

Independent Auditors' Report

Board of Directors
Mines Management, Inc.
Spokane, Washington

We have audited the accompanying consolidated balance sheets of Mines Management, Inc. (an Idaho Corporation) and subsidiary as of December 31, 2002 and 2001, and the related consolidated statements of income, stockholders' equity, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Mines Management, Inc. and subsidiary as of December 31, 2002 and 2001, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

LeMASTER & DANIELS PLLC
Certified Public Accountants

Spokane, Washington
March 21, 2003



Consolidated Balance Sheet

(audited)

	December 31,	
	2002	2001
<u>Assets</u>		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 263,475	\$ 33,993
Accounts receivable	760	2,524
Prepaid expenses	500	500
Total current assets	264,735	37,017
MINERAL PROPERTIES	368,681	360,180
PROPERTY AND EQUIPMENT:		
Mine buildings	11,031	11,031
Equipment	44,098	44,098
Office equipment	12,596	10,723
	67,725	65,852
Less accumulated depreciation	64,858	64,014
	2,867	1,838
INVESTMENTS:		
Available-for-sale securities	14,298	846
	\$ 650,581	\$ 399,881
<u>Liabilities and Stockholders' Equity</u>		
CURRENT LIABILITIES:		
Accounts payable	\$ 43,438	\$ 2,593
State income taxes payable	164	164
Payroll taxes payable	1,971	1,005
Total current liabilities	45,573	3,762
COMMITMENTS		
STOCKHOLDERS' EQUITY:		
Common stock – 100,000,000 shares, \$.01 par value, authorized; 6,202,956 and 4,946,956 shares issued and outstanding	62,030	49,470
Issuable common stock	-	22,500
Preferred stock – 10,000,000 shares, no par value, authorized; no shares issued and outstanding	-	-
Additional paid-in capital	1,827,505	1,362,365
Retained earnings (deficit)	(1,287,660)	(1,039,062)
Accumulated other comprehensive income	3,133	846
Total stockholders' equity	605,008	396,119
	\$ 650,581	\$ 399,881

See accompanying notes to consolidated financial statements.



Consolidated Income Statement

(audited)

	Years Ended	
	December 31,	
	2002	2001
REVENUE:		
Royalties	\$ -	\$ 25,000
Oil and gas	<u>5,470</u>	<u>7,551</u>
Total revenue	<u>5,470</u>	<u>32,551</u>
OPERATING EXPENSES:		
Depreciation	844	905
Legal and accounting	28,094	7,252
Miscellaneous	12,057	3,479
Oil and gas operating	1,442	2,383
Rent and office	10,274	2,314
Salaries, officer and staff	13,649	9,947
Taxes and licenses	1,674	1,254
Telephone	3,967	1,925
Exploration	7,454	1,800
Fees, filing, and licenses	25,043	2,112
Directors' and officers' compensation	<u>150,000</u>	<u>-</u>
Total operating expenses	<u>254,498</u>	<u>33,371</u>
LOSS FROM OPERATIONS	(249,028)	(820)
OTHER INCOME:		
Interest	<u>430</u>	<u>837</u>
NET INCOME (LOSS)	<u>\$(248,598)</u>	<u>\$ 17</u>
NET INCOME (LOSS) PER SHARE	<u>\$ (0.045)</u>	<u>\$ NIL</u>
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING	<u>5,472,460</u>	<u>4,946,956</u>



Mines Management, Inc. and Subsidiary

Consolidated Statement of Stockholder's Equity

(U.S. Dollars)

	<u>Common Stock</u>		<u>Issuable Common Stock</u>		Additional Paid-in Capital	Retained Earnings (Deficit)	Accumulated Other Comprehensive Income	Total
	Shares	Amount	Shares	Amount				
BALANCES, DECEMBER 31, 2000	4,946,956	\$ 49,470	90,000	\$ 22,500	\$1,362,365	\$ (1,039,079)	\$ 1,801	\$ 397,057
Comprehensive Loss								
Adjustment to net unrealized gain on marketable securities	-	-	-	-	-	-	(955)	(955)
Net income	-	-	-	-	-	17	-	17
Comprehensive loss								(938)
BALANCES, DECEMBER 31, 2001	4,946,956	49,470	90,000	22,500	1,362,365	(1,039,062)	846	396,119
Common stock issued for cash	786,000	7,860	-	-	295,340	-	-	303,200
Common stock issued for services	5,000	50	-	-	1,950	-	-	2,000
Common stock issued to directors	375,000	3,750	-	-	146,250	-	-	150,000
Issuable common stock issued	90,000	900	(90,000)	(22,500)	21,600	-	-	-
Comprehensive loss:								
Adjustment to net unrealized gain on marketable securities	-	-	-	-	-	-	2,287	2,287
Net loss	-	-	-	-	-	(248,598)	-	(248,598)
Comprehensive loss								(246,311)
BALANCES, DECEMBER 31, 2002	6,202,956	\$ 62,030	-	\$ -	\$ 1,827,505	\$ (1,287,660)	\$ 3,133	\$ 605,008

