Proceeds on sale of project	-	1,915,441
Investment in Rio Verde subscription receipts	-	(500,500)
Investment in Tlou rights offering		(1,556,130)
Proceeds on maturity of term deposit	-	3,503,928
Cash balance deconsolidated on distribution of Rio Verde shares		(13,356,080)
Proceeds on sale of investments	1,193,321	1,366,335
Acquisition of resource properties and deferred expenditures	(2,723,449)	(14,509,468)
Cash flows from operations	(618,733)	(21,354,932)
Cash flows from discontinued operations	-	(5,011,437)
Net cash flows used in investing activities	(618,733)	(26,366,369)
Cash flows from financing activities		
Proceeds from exercise of options	30,000	315,851
Proceeds from exercise of warrants	-	3,193,857
Proceeds from share issuance	-	26,850,542
Cash flows from continuing operations	30,000	30,360,250
Cash flows from discontinued operations	-	11,785,703
Net cash flows from financing activities	30,000	42,145,953
Net (decrease) increase in cash and cash equivalents	(5,084,688)	9,224,740
Cash and cash equivalents, beginning of the year	21,570,417	12,345,677
Cash and cash equivalents, end of the year	$ 16,485,729	$ 21,570,417

The accompanying notes are an integral part of these consolidated financial statements.

1. NATURE OF OPERATIONS

Talon Metals Corp. ("Talon" or the "Company") is a mineral exploration company focused on the exploration and development of its iron projects in Brazil. The Company has three indirect subsidiaries incorporated in Brazil. They are Brazmin Ltda. ("Brazmin"), Talon Ferrous Mineração Ltda. ("Ferrous") and Talon Iron Mineração Ltda ("TIML"). The Company, through TIML and Ferrous, holds a 100% interest in the Company's only material project, the Trairão iron project (the "Trairão Project").

The Company's head office address is Craigmuir Chambers, P.O. Box 71, Road Town, Tortola, British Virgin Islands.

Subsidiaries are entities over which the Company has the power, directly or indirectly, to govern the financial and operating policies of the entity so as to obtain benefits from its activities. In assessing control, potential voting rights that are presently exercisable or convertible, are taken into account in the assessment of whether control exists. Subsidiaries are fully consolidated from the date on which control is transferred to the Company. They are deconsolidated from the date on which control ceases.

All intercompany accounts and transactions have been eliminated.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Statement of compliance

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

Basis of preparation

The financial statements are presented in Canadian dollars. The financial statements are prepared on the historical cost basis, except for portfolio investments and financial instruments that are measured at fair value.

Foreign currencies

Functional and presentation currency

The Canadian dollar is the functional currency and reporting currency of the Company and of all its subsidiaries.

The consolidated financial statements are presented in Canadian dollars. Monetary items are translated into Canadian dollars at the rate of exchange in effect at the end of the reporting period. Revenues and expenses are translated into Canadian dollars at the rates of exchange prevailing when the underlying transactions occurred.

Foreign exchange gains and losses resulting from the settlement of foreign currency transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognized in the consolidated statements of loss and comprehensive loss.

Cash and cash equivalents

Cash and cash equivalents consist of cash deposits in banks, certificates of deposit and short-term investments with remaining maturities of three months or less at the time of acquisition.

Investments in associates

The Company accounts for its investments in companies over which it has significant influence using the equity basis of accounting whereby the investments are initially recorded at cost and subsequently adjusted to recognize the Company's share of earnings or losses of the investee companies and reduced by dividends received, if any. Carrying values of investments are reviewed for indicators of impairment and written down to estimated recoverable amount if there is evidence of impairment. Such impairment is recorded in the consolidated statements of loss and comprehensive loss.

Equipment

Equipment is carried at cost, less accumulated depreciation and accumulated impairment losses. The cost of an item of equipment consists of the purchase price, any costs directly attributable to bringing the asset to the location and condition necessary for its intended use and an initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located. An item of equipment is derecognized upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on disposal of the asset, determined as the difference between the net disposal proceeds and the carrying amount of the asset, is recognized in profit or loss. Where an item of equipment comprises major components with different useful lives, the components are accounted for as separate items of equipment. Expenditures incurred to replace a component of an item of equipment that is accounted for separately, including major inspection and overhaul expenditures are capitalized.

The Company provides for depreciation of its equipment at the following annual rate:

Office and computer equipment	20% straight line basis

Assets held for sale

Long-lived assets are classified as held for sale when certain criteria are met, which include: the Company's commitment to a plan to sell the assets; the assets are available for immediate sale in their present condition; an active program to locate buyers and other actions to sell the assets has been initiated; the sale of the assets is probable and their transfer is expected to qualify for recognition as a completed sale within one year; the assets are being actively marketed at reasonable prices in relation to their fair value; and it is unlikely that significant changes will be made to the plan to sell the assets or that the plan will be withdrawn.

The Company measures assets held for sale at the lower of carrying amount or fair value less cost to sell. These assets are not depreciated.

Resource properties and deferred exploration and evaluation costs

Interests in mineral exploration properties are recorded at cost. Exploration expenditures, other than those of a general nature, relating to mineral properties in which an interest is retained are deferred and carried as an asset until the results of the projects are known. If the project is unsuccessful or if exploration has ceased because continuation is not economically feasible, the cost of the property and the related exploration expenditures are written off. During 2012 and 2011, the Company only capitalized costs on its core properties and expensed all costs related to properties that were of a secondary focus.

The cost of mineral properties includes the cash consideration paid and the negotiated value of shares issued on the acquisition of properties. Properties acquired under option agreements, whereby option payments are made at the discretion of the company, are recorded in the financial statements at the time payments are made. The proceeds from options granted on properties are credited to the cost of the related property.

Once the feasibility of a project has been established, deferred exploration expenses and other costs are segregated as deferred development expenditures. These costs are amortized over the estimated useful life of the related mineral property as commercial production commences. If the net carrying amount of the deferred exploration expenses is not recoverable, these costs are written down to net recoverable amount of the deferred exploration expense.

