

**CANADA ZINC METALS CORP.**

**CONSOLIDATED FINANCIAL STATEMENTS**

**YEARS ENDED JUNE 30, 2010 AND 2009**

**AUDITORS' REPORT**

To the Shareholders of  
Canada Zinc Metals Corp.

We have audited the consolidated balance sheets of Canada Zinc Metals Corp. as at June 30, 2010 and 2009 and the consolidated statements of loss and deficit, comprehensive loss and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance 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.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at June 30, 2010 and 2009 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

**“DAVIDSON & COMPANY LLP”**

Vancouver, Canada

Chartered Accountants

September 27, 2010



# CANADA ZINC METALS CORP.

## CONSOLIDATED BALANCE SHEETS AS AT JUNE 30

	2010	2009
<b>ASSETS</b>		
<b>Current</b>		
Cash and cash equivalents	\$ 9,281,997	\$ 6,389,394
Receivables	67,972	83,730
METC recoverable (Note 6)	921,063	–
Prepaid expenses	373,081	693
Marketable securities (Note 3)	450,000	–
Due from related parties (Note 10(e))	–	50,000
	<b>11,094,113</b>	<b>6,523,817</b>
<b>Other assets</b> (Note 4)	<b>89,000</b>	<b>89,000</b>
<b>Equipment and leasehold improvements</b> (Note 5)	<b>3,973</b>	<b>7,200</b>
<b>Long-term prepaid expenses</b>	<b>75,000</b>	<b>75,000</b>
<b>Resource properties</b> (Note 6)	<b>52,179,664</b>	<b>51,120,891</b>
	<b>\$ 63,441,750</b>	<b>\$ 57,815,908</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current</b>		
Accounts payable and accrued liabilities	\$ 1,295,366	\$ 241,980
Due to related parties (Note 10)	61,532	2,470
	<b>1,356,898</b>	<b>244,450</b>
<b>Future income taxes</b> (Note 8)	<b>7,040,397</b>	<b>1,514,583</b>
<b>Shareholders' equity</b>		
Capital stock (Note 7)	72,370,651	64,084,820
Contributed surplus (Note 7)	8,226,203	8,406,348
Deficit	(25,627,399)	(16,434,293)
Accumulated other comprehensive income (Note 13)	75,000	–
	<b>55,044,455</b>	<b>56,056,875</b>
	<b>\$ 63,441,750</b>	<b>\$ 57,815,908</b>

Nature and continuance of operations (Note 1)  
Subsequent events (Note 15)

On behalf of the Board:

"Peeyush Varshney" Director

"Marco Strub" Director

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

# CANADA ZINC METALS CORP.

## CONSOLIDATED STATEMENTS OF LOSS AND DEFICIT FOR THE YEARS ENDED JUNE 30

	2010	2009
<b>ADMINISTRATION EXPENSES</b>		
Administration (Note 10)	\$ 60,000	\$ 60,000
Amortization	3,227	3,885
Bonuses (Note 10)	226,750	–
Consulting	677,215	6,250
Flow through taxes (Notes 6 and 8)	601,595	22,560
Interest and bank charges:		
- bank charges	3,369	2,247
- interest (Note 8)	54,689	–
Investor relations	1,388	23,542
Management fees (Note 10)	150,000	150,000
Office and miscellaneous	51,524	63,808
Professional fees	73,863	83,444
Regulatory fees	14,975	12,040
Rent	61,028	59,438
Stock-based compensation (Note 7)	1,279,122	1,154,111
Transfer agent fees	6,841	10,909
Travel and promotion	73,647	90,904
Wages and benefits	358,252	480,607
<b>Loss before other items</b>	<b>(3,697,485)</b>	<b>(2,223,745)</b>
<b>OTHER ITEMS</b>		
Interest and other income	36,036	80,256
Write-off of resource properties (Note 6)	(5,843)	(20,622)
Write-off of accounts payable	–	2,930
	<b>30,193</b>	<b>62,564</b>
<b>Loss before income taxes</b>	<b>(3,667, 292)</b>	<b>(2,161,181)</b>
<b>Future income tax (expense) recovery (Note 8)</b>	<b>(5,525,814)</b>	<b>428,130</b>
<b>Loss for the year</b>	<b>(9,193,106)</b>	<b>(1,733,051)</b>
<b>Deficit, beginning of year</b>	<b>(16,434,293)</b>	<b>(14,701,242)</b>
<b>Deficit, end of year</b>	<b>\$ (25,627,399)</b>	<b>\$ (16,434,293)</b>
<b>Basic and diluted loss per common share</b>	<b>\$ (0.10)</b>	<b>\$ (0.02)</b>
<b>Weighted average number of common shares outstanding</b>	<b>91,308,065</b>	<b>76,028,188</b>

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

# CANADA ZINC METALS CORP.

## CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS FOR THE YEARS ENDED JUNE 30

	<b>2010</b>		2009	
<b>Loss for the year before comprehensive loss</b>	\$	<b>(9,193,106)</b>	\$	(1,733,051)
<b>Adjustment for the change in fair value of securities during the year (Note 13)</b>		<b>75,000</b>		–
<b>Comprehensive loss for the year</b>	\$	<b>(9,118,106)</b>	\$	(1,733,051)

