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**MEGASTAR DEVELOPMENT CORP.**  
INTERIM CONSOLIDATED FINANCIAL STATEMENTS  
May 31, 2005 and 2004

Unaudited

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Notice to Reader:

The attached financial statements have been prepared by the Management of Megastar Development Corp. and have not been reviewed by the auditors of Megastar Development Corp.

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**MEGASTAR DEVELOPMENT CORP.**  
**INTERIM CONSOLIDATED BALANCE SHEETS**  
May 31, 2005 and February 28, 2005

**Unaudited**

	<u>ASSETS</u>	<u>2005</u>	<u>2005</u>
Current			
Cash		\$ 134,141	\$ 14,579
GST receivable		7,662	7,228
Prepaid expenses		5,000	-
		146,803	21,807
Mineral properties – Note 4 and Schedule 1		147,685	146,775
		\$ 294,488	\$ 168,582
<u>LIABILITIES</u>			
Current			
Accounts payable and accrued liabilities – Note 6		\$ 25,026	\$ 44,188
Due to related parties – Note 6		500	16,541
		25,526	60,729
<u>SHAREHOLDERS' EQUITY</u>			
Share capital – Notes 2, 5, and 6		5,667,425	5,411,619
Contributed surplus – Note 2		102,216	140,335
Deficit		( 5,500,679)	( 5,444,101)
		268,962	107,853
		\$ 294,488	\$ 168,582

APPROVED BY THE DIRECTORS:

"Dusan Berka" \_\_\_\_\_, Director

"Hanif Sachedina" \_\_\_\_\_, Director

**MEGASTAR DEVELOPMENT CORP.**  
**INTERIM STATEMENTS OF LOSS AND DEFICIT**  
for the three month periods ended May 31, 2005 and 2004  
**Unaudited**

	<u>2005</u>	<u>2004</u>
Administrative expenses		
Administrative fees	\$ -	\$ 4,000
Bank charges and interest	39	115
Consulting	8,000	3,125
Filing fees	2,075	1,120
Investor relations	15,000	-
Legal and accounting fees	5,020	9,017
Management fees – Note 6	10,500	6,000
Office, telephone and miscellaneous	1,024	86
Rent	2,121	-
Shareholder information	499	4,130
Stock based compensation charges	10,438	-
Transfer agent	1,653	1,539
Travel and promotion	209	-
	<hr/>	<hr/>
Net loss for the period	( 56,578)	( 29,132)
	<hr/>	<hr/>
Deficit, beginning of the period	( 5,444,101)	( 5,082,141)
	<hr/>	<hr/>
Deficit, end of the period	\$ ( 5,500,679)	\$ ( 5,111,273)
	<hr/>	<hr/>
Basic and diluted loss per share	\$ ( 0.005)	\$ ( 0.003)
	<hr/>	<hr/>

**MEGASTAR DEVELOPMENT CORP.**  
**INTERIM STATEMENTS OF CASH FLOWS**  
for the three month periods ended May 31, 2005 and 2004  
**Unaudited**

	<u>2005</u>	<u>2004</u>
<b>Operating Activities</b>		
Net loss for the period	\$ ( 56,578)	\$ ( 29,132)
Add (deduct) items not affecting cash		
Stock based compensation	10,438	-
	<u>( 46,140)</u>	<u>( 29,132)</u>
<b>Changes in non-cash working capital items</b>		
GST receivable	( 434)	1,879
Prepaid expenses	( 5,000)	740
Accounts payable and accrued liabilities	( 19,162)	2,217
	<u>( 70,736)</u>	<u>( 24,296)</u>
<b>Investing Activities</b>		
Resource properties expenditures	( 910)	-
	<u>( 910)</u>	<u>-</u>
<b>Financing Activities</b>		
Decrease in related parties	( 16,041)	( 2,058)
Issuance of common shares, net of issue costs	207,249	102,000
	<u>191,208</u>	<u>99,942</u>
<b>Increase (decrease) in cash during the period</b>	<u>119,562</u>	<u>75,646</u>
<b>Cash, beginning of the period</b>	<u>14,579</u>	<u>82,668</u>
<b>Cash, end of the period</b>	<u>\$ 134,141</u>	<u>\$ 158,314</u>

**MEGASTAR DEVELOPMENT CORP.**  
**INTERIM SCHEDULE OF MINERAL PROPERTIES**  
for the three month periods ended May 31, 2005 and 2004  
**Unaudited**

	Simkar Property Canada	Kauputau Property Canada	Three months ended May 31	
			2005 Total	2004 Total
<b>Acquisition Costs</b>				
Balance, beginning of period	\$ -	\$ 38,116	\$ 38,116	\$ -
		<u>38,116</u>	<u>38,116</u>	<u>-</u>
<b>Deferred Exploration Expenditures</b>				
Balance, beginning of period	108,659	-	108,659	25,264
Geophysical analysis	910	-	910	-
	<u>109,569</u>	<u>-</u>	<u>109,569</u>	<u>25,264</u>
<b>Balance at end of period</b>	<u>\$ 109,569</u>	<u>\$ 38,116</u>	<u>\$ 147,685</u>	<u>\$ 25,264</u>

