



 **Vital Metals Ltd**

ANNUAL REPORT 2006

Corporate Directory

Directors

William Ryan Executive Chairman
Mark McAuliffe Independent Non-Executive Director
D. Ross Kennedy Independent Non-Executive Director
Andrew Simpson Independent Non-Executive Director
Colin Hunter Independent Non-Executive Director

Company Secretary

John Sobolewski

Principal Office

Level 1, 335 Hay Street
Subiaco WA 6008

Registered Office

Level 1, 335 Hay Street
Subiaco WA 6008

Auditors

KPMG
152–158 St George’s Terrace
Perth WA 6000

Share Registry

Security Transfer Registrars Pty Ltd
770 Canning Hwy
Applecross WA 6153

Annual General Meeting

The Annual General Meeting of Vital Metals Ltd will be held at the Celtic Club,
48 Ord Street, West Perth WA at 10.00am on Tuesday, 21 November 2006.

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Chairman's Review



Dear Fellow Shareholder

This is the first full Annual Report since Vital Metals listed on the ASX in October 2005 and covers a period of exceptional prosperity for the mining industry generally. In the case of Vital Metals Ltd, its inaugural year has been one of intense activity, specifically at the company's flagship Watershed Tungsten Project.

As most of you will be aware, Watershed is a world class deposit of scheelite (the most common ore of tungsten) situated in far North Queensland. Watershed was discovered by the Utah Development Company in 1978 and extensively explored by that company over the following seven years. Vital acquired the deposit as its key Project with the clear objective of carrying out any and all technical and associated work that is required to complete a full Feasibility Study at a standard suitable for mine development and financing.

Based on thorough analysis of the world tungsten market, Vital is attempting to build a large mine, to produce, in the first instance, a concentrate product containing 4,000 tonnes of contained WO_3 per annum, with a mine life of at least ten years. This figure would represent approximately seven per cent of the entire world usage and would be amongst the largest such mines in the world.

The work that must be done to achieve this objective began immediately following the IPO fund-raising of \$8 million with the establishment of a fully

self-contained camp facility for twenty persons at the Watershed site, the commencement of metallurgical and infill drilling in late November 2005 followed by a program of metallurgical evaluation test work and the commencement of detailed environmental studies in the first quarter of 2006.

Diamond drilling continued until the end of January 2006 when the tropical wet season stopped operations. Following the wet season it became necessary to secure new drilling contractors; a task which proved difficult and delayed the overall evaluation program for several months—a most frustrating situation for the directors and shareholders alike.

In the interim, our technical team of geologists and geological consultants have re-logged and re-evaluated much of the old Utah drill core and have developed a new model of the Watershed mineralisation—with important implications.

I am pleased to report that the drilling program is now back 'on track' and we expect to complete most of the planned resource drill-out before the onset of the 2007 'wet'. At the time of writing this report, no assay results are yet available from any of the 15 holes drilled or in progress, but there is visible scheelite in portions of the core from most of the holes completed.

Our environmental consultants have completed a comprehensive 'current status' evaluation and report of the important environmental factors at and around the Watershed deposit. This assessment will be a most

Chairman's Review



Aerial photograph of the Watershed Tungsten Project.

important component in allowing the company to gauge and to minimise the effect of any mining and processing operation in the area.

In the metallurgical studies we have completed two stages of testing and evaluation work and believe the processing route is likely to be a simple one involving size reduction to what is being indicated as a pleasingly coarse liberation size for the scheelite, gravity recovery from the coarse size fraction and flotation treatment of the fines.

We have also instigated search and evaluation measures for water supply and are in the process of assessing the power supply options, as grid power may well be available to this Project.

Like most of our fellow explorers and developers in this industry at this time, Vital is experiencing some difficulties with cost pressures and in obtaining adequate experienced personnel and contractors when needed. However, I can assure all shareholders that all Project work is being performed thoroughly and as rapidly as possible, with a strong outside 'technical audit' component and, most of all with genuine commitment.

The demand for tungsten concentrates has followed the general trend of most metals and has been very buoyant for the past eighteen months with the outlook forecast to be one of continuing strength. Current price for concentrates has been hovering around US\$200 per metric tonne unit for over twelve months and is predicted to continue at around these levels.

All directors and staff of Vital are enthusiastic about the possibilities for the development of Watershed and about the latent potential of this mineral deposit. At this time next year we expect to be able to deliver to you a complete Evaluation and Feasibility Report on the future for this Project.

In conclusion, I must thank all of my fellow directors for their support throughout this first year and all of the company's staff, consultants and contractors for their efforts during this same period. In particular I must single out Bruce Pertzelt, our Principal Geologist and Andrew Harwood, the Watershed Project Geologist, who have carried much of the load of accelerating and maintaining the pace of field activities at site during this year.

We look forward to these most important developments over the coming twelve months.

A handwritten signature in black ink, appearing to read 'W. Ryan', written in a cursive style.

William J Ryan
Executive Chairman

Report on Operations



Drilling at Watershed.

Vital Metals Ltd listed on the ASX in October 2005 as a company specifically focused on tungsten and molybdenum. Vital is involved in three projects; the Watershed deposit in Queensland and Mt Alexander and Mt Mulgine in Western Australia.

The principal focus of the work to date has been the flagship 'Watershed' scheelite deposit located in far North Queensland. Scheelite is one of the two common ores of tungsten and is chemically known as calcium tungstate (CaWO_4). The deposit was discovered and drilled extensively by the Utah Development Company

(UDC) in the period 1978 to 1985 and is a potentially world-class ore body.

On the basis of forty-three diamond core holes UDC estimated an Inferred Resource of 13,900,000 tonnes at an average grade of 0.35 per cent WO_3 . This estimate preceded the JORC Code but is considered compliant as an Inferred Resource under current guidelines.

It is on this project that the company has concentrated the majority of its effort and expenditure.

Report on Operations

Watershed – Queensland (Vital 100 per cent)

Watershed is located approximately 170 kilometres north-west of Cairns and some 35 kilometres north-west of the township of Mt Carbine. The project was purchased at listing from BHP Billiton, who had inherited it and its very extensive database, when they completed the takeover of UDC.

UDC had completed some 56 diamond core holes in the area of which 43 were drilled into the actual Watershed resource. All core has been stored in an orderly fashion at site since that time.

Vital Metals' objective has been to pursue a feasibility study on this deposit by:

1. Completing a major program of in-fill and extension diamond drilling to raise the status of the Inferred Resource to Measured and Indicated;
2. Carrying out adequate metallurgical development work to design an optimum process flow sheet to recover the scheelite from the ore;
3. Completing a comprehensive assessment of the existing environmental conditions in order to facilitate the assessment of the impact of a major mining operation in that environment;
4. Assessing all landowner, Native Title and Cultural Heritage issues;
5. Locating suitable water supplies to feed to the operation;
6. Conducting a full review of all marketing issues associated with the production and sale of scheelite concentrate;
7. Constructing a detailed financial model for such an operation; and
8. Combining all the above technical and financial information into a document appropriate for securing suitable funding for development.

Resource Drilling

Drilling first began in November 2005, shortly after listing, and 987 metres were completed in the form of four large diameter (PQ/HQ) metallurgical holes and two HQ/NQ holes (MWD077 and MWD078) that twinned previous UDC holes.

The samples from the metallurgical holes were used in the test program described below while the twin holes produced slightly more favourable results than achieved by UDC. Vital Hole MWD077 encountered a best intercept of 9 metres at 1.028 per cent WO_3 in comparison with the equivalent UDC interval averaging 0.235 per cent WO_3 while Vital Hole MWD078 achieved a best intercept of 4 metres at 0.863 per cent WO_3 , roughly the same as the UDC equivalent.

The drilling was aborted by Vital at the end of January 2006 due to a combination of excessive cost and slow progress. New contractors were sought but drilling was not resumed until July 2006. Two new diamond rigs began two individual 4,000 metre contracts during July.

It is anticipated that the in-fill program should be approaching completion by the end of the 2006 calendar year.

Geological investigations by Vital's geologists and consultants have led to the development of a new model for the Watershed mineralisation compared with that proposed by UDC. One of the consequences of the adoption of this model is that most of the Vital holes will, for the immediate future, be drilled from south to north rather than the west to east azimuth adopted for most of the UDC drilling.

As at 3 September 2006, since the resumption of drilling activity, a further 2,960 metres in 15 holes have been drilled. Unfortunately, at the time of writing, no assay results from the cut core are to hand.



Andrew Harwood (Project Geologist) examining Watershed diamond drill core.

Report on Operations



Watershed core yard.

Source Rocks and Style of Mineralisation

A systematic re-appraisal of the geology and mineralisation of the Watershed tungsten deposit has been in progress over the first half of 2006 and is continuing, in conjunction with the current Vital Metals' in-fill drilling program. This re-appraisal has included re-logging core from diamond drill holes completed by previous explorers, Utah and Geopeko, in the period 1980 to 1985.

To date a total of 15 holes, from the suite of 54 holes that delineated the deposit, have been re-logged by the Vital team.

As part of this re-logging a limited suite of six selected specimens of altered and mineralised core has been the subject of detailed petrological study. This study has confirmed the existence of a significant new style of scheelite mineralisation which has previously not been identified; namely that high grade, coarse disseminated scheelite occurs in an altered igneous rock.

This rock is now referred to as an '**albitised granite**' to describe the style of alteration, (in which original feldspar has been altered to albite) and to identify the different rock type (granite) which contrasts to the sedimentary type of host rock in which, to date, the scheelite mineralisation at Watershed has been found.

Details of these occurrences are given in Table 1.

Hole ID	From (m)	To (m)	Interval	% WO ₃	Comments
MWD005	66.0	68.0	2.0	3.49	Albitised granite from 66.8 to 67.75 hosted by Arenite
MWD009	88.0	90.0	2.0	1.77	Albitised granite from 88.76 to 88.98 hosted by Arenite
MWD011	39.0	42.00	3.0	1.07	Albitised granite from 39.7 to 41.1 hosted by Arenite
MWD018	96.0	98.0	2.0	1.37	Albitised granite from 96.95 to 97.40 hosted by Arenite
MWD027	226.0	230.0	4.0	1.52	Albitised granite from 226.75 to 229.85 cut by a massive quartz vein from 227.55 to 229.55

Table 1. Albitised granite intercepts in previous Utah drill holes.

Note: Interval is down-hole length and is not necessarily a true width. (m = metres).

Report on Operations



Aerial photograph of the Watershed Tungsten Project.

Report on Operations



Cutting core at Watershed.

Occurrences of albitised granite have been observed in five of the previous Utah drill holes. Each occurrence falls within a zone where high-grade scheelite mineralisation has been reported from the routine half-core samples taken by Utah in their 1980-1982 drilling campaign. These occurrences are of a dyke-like form (tabular shaped bodies intruded into the sedimentary rock sequence) and those identified so far occur in the south-western part of the Watershed deposit.

Since taking over the Project last year, Vital's geological team has developed a revised model for the Watershed mineralisation. This new model proposes the scheelite mineralisation to be attributable primarily to quartz-vein swarms and replacement-style alteration of favourable host rocks adjacent to veins – in association with the strata-bound deposit style proposed previously by Utah and Geopeko. The significance of this new model is that it postulates a granite source for the tungsten mineralisation.

Subsequent to an extended field visit to Watershed at the end of 2005, Vital's geological consultant Dr Teunis Kwak—an international skarn and tungsten expert—has also concluded that it is most probable the scheelite mineralisation is genetically related to a granite pluton.

The Vital team's recent conclusion, that high-grade scheelite mineralisation occurs in altered granitic rock—specifically **albitised granite**—in dyke-like occurrences at Watershed is significant and provides further evidence of the probable genetic link between the mineralisation and a granitic pluton at depth.

Vital intends to investigate this new style of mineralisation in greater detail and will pursue this search in conjunction with the current program of drilling, which is primarily designed to upgrade the Utah resource estimate.

The three occurrences of albitised granite observed to date are related to high-grade zones of scheelite mineralisation and Vital will investigate the probability that the narrow dyke-like occurrences are apophyses (offshoots) from larger, altered and mineralised bodies at depth.

These bodies, if present, could be considered to be parent bodies to the dyke-like occurrences and as such would be of larger areal extent. However, although their existence is only postulated at this stage and their position and size remains unknown, they constitute an exciting second-stage target which could substantially enhance the value of this unique deposit.

The successful delineation of such bodies or body however obviously would have a substantial (positive) impact on the quantum of the resource(s) at Watershed.

Report on Operations



Drilling at Watershed.



Watershed core yard.

Metallurgical Testing

To date the metallurgical test program has been split into two parts; being the trials on the use of conventional (X-Ray fluorescence) ore sorting and the testing of gravity concentration for coarse scheelite recovery.

(a) Ore Sorting

UDC carried out ore sorting trials on samples of Watershed material in 1982 with some impressive results. Using a prototype sorting machine in Melbourne, the mineralised material was upgraded in various tests by a factor varying between 3.5 and 4 times with an overall scheelite loss of less than ten per cent. Hand sorting tests by Promet Engineers Pty Ltd, on behalf of Vital Metals in 2005 achieved similar results.

In early 2006 a series of tests on Watershed material of varying grades was conducted at the test facility of equipment manufacturer CommoDas in

Hamburg, Germany. The final results of these tests are awaiting assay data but, on a tonnage basis, were most encouraging for the medium-grade and the high-grade material and somewhat inconclusive for the low-grade samples.

The mass separation characteristics are illustrated in Chart 1 (below) which shows—for the high-grade material—a 58 per cent to 41 per cent reject/accept ratio which is most encouraging, depending on the tungsten contents of the two fractions.

For the low-grade material (circa 0.07 per cent WO_3) the sensors had difficulty in identifying the finer, disseminated scheelite and further work with various wavelength X-rays is needed. This work will be conducted in Germany probably in October of 2006.