See accompanying notes to consolidated financial statements.



Mines Management, Inc. and Subsidiary

Consolidated Statement of Cash Flows

(U.S. Dollars)

	Years Ended December 31,	
	<u>2002</u>	<u>2001</u>
Increase (Decrease) in Cash and Cash Equivalents		
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Income (Loss)	\$ (248,598)	\$ 17
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Issuance of common stock to directors	150,000	-
Issuance of common stock for services	2,000	-
Common stock received in exchange for services performed	(11,165)	-
Depreciation	844	905
Changes in assets and liabilities:		
Accounts receivable	1,764	(958)
Prepaid expenses	-	1,800
Accounts Payable	40,845	1,667
Payroll taxes payable	966	1,005
Net cash provided by (used in) operating activities	(63,344)	4,436
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of office equipment	(1,873)	-
Increase in mineral properties	(8,501)	-
Net cash used in investing activities	(10,374)	-
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from sales of common stock	303,200	-
NET INCREASE IN CASH AND CASH EQUIVALENTS	229,482	4,436
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	33,993	29,557
CASH AND CASH EQUIVALENTS, END OF YEAR	\$ 263,475	\$ 33,993
Supplemental Disclosure of Cash Flows Information:		
Income taxes paid	\$ 150	\$ 150
Noncash Financing Activity		
Issuance of common stock for services	\$ 152,000	\$ -

See accompanying notes to consolidated financial statements.



Mines Management, Inc. and Subsidiary

Notes to Consolidated Financial Statements

(U.S. Dollars)

NOTE 1 — ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Organization:

Mines Management, Inc. (the Company) is a publicly held Idaho corporation incorporated in 1947. The Company acquires, explores and develops mineral and oil properties principally in North America. The Company performed exploration activities in South America in 2002 and 2001.

Summary of Significant Accounting Policies:

- a. The accompanying consolidated financial statements include the accounts of Mines Management, Inc., and its wholly-owned subsidiary, Newhi, Inc. Intercompany balances and transactions have been eliminated. Newhi, Inc., was formed by the Company for the purpose of merger with Heidelberg Silver Mining Company, Inc. In the merger, completed on April 15, 1988, Heidelberg Silver Mining Company, Inc., was merged into Newhi, Inc. To effect the merger, the Company issued 367,844 shares of its previously unissued common stock. Also in connection with this merger, the Company issued 11,117 shares of common stock and paid \$4,446 as a finders' fee. As of December 31, 2002 and 2001, a portion of the shares to be distributed to the Heidelberg Silver Mining Company, Inc., stockholders has yet to be issued. Even though a number of stockholders have elected not to return their shares upon the merger, the Company is holding approximately 60,000 shares to be delivered at their request.
- b. The Company capitalizes acquisition and exploration costs on nonoperating mining properties. Costs to maintain the mineral rights and leases are expensed as incurred. Upon commencement of operations, the capitalized costs will be amortized based on proven or probable reserves. Capitalized costs are charged to operations as impairment losses when title to the property has expired or when management believes the properties are not economically feasible to develop or hold for future development.
- c. In accordance with Financial Accounting Standards Board Statement No. 121, "Accounting for Impairment of Long-Lived Assets," the Company reviews its long-lived assets quarterly to determine if any events or changes in circumstances have transpired which indicate that the carrying value of its assets may not be recoverable. Management does not believe that any impairment adjustment is needed to the carrying value of assets at December 31, 2002.
- d. Property and equipment are stated at cost. Buildings were depreciated on the straight-line basis and were fully depreciated at December 31, 2002 and 2001, respectively. Machinery and furniture are generally being depreciated using accelerated methods over estimated useful lives ranging from five to ten years.
- e. Basic and diluted loss per share are computed using the weighted average number of shares outstanding during the year (5,472,460 and 4,946,956 in 2002 and 2001, respectively). Stock options and warrants outstanding and issuable shares are antidilutive and are not considered in the computation.
- f. Cash and cash equivalents include cash on hand, cash in banks, and investments in money market funds.
- g. Deferred income tax is provided for differences between the basis of assets and liabilities for financial and income tax reporting. A deferred tax asset, subject to a valuation allowance, is recognized for estimated future tax benefits of tax-basis operating losses being carried forward.
- h. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 differ from estimates.