**MEGASTAR DEVELOPMENT CORP.**  
**NOTES TO THE INTERIM FINANCIAL STATEMENTS**

May 31, 2005

**Unaudited**

Note 1 Nature of Operations

The Company is a development stage public Company whose shares trade on the TSX Venture Exchange. The Company is in the process of exploring its resource properties and has not yet determined whether this property contains mineral reserves that are economically recoverable. The consolidated financial statements have been prepared on a going concern basis. At May 31, 2005, the Company has working capital of \$121,277, has not yet achieved profitable operations and has incurred losses of \$5,500,679.

While the information presented in the accompanying interim three month financial statements is unaudited, it includes all adjustments which are, in the opinion of management, necessary to present fairly the financial position, results of operations and cash flows for the interim periods presented. All adjustments are of a normal recurring nature. Except as disclosed below, these financial statements follow the same accounting policies and methods in their application as the annual February 28, 2005 audited financial statements. It is suggested that these financial statements be read in conjunction with the Company's February 28, 2005 annual financial statements.

Note 2 Change in Accounting Policies

Effective for fiscal years commencing on or after January 1, 2004, Canadian generally accepted accounting principles require the fair value of all share purchase options to be expensed over their vesting period with a corresponding increase to contributed surplus. Upon exercise of share purchase options, the consideration paid by the option holder, together with the amount previously recognized in contributed surplus, is recorded as an increase to share capital. Previously only share purchase options granted to non-employees followed this method and options granted to employees were not expensed.

Note 3 Summary of Significant Accounting Policies

The financial statements of the Company have been prepared in accordance with generally accepted accounting principles in Canada and are stated in Canadian dollars. Because a precise determination of many assets and liabilities is dependent on future events, the preparation of financial statements for a period necessarily involves the use of estimates which have been made using careful judgment. Actual results may differ from those estimates. The financial statements have, in management's opinion, been properly prepared within reasonable limits of materiality and within the framework of the significant accounting policies summarized below.

a) Principles of Consolidation

These consolidated financial statements include the accounts of Megastar Development Corp. and its wholly-owned subsidiary, 1055019 Ontario Limited, ("OntarioCo."). All intercompany transactions have been eliminated.

Note 3 Summary of Significant Accounting Policies – (cont'd)

b) Mineral Properties

The Company defers the cost of acquiring, maintaining its interest, exploring and developing mineral properties until such time as the properties are placed into production, abandoned, sold or considered to be impaired in value. Costs of producing properties will be amortized on a unit of production basis and costs of abandoned properties are written off. Proceeds received on the sale of interests in mineral properties are credited to the carrying value of the mineral properties, with any excess included in operations. Write-downs due to impairment are charged to operations.

The Company is in the process of exploring and developing its mineral properties and has not yet determined the amount of reserves available. Management reviews the carrying value of mineral properties on a periodic basis and will recognize impairment in value based on current exploration results, the prospect of further work being carried out by the Company, the assessment of future probability of profitable revenues from the property or from the sale of the property. Amounts shown for properties represent costs incurred net of write-downs and recoveries, and are not intended to represent present or future values.

c) Foreign Currency Translation

Monetary items denominated in a foreign currency are translated into Canadian dollars at exchange rates prevailing at the balance sheet date and non-monetary items are translated at exchange rates prevailing when the assets were acquired or obligations incurred. Foreign currency denominated revenue and expense items are translated at the exchange rates prevailing at the transaction date. Gains or losses arising from the transactions are included in operations.

d) Basic and Diluted Loss Per Share

Basic loss per share are computed by dividing the loss for the period by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflect the potential dilution that could occur if potentially dilutive securities are exercised or converted to common stock. The dilutive effect of options and warrants and their equivalent is computed by application of the treasury stock method and the effect of convertible securities by the "if converted" method. Fully dilutive amounts are not presented when the effect of the computations are anti-dilutive due to the losses incurred. Accordingly, there is no difference in the amounts presented for basic and diluted loss per share.

Note 3 Summary of Significant Accounting Policies – (cont'd)

e) Financial Instruments

The carrying value of the Company's financial instruments, consisting of cash, amounts receivable, accounts payable and accrued liabilities approximates their fair value due to the short-term maturity of such instruments. Unless otherwise noted, it is management's opinion that the Company is not exposed to significant interest, currency or credit risks arising from these financial instruments.

f) Income Taxes

The Company follows the asset and liability method of accounting for income taxes. Under this method, current income taxes are recognized for the estimated income taxes payable for the current period. Future income tax assets and liabilities are recognized for temporary differences between the tax and accounting basis of assets and liabilities as well as for the benefit of losses available to be carried forward to future years for tax purposes only if it is more likely than not that they can be realized.