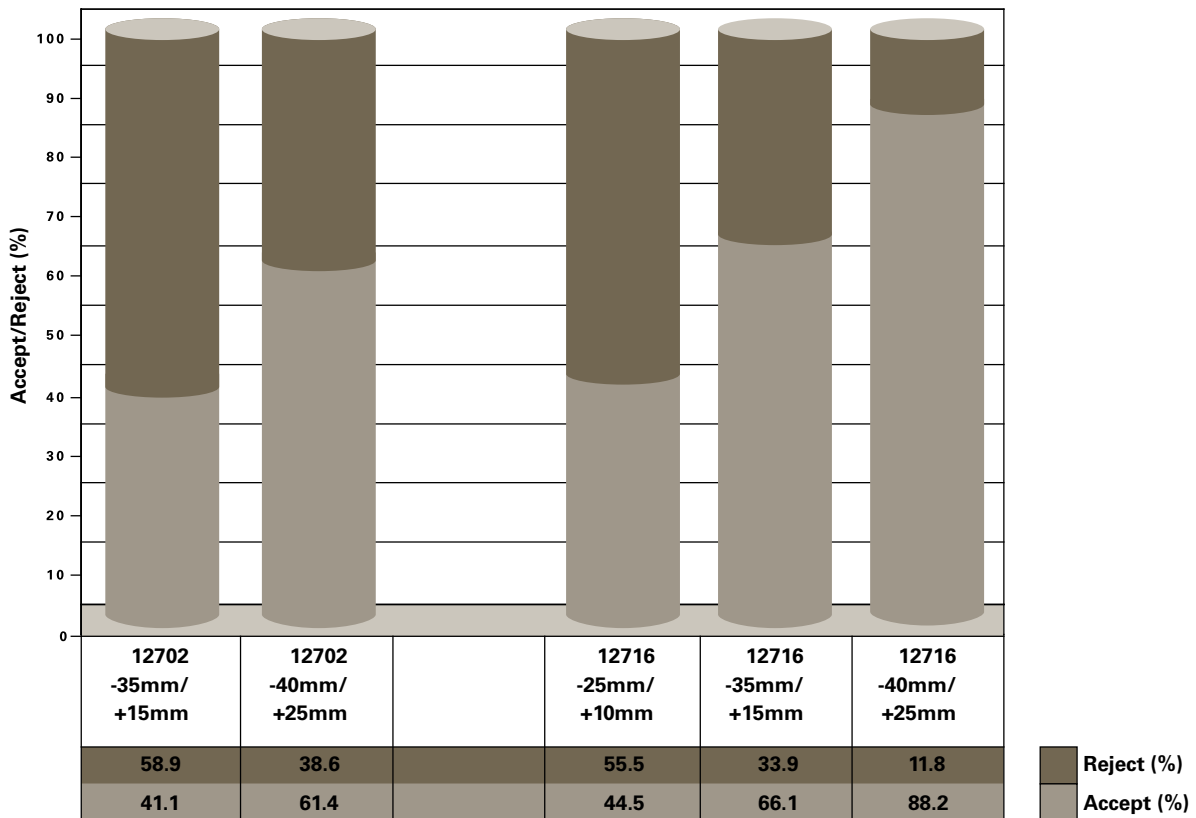


Chart 1. Ore sorting - qualitative test results.

Report on Operations



Drilling at Watershed.

(b) Mineral Dressing

Through its metallurgical consultants, Promet Engineers Pty Ltd, the Company has conducted two stages of metallurgical evaluation and test work on the large diameter drill core used as sample material. The work to date has included an assessment of the liberation size of the scheelite particles and the determination of key characteristics of the ore such as hardness, abrasion and the like. First tests have also been completed on the recovery of scheelite by conventional gravity separation processes. The essential assay data from these tests is not available at the time of writing.

The pace of the development of the metallurgical flow sheet is planned to accelerate substantially over the next three months and the results will be reported at appropriate stages.

Environmental

A comprehensive series of field surveys designed to assess the status of the local water drainages and flora and fauna occurrences have been completed at the site of the deposit and most of the area that may be affected by any planned mining and processing operation.

The purpose of this work was to facilitate the compilation of a thorough Environmental Baseline Study which will be required in the future assessment of the effect of a substantial mining operation on the local and regional environment.

Aboriginal Matters

Contact has been made with the Traditional Landowners and Cultural Heritage Clearance has been obtained for the proposed drilling program and sites. A more comprehensive inspection of the entire Project Area is planned for the second half of 2006.

The Project Area straddles two Pastoral Holdings, one of which has permanently extinguished Native Title. The actual Watershed deposit is located almost entirely on the area of extinguishment. However, the Company wishes to work in co-operation with the local community and will consult with the Traditional Owners as regards future activities.

Water Supply

Preliminary work on the location of suitable ground water sources has commenced.

Report on Operations

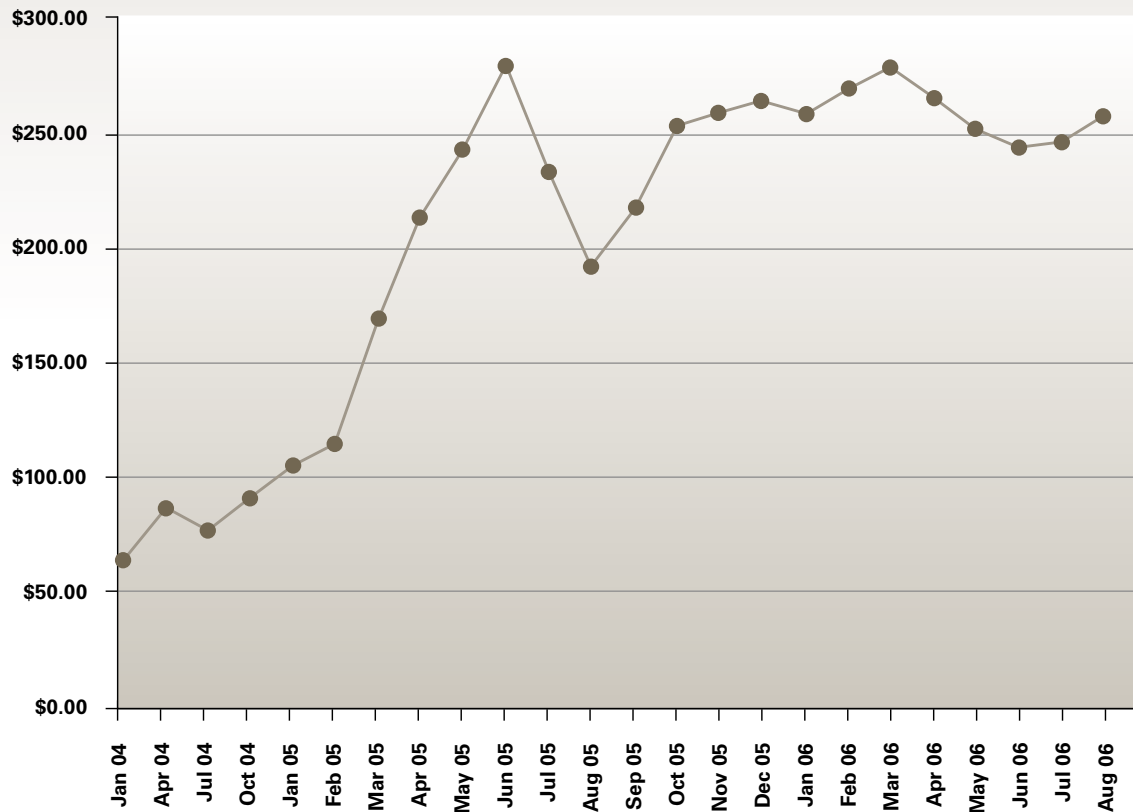


Chart 2. Price History for tungsten as APT 2004-6.

Marketing

Vital Metals has maintained regular communications with the major western world tungsten consumers and is well positioned to capitalise on current marketing conditions when the need arises. The company has also been approached by a number of substantial Chinese tungsten buyers.

The current price for tungsten concentrates and for the more regularly-traded intermediate product, APT (ammonium paratungstate), has been strong throughout the year and, on the basis of the best available information, the future outlook for tungsten is excellent. The APT price for the past two years is shown in Chart 2 (above).

Outlook

The Company is on track to complete a detailed study of all technical and financial aspects of a scheelite mining and processing operation and to prepare a feasibility study document suitable for submission to potential funding institutions by the end of June 2007.

EPM14735 (Vital 100 per cent; tungsten mineralisation only)

In addition to the work being undertaken at the main Watershed deposit located on MDL127 described above, the Company is also conducting exploratory work involving geochemical sampling and target verification on EPM14735 (held by Republic Gold Ltd) which surrounds and adjoins MDL127 mainly on the southern side.

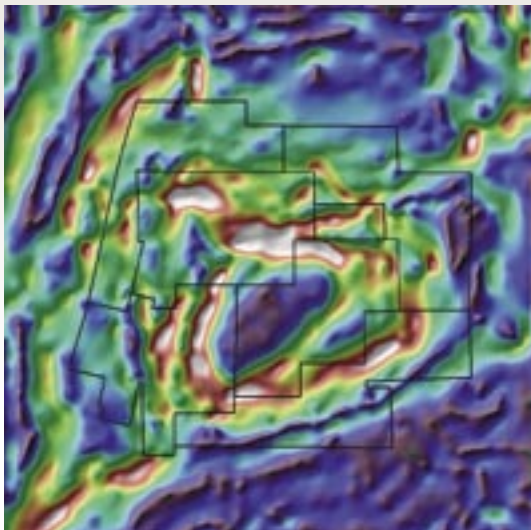
Vital has purchased the rights to any and all tungsten mineralisation on this Permit and has an obligation to expend a minimum of \$75,000 by the end of 2006.

Preliminary investigations have suggested several promising targets for tungsten mineralisation within this area.

EPM15064 (Vital 100 per cent)

This tenement adjoins and surrounds MDL127 principally on the northern boundary. This EPM has now been granted and exploration will be conducted in conjunction with the investigations of the northern extension to the Watershed mineralisation.

Report on Operations



*Mt Mulgine Bouguer Gravity Survey
Total Horizontal Gradient.*

Mt Mulgine - Western Australia (Vital earning 70 per cent)

The Mt Mulgine project is situated some 400 kilometres north of Perth in the mid-west area of Western Australia. Vital Metals Ltd can earn seventy per cent equity in the tungsten and molybdenum mineralisation by sole funding the next \$750,000 over three years (since listing).

Previous exploration by a number of companies since 1965 has identified and semi-quantified two substantial deposits of tungsten (as scheelite) at the 'Hill' deposit and tungsten/molybdenum at the 'Trench' deposit. In terms of the current estimate of the contained tungsten content, the Trench deposit rates as the eight largest accumulation on earth (at 83.4 million tonnes at an average grade of 0.136 per cent WO_3 plus an unquantified molybdenum content) but is of an overall very low grade. Nevertheless, it is a large prize worthy of further work.

A representative suite of both mineralised and un-mineralised core samples from the Hill and Trench deposits were tested for physical properties to help choose appropriate geophysical exploration methods. Based on the samples, electrical and electromagnetic methods recorded no geophysical response and were therefore not recommended. Ground gravity was determined to be the most effective method to assist mapping of lithologies and to discern potentially mineralised granite bodies and apophyses (offshoots) underlying mafic units.

A ground gravity survey was completed over the project area, with detailed coverage in the central portion of the tenement package. Preliminary interpretation has identified several gravity lows and also additional areas of granite which have previously been mapped as mafic rocks by Government geologists. Interpretation and modelling of the data is continuing with an infill program planned in the September quarter. Integration and reinterpretation of geophysical data conducted by previous explorers was also completed.



Skarn outcrop at Love's Find.

Compilation and verification of the database is continuing and will facilitate interpretation of the geophysical data and in exploration targeting.

Mt Alexander

The Mt Alexander prospects, specifically Moodang Well and Love's Find are located adjacent to and twenty kilometres south of Nanutarra in the southern Pilbara region of Western Australia (about 275 kilometres south of Karratha). Previous work at Moodang Well, particularly by the Australian and New Zealand Exploration Company in the 1970s had identified and drilled a number of scheelite-bearing skarns, including some of particularly high-grade.

Potential exists to further explore and develop a number of these scheelite bearing-skarns which together have the potential to aggregate a modest tonnage of material to form the basis for a modest-size, high-grade mining operation.

A field visit to Moodang Well and Love's Find was completed by company geologists accompanied by a consultant geologist who specialises in skarn deposits and associated tungsten mineralisation. Most of the visit was concentrated at Moodang Well where it was determined that mineralisation has formed from replacement of minerals within shallow water sediments by fluids derived from the intrusion of granitic bodies (adamellite) to form mineralised skarns (dolomitic marble) during metamorphism.

Mineralisation is hosted within granite-related veins (greisen) which formed after metamorphism. Three types of skarn were observed of which the most common was dominated by the mineral vesuvianite (idocrase) and contained scheelite. This type of skarn occurs as narrow layers between one to three metres wide, but the scheelite also occurs outside of the skarn units. Night lamping fluoresced blue indicating that little or no powellite (a tungsten/molybdenum mineral) is present.

Directors' Report

The Directors submit their Report on Vital Metals Ltd (the "Company") and of the consolidated entity, being the Company and its controlled entities for the year ended 30 June 2006 and the auditor's report thereon.

DIRECTORS

The names and details of the directors of the Company in office at any time during or since the end of the year are:

Director **William J Ryan M.E., F.AusIMM, FAICD**

Appointed 9 December 2004

Position Executive Chairman

Mr Ryan holds a Masters degree in chemical engineering and has over 40 years experience in mining, metallurgy and management. His career has included 4 years in metallurgical research at Amdel in Adelaide, 11 years at Endeavour Resources Limited in Melbourne, a brief role at Bond Resources in 1981 and 1982 following which he operated his own consultancy, Rytech Pty Ltd, until 1987. He took control of what became Titan Resources NL in late 1987 and resigned from that position after 17 years in June 2004.

He was the longest serving President of the influential mining lobby group AMEC for 5 years (1995 – 2000), a Councillor of the WA Chamber of Minerals and Energy for 2 years and an inaugural Councillor of the Australian Gold Council.

Mr Ryan was appointed non-executive Chairman of Sirius Mining Ltd in May 2006. Mr Ryan resigned as a non-executive director of Gindalbie Metals on 24 November 2005 and Jupiter Mines Limited on 31 March 2006. He is a Fellow of the Australasian Institute of Mining and Metallurgy and a Fellow of the Australian Institute of Company Directors.

Director **Donald Ross Kennedy B.Sc. (Hons), F.AusIMM, CPGEO, MAIG, MICA, MGSA, MAICD**

Appointed 20 January 2005

Position Lead Independent Non-Executive Director

Mr Kennedy is a geologist with over 40 years experience in multi-commodity exploration within Australia and overseas and with a proven track record of success. During the 20 years until 1985 he held senior positions with major international mining houses Anaconda Australia Inc., Union Miniere Development and Mining and Rio Tinto Ltd. In this period he discovered the namesake Redross nickel deposit (WA) and identified the deep, high grade mineralisation at Porgera (PNG). Mr. Kennedy was Managing director of Astro Mining NL for 2 years before joining the Board of Resolute Ltd in 1987. In the following 13 years Ross was the leader of one of the most successful exploration teams in Australia and led the team that was responsible for the discovery of a number of commercial gold deposits, including Marymia, Chalice, Higginsville and Challenger in Australia and Nkran and Golden Pride in Africa. He also pegged and farmed out the Plutonic gold deposit in WA. In 1993 the Geological Society of Australia (WA Division) awarded Ross Kennedy the Gibb Maitland Medal in recognition of his substantial contribution to geoscience.