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

# CANADA ZINC METALS CORP.

## CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED JUNE 30

	2010	2009
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Loss for the year	\$ (9,193,106)	\$ (1,733,051)
Items not affecting cash:		
Amortization	3,227	3,885
Interest accrued	54,689	–
Stock-based compensation	1,279,122	1,154,111
Write-off of accounts payable	–	(2,930)
Write-off of resource properties	5,843	20,622
Future income tax expense (recovery)	5,525,814	(428,130)
Changes in non-cash working capital items:		
Decrease in receivables	15,758	197,898
(Increase) decrease in prepaid expenses	(372,388)	278,936
Decrease in due from related parties	55,358	1,514
Increase (decrease) in accounts payable and accrued liabilities	624,724	(46,966)
Cash used in operating activities	(2,000,959)	(554,111)
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Marketable securities costs	(375,000)	–
Other assets	–	(4,000)
Resource property costs	(1,558,002)	(8,935,073)
Cash used in investing activities	(1,933,002)	(8,939,073)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Issuance of capital stock, net of issuance costs	7,067,117	11,568,689
Common shares repurchased (Note 7)	(240,553)	–
Cash provided by financing activities	6,826,564	11,568,689
<b>Increase in cash and cash equivalents during the year</b>	<b>2,892,603</b>	<b>2,075,505</b>
<b>Cash and cash equivalents, beginning of year</b>	<b>6,389,394</b>	<b>4,313,889</b>
<b>Cash and cash equivalents, end of year</b>	<b>\$ 9,281,997</b>	<b>\$ 6,389,394</b>
<b>Cash and cash equivalents</b>		
Cash	\$ 65,371	\$ 48,823
Guaranteed Investment Certificates	\$ 9,216,626	\$ 6,340,571

### Supplemental disclosure with respect to cash flows (Note 9)

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

**1. NATURE AND CONTINUANCE OF OPERATIONS**

Canada Zinc Metals Corp. (the “Company”) is incorporated under the laws of the Province of British Columbia. The Company operates in one business segment, that being the exploration and development of resource properties in Canada, and has not yet determined whether these properties contain ore reserves that are economically recoverable. The recoverability of the amounts shown for resource properties and related deferred costs is dependent upon the existence of economically recoverable reserves, the ability of the Company to obtain necessary financing to complete their development, and upon future profitable production.

These consolidated financial statements have been prepared with the assumption that the Company will be able to realize its assets and discharge its liabilities in the normal course of business rather than through a process of forced liquidation. The continuing operations of the Company are dependent upon its ability to continue to raise adequate financing and to commence profitable operations in the future.

June 30,	2010	2009
Working capital	\$ 9,737,215	\$ 6,279,367
Deficit	(25,627,399)	(16,434,293)

On February 23, 2007, the Company acquired 96% of the issued and outstanding capital stock of Ecstall Mining Corp. (“Ecstall”), a company engaged in the exploration and development of resource properties. During the year ended June 30, 2008, the Company acquired the remaining 4% of the issued and outstanding capital stock of Ecstall, increasing the Company’s ownership interest to 100%.

Effective September 26, 2008, the Company changed its name from Mantle Resources Inc. to Canada Zinc Metals Corp. and commenced trading under its new name and symbol “CZX”. There was no consolidation of share capital.

**2. SIGNIFICANT ACCOUNTING POLICIES**

**(a) Principles of consolidation**

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in Canada and include the accounts of the Company and its wholly owned subsidiary, Ecstall. All inter-company transactions and balances have been eliminated upon consolidation.

**(b) Use of estimates**

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the year. Actual results could differ from these estimates.

**(c) Cash and cash equivalents**

The Company considers cash and cash equivalents to include cash on deposit and highly liquid short-term interest bearing fixed and variable rate Guaranteed Investment Certificates. Interest earned is recognized immediately in the statement of operations.

**2. SIGNIFICANT ACCOUNTING POLICIES (cont'd...)**

**(d) Equipment and leasehold improvements**

Equipment is recorded at cost less accumulated amortization and is amortized over their estimated useful lives using the declining-balance method at the following annual rates:

Computers	30-45%
Equipment and furniture	20%

Leasehold improvements are amortized over the term of the lease using the straight-line method.

In the year of acquisition, one-half of the annual amortization is recorded.

**(e) Resource properties**

The Company records its interests in resource properties and areas of geological interest at cost. All direct and indirect costs relating to the acquisition of these interests are capitalized on the basis of specific claim blocks or areas of geological interest until the properties to which they relate are placed into production, sold or management has determined there to be an impairment. These costs will be amortized on the basis of units produced in relation to the proven reserves available on the related property following commencement of production. Resource properties which are sold before that property reaches the production stage will have all revenues from the sale of the property credited against the cost of the property. Properties which have reached the production stage will have a gain or loss calculated based on the portion of that property sold.

The recorded cost of resource exploration interests is based on cash paid, the value of share considerations and exploration and development costs incurred. The recorded amount may not reflect recoverable value as this will be dependent on the development program, the nature of the mineral deposit, commodity prices, adequate funding and the ability of the Company to bring its projects into production.

Management evaluates each resource interest on a reporting period basis or as changes in events and circumstances warrant, and makes a determination based on exploration activity and results, estimated future cash flows and availability of funding as to whether costs are capitalized or charged to operations. Resource property interests, where future cash flows are not reasonably determinable, are evaluated for impairment based on management's intentions and determination of the extent to which future exploration programs are warranted and likely to be funded.

The amounts shown for resource properties and deferred exploration costs represent costs incurred to date, and do not necessarily represent present or future values which are entirely dependent upon the economic recovery from production or from disposal.