The amounts shown for mineral properties and deferred exploration costs represents cost to date, and do not necessarily represent present or future values as they are entirely dependent upon the economic recovery of future reserves.

The Company does not accrue the estimated future costs of maintaining its mineral properties in good standing.

Impairment of non-financial assets

At the end of each reporting period the carrying amounts of the Company's non-financial assets are reviewed to determine whether there is any indication that those assets have suffered an impairment loss. Where such an indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment, if any. The recoverable amount is the higher of fair value less costs to sell and value in use. Fair value is determined as the amount that would be obtained from the sale of the asset in an arm's length transaction between knowledgeable and willing parties. In order to determine fair value, the Company considers multiple valuation approaches, including the income, market and cost approaches. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount and the impairment loss is recognized in the profit or loss for the period.

Where an impairment loss subsequently reverses, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset in prior years. A reversal of an impairment loss is recognized immediately in profit or loss.

Asset retirement obligations

A provision is recognized on the balance sheet when the Company has a present legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability. The Company's asset retirement obligations arise from its obligations to undertake site reclamation and remediation in connection with its resource properties. The estimated costs of reclamation are based on current regulatory requirements and the estimated reclamation costs at the date of purchase. Future changes to those regulations and standards, as well as changes resulting from operations may result in actual reclamation costs differing from the estimate.

Deferred taxes

The Company uses the asset and liability method of accounting for income taxes, under which deferred income tax assets and liabilities are recognized for the estimated future income tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective income tax bases. Deferred income tax assets and liabilities are measured using income tax rates in effect for the period in which those temporary differences are expected to be recovered or settled. The effect on deferred income tax assets and liabilities of a change in income tax rates or laws is recognized as part of the provision for income taxes in the period the changes are considered substantively enacted.

Deferred income tax benefits attributable to these differences, if any, are recognized to the extent that the realization of such benefits is probable.

Financial assets and liabilities

Financial instruments are measured on initial recognition at fair value, plus, in the case of financial instruments other than those classified as "fair value through profit and loss", directly attributable transaction costs. Measurement of financial assets in subsequent periods depends on whether the financial instrument has been classified as "fair value through profit and loss", "available-for-sale", "held-to-maturity", or "loans and receivables" as defined by IAS 39, *Financial Instruments: Recognition and Measurement* ("IAS 39"). Measurement of financial liabilities subsequent to initial recognition depends on whether they are classified as fair value through profit and loss or ‘‘other financial liabilities’’.

Financial assets and financial liabilities at fair value through profit and loss include financial assets and financial liabilities that are held for trading or designated upon initial recognition as fair value through profit and loss. These financial instruments are measured at fair value with changes in fair values recognized in the consolidated statements of loss and comprehensive loss. Financial assets classified as available-for-sale are measured at fair value, with changes in fair values recognized in other comprehensive income ("OCI"), except when there is objective evidence that the asset is impaired, at which point the cumulative loss that had been previously recognized in OCI is recognized within the consolidated statements of loss and comprehensive loss. Financial assets classified as held-to-maturity and loans and receivables are measured subsequent to initial recognition at amortized cost using the effective interest method. Financial liabilities, other than financial liabilities classified as fair value through profit and loss, are measured in subsequent periods at amortized cost using the effective interest method.

The Company has classified its financial instruments as follows:

Cash and cash equivalents	-	Fair value through profit and loss
Investments	-	Fair value through profit and loss
Accounts and other receivables	-	Loans and receivables
Accounts payable and accrued liabilities	-	Other liabilities

Financial instruments recorded at fair value on the consolidated balance sheets are classified using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy has the following levels:

- Level 1 - valuation based on quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 - valuation techniques based on inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices);
- Level 3 - valuation techniques using inputs for the asset or liability that are not based on observable market data (unobservable inputs).

At December 31, 2012, cash and cash equivalents and investment in marketable securities have been measured using level 1 inputs.

Interest and other income

Interest income is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable. The proceeds from options granted on properties are credited to the cost of the related property, but where the proceeds exceed the property’s carrying value, any excess proceeds are credited to income.

Stock option compensation payments

The Company's shareholder approved stock option plan allows employees, directors and consultants of the Company to acquire shares of the Company. The fair value of options granted is recognized as an employee or consultant expense with a corresponding increase in equity. An individual is classified as an employee when the individual is an employee for legal or tax purposes (direct employee) or provides services similar to those performed by a direct employee, and includes directors and most consultants of the Company. The fair value is measured at grant date and each tranche is recognized over the period during which the options vest. The fair value of the options granted is measured using the Black-Scholes option pricing model taking into account the terms and conditions upon which the options were granted.

Loss per share

Basic loss per common share is calculated by dividing the loss attributed to shareholders for the period by the weighted average number of common shares outstanding in the period. Diluted loss per common share is calculated by adjusting the weighted average number of common shares outstanding to assume conversion of all dilutive potential common shares.

Reclassification

Amounts in the consolidated statement of loss and comprehensive loss from the prior year have been reclassified to conform to the current year's presentation.

Segment reporting

A segment is a component of the Company that is distinguishable by economic activity (business segment), or by its geographical location (geographical segment), which is subject to risks and rewards that are different from those of other segments. The Company operates in one business segment, namely, mineral exploration.

Future changes in accounting policies

IFRS 7 Financial Instruments: Amendment regarding Offsetting Financial Assets and Financial Liabilities. This amendment enables users of the financial statements to better compare financial statements prepared in accordance with IFRS and US Generally Accepted Accounting Principles. The Company will start the application of IFRS 7 effective from January 1, 2013. The Company does not expect any impact to the financial statements as a result of adopting this amendment.

IFRS 9 Financial Instruments: This standard replaces the current IAS 39 Financial Instruments Recognition and Measurement. The standard introduces new requirements for classifying and measuring financial assets and liabilities. The Company will start the application of IFRS 9 in the financial statements effective from January 1, 2015. The Company has not yet evaluated the impact on the financial statements.