Mr Kennedy is Chairman of Jindalee Resources, Energy Metals Ltd and a non-executive director of Great Western Ltd, is a Certified Practising Geologist, a Fellow of the Australasian Institute of Mining and Metallurgy and a Member of the Australian Institute of Geoscientists, the Geological Society of Australia, the Mineral Industry Consultants Association and the Australian Institute of Company Directors.

Director **Andrew Simpson Grad Dip. Bus (Curtin), MAICD**

Appointed 23 February 2005

Position Independent Non-Executive Director

Mr Simpson holds a Graduate Diploma in Business and Administration (majoring in Marketing and Finance) from Curtin University and is currently the Managing Director and Principal of Resource and Technology Marketing Services Pty Ltd (RTM) in Perth.

Mr Simpson's professional career began with Allied Eneabba in 1975 where he held a variety of positions, including Marketing Manager and Commercial Manager (R&D) over an 11 year period. Andrew then moved to become Managing Director of Dolmar Chemicals in WA, Group General Manager – Marketing and Business Development with Simcoa Operations in WA, Executive Director of Simcoa International and CEO of Atomaer, a WA based mining technology company. He formed RTM in 1999 to specialize in strategic and business planning, resource project assessment and marketing. RTM is recognized as one of Australia's leading market research consultants to the international mining industry.

Mr Simpson is non-executive Chairman of Swick Mining Services Pty Ltd, a director of Wintech International, a director of Consolidated Minerals Limited and a Member of the Australian Institute of Company Directors.

Directors' Report

DIRECTORS – continued

Director **Colin Hunter BSc, PhD**

Appointed 23 February 2005

Position Independent Non-Executive Director

Mr Hunter graduated from the University of Manchester (UK) with a BSc Hons degree in Metallurgy and was awarded a PhD from Brunel University (UK) in 1985 for his work on the froth flotation of sulphide minerals. He moved to South Africa and worked for 3 years with Impala Platinum Limited before joining Gencor Process Research where he rose to the position of Head of Minerals Engineering. In 1993 he joined the Ashanti Goldfields Company in Ghana to help commission and run the Sansu sulphide treatment plant, the largest bacterial leaching (Biox) plant in the world.

Mr Hunter has since been involved with the bio-leaching of refractory gold and a development of the process for bio-leaching nickel and other base metals and is a founding director of Bio-Hydro Metallurgy Ltd, which was established to develop bio-leach processes for chalcopyrite, zinc and other sulphide mineral systems.

In 1998 Bio-Hydro Metallurgy formed a joint venture company, Pacific Ore Technology Ltd, with Australian nickel miner, Titan Resources NL. Colin has since been operating as Technical Director for Pacific Ore Technology and has been responsible for managing the development of the BioHeap™ Process.

Director **Mark McAuliffe B.Juris, LLB, MAICD**

Appointed 9 December 2004

Position Independent Non-Executive Director

Mr McAuliffe is a solicitor with over 25 years in acting for and advising mining companies, public listed companies and institutions upon a wide range of legal issues. He holds a Bachelor of Jurisprudence and a Bachelor of Laws from the University of WA. His career includes advising and documenting a wide range of mining transactions from acquisitions through joint ventures, initial public offerings and capital raisings. This mining experience extends beyond Australian jurisdiction and includes transactions in a number of countries in Africa and South America.

Mr McAuliffe commenced his career at Downing and Downing before establishing his own firm in 1989. Mr McAuliffe is presently a legal practitioner and director of McAuliffe Legal. He has extensive experience as a company director for a wide range of client companies. Mr McAuliffe is Chairman of Hazelwood Resources Ltd and a member of the Australian Institute of Company Directors.

COMPANY SECRETARY

The company secretary is John Adam Sobolewski B. Comm. CA. Mr Sobolewski is a member of the Institute of Chartered Accountants in Australia and has held similar positions with Titan Resources Limited and Croesus Mining NL. Mr Sobolewski was appointed to the position of company secretary on 1st March 2006.

PRINCIPAL ACTIVITIES

The principal activities of the economic entity during the year were mineral exploration.

There were no significant changes in the nature of the economic entity's principal activities during the year.

DIVIDENDS

No dividends were paid during the period and the Directors do not recommend the payment of a dividend.

Directors' Report

OPERATING AND FINANCIAL REVIEW

The consolidated loss of the economic entity after providing for income tax amounted to \$1,069,312 (2005: \$240,245). A review of the operations of the economic entity during the financial year, the results of those operations, together with future prospects are set out elsewhere in this annual report.

Other than noted below there were no significant changes in the state of affairs of the Company during the period.

On 10 August 2005 the Company lodged a prospectus with the Australian Securities & Investments Commission inviting investors to apply for 40,000,000 ordinary fully paid shares at \$0.20 per share.

Within 7 days of the lodgement of the Prospectus the Company also lodged a Listing Application for its shares with the Australian Stock Exchange Ltd.

The Company closed its offer to the public on 28 September 2005 as it had received applications for in excess of 40,000,000 shares.

The Company allotted and issued 40,000,000 shares on 3 October 2005 and commenced trading on the Official List of the Australian Stock exchange on 11 October 2005

Conditional on listing on Australian Stock Exchange the Company allotted and issued:

- 2,000,000 fully paid ordinary shares at \$0.20 per share for the right to earn up to a 70% equity in the Mount Mulgine Project's mining and exploration tenements through the sole funding of exploration costs of \$750,000 within 3 years from the date the Company lists on ASX;
- 7,500,000 fully paid ordinary shares at \$0.20 per share for the acquisition of 100% of the issued shares in Mount Alexander Resources Pty Ltd which owns the tenements comprising the Mt Alexander Project;
- 8,000,000 fully paid ordinary shares at \$0.20 per share for the acquisition of 100% of the issued shares in North Queensland Tungsten Pty Ltd which has acquired the Watershed Project; and
- 500,000 fully paid ordinary shares at \$0.20 per share and the payment of \$20,000 upon exercise of an option to acquire the rights to certain minerals within a granted mining tenement surrounding North Queensland Tungsten Pty Ltd's Watershed Project.

SIGNIFICANT POST BALANCE DATE EVENTS

No matters or circumstances have arisen since the end of the financial period which has significantly affected, or may affect the operations of the Company, the results of those operations, or the state of affairs of the Company in financial years subsequent to the financial period ended 30 June 2006.

LIKELY DEVELOPMENTS

Information on the likely developments in the operations of the Company and the expected results of those operations have not been included in this Report because the Directors believe it would be likely to result in unreasonable prejudice to the Company.

ENVIRONMENTAL REGULATION

The Company is subject to and compliant with all aspects of environmental regulation of its exploration activities. The Directors are not aware of any environmental law that is not being complied with.

Directors' Report

REMUNERATION REPORT (Audited)

Remuneration of directors and executives is referred to as compensation throughout this report. Key management personnel have authority and responsibility for planning, directing and controlling the activities of the Company and the consolidated entity including directors of the Company and other executives. They include the five most highly remunerated s300A directors and executives for the Company and the Consolidated Entity. Compensation levels for directors and key management personnel of the Company and consolidated entity are competitively set to attract and retain appropriately qualified and experienced directors and executives.

The Board is responsible for compensation policies and practices. The Board, where appropriate, seeks independent advice on remuneration policies and practices, including the compensation packages and terms of employment.

The compensation structures explained below are designed to attract suitably qualified candidates, reward the achievement of strategic objectives, and achieve the broader outcome of creation of value for shareholders. The compensation structures take into account a number of factors, including length of service, particular experience of the individual concerned, and overall performance of the Company.

Fixed compensation

Fixed compensation consists of base compensation (which is calculated on a total cost basis and includes any FBT charges related to employee benefits including motor vehicles), as well as employer contributions to superannuation funds. Compensation levels are reviewed annually by the Board where applicable.

Share based remuneration

Share options are granted to key employees as Directors feel that this is the most appropriate method of aligning performance to the interests of shareholders.

Service contracts

The Company has entered into a service agreement with Mr Ryan. The agreement entitles Mr Ryan to receive a salary of \$240,000 per annum, a motor vehicle allowance not exceeding \$10,000 and the reimbursement of other costs. The Company may terminate this agreement by providing at least 6 months notice. Mr Ryan may terminate this agreement by providing at least 3 months notice.

Mr John Sobolewski, Company Secretary, has a contract of employment with the Company. This contract is for an unlimited term and is capable of termination on 4 weeks notice. Upon termination, Mr Sobolewski is entitled to payment of his notice period. Under the terms of this agreement, Mr Sobolewski receives a salary of \$115,000 per annum, a motor vehicle, statutory superannuation and medical benefits.

Mr Bruce Pertzel, Principal Geologist, has a contract of employment with the Company. This contract ends on 31 December 2006. Mr Pertzel is employed for a minimum of 10 days per calendar month during the term of his contract. Under the terms of this agreement, Mr Pertzel receives a daily rate of \$735 per day plus superannuation.

Non-executive directors

Non-executive directors received a fixed fee for their services of \$36,000 per annum plus statutory superannuation as per the Prospectus dated 10 August 2005. The Chairman receives \$55,000 per annum plus statutory superannuation as per the Prospectus dated 10 August 2005.

There is no direct link between remuneration paid to any non-executive directors and corporate performance. There are no termination or retirement benefits for non-executive directors (other than statutory superannuation).

Remuneration

The Details of the nature and amount of each major element of the remuneration of the directors and key management personnel of the Company during the financial period set out in the tables below.

The key management personnel of the parent entity and the consolidated entity include the directors and the following executive officers:

- John Sobolewski – Company Secretary/Financial Controller (Appointed 1st March 2006)
- Oscar Aamodt – Company Secretary (Appointed 25th October 2005, resigned 3rd March 2006)
- Ross Arancini – Company Secretary (Resigned 25th October 2005)
- Bruce Pertzel – Principal Geologist (Appointed 1st November 2005)

Directors' Report

REMUNERATION REPORT (Audited) – continued

2006	Short-term benefits			Post-employment	Equity	Total	Value of
	Salary and	Cash	Non-monetary	benefits	compensation		Options as a
	fees	bonus	benefits	Super-annuation	Value of		Proportion of
	\$	\$	\$	\$	\$	\$	%
Directors							
W Ryan	214,229	–	6,357	19,281	–	239,867	–
D Kennedy	36,000	–	–	3,240	–	39,240	–
A Simpson	36,000	–	–	3,240	–	39,240	–
C Hunter	36,000	–	–	3,240	–	39,240	–
M McAuliffe	36,000	–	–	3,240	–	39,240	–
Executives							
J Sobolewski	38,333	–	2,859	3,450	17,070	61,712	27.66
O Aamodt	49,500	–	–	4,455	9,760	63,715	15.32
R Arancini	15,000	–	–	–	–	15,000	–
B Pertzelt	107,678	–	1,998	9,691	17,080	136,447	12.52

2005	Short-term benefits			Post-employment	Equity	Total	Value of
	Salary and	Cash	Non-monetary	benefits	compensation		Options as a
	fees	bonus	benefits	Super-annuation	Value of		Proportion of
	\$	\$	\$	\$	\$	\$	%
Directors							
W Ryan	13,750	–	–	1,238	25,795	40,783	63.25
D Kennedy	9,000	–	–	810	25,795	35,605	72.45
A Simpson	9,000	–	–	810	25,795	35,605	72.45
C Hunter	9,000	–	–	810	25,795	35,605	72.45
M McAuliffe	9,000	–	–	810	25,795	35,605	72.45
E Cranston	–	–	–	–	1,548	1,548	100.00
Executives							
R Arancini	–	–	–	–	15,477	15,477	100.00

The following factors and assumptions were used in determining the fair value of options on grant date:

Grant Date	Expiry Date	Fair value per option	Exercise Price	Estimated Volatility	Risk Fee Interest Rate
9 March 2006	9 March 2008	\$0.0488	\$0.20	100%	5.335%
1 June 2006	1 June 2008	\$0.0569	\$0.20	75%	5.335%
31 March 2005	30 June 2008	\$0.0516	\$0.20	50%	5.275%

All options refer to options over ordinary shares of Vital Metals Ltd which are exercisable on a one for one basis.

DIRECTORS' INTERESTS

As at the date of this Report the relevant interest of each director in the shares and options of the Company is as follows:

	Ordinary Shares		Options over Ordinary Shares	
	Direct	Indirect	Direct	Indirect
W Ryan	1	5,000,000	–	500,000
D Kennedy	–	400,000	–	500,000
A Simpson	–	400,000	–	500,000
C Hunter	–	400,000	–	500,000
M McAuliffe	1	490,000	–	500,000

Directors' Report

REMUNERATION REPORT (Audited) – continued

DIRECTORS' MEETINGS

The following directors' meetings (including meetings of committees of directors) were held during the period and the number of meetings attended by each of the directors during the year were:

Director	Directors' meetings held while a Director	Number of Directors' meetings attended	Number of Audit Committee meetings held	Number of Audit Committee Meetings attended
W Ryan	11	11	**	**
D Kennedy	11	10	**	**
A Simpson	11	10	2	2
C Hunter	11	8	2	-
M McAuliffe	11	11	2	2

** Not a member of the audit committee.

OPTIONS

During or since the end of the financial year the Company granted options to the following directors and executives as part of their remuneration:

Director/Executive	Number Issued	Number Vested	Exercise Price	Expiry Date	Fair Value Per Option At Grant Date
O Aamodt	200,000	200,000	\$0.20	9 March 2008	\$0.0488
J Sobolewski	300,000	300,000	\$0.20	1 June 2008	\$0.0569
B Pertzel	350,000	350,000	\$0.20	9 March 2008	\$0.0488

Further details of the options granted are contained in the Remuneration Report section of the Directors' Report.

As at the date of this report the following options were on issue:

Number	Exercise Price	Expiry Date
4,830,000	\$0.20	30 June 2008
800,000	\$0.20	9 March 2008
850,000	\$0.20	1 June 2008

Options on issue were issued to the following parties:

Directors	2,500,000
Executives	650,000
Previous executives	530,000
Employees	800,000
Other (Stockbrokers)	2,000,000
Total	6,480,000

During or since the end of the financial year no options were exercised.