**(f) Deferred exploration costs**

The Company defers all exploration costs relating to mineral properties and areas of geological interest until the properties to which they relate are placed into production, sold, abandoned or management has determined there to be an impairment. These costs will be amortized on the basis of units produced in relation to the estimated reserves available on the related property following commencement of production or written-off to operations in the period related properties are abandoned.



**2. SIGNIFICANT ACCOUNTING POLICIES (cont'd...)**

**(f) Deferred exploration costs (cont'd...)**

In March 2009 the CICA approved EIC 174, Mining Exploration Costs. The guidance clarified that an enterprise that has initially capitalized exploration costs has an obligation in the current and subsequent accounting periods to test such costs for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. The Company has performed an assessment as of June 30, 2010 and believes there to be no impact on its financial statements.

**(g) Asset retirement obligations**

The Company recognizes the fair value of a liability for an asset retirement obligation in the year in which it is incurred when a reasonable estimate of fair value can be made. The carrying amount of the related long-lived asset is increased by the same amount as the liability. The Company does not have any significant asset retirement obligations for the years presented.

**(h) Impairment of long-lived assets**

The carrying values of long-lived assets with fixed or determinable lives are reviewed for impairment whenever events or changes in circumstances indicate the recoverable value may be less than the carrying amount. Recoverable value determinations are based on management's estimates of undiscounted future net cash flows expected to be recovered from specific assets or groups of assets through use or future disposition. Impairment charges are recorded in the period in which determination of impairment is made by management.

Assets with indefinite or indeterminable lives are not amortized and are reviewed for impairment on a reporting basis using fair value determinations through management's estimate of recoverable value.

**(i) Flow-through shares**

Canadian tax legislation permits a company to issue flow-through shares whereby the deduction for tax purposes relating to qualified resource expenditures is claimed by the investors rather than the Company. Recording these expenditures for accounting purposes gives rise to taxable temporary differences.

When flow-through expenditures are renounced, a portion of the future income tax assets that were not recognized in previous years, due to the recording of a valuation allowance, are recognized as recovery of income taxes in the statement of loss and deficit.

**(j) Stock-based compensation**

The Company uses the fair value method whereby the Company recognizes compensation costs for the granting of all stock options and direct awards of stock using the Black-Scholes option pricing model. Any consideration paid on the exercise of stock options is credited to capital stock.

**(k) Loss per share**

The Company uses the treasury stock method to compute the dilutive effect of options, warrants and similar instruments. Under this method, the dilutive effect on loss per common share is recognized on the use of the proceeds that could be obtained upon exercise of options, warrants and similar instruments. It assumes that the proceeds would be used to purchase common shares at the average market price during the year. For the years presented, this calculation proved to be anti-dilutive.

**2. SIGNIFICANT ACCOUNTING POLICIES (cont'd...)**

**(k) Loss per share (cont'd...)**

Basic loss per common share is calculated using the weighted average number of common shares outstanding during the year and does not include outstanding options and warrants.

**(l) Financial instruments**

All financial instruments are classified into one of five categories: held-for-trading, held-to-maturity investments, loans and receivables, available-for-sale financial assets or other financial liabilities. All financial instruments and derivatives are measured in the balance sheet at fair value except for loans and receivables, held-to maturity investments and other financial liabilities which are measured at amortized cost. Subsequent measurement and changes in fair value will depend on their initial classification as follows. Held-for-trading financial assets are measured at fair value and changes in fair value are recognized in net income. Available-for-sale financial instruments are measured at fair value with changes in fair value recorded in other comprehensive income until the instrument is derecognized or impaired.

The Company has classified its cash and cash equivalents as held-for-trading. Marketable securities are classified as available-for-sale. Receivables, METC Recoverable, and due from related parties are classified as loans and receivables. Accounts payable and accrued liabilities as well as due to related parties are classified as other financial liabilities, all of which are measured at amortized cost.

The CICA Handbook Section 3862, Financial Instruments – Disclosures, and Section 3863, Financial Instruments Presentation, revised and enhanced disclosure requirements while carrying forward presentation requirements. These new sections placed increased emphasis on disclosure about the nature and extent of risks arising from financial instruments and how the entity manages those risks.

Disclosure is also required on the inputs used in making fair value measurements, including their classification within a hierarchy that prioritizes their significance. The three levels of the fair value hierarchy are:

Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities;

Level 2 – Inputs other than quoted prices that are observable for the asset or liability either directly or indirectly;  
and

Level 3 – Inputs that are not based on observable market data.

The Company has included disclosure recommended by this section in Note 12 to these consolidated financial statements.

**(m) Income taxes**

Income taxes are accounted for using the asset and liability method. Under this method of tax allocation, future tax assets and liabilities are determined based on differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases (“temporary differences”) and losses carried forward. Future income tax assets and liabilities are measured using the enacted tax rates expected to be in effect when the temporary differences are likely to reverse. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the date of enactment or substantive enactment. The amount of future income tax assets recognized is limited to the amount that is more likely than not to be realized.

**2. SIGNIFICANT ACCOUNTING POLICIES (cont'd...)**

**(n) Comparative figures**

Certain comparative figures have been reclassified to conform to the current year's presentation.

**(o) Adoption of new accounting standards**

Effective for the year ended June 30, 2010, the Company adopted new accounting standards that were issued by the CICA, as listed below. This standard was adopted on a prospective basis and is primarily related to disclosures. There were no adjustments recorded to the opening balance sheet items or deficit as a result of its initial adoption of these standards.