IFRS 10 Consolidated Financial Statements: This standard replaces the current IAS 27 Consolidated and Separate Financial Statements. The standard identifies the concept of control as the determining factor in whether an entity should be included within the consolidated financial statements of the parent company. The Company will start the application of IFRS 10 in the financial statements effective from January 1, 2013. The Company does not expect any impact to the financial statements as a result of adopting this standard.

IFRS 12 Disclosure of Interests in Other Entities: This standard requires disclosures relating to an entity's interests in subsidiaries, joint arrangements and associates, including the reporting entity's involvement with other entities. The Company will start the application of IFRS 12 in the financial statements effective from January 1, 2013. The Company does not expect any impact to the financial statements as a result of adopting this standard.

IFRS 13 Fair Value Measurements: This standard defines fair value, provides guidance on its determination and introduces consistent requirements for disclosures on fair value measurements. The Company will start the application of IFRS 13 in the financial statements effective from January 1, 2013. The Company does not expect any impact to the financial statements as a result of adopting this standard.
IAS 1 Presentation of Financial Statements: The standard provides guidance on the presentation of items of other comprehensive income ("OCI") and their classification within OCI. The Company will start the application of this standard in the financial statements effective from January 1, 2013. The Company does not expect any impact to the financial statements as a result of adopting this standard.

IAS 32 Financial Instruments; Offsetting Financial Assets and Financial Liabilities: The amendment provides further clarification on the application of the offsetting requirements. The Company will start the application of IAS 32 in the financial statements effective from January 1, 2014. The Company has not yet evaluated the impact on the financial statements.

3. SIGNIFICANT ACCOUNTING JUDGMENTS AND ESTIMATES

The preparation of these consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and reported amounts of expenses during the reporting period. Actual outcomes could differ from these estimates. The consolidated financial statements include estimates which, by their nature, are uncertain. The impacts of such estimates are pervasive throughout the consolidated financial statements, and may require accounting adjustments based on future occurrences. Revisions to accounting estimates are recognized in the period in which the estimate is revised and also in future periods when the revision affects both current and future periods.

Significant assumptions about the future and other sources of estimation uncertainty that management has made at the end of each reporting period and for the periods then ended, that could result in a material adjustment to the carrying amounts of assets and liabilities, in the event that actual results differ from assumptions made, relate to, but are not limited to, the valuation of resource properties and the provision for distribution of Rio Verde shares to certain option holders.

The uncertainty in regards to the valuation of resource properties arises as a result of the estimates and judgements such as forecasts of metal prices, operating costs, capital costs and income taxes among numerous other valuation inputs, discount rates, comparability of the Company's properties to those of other market participants and the selection of market-participant assumptions used in the determination of fair value.

The uncertainty in regards to the provision for distribution of Rio Verde shares to option holders arises as a result of estimating the probability that certain option holders will exercise their options.

4. ACQUISITIONS AND SPIN OFF

Acquisition of Rio Verde Shares

On December 10, 2010, Talon entered into an agreement with Rio Verde Minerals Corporation ("Rio Verde Private Co."), at that time a private Brazilian focused fertilizer company, pursuant to which Talon transferred to Rio Verde Private Co. all of Talon's rights in the Sergipe Potash Project licenses in return for approximately 26.6 million shares of Rio Verde Private Co. (representing approximately 54% of the shares in Rio Verde Private Co.).

The Company assessed that control existed over Rio Verde Private Co., and as such Rio Verde Private Co. was fully consolidated until July 27, 2011.

(Expressed in Canadian dollars)

Rio Verde Dilution

Subsequent to the effective date of the Company's acquisition and prior to December 31, 2010, Rio Verde Private Co. issued 5,550,000 common shares to third parties (non-controlling interests or NCI) for proceeds of approximately $2.8 million thereby diluting Talon's ownership interest from 54% to 49%.

Subsequent to December 31, 2010, Rio Verde Private Co. issued 2,910,000 common shares to non-controlling interests for proceeds of approximately $1.45 million thereby diluting Talon's ownership interest from 49% to 44%. The Company retained effective control over Rio Verde Private Co. until July 27, 2011 (see "Distribution of Rio Verde shares"). Under applicable accounting guidance, changes in a parent's ownership interest after control is obtained that do not result in a change in control of the subsidiary are accounted for as equity transactions. As the Company continued to control Rio Verde Private Co. until July 27, 2011, the Company adjusted the carrying amounts of the controlling and non-controlling interests to reflect the changes in their relative interests in Rio Verde Private Co. In April 2011, the Company's shareholding in Rio Verde Private Co. was further reduced by a distribution of one million shares. As a result of the foregoing, the Company recorded in the year ended December 31, 2011 consolidated financial statements:

(i) An increase of $883,376 to NCI; and
(ii) A dilution adjustment of $285,977 as a reduction of deficit.

Distribution of Rio Verde Shares

On July 28, 2011, in accordance with the Plan of Arrangement as voted on and approved by shareholders of the Company, Talon distributed most of its shares of Rio Verde Minerals Development Corp. ("Rio Verde"), the resulting Toronto Stock Exchange listed entity, to Talon shareholders (the "RV Distribution"). Talon shareholders of record at the close of business on July 27, 2011 received one ordinary share of Rio Verde for every four shares of Talon held.

As a result, the following amounts, totalling $8,879,994, were recognized:

(i) A gain on distribution of non-cash asset to shareholders of $11,030,314; and
(ii) Net loss from discontinued operations of $2,150,320.

The following table presents the condensed statements of operations of Rio Verde Private Co. for the periods January 1 to July 27, 2011 and December 10 to December 31, 2010.

	January 1 - July 27, 2011	December 10 - 31, 2010
Expenses		
Office and administration	$ 1,076,486	$ 48,104
Professional fees	836,574	22,959
Share-based payments	194,700	-
Amortization	11,832	3,116
	2,119,592	74,179
Net loss before the following	2,119,592	74,179
Interest income	(33,218)	(27,504)
Write-down of equipment	63,946	-
Net loss and comprehensive loss	$ 2,150,320	$ 46,675

(Expressed in Canadian dollars)

The following table presents the cash flows attributable to the operating, investing and financing activities of Rio Verde Private Co. operations for the periods January 1 to July 27, 2011 and December 10 to December 31, 2010.