Note 4 Resource Properties

a) Simkar Property, Quebec, Canada

The Company's wholly owned subsidiary has a 100% interest in two contiguous mining concessions totalling 557 acres located in Louvicourt Township, Quebec.

All acquisition costs pertaining to this property were written off in a previous year.

b) Kauputau Properties, Quebec, Canada

Pursuant to an acquisition agreement dated February 7, 2005, the Company acquired a 100% interest in 63 mineral claims situated in Northern Quebec ("Kauputau Property"). Consideration for the interest is cash of \$6,615 (paid) and 250,000 common shares (issued). The vendors retained a 2% net smelter royalty of which 1% can be purchased by the Company at any time for \$1,000,000.

Note 5 Share Capital

a) Authorized: Unlimited number of common shares without par value

MEGASTAR DEVELOPMENT CORP.  
Notes to the Interim Financial Statements  
May 31, 2005 and 2004— Page 4  
Unaudited

Note 5 Share Capital – (cont'd)

	<u>Number</u>	<u>Amount</u>
b) Issued:		
Balance at February 29, 2004	9,638,983	\$ 5,178,280
Change in accounting policy	-	87,464
For cash:		
- pursuant to private placements - at \$0.17	600,000	102,000
- pursuant to stock options exercised - at \$0.11	175,000	19,250
- at \$0.13	75,000	9,750
- pursuant to warrants exercised - at \$0.15	15,000	2,250
Pursuant to acquisition of mineral properties		
- at \$0.11	250,000	27,500
Recovery of future income tax assets	-	(14,875)
Balance at February 28, 2005	10,753,983	5,411,619
For cash:		
- pursuant to private placements - at \$0.14	1,250,000	175,000
- pursuant to stock options exercised - at \$0.13	75,000	9,750
- pursuant to warrants exercised - at \$0.15	150,000	22,500
Transfer from contributed surplus		48,556
Balance at May 31, 2005	<u>12,228,983</u>	<u>\$ 5,667,425</u>

c) Escrow

At May 31, 2005, 131,250 shares are held in escrow by the Company's transfer agent. The release of these shares is subject to regulatory approval.

d) Commitments:

Stock-based Compensation Plan

The Company has granted share purchase options to directors, employees and non-employees to assign one common share for cash options held. The share purchase options have vesting terms ranging from immediate upon granting to over eighteen months. A summary of the status of the options outstanding at May 31, 2005:

	<u>Options</u>	<u>Weighted Average Exercise Price</u>
Outstanding at beginning of period	1,340,000	\$0.13
Granted	200,000	\$0.15
Exercised	<u>(75,000)</u>	\$0.13
Outstanding at end of period	<u>1,465,000</u>	\$0.13
Exercisable at end of period	<u>908,750</u>	

MEGASTAR DEVELOPMENT CORP.  
 Notes to the Interim Financial Statements  
 May 31, 2005 and 2004- Page 5  
 Unaudited

Note 5 Share Capital – (cont'd)

d) Commitments – (cont'd):

Stock-based Compensation Plan – (cont'd)

At May 31, 2005 the Company the following share purchase options are outstanding:

<u>Number</u>	<u>Exercise Price</u>	<u>Expiry Date</u>
445,000	\$0.11	December 5, 2008
120,000	\$0.25	January 28, 2009
50,000	\$0.25	August 23, 2006
650,000	\$0.11	January 17, 2010
<u>200,000</u>	<u>\$0.15</u>	<u>March 1, 2007</u>
<u>1,465,000</u>		

Effective March 1, 2004, the Company has adopted the new policy to record the fair value of compensation expense on the granting of stock options. The fair value is determined using the Black-Scholes model. For the three month period ended May 31, 2005, the Company recorded a compensation charge of \$10,438.

The following assumptions were used for the Black-Scholes model:

Risk free rates	2.5% - 2.78%
Dividend yield	0%
Expected volatility	76% - 102%
Weighted average expected stock option life	2 - 5 years

Warrants

At May 31, 2005, the Company has 3,185,000 share purchase warrants outstanding entitling the holders thereof the right to purchase one common share for each warrant held:

<u>Number</u>	<u>Exercise Price</u>	<u>Expiry Date</u>
1,335,000	\$0.15	January 26, 2006
600,000	\$0.23	April 2, 2006
<u>1,250,000</u>	<u>\$0.20</u>	<u>May 19, 2007</u>
<u>3,185,000</u>		

800,000 warrants at \$0.16 expired unexercised during the period.