**Goodwill and Intangible Assets – CICA Handbook Section 3064**

This Section replaces Section 3062 "Goodwill and Other Intangible Assets" and Section 3450 "Research and Development Costs". The new Section establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill are unchanged from the standards included in Section 3062. The adoption of this section did not have a significant effect on these financial statements.

**(p) Recent accounting pronouncements**

***International Financial Reporting Standards***

In 2006, the Canadian Accounting Standards Board ("AcSB") published a strategic plan that will significantly affect financial reporting requirements for Canadian companies. The AcSB strategic plan outlines the convergence of Canadian generally accepted accounting principles ("GAAP") with International Financial Reporting Standards ("IFRS") over an expected five year transitional period. In February 2008, the AcSB announced that 2011 is the changeover date for publicly-listed companies to use IFRS, replacing Canada's own GAAP. The date is for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The transition date of July 1, 2011 will require the restatement for comparative purposes of amounts reported by the Company for the year ended June 30, 2011.

The Company's IFRS transition plan includes internal training, external consulting on complex issues and Board and Audit Committee oversight. The Company continues to monitor and assess the impact of convergence of Canadian GAAP and IFRS.

***Business Combinations – Section 1582, Consolidated Financial Statements – Section 1601 and Non-Controlling Interests – Section 1602***

In January 2009, the CICA issued Section 1582, Business Combinations, which will provide the Canadian equivalent to International Financial Reporting Standard IFRS 3, Business Combinations, and replace the existing Section 1581, Business Combinations. The new standard will apply prospectively to business combinations for which the acquisition date is on or after January 1, 2011. Earlier adoption is permitted as of the beginning of a fiscal year, in which case an entity would also be required to early adopt Section 1601, Consolidated Financial Statements and Section 1602, Non-controlling Interests. Management does not expect that the adoption of these new standards will have a significant impact on the Company's financial statements.

**3. MARKETABLE SECURITIES**

During the year ended June 30, 2010, the Company invested \$375,000 by subscribing for 1,875,000 units of TNR Gold Corp. (“TNR”) at a price of \$0.20 per unit. Each unit consisted of one common share and one-half of a common share purchase warrant. The quoted market value of the marketable securities as of June 30, 2010 was \$450,000 (June 30, 2009 – \$Nil). The exercise price of the 937,500 warrants was \$0.30 per share, and all warrants expired unexercised on July 28, 2010.

**4. OTHER ASSETS**

Other assets comprise a reclamation bond of \$89,000 (2009 – \$89,000) posted with the Government of British Columbia.

**5. EQUIPMENT AND LEASEHOLD IMPROVEMENTS**

	2010			2009		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Computers	\$ 14,909	\$ 12,574	\$ 2,335	\$ 14,909	\$ 10,124	\$ 4,785
Equipment and furniture	4,026	2,598	1,428	4,026	2,241	1,785
Leasehold improvements	2,522	2,312	210	2,522	1,892	630
	<u>\$ 21,457</u>	<u>\$ 17,484</u>	<u>\$ 3,973</u>	<u>\$ 21,457</u>	<u>\$ 14,257</u>	<u>\$ 7,200</u>

**6. RESOURCE PROPERTIES**

Title to resource properties involves certain inherent risks due to the difficulties of determining the validity of certain claims as well as the potential for problems arising from the frequently ambiguous conveyancing history characteristic of many resource properties. The Company has investigated title to all of its resource properties and, to the best of its knowledge, title to all of its properties are in good standing.

**DA Property, Northwest Territories**

The Company holds an 8.2% interest, subject to a 5% gross overriding royalty (“GOR”) on diamonds, a 5% net smelter returns (“NSR”) royalty on other minerals, and a 10% net profits interest (“NPI”), in certain mineral claims located in the Northwest Territories. Pursuant to an amended and restated Mineral Property Option Agreement, dated August 30, 1998, the Company has the option to reduce the GOR and NSR interests to 2.25% and 2%, respectively, and eliminate entirely the NPI by completing certain share issuances and cash payments to the original property owner within 90 days of a production decision.

**Akie Property, British Columbia**

The Company owns a 100% interest in the Akie property, which resulted from Company expenditures and the acquisition of Ecstall Mining Corporation (Note 1).

**Kechika Regional, British Columbia**

During fiscal 2007, the Company acquired the following properties pursuant to the acquisition of Ecstall Mining Corporation:

- Kechika South Properties, Omineca Mining Division. The Company owns a 100% interest in two properties,
- Kechika North Properties, Liard Mining Division. The Company owns a 100% interest in three properties of which, certain claims are subject to a 0.5% net smelter royalty.

CANADA ZINC METALS CORP.  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 JUNE 30, 2010

6. **RESOURCE PROPERTIES (cont'd...)**

The following table summarizes resource property expenses by property.

