



**BAFFINLAND IRON MINES CORPORATION**  
**2<sup>nd</sup> QUARTER REPORT**  
June 30, 2008



**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION  
FOR THE SECOND QUARTER ENDED JUNE 30, 2008**

## INTRODUCTION

The following is management's discussion and analysis of the financial condition and results of operations of Baffinland Iron Mines Corporation ("Baffinland" or the "Company") for the three and six month periods ended June 30, 2008, and its financial position as at June 30, 2008, and should be read in conjunction with the unaudited interim financial statements of the Company as at and for the period ended June 30, 2008, including the notes thereto, as well as the audited financial statements of the Company as at and for the year ended December 31, 2007, including the notes thereto. The Company's financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). Additional information relating to the Company, including the Company's Annual Information Form dated March 10, 2008 and subsequent press releases has been filed electronically through the System for Electronic Document Analysis and Retrieval ("SEDAR") and is available online at [www.sedar.com](http://www.sedar.com). The date of this management's discussion and analysis is July 29, 2008. All figures are in Canadian dollars unless otherwise noted.

The Company's common shares ("Common Shares") and Common Share purchase warrants ("Warrants") are listed on the Toronto Stock Exchange (the "TSX") under the trading symbol "BIM" and "BIM.WT", respectively.

### Cautionary Note Regarding Forward-Looking Information

Certain information included in this management's discussion and analysis may constitute forward-looking information within the meaning of securities laws. In some cases, forward-looking information can be identified by the use of terms such as "may", "will", "should", "expect", "believe", "plan", "scheduled", "intend", "estimate", "forecast", "predict", "potential", "continue", "anticipate" or other similar expressions concerning matters that are not historical facts. Forward-looking information may relate to management's future outlook and anticipated events or results, and may include statements or information regarding the future plans or prospects of the Company. Without limitation, statements about the Company's planned bulk sample program, including shipment of ore samples, and other plans and intentions in order to advance the development of the Mary River iron ore deposits (the "Mary River Property"), development of a bulk sample reclamation plan, completion of the basic engineering and the definitive capital cost estimate for construction at the Mary River Property, completion of the regulatory process and estimates about project construction timelines and the commencement of commercial ore shipments, as well as statements about the Company's planned drilling program, the Company's goal to add one or more strategic investors and substantially all of the information contained in and/or derived from the DFS (as defined under "Overview"), constitutes forward-looking information. Actual results may vary. See "Risks and Uncertainties".

Forward-looking information is based on certain factors and assumptions regarding, among other things, the estimation of mineral reserves and resources, the realization of mineral reserve and resource estimates, iron ore prices, the timing and amount of future exploration expenditures, the estimation of initial and sustaining capital requirements, the estimation of labour and operating costs, the availability of necessary financing and materials, including financing to conduct the 2008 drilling program and the other activities necessary to continue to develop the Mary River Property in the short and long-term, the progress of construction and development activities, the receipt of necessary regulatory approvals, and assumptions with respect to environmental risks, title disputes or claims, weather conditions, climate change and other similar matters. While the Company considers these assumptions to be reasonable based on information currently available to it, they may prove to be incorrect. Without limitation, in estimating an initial capital cost for the Mary River Property of \$4.1 billion, the Company has assumed, among other things, certain geotechnical design criteria for the rail corridor and certain inputs for construction costs, including labour and material costs. In making

statements concerning the planned engineering and construction schedule of the Mary River Property, including the timing of completion of basic engineering and project construction and the commencement of commercial production, the Company has assumed, among other things, that iron ore prices will not change materially from the prices used in its current financial forecasts, that it will obtain in a timely fashion all of the financing, regulatory approvals and other authorizations required to enable the continued exploration and development of the Mary River Property, and the construction and mining activities required in order to complete such activities, and that such activities will proceed in the ordinary course without undue disruption. See "Risks and Uncertainties".

Forward-looking information is subject to certain factors, including risks and uncertainties, which could cause actual results to differ materially from what management currently expects. These factors include risks inherent in the exploration and development of mineral deposits, risks relating to changes in iron ore prices and the worldwide demand for and supply of iron ore, uncertainties inherent in the estimation of mineral reserves and resources, risks relating to the remoteness of the Mary River Property including access and supply risks, reliance on key personnel, construction and operational risks inherent in the conduct of mining activities, including the risk of increases in capital and operating costs and the risk of delays or increased costs that might be encountered during the construction and development process, the risk of fluctuations in the Canadian/U.S. dollar exchange rate, regulatory risks, including risks relating to the acquisition of the necessary licenses and permits, financing, capitalization and liquidity risks, including the risk that the financing necessary to fund the exploration and development activities at the Mary River Property may not be available on satisfactory terms, or at all, environmental risks, including risks relating to climate change and the potential impact of global warming on project timelines and on construction and operating costs, and insurance risks. See "Risks and Uncertainties".

You should not place undue importance on forward-looking information and should not rely upon this information as of any other date. While the Company may elect to, the Company is under no obligation and does not undertake to update this information at any particular time, except as required by law.

#### **Disclosure and Internal Controls and Procedures**

During the most recent quarter end there were no changes in the Company's internal control over financial reporting that materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

#### **OVERVIEW**

Baffinland is a Canadian company that was formed pursuant to Articles of Incorporation under the *Business Corporation Act* (Ontario) on March 10, 1986. The Company owns three mining leases covering approximately 1,600 hectares in the Mary River area, Baffin Island, Nunavut, Canada. The Company is a mineral exploration and development company with a sole focus on the advancement of its Mary River Property (the "Project"), which consists of four high-grade hematite/magnetite deposits. The Project is in its early stages after having been originally discovered and studied in the 1960's. Favourable iron ore markets in the last few years, iron ore and steel industry consolidation, and technical advances in arctic mining and shipping have warranted further work on this potentially important new source of lump iron ore targeted at the European steel market.

The Definitive Feasibility Study (“DFS”) coordinated by Aker Solutions (formerly Aker Kvaerner E&C) was completed in February 2008. Aker Solutions completed an updated technical report on the Mary River Property, which was filed on SEDAR in March 2008 (the “Technical Report”). In June, 2008 Aker Solutions completed the Blue Sky Study investigating expansion beyond the 18 million tonnes per annum planned in the DFS.

On June 19, 2008, the Company announced the appointment of AMEC Americas Ltd. (“AMEC”) to provide engineering, procurement and construction management services (“EPCM”) for the Project including basic and detailed engineering services, logistics planning, procurement support and construction management services over the next six years. AMEC is a global organization with extensive corporate resources, a worldwide staff of over 20,000 people, a proven track record and more northern experience than any other engineering/construction company, with over \$30 billion of successful EPCM Northern Canadian projects completed or in progress.

In July 2008, the Company announced revised targets for the shipment of high grade iron ore under its Bulk Sample Program from the Mary River deposits to key European blast furnace operators in 2008. The Company now anticipates the shipping of between 120,000 tonnes and 150,000 tonnes of iron ore to steelmakers in three trial cargos, of which two will be lump iron ore and one of iron ore fines. The shipments will occur between the end of August and September 2008. A reduction in the amount of iron ore anticipated to be shipped in 2008 under this program is primarily due to the advent of an earlier than anticipated spring melt combined with severe rainfall in the later part of June resulting in a need for extensive construction and maintenance work along the full length of the 100-kilometre tote road to the shipping site at Milne Inlet. Haulage of the bulk sample on this road has been interrupted for approximately six weeks. Drier weather recently has helped expedite work on the road and full ore haulage is expected to resume by July 31, 2008.

Discussions with potential customers indicate that the revised bulk sample size will be sufficient to meet the original program objectives that being the final metallurgical test of the Mary River iron ore. The test results will be part of a “blast furnace technical report” that will be shared with potential customers and will form the basis for the negotiation of long-term sales and purchase agreements.

As of July 29, 2008, blasted ore under the revised bulk sample program totaled 166,956 tonnes, with 108,316 tonnes hauled to the crusher and 98,400 tonnes crushed. A total of 45,169 tonnes of ore has been hauled to Milne Inlet. An additional 40,000 to 50,000 tonnes of ore is scheduled to be mined and crushed during the month of August.