MEGASTAR DEVELOPMENT CORP.  
Notes to the Interim Financial Statements  
May 31, 2005 and 2004— Page 6  
Unaudited

Note 6 Related Party Transactions

The Company incurred charges with directors and officers of the Company, companies with common directors and an accounting firm in which a former director is a partner:

	Periods ended May 31,	
	2005	2004
Accounting fees	\$ -	\$ 2,033
Consulting fees	-	3,125
Management fees	10,500	10,000
	<u>\$ 10,500</u>	<u>\$ 15,158</u>

Included in accounts payable and accrued liabilities is \$3,852 (2004: \$5,778) due to an accounting firm in which a former director is a partner.

Amounts due to related parties are unsecured, non-interest bearing and have no specific terms of repayment.

During the period ended May 31, 2005, directors and officers purchased 390,000 common shares at \$0.14 per share pursuant to a private placement.

Note 7 Subsequent Events

Subsequent to May 31, 2005, the Company:

- a) The Company entered into an agreement to purchase mineral properties located in Quebec known as the Ralleau Project. Consideration payable is \$1,000 cash and the issuance of 250,000 common shares. The vendors will retain a 2% net smelter royalty of which 1% can be purchased at any time for \$1,000,000. This acquisition is subject to regulatory approval.
- b) The Company has entered into an agreement for investor relations services at \$7,500 per month plus out of pocket expenses. The term of the agreement is one year commencing July 1, 2005 and may be cancelled by either party with 30 days notice. The agreement is subject to regulatory approval.

**FORM 52-109FT2**

***CERTIFICATION OF INTERIM FILINGS DURING TRANSITION PERIOD***

**I, Dusan Berka, President and Chief Executive Officer of Megastar Development Corp., certify that:**

- 1) I have reviewed the interim filings (as this term is defined in Multilateral Instrument 52-109 *Certification of Disclosure in Issuers' Interim Filings*) of **Megastar Development Corp.**, (the issuer) for the quarter ending **May 31, 2005**;
- 2) Based on my knowledge, the interim filings do not contain any untrue statement of a material fact or omit to state a material fact required to be stated or that is necessary to make a statement not misleading in light of the circumstances under which it was made, with respect to the period covered by the interim filings; and
- 3) Based on my knowledge, the interim financial statements together with the other financial information included in the interim filings fairly present in all material respects the financial condition, results of operations and cash flows of the issuer, as of the date and for the periods presented in the interim filings.

Dated: July 22, 2005

*"Dusan Berka"*

Dusan Berka, P. Eng.  
President and Chief Executive Officer

**FORM 52-109FT2**

***CERTIFICATION OF INTERIM FILINGS DURING TRANSITION PERIOD***

**I, Hanif Sachedina, Secretary and Chief Financial Officer of Megastar Development Corp., certify that:**

- 1) I have reviewed the interim filings (as this term is defined in Multilateral Instrument 52-109 *Certification of Disclosure in Issuers' Interim Filings*) of **Megastar Development Corp.**, (the issuer) for the quarter ending **May 31, 2005**;
- 2) Based on my knowledge, the interim filings do not contain any untrue statement of a material fact or omit to state a material fact required to be stated or that is necessary to make a statement not misleading in light of the circumstances under which it was made, with respect to the period covered by the interim filings; and
- 3) Based on my knowledge, the interim financial statements together with the other financial information included in the interim filings fairly present in all material respects the financial condition, results of operations and cash flows of the issuer, as of the date and for the periods presented in the interim filings.

Dated: July 22, 2005

*"Hanif Sachedina"*

Hanif Sachedina,  
Secretary and Chief Financial Officer

**MEGASTAR DEVELOPMENT CORP.**

**Form 51-102F1**

**Management's Discussion & Analysis  
for Quarter Ended May 31, 2005**

Item 1: **INTERIM MD & A**

**Forward-looking Information**

The following interim MD & A should be read in conjunction with the Company's interim financial statements for the three month ended May 31, 2005 and the annual MD & A and annual audited financial statements for the year ended February 28, 2005. This Management Discussion and Analysis ("MD&A") contains certain forward-looking statements and information relating to Megastar Development Corp. ("MDV" or the "Company") that are based on the beliefs of its management as well as assumptions made by and information currently available to MDV. When used in this document, the words "anticipate", "believe", "estimate", "expect" and similar expressions, as they relate to MDV or its management, are intended to identify forward-looking statements. This MD&A contains forward-looking statements relating to, among other things, regulatory compliance, the sufficiency of current working capital, the estimated cost and availability of funding for the continued exploration and development of MDV exploration properties. Such statements reflect the current views of MDV with respect to future events and are subject to certain risks, uncertainties and assumptions. Many factors could cause the actual results, performance or achievements of MDV to be materially different from any future results, performance or achievements that may be expressed or implied by such forward-looking statements. Aside from factors identified in the annual MD&A, additional important factors, if any, are identified here.

**1.1 Date**

The following discussion and analysis was approved by the Directors of the Company on July 22, 2005. All figures are in Canadian dollars unless otherwise noted.