	January 1 - July 27, 2011	December 10 - 31, 2010
Cash flows from operating activities		
Net loss for the period	$ (2,150,320)	$ (46,675)
Amortization	11,832	3,116
Write-down of equipment	63,946	-
Share-based payments	194,700	-
	(1,879,842)	(43,559)
Net change in non-cash working capital:		
Sundry receivables and prepaid expenses	42,145	(74,778)
Accounts payable and accrued liabilities	438,965	(435,273)
	(1,398,732)	(553,610)
Cash flows from investing activities		
Mineral property expenditures	(2,988,353)	(102,240)
Acquisition of equipment	(59,214)	(53,715)
Deposit	(1,963,870)	-
	(5,011,437)	(155,955)
Cash flows from financing activities		
Proceeds of issuance of share capital, net of issuance costs	11,785,703	2,720,113
Proceeds from long-term debt	-	4,057
	11,785,703	2,724,170
Change in cash and cash equivalents	5,375,534	2,014,605
Cash and cash equivalents, beginning of the period	7,980,546	5,965,941
Cash and funds in trust, end of the period	$ 13,356,080	$ 7,980,546
Cash and funds held in trust, consist of:		
Cash balances	$ 2,941,819	$ 7,980,546
Funds held in trust	10,414,261	-
	$ 13,356,080	$ 7,980,546

Provision for Distribution of Rio Verde Share to Option holders

The Company retained shares in Rio Verde, to be distributed in most part, to Talon option holders as of July 27, 2011, upon the future exercise by them of their options, on the basis of one ordinary share of Rio Verde for every four Talon options exercised, in accordance with the Plan of Arrangement as voted on and approved by shareholders. A provision of $516,000 (2011 - $510,000) has been recognized for this purpose in the consolidated balance sheets. This provision has been based on the closing share price of Rio Verde as at the relevant reporting date and a probability adjustment to take into account that certain options are out-of-the-money. The recognized liability represents approximately 74% (2011 – 77%) of the potential maximum cash payment.

(Expressed in Canadian dollars)

5. INVESTMENTS

(a) Temporary investments

	December 31, 2012			December 31, 2011		
	Number	Price	Value	Number	Price	Value
Lago Dourado Minerals Ltd.shares	500,000	0.21	$ 105,000	500,000	0.36	$ 177,500
Lago Dourado Minerals Ltd. warrants	-	-	-	500,000	0.08	40,500
Brazilian Gold Corporation shares	3,191,489	0.20	638,298	1,147,967	0.43	493,622
Rio Verde Minerals Development Corporation shares	1,804,838	0.39	703,887	3,467,927	0.30	1,040,378
Rio Verde Minerals Development Corporation warrants	770,000	-	-	770,000	0.19	146,300
			$ 1,447,185			$ 1,898,300

The Lago Dourado Minerals Ltd. warrants expired on July 13, 2012. In 2011, the Lago Dourado Minerals Ltd. warrants were valued using the following assumptions: expected life of 0.70 years, risk-free interest rate of 1.4%, dividend rate of 0%, volatility of 96%, and exercise price of $0.50.

At December 31, 2011, the Company held a total of 1,147,967 Brazilian Gold Corporation ("Brazilian Gold") shares. All of these shares were sold by the Company during the first quarter of 2012. A further 3,191,489 Brazilian Gold shares were received during the first quarter of 2012 under the terms of the amended Sao Jorge sale agreement (see note 6(b)).

The Company has fair valued the Rio Verde warrants at December 31, 2012 at nil because Rio Verde is expected to go-private in Q2 2013 as a result of a merger (in essence a take-over) announced in December 2012 and because the warrants are significantly out-of-the-money. At December 31, 2011, the Rio Verde warrants were valued using the Black-Scholes option pricing model with the following assumptions: expected life of 4.5 years, risk-free interest rate of 2.35%, dividend rate of 0%, and volatility of 110%. These warrants have an exercise price of $0.85 per warrant and expire on July 27, 2016.

(b) Long term investments

Tlou Energy Limited

	2012	2011
Investment in Tlou Energy, beginning of the year	$ 19,615,514	$ 20,937,027
Investment during the year	-	1,556,131
Total comprehensive income (loss) for the year	(2,252,528)	(2,877,644)
Impairment write-down	(11,255,843)	-
Investment in Tlou Energy, end of the year	$ 6,107,143	$ 19,615,514

Effective November 30, 2010, the Company completed a transaction with Tlou Energy Limited ("Tlou Energy") in which Talon transferred to Tlou Energy all of the Company's rights in the Saber Gas Project licenses and some property, plant and equipment, in return for a 30% ownership interest in Tlou Energy valued at approximately $21 million. The Company accounts for its investment in Tlou Energy using the equity method.

In October 2011, the Company took up all of its rights in a Tlou Energy rights offering acquiring another 2,571,428 shares of Tlou Energy (to add to its existing holding of 19,285,714 shares), for a cost of $1,556,131. After this transaction, the Company's share in Tlou Energy increased to 21,857,142 shares, representing approximately 31%. The Company also has the option to increase its investment by subscribing for up to an additional 4,945,055 shares of Tlou Energy at an exercise price of AUD $1.25 each, exercisable until the later of (i) June 30, 2013, and (ii) 30 days after the options have been released from any mandatory escrow required by the Australian Securities Exchange ("ASX") in connection with Tlou Energy's proposed listing.

The impairment loss on the investment in Tlou Energy during 2012 was based on the Company's assessment of the fair value of its interest in Tlou Energy, taking into account various approaches to valuation including the income, cost and market approaches, but primarily the market approach. The write-down was based on a number of factors, including discussions management had with market participants in connection with the price at which Tlou Energy might raise capital in the near term and the general challenging market conditions associated with the ability for junior exploration companies to raise capital.