A detailed “port plan” has been developed with respect to the operations at Milne Inlet. Logistec Stevedoring Inc. and their subcontractor, Ocean Construction Inc., have secured the tug, ore barges and work boats required to support the loading of the bulk carriers that is currently expected to occur in August and September of 2008. A Charter Party has been executed with Fednav Limited to secure two new super-handimax vessels for the shipment of ore from Milne Inlet to Rotterdam.

If as a result of these steps the Company determines that the iron ore deposits on the Mary River Property have sufficient quality and quantity to take advantage of the present favourable market conditions for potential new iron ore producers, the Company hopes to advance the Mary River Property to a development stage. Based on information gathered to date production is now expected to begin in 2013 in order to build the stockpiles that will result in first commercial deliveries in 2014. This schedule assumes, among other things, that permits will be in hand to commence construction in the summer of 2010 and that the necessary debt and equity financing will be available as needed. There is no assurance that this financing will be obtained on

favourable terms, or at all. Failure to obtain such additional financing could result in the delay or indefinite postponement of further exploration and development of the Mary River Property. See "Risks and Uncertainties".

## Financial Quarter Summary

Set forth below is certain selected financial information in respect of the eight most recently completed quarters of the Company. This unaudited data is derived from the Company's financial statements which are prepared in accordance with Canadian GAAP.

### BALANCE SHEETS as at

\$000's (unaudited)

	Jun. 30	Mar. 31	Dec. 31	Sep. 30	Jun. 30	Mar. 31	Dec. 31	Sep. 30
	2008	2008	2007	2007	2007	2007	2006	2006
<b>ASSETS</b>								
Current	141,836	193,905	50,474	52,387	67,788	36,240	13,977	8,292
Restricted cash	5,407	5,407	-	-	-	-	-	-
Long term investments	14,407	14,407	14,907	17,907	-	-	-	-
Capital and mining Interest	69,428	13,187	12,383	12,347	9,422	5,307	846	880
	<u>231,078</u>	<u>226,906</u>	<u>77,764</u>	<u>82,641</u>	<u>77,210</u>	<u>41,547</u>	<u>14,823</u>	<u>9,172</u>
<b>LIABILITIES AND EQUITY</b>								
Current	26,352	21,068	19,656	27,853	9,824	3,762	2,670	6,409
Asset retirement obligation	509	476	-	-	-	-	-	-
Due to related parties								123
	<u>26,861</u>	<u>21,544</u>	<u>19,656</u>	<u>27,853</u>	<u>9,824</u>	<u>3,762</u>	<u>2,670</u>	<u>6,532</u>
Future income tax liability	-	-	10,302	3,971	-	2,223	3,651	450
	<u>26,861</u>	<u>21,544</u>	<u>29,958</u>	<u>31,824</u>	<u>9,824</u>	<u>5,985</u>	<u>6,321</u>	<u>6,982</u>
Shareholders' equity	<u>204,217</u>	<u>205,362</u>	<u>47,806</u>	<u>50,817</u>	<u>67,386</u>	<u>35,562</u>	<u>8,502</u>	<u>2,190</u>
	<u>231,078</u>	<u>226,906</u>	<u>77,764</u>	<u>82,641</u>	<u>77,210</u>	<u>41,547</u>	<u>14,823</u>	<u>9,172</u>
<b>WORKING CAPITAL</b>								
	115,484	172,837	30,818	24,534	57,964	32,478	11,307	1,760
Common shares outstanding (000's)	148,000	147,987	95,100	88,126	79,868	63,894	51,930	46,112

### STATEMENTS OF OPERATIONS for the three months ended

\$000's except per share (unaudited)

	Jun. 30	Mar. 31	Dec. 31	Sep. 30	Jun. 30	Mar. 31	Dec. 31	Sep. 30
	2008	2008	2007	2007	2007	2007	2006	2006
<b>INTEREST AND OTHER INCOME</b>	1,374	231	298	211	424	261	118	90
<b>EXPENSES</b>								
Administrative	2,511	4,403	5,514	3,835	1,835	1,520	1,297	955
Exploration	1,054	34,587	28,532	37,730	16,690	4,563	5,334	14,159
	<u>3,565</u>	<u>38,990</u>	<u>34,046</u>	<u>41,565</u>	<u>18,525</u>	<u>6,083</u>	<u>6,631</u>	<u>15,114</u>
Loss before income taxes	(2,191)	(38,759)	(33,748)	(41,354)	(18,101)	(5,822)	(6,513)	(15,024)
Future income tax recovery	-	10,301	6,709	20,597	2,223	1,428	2,399	4,200
<b>NET LOSS</b>	<u>(2,191)</u>	<u>(28,458)</u>	<u>(27,039)</u>	<u>(20,757)</u>	<u>(15,878)</u>	<u>(4,394)</u>	<u>(4,114)</u>	<u>(10,824)</u>
Net Loss per share	(\$0.01)	(\$0.29)	(\$0.30)	(\$0.26)	(\$0.23)	(\$0.07)	(\$0.08)	(\$0.24)

## FINANCIAL HIGHLIGHTS

The net loss recorded by the Company for the three months ended June 30, 2008 was \$2,191,022. This compared to a net loss of \$15,877,982 for the same period in 2007. The net loss for the six month period ended June 30, 2008 was \$10,376,113 higher than the same period of the previous year for the reasons noted below.

During the three month period ended June 30, 2008 the Company recorded interest and other income of \$1,374,280 as compared to \$424,148 for the same period in 2007. For the six month period ending June 30, 2008, interest and other income was \$1,605,149, an increase of \$920,340 over the same period of the previous year. Interest and other income was higher due to an increase in cash and cash equivalent balances during the period from the Equity Offering (as defined below) completed late in the first quarter of 2008. See "Capital Stock".

Professional fees for the second quarter of 2008 were \$200,846, an increase of \$26,967 as compared to the same period of 2007. For the six month period ended June 30, 2008, professional fees of \$662,022 were \$242,555 higher than the same period in 2007. The increase was a result of increased legal costs as well as fees related to the Equity Offering and listing of Common Shares on the TSX during 2008.

Office and general expenses were \$261,539 and \$301,184 higher respectively for the three and six months ended June 30, 2008 compared to 2007. The primary reason for these increases is related to increased expenditures including rent and supply costs resulting from an increase in staff.

Salaries of \$656,635 for the three month period ended June 30, 2008, represented an increase of \$104,796 as compared to the same period in 2007. For the six month period, salaries of \$1,306,054 were \$444,120 higher. The increase is due to the hiring of additional staff as a result of the Company's expansion of its exploration and project development activities.

Shareholder relation expenses for the three month period ended June 30, 2008 of \$85,589 increased by \$55,834 when compared to the same period of the previous year due to an increase in investor relation activities in 2008. For the six month period ended June 30 2008, shareholder relation expenses increased by \$19,060 to \$111,508.

Stock based compensation expenses for the second quarter June 30, 2008 were \$232,883 higher than the same period in 2007. For the six month period, stock based compensation expenses of \$3,098,862 were \$1,770,697 higher than the comparative period in 2007. The variances are related to the timing of option grants and the increase in the number of staff over the period who have received the options.

The impairment of the Company's long term investments is related to an impairment of certain asset backed commercial paper. The Company recorded \$500,000 impairment charge in the first quarter of 2008. Management has assessed the value of its asset backed commercial paper for the second quarter and determined that no adjustment is required at this time. See "Liquidity and Capital Resources".

For the three months ended June 30, 2008, amortization and accretion expenses decreased by \$3,851. Effective April 1, amortization for capital assets utilized in developing Deposit No. 1 is capitalized to mining interests resulting in a lower charge to amortization and accretion expense in the second quarter when compared to the same period in the prior year. For the six months ended June 30, 2008 amortization and accretion expenses have increased by \$285,572. The net increase is the result of capital asset additions in 2007 and 2008, which are now being amortized and offset by amounts capitalized to mining interests.