**1.2 Overall Performance**

The Company's exploration focus has been on the company's 100% owned SIMKAR property. Megastar Development Corp. has a 100-per-cent interest in two mining concessions consisting of 557 acres in the Louvicourt township of Quebec, approximately 20 kilometres east of Val d'Or, Que. The Simkar property is situated within the Abitibi greenstone belt, one of the largest of the Archean greenstone terrains in the world and host to a major proportion of Canada's precious and base metals resources and historic production. While the Simkar property was owned and operated by the Louvicourt Goldfield Corp. in the mid-1940s, it produced approximately 32,000 ounces of gold between 1947 and 1949. Current gold prices around the

\$400-(U.S.)-per-ounce level and new technology in mining methods, coupled with ease of access and local infrastructure, make both its immediate and long-term potential an attractive exploration proposition.

The Company has spent over \$800,000 on a drilling program 7 years ago. The Company has received an engineering report recommending a further drilling program on the Simkar Property. After raising sufficient funds for further exploration and drilling program by way of private placements in early 2004, the Company entered into an exploration and diamond drilling contract for its Simkar property in Val d'Or, Que., as announced in the News Release dated August 5, 2004. The field exploration and drilling program was supervised and managed by Anglaumaque Explorations Inc. of Val d'Or, Que., under the stewardship of its president, Glenn J. Mullan, P. Geo. InnovExplo Inc., also of Val d'Or, Que., was the geological consultant and primary on-site contractor. The Company advanced \$100,000 to Anglaumaque Explorations Inc., the project manager and supervisor, to cover the cost of the summer 2004 exploration and drilling program. The exploration program and drilling on the company's 100-per-cent-owned Simkar property began in mid-August 2004 as announced in the News Release dated August 23, 2004 and continued through September. The program consisted of 900 meters of NQ-core diamond drilling and commenced following refurbishment of the grid on the property.

A result of the completed diamond drill testing was announced in the News Release dated December 13, 2004. The purpose of the program was to identify VMS mineralization on the northeast extent of a 900-meter long IP anomaly (Hole 04-SKR-01) and to test the possible extension of the A-B deformation zone (Holes 04-SKR-02 and 04-SKR-03).

Hole 04-SKR-01 was principally drilled to characterize the favorable North Rhyolite and establish its potential to host an economic polymetallic deposit. The presence of calc-alkaline rhyodacite and transitional rhyodacite and some typical alteration combined with anomalous Au-Cu values (7.43 g Au/T and 0.1% Cu over 0.82 m, 0.2% Cu over 1.1 m and 0.13% Cu over 1.31 m core length) suggest a mineralized zone that could be associated to a volcanogenic system while the high grade gold values within the altered zones suggests that the North Rhyolite is a valid target area for gold-enriched sulphide zones. Lithochemical samples were taken from previously drilled hole 97-SKR-07, which also crossed the favourable horizon. Additional work is recommended and drill hole casing was left in place for additional surveying and or drilling.

Drill testing in hole 04-SKR-02 and 04-SKR-03 were drilled to test the A-B and East zones respectively. Although only anomalous gold values were obtained (up to 1.30 g/t Au over 1.02m core length), drilling confirms that the main structure and Felsic Porphyry dyke are southeast of the old shaft and remains open at depth. Following the results of the geochemical sampling, the company will establish a follow-up program to explore the Au-Cu potential within the North Rhyolite. Qualified Person Carl Pelletier, B.Sc., P. Geo. of the consulting firm Innovexplo Inc., supervised the drill program and samples were assayed for Au and most of them for Au-Ag-Cu-Zn by ALS Chemex Chimitec employing conventional atomic absorption spectroscopy and fire assay analytical techniques. A QAQC program, including certified reference material, blank samples and duplicate samples were used during the program.

A NI 43-101 Technical Report prepared by Qualified Person Carl Pelletier, B.Sc., P. Geo. was filed and is available on Sedar at

<http://www.sedar.com/DisplayCompanyDocuments.do?lang=EN&issuerNo=00005816>

On March 15, 2004, the Company signed a letter of intent (thereafter “LOI”) to enter into an option agreement with Golden Patriot (GPTC) to acquire a 50% interest in the Debut gold property located in Elko county, Nevada. Under the terms of the option, Megastar Development will incur work exploration and development costs of \$1-million (U.S.), and will pay GPTC a cash consideration of \$201,600 (U.S.) and issue 500,000 shares over five years. This transaction is subject to approval of the TSX Venture Exchange. On May 14, 2004, the Company announced that it has decided not to proceed with this LOI. The Company will maintain its focus on advancing the exploration of the 100% owned Simkar property in Louvicourt Township, Quebec.