	Akie Property	Kechika Regional	DA	Total
<b>Acquisition Costs:</b>				
Balance, June 30, 2008	\$ 24,174,119	\$ 346,740	\$ 71,535	\$ 24,592,394
Additions	–	1,524	–	1,524
Write-off	(790)	(19,832)	–	(20,622)
Balance, June 30, 2009	24,173,329	328,432	71,535	24,573,296
Additions	2,000	–	–	2,000
Balance, June 30, 2010	24,175,329	328,432	71,535	24,575,296
<b>Deferred Exploration Costs:</b>				
Balance, June 30, 2008	19,053,980	161,928	150,025	19,365,933
Additions:				
Geological Consulting	834,930	346,996	–	1,181,926
Drilling	4,273,940	–	–	4,273,940
Environmental studies	463,901	–	–	463,901
Road construction	1,068,307	193,588	–	1,261,895
Balance, June 30, 2009	25,695,058	702,512	150,025	26,547,595
Additions:				
Geological consulting	495,362	220,047	–	715,409
Camp operating	188,715	249,974	–	438,689
Drilling	487,282	–	–	487,282
Community consultations	159,069	–	–	159,069
Environmental studies	109,072	–	–	109,072
Metallurgical analysis	52,200	–	–	52,200
Road and transportation	21,958	–	–	21,958
Less:				
Write-off of camp equipment	(5,843)	–	–	(5,843)
METC	(921,063)	–	–	(921,063)
Balance, June 30, 2010	26,281,810	1,172,533	150,025	27,604,368
<b>June 30, 2010</b>	<b>\$ 50,457,139</b>	<b>\$ 1,500,965</b>	<b>\$ 221,560</b>	<b>\$ 52,179,664</b>

The Company applied for the 20% British Columbia Mining Exploration Tax Credit (“METC”) and the enhanced tax credit of an additional 10% for Mountain Pine Beetle affected areas, on qualified mining exploration costs incurred by the Company in fiscal 2008.

During the year ended June 30, 2010, the Company received the Canada Revenue Agency’s (“CRA”) approval of \$921,063 in METC for its fiscal 2008 application. The Company recorded this amount in METC recoverable with a corresponding reduction in Resource Properties on the consolidated balance sheet as at June 30, 2010. The METC was received subsequent to year end.

The Company accrued \$44,278 in additional part XII.6 tax on flow-through funds related to fiscal years 2006 to 2008 upon receipt of the CRA’s flow-through assessment and paid the amount subsequent to the year ended June 30, 2010.

During the year ended June 30, 2010, the Company wrote-off \$5,843 of obsolete camp equipment which was no longer in use.

CANADA ZINC METALS CORP.  
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
 JUNE 30, 2010

7. CAPITAL STOCK AND CONTRIBUTED SURPLUS

(a) Authorized and issued

	Number of Shares	Amount	Contributed Surplus
Authorized Unlimited common shares without par value			
As at June 30, 2008	69,105,118	\$ 54,356,255	\$ 7,252,237
Private placements (v), (vii)	19,363,778	11,964,900	–
Rounding adjustment (vi)	18	–	–
Share issuance costs (v), (vii)	–	(396,211)	–
Stock- based compensation	–	–	1,154,111
Tax benefit renounced to Flow-through share subscribers	–	(1,840,124)	–
Balance, June 30, 2009	88,468,914	64,084,820	8,406,348
Exercise of options (ii)	3,492,500	2,492,347	(1,642,847)
Exercise of warrants (iii)	5,750,000	3,450,000	–
Private placement (i)	5,000,000	3,000,000	–
Share issuance costs (i)	–	(232,383)	–
Stock- based compensation	–	–	1,279,122
Balance, June 30, 2010	102,711,414	72,794,784	8,042,623
Repurchase of capital stock – Normal Course Issuer Bid (iv)	(590,000)	(424,133)	183,580
Balance, June 30, 2010	102,121,414	\$ 72,370,651	\$ 8,226,203

During the year ended June 30, 2010:

- (i) the Company completed a non-brokered private placement of 5,000,000 units at a price of \$0.60 per unit for total gross proceeds of \$3,000,000. Each unit consists of one common share and one half of a common share purchase warrant. Each whole warrant entitles the holder to purchase, at any time within 18 months from closing, one common share of the Company at a price of \$0.80. All shares issued pursuant to the private placement are subject to a hold period expiring on October 8, 2010. The Company paid \$210,000 as a finder's fee and another \$22,383 was paid in regulatory costs on this private placement.
- (ii) an aggregate of 3,492,500 stock options were exercised at a price ranging from \$0.20 per share to \$0.25 per share and a total of 3,492,500 common shares were issued for total proceeds of \$849,500. In addition, a reallocation of \$1,642,847 from contributed surplus to share capital was recorded on the exercise of these options.

**7. CAPITAL STOCK AND CONTRIBUTED SURPLUS (cont'd...)**

**(a) Authorized and issued (cont'd...)**

- (iii) 5,750,000 share purchase warrants were exercised by Tongling Nonferrous Metals Group Holdings Co. Ltd. ("Tongling") at a price of \$0.60 per share and 5,750,000 common shares were issued for total proceeds of \$3,450,000.
- (iv) the Company received TSX Venture Exchange ("TSXV") approval to commence a normal course issuer bid ("NCIB") to purchase at market price up to 4,423,445 of its common shares, representing approximately 5% of the Company's issued and outstanding common shares as at June 30, 2009. The NCIB commenced on July 31, 2009 and will stay open for 12 months. During the year ended June 30, 2010, the Company had repurchased 590,000 shares of its common shares for a total consideration of \$240,553 at a weighted average price of \$0.41 per share under the NCIB, of which \$424,133 was recorded as a reduction to capital stock for the assigned value of the shares, and \$183,580 was allocated to contributed surplus.