INSURANCE AND INDEMNITY OF OFFICERS

The Company has entered into an agreement to indemnify all directors and the company secretary against any liability arising from a claim brought by a third party against the Company. The agreement provides for the Company to pay all damages and costs which may be awarded against the officer or director.

During the period the Company has paid an insurance premium in respect of a Directors' and Officers' Liability Insurance Contract. The insurance premium relates to liabilities that may arise from an Officer's position, with the exception of conduct involving a wilful breach of duty or improper use of information or position to gain personal advantage.

The officers covered by the insurance policies are the Directors and the Company Secretary.

The contract of insurance prohibits the disclosure of the nature of the liabilities and the amount of premium.

Directors' Report

CORPORATE GOVERNANCE

The Company has adopted systems of control and accountability as the basis for the administration of corporate governance. The Board is committed to administering the policies and procedures with openness and integrity, pursuing the true spirit of corporate governance commensurate with the Company's needs. To the extent they are applicable; the Company has adopted the Ten Essential Corporate Governance Principles and Best Practice Recommendations ("Recommendations") as published by ASX Corporate Governance Council.

Further information about the Company's corporate governance practices is set out on the Company's website at www.vitalmetals.com.au. In accordance with the recommendations of the ASX, information published on the Company's website includes charters (for the board and its sub-committees), codes of conduct and other policies and procedures relating to the board and its responsibilities.

As the Company's activities develop in size, nature and scope, the size of the Board and the implementation of additional corporate governance structures will be given further consideration.

The Board's key roles are to:

- a) increase shareholder value within an appropriate framework which safeguards the rights and interests of the Company's shareholders; and
- b) ensure the Company is properly managed.

The Board is collectively responsible for promoting the success of the Company by:

- a) supervising the Company's framework of control and accountability systems to enable risk to be assessed and managed;
- b) ensuring the Company is properly managed;
- c) approving and monitoring the progress of major capital expenditure, capital management, and acquisitions and divestitures;
- d) approving the annual budget;
- e) monitoring the financial performance of the Company;
- f) approving and monitoring financial and other reporting;
- g) providing overall corporate governance of the Company, including conducting regular reviews of the balance of responsibilities within the Company to ensure division of functions remain appropriate to the needs of the Company;
- h) appointing the external auditor (where applicable, based on the recommendations of the Audit Committee) and the appointment of a new external auditor when any vacancy arises, provided that any appointments made by the Board must be ratified by shareholders at the next Annual General Meeting of the Company;
- i) liaising with the Company's external auditors and Audit Committee; and
- j) monitoring and ensuring compliance with all of the Company's legal obligations, in particular those obligations relating to the environment, native title, cultural heritage and occupational health and safety.

To assist in the execution of its responsibilities, the Board has established an Audit Committee and an Audit Committee Charter. The Audit Committee Charter is available on the Company's website. The members of the Audit Committee during the year were:

- Andrew Simpson (Chair and non-executive director)
- Mark McAuliffe (non-executive director)
- Colin Hunter (non-executive director)

The Board must convene regular meetings with such frequency as is sufficient to appropriately discharge its responsibilities.

The Board annually reviews the effectiveness of the Board, its committees, individual directors, and senior executives. All directors have an opportunity to contribute to the review process. The performance criteria take into account each director's contribution to setting the direction, strategy and financial objectives of the group, and monitoring compliance with regulatory requirements and ethical standards.

Directors' Report

CORPORATE GOVERNANCE – continued

Delegated Authority

The Executive Chairman is responsible for running the affairs of the Company under delegated authority from the Board and to implement the policies and strategy set by the Board. In carrying out his responsibilities the Executive Chairman must report to the Board in a timely manner and ensure all reports to the Board present a true and fair view of the Company's financial condition and operational results.

Each director has the right of access to all relevant Company information and to the Company's executives and, subject to prior consultation with the Chairman, may seek independent professional advice from a suitably qualified advisor at the consolidated entity's expense. The Director must consult with an advisor suitably qualified in the relevant field, and obtain the Chairman's approval of the fee payable for the advice before proceeding with the consultation. A copy of the advice received by the director is made available to all other members of the Board.

The Executive Chairman and Chief Financial Officer have declared, in writing to the Board, that the financial reporting risk management and associated compliance and controls have been assessed and found to be operating efficiently and effectively, and that the Company's financial reports are founded on a sound system of risk management and internal compliance and control which implements the policies adopted by the Board.

Code of Conduct

The Company's Code of Conduct is available on the Company's website. This Code of Conduct sets out the principles and standards which the Board, management and employees of the Company are encouraged to strive towards when dealing with each other, shareholders and the broad community.

Share Trading Policy

The Board has also adopted a policy and procedure on dealing in the Company's securities by directors, officers and employees which prohibits dealing in the Company's securities when those persons possess inside information. It also provides that the written acknowledgement of the Chairman should be obtained prior to trading.

The Board sets out below its "if not, why not" report in relation to those matters of corporate governance where the Company's practices depart from the Recommendations.

Principle 2 Recommendation 2.2

The Chairman does not satisfy the test of independence as set out in Box 2.1 of the ASX Principles of Good Corporate Governance and Best Practice Recommendations Independence ("Independence Test").

Whilst the Board recognises the importance of independence in decision making, it does not comply with best practice recommendation 2.2 as William Ryan, the current Chairman, does not satisfy paragraphs 1 and 2 of the Independence Test, in that he has an executive role in the Company and he is a substantial shareholder. The Board believes that William Ryan is the most appropriate person for the position as Chairman because of his industry experience and pivotal role in preparing the Company for listing.

The Board has appointed Ross Kennedy to act as a lead independent director, and the board believes this will enable the board to act independently in the event any conflict arises which would make it inappropriate for William Ryan to act in the capacity of Chairman.

Principle 2 Recommendation 2.3

The roles of Chairman and Managing Director are exercised by William Ryan, which is not in compliance with best practice recommendation 2.3

While the Board recognises the importance of the need for the division of responsibilities between the chairman and the managing director, it considers the existing structure provides unified leadership important to a newly incorporated company with early stage exploration projects. Mr Ryan's dual role makes him responsible (along with the whole board) for determining strategic direction of the Company as well as having primary responsibility for day to day management. At present this dual role assists the Company to run in a cost effective and efficient manner.

The Board intends to re-consider the duality of William Ryan's role and the merits of appointing a new managing director as the Company evolves and increases its operations.

Directors' Report

CORPORATE GOVERNANCE – continued

Principle 2 Recommendation 2.4

There is no nomination committee.

The Board considers those matters and issues arising that would usually fall to a nomination committee. The Board considers that no efficiencies or other benefits would be gained by establishing a separate nomination committee. Candidates for the Board are considered and selected by reference to a number of factors which include, but are not limited to, their relevant experience and achievements, compatibility with other Board members, credibility within the Company's scope of activities, and intellectual and physical ability to undertake Board duties and responsibilities. Directors are initially appointed by the full Board, subject to election by shareholders at the next general meeting.

Principle 9 Recommendation 9.2

There is no separate remuneration committee.

Due to the small size and structure of the Board, a separate remuneration committee is not considered to add any efficiency to the process of determining the levels of remuneration for the directors and key executives. The Board considers that it is more appropriate to set aside time at Board meetings each year to specifically address matters that would ordinarily fall to a remuneration committee. When considering matters of remuneration, the Board functions in accordance with the Remuneration Committee Charter which was adopted on 18 April 2005.

In addition, all matters of remuneration will continue to be determined in accordance with Corporations Act requirements, especially in respect of related party transactions. That is, no directors participate in any deliberations regarding his or her own remuneration or related issues.

NON-AUDIT SERVICES

No non-audit services were provided during the financial year.

AUDITOR'S INDEPENDENCE STATEMENT UNDER SECTION 307C OF THE CORPORATIONS ACT

The Auditor's Independence Statement is attached as page 56 of the Financial Report and forms part of the Directors' Report for the period ended 30 June 2006.

Signed in accordance with a resolution of the directors



W J Ryan

Director

1st September 2006

Income Statements for the year ended 30 June 2006

	Note	Consolidated		The Company	
		12 months to 30 June 2006	7 months to 30 June 2005	12 months to 30 June 2006	7 months to 30 June 2005
		\$	\$	\$	\$
Revenue					
Interest income		237,632	–	237,632	–
Total revenue		237,632	–	237,632	–
Expenses					
Administration expenses		1,267,650	240,128	1,256,545	240,128
Depreciation	2	39,294	117	19,963	117
Total expenses		1,306,944	240,245	1,276,508	240,245
Loss before income tax expense		(1,069,312)	(240,245)	(1,038,876)	(240,245)
Income tax (expense) / benefit	3	–	–	–	–
Loss for the year		(1,069,312)	(240,245)	(1,038,876)	(240,245)

		Cents per Share	
Basic loss per share (cents per share)	25	(1.94)	(8.58)
Diluted loss per share (cents per share)	25	(1.94)	(8.58)

The accompanying notes form part of these financial statements.

Statement of Changes in Equity

for the year ended 30 June 2006

CONSOLIDATED	Attributable to equity holders of the parent			Total Equity \$
	Issued Capital \$	Retained Earnings \$	Other Reserves \$	
	At 1 July 2005	347,963	(240,245)	
Loss for the period	–	(1,069,312)	–	(1,069,312)
Share issues	11,600,000	–	–	11,600,000
Capital raising expenses	(716,789)	–	–	(716,789)
Issue of options to stockbrokers	–	–	103,180	103,180
Issue of options to employees	–	–	87,405	87,405
At 30 June 2006	11,231,174	(1,309,557)	335,037	10,256,654

for the year ended 30 June 2005

CONSOLIDATED	Attributable to equity holders of the parent			Total Equity \$
	Issued Capital \$	Retained Earnings \$	Other Reserves \$	
	At 1 July 2004	–	–	
Loss for the period	–	(240,245)	–	(240,245)
Share issues	610,001	–	–	610,001
Capital raising expenses	(262,038)	–	–	(262,038)
Issue of options to directors	–	–	144,452	144,452
At 30 June 2005	347,963	(240,245)	144,452	252,170

The accompanying notes form part of these financial statements.

Statements of Financial Position as at 30 June 2006

	Note	Consolidated		The Company	
		2006	2005	2006	2005
		\$	\$	\$	\$
CURRENT ASSETS					
Cash and cash equivalents	5	4,919,410	371,010	4,902,757	371,010
Trade and other receivables	6	181,704	28,616	127,311	28,616
TOTAL CURRENT ASSETS		5,101,114	399,626	5,030,068	399,626
NON-CURRENT ASSETS					
Receivables	6	–	–	1,635,268	–
Investments	7	–	–	3,195,465	–
Property, plant and equipment	8	530,640	3,001	228,933	3,001
Intangible assets	9	5,406,285	2,572	662,749	2,572
TOTAL NON-CURRENT ASSETS		5,936,925	5,573	5,722,415	5,573
TOTAL ASSETS		11,038,039	405,199	10,752,483	405,199
CURRENT LIABILITIES					
Trade and other payables	10	623,953	153,029	350,185	153,029
Interest bearing liabilities	11	44,847	–	32,095	–
Provisions	12	22,774	–	22,774	–
TOTAL CURRENT LIABILITIES		691,574	153,029	405,054	153,029
NON CURRENT LIABILITIES					
Interest bearing liabilities	11	89,811	–	60,339	–
TOTAL NON-CURRENT LIABILITIES		89,811	–	60,339	–
TOTAL LIABILITIES		781,385	153,029	465,393	153,029
NET ASSETS		10,256,654	252,170	10,287,090	252,170
EQUITY					
Issued capital	13	11,231,174	347,963	11,231,174	347,963
Reserves	14	335,037	144,452	335,037	144,452
Retained earnings / (Accumulated losses)	19	(1,309,557)	(240,245)	(1,279,121)	(240,245)
TOTAL EQUITY		10,256,654	252,170	10,287,090	252,170

The accompanying notes form part of these financial statements.

Statements of Cash Flows for the year ended 30 June 2006

	Note	Consolidated		The Company	
		12 months to 30 June 2006	7 months to 30 June 2005	12 months to 30 June 2006	7 months to 30 June 2005
		\$	\$	\$	\$
Cash Flows from Operating Activities					
Payments to suppliers and employees		(927,175)	(45,485)	(871,416)	(45,485)
Interest received		236,272	–	236,272	–
Net cash provided by/(used in) operating activities	24	(690,903)	(45,485)	(635,144)	(45,485)
Cash Flows from Investing Activities					
Security bonds		(59,761)	(3,000)	(46,731)	(3,000)
Payment for property, plant and equipment		(322,148)	(3,118)	(152,717)	(3,118)
Payment for exploration expenditure		(1,563,258)	(2,572)	(182,864)	(2,572)
Net cash provided by/(used in) investing activities		(1,945,167)	(8,690)	(382,312)	(8,690)
Cash Flows from Financing Activities					
Loans (to)/from subsidiaries		–	–	(1,635,268)	–
Net proceeds from issue of shares		7,184,470	377,535	7,184,471	377,535
Loans (to)/from related parties		–	47,650	–	47,650
Net cash provided by/(used in) financing activities		7,184,470	425,185	5,549,203	425,185
Net increase/(decrease) in cash held		4,548,400	371,010	4,531,747	371,010
Cash at 1 July		371,010	–	371,010	–
Cash at 30 June	5	4,919,410	371,010	4,902,757	371,010

The accompanying notes form part of these financial statements.

Notes to the Financial Statements for the year ended 30 June 2006

1. Summary of Significant Accounting Policies

Vital Metals Ltd (the "Company") is a company domiciled in Australia. The consolidated financial report of the Company for the financial year ended 30 June 2006 comprise the Company and its subsidiaries (together referred to as the "consolidated entity") and the consolidated entity's interest in associates and jointly controlled entities.

The financial report was authorised for issue by the directors on 1st September 2006.

(a) Statement of compliance

The financial report is a general purpose financial report which has been prepared in accordance with Australian Accounting Standards ('AASBs') adopted by the Australian Accounting Standards Board ('AASB') and the Corporations Act 2001. International Financial Reporting Standards ('IFRSs') form the basis of Australian Accounting Standards ('AASBs') adopted by the AASB, and for the purpose of this report are called Australian equivalents to IFRS ('AIFRS') to distinguish from previous Australian GAAP. The financial reports of the consolidated entity and the Company also comply with IFRSs and interpretations adopted by the International Accounting Standards Board.