## OPERATIONS

On the basis of the completion of the DFS in February 2008 and the Equity Offering in the first quarter, effective April 1, 2008 the Company is capitalizing mine development expenditures related to the advancement of Deposit No. 1. Total expenditures of \$89,939,158 incurred during the six months ended June 30, 2008 were \$68,686,139 more than in the same period in 2007. For the second quarter of 2008, total expenditures of \$55,352,027 were \$38,661,892 higher than in the second quarter of 2007. The increases in the three and six month periods ended June 30, 2008 are due to the advancement of the revised bulk sample program, metallurgical test work, environmental baseline studies, and various studies related to the then in-progress DFS. Set forth below is certain information in respect of the Company's mine development expenditures.

### Mine Development and Exploration Expenditures for the six month period ended June 30

	<u>2008</u>	<u>2007</u>
Mine Development/Exploration	\$ 45,069,302	\$ 12,303,009
Definitive Feasibility Study	5,061,594	3,842,715
Bulk Sample and site preparation	32,890,451	-
Health and Safety	1,014,891	109,359
Environmental and Permitting	5,038,691	4,162,380
Metallurgical Testing	702,423	835,556
Marketing	161,806	-
	<u>\$ 89,939,158</u>	<u>\$ 21,253,019</u>

Effective April 1, 2008 the Company is capitalizing expenditures related to the development of Deposit No. 1. Of the aggregate \$89,939,158 spent in the six months ended June 30, 2008 relating to mine development, \$54,297,504 has been capitalized to mining interests.

The Technical Report completed in the first quarter of 2008 sets forth a number of recommendations to assist the Company in advancing the development of the Mary River Property, with particular emphasis on geotechnical and other field surveys and construction planning. The recommendations include the following:

- continuing with environmental baseline studies;
- carrying out an additional geotechnical program in 2008 and onward, including drilling, laboratory testing and geophysical programs, to better define actual conditions present and adjust design and costs accordingly;
- completing a near-surface drill program prior to detailed engineering;
- continuing near-surface step-out drilling on Deposit Nos. 1, 2 and 3;
- in order to maximise the in-pit reserves, in-fill drilling inside the pit limits, which may result in upgrading the inferred mineralised rock category to indicated or measured categories;

- defining the overburden surface accurately within the perimeter of the final pit, allowing for a more accurate slope design and a better estimate of the required waste stripping which may affect the drill, load and haul operations;
- more detailed geotechnical test work and study to define the pit slopes for different rock types, i.e., overburden, mineralised rock, and waste rock;
- defining water condition within the pit and waste dumps in order to finalise the slope stability analysis for both open-pit and waste dumps;
- conduct of drill and blastability tests in order to estimate a more accurate drill and blast pattern;
- continuing geotechnical investigations along the proposed rail alignment;
- specific geotechnical investigations for the tunnels and bridge crossings;
- continuing optimisation of the rail route alignment;
- completion of rail equipment specifications considering cold climatic requirements;
- collection of additional data for dock and causeway at Steensby;
- carrying out further optimisation of the dock design; and
- developing a more detailed schedule for construction considering various constraints, including possible environmental restrictions.

The Company continues to work on the foregoing recommendations with work continuing this year and into 2009 and 2010. The degree of progress with regards to these additional plans will depend on, among other things, the ability of the Company to obtain the necessary financing and permits. See "Risks and Uncertainties".

During the first quarter of 2008 the Company signed a land lease with the Qikiqtani Inuit Association (the "QIA") covering an estimated surface area of approximately 10,567 hectares on Baffin Island, Nunavut. The Company has provided a \$5,407,000 irrevocable letter of credit to the QIA which provides security for future reclamation and abandonment costs. In June 2008, the QIA advised the Company of an intent to review the adequacy of the level of security provided.

The letter of credit is renewable and expires in October 2009. The amount related to the letter of credit has been classified as restricted cash.

In March 2008 the Company submitted a Development Proposal and associated applications in order to initiate regulatory review of the Project. The Project as described in the Development Proposal involves the construction, operation, closure, and reclamation of a conventional 18 million tonnes per annum open pit mine at Deposit No. 1 consistent with the DFS.

In April 2008 the Nunavut Planning Commission ("NPC") completed a review of the proposed Project as the first step in the requisite regulatory review process under the Nunavut Land Claims Agreement ("NLCA"). The NPC deemed the Project to be in conformance to the North Baffin Land Use Plan and as a result of this determination the Nunavut Impact Review Board (the "NIRB") subsequently initiated an environmental screening of the Project. The NIRB completed its Decision Report in June 2008 and determined that the

Project requires a public review under Part 5 or 6 of the NLCA. The NIRB is awaiting a decision from the Minister of Indian and Northern Affairs on the Decision Report, including guidance with respect to a procedural concern raised by some parties as it relates to the conformity determination of the NPC.

In June 2008 the Company signed a Memorandum of Understanding with the QIA. Under the Memorandum, the parties have agreed to develop and promote the delivery of mine-related training, training related to economic and community development, labour market research, curriculum development, career development and other related activities for the benefit of Inuit in the communities associated with the Project. A key goal of the agreement is to facilitate Inuit participation in the construction of the Project, which is anticipated to commence in 2010.

The Company announced in June 2008 that Aker Solutions has completed a study for the potential expansion of the Project based on the development of a second open pit encompassing Deposits No. 2 and No. 3, located approximately three kilometres from Deposit No. 1. The study assumes that additional production beyond the 18 million tonnes per annum planned in the DFS would come on-line in the fourth year of production. The study is completed to a scoping level of detail, with an estimating confidence of +/- 20 percent.

Results from the study are consistent with management's expectations and the study will contribute to strategic planning for the Project. The majority of the resources included in the Deposit No. 2 and No. 3 open pit are classified as "inferred", which are considered too speculative geologically to have the economic considerations applied to them that would enable them to be categorised as mineral reserves, and there is no certainty that the conclusions of the study will be realized.

## **RELATED PARTY TRANSACTIONS**

During the three and six month period ended June 30, 2008 a related party controlled by a director and a shareholder paid \$19,500 (2007 - \$18,000) and \$39,000 (2007 - \$36,000) respectively. The payments to the Company related to lease and operating costs. These cost recoveries were included in office and general expenses and were in the normal course of business and are measured at the cost amount, which is the consideration established and agreed to between the related parties.

## **CAPITAL STOCK**

In January 2007, the Company raised gross proceeds of approximately \$30 million through the completion of a public offering of 10,909,100 units ("Units") at a price of \$2.75 per Unit. Each Unit was comprised of one Common Share and one-half of one Warrant, with each whole Warrant entitling the holder thereof to purchase one additional Common Share at a price of \$5.50 until January 31, 2012, subject to adjustment in certain events.

In March 2007, a private placement was completed for an aggregate of 1,054,875 Units at a price of \$2.75 per Unit, for total gross proceeds to the Company of approximately \$2.9 million. Each Unit was comprised of one Common Share and one-half of one Warrant, with each whole Warrant entitling the holder thereof to purchase one additional Common Share at a price of \$5.50 until January 31, 2012, subject to adjustment in certain events.

In June 2007, a flow-through private placement was completed for an aggregate of 15,973,505 Common Shares at a price of \$3.10 per share, for total gross proceeds to the Company of approximately \$49.5 million.

In July 2007, 5,000 Common Share purchase options were exercised for total gross proceeds to the Company of \$13,000.

In September 2007, a flow-through private placement was completed for an aggregate of 5,128,204 Common Shares at a price of \$3.90 per share, for total gross proceeds to the Company of approximately \$20 million.

In September 2007, a private placement was completed for an aggregate of 3,125,000 Common Shares at a price of \$3.20 per share, for total gross proceeds to the Company of approximately \$10 million.

In October 2007, 12,500 Common Share purchase options were exercised for total gross proceeds to the Company of \$32,500.

In November 2007, a flow-through private placement was completed for an aggregate of 6,961,839 Common Shares at a price of \$5.30 per share, for total gross proceeds to the Company of approximately \$37 million.

In March 2008, the Company completed a public equity offering pursuant to which 52,886,985 Common Shares were issued at a price of \$3.65 per Common Share for total gross proceeds to the Company of approximately \$193 million (the "Equity Offering").

In May 2008, 12,500 Common Share purchase options were exercised for total gross proceeds to the Company of \$32,500.