During the year ended June 30, 2009:

- (v) the Company completed a non-brokered private placement of 7,863,778 flow-through shares at a price of \$0.90 per share for total gross proceeds of \$7,077,400. An aggregate of \$330,920 was paid as finders' fees and another \$35,666 was paid in regulatory costs on this private placement.
- (vi) the Company issued 18 common shares to be held in a trustee account to correct actual entitlements of shares. The difference was a result of fractional rounding accumulated from exchanges processed for previous capital consolidations.
- (vii) the Company completed a non-brokered private placement of 11,500,000 units at a price of \$0.425 per unit subscribed by Tongling for gross proceeds of \$4,887,500. Each unit consisted of one common share and one-half of a common share purchase warrant. Each whole warrant entitled the purchaser to purchase, at any time within 24 months from closing, one common share of the Company at a price of \$0.60 during the first year and at a price of \$0.80 during the second year. An aggregate of \$29,625 was paid in regulatory and other costs on this private placement.

**(b) Stock options**

The Company has adopted a 20% fixed stock option plan whereby the Company has reserved 13,522,821 common shares under the plan. The term of any options granted under the plan is fixed by the Board of Directors and may not exceed ten years from date of grant.

The number of options granted to a consultant in a 12 month period must not exceed 2% of the issued shares of the Issuer from the date of grant. Options issued to consultants performing investor relations activities must vest in stages over 12 months with no more than 1/4 of the options vesting in any three month period. Stock options granted to directors, officers and employees of the Company vest immediately.

Stock option transactions and the number of stock options outstanding are summarized as follows:

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7. CAPITAL STOCK AND CONTRIBUTED SURPLUS (cont'd...)

(b) Stock options (cont'd...)

	Number of Options	Weighted Average Exercise Price
Balance, June 30, 2008	8,447,500	\$ 1.01
Granted	3,527,500	0.25
Re-priced from	(1,768,000)	1.08
Re-priced to	1,768,000	0.25
Cancelled	(3,777,000)	1.08
Balance, June 30, 2009	8,198,000	0.46
Granted	3,980,000	0.49
Exercised	(3,492,500)	0.24
Cancelled	(1,460,000)	1.04
Balance, June 30, 2010	7,225,500	\$ 0.47
Exercisable, June 30, 2010	6,225,500	\$ 0.47

Stock options outstanding and exercisable at June 30, 2010 are summarized as follows:

Number of Options	Exercise Price	Expiry Date	Exercisable
100,000	\$0.64	October 13, 2010	100,000
10,000	\$0.81	January 9, 2011	10,000
155,000	\$0.70	November 14, 2016	155,000
22,500	\$0.25	November 14, 2011	22,500
175,000	\$0.25	April 10, 2012	175,000
50,000	\$0.25	July 3, 2012	50,000
50,000	\$1.15	July 3, 2012	50,000
70,000	\$1.30	November 28, 2012	70,000
420,000	\$1.05	February 11, 2018	420,000
318,000	\$0.25	February 11, 2018	318,000
150,000	\$0.25	April 1, 2013	150,000
75,000	\$1.05	April 29, 2013	75,000
275,000	\$0.25	October 21, 2013	275,000
1,475,000	\$0.25	October 31, 2018	1,475,000
700,000	\$0.40	September 22, 2014	262,500
500,000	\$0.40	October 9, 2019	500,000
860,000	\$0.41	October 13, 2016	660,000
100,000	\$0.50	November 16, 2012	87,500
100,000	\$0.70	November 16, 2012	87,500
1,320,000	\$0.63	January 15, 2020	1,282,500
300,000	\$0.50	May 15, 2015	–
7,225,500			6,225,500

During the year ended June 30, 2010, under the fair value based method a total of \$1,279,122 (2009 – \$1,053,531) in stock-based compensation expense was recorded in the statements of loss and deficit for stock options granted to directors, officers, employees and consultants of the Company.



**7. CAPITAL STOCK AND CONTRIBUTED SURPLUS (cont'd)**

**(b) Stock options (cont'd...)**

During the year ended June 30, 2009, the Company also re-priced previously granted stock options to a number of employees and consultants to acquire 1,768,000 common shares at a price between \$0.70 per share and \$1.40 per share, expiring between January 9, 2011 and February 11, 2018, to \$0.25 per share. The Company recorded \$Nil (2009 - \$100,580) in additional stock-based compensation expense in connection with the re-pricing.

The fair value of stock options used to calculate compensation expense has been estimated using the Black-Scholes option pricing model with the following weighted average assumptions:

June 30,	2010	2009
Risk free interest rate	2.81%	3.21%
Expected dividend yield	0%	0%
Stock price volatility	98%	108%
Expected life of options	8.2 years	7.7 years

The weighted average fair value of options granted or re-priced during the year ended June 30, 2010 was \$0.41 (2009 – \$0.30) per share.