On March 3, 2005 Megastar Development Corporation announced the completion of the purchase of a 100% interest in the KAUPUTAU Property located in the Opinaca reservoir region, James Bay, Quebec. The KAUPUTAU property is accessible via an all-weather road and consists of 63 designated cells (mining claims) fully covering a target feature identified by a high sensitivity EM and magnetic airborne survey performed by SIAL Géosciences Inc. The geophysical data confirmed regional scale folding along with more complex smaller scale folds and potential faults and shears. Air photo interpretation suggests the presence of late intrusive bodies and a Government sponsored regional mapping program has identified anomalous gold, silver and copper values within a sulfide bearing (pyrite-chalcopyrite) sheared volcanic tuff on the property. The James Bay region, features two important volcanic belts, Eastmain and La Grande, and has been the focus of a recent staking rush following Virginia Gold Mines’ (VIA: TSX) discovery on the Eleonore Property (to the north of KAUPUTAU) where several holes have yielded outstanding results including intersections ranging up to 22.27 g/t Au over 11.05 m. Other discoveries in the area include the Clearwater, Opinaca and Elmer (Eastmain – Barrick).

#### **Other**

Pursuant to a “Stock Option Plan” as approved by the shareholders at the Annual general Meeting that was held on June 24, 2004 the Company has implemented a Fixed Stock Option Plan whereby a maximum number of shares reserved for issuance under the plan at any one time will not exceed 2,047,796 shares. Under this plan the following incentive stock options were granted: On August 23, 2004 the Company granted 50,000 incentive stock options at \$0.25 expiring on August 23, 2006; on January 17, 2005 the Company granted 650,000 incentive stock options at \$0.11 expiring on January 17, 2010; on March 3, 2005 the Company granted 200,000 incentive stock options at \$0.15 expiring on March 3, 2007.

As per the News Release dated July 28, 2004 the Company announced that it has retained Arlitt Financial Corp. (“AFC”) to manage corporate communications, and investor relations. In consideration for the services to be provided by “AFC” for the next 12 months, the Company had agreed to pay a monthly fee of \$5,000 plus GST, guaranteed for the next 3 months and on a month-to-month basis thereafter, and to issue 200,000 options at an exercise price of 20 cents. Subsequently on October 29, 2004 the Company announced that it did not renew the investor relations agreement with “AFC”. As a result of the termination of AFC agreement, the stock options previously granted to AFC have been cancelled.

Subsequent to the year ended February 28, 2005 the Company has filed documentation for regulatory approval of the following transactions:

- 1) As per the News Release dated March 2, 2005, the Company entered into an investor relations agreement with 600273 BC LTD, whose president is Cameron D. Stretch. Under the terms of the agreement the company will pay a monthly fee of \$5000 per month and issue 200,000 stock options at an exercise price of 15 cents.
- 2) As per the News Release dated May 30, 2005 the Company announced that further to the news releases of April 18 and 29, 2005 and TSX Venture Exchange acceptance dated May 19, 2005, it has closed its non-brokered private placement in respect of 1.25 million units at a price of \$0.14 per unit for total gross proceeds of \$175,000. Each unit consists of one share plus one share purchase warrant exercisable for two years at an exercise price of \$0.20 per share. The shares and warrants issued are subject to a hold period of four months, expiring September 20, 2005 and a voluntary twelve month pooling agreement expiring May 20, 2006. The net proceeds of the offering will be used for current working capital and continuing exploration on the company's properties. The company is currently focused on the Simkar Gold Project near Val Dor Quebec, where IP, Megatam and Titan 24 surveys have identified 9 prospective anomalies including a coincident "priority 1" target.
- 3) As per the News Release dated June 1, 2005 the Company announced that it has entered into an agreement for the acquisition of the Ralleau Project located in Ralleau Township, approximately 40km east of Quévillon, Quebec. Pursuant to the agreement the company will pay \$1,000 and issue 250,000 shares in the capital of Megastar Development Corporation. The Vendors retain a 2% Net Smelter Royalty of which 1% can be purchased by the company at any time for \$1,000,000. The Ralleau acquisition is subject to regulatory approval and represents a non-arms length agreement with Richard Roy P. Geo, a director of Megastar Development Corporation. Mr. Roy is a Qualified Person as defined by NI 43-101. He has extensive experience in exploration of gold, silver, and copper and has supervised and coordinated exploration programs on various properties located throughout Quebec, Ontario, and Nunavut.

### 1.3 Selected Annual Information

N/A

### 1.4 Results of Operations

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may be different from those estimates. Additional significant accounting policies are detailed in Note 2 attached to the financial statements.

The Company's current exploration focus has been on the company's 100% owned SIMKAR property located in Louvicourt Township, Val d'Or, Quebec. The Company has also been actively reviewing numerous exploration projects during the period under review in search of additional projects of merit.