The issued and outstanding capital of the Company at June 30, 2008 was 147,999,553 Common Shares (on a non-fully diluted basis). As at June 30, 2008 the Company had 5,981,988 Warrants and 6,967,000 stock options outstanding.

## LIQUIDITY AND CAPITAL RESOURCES

Working capital was \$115,484,632 at June 30, 2008 compared to \$30,818,092 at December 31, 2007. The increase was primarily related to the completion of the Equity Offering, net of cash used during 2008.

During the first quarter, the Company provided \$5,407,000 in cash to support an irrevocable letter of credit to the QIA which provides security for future site reclamation and abandonment costs. The letter of credit is renewable and expires in October 2009 and has been classified as restricted cash.

In July and August of 2007, the Company invested a total of \$43,844,320 in the following asset backed commercial paper notes ("ABCP") with three separate trusts managed by the Coventree Capital Group Inc. ("Coventree"):

<u>Maturity Date</u>	<u>Issuer</u>	<u>Value Date</u>	<u>Nominal Value</u>
August 13, 2007	Structured Investment Trust III	July 3, 2007	\$9,949,500
August 13, 2007	Structured Investment Trust III	July 10, 2007	9,957,500
August 15, 2007	Skeena Capital Trust Series A	August 3, 2007	6,989,220
August 16, 2007	Lafayette Structured Credit Trust	August 2, 2007	6,987,400
August 30, 2007	Skeena Capital Trust Series A	July 30, 2007	<u>9,960,700</u>
			<u>\$43,844,320</u>

Of the approximately \$43.8 million that the Company invested in ABCP with Coventree, \$23,741,832 has been repaid. As at June 30, 2008, the Company held \$14,407,000 (face value - \$19,907,000) in Structured Investment Trust III Series A. This financial asset is classified as "held to maturity" and is measured at amortized cost. The maturity date of this ABCP was August 13, 2007. At the time the Company acquired this investment, the non-bank sponsored ABCP was rated as R-1 (High) by DBRS Limited ("DBRS"), the highest credit rating for commercial paper. In mid August 2007 a number of sponsors of non-bank managed ABCP, including those with which the Company had invested announced that they could not place ABCP due to unfavourable conditions in the Canadian capital markets.

DBRS placed certain of the ABCP vehicles ("conduits") "Under Review with Developing Implications" following the August 16, 2007 announcement that a group representing banks, asset providers and major investors had agreed in principle to a long-term proposal and interim agreement to convert the ABCP into term floating-rate notes ("FRNs") maturing no earlier than the scheduled termination dates of the underlying assets (the "Montreal Accord").

On September 6, 2007, a Pan-Canadian Investors Committee (the "Committee") consisting of a group of large ABCP investors was formed. The Committee subsequently retained Goodmans LLP and JP Morgan Chase as legal and financial advisors, respectively, to oversee the proposed restructuring process.

On December 23, 2007, the Committee announced that an agreement in principle had been reached regarding a comprehensive restructuring of the third party sponsored ABCP. The restructuring plan: (i) replaces the affected ABCP with long term notes whose maturity is similar to that of the underlying assets; (ii) pools certain series of the third party sponsored ABCP which are supported in whole or in part by underlying synthetic assets; and (iii) mitigates the margin call risk associated with many of the existing conduits (including Structured Investment Trust III - Series A) by reducing the probability of a margin call and also providing a credit facility to draw upon should a margin call occur.

On March 17, 2008, the Ontario Superior Court of Justice granted an application by the Committee under the Companies' Creditors Arrangement Act ("CCAA") establishing procedures for noteholder approval of the restructuring plan. Under the CCAA, the plan had to be approved by a majority of noteholders (regardless of the size of their holdings) as well as by noteholders representing not less than two thirds of the total aggregate principal amount of affected ABCP investments. At a meeting held on April 25, 2008, 96% of noteholders, by number and value endorsed the plan. The restructuring plan was sanctioned by the Ontario Superior Court of Justice on June 5, 2008.

On June 18, 2008 proceedings were taken by a number of corporate noteholders in the Ontario Court of Appeal seeking to challenge the Ontario Superior Court of Justice decision that sanctioned the restructuring plan. The Ontario Court of Appeal heard the appeal on June 25 and 26, 2008 and has not yet issued a decision on the matter.

Given the disruption in the third party sponsored ABCP market, quoted market values of such investments are not available. Accordingly, the Company has determined the fair value of its investments in ABCP using available information regarding the proposed restructuring, market conditions and other factors as at the measurement date. Should the restructuring plan be successful, the ABCP investments will be converted into new notes with maturities matching the underlying assets. The new notes will bear interest rates commensurate with the nature of the underlying assets less the cost of the margin funding facility and other administrative expenses.

Notwithstanding that the fact that the proposal is expected to go forward uncertainty remains as to whether a secondary market for the resulting securities will be develop after the restructuring. This impacts the ability to estimate the amount and timing of cash flows associated with the Company's ABCP investment.

Under a successful restructuring, the most significant variable in the valuation of the company's ABCP is the yield that prospective investors will require. Accordingly, the Company conducted a sensitivity analysis of the potential yield requirements to arrive at an estimated the fair value of its ABCP between \$13.2 million and \$15.2 million. Additionally, the Company used a probability weighted valuation technique to take into account two different scenarios: (1) the restructuring is successful and a market develops for the notes and (2) the restructuring is unsuccessful. Management has assigned a probability of 97% to the restructuring occurring as outlined above.

For the year ended December 31, 2007 the Company recorded a \$5,195,488 impairment charge as a reduction in fair value since the loss is considered to be other than temporary. An additional \$500,000 impairment charge was recorded in the first quarter of 2008. There have been no changes recorded during the second quarter.

The assumptions incorporated to value the investment are as follows:

Notes to be received	Amount (\$)	Settlement Date	Maturity Date	Effective Coupon <sup>(i)</sup>	Required Yield <sup>(ii)</sup>
<b>MAV2 Notes</b>					
A1	13,558,400	01/09/2008	31/12/2016	3.67%	7.17%
A2	3,211,200	01/09/2008	31/12/2016	3.67%	9.17%
B	535,200	01/09/2008	31/12/2016	0.00%	24.17%
C	535,200	01/09/2008	31/12/2016	0.00%	34.17%
<b>IA Tracking Notes</b>					
Class 14	2,160,000	01/09/2008	20/12/2012	4.41%	18.91%

(i) Estimated by converting the floating rate interest to a fixed rate by employing an interest rate swap

(ii) Estimated fixed yield to maturity required by prospective investors

Since the fair value of the resulting securities are determined using a discounted cash flow approach and are based on the Company's assessment of market conditions as at June 30, 2008, the fair values reported may change materially in subsequent periods.

No estimate of the restructuring costs, which have been stated as being immaterial by the restructuring committee, nor any interest income which may have been accrued since August 13, 2007, have been included in the fair value assessment due to a lack of verifiable information. Any interest income will be recognized on a cash basis.

Current assets at June 30, 2008 were \$141,836,191, compared to \$50,474,153 at December 31, 2007, an increase of \$91,362,038. Cash and cash equivalents increased by \$93,932,891 as a result of the completion of the Equity Offering offset by exploration and mine development expenditures incurred during the first and second quarter of 2008. Accounts receivable decreased by \$368,219 and prepaids increased by \$3,006,806. The decrease in accounts receivable is related to a decrease in GST and excise tax receivable due to payments being received. The increase in prepaids is due to prepayment of fuel scheduled for delivery during the third quarter. The decrease in inventory of \$5,209,440 is due to consumption of supplies. During the six months ended June 30, 2008 the Company spent approximately \$89,939,158 on exploration and mine development activities of which \$54,297,504 has been capitalized to mining interests.

Current liabilities at June 30, 2008 were \$26,351,559 compared to \$19,656,061 at December 31, 2007, an increase of \$6,695,498. The increase in current liabilities is a result of increased accounts payable due to increased exploration and development activity at the Mary River Property.

The Company spent \$2,403,751 on capital assets in the second quarter, which included the purchase of the Steensby camp. For the six month period ended June 30, 2008 the Company spent \$3,071,050 on capital assets to be utilized for the Project. The Company currently expects that a majority of the Company's expenditures for the balance of 2008 will be related to operational expenditures, an environmental impact assessment study, completion of the revised bulk sample and other activities to advance the exploration and development of the Mary River Property.