As at December 31, 2012, Tlou Energy was an unlisted public Australian company.

The following is summarized financial information for Tlou Energy stated in Australian dollars. During 2011 and 2012, the Australian dollar was approximately equal to the value of a Canadian dollar.

	December 31, 2012	December 31, 2011
Total assets	$ 32,633,005	$ 36,721,881
Total liabilities	$ 5,016,091	$ 4,208,005

	Year ended December 31, 2012	Year ended December 31, 2011
Revenues	$ 76,254	$ 730,171
Net loss and comprehensive loss	$ (6,976,414)	$ (9,592,144)

6. RESOURCE PROPERTIES AND DEFERRED EXPENDITURES

The properties on which the Company's subsidiaries carry out exploration and development activities are located in Brazil. Details of additions and impairments for the year ended December 31, 2012 and 2011 are comprised as follows:

	December 31, 2010	Additions	Dispositions and write downs	December 31, 2011	Additions	December 31, 2012
Mineral Properties:						
Trairao Project	$ 606,006	$ 13,474,239	$ (23,421)	$ 14,056,824	$ 2,558,106	$ 16,614,930
Inaja South Project	-	981,965	-	981,965	160,679	1,142,644
Rio Verde Projects (including Sergipe)	8,108,941	3,065,648	(11,174,589)	-	-	-
Agua Branca Gold Project	1,118,904	44,319	(1,163,223)	-	-	-
Campo Grande Gold Project	519,586	8,945	-	528,531	4,664	533,195
Other Projects	597,477	-	(597,477)	-	-	-
	$ 10,950,914	$ 17,575,116	$ (12,958,710)	$ 15,567,320	$ 2,723,449	$ 18,290,769

Although the Company believes it has taken reasonable measures to ensure proper title to its mineral properties in which it has an interest, there is no guarantee that title to any of its mineral properties will not be challenged or impaired. Third parties may have valid claims underlying portions of the Company's interests, including prior unregistered liens, agreements, transfers or claims, including native land claims, and title may be affected by, among other things, undetected defects. In addition, the Company may be unable to operate its properties as permitted or to enforce its rights with respect to its properties.

(a) Trairão Project and Inajá South Project

On September 29, 2010, Talon announced that it had acquired 100% of the rights to the Trairão Project and the Inajá South Project in Pará State, Brazil, through concluding two separate agreements with Codelco do Brasil Mineração Ltda ("Codelco") and Barrick International (Barbados) Corp. ("Barrick Barbados").

Under the agreement with Codelco, Talon paid Codelco a nominal purchase price and will pay a royalty of US$0.7005 per tonne of iron mined and sold, in the event of mining in the future on the licences.

Under the agreement with Barrick Barbados, Talon paid Barrick Barbados a nominal purchase price and is obliged to pay certain production related royalties, at varying levels in respect of specific metals. In the case of the Trairão Project, the royalty payable to Barrick Barbados is US$0.2995 per tonne of iron mined and sold. However, Talon has the right to buy back this royalty for US$599,000 during the 12 month period following the start of commercial production. In the case of the Inajá South Project, Barrick Barbados will receive a net smelter royalty of 0.5% for any base metals sold (sales tonnes) and 1.0% for any precious metals sold (sales tonnes). Talon has the right to buy back the royalty for US$1 million during the 12 month period following the start of commercial production. Barrick Barbados has the right to buy back up to a 50% interest in any future gold mining operation in the event that Talon completes a feasibility study with respect to a deposit which identifies reserves totalling at least three million ounces of gold.

(b) São Jorge Gold Project (see note 7)

Talon entered into an option agreement (the "São Jorge Agreement") dated June 14, 2010 with Brazilian Gold whereby Brazilian Gold was granted an option to purchase a 100% interest in the São Jorge Gold Project. Under the São Jorge Agreement, in order to exercise the option, Brazilian Gold was required to pay Talon a total of $2,250,000 in cash and $2,250,000 in Brazilian Gold shares (calculated as the number of Brazilian Gold shares equal to the dollar amount divided by the twenty day volume-weighted average trading price of Brazilian Gold shares) in three payments of cash and shares. As provided for under the São Jorge Agreement, Brazilian Gold made the first two payments totalling $1.5 million in cash and $1.5 million in Brazilian Gold shares. On February 17, 2012, the Company and Brazilian Gold entered into an amendment agreement ("São Jorge Amendment Agreement") whereby the parties agreed that if the final option payment was made at the time of the São Jorge Amendment Agreement, Talon would accept such payment as $1.5 million in Brazilian Gold shares, instead of $750,000 in cash and $750,000 in Brazilian Gold shares. Given this, Brazilian Gold has exercised the option resulting in the Company indirectly transferring to Brazilian Gold its indirect subsidiary Brazilian Resources Mineracao Ltda. which owns a 100% interest in the São Jorge Gold Project. Talon's wholly-owned subsidiary Brazmin retains a 1% net smelter return royalty ("NSR") over the São Jorge Gold Project.

The related project amounts were classified under Assets Held for Sale, as at December 31, 2011. As of December 31, 2012, the Company no longer owned the São Jorge Gold Project.

(c) Campo Grande Gold Project

The Campo Grande project is located approximately 110 km west of Belo Horizonte, the capital of Minas Gerais State, Brazil. This project consists of one exploration license covering 761 hectares and one exploration license application covering 1,893 hectares (for a total of 2,654 hectares), which are held 100% by Brazmin. An NSR of 1.5% is held by a third party over the exploration license.

7. ASSETS HELD FOR SALE

The Company received 3,191,489 Brazilian Gold shares (valued at $1,500,000 at the time of receipt) during the first quarter of 2012, being the final payment in respect of the "Assets held for sale" relating to the Sao Jorge Gold Project. The difference between the carrying amount at December 31, 2011 of $1,452,978 and the proceeds received of $1,500,000 being, $47,022 was recognized in 2012 on the statement of loss and comprehensive loss as accretion of present value on long-term assets.