This is the consolidated entity's first financial report prepared in accordance with Australian Accounting Standards, being AIFRS and IFRS, and AASB 1 *First-Time Adoption of Australian Equivalents to International Financial Reporting Standards* has been applied. An explanation of how the transition to AIFRS has affected the reported financial position, financial performance and cash flows of the consolidated entity and the Company is provided in note 1(t).

(b) Basis of preparation

The financial report is presented in Australian dollars.

Issued standards not early adopted

The following standards and amendments were available for early adoption but have not been applied by the consolidated entity in these financial statements:

- AASB 7 *Financial instruments: Disclosure* (August 2005) replacing the presentation requirements of financial instruments in AASB 132. AASB 7 is applicable for annual reporting periods beginning on or after 1 January 2007
- AASB 2005-9 *Amendments to Australian Accounting Standards* (September 2005) requires that liabilities arising from the issue of financial guarantee contracts are recognised in the balance sheet. AASB 2005-9 is applicable for annual reporting periods beginning on or after 1 January 2006
- AASB 2005-10 *Amendments to Australian Accounting Standards* (September 2005) makes consequential amendments to AASB 132 *Financial Instruments: Disclosures and Presentation*, AASB 101 *Presentation of Financial Statements*, AASB 114 *Segment Reporting*, AASB 117 *Leases*, AASB 133 *Earnings per Share*, AASB 139 *Financial Instruments: Recognition and Measurement*, AASB 1 *First-time Adoption of Australian Equivalents to International Financial Reporting Standards*, AASB 4 *Insurance Contracts*, AASB 1023 *General Insurance Contracts* and AASB 1038 *Life Insurance Contracts*, arising from the release of AASB 7. AASB 2005-10 is applicable for annual reporting periods beginning on or after 1 January 2007
- AASB 119 *Employee Benefits* (December 2004)
- AASB 2004-3 *Amendments to Australian Accounting Standards* (December 2004) amending AASB 1 *First time Adoption of Australian Equivalents to International Financial Reporting Standards* (July 2004), AASB 101 *Presentation of Financial Statements* and AASB 124 *Related Party Disclosures*
- AASB 2005-1 *Amendments to Australian Accounting Standards* (May 2005) amending AASB 139 *Financial Instruments: Recognition and Measurement*
- AASB 2005-3 *Amendments to Australian Accounting Standards* (June 2005) amending AASB 119 *Employee Benefits* (either July or December 2004)
- AASB 2005-4 *Amendments to Australian Accounting Standards* (June 2005) amending AASB 139 *Financial Instruments: Recognition and Measurement*, AASB 132 *Financial Instruments: Disclosure and Presentation*, AASB 1 *First-time Adoption of Australian Equivalents to International Financial Reporting Standards* (July 2004), AASB 1023 *General Insurance Contracts* and AASB 1038 *Life Insurance Contracts*
- AASB 2005-5 *Amendments to Australian Accounting Standards* (June 2005) amending AASB 1 *First time Adoption of Australian Equivalents to International Financial Reporting Standards* (July 2004), and AASB 139 *Financial Instruments: Recognition and Measurement*
- AASB 2005-6 *Amendments to Australian Accounting Standards* (June 2005) amending AASB 3 *Business Combinations*

Notes to the Financial Statements for the year ended 30 June 2006

1. Summary of Significant Accounting Policies (continued)

(b) Basis of preparation (continued)

- AASB 2006-1 *Amendments to Australian Accounting Standards* (January 2006) amending AASB 121 *The Effects of Changes in Foreign Exchange Rates* (July 2004)
- UIG 4 *Determining whether an Arrangement contains a Lease*
- UIG 5 *Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds*
- UIG 7 *Applying the Restatement Approach under AASB 129 Financial Reporting in Hyperinflationary Economies*
- UIG 8 *Scope of AASB 2*.

The consolidated entity plans to adopt AASB 7, AASB 2005-9, AASB 2005-10, AASB 119, AASB 2004-3, AASB 2005-1, AASB 2005-3, AASB 2005-4, AASB 2005-5, AASB 2005-6, AASB 2006-1 and UIG 4 in the 2007 financial year.

The initial application of AASB 7 and AASB 2005-10 is not expected to have an impact on the financial results of the Company and the consolidated entity as the standard and the amendment are concerned only with disclosures.

The impact of the initial application of AASB 2005-9, if any, has not yet been determined.

The initial application of AASB 119, AASB 2004-3, AASB 2005-1, AASB 2005-3, AASB 2005-4, AASB 2005-5, AASB 2005-6, AASB 2006-1, UIG 4, UIG 5, UIG 7 and UIG 8 is not expected to have an impact on the financial results of the Company.

The financial report is prepared on the historical cost basis. The preparation of a financial report in conformity with Australian Accounting Standards requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates. These accounting policies have been consistently applied by each entity in the consolidated entity.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

The accounting policies set out below have been applied consistently to all periods presented in the consolidated financial report and in preparing an opening AIFRS balance sheet for the purposes of the transition to Australian Accounting Standards – AIFRS.

The accounting policies have been applied consistently by all entities in the consolidated entity.

(c) Basis of consolidation

Subsidiaries

Subsidiaries are entities controlled by the Company. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable or convertible are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

Investments in subsidiaries are carried at their cost of acquisition in the Company's financial statements.

Transactions eliminated on consolidation

Intragroup balances and any unrealised gains and losses or income and expenses arising from intragroup transactions, are eliminated in preparing the consolidated financial statements.

Unrealised gains arising from transactions with associates and jointly controlled entities are eliminated to the extent of the consolidated entity's interest in the entity with adjustments made to the 'Investment in associates' and 'Share of associates net profit' accounts.

Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment. Gains and losses are recognised as the contributed assets are consumed or sold by the associates and jointly controlled entities or, if not consumed or sold by the associate or jointly controlled entity, when the consolidated entity's interest in such entities is disposed of.

Interests in joint venture operations

The Consolidated Entity's interest in its joint venture operation is accounted for by recognising the Consolidated Entity's share of assets and liabilities from the joint venture, as well as expenses incurred by the Consolidated Entity and the Consolidated Entity's share of income earned from the joint venture, in the consolidated financial statements.

Notes to the Financial Statements for the year ended 30 June 2006

1. Summary of Significant Accounting Policies (continued)

(d) Property, plant and equipment

Property, plant and equipment is stated at cost less accumulated depreciation and impairment losses. The cost of self-constructed assets includes the cost of materials, direct labour, the initial estimate, where relevant, of the costs of dismantling and removing the items and restoring the site on which they are located, and an appropriate proportion of production overheads.

Where parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items of property, plant and equipment.

Leased Assets

Leases in terms of which the consolidated entity assumes substantially all the risks and rewards of ownership are classified as finance leases. Property, plant and equipment acquired by way of finance lease is stated at an amount equal to the lower of its fair value and the present value of the minimum lease payments at inception of the lease, less accumulated depreciation and impairment losses.

Subsequent costs

The consolidated entity recognises in the carrying amount of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred if it is probable that the future economic benefits embodied within the item will flow to the consolidated entity and the cost of the item can be measured reliably. All other costs are recognised in the income statement as an expense as incurred.

Depreciation

Depreciation is charged to the income statement on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment. The estimated useful lives in the current and comparative periods are as follows:

Buildings	over 10 years
Plant and equipment	over 3 to 20 years

The residual value, the useful life and the depreciation method applied to an asset are reassessed at least annually.

Derecognition

Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the item) is included in the income statement in the period the item is derecognised.

(e) Intangibles – exploration and evaluation expenditure

Exploration and evaluation expenditure, including the costs of acquiring the licences, are capitalised as exploration and evaluation assets on an area of interest basis. Costs incurred before the consolidated entity has obtained the legal rights to explore an area are recognised in the income statement.

Exploration and evaluation assets are only recognised if the rights of the area of interest are current and either:

- (i) the expenditures are expected to be recouped through successful development and exploitation of the area of interest; or
- (ii) activities in the area of interest have not at the reporting date, reached a stage which permits a reasonable assessment of the existence or otherwise of economically recoverable reserves and active and significant operations in, or in relation to, the area of interest are continuing.

Exploration and evaluation assets are assessed for impairment if (i) sufficient data exists to determine technical feasibility and commercial viability, and (ii) facts and circumstances suggest that the carrying amount exceeds the recoverable amount (see impairment accounting policy (h)). For the purposes of impairment testing, exploration and evaluation assets are allocated to cash-generating units to which the exploration activity relates. The cash generating unit shall not be larger than the area of interest.

Once the technical feasibility and commercial viability of the extraction of mineral resources in an area of interest are demonstrable, exploration and evaluation assets attributable to that area of interest are first tested for impairment and then reclassified from intangible assets to mining property and development assets within property, plant and equipment.

(f) Trade and other receivables

Trade and other receivables are stated at their amortised cost less impairment losses.

(g) Cash and cash equivalents

Cash and cash equivalents comprise cash at bank and in hand, short-term bills and call deposits.

For the purposes of the Statement of Cash Flows, cash and cash equivalents consist of cash and cash equivalents as defined above.

Notes to the Financial Statements for the year ended 30 June 2006

1. Summary of Significant Accounting Policies (continued)

(h) Impairment

The carrying amounts of the consolidated entity's assets other than exploration and evaluation expenditure (Refer 1(e)), and deferred tax assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any indication of impairment exists, the asset's recoverable amount is estimated.

An impairment loss is recognised whenever the carrying amount of an asset or its cash generating unit exceeds its recoverable amount. Impairment losses are recognised in the income statement unless the asset has previously been revalued, in which case the impairment loss is recognised as a reversal to the extent of that previous revaluation with any excess recognised as a reversal through the income statement.

Impairment of receivables is not recognised until objective evidence is available that a loss event has occurred. Significant receivables are individually assessed for impairment.

Recoverable amount of other assets is the greater of fair value less costs to sell and value in use. It is determined for an individual asset, unless the asset's value in use cannot be estimated to be close to its fair value less costs to sell and it does not generate cash inflows that are largely independent of those from other assets or groups of assets, in which case, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

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.

Impairment losses are reversed when there is an indication that the impairment loss may no longer exist and there has been a change in the estimate used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment had been recognised.

Derecognition of financial assets and liabilities

Current accounting policy

A financial asset (or, where applicable, a part of a financial asset or part of a group of similar financial assets) is derecognised when:

- the rights to receive cash flows from the asset have expired;
- the consolidated entity retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party; or
- the consolidated entity has transferred its rights to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

A financial liability is derecognised when the obligation under the liability is discharged, cancelled or expired. When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability. The difference in the respective carrying amounts is recognised in profit and loss.

Comparative period policy

A financial asset was derecognised when the contractual right to receive or exchange cash no longer existed. A financial liability was derecognised when the contractual obligation to deliver or exchange cash no longer existed.

(i) Share capital

Transaction costs

Transaction costs of an equity transaction are accounted for as a deduction from equity, net of any related income tax benefit.

Notes to the Financial Statements for the year ended 30 June 2006

1. Summary of Significant Accounting Policies (continued)

(j) Employee benefits

(1) Share-based payment transactions

The Consolidated Entity provides benefits to employees (including directors) of the Consolidated Entity in the form of share options. The fair value of options granted is recognised as an employee expense with a corresponding increase in equity. The fair value is measured at grant date and spread over the period during which the employees become unconditionally entitled to the options. The fair value of the options granted is measured using a binomial option valuation model, taking into account the terms and conditions upon which the options were granted.

The cost of equity-settled transactions is recognised, together with a corresponding increase in equity, on the date on which the relevant employees become fully entitled to the award ("vesting date"). The amount recognised as an expense is adjusted to reflect the actual number that vest.

The dilutive effect, if any, of outstanding options is reflected as additional share dilution in the computation of earnings per share.

(2) Defined contribution superannuation funds

Obligations for contributions to defined contribution superannuation funds are recognised as an expense in the income statement as incurred.

(3) Wages, salaries, annual leave, sick leave and non-monetary benefits

Liabilities for employee benefits for wages, salaries, annual leave and sick leave that are expected to be settled within 12 months of the reporting date represent present obligations resulting from employees' services provided to reporting date, are calculated at undiscounted amounts based on remuneration wage and salary rates that the Consolidated Entity expects to pay as at reporting date including related on-costs, such as workers compensation insurance and payroll tax. Non-accumulating monetary benefits, such as medical care, and motor vehicles, are expensed based on the net marginal cost to the Consolidated Entity as the benefits are taken by the employees.

(k) Provisions

Provisions are recognised when the Consolidated Entity has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

If the effect of the time value of money is material, 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.

(l) Site restoration

The Company provides for the future cost of rehabilitating its exploration sites in accordance with the environmental and legal obligations imposed on the tenements. A provision for restoration is required to be brought to account as soon as there is a probable outflow of resources that can be measured reliably. Provisions for restoration are based on the discounted cash flow of expected future cost.

The amount of the provision for future restoration costs is capitalised and is depreciated. The unwinding of the effect of discounting on the provision is recognised as a finance cost.

(m) Trade and other payables

Trade and other payables are stated at their amortised cost. Trade payables are non-interest bearing and are normally settled on 60-day terms.

(n) Interest-bearing borrowings

Interest-bearing borrowings are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost with any difference between cost and redemption value being recognised in the income statement over the period of the borrowings on an effective interest basis.

Notes to the Financial Statements for the year ended 30 June 2006

1. Summary of Significant Accounting Policies (continued)

(o) Leases

Operating Lease payments

Leases where the lessor retains substantially all the risks and benefits of ownership of the asset are classified as operating leases. Initial direct costs incurred in negotiating an operating lease are recognised over the term of the lease on the same basis as the lease expense.

Operating lease payments are recognised as an expense in the income statement on a straight-line basis over the term of the lease.

Finance lease payments

Minimum lease payments are apportioned between the finance charge and the reduction of the outstanding liability. The finance charge is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

(p) Revenue

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Consolidated Entity and the revenue can be reliably measured. The following specific recognition must also be met before revenue is recognised:

Interest revenue

Interest revenue is recognised on an accruals basis.

(q) Income tax

Income tax on the profit or loss for the year comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The following temporary differences are not provided for: initial recognition of goodwill, the initial recognition of assets or liabilities that affect neither accounting nor taxable profit, and differences relating to investments in subsidiaries to the extent that they will probably not reverse in the foreseeable future. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Additional income taxes that arise from the distribution of dividends are recognised at the same time as the liability to pay the related dividend.