The Company filed the Technical Report related to the DFS on SEDAR and reported 365 million tonnes of proven and probable reserves at Deposit No. 1. Effective April 1, 2008 the Company commenced capitalization of its development expenditures related to Deposit No. 1.

The DFS estimates the initial capital costs, after a production decision is made, for the development of the Mary River Property to be \$4.1 billion at a production rate of 18 million tonnes per year, including all direct and indirect costs, contingencies and owner's costs. Sustaining capital is estimated to be \$400 million over the life of the Project, including project reclamation and closure costs. The following table provides an itemized summary for the estimated capital costs of the Project.

<b>Summary of Total Capital Costs</b>	
<b>Direct Costs</b>	<b>\$ Millions</b>
Mining .....	23
Mary River Site.....	591
Railway .....	1,215
Steensby Site .....	706
<b>Direct Costs Subtotal</b>	<b>2,535</b>
<b>Indirect Costs</b>	
Support.....	988
Owner's Costs.....	86
Gravel .....	29
Contingency.....	438
<b>Indirect Cost Subtotal .....</b>	<b>1,540</b>
<b>Initial Capital Cost Total .....</b>	<b>4,075</b>

The assumptions that are most sensitive in the capital cost estimate are the assumption of parity between the Canadian and US dollar during the construction period, the geotechnical design criteria for the rail corridor and assumptions regarding construction costs, and in particular labour and material costs. While the Company considered these assumptions to be reasonable based on information currently available to it, they may prove to be incorrect. The capital cost estimates are subject to certain factors, including risks and uncertainties, which could cause actual results to differ materially from what management expects. See "Risks and Uncertainties".

The Company's operating and capital expenditures are expected to substantially increase in subsequent years with the advancing of exploration and development activities. The amounts and timing of expenditures will depend on, among other things, the progress of ongoing exploration and development and on the Company's ability to finance such activities. The Company does not currently have sufficient funding to commence or complete the development of the Mary River Property. The Company's historical capital needs have been met by the issuance of equity securities. The Company will require substantial additional funds to further explore and develop the Mary River Property. The Company has limited financial resources and no current source of recurring revenue, and there is no assurance that additional funding will be available to the Company to carry out the completion of its planned exploration activities, for additional exploration or for the substantial capital that will be required in order to place the property into commercial production. In order to finance the development of the Mary River Property, the Company will have to issue additional equity, borrow sufficient funds from third party lenders or both. There can be no assurance that the Company will be able to obtain adequate financing in the future or that the terms of such financing will be favourable. Failure to obtain such additional financing could result in the delay or indefinite postponement of further exploration and development of the Mary River Property. The terms of any additional financing obtained by the Company could result in substantial dilution to the shareholders of the Company. See "Risks and Uncertainties".

## CAPITAL STOCK AND DEFICIT

Shareholders' equity at June 30, 2008 was \$204,216,606, compared to \$47,806,239 at December 31, 2007, an increase of \$156,410,367. This occurred as a result of the following:

Contributed surplus (fair value vested portion of stock options granted)	\$ 3,219,737
Capital stock	183,839,341
Deficit:	
Net loss for the period	(30,648,711)
	<u>\$ 156,410,367</u>

The following Common Shares and convertible securities of the Company were outstanding at July 29, 2008:

	Expiry Date	Exercise Price (Cdn\$)	Securities Outstanding	Common Shares on Exercise
Common shares				147,999,553
Warrants	January 31, 2012	\$5.50	5,981,988	5,981,988
Options	Feb 25/09 to Apr 1/13	1.00 to 4.40	6,967,000	6,967,000

## **OFF-BALANCE SHEET ITEMS**

The Company does not have any off-balance sheet arrangements.

## **RISKS AND UNCERTAINTIES**

An investment in the securities of the Company is subject to a number of risks. In addition to the other information contained in this management's discussion and analysis and the Company's other publicly filed disclosure documents, investors should give careful consideration to the following factors, which are qualified in their entirety by reference to, and must be read in conjunction with, the detailed information appearing elsewhere in this management's discussion and analysis. Any of the matters highlighted in these risk factors could have a material adverse effect on the Company's business prospects or financial condition and could result in a delay in the development of the Mary River Property.

### *Nature of the Company's Exploration Activities*

The exploration for and development of mineral deposits involves significant risks which even a combination of careful evaluation, experience and knowledge may not eliminate. Few properties that are explored are ultimately developed into producing mines. The Mary River Property is still in the exploration and development stage. Significant expenses will be required to establish additional ore reserves and to construct mining and material handling facilities at the Mary River Property. It is impossible to provide any assurance that the exploration programs planned by the Company will result in a profitable commercial mining operation.

### *Iron Ore Prices*

The development and success of the Mary River Property will be dependent, in part, on the future price of iron ore. Iron ore prices are subject to fluctuation and are affected by a number of factors which are beyond the control of the Company. Such factors include, but are not limited to, global and regional supply and demand, and the political and economic conditions of major iron-ore producing countries throughout the world. The price of iron ore has increased substantially in recent years, and future significant price declines could cause continued exploration and development of the Mary River Property to be impracticable.

The future trend in the price of iron ore cannot be predicted with any degree of certainty. The market price of iron ore affects the economics of any potential development project, as well as having an impact on the perceptions of investors with respect to the Mary River Property and the ability of the Company to raise capital. A decrease in the market price of iron ore could affect the Company's ability to finance the continued exploration and the development of the Mary River Property. There can be no assurance that the market price of iron ore will remain at current levels or that such prices will improve or that market prices will not fall.

### *Mineral Reserves and Resources*

The activities of the Company are directed towards the search, evaluation and development of iron ore deposits. There is no certainty that the expenditures to be made by the Company will result in discoveries of economic ore bodies. Whether the Mary River Property will be commercially viable depends on a number of factors, including: the particular attributes of the deposit, such as size, grade and proximity to infrastructure, steel and other metal prices, government regulations, and environmental protection. Many of these factors are outside of the control of the Company and the exact effect of these factors cannot accurately be predicted.

The Mary River Property consists of both mineral resources and mineral reserves. Mineral resources that are not mineral reserves do not have demonstrated economic viability. Due to the uncertainty that may attach to indicated mineral resources, there is no assurance that mineral resources will be upgraded to proven and probable ore reserves. Inferred mineral resources are considered too speculative geologically to have the economic considerations applied to them that would enable them to be categorized as mineral reserves.

### *Production Estimates May be Inaccurate*

No assurance can be given that production estimates for the Mary River Property as described in the DFS will be achieved. These production estimates are based on, among other things, the accuracy of reserve estimates, the accuracy of assumptions regarding ground conditions and physical characteristics of ores, such as hardness and presence or absence of particular metallurgical characteristics, and the accuracy of estimated rates and costs of mining and processing.

Actual production may vary from estimates for a variety of reasons, including actual ore mined varying from estimates of grade, tonnage, dilution and metallurgical and other characteristics, short-term operating factors relating to the mineral reserves, such as the need for sequential development of orebodies and the processing of new or different ore grades, risks and hazards associated with mining, natural phenomena, such as inclement weather conditions and unexpected labour shortages. Failure to achieve production estimates could have an adverse impact on the Company's future cash flows, earnings, results of operations, stated reserves and financial condition.

### *Mine Development and Completion*

Feasibility studies are used to determine the economic viability of a deposit. Many factors are involved in the determination of the economic viability of a deposit, including the achievement of satisfactory mineral reserve estimates, the level of estimated metallurgical recoveries, capital and operating estimates and the estimate of future commodity prices. Capital and operating cost estimates are based on many factors, including anticipated tonnage and grades of ore to be mined, the configuration of the ore body, ground and mining conditions, expected recovery rates of the ore and anticipated environmental and regulatory compliance costs. Each of these factors involves uncertainties and, as a result, the Company cannot give any assurance that the estimates in the DFS will be correct or that the Mary River Property will produce profitable operating mine(s). If a mine is developed, actual operating results may differ from those anticipated in the DFS. There can be no assurance that delays will not be experienced. Should there be any delays, such delays may result in an increase in capital requirements, costs and expenditures.