(Expressed in Canadian dollars)

Assets held for sale are comprised of the following:

	December 31, 2012	December 31, 2011
Saber plant and equipment	$ 262,400	$ 262,400
Sao Jorge Gold Project	-	1,452,978
	$ 262,400	$ 1,715,378

During 2012, the Company sold equipment for $911,395 that previously had been written down to nil and recognized a gain on sale of the same amount.

8. SHARE CAPITAL AND OTHER EQUITY

(a) Authorized, issued and outstanding common shares

Authorized – 100,000,000,000 common shares, no par value.
Issued and outstanding - 92,076,687 common shares at December 31, 2012, and 92,001,687 common shares at December 31, 2011.

On April 29, 2011, the Company completed a bought deal prospectus offering of 9,804,000 units (each a "Unit") at a price of $2.55 per Unit for gross proceeds of $25,000,200. The Underwriters exercised their full overallotment option to acquire 1,470,600 additional Units for additional gross proceeds of $3,750,030. In total, 11,274,600 Units were sold for gross proceeds of $28,750,230. Each Unit consisted of one common share in the capital of the Company (each a "Common Share") and one-half of one common share purchase warrant (each whole common share purchase warrant, a "Unit Warrant"). Each Unit Warrant entitled the holder thereof to purchase one Common Share at a price of $3.10 at any time up to October 29, 2012. In addition, 552,852 broker warrants were issued on April 29, 2011. These broker warrants expired on October 29, 2012. (The Unit Warrants together with the broker warrants, "Warrants").

The proceeds were prorated to Common Shares and Warrants based on the relative fair value of each component, as follows: Common Shares - $23.5 million; Warrants - $5.2 million. The Black-Scholes option pricing model was used to determine the fair value of the Warrants using the following assumptions: expected dividend yield – nil; expected volatility –112%; risk free interest rate – 1.62%; and an expected life of eighteen months.

During 2012, all the Warrants expired and the proceeds attributed to the Warrants were reclassified to share capital.

(b) Warrants

Warrant transactions during the years ended December 31, 2012 and December 31, 2011 are as follows:

(Expressed in Canadian dollars)

	2012					2011				
	Number of Warrants		Weighted average exercise price	Fair Value		Number of Warrants		Weighted average exercise price		Fair Value
Outstanding – beginning of the year	6,190,152	$	3.05	$5,546,292		5,323,163	$	0.60	$	1,388,815
Issued						5,637,300		3.10		5,250,038
Issued						552,852		2.55		643,150
Cost of issuance										(346,896)
Expired	(6,190,152)		3.05	(5,546,292)						
Exercised						(5,323,163)		0.60		(1,388,815)
Outstanding – end of the year	-	$	-	-		6,190,152	$	3.05	$	5,546,292

9. STOCK OPTION COMPENSATION PAYMENTS – EMPLOYEE SHARE OPTION PLAN

The Company has adopted a stock option plan (the "Plan") for its directors, officers, employees and consultants to acquire common shares of the Company. The exercise price of each option is determined by the board of directors of Talon but, in any event, is not lower than the closing market price on the Toronto Stock Exchange on the trading day immediately preceding the date the option is granted. The terms and conditions of the options are determined by the board of directors of the Company pursuant to the rules of the Plan. All options are granted for a term not exceeding ten years from the grant date. The total number of options that can be granted is limited to 12.5% of the issued and outstanding share capital of the Company.

A summary of the status of the options outstanding as at December 31, 2012 and as at December 31, 2011 and changes during the years ended on those dates is presented below:

	December 31, 2012			December 31, 2011		
	Number of stock options		Weighted average exercise price	Number of stock options		Weighted average exercise price
Outstanding – beginning of the year	9,489,350	$	1.00	6,739,000	$	0.45
Granted	2,800,000		0.45	1,485,000		1.93
Granted	465,408		0.37	2,085,000		1.95
Granted	1,279,592		0.415	250,000		1.00
Granted	400,000		0.33			
Cancelled	(500,000)		0.40	(50,000)		0.70
Cancelled	(430,000)		1.58	(150,000)		1.58
Cancelled	(950,000)		1.95	(45,000)		1.95
Cancelled	(60,000)		0.70	(30,000)		2.48
Cancelled	(30,000)		2.12			
Exercised	-		-	(109,500)		0.39
Exercised	(75,000)		0.40	(685,150)		0.40
Outstanding – end of the year	12,389,350	$	0.70	9,489,350	$	1.00

1,733,733 of the 12,389,350 options outstanding have been issued outside of the Company's Plan.

(Expressed in Canadian dollars)

The weighted average share price when options were exercised was $0.37 (2011 - $1.42).

As at December 31, 2012, the Company had the following stock options outstanding:

Date of grant	Number of options	Exercisable	Exercise price	Expiry date
February 18, 2008	200,000	200,000	$0.57	February 18, 2013
June 11, 2009	490,000	490,000	$0.385	June 11, 2014
May 21, 2010	3,669,350	3,669,350	$0.40	May 21, 2015
October 26, 2010	900,000	900,000	$0.70	October 26, 2015
January 17, 2011	305,000	305,000	$1.58	January 17, 2016
February 7, 2011	40,000	40,000	$2.12	February 7, 2016
March 3, 2011	500,000	500,000	$2.48	March 3, 2016
May 25, 2011	1,090,000	1,090,000	$1.95	May 25, 2016
October 1, 2011	250,000	250,000	$1.00	October 1, 2016
January 31, 2012	2,800,000	700,000	$0.45	January 31, 2017
April 4, 2012	1,279,592	491,828	$0.415	April 4, 2017
April 25, 2012	465,408	30,672	$0.37	April 25, 2017
June 15, 2012	400,000	100,000	$0.33	June 15, 2017
	12,389,350	8,766,850		

A stock option compensation payment cost of $1,024,194 for the options vested in the year ended December 31, 2012 (2011 – $6,020,178) was recognized in the consolidated statements of loss and comprehensive loss.