**(c) Warrants**

As at June 30, 2010, the Company had outstanding share purchase warrants, enabling holders to acquire common shares as follows:

Number of Warrants	Exercise Price	Expiry Date
2,500,000	\$0.80	December 7, 2011

Warrant transactions and the number of warrants outstanding and exercisable are as follows:

	Number of Warrants	Weighted Average Exercise Price
Balance, June 30, 2008	5,435,000	\$ 1.09
Warrants expired	(5,435,000)	1.09
Warrants granted (Note 7(a) (vii))	5,750,000	0.60
Balance, June 30, 2009	5,750,000	0.60
Warrants exercised	(5,750,000)	0.60
Warrants granted (Note 7(a) (i))	2,500,000	0.80
Balance, June 30, 2010	2,500,000	\$ 0.80

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**8. INCOME TAXES**

A reconciliation of current income taxes at statutory rates with the reported taxes is as follows:

	2010	2009
Loss before income tax recovery	\$ (3,667,292)	\$ (2,161,181)
Expected income tax recovery at statutory rates	(1,072,683)	(653,757)
Net, non-deductible expenses	202,645	182,572
Recognized benefits of non-capital losses carried forward	6,395,852	43,055
Total income taxes (recovery)	\$ 5,525,814	\$ (428,130)

Details of future income tax assets (liabilities) are as follows:

	2010	2009
Equipment	\$ 74,150	\$ 12,031
Resource properties	(9,709,175)	(3,694,641)
Non-capital losses carried forward	2,368,866	1,826,943
Capital losses	3,052	3,174
Share issuance costs	222,710	337,910
	(7,040,397)	(1,514,583)
Less: Valuation allowance	-	-
	\$ (7,040,397)	\$ (1,514,583)

During the year ended June 30, 2009, the Company issued 7,863,778 flow-through common shares for gross proceeds of \$7,077,400. The flow-through agreement requires the Company to renounce certain deductions for Canadian exploration expenditures incurred on the Company's resource properties. Future income taxes of \$1,840,124 on the exploration expenditures renounced to shareholders were applied against capital stock.

The Company was unable to incur exploration expenditures between the September 2008 flow through share issuance and December 31, 2009 to the extent it originally anticipated. It is the Company's intention to expend the balance of the flow through funds raised in 2008 on eligible exploration in Canada during the period from January 1, 2010 through October 31, 2010. As at June 30, 2010, the Company incurred \$3,479,021 in eligible exploration expenditures.

Subsequent to the year ended June 30, 2010, the Company filed the amendments to eligible Canadian exploration expenditures previously renounced to the flow-through shareholders. As a result of the expenditure shortfall and the amendment of the previous renunciations of explorations expenditures, the Company accrued \$579,877 in part XII.6 tax for 2009 and an additional \$54,689 in interest payable. Both amounts were paid subsequent to June 30, 2010.

The Company has non-capital losses of approximately \$9,475,000 which may be carried forward and applied against taxable income in future years. These losses, if unutilized, will expire through 2030. Subject to certain restrictions, the Company also has resource expenditures available to reduce taxable income in future years. Future tax benefits which may arise as a result of these non-capital losses and resource deductions have not been reflected in these financial statements.

**9. SUPPLEMENTAL DISCLOSURE WITH RESPECT TO CASH FLOWS**

June 30	2010	2009
Cash paid during the period for interest	\$ -	\$ -
Cash paid during the period for income tax	\$ -	\$ -

Significant non-cash transactions for the year ended June 30, 2010 included:

- (a) Included in accounts payable is \$450,222 (2009 -\$76,249) in resource property expenditures.
- (b) Included in due to related parties is \$53,704 (2009 -\$Nil) in resource property expenditures.
- (c) Upon the exercise of stock options, \$1,642,847 (2009 - \$Nil) was allocated to contributed surplus (Note 7(a)(ii)).
- (d) Included in marketable securities is \$75,000 (2009 - \$Nil) of unrealized gain which was allocated to accumulated other comprehensive income (Note 13).

**10. TRANSACTIONS WITH RELATED PARTIES**

During the year ended June 30, 2010:

- (a) the Company paid or accrued \$150,000 (2009 - \$150,000) for management fees and \$60,000 (2009 - \$60,000) for administrative fees to a company partially controlled by a director and an officer of the Company.
- (b) the Company paid bonuses totalling \$226,750 (2009 - \$Nil) to a company partially controlled by a director and an officer of the Company.
- (c) the Company paid or accrued \$148,000 (2009 - \$108,000) for consulting and geological services fees, included in resource properties, to a company controlled by a director of the Company. The Company also paid a bonus of \$1,500 (2009 - \$Nil), included in wages and benefits in the consolidated statements of operations and deficit, to this director. As at June 30, 2010, \$54,600 (2009 - \$Nil) was due to this company.
- (d) As at June 30, 2010, \$6,932 (2009 - \$2,470) was due to directors and officers of the Company. The amount resulted from expense reimbursement and is unsecured and non-interest bearing with no fixed terms of repayment. These amounts were fully repaid subsequent to the year end.
- (e) The Company received \$50,000 for a loan repayment from a former director of the Company.

These transactions were in the normal course of operations and were measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

**11. CAPITAL DISCLOSURE**

The Company's objective is to manage its capital to ensure that there are adequate capital resources to safeguard the Company's ability to continue as a going concern through the optimization of its capital structure. The capital structure consists of shareholders' equity and working capital.

In order to achieve this objective, the Company makes adjustments to it in light of changes in economic conditions and risk characteristics of the underlying assets. To maintain or adjust capital structure, the Company may invest its excess cash in interest bearing accounts of Canadian chartered banks and/or raise additional funds externally as needed. The Company has no significant debt and is not subject to externally imposed capital requirements. There were no changes to the Company's capital management structure during the year ended June 30, 2010.

## 12. FINANCIAL INSTRUMENTS

The fair value of the Company's receivables, METC recoverable, due from related parties, accounts payable and accrued liabilities, and due to related parties approximate carrying value, which is the amount recorded on the consolidated balance sheet. The Company's other financial instruments, cash and cash equivalents and marketable securities, under the fair value hierarchy are based on level one quoted prices in active markets for identical assets or liabilities.