### *Mining Operations*

Mining operations generally involve a high degree of risk and potential future mining operations will be subject to the risks inherent in the mining industry, including fluctuations in fuel prices, commodity prices, exchange rates, metal prices, costs of constructing and operating a mine and processing facilities in a specific environment, the availability of economic sources of energy and the adequacy of water supplies, adequate access to the site, unanticipated transportation costs, delays and repair costs resulting from equipment failure, changes in the regulatory environment (including regulations relating to prices, royalties, duties, taxes, restrictions on production, quotas on exportation of minerals, as well as the costs of protection of the environment), and industrial accidents and labour actions or unrest. The Company is also subject to all the hazards and risks normally encountered in the exploration for, and development and production of iron ore, including variations in grade and other geological differences, surface or underground conditions, processing problems, mechanical equipment performance, accidents, labour disputes, force majeure risks and natural disasters. Such risks could result in: personal injury or fatality, damage to or destruction of mining properties, processing facilities or equipment, environmental damage, delays or reductions in mining production, monetary losses, and possible legal liability. The occurrence of any of these factors could materially and adversely affect the development of a project, and, as a result, materially and adversely affect the Company's business, financial condition, results of operations and cash flow.

### *Licenses and Permits*

The exploration of the Mary River Property requires licenses and permits from the Canadian government and the government of Nunavut and consents from third-parties. The current exploration and bulk sample programs were approved in 2007 pursuant to the federal and territorial environmental assessment processes, and licenses and permits have been issued accordingly. In the first quarter of 2008, the Company received permit amendments facilitating operational enhancements to its exploration and geotechnical program. The Company has or expects to have all of the permits that it requires to execute the work currently planned under these programs and does not currently anticipate that the necessary permits will not be in place to execute such programs.

If the exploration of the Mary River Property warrants the development of the Mary River Property into a commercial mine, then the Company will require additional permits to mine the Mary River Property. In order to develop a mine at the Mary River Property, the Company must secure necessary licenses, permits and third party consents after first successfully completing regulatory review in accordance with the requirements of the Nunavut Land Claims Agreement and any other applicable legislation, including the successful negotiation of an Inuit Impact and Benefits Agreement (the "IIBA") with the QIA. There can be no guarantee that the Company will be able to complete the regulatory review process(es), successfully negotiate the IIBA and obtain or maintain all necessary licenses, permits and third-party consents that may be required to explore and, if warranted, develop and mine the Mary River Property.

The Company's rights to the Mary River Property mineral deposits are held in the form of leases from the Canadian government. If the Company fails to meet the specific requirements of a lease, the lease may terminate or expire. There can be no assurance that any of the obligations required to maintain each lease will be met. The termination or expiration of the Company's leases would have a material adverse effect on the Company's business prospects and financial condition.

### ***Regulatory and Environmental Risks***

The mineral exploration activities of the Company are subject to various laws governing prospecting, development, production, taxes, labour standards and occupational health, mine safety, toxic substances and other matters. Mining and exploration activities are also subject to various laws and regulations relating to the protection of the environment. Although the exploration activities of the Company are currently carried out in accordance with all applicable rules and regulations, no assurance can be given that new rules and regulations will not be enacted or that existing rules and regulations will not be applied in a manner which could limit or curtail exploration, production or development. Amendments to current laws and regulations governing the operations and activities of the Company or the more stringent implementation thereof could have a substantial adverse impact on the Company.

### ***Climate Change***

Canada ratified the Kyoto Protocol to the United Nations Framework Convention on Climate Change in late 2002 and the Kyoto Protocol came into effect in Canada in February 2005. Various levels of governments in Canada are developing a number of policy measures in order to meet Canada's emission reduction obligations under the protocol. While the impact of the protocol and these measures cannot be quantified at this time, the likely effect will be to increase costs for fossil fuels, electricity and transportation, restrict industrial emission levels, impose added costs for emissions in excess of permitted levels and increase costs for monitoring and reporting.

In addition, the effects of global warming could include, among other things, increased temperatures, precipitation and evaporation, which in turn could lead to melting permafrost and an increase in active layer depth on Baffin Island. These and other effects of climate change may require additional costs in the development of the Mary River Property, including with respect to the design and construction of the Company's infrastructure.

### ***Remote Northern Location***

The Mary River Property, because of its remote northern location and limited accessibility, is subject to special climate and transportation risks. These risks include the inability to operate or to operate efficiently during periods of extreme cold, the unavailability of materials and equipment, and unanticipated transportation costs. Adverse weather conditions may also prevent the operation of equipment on land, in the air or on the ocean. Such factors can add to the cost of mine exploration, development, production and operation, thereby affecting the Company's financial condition.

### ***Equipment and Supplies***

A shortage of equipment and supplies could affect the Company's ability to operate. The Company is dependent on various supplies and equipment to carry out its exploration activities and mining operations. The shortage of supplies, equipment and parts could have a material adverse effect on its ability to carry out its operations and therefore limit or increase the cost of exploration and related activities.

### ***Infrastructure***

Development and exploration activities depend on adequate infrastructure, including reliable roads, power sources, water supply, storage, rail and port facilities. The Company's inability to secure adequate access to such infrastructure, as well as other events outside of its control, such as extreme weather, sabotage, government or other interference in the maintenance or provision of such infrastructure, could adversely affect the Company's operations and financial condition.

### ***Capitalization, Commercial Viability and Dilution***

The Company does not currently have sufficient funding to commence or complete the development of the Mary River Property. The Company's historical capital needs have been met by the issuance of Common Shares. The Company will require substantial additional funds to further explore and develop the Mary River Property. The Company has limited financial resources and no current source of recurring revenue, and there is no assurance that additional funding will be available to the Company to carry out the completion of its planned exploration activities, for additional exploration or for the substantial capital that will be required in order to place the property into commercial production. In order to finance the development of the Mary River Property, the Company will have to issue additional equity, borrow sufficient funds from third party lenders or both. There can be no assurance that the Company will be able to obtain adequate financing in the future or that the terms of such financing will be favourable. Failure to obtain such additional financing could result in the delay or indefinite postponement of further exploration and development of the Mary River Property. The terms of any additional financing obtained by the Company could result in substantial dilution to the shareholders of the Company.

It is a goal of the Company to add one or more minority strategic partners. However, there can be no assurance that a strategic investor will invest in the Company or that such investment will be on favourable terms. Any future equity investment by a strategic investor could result in the dilution of the existing shareholders of the Company.

### ***Future Profitability Depends on the Success of the Mary River Property***

The Mary River Property is the Company's only property, and the Company anticipates that substantially all of its net income in the future will come from the Mary River Property. There are no assurances that the Company will be able to successfully complete commission and operate the Mary River Property. If it is unable to do so, its ability to generate net income will be materially adversely affected.

### ***The Company Expects to Incur Losses for the Foreseeable Future***

The Company has incurred losses since its inception and the Company expects to incur losses for the foreseeable future. The Company expects to continue to incur losses unless and until such time as the Mary River Property enters into commercial production and generates sufficient revenues to fund continuing operations. The Mary River Property is the Company's only property and its development will require the commitment of substantial financial resources. The amount and timing of expenditures will depend on a number of factors, including the progress of ongoing exploration and development, the results of consultants' analysis and recommendations and the rate at which operating losses are incurred. If the Company is unable to develop the Mary River Property into a profitable commercial mining operation and/or acquire additional properties, then the Company will have no source of revenue or income, and there can be no assurance that the Company will ever achieve profitability.

### *Exchange Rate Fluctuations*

Iron ore is priced and sold in U.S. dollars, and many, but not all, of the Company's expected operating and capital costs are also priced in U.S. dollars. As a result, the Company expects to be affected by changes in the Canadian dollar/U.S. dollar exchange rate. The Canadian dollar/U.S. dollar exchange rate has varied significantly over the last several years. The Company does not currently use foreign currency options and forward foreign exchange contracts to purchase Canadian dollars in order to hedge against the effects of currency fluctuations.