In January 2012, 2.8 million options were issued to an officer of the Company. These have a contractual life of 5 years and an exercise price of $0.45. They vest as follows: 700,000 vested on February 9, 2012, 700,000 on the earlier of 12 months from the date of grant or the date that the 5 day volume weighted average trading price ("VWAP") is at least $1.00, 700,000 on the earlier of 18 months from the date of grant or the date that the VWAP is at least $1.50 and 700,000 on the earlier of 24 months from the date of grant or the date that the VWAP is at least $2.00.

In April 2012, 1,279,592 options were issued to certain of the officers, employees and consultants of the Company. These have a contractual life of 5 years and an exercise price of $0.415. They vest as follows: 491,828 vested on April 4, 2012, 157,500 on the earlier of April 1, 2013 or the date that the VWAP is at least $1.00 and 146,973 on the earlier of October 1, 2013, or the date that the VWAP is at least $1.50. In addition, 250,000 options vest on the earlier of March 20, 2013 or the date that the VWAP is at least $1.00 and another 233,291 options vest on the earlier of September 20, 2013, or the date that the VWAP is at least $1.50.

Also in April 2012, 465,408 options were issued to certain of the officers, employees and consultants of the Company. These have a contractual life of 5 years and an exercise price of $0.37. They vest as follows: 30,672 vested on April 25, 2012, 10,527 will vest on the earlier of October 1, 2013 or the date that the VWAP is at least $1.50 and 157,500 on the earlier of April 1, 2014 or the date that the VWAP is at least $2.00. In addition, 16,709 options vest on the earlier of September 20, 2013 or the date that the VWAP is at least $1.50 and another 250,000 options vest on the earlier of March 20, 2014, or the date that the VWAP is at least $2.00.

In June 2012, 400,000 options were issued to an officer of the Company. These have a contractual life of 5 years and an exercise price of $0.33. They vest as follows: 100,000 vested on June 15, 2012, 100,000 on the earlier of 12 months from the date of grant or the date that the VWAP is at least $1.00, 100,000 on the earlier of 18 months from the date of grant or the date that the VWAP is at least $1.50 and 100,000 on the earlier of 24 months from the date of grant or the date that the VWAP is at least $2.00.

(Expressed in Canadian dollars)

During 2011, the Company issued options to certain of its officers, directors, employees and consultants, of which some vested and some were cancelled as follows:

- February 2011 - 70,000 options were granted with an exercise price of $2.12 which vested on the date of grant and have a life of 5 years of which 30,000 were cancelled in 2012.
- March 2011 - 530,000 options were granted with an exercise price of $2.48 which vested on the date of grant and have a life of 5 years of which 30,000 were cancelled in 2011.
- May 2011 - 2,085,000 options were granted with an exercise price of $1.95 and a life of 5 years. Other than as hereinafter provided, the May 2011 options vested immediately. 1,000,000 of the May 2011 options were to vest in equal amounts after 6 months, 12 months, 18 months and 24 months from the date of grant. In the first quarter of 2012, the options that were due to vest after 12 months, vested immediately and the options that were due to vest 18 and 24 months after the date of grant were cancelled. In addition, 150,000 of the May 2011 options were subject to vesting. 50,000 of these options vested immediately, 50,000 vested after 6 months, and 50,000 were to vest after 12 months. All 150,000 of these options were cancelled in January 2012.
- October 2011 – 250,000 options were granted with an exercise price of $1.00 and a life of 5 years. They vest in equal amounts after 6 and 12 months from the date of grant. In the second quarter of 2012, the 125,000 options that were to vest in 12 months vested immediately and the expiry date of each set of 125,000 options was changed to June 30, 2013 and December 31, 2013, respectively.

The fair value of the options granted was determined using the Black-Scholes option pricing model, using the following range of assumptions:

	2012	2011
Risk-free interest rate	1.4%	1.4%
Expected life	5 years	5 years
Expected volatility	102-111%	215-235%
Dividend yield	Nil	Nil

10. LOSS PER SHARE

(a) Basic

Basic loss per share has been calculated using the weighted average number of common shares outstanding during the year.

(b) Diluted

Diluted loss per share has not been presented as it is anti-dilutive.

11. FINANCIAL INSTRUMENTS

The Company's financial instruments include cash and cash equivalents, term deposits, accounts and other receivables, investments, accounts payable and accrued liabilities.

The Company has classified its financial assets and liabilities into the following levels (as discussed in Note 2) as follows:

Level 1		
Cash and cash equivalents	$	16,485,729
Investments	$	1,447,186

12. FINANCIAL RISK MANAGEMENT

(a) Credit risk management

Certain of the Company's financial assets are exposed to a degree of credit risk. The Company endeavors to mitigate credit risk by holding its cash and cash equivalents as cash deposits, short-term government treasury bills, money market funds and GIC's with major commercial banks.

Credit risk relating to accounts receivable arises from the possibility that any counterparty to an instrument fails to perform. The Company does not feel there is significant counterparty risk that could have an impact on the fair value of cash and cash equivalents and receivables.

(b) Liquidity risk

The Company has in place a planning and budgeting process to help determine the funds required to support the Company's normal operating requirements on an ongoing basis and its capital, development and exploration expenditures. The Company ensures that there are sufficient funds to meet its short-term requirements, taking into account its anticipated cash flows from operations and its holdings of cash and cash equivalents.

As of December 31, 2012, the Company had a cash and cash equivalents balance of $16,485,729 (December 31, 2011 - $21,570,417) to settle current liabilities of $1,072,118 (December 31, 2011 - $1,610,003).

(c) Market risk

Market risk is the risk that changes in market prices including foreign exchange rates and interest rates will affect the Company's income or the value of its financial instruments. The Company records its investments using the close price at the end of the reporting period. Changes in the close price will affect the fair value of these investments. A 5% change in the value of the Company's investments on the last day of the year with all other facts/assumptions held constant, would have affected net loss of the Company for the year ended December 31, 2012, by approximately $72,359.

(d) Foreign exchange risk

The Company is exposed to movements in the United States Dollar and the Brazilian Real as transfers are made to the Brazilian subsidiaries of the Company in United States Dollars and subsequently converted in Brazil to Brazilian Reals.