Notes to Consolidated Financial Statements (continued)

NOTE 2 — STOCKHOLDERS' EQUITY:

Common Stock:

In 1999, the Company authorized the issuance of 90,000 shares of common stock for director fees and officer compensation. The shares were valued at \$0.25 per share, the estimated market value on the authorization date. The shares were issued in 2002.

In 2002, the Company sold 370,000 common shares for \$37,000 (\$0.10 per share). In connection with the stock sales, the Company granted warrants to purchase up to 370,000 common shares at \$0.20 per share through June 10, 2003. As of December 31, 2002, warrants for 50,000 shares had been exercised. In 2002, the Company sold 366,000 common shares for \$256,200 (\$0.70 per share). In connection with the stock sales, the Company granted warrants to purchase up to 366,200 common shares at \$0.80 per share through November 23, 2003. As of December 31, 2002, no warrants had been exercised. In 2002, the Company issued 375,000 shares of common stock for directors' fees and officer compensation. The shares were valued at \$0.40 per share, the fair market value on the authorization date. In 2002, the Company issued 5,000 shares of common stock to an outside party for services. These shares were valued at \$0.20 per share, which was the fair market value at the date of issuance.

Preferred Stock:

The Company has authorized 10,000,000 shares of no-par-value preferred stock. Through December 31, 2002, the Company had not issued any of the authorized preferred stock.

NOTE 3 — MINING PROPERTIES:

Mining properties are comprised of acquisition, exploration, and development costs related to the Advance and Iroquois properties in the Northport region of northeastern Washington State and the Montanore property in northwestern Montana, as shown below:

	December 31,	
	2002	2001
Montanore	\$ 142,708	\$ 134,207
Advance	2,139	2,139
Iroquois	223,834	223,834
	\$ 368,681	\$ 360,180

The Montanore property (formerly the Noxon property) located in northwestern Montana includes 18 mining claims covering 355 acres plus one five acre patented mill site. In August 2002 the Company acquired controlling interest of the Montanore silver copper deposit in Sanders County, Montana. The Company received a quitclaim deed from Noranda Mineral Corp. (Noranda) that elected to withdraw from the project. The mineral rights acquired by the Company are subject to a \$0.20 per ton royalty, and a 5% Net Profits royalty which would commence after the operator has recovered all of its exploration and development costs. Between 1988 and 2002 Noranda carried out extensive geological, environmental, and engineering studies related to the project that is considered to be one of the largest silver deposits in the world. This work led to the definition of a resource of 135 million tons containing 260 million ounces of silver and 2 billion pounds of copper. In December 2002, the Company received a quitclaim deed to all intellectual property connected with studies that Noranda carried out on the project. The Advance property consists of 720 acres of patented mineral rights. Although the Company does not own the overlying surface rights to its patented mineral rights, it does have right of access to explore and mine. The Iroquois property consists of 64 acres of patented mineral and surface rights and 15 unpatented mining claims containing 300 acres.

NOTE 4 — MARKETABLE SECURITIES:

The Company owns 45,000 free-trading shares of Bitterroot Resources, Ltd. (BTT) a public Canadian corporation traded on the Toronto Venture Exchange. The shares are held as "available for sale." This investment is being recorded at fair market value with a corresponding



Notes to Consolidated Financial Statements (continued)

adjustment to stockholders' equity. The 45,000 free-trading shares at December 31, 2002 and 2001, have an approximate market value of \$3,133 and \$846 U.S. funds, respectively. The Company also owns 196,000 free-trading shares of Centram Exploration Ltd., a public Canadian corporation traded on the Toronto Venture Exchange. The shares are held as "available for sale." The shares were received in year 2002 in exchange for administrative services provided by Mines Management, Inc. The shares were valued at \$11,165 at December 31, 2002.

NOTE 5 — STOCK OPTIONS:

During the year ended December 31, 1998, the stockholders of the Company approved two stockbased compensation plans: a fixed employee stock-based compensation plan and a performance-based plan. Under the fixed plan, the Company may grant options to purchase up to 460,000 shares of common stock. The option price shall not be less than the fair market value on the date of grant of the shares. Stock options shall be exercisable within ten years from the date of the grant of the option. Options under the fixed plan vest immediately.