### *Competition*

The mining industry is intensely competitive in all of its phases, and the Company competes with many companies possessing greater financial resources and technical facilities than itself with respect to the recruitment and retention of qualified employees and other persons to carry out its mineral exploration activities. Recent increases in commodity prices have encouraged increases in exploration, development and construction activities, which have resulted in increased demand for, and cost of, exploration, development and construction services and equipment (including mining fleet equipment). Increased demand for services and equipment could cause project costs to increase materially, resulting in delays if services or equipment cannot be obtained in a timely manner due to inadequate availability, and could increase potential scheduling difficulties and costs due to the need to coordinate the availability of services or equipment, any of which could materially increase project exploration, development or construction costs or result in project delays or both. Any such material increase in costs would adversely affect the Company's results of operations and financial condition.

### *Insurance*

In the course of the exploration, development and production of mineral properties, several risks and, in particular, unexpected or unusual geological or operation conditions, may occur. It is not always possible to fully insure against such risks, and the Company may decide not to take out insurance against such risks as a result of high premiums or other reasons. Should such liabilities arise they could materially adversely affect the financial condition of the Company.

The Company is not insured against most environmental risks. Insurance against environmental risks (including potential liability for pollution or other hazards as a result of the disposal of waste products occurring from exploration and production) has not been generally available to companies within the mining industry. The Company periodically evaluates the cost and coverage of the insurance against certain environmental risks to determine if it would be appropriate to obtain such insurance. Without such insurance, the payment of any such environmental liabilities for which the Company becomes responsible could materially adversely affect the financial condition of the Company.

### *Reliance on Key Personnel*

The Company's success depends in large measure on the continued contributions of certain of the Company's executive officers and other key management and personnel, certain of whom would be difficult to replace. The loss of the services of such key personnel could have a material adverse effect on the Company. The Company does not maintain key person insurance.

### *Limited History*

The Company has no history of mining iron ore and the Mary River Property is still in the exploration and development stage. The future development of the Mary River Property will require the construction and operation of a mine and related infrastructure. The costs, timing and complexities of mine construction and development are increased by the remote northern location of the Mary River Property. It is common in new mining operations to experience unexpected problems and delays during construction, development, and mine start-up. In addition, delays in the commencement of mineral production often occur. Accordingly, there are no assurances that the Company's activities will result in profitable mining operations, that the Company will successfully establish mining operations or profitably produce iron ore, or that the Company will meet any of its current timelines or schedules.

### **CONTRACTUAL OBLIGATIONS**

The following table lists, as of June 30, 2008, information with respect to the Company's contractual obligations:

	<b>Payments Due By Period</b>				
	<b>Total</b>	<b>Less than 1 year</b>	<b>1-3 Years</b>	<b>3-4 Years</b>	<b>After 5 Years</b>
Office Lease	\$ 341,300	\$ 146,300	\$ 195,000	\$ -	\$ -
Land Lease	1,056,000	528,000	528,000	-	-
Asset Retirement Obligation	5,407,000	-	-	-	5,407,000
Contractor Obligation	7,000,000	7,000,000	-	-	-
<b>Total</b>	<b>\$ 13,804,300</b>	<b>\$ 7,674,300</b>	<b>\$ 723,000</b>	<b>\$ -</b>	<b>\$ 5,407,000</b>

Contractual obligations exclude expenses of a fixed nature expected to be incurred in the normal course of business.

### **OUTLOOK**

The Company intends to achieve its objective of continuing to explore and develop the Mary River Property through the following activities:

- completion of the bulk sample ore shipments in the third quarter of 2008;
- establish commitments with several key construction contractors associated with the 2009 pre-construction mobilization;
- develop a bulk sample reclamation plan and complete demobilization of selected equipment from the bulk sample program in 2009;
- continuing the consultation process with the local communities on Baffin Island and in Nunavut that is expected to lead to the development of an IIBA by the end of 2009;
- continue exploration, geotechnical and geo-mechanical drilling programs during the 2008, 2009 and 2010 field seasons;

- obtaining the necessary approvals to stage equipment and materials at Milne Inlet, Steensby Inlet and Mary River in the summer of 2009 in order to facilitate construction commencement in 2010;
- continue with environmental baseline and Inuit traditional knowledge studies, and complete a Draft Environmental Impact Statement to advance the regulatory program;
- completion of the basic engineering and the definitive capital cost estimate for construction at the Mary River Property by early 2010; and
- addition of one or more minority strategic partners.

Basic engineering for the Project is anticipated to be completed in early 2010, leading to the definitive capital cost estimate for control during project construction. With regulatory approval to stage equipment and materials in 2009 and completion of the regulatory process in 2010, it is expected that project construction will then proceed, with commissioning and start-up of the Project anticipated in early 2014. Full commercial ore shipments are scheduled to commence in May 2014, with 11.8 million tonnes delivered to market in that year.

In order to advance the development of the Mary River Property the Company will be required to obtain additional equity and/or debt financing, and there is no assurance that this financing will be obtained on favourable terms, or at all. Failure to obtain such additional financing could result in the delay or indefinite postponement of further exploration and development of the Mary River Property. See “Risks and Uncertainties”.

## **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

### **New Accounting Standards**

#### **Capital Disclosures and Financial Instruments – Disclosures and Presentation**

On December 1, 2006, the Canadian Institute of Chartered Accountants (“CICA”) issued three new accounting standards: Capital Disclosures (Handbook Section 1535), Financial Instruments – Disclosures (Handbook Section 3862), and Financial Instruments – Presentation (Handbook Section 3863). These new standards became effective for the Company on October 1, 2007.

#### **International Financial Reporting Standards (“IFRS”)**

In 2006, the Canadian Accounting Standards Board (“AcSB”) published a new 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”) and IFRS over an expected five year transitional period. In February 2008 the AcSB announced that January 1, 2011 is the changeover date for publicly-listed companies to use IFRS, replacing GAAP, effecting interim and annual financial statements relating to fiscal years after this time. The transition date of January 1, 2011 will require the restatement for comparative purposes of amounts reported by the Company for the year ended December 31, 2010. The Company is currently assessing the impact of the convergence of Canadian GAAP with IFRS on results of operations, financial position and disclosures. A project team has been set up to manage this transition and to ensure successful implementation within the required timeframe. The Company will provide disclosures of the key elements of our plan and progress on this transition as the information becomes available during the transition period.

## **Capital Disclosures**

Handbook Section 1535 specifies the disclosure of (i) an entity's objectives, policies and processes for managing capital; (ii) quantitative data about what the entity regards as capital; (iii) whether the entity has complied with any capital requirements; and (iv) if it has not complied, the consequences of such non-compliance. The disclosure recommended by the Handbook is as follows:

The Company manages its capital structure and makes adjustments to it, based on the funds available to the Company, in order to support the exploration and development of mineral property. The Board of Directors does not establish quantitative return on capital criteria for management, but rather relies on the expertise of the Company's management to sustain future development of the business.

The property in which the Company currently has an interest is in the development stage and the Company is dependent on external financing to fund its activities. In order to carry out planned exploration and development and pay for administrative costs, the Company will spend its existing working capital and raise additional amounts as needed.

Management reviews its capital management approach on an ongoing basis and believes that this approach, given the relative size of the Company, is reasonable.

There were no changes in the Company's approach to capital management during the three months ended June 30, 2008. The Company is not subject to externally imposed capital requirements.

## **Financial Instruments**

Handbook Sections 3862 and 3863 replace Handbook Section 3861, Financial Instruments – Disclosure and Presentation, revising and enhancing its disclosure requirements, and carrying forward unchanged its presentation requirements. These new sections place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks.

The Company's risk exposures and the impact on the Company's financial instruments are summarized below:

### **Credit risk**

The Company's credit risk is primarily attributable to ABCP and accounts receivables. The Company has no significant concentration of credit risk arising from operations. Short-term investments consist of guaranteed investment certificates, which have been invested with reputable financial institutions with original maturities of less than 90 days and management believes the risk of loss to be remote. Accounts receivable consist of goods and services tax due from the Federal Government of Canada. Management believes that the credit risk concentration with respect to accounts receivable is remote.