Tax consolidation

The Company and its wholly-owned Australian resident entities have formed a tax-consolidated group with effect from 3 October 2005 and are therefore taxed as a single entity from that date. The head entity within the tax-consolidated group is Vital Metals Ltd.

Current tax expense/income, deferred tax liabilities and deferred tax assets arising from temporary differences of the members of the tax-consolidated group are recognised in the separate financial statements of the members of the tax-consolidated group using the 'separate taxpayer within group' approach by reference to the carrying amounts of assets and liabilities in the separate financial statements of each entity and the tax values applying under tax consolidation.

Any current tax liabilities (or assets) and recognised deferred tax assets arising from unused tax losses of the subsidiaries is assumed by the head entity in the tax-consolidated group and are recognised as amounts payable (receivable) to (from) other entities in the tax-consolidated group in conjunction with any tax funding arrangement amounts (refer below). Any difference between these amounts is recognised by the Company as an equity contribution or distribution.

The Company recognises deferred tax assets arising from unused tax losses of the tax-consolidated group to the extent that it is probable that future taxable profits of the tax-consolidated group will be available against which the asset can be utilised.

Any subsequent period adjustments to deferred tax assets arising from unused tax losses as a result of revised assessments of the probability of recoverability is recognised by the head entity only.

Notes to the Financial Statements for the year ended 30 June 2006

1. Summary of Significant Accounting Policies (continued)

(q) Income tax (continued)

Nature of tax funding arrangements and tax sharing arrangements

The head entity, in conjunction with other members of the tax-consolidated group, has entered into a tax funding arrangement which sets out the funding obligations of members of the tax-consolidated group in respect of tax amounts. The tax funding arrangements require payments to/from the head entity equal to the current tax liability (asset) assumed by the head entity and any recognised tax-loss deferred tax asset assumed by the head entity, resulting in the head entity recognising an inter-entity receivable (payable) equal in amount to the tax liability (asset) assumed. The inter-entity receivable (payable) are at call.

Contributions to fund the current tax liabilities are payable as per the tax funding arrangement and reflect the timing of the head entity's obligation to make payments for tax liabilities to the relevant tax authorities.

The head entity in conjunction with other members of the tax-consolidated group, has also entered into a tax sharing agreement. The tax sharing agreement provides for the determination of the allocation of income tax liabilities between the entities should the head entity default on its tax payment obligations. No amounts have been recognised in the financial statements in respect of this agreement as payment of any amounts under the tax sharing agreement is considered remote.

(r) Goods and services tax

Revenues, expenses and assets are recognised net of the amount of goods and services tax (GST), except where the amount of GST incurred is not recoverable from the Australian Taxation Office (ATO). In these circumstances the GST is recognised as part of the cost of acquisition of the asset or as part of an item of the expense.

Receivables and payables are stated with the amount of GST included.

The net amount of the GST recoverable from, or payable to, the ATO is included as a current asset or liability in the balance sheet.

Cash flows are included in the statement of cash flows on a gross basis. The GST components of cash flows arising from investing and financing activities which are recoverable from, or payable to, the ATO are classified as operating cash flows.

(s) Segment reporting

A segment is a distinguishable component of the consolidated entity that is engaged either in providing products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and rewards that are different from those of other segments.

Notes to the Financial Statements for the year ended 30 June 2006

1. Summary of Significant Accounting Policies (continued)

(t) Explanation of transition to AIFRSs

As stated in significant accounting policies note 1(a), these are the consolidated entity's first consolidated financial statements prepared in accordance with AIFRSs.

The policies set out in the significant accounting policies section of this report have been applied in preparing the financial statements for the financial year ended 30 June 2006, the comparative information presented in these financial statements for the financial year ended 30 June 2005 and in the preparation of an opening AIFRS balance sheet at 1 July 2005 (the consolidated entity's date of transition).

In preparing its opening AIFRS balance sheet, the consolidated entity has adjusted amounts reported previously in financial statements prepared in accordance with its old basis of accounting (previous GAAP). An explanation of how the transition from previous GAAP to AIFRSs has affected the consolidated entity's financial position, financial performance and cash flows is set out in the following tables and the notes that accompany the tables.

Reconciliation of total equity as presented under AGAAP to that under AIFRS

(A) The company did not exist at 1 July 2004 and therefore no reconciliation of equity at that date is necessary.

(B) Reconciliation of equity at 30 June 2005

	Consolidated and Company		
	Previous GAAP at 30 June 2005	Adjustments on introduction of AIFRS*	AIFRS at 30 June 2005
	\$		\$
Current assets			
Cash assets	371,010		371,010
Trade and other receivables	28,616		28,616
Total current assets	399,626		399,626
Non-current assets			
Property, plant and equipment	3,001		3,001
Exploration and evaluation costs	2,572		2,572
Total non-current assets	5,573		5,573
Current Liabilities			
Payables	153,029		153,029
Total current liabilities	153,029		153,029
Net assets	252,170		252,170
Equity			
Contributed Equity	347,963		347,963
Reserves		**144,452	144,452
Accumulated losses	(95,793)	(144,452)	(240,245)
Total equity	252,170		252,170

Notes to the Financial Statements for the year ended 30 June 2006

1. Summary of Significant Accounting Policies (continued)

(t) Explanation of transition to AIFRSs (continued)

Reconciliation of profit after tax under AGAAP to that under AIFRS

	Consolidated and Company
	Year ended
	30 June 05
	\$
Loss after tax as previously reported	(95,793)
Expense for equity based payment*	**(144,452)
Loss after tax under AIFRS	(240,245)

* Notes to the reconciliation of equity and profit

** Under previous AGAAP, the consolidated entity did not account for equity-settled share based payments. Such payments are now recognised at fair value in accordance with AASB 2. The effect in the consolidated entity of accounting for equity-settled share based payment transactions at fair value is to increase expenses by \$144,452 for the period to 30 June 2005. The adoption of AASB 2 is equity-neutral for equity-settled transactions. The expense recognised for the consumption of employee services received as consideration for share options granted will be deductible for tax purposes when the share options are exercised. The share options in question were granted to Directors.

Fair Value of share options and assumptions

The fair value of services received in return for share options granted to employees is measured by reference to the fair value of options granted. The estimate of the fair value of the services is measured based on a binomial option valuation methodology. The life of the options and early exercise option are built into the option model.

The assumptions used for the options valuation are as follows:

Fair value at measurement date	5.159 cents/option
Exercise price	20 cents
Share Price	20 cents
Expected volatility	50%
Risk free Interest rate (based on 3 year Government bond rate)	5.275%
Option expiry date	30 June 2008

Explanation of material adjustments to the cash flow statements

There are no material differences between the cash flow statements presented under AIFRS and those presented under AGAAP.

Notes to the Financial Statements for the year ended 30 June 2006

	Consolidated		The Company	
	2006	2005	2006	2005
	\$	\$	\$	\$

2. Other Income and Expenses

The following significant revenue and expense items not separately highlighted in the Income Statement are relevant in explaining the financial performance:

Expenses

Depreciation of non-current assets

- land and buildings	14,098	-	3,314	-
- leased plant and equipment	8,181	-	7,477	-
- plant and equipment	15,345	-	7,511	-
- office equipment	1,670	117	1,661	117
Total Depreciation	39,294	117	19,963	117

Employee benefit and director compensation expense	772,805	198,680	772,805	198,680
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3. Income Tax Expense

a) The major components of income tax expense are:

Income Statement

Current income tax

Current income tax charge	835,832	83,022	338,122	83,022
Adjustments in respect of current income tax of previous years	-	-	-	-

Deferred income tax

Relating to origination and reversal of temporary differences	(517,252)	(11,241)	(28,642)	(11,241)
Unused tax losses not recognised as DTA	(318,580)	(71,781)	(309,480)	(71,781)

Income tax expense (income) reported in the income statement	-	-	-	-
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The aggregate amount of income tax attributable to the financial period differs from the amount calculated on the operating loss. The differences are recorded as follows:

Accounting Loss	(1,069,312)	(240,245)	(1,038,875)	(240,245)
Prima facie tax payable at 30%	(320,794)	(72,074)	(311,662)	(72,074)
Add tax effect of:				
Non - deductible items	2,214	293	2,182	293
Tax losses not brought to account	318,580	71,781	309,480	71,781

Income tax expense on loss	-	-	-	-
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Notes to the Financial Statements for the year ended 30 June 2006

3. Income Tax Expense (continued)

b) Deferred income tax

Deferred income tax at 30 June relates to the following:

Consolidated	Balance Sheet	
	2006	2005
	\$	\$
<i>Deferred tax liabilities</i>		
Depreciation	50,719	–
Exploration expenses	515,638	–
Other	3,640	–
Set-off of tax assets	(569,997)	–
	–	–
<i>Deferred tax assets</i>		
Tax value of loss carry forwards	550,415	–
Set-off to deferred tax liability	(569,997)	–
Accrued expenses	12,750	1,343
Provisions	6,832	6,300
Non-recognition of deferred taxes	–	(7,643)
	–	–

The Company	Balance Sheet	
	2006	2005
	\$	\$
<i>Deferred tax liabilities</i>		
Formation Expenses	–	–
Movements in depreciation	–	–
Exploration expenses	–	–
Prepayments	–	–
Equity raising costs	–	–
Accrued expenses	–	–
Provisions	–	–
	–	–
<i>Deferred tax assets</i>		
Tax value of loss carry forwards	550,415	–
Accrued expenses	12,750	1,343
Provisions	6,832	6,300
Non-recognition of deferred taxes	(569,997)	(7,643)
	–	–

Notes to the Financial Statements for the year ended 30 June 2006

3. Income Tax Expense (continued)

c) Tax Losses

At 30 June 2006, Vital Metals consolidated group has \$2,795,994 (2005: Nil) of tax losses that are available indefinitely for offset against future taxable profits of the company. No deferred tax assets has been recognised on the Balance Sheet in respect of the amount of these losses.

Unrecognised deferred tax balances

	Consolidated		The Company	
	2006	2005	2006	2005
	\$	\$	\$	\$
<i>Deferred tax assets</i>				
Tax losses - revenue	838,798	–	337,950	–
Tax losses - capital	–	–	–	–
	838,798	–	337,950	–

The potential deferred tax asset will only be obtained if:

- assessable income is derived of a nature and of amount sufficient to enable the benefit from the deductions to be realised or the benefit can be utilised by the Company and/or the consolidated entity in accordance with Division 170 of the Income Tax Assessment Act 1997;
- conditions for deductibility imposed by the law are complied with; and
- no changes in tax legislation adversely affect the realisation of the benefit from the deductions.

d) Tax Consolidation Legislation

Vital Metals Ltd and its controlled entities implemented the tax consolidations legislation as of 4 October 2005. The Australian Tax Office will be notified of this decision on lodgement of the 2006 income tax return.

The controlled entities have been fully compensated for all deferred tax assets and liabilities transferred to Vital Metals Ltd on the date of implementation of the legislation. The entities have also entered into a tax sharing and compensation agreement. Under the terms of this agreement, the wholly owned entities reimburse Vital Metals Ltd for any current income tax payable or receivable by Vital Metals Ltd arising in respect of their activities. The reimbursements are payable or receivable at the same time as the associated income tax liabilities fall due or refunds are receivable and have therefore been recognised as a current tax related receivable or payable (where applicable) by Vital Metals Ltd. The group has decided to use the "Separate taxpayer within group" approach in accordance with UIG 1052 in order to account for the current and deferred tax amounts amongst the entities within the consolidated group.

Notes to the Financial Statements for the year ended 30 June 2006

	Consolidated		The Company	
	2006	2005	2006	2005
	\$	\$	\$	\$

4. Auditors' Remuneration

Remuneration of the auditor of the parent entity for:

- auditing or reviewing of the financial reports	28,050	9,000	28,050	9,000
- non-audit services				
Independent accountant report for prospectus	-	12,000	-	12,000

5. Cash and Cash Equivalents

Cash at bank and on hand	32,241	371,010	15,588	371,010
Call deposits	4,887,169	-	4,887,169	-
Cash and cash equivalents in the statement of cash flows	4,919,410	371,010	4,902,757	371,010

6. Trade and Other Receivables

Current

Other trade receivables	78,688	25,616	36,295	25,616
Security deposits	58,731	3,000	46,731	3,000
Prepayments	44,285	-	44,285	-
	181,704	28,616	127,311	28,616

Non-Current

Amount receivable from controlled entities (Note 23)	-	-	1,635,268	-
	-	-	1,635,268	-

7. Investments

In the financial statements of the Company, investments in subsidiaries are accounted for at cost and included with other financial assets.

The consolidated entity has the following investments in subsidiaries:

	Class	Country of Incorporation	Investment At Cost	
			2006	2005
			\$	\$
Parent Entity				
Vital Metals Ltd	Ord	Australia	-	-
Controlled Entities (100%)				
North Queensland Tungsten Pty Ltd	Ord	Australia	1,645,465	-
Mount Alexander Resources Pty Ltd	Ord	Australia	1,550,000	-
			3,195,465	-

North Queensland Tungsten Pty Ltd and Mount Alexander Resources Pty Ltd were acquired during the year (Note 29).