At December 31, 2002, the following fixed plan options were outstanding:

Optionee	Number of Shares Granted	Option Price	Option Period	Expiration
Directors:				
Robert L. Russell	100,000	\$0.30 per share	5 years	February 22, 2004
Jack Gustavel	75,000	\$0.40 per share	5 years	May 18, 2003
Roy Franklin	75,000	\$0.40 per share	5 years	May 18, 2003
Robert L. Russell	60,000	\$0.40 per share	5 years	September 15, 2007
Jack Gustavel	25,000	\$0.40 per share	5 years	September 15, 2007
Roy Franklin	25,000	\$0.40 per share	5 years	September 15, 2007
Jerry Pogue	<u>100,000</u>	\$0.40 per share	5 years	September 15, 2007
	<u>460,000</u>			

Under the incentive plan, the Company may grant options to purchase up to 460,000 shares of common stock. The option price shall not be less than the fair market value on the date of grant of the shares. Stock options shall be exercisable within ten years from the date of the grant of the option. Options under the incentive plan vest immediately.

At December 31, 2002, the following incentive-based plan options were outstanding:

Optionee	Number of Shares Granted	Option Price	Option Period	Expiration
William Green	100,000	\$0.40 per share	5 years	May 18, 2003
William Green	100,000	\$0.44 per share	5 years	September 15, 2007
Chris Broili	100,000	\$0.40 per share	5 years	May 18, 2003
Glenn Dobbs	<u>100,000</u>	\$0.82 per share	5 years	December 4, 2007
	<u>400,000</u>			

As permitted under accounting principles generally accepted in the United States of America, option grants under the plans are accounted for following the provisions of APB Opinion No. 25 and its related interpretations. Accordingly, no compensation cost has been recognized for the grants. Had compensation cost been determined based on the fair value method prescribed in Statement of Financial Accounting Standards (SFAS) No. 123, the reported net loss and per-share amounts would have been increased to approximately \$300,000 for 2002 (\$0.0549 per share). There is no pro forma effect on the net income for 2001. In determining the pro forma amounts above, the value of the grants was estimated at the grant date to be \$0.128 per optioned share for 2002 using the fair value method prescribed in SFAS No. 123, based on the Black Scholes option-pricing model with the following assumptions:

Dividend rate	-0-%
Risk-free interest rate	3.03%



Notes to Consolidated Financial Statements (continued)

NOTE 5 — STOCK OPTIONS (continued)

The following summarizes option activity for the years presented:

	Shares Under Option	Weighted-Average Exercise Price Per Share
Balance, at January 1, 2001	450,000	\$ 0.38
Issued	-	-
Forfeited	-	-
Exercised	-	-
Balance at December 31, 2001	450,000	0.38
Issued	410,000	0.51
Forfeited	-	-
Exercised	-	-
Balance at December 31, 2002	860,000	\$ 0.44

Options outstanding at December 31, 2002, have a remaining contractual life of approximately 2.8 years. Subsequent to year-end December 31, 2002, the Company approved a new stock option plan. Pursuant to the terms of the agreement, the Company authorized the issuance of 500,000 options to purchase common stock to the president and chief executive officer, Glenn Dobbs. The option price is \$1.60 per share and expires five years from date of issuance. This grant of options is subject to certain performance conditions. Additionally, subsequent to year end, the Company issued 110,000 options to purchase common stock to two employees. The option prices range from \$1.25 to \$1.60 per share and expire five years from the date of issuance.

NOTE 6 — CONCENTRATION OF CREDIT RISK:

The Company maintains its cash and cash equivalents in two financial institutions. Balances are insured by the Federal Deposit Insurance Corporation up to \$100,000 per institution.

NOTE 7 — DEFERRED INCOME TAX:

At December 31, 2002 and 2001, the Company had deferred tax assets of \$115,000 and \$125,000, related to tax-basis net operating loss carryforwards. The deferred tax assets were fully reserved by a valuation allowance at each date. Changes in the deferred tax asset valuation allowance for 2002 and 2001 relate only to corresponding changes in the deferred tax assets for those years.

At December 31, 2002, the Company had federal tax-basis net operating loss carryforwards totaling approximately \$760,000, which expire in various amounts from 2003 through 2022.