## 1.5 Summary of Quarterly Results

The following table sets forth selected (unaudited) quarterly financial information for each of the last eight most recently completed quarters:

For the Quarter Periods Ending on	May 31, 2005	February 28, 2005	Nov. 30, 2004	August 31, 2004
Total Revenues	\$ Nil	\$ Nil	\$ Nil	\$ Nil
Net Income (Loss) before discontinued operations and extraordinary items	(\$56,578)	(\$57,605)	(\$35,700)	(\$52,643)
Total Net Income (loss)	(\$56,578)	(\$57,605)	(\$35,700)	(\$52,643)
Basic (Loss) per share	(\$0.005)	(\$0.006)	(\$0.003)	(\$0.005)

For the Quarter Periods Ending on	May 31, 2004	February 29, 2004	Nov. 30, 2003	August 31, 2003
Total Revenues	\$ Nil	\$ Nil	\$ Nil	\$ Nil
Net Income (Loss) before discontinued operations and extraordinary items	(\$29,132)	(\$24,441)	(\$43,814)	(\$34,004)
Total Net Income (loss)	(\$29,132)	(\$24,441)	(\$43,814)	(\$34,004)
Basic (Loss) per share	(\$0.003)	(\$0.01)	(\$0.0006)	(\$0.004)

Administration expenses of \$56,578 for the three months end May 31, 2005 represented an increase of \$27,446 from the prior year, primarily due to the recognition of stock based compensation charges of \$10,438 and investor relations expenses of \$15,000. Stock based compensation is a result of the change in accounting policy affecting options which have been granted or vested during the period.

## 1.6 Liquidity

The Company has no history of profitable operations and its mineral projects are at an early stage. Therefore, it is subject to many risks common to comparable junior venture resource companies, including under-capitalization, cash shortages and limitations with respect to personnel, financial and other resources as well as a lack of revenues.

At May 31, 2005, the Company has increased working capital to \$121,277, compared to working capital deficiency of \$38,922 at February 28, 2005.

The Company's ability to continue as a going concern in the short term is dependent upon its ability to obtain financing. The Company obtains financing by the issuance of share capital or from the disposition of its mineral prospects. Although the Company has been successful in the past in obtaining financing, there can be no assurance that it will be able to obtain adequate financing in the future or that the terms of such financing will be favorable.

**1.7 Capital Resources**

The Company's sources of funds are derived from: (i) private placement financings (flow through and non-flow through) and (ii) amounts owing to related parties.

Additional disclosure concerning the Company's administrative expenses and resource property obligations and commitments are provided in the Company's Consolidated Statement of Loss and Deficit and Notes therein.

**1.8 Off-Balance Sheet Arrangements**

The Company has no off-Balance Sheet arrangements.

**1.9 Transactions with Related Parties**

The Company incurred charges with directors and officers of the Company, companies with common directors and an accounting firm in which a former director is a partner:

	Periods ended May 31,	
	<u>2005</u>	<u>2004</u>
Accounting fees	\$ -	\$ 2,033
Consulting fees	-	3,125
Management fees	10,500	10,000
	<u>\$ 10,500</u>	<u>\$ 15,158</u>

Included in accounts payable and accrued liabilities is \$3,852 (2004: \$5,778) due to an accounting firm in which a former director is a partner.

Amounts due to related parties are unsecured, non-interest bearing and have no specific terms of repayment.

During the period ended May 31, 2005, directors and officers purchased 390,000 common shares at \$0.14 per share pursuant to a private placement.

### **1.10 Fourth Quarter**

N/A

### **1.11 Proposed Transactions**

#### **RALLEAU Property**

As per the News Release dated June 1, 2005 the Company announced that it has entered into an agreement for the acquisition of the Ralleau Project located in Ralleau Township, approximately 40km east of Quévillon, Quebec. Pursuant to the agreement the company will pay \$1,000 and issue 250,000 shares in the capital of Megastar Development Corporation. The Vendors retain a 2% Net Smelter Royalty of which 1% can be purchased by the company at any time for \$1,000,000. The Ralleau acquisition is subject to regulatory approval and represents a non-arms length agreement with Richard Roy P. Geo, a director of Megastar Development Corporation. Mr. Roy is a Qualified Person as defined by NI 43-101. He has extensive experience in exploration of gold, silver, and copper and has supervised and coordinated exploration programs on various properties located throughout Quebec, Ontario, and Nunavut.

### **1.12 Critical Accounting Estimates**

N/A

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

Effective for fiscal years commencing on or after January 1, 2004, Canadian generally accepted accounting principles require the fair value of all share purchase options to be expensed over their vesting period with a corresponding increase to contributed surplus. Upon exercise of share purchase options, the consideration paid by the option holder, together with the amount previously recognized in contributed surplus, is recorded as an increase to share capital. Previously only share purchase options granted to non-employees followed this method and options granted to employees were not expensed.

The Company has adopted the new policy on a retroactive basis with no restatement of prior periods. Accordingly on March 1, 2004, deficit increased by \$186,880, contributed surplus increased by \$99,416 and share capital increased by \$87,464 to account for share purchase option expense that would have been charged to operations in 2003 and 2004 with respect to employee share purchase options granted and exercised since March 1, 2002. The Company uses the Black-Scholes option valuation model to calculate the fair value of share purchase options at the date of grant. Option pricing models require the input of highly subjective assumptions, including the expected price volatility. Changes in these assumptions can materially affect the fair value estimate and, therefore, the existing do not necessarily provide a reliable single measure of the fair value of the Company's share purchase options.