Notes to the Financial Statements for the year ended 30 June 2006

	Consolidated		The Company	
	2006	2005	2006	2005
	\$	\$	\$	\$
8. Property, Plant and Equipment				
Buildings				
At cost	237,501	–	66,289	–
Accumulated depreciation	(14,098)	–	(3,314)	–
Total land and buildings	223,403	–	62,975	–
Plant and Equipment				
At cost	166,841	–	59,785	–
Accumulated depreciation	(15,346)	–	(7,512)	–
	151,495	–	52,273	–
Leased Plant & Equipment				
Capitilised Lease Assets	144,739	–	102,516	–
Accumulated depreciation	(8,181)	–	(7,477)	–
	136,558	–	95,039	–
Total plant and equipment	288,053	–	147,312	–
Office equipment				
At cost	20,970	3,118	20,423	3,118
Accumulated depreciation	(1,786)	(117)	(1,777)	(117)
Total office equipment	19,184	3,001	18,646	3,001
Total property, plant and equipment	530,640	3,001	228,933	3,001

Movements in Carrying Amounts

Movements in the carrying amounts for each class of property, plant and equipment between the beginning and the end of the current financial year

	Land and Buildings	Leased Plant & Equipment	Plant and Equipment	Office Equipment	Total
The Company:					
Balance at the beginning of the year	–	–	–	3,001	3,001
Acquisitions	66,289	102,516	59,785	17,305	245,895
Depreciation expense	(3,314)	(7,477)	(7,512)	(1,660)	(19,963)
Carrying amount at the end of the year	62,975	95,039	52,273	18,646	228,933
Consolidated:					
Balance at the beginning of the year	–	–	–	3,001	3,001
Acquisitions	237,501	144,739	166,841	17,852	566,933
Depreciation expense	(14,098)	(8,181)	(15,346)	(1,669)	(39,294)
Carrying amount at the end of the year	223,403	136,558	151,495	19,184	530,640

Notes to the Financial Statements for the year ended 30 June 2006

	Consolidated		The Company	
	2006	2005	2006	2005
	\$	\$	\$	\$

9. Intangible Assets

Non Current

Exploration & Development Expenditure

Costs carried forward in respect of areas of interest in:

Exploration and Evaluation Phases:

Opening balance at 1 July	2,572	–	2,572	–
Tenements acquired on listing	3,897,654	–	520,000	–
Exploration expenditure during the year	1,506,059	2,572	140,177	2,572
Closing balance at 30 June	5,406,285	2,572	662,749	2,572

10. Trade and Other Payables

Trade creditors and accruals	623,953	153,029	350,185	153,029
	623,953	153,029	350,185	153,029

11. Interest Bearing Liabilities

Current

Finance lease liabilities (Note 20)	44,847	–	32,095	–
	44,847	–	32,095	–

Non Current

Finance lease liabilities (Note 20)	89,811	–	60,339	–
	89,811	–	60,339	–

12. Provisions

Current

Employee benefits

Liability for annual leave	22,774	–	22,774	–
	22,774	–	22,774	–

Notes to the Financial Statements for the year ended 30 June 2006

	Consolidated		The Company	
	2006	2005	2006	2005
	\$	\$	\$	\$
13. Issued Capital				
Ordinary shares				
At the beginning of the reporting period	347,963	1	347,963	1
Shares issued during the year		347,962		347,962
40,000,000 on 3 October 2005	8,000,000		8,000,000	
18,000,000 on 4 October 2006	3,600,000		3,600,000	
Less: Capital raising expenses	(716,789)		(716,789)	
At reporting date	11,231,174	347,963	11,231,174	347,963

Ordinary shares participate in dividends and the proceeds on winding up of the parent entity in proportion to the number of shares held. At shareholders meetings each ordinary share is entitled to one vote when a poll is called, otherwise each shareholder has one vote on a show of hands.

	Consolidated		The Company	
	2006	2005	2006	2005
Number of shares	No.	No.	No.	No.
At the beginning of the reporting period	12,050,003	–	12,050,003	–
Shares issued during year				
9 December 2004		3		3
31 March 2005		7,900,000		7,900,000
18 April 2005		4,150,000		4,150,000
3 October 2005	40,000,000		40,000,000	
4 October 2005	18,000,000		18,000,000	
At reporting date	70,050,003	12,050,003	70,050,003	12,050,003

	Consolidated		The Company	
	2006	2005	2006	2005
	\$	\$	\$	\$
14. Reserves				
Option premium reserve	103,180	–	103,180	–
Share based payment reserve	231,857	144,452	231,857	144,452
	335,037	144,452	335,037	144,452

15. Commitments

Mineral Tenement Commitments

The economic entity has certain minimum obligations in pursuance of the terms and conditions of tenement licences in the forthcoming year. Whilst these obligations are capable of being varied from time to time, in order to maintain current rights of tenure to mining tenements, the economic entity will be required to outlay in 2006/07 amounts of approximately \$573,500. These obligations are expected to be fulfilled in the normal course of operations.

Notes to the Financial Statements for the year ended 30 June 2006

16. Financial Instruments

(a) Credit Risk Exposures

The credit risk on financial assets of the economic entity which have been recognised on the Statement of Financial Position is generally the carrying amount, net of any provisions for doubtful debts.

(b) Interest Rate Risk Exposures

The economic entity's exposure to interest rate risk, which is the risk that a financial instruments value will fluctuate as a result of changes in market interest rates, and the effective weighted average interest rate for each class of financial assets and financial liabilities is set out below.

Exposures arise predominantly from assets and liabilities bearing variable interest rates as the economic entity intends to hold fixed rate assets and liabilities to maturity.

2006	Weighted Average Interest rate	Notes	Floating Interest rate	Fixed Interest rate	Non Interest Bearing	Total
Financial Assets						
Cash and cash equivalents	5.73%	5	4,919,410	–	–	4,919,410
Trade and other receivables	–	6	–	–	181,704	181,704
			4,919,410	–	181,704	5,101,114
Financial Liabilities						
Trade and other payables	–	10	–	–	623,953	623,953
Finance Lease	8.03%	11	–	134,658	–	134,658
Net financial assets / (liabilities)			4,919,410	(134,658)	(442,249)	4,342,503

2005	Weighted Average Interest rate	Notes	Floating Interest rate	Fixed Interest rate	Non Interest Bearing	Total
Financial Assets						
Cash and cash equivalents	–	5	–	–	371,010	371,010
Trade and other receivables	–	6	–	–	28,616	28,616
			–	–	399,626	399,626
Financial Liabilities						
Trade and other payables	–	10	–	–	153,029	153,029
Net financial assets / (liabilities)			–	–	246,597	246,597

Reconciliation of Net Financial Assets to Net Assets

	Notes	2006 \$	2005 \$
Net financial assets/(liabilities) as above		4,342,503	246,597
Non financial assets / (liabilities)			
- Property, plant & equipment	8	530,640	3,001
- Other non-current assets	9	5,406,285	2,572
- Provisions	12	(22,774)	–
Net assets per statement of financial position		10,256,654	252,170

Notes to the Financial Statements for the year ended 30 June 2006

16. Financial Instruments (continued)

(c) Net Fair Value of Financial Assets and Liabilities

The carrying amounts of all financial assets and liabilities equal their respective net fair values at balance date.

On-balance Sheet

The net fair value of cash, cash equivalents, non interest bearing monetary financial assets and financial liabilities of the economic entity equal their carrying value.

17. Segment Reporting

The economic entity operates in one business and geographical segment being mineral exploration and prospecting for minerals in Australia.

18. Key Management Personnel Disclosures

(a) The following were key management personnel of the consolidated entity at any time during the reporting period and unless otherwise indicated were key management personnel for the entire period

Parent Entity Directors

William Ryan
D. Ross Kennedy
Mark McAuliffe
Andrew Simpson
Colin Hunter

Executives

Ross Arancini (Company Secretary - Resigned 25th October 2005)
Oscar Aamodt (Company Secretary - Appointed 25th October 2005 - Resigned 3rd March 2006)
John Sobolewski (Company Secretary - Appointed 1st March 2006)
Bruce Pertz (Principal Geologist)

(b) Key management personnel compensation

The key management personnel compensation included in employee benefit and director compensation expenses are as follows:

	Consolidated		The Company	
	2006	2005	2006	2005
	\$	\$	\$	\$
Short term employee benefits	358,229	49,750	358,229	49,750
Other long term benefits	-	-	-	-
Post employment benefits	49,837	4,478	49,837	4,478
Termination benefits	-	-	-	-
Equity compensation benefits	43,910	130,523	43,910	130,523
	451,976	184,751	451,976	184,751

(c) Individual directors and executives compensation disclosures

Information regarding individual directors and executives compensation is provided in the Remuneration Report section of the Directors' report.

Apart from the details disclosed in this note, no director has entered into a material contract with the Company or the consolidated entity since the end of the previous financial year and there were no material contracts involving directors interests existing at year end.

Notes to the Financial Statements for the year ended 30 June 2006

18. Key Management Personnel Disclosures (continued)

(d) Other key management personnel transactions with the Company or its controlled entities

A number of key management persons, or their related parties, hold positions in other entities that result in them having control or significant influence over the financial or operating policies of those entities.

A number of these entities transacted with the Company or its subsidiaries in the reporting period. The terms and conditions of the transactions with management persons and their related parties were no more favourable than those available, or which might reasonably be expected to be available, on similar transactions on an arms-length basis.

The aggregate amounts recognised during the year relating to key management personnel and their related parties were as follows:

Key management persons	Transaction	Consolidated		The Company	
		2006	2005	2006	2005
		\$	\$	\$	\$
Andrew Simpson	Marketing fees (i)	13,750	10,000	13,750	10,000
Mark McAuliffe	Legal fees (ii)	47,562	25,337	47,562	25,337
D. Ross Kennedy	Consulting fees (iii)	9,343	3,625	9,343	3,625

(i) During the year an entity associated with Mr Simpson was paid \$13,750 for consultancy services provided on normal commercial terms and conditions.

(ii) During the year the Company paid a partnership of which Mr McAuliffe is a partner \$47,562 for legal services provided on normal commercial terms and conditions.

(iii) During the year the Company paid a company associated with Mr Kennedy \$9,343 for consultancy services provided on normal commercial terms and conditions.

(e) Options and Rights Holdings

Number of Options held by Directors and Executives

	Balance 1.07.05	Granted as Remuneration	Options Exercised	Net Change Other	Balance 30.06.06
Parent Entity Directors					
William Ryan	500,000	–	–	–	500,000
D. Ross Kennedy	500,000	–	–	–	500,000
Mark McAuliffe	500,000	–	–	–	500,000
Andrew Simpson	500,000	–	–	–	500,000
Colin Hunter	500,000	–	–	–	500,000
Executives					
Ross Arancini	300,000	–	–	–	300,000
Oscar Aamodt	–	200,000	–	–	200,000
John Sobolewski	–	300,000	–	–	300,000
Bruce Pertzelt	–	350,000	–	–	350,000
	2,800,000	850,000	–	–	3,650,000

All options have vested and are exercisable.

Notes to the Financial Statements for the year ended 30 June 2006

18. Key Management Personnel Disclosures (continued)

(f) Shareholdings

Number of shares held by Directors and Executives.

	Balance 1.07.05	Received as Remuneration	Options Exercised	Net Change Other	Balance 30.06.06
Parent Entity Directors					
William Ryan	5,000,001	–	–	–	5,000,001
D. Ross Kennedy	400,000	–	–	–	400,000
Mark McAuliffe	400,001	–	–	90,000	490,001
Andrew Simpson	400,000	–	–	–	400,000
Colin Hunter	400,000	–	–	–	400,000
Executives					
Ross Arancini	–	–	–	200,000	200,000
Oscar Aamodt	–	–	–	50,000	50,000
John Sobolewski	–	–	–	–	–
Bruce Pertzelt	–	–	–	115,000	115,000
	6,600,002	–	–	455,000	7,055,002

Net change other refers to shares purchased and sold during the financial year.

	Consolidated		The Company	
	2006	2005	2006	2005
	\$	\$	\$	\$

19. Retained Earnings / (Accumulated Losses)

Retained earnings/(accumulated losses) at the beginning of the financial year	(240,245)	–	(240,245)	–
Dividends paid	–	–	–	–
Profit/(loss) for the year	(1,069,312)	(240,245)	(1,038,876)	(240,245)
Retained earnings / (accumulated losses) at the end of the financial year	(1,309,557)	(240,245)	(1,279,121)	(240,245)

Notes to the Financial Statements for the year ended 30 June 2006

20. Leasing Commitments

a) Finance Lease Commitments ⁽ⁱ⁾

	Consolidated		The Company	
	2006	2005	2006	2005
	\$	\$	\$	\$
Payable				
- not later than 1 year	54,516	-	38,511	-
- later than 1 year but not later than 5 years	96,591	-	64,582	-
Minimum lease payments	151,107	-	103,093	-
Less future finance charges	16,449	-	10,659	-
Total Lease Liability	134,658	-	92,434	-

(i) The consolidated entity's finance lease liabilities are secured by the leased assets, as in the event of default, the leased assets revert to the lessor.

b) Operating Lease Commitments

Leases as lessee				
Payable				
	2006	2005	2006	2005
- not later than 1 year	73,698	-	73,698	-
- later than 1 year but not later than 5 years	241,760	-	241,760	-
Total Lease Liability	315,458	-	315,458	-

21. Joint Ventures

The Consolidated Entity has interests in the following joint venture:

Activities	Equity Interest		Carrying Value	
	2006	2005	2006	2005
Tenement Area			\$	\$
Mt Mulgine	-	-	662,749	-
	Tungsten/ Molybdenum			

The carrying value in the above joint venture represents exploration expenditure and is included in the total of \$5,406,285 (2005: nil) at Note 9. This exploration expenditure has been accounted for in accordance with Note 1(e).

In order to earn 70% of the Mt Mulgine Joint Venture, the Company is required to sole fund \$750,000 of exploration costs within three years from the date the Company listed on the ASX (40% will be earned upon expenditure of \$500,000). As at 30 June 2006, a total of \$121,955 (excluding acquisition costs) has been incurred.

22. Contingent Liabilities

i) Department of Industry & Resources

Performance Bonds totalling \$14,500 (2005: \$nil) have been granted in favour of the Department of Industry & Resources.

Notes to the Financial Statements for the year ended 30 June 2006

	Consolidated		The Company	
	2006	2005	2006	2005
	\$	\$	\$	\$
23. Related Party Transactions				
(a) Loans to 100% controlled entities				
Receivables (Note 6)				
Mount Alexander Resources Pty Ltd	-	-	55,341	-
North Queensland Tungsten Pty Ltd	-	-	1,579,927	-
	-	-	1,635,268	-

Loans outstanding between the Company and its controlled entities have no fixed date of repayment and are non-interest bearing.

24. Reconciliation of Cash Flows from Operating Activities

(a) Cash flows from operating activities

Profit/(loss) for the year	(1,069,312)	(240,245)	(1,038,876)	(240,245)
Non-cash flows in profit:-				
Depreciation	39,294	117	19,963	117
Options issue expense	190,585	144,452	190,585	144,452
Changes in assets and liabilities:-				
Decrease / (Increase) in trade debtors	(38,544)	(21,636)	(43,965)	(21,636)
Increase / (Decrease) in trade creditors and accruals	164,300	71,827	214,374	71,827
Charges to provisions	22,774	-	22,774	-
Net cash from operating activities	(690,903)	(45,485)	(635,145)	(45,485)

(b) Non-cash Financing and Investing Activities

- 2,000,000 fully paid ordinary shares at \$0.20 per share for the right to earn up to a 70% equity in the Mt Mulgine Project's mining and exploration tenements through the sole funding of exploration costs of \$750,000 within 3 years from the date the Company lists on ASX;
- 7,500,000 fully paid ordinary shares at \$0.20 per share for the acquisition of 100% of the issued shares of Mount Alexander Resources Pty Ltd which owned the tenements comprising the Mt Alexander Project;
- 8,000,000 fully paid ordinary shares at \$0.20 per share for the acquisition of 100% of the issued shares in North Queensland Tungsten Pty Ltd which acquired the Watershed Project; and
- 500,000 fully paid ordinary shares at \$0.20 per share and the payment of \$20,000 upon the exercise of an option to acquire the rights to certain minerals within a granted mining tenement surrounding North Queensland Tungsten Pty Ltd's Watershed Project.