### Financial Risk Management

The Company is exposed in varying degrees to a variety of financial instrument related risks.

#### *Credit Risk*

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss. The Company's primary exposure to credit risk is on its bank accounts and short-term investments, whose balances at June 30, 2010 were \$65,371 and \$9,216,626 respectively. Bank accounts are held with a major bank in Canada. As all of the Company's cash is held by a Canadian bank and all the cash equivalents are also held by the same Canadian bank, there is a concentration of credit risk with one bank in Canada. This risk is managed by using a major bank that is a high credit quality financial institution as determined by rating agencies. The Company's secondary exposure to credit risk is on its receivables. This risk is minimal as receivables consist primarily of refundable government sales taxes and the METC recoverable, which was received subsequent to the year end.

#### *Currency Risk*

The Company operates in Canada and is therefore not exposed to significant foreign exchange risk arising from transactions denominated in a foreign currency.

#### *Interest Rate Risk*

The Company is exposed to interest rate risk as bank accounts earn interest income at variable rates. The income earned on these bank accounts is subject to the movements in interest rates. The cash proceeds from the Company's financing activities are invested in a guaranteed investment certificate at a variable rate of approximately 1%, which are readily convertible to known amounts of cash and not exposed to a risk of loss in value.

#### *Liquidity Risk*

Liquidity risk arises through the excess of financial obligations over available financial assets due at any point in time. The Company's objective in managing liquidity risk is to maintain sufficient readily available reserves in order to meet its liquidity requirements at any point in time. The Company achieves this by maintaining sufficient cash and cash equivalents. As at June 30, 2010, the Company was holding cash of \$65,371 and guaranteed investment certificates of \$9,216,626 to settle current liabilities of \$1,356,898. Management believes it has sufficient funds to meet its current obligations as they become due.

#### *Price risk*

The Company is exposed to price risk with respect to commodity and equity prices. Equity price risk is defined as the potential adverse impact on the Company's earnings due to movements in individual equity prices or general movements in the level of the stock market. Commodity price risk is defined as the potential adverse impact on earnings and economic value due to commodity price movements and volatilities. The Company closely monitors certain commodity prices, individual equity movements, and the stock market to determine the appropriate course of action to be taken by the Company.

**12. FINANCIAL INSTRUMENTS (cont'd...)**

The Company currently maintains investments in certain marketable securities. There can be no assurance that the Company can exit these positions if required, resulting in proceeds approximating the carrying value of these securities.

**13. ACCUMULATED OTHER COMPREHENSIVE INCOME**

Comprehensive loss is the change in shareholders' equity during a period from transactions and other events from non-owner sources. The Company includes the account "Accumulated other comprehensive income" in the shareholders' equity section of the consolidated balance sheets.

Accumulated other comprehensive income is comprised of the following:

Balance, June 30, 2009 and 2008	\$	–
Adjustment for change in fair value of securities during the year		75,000
Balance, June 30, 2010	\$	75,000

**14. SEGMENTED INFORMATION**

The Company has one reportable operating segment, being the acquisition and exploration of resource properties in Canada. All of the Company's assets are located in Canada.

**15. SUBSEQUENT EVENTS**

Subsequent to the year ended June 30, 2010, the Company:

- (a) entered into a financing arrangement with Tongling pursuant to which Tongling has subscribed, by way of a non-brokered private placement, to 31,386,224 units of Canada Zinc Metals at a price of \$0.5735 per unit for gross proceeds of \$18,000,000. Each unit consists of one common share and one half of a common share purchase warrant. Each whole warrant shall entitle the purchaser to purchase, at any time within 24 months from closing, one additional common share of the Company at a price of \$0.675 during the first year and at a price of \$0.775 during the second year. Upon completion of the private placement, Tongling will own approximately a 36% equity position in Canada Zinc Metals. The financing is subject to receiving the necessary approvals of the Tongling board of directors, the relevant Chinese regulatory departments, the TSXV and the shareholders of the Company.
- (b) received the TSXV approval to purchase at market price up to 5,135,570 common shares, being approximately 5% of the Company's issued and outstanding common shares, by way of a normal course issuer bid (the "New Bid") through the facilities of the TSXV. The Bid commenced on August 1, 2010 and will stay open for 12 months.

The NCIB purchases subsequent to June 30, 2010 are summarized as follows:

	July 1, 2010 to July 31, 2010	August 1, 2010 to September 27, 2010 ("The New Bid")	Total NCIB purchases subsequent to June 30, 2010
Number of shares	154,000	352,500	506,500
Purchase price	\$ 70,948	\$ 146,165	\$ 217,113

**15. SUBSEQUENT EVENTS (cont'd...)**

The purchases are made in accordance with the policies and rules of the TSXV. The Company will pay the market price of the common shares at the time of acquisition and will not purchase more than 2% of the total issued and outstanding common shares within any 30 day period.

1,029,000 common shares were returned to the Company's treasury for cancellation.

- (c) 75,000 stock options were exercised at a price of \$0.25 per share and 75,000 common shares were issued for total proceeds of \$18,750.
- (d) entered into an agreement with Translloyd Consulting GmbH ("Translloyd") for of investor relations and communications services. Translloyd's engagement, which is subject to regulatory approval, is effective September 1, 2010, for a term of six months, thereafter renewable on a month to month basis. The Company will pay Translloyd a fee of \$7,000 per month and reimburse it for approved expenses.