During the year ended February 28, 2005, the fair value of share purchase options expensed was \$40,919. Had the Company expensed the fair value of share purchase options in prior periods, the following pro forma amounts would have resulted:

	February 29, 2004
Net loss for the year as reported	\$ (121,420)
Stock-based compensation	<u>(172,570)</u>
Pro forma loss for the year	<u>\$ (293,990)</u>
Pro forma basic and diluted loss per share	<u>\$ (0.03)</u>

The fair value of share options was estimated using the Black-Scholes option pricing model with the following assumptions:

	Years ended	
	February 28, 2005	February 29, 2004
Risk-free interest rate	2.5% - 2.78%	4.11%
Dividend yield	-	-
Expected stock price volatility	76% - 102%	95%
Weighted average value per share expected stock option life	2 - 5 years	5 years

### Flow-through Shares

In March 2004, the Canadian Institute of Chartered Accountants issued Emerging Issue Committee Abstract No. 146, Flow-through Shares, which clarifies the recognition of previously unrecorded future income tax assets caused by renouncement of expenditures relating to flow-through shares. The Company has adopted prospectively the new recommendation for flow-through shares issued after March 19, 2004 and now records the tax effect related to the renounced deductions as a reduction of income tax expense in the statement of loss and deficit on the date that the Company renounces the deductions for investors whereas previously the tax effect was recorded as a credit to equity. As a result of this change in policy the Company recorded a recovery of future income tax assets with a corresponding reduction to share capital of \$14,875 with respect to flow-through shares totalling \$42,500 issued after March 19, 2004 and renounced during the year ended February 28, 2005.

### **1.14 Financial Instruments and Other Instruments**

MDV's financial instruments consist of cash and short-term deposits, receivables and accounts payables. Unless otherwise noted, it is management's opinion that the Company is not exposed to significant interest, currency or credit risks arising from the financial instruments. The fair value of these financial instruments approximates their carrying value due to their short-term maturity or capacity of prompt liquidation.

**1.15 Other MD&A Requirements**

**A. Authorized and Issued Share Capital as at May 31, 2005:**

Authorized: an unlimited number of Common shares without par value  
 Issued and outstanding: 12,228,983 common shares for a net consideration of \$5,667,425

**B. Options, Warrants & Convertible Securities Outstanding as at May 31, 2005:**

The following options, warrants, and convertible securities were outstanding as at May 31, 2005:

<b>Options</b>		
Number	Exercise Price	Expiring Date
445,000	\$0.11	December 5, 2008
120,000	\$0.25	January 28, 2009
50,000	\$0.25	August 23, 2006
650,000	\$0.11	January 17, 2010
<u>200,000</u>	\$0.15	March 1, 2007
<u>1,465,000</u>		

At May 31, 2005, the Company has 3,185,000 share purchase warrants outstanding entitling the holders thereof the right to purchase one common share for each warrant held:

<b>Warrants</b>		
Number	Exercise Price	Expiring Date
800,000	\$0.16	April 15, 2005
1,335,000	\$0.15	January 26, 2006
600,000	\$0.23	April 2, 2006

800,000 warrants at \$0.16 expired unexercised during the period.

**MEGASTAR DEVELOPMENT CORP.**

**LISTING:**

TSX Venture Exchange  
Symbol **MDV**

**HEAD OFFICE:**

#600 – 625 Howe Street  
Vancouver, BC  
V6C 2T6

Tel.: 604-683-6648

Fax : 604-683-1350

Email: [dberka@megastardevelopment.com](mailto:dberka@megastardevelopment.com)

Website: [www.megastardevelopment.com](http://www.megastardevelopment.com)

**MAILING ADDRESS:**

#600 – 625 Howe Street  
Vancouver, B.C.  
V6C 2T6

Tel: 604-683-6648

Fax: 604-683-1350

Email:

[info@megastardevelopment.com](mailto:info@megastardevelopment.com)

**DIRECTORS AND OFFICERS:**

Dušan Berka, P. Eng., President/Director

Hanif Sachedina, Secretary/Director

Richard Roy, P. Geo., Director

James Reamsbottom, Director

**REGISTRAR AND TRANSFER  
AGENT:**

Pacific Corporate Trust Company  
Ltd.

10<sup>th</sup> Floor - 625 Howe Street

Vancouver, B.C. V6C 3B8

**AUDITORS:**

Amisano Hanson, CA

#604 – 750 West Pender Street

Vancouver, B.C.

V6C 2T7

**LEGAL COUNSEL:**

Clark Wilson, LLP

Solicitor – William L. Macdonald

#800 – 885 West Georgia Street

Vancouver, B.C. V6C 3H1