Notes to the Financial Statements for the year ended 30 June 2006

25. Earnings per Share

(a) Basic Earnings per Share

The calculation of basic earnings per share for the year ended 30 June 2006 was based on the loss attributable to ordinary shareholders of \$1,069,312 (30 June 2005: \$240,245) and a weighted number of ordinary shares outstanding during the year ended 30 June 2006 of 55,003,428 (2005: 2,799,592) calculated as follows:

	Consolidated	
	2006	2005
Loss for the period	(1,069,312)	(240,245)
Loss attributable to ordinary shareholders	(1,069,312)	(240,245)

Weighted average number of ordinary shares	Number of shares	
	2006	2005
Issued ordinary shares at 1 July 2005	12,050,003	3
Effect of shares issued on 31 March 2005	–	1,969,589
Effect of shares issued on 18 April 2005	–	830,000
Effect of shares issued on 3 October 2005	29,589,041	–
Effect of shares issued on 4 October 2005	13,364,384	–
Weighted average number of ordinary shares at 30 June 2006	55,003,428	2,799,592

(b) Diluted Earnings per Share

As the group has made a loss for the year and options issued are not in the money, the options have no dilutive effect. Therefore, diluted earnings per share is equal to basic earnings per share.

26. Employee Benefits

(a) Employees Share Option Plan

The Vital Metals Ltd Share Option Plan was approved in April 2005.

The issue to each individual Employee, Key Employee or Director is controlled by virtue of the provisions of both the Share Plan and the Australian Stock Exchange Limited Listing Rules. Under the Share Scheme the number of shares an eligible person will be entitled to receive each year will be determined by the Board of Directors in their sole discretion.

Employees, key employees and directors are entitled to take up ordinary shares at a cost determined by the Board with regard to the market value of the shares when the Board resolves to offer the Option.

As at June 30 2006, 1,650,000 20 cent, employee options have been issued. Of these, nil were cancelled as per the terms and conditions of the scheme, nil were exercised as per the terms and conditions of the scheme, and 1,650,000 remain unconverted to ordinary shares. These options are not listed, may not be traded and lapse within six months of an employee leaving the company.

The closing market price of an ordinary share of Vital Metals Ltd on the Australian Stock Exchange at 30 June 2006 was \$0.20 (2005 n/a).

Notes to the Financial Statements for the year ended 30 June 2006

26. Employee Benefits (continued)

	Consolidated		The Company	
	2006	2005	2006	2005
	No.	No.	No.	No.
(b) Movement in the number of share options held by employees are as follows:				
Opening Balance	2,830,000	–	2,830,000	–
Granted during the year	1,650,000	2,830,000	1,650,000	2,830,000
Exercised during the year	–	–	–	–
Lapsed during the year	–	–	–	–
Closing balance	4,480,000	2,830,000	4,480,000	2,830,000

(c) Details of share options exercised during the year:

No share options were exercised during the year.

(d) Details of share options outstanding as at end of year:

	Grant Date	Expiry Date	Exercise Price	No.	No.	No.	No.
	31-Mar-05	30-Jun-08	\$0.20	2,830,000	2,830,000	2,830,000	2,830,000
	9-Mar-06	9-Mar-08	\$0.20	800,000	–	800,000	–
	1-Jun-06	1-Jun-08	\$0.20	850,000	–	850,000	–
				4,480,000	2,830,000	4,480,000	2,830,000
Number of employees at year end				8	2	8	2

Optionholders have no voting or dividend rights until shares are allotted pursuant to the exercise of the relevant options.

Notes to the Financial Statements for the year ended 30 June 2006

26. Employee Benefits (continued)

(e) Employee expenses	Consolidated		The Company	
	2006	2005	2006	2005
	\$	\$	\$	\$
Share options granted in 2005 - equity settled (i)	-	144,452	-	144,452
Share options granted in 2006 - equity settled (ii)	87,405	-	87,405	-
Total expense recognised as employee costs	87,405	144,452	87,405	144,452

(i) Fair value of each option at grant date was \$0.0516 per option.

(ii) Fair value of 800,000 options at grant date was \$0.0488 per option and fair value of 850,000 options at grant date was \$0.0569 per option.

Further assumptions are disclosed in the remuneration report.

27. Dividends

No dividends were paid during the period and the Directors do not recommend the payment of a dividend.

28. Subsequent Events

No matters or circumstances have arisen since the end of the financial period which has significantly affected, or may affect the operations of the Company, the results of those operations, or the state of affairs of the Company in financial years subsequent to the financial period ended 30 June 2006.

29. Acquisition Of Subsidiaries

On 4 October 2005, the Company acquired all of the shares (100%) in Mount Alexander Resources Pty Ltd ("MAR"), the consideration for the purchase was the issue of 7,500,000 VML ordinary shares to the vendors at a fair value of 20 cents per share. MAR holds the beneficial interest in, and has the right to become the registered holder of those Mt Alexander Tenements which are currently registered in the name of Breamlea Pty Ltd. In the period to 30 June 2006 the subsidiary contributed a loss of \$2,943 to the consolidated net loss for the period.

The acquisition had the following effect on the consolidated entities assets and liabilities.

MAR net assets at acquisition date

	Recognised values	Fair value adjustments	Carrying amounts
	\$	\$	\$
Cash at bank	596	-	596
Receivables	1,030	-	1,030
Exploration, evaluation and development expenditure	44,984	1,512,072	1,557,056
Trade and other payables	(8,682)	-	(8,682)
Net identifiable assets and liabilities	37,928	1,512,072	1,550,000

Notes to the Financial Statements for the year ended 30 June 2006

29. Acquisition Of Subsidiaries (continued)

On 4 October 2005, the Company acquired all of the shares (100%) in North Queensland Tungsten Pty Ltd ("NQT"), the consideration for the purchase was the issue of 8,000,000 VML ordinary shares to the vendor at a fair value of 20 cents per share. NQT holds the beneficial interest in the Watershed Project tenement MDL 127. In the period to 30 June 2006 the subsidiary contributed a loss of \$37,961 to the consolidated net loss for the period.

The acquisition had the following effect on the consolidated assets and liabilities.

NQT net assets at acquisition date

	Recognised values	Fair value adjustments	Carrying amounts
	\$	\$	\$
Cash at bank	10	–	10
Receivables	12,000	–	12,000
Exploration, evaluation and development expenditure	164,888	1,655,710	1,820,598
Buildings, plant and equipment	90,952	–	90,952
Trade and other payables	(278,095)	–	(278,095)
Net identifiable assets and liabilities	(10,245)	1,655,710	1,645,465

Notes to the Financial Statements for the year ended 30 June 2006

Shareholders Information as at 30 August 2006

1 The total number of issued fully paid ordinary shares was 70,050,003.

2 The distribution of holdings was:

	Fully paid ordinary shares	20c options
1 - 1,000	2,275	-
1,001 - 5,000	195,551	-
5,001 - 10,000	1,338,845	-
10,001 - 100,000	14,246,771	130,000
100,001 - and over	54,266,561	6,350,000
Total	70,050,003	6,480,000

Voting rights	Full	None
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Ordinary shares participate in dividends and the proceeds on winding up of the parent entity in proportion to the number of shares held. At shareholders meetings each ordinary share is entitled to one vote when a poll is called, otherwise each shareholder has one vote on a show of hands.

3 The number of holders of less than a marketable parcel of fully paid shares is 10.

4 Substantial shareholders are Consolidated Minerals Ltd with 8,500,000 shares being 12.13% of the issued capital, Stanley Macdonald with 8,000,000 shares being 11.42% of the issued capital, Breamlea Pty Ltd with 5,480,250 shares being 7.82% of the issued capital and Rytech Pty Ltd with 5,000,000 shares being 7.14% of the issued capital.

5 Top 20 Shareholders

Name	Fully paid ordinary shares	% Held of Issued Ordinary Capital
Consolidated Minerals Ltd	8,500,000	12.13
Stanley Allan Macdonald	8,000,000	11.42
Breamlea Pty Ltd	5,480,250	7.82
Rytech Pty Ltd	5,000,000	7.14
Gindalbie Metals Ltd	2,000,000	2.86
Topspeed Pty Ltd	1,559,025	2.23
Lonsdale Investments Pty Ltd	1,413,825	2.02
Robyn Anne Starkey	1,190,000	1.70
Kingslane Pty Ltd	1,000,000	1.43
Satinbrook Pty Ltd	1,000,000	1.43
Cordin Pty Ltd	605,925	0.86
Trustees National Australia	600,000	0.86
Lift Capital Nominees	600,000	0.86
Wythenshawe Pty Ltd	550,000	0.79
Mathew De Wayne	530,000	0.76
National Nominees Limited	521,500	0.74
SDC Pty Ltd	520,000	0.74
Republic Gold Limited	500,000	0.71
Victor John Plummer	500,000	0.71
Ajava Holdings Pty Ltd	500,000	0.71
	40,570,525	57.92

Directors' Declaration for the year ended 30 June 2006

- 1 In the opinion of the directors of Vital Metals Ltd ('the Company'):
 - (a) the financial statements and notes [including the remuneration disclosures that are contained in the Remuneration report in the Directors' report] are in accordance with the Corporations Act 2001, including:
 - (i) giving a true and fair view of the financial position of the Company and the consolidated entity as at 30 June 2006 and of their performance, as represented by the results of their operations and their cash flows, for the financial year ended on that date; and
 - (ii) complying with Australian Accounting Standards and the Corporations Regulations 2001; and
 - (b) the remuneration disclosures that are contained in the Remuneration report in the Directors' report comply with Australian Accounting Standard AASB 124 Related Party Disclosures and ASIC Class Order 06/105 *Calculation of director and executive remuneration*/ Corporations Act Regulation 2M.6.04.
 - (c) there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.
- 2 The directors have been given the declarations by the executive chairman and chief financial officer for the financial year ended 30 June 2006 pursuant to Section 295A of the Corporations Act 2001.

This declaration is made in accordance with a resolution of the Board of Directors and is signed for and on behalf of the directors by:



W J Ryan
Director

1st September 2006

Independent Audit Report



Independent audit report to members of Vital Metals Ltd

Scope

The financial report, remuneration disclosures and directors' responsibility

The financial report comprises the income statements, statements of changes in equity, balance sheets, statement of cash flows, accompanying notes to the financial statements, and the directors' declaration for both Vital Metals Ltd (the "Company") and Vital Metals Ltd and its Controlled Entities (the "Consolidated Entity") for the year ended 30 June 2006. The Consolidated Entity comprises both the Company and the entities it controlled during that year.

As permitted by the Corporations Regulations 2001, the Company has disclosed information about the remuneration of directors and executives ("remuneration disclosures"), required by Australian Accounting Standard AASB 124 *Related Party Disclosures*, under the heading "Remuneration report" in the directors' report and not in the financial report.

The Remuneration report also contains information not required by Australian Accounting Standard AASB 124 which is not subject to our audit.

The directors of the Company are responsible for the preparation and true and fair presentation of the financial report and the Remuneration report in accordance with the *Corporations Act 2001*. This includes responsibility for the maintenance of adequate accounting records and internal controls that are designed to prevent and detect fraud and error, and for the accounting policies and accounting estimates inherent in the financial report. The directors are also responsible for preparing the relevant reconciling information regarding the adjustments required under the Australian Accounting Standard AASB 1 *First-time Adoption of Australian equivalents to International Financial Reporting Standards*. The directors are also responsible for the remuneration disclosures contained in the directors' report.

Audit approach

We conducted an independent audit in order to express an opinion to the members of the Company. Our audit was conducted in accordance with Australian Auditing Standards in order to provide reasonable assurance as to whether the financial report is free of material misstatement and the remuneration disclosures comply with AASB 124. The nature of an audit is influenced by factors such as the use of professional judgement, selective testing, the inherent limitations of internal control, and the availability of persuasive rather than conclusive evidence. Therefore, an audit cannot guarantee that all material misstatements have been detected.

We performed procedures to assess whether in all material respects the financial report presents fairly, in accordance with the *Corporations Act 2001*, Australian Accounting Standards and other mandatory financial reporting requirements in Australia, a view which is consistent with our understanding of the Company's and the Consolidated Entity's financial position, and of their performance as represented by the results of their operations and cash flows and whether the remuneration disclosures comply with Australian Accounting Standard AASB 124.

We formed our audit opinion on the basis of these procedures, which included:

- examining, on a test basis, information to provide evidence supporting the amounts and disclosures in the financial report, and
- assessing the appropriateness of the accounting policies and disclosures used and the reasonableness of significant accounting estimates made by the directors.

While we considered the effectiveness of management's internal controls over financial reporting when determining the nature and extent of our procedures, our audit was not designed to provide assurance on internal controls.

Independent Audit Report



Audit opinion

In our opinion:

- (1) the financial report of Vital Metals Ltd is in accordance with:
 - a) the *Corporations Act 2001*, including:
 - i) giving a true and fair view of the Company's and Consolidated Entity's financial position as at 30 June 2006 and of their performance for the financial year ended on that date; and
 - ii) complying with Australian Accounting Standards and the Corporations Regulations 2001; and
 - (b) other mandatory financial reporting requirements in Australia; and
- (2) the remuneration disclosures contained in the remuneration report in the directors' report comply with Australian Accounting Standard AASB 124 *Related Party Disclosures*.

A handwritten signature in black ink, appearing to read 'T R Hart', written over the printed name and title.

KPMG
KPMG

T R Hart
Partner

Perth
1 September 2006

Auditor's Independence Statement



Lead Auditor's Independence Declaration under Section 307C of the Corporations Act 2001

To: the directors of Vital Metals Ltd

I declare that, to the best of my knowledge and belief, in relation to the audit for the financial year ended 30 June 2006 there have been:

- (i) no contraventions of the auditor independence requirements as set out in the Corporations Act 2001 in relation to the audit; and
- (ii) no contraventions of any applicable code of professional conduct in relation to the audit.


KPMG
T R Hart
Partner

Perth
1 September 2006



Vital Metals Ltd

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