At December 31, 2012, the Company had net monetary assets and liabilities in foreign currencies, as follows (Canadian dollar equivalent):

United States dollars	$6,696,049
Brazilian Real	$ 167,262

If foreign exchange rates changed by 5% on the last day of the year with all other facts/assumptions held constant, there would be a change in the net loss of the Company for the year ended December 31, 2012 of approximately $343,165.

The Company entered into currency hedging activities during February and March 2012 in order to preserve the value of cash held in Brazilian Real.

(e) Interest rate risk

Interest rate risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The risk of investing cash equivalents into fixed interest rate investments is mitigated by the short terms in which these investments mature. The Company is exposed to interest rate risk only to the extent of its interest income on Treasury bills and money market funds. These are typically short-term investments with a term of less than ninety days. The Company has no interest bearing debt.

13. CAPITAL RISK MANAGEMENT

Capital is comprised of equity which at December 31, 2012 was $41,736,860 (December 31, 2011 - $59,233,182). The Company manages its capital structure and makes adjustments to it, in order to have the funds available to support its exploration, development and operations activities.

The Company's objective when managing capital is to safeguard the Company's ability to continue as a going concern in order to pursue the exploration of its mineral properties and maximize shareholder returns. The Company satisfies its capital requirements through careful management of its cash resources and by utilizing bank indebtedness or equity issues, as necessary, based on the prevalent economic conditions of both the industry and the capital markets and the underlying risk characteristics of the related assets. As at December 31, 2012, the Company had no bank debt.

Management reviews its capital management approach on an ongoing basis. There were no changes in the Company's approach to capital management during the year ended December 31, 2012. The Company is not subject to externally imposed capital requirements.

14. RELATED PARTY TRANSACTIONS AND BALANCES

Related parties include the board of directors of the Company, close family members and enterprises which are controlled by these individuals as well as certain persons performing similar functions.

Effective April 1, 2011, the Company entered into a revised administrative and advisory services agreement (the "**Tau Agreement**") with Tau Capital Corp. ("**Tau**"). Warren Newfield and Greg Kinross, both directors of Talon are also directors of Tau. Under the Tau Agreement, Talon agreed to pay Tau a monthly service fee of $58,500. Effective April 1, 2012, the parties agreed to lower the monthly service fee to $25,000, given that Tau would be providing fewer direct services to Talon. On June 1, 2012, the Tau Agreement was terminated by the parties. For the year ended December 31, 2012, fees paid for these services were $225,500 (2011 - $625,500).

Effective April 1, 2011, Talon entered into a services agreement with a company owned by an officer and director of Talon (Luis Azevedo) (the "**Brazil Agreement**"). Pursuant to the Brazil Agreement, the company provides Talon with certain accounting, legal and general administrative functions in Brazil. The Brazil Agreement had an initial term of one year and automatically renewed for additional one year terms, until terminated in accordance with its terms. Under the Brazil Agreement, Talon agreed to pay a monthly service fee of US$33,000. Effective May 1, 2012, the parties agreed to lower the monthly service fee to US$23,000 and, on October 1, 2012, the parties agreed to further lower the monthly service fee to US$18,000. Coupled with the revised fee in October 2012, the parties agreed to a one year term for the Brazil Agreement terminating September 30, 2013, unless extended by agreement of the parties. For the year ended December 31, 2012, fees paid amounted to $309,726 (2011 - $360,254).

Accounts payable and accrued liabilities at December 31, 2012 include $1,919 payable to Tau (2011 - $60,000 payable to Luis Azevedo, an officer of the Company for consulting fees).

The remuneration of directors and officers of the Company for the years ended December 31, 2012 and 2011 were as follows:

		2012		2011
Cash compensation	$	1,619,457	$	869,142
Share based compensation	$	1,007,676	$	943,766
Aggregate compensation	$	2,627,133	$	1,812,908

Included in cash compensation is severance cost of $354,369 (2011 – nil).

Certain officers of the Company were awarded the following share options during the year ended December 31, 2012:

Date Granted	Number	Exercise Price		Expiration Date
January 31, 2012	2,800,000	$	0.45	January 31, 2017
April 4, 2012	975,277	$	0.415	April 04, 2017
April 25, 2012	354,723	$	0.37	April 25, 2017
June 15, 2012	400,000	$	0.33	June 15, 2017

15. INCOME TAXES

The Company is incorporated in the British Virgin Islands. There is no corporate tax in the British Virgin Islands. The Brazilian subsidiaries have loss carry forwards of approximately $8 million which are available to shelter future taxable income. These losses have no expiry date, but can only be offset against taxable income to the extent of 30% in a year.

The Company has taken a full valuation allowance against the deferred tax asset relating to the losses, and according, no deferred income tax asset has been recognized in these consolidated financial statements.

16. GEOGRAPHIC INFORMATION

Interest income is earned in Canadian dollars, United States dollars and Brazilian Real. Almost all of the Company's equipment is in Brazil and all of the mineral properties are located in Brazil.

17. PRIOR PERIOD ADJUSTMENTS

(a) The consolidated financial statements of the Company as at December 31, 2011 and for the year then ended have been adjusted to account for a portion of the gain in connection with the distribution of the shares of Rio Verde as a result of a Plan of Arrangement as voted on and approved by shareholders of the Company (Note 4). A portion of the gain, amounting to $9,862,385 was credited directly to retained earnings. Under IFRS, it should have been reported as a gain in the consolidated statements of loss and comprehensive loss. The effect of this prior period adjustment is an increase to net income and no change to the reported assets or liabilities.

(b) The consolidated financial statements of the Company as at December 31, 2011 and for the year then ended have been adjusted to account for the provision for distribution of Rio Verde shares to option holders in connection with the Plan of Arrangement as voted on and approved by shareholders of the Company (Note 4). The effect of this prior period adjustment for the year ended December 31, 2011 has been to increase current liabilities, as well as expenses, in the amount of $510,000.