### **Liquidity risk**

The Company's approach to managing liquidity risk is to ensure that it will have sufficient liquidity to meet liabilities when due. As at June 30, 2008, the Company had a cash balance of \$132,074,811 (December 31, 2007 - \$38,141,920) to settle current liabilities of \$25,611,269 (December 31, 2007 - \$19,656,061).

**Interest rate risk**

The Company has cash balances and no interest-bearing debt. The Company's current policy is to invest excess cash in investment-grade short-term deposit certificates issued by Canadian banking institutions. The Company periodically monitors the investments it makes and is satisfied with the credit ratings of its banks.

**Foreign currency risk**

The Company's functional currency is the Canadian dollar and major purchases are transacted in Canadian dollars. The Company funds certain exploration and administrative expenses on a transaction by transaction basis using US dollar currency converted from its Canadian dollar bank accounts held in Canada. Management believes the foreign exchange risk derived from currency conversions is negligible and therefore does not hedge its foreign exchange risk.

**Price risk**

The Company is exposed to price risk with respect to iron ore prices. The price of iron ore has increased substantially in recent years, however future significant price declines could cause continued exploration and development of the Mary River Property to be impracticable.

**Sensitivity analysis**

The Company has designated its cash and cash equivalents as held-for-trading, which are measured at fair value.

As of June 30, 2008, the carrying amount of accounts receivable equals fair market value.

Based on management's knowledge and experience of financial markets, the Company believes the following movements are "reasonably possible" over a six month period:

- Cash and cash equivalents include deposits which are at variable interest rates. Sensitivity to a plus or minus 1% change in rates would affect net loss by \$1,136,000.
- The Company does not hold significant balances in foreign currencies to give rise to exposure to foreign exchange risk.
- Price risk is remote since the Company is not presently a producing entity.

**Going Concern**

Management has prepared its financial statements using accounting principles applicable to a going concern, which assumes continuity of operations and realization of assets and settlement of liabilities in the normal course of business. Should the going concern assumption no longer be valid, adjustments would be required to the carrying values of assets and liabilities and to the reported expenses and balance sheet classifications. These adjustments could be material.

### **Use of estimates**

The preparation of financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount of revenues and expenses during the reported period. These estimates are reviewed periodically, and as adjustments become necessary, they are made in the period in which they become known. Actual results could differ materially from these estimates.

### **Fair value of financial instruments**

The carrying value of cash and cash equivalents accounts receivable and accounts payable approximate their fair values due to their immediate or short term nature.

### **Development Stage Entity**

The Company has adopted the Accounting Guideline 11 – Enterprises in the Development Stage (AcG11), relating to enterprises in the development stage, as detailed by the Canadian Institute of Chartered Accountants. The Company is devoting its efforts to activities of raising capital and exploring for natural resources which may lead to the feasibility of developing the Mary River Property.

### **Exploration Expenditures**

The Company expenses exploration expenditures as incurred. However, costs related to property acquisitions are capitalized. Development expenditures on the property will be capitalized once mineral reserves have been established. Development costs together with the cost of mining interests will be charged to operations on a units-of-production method based on estimated recoverable reserves. If the mining interests are abandoned, or if an impairment in asset values has been determined, the capitalized costs will be reduced to fair value through a charge to operations.

### **Stock Based Compensation**

Compensation expense is recognized in equal instalments over the vesting period of the options issued. The expense is determined using an option pricing model that takes into account the exercise price, the term of the options, the current stock price, the expected volatility of the underlying shares, the expected dividend yield and the risk free rate for the term of the option.

**BAFFINLAND IRON MINES CORPORATION**  
A Development Stage Entity

**Interim Financial Statements**  
Second Quarter, June 30, 2008  
(Unaudited)

**BAFFINLAND IRON MINES CORPORATION****(Development Stage Entity)****BALANCE SHEETS****(Unaudited)**

	<b>As At June 30 2008</b>	<b>As At December 31 2007</b>
	<u>                    </u>	<u>                    </u>
<b>ASSETS</b>		
<b>Current</b>		
Cash and cash equivalents (Note 5)	\$ 132,074,811	\$ 38,141,920
Accounts receivable	2,794,491	3,162,710
Inventory (Note 7)	3,437,446	8,646,886
Prepaid expenses	3,529,443	522,637
	<u>141,836,191</u>	<u>50,474,153</u>
<b>Restricted Cash (Note 6)</b>	5,407,000	-
<b>Mining interests (Note 8 )</b>	54,761,952	1
<b>Long term investments (Note 9)</b>	14,407,000	14,907,000
<b>Capital assets (Note 10)</b>	14,665,522	12,382,573
	<u>\$ 231,077,665</u>	<u>\$ 77,763,727</u>
<b>LIABILITIES</b>		
<b>Current</b>		
Accounts payable	\$ 26,351,559	\$ 19,656,061
<b>Asset retirement obligation (Note 11)</b>	509,500	-
<b>Future income tax liability (Note 14)</b>	-	10,301,427
	<u>26,861,059</u>	<u>29,957,488</u>
<b>SHAREHOLDERS' EQUITY AND DEFICIT</b>		
<b>Capital stock (Note 12)</b>	333,017,434	149,178,093
<b>Warrants (Note 12)</b>	3,023,371	3,023,371
<b>Contributed surplus (Note 12)</b>	10,133,540	6,913,803
<b>Deficit</b>	<u>(141,957,739)</u>	<u>(111,309,028)</u>
	<u>204,216,606</u>	<u>47,806,239</u>
	<u>\$ 231,077,665</u>	<u>\$ 77,763,727</u>

Nature of operations and going concern (Note 1)

Contingencies and commitments (Note 17)

The accompanying notes are an integral part of the financial statements

**BAFFINLAND IRON MINES CORPORATION**  
**(Development Stage Entity)**  
**STATEMENTS OF OPERATIONS AND COMPREHENSIVE LOSS AND DEFICIT**  
(Unaudited)

	Three Months Ended June 30		Six Months Ended June 30		Cumulative from January 1
	2008	2007	2008	2007	2003
Interest and other income	\$1,374,280	\$424,148	\$1,605,149	\$684,809	\$4,170,319
Expenses					
Exploration	1,054,522	16,690,135	35,641,653	21,253,023	173,475,667
Amortization and accretion	46,559	50,410	385,052	99,480	1,026,215
Salaries	656,635	551,839	1,306,054	861,934	4,739,957
Stock-based compensation (Note 13)	932,001	699,118	3,098,862	1,328,165	9,034,168
Office and general	523,533	261,994	763,171	461,987	2,598,316
Professional fees	200,846	173,879	662,022	419,467	2,645,931
Shareholder relations	85,589	29,755	111,508	92,448	894,743
Travel	65,617	68,255	86,965	91,866	620,429
Impairment of long term investments (Note 9)			500,000		5,695,488
	<u>3,565,302</u>	<u>18,525,385</u>	<u>42,555,287</u>	<u>24,608,370</u>	<u>200,730,914</u>
Net loss for the period before taxes	(2,191,022)	(18,101,237)	(40,950,138)	(23,923,561)	(196,560,595)
Future income tax recovery (Note 14)	-	2,223,255	10,301,427	3,650,963	57,957,276
Net loss & comprehensive loss for the period	(2,191,022)	(15,877,982)	(30,648,711)	(20,272,598)	(138,603,319)
Deficit, beginning of period	<u>(139,766,717)</u>	<u>(47,635,346)</u>	<u>(111,309,028)</u>	<u>(43,240,730)</u>	
Deficit, end of period	<u>(\$141,957,739)</u>	<u>(\$63,513,328)</u>	<u>(\$141,957,739)</u>	<u>(\$63,513,328)</u>	
Net loss per share (Note 16)	<u>(\$0.01)</u>	<u>(\$0.23)</u>	<u>(\$0.25)</u>	<u>(\$0.32)</u>	

# BAFFINLAND IRON MINES CORPORATION

(Development Stage Entity)

## STATEMENTS OF CASH FLOWS

(Unaudited)

	Three Months Ended		Six Months Ended		Cumulative from
	June 30		June 30		January 1
	2008	2007	2008	2007	2003
<b>Operating activities</b>					
Loss for the period	(\$2,191,022)	(\$15,877,982)	(\$30,648,711)	(\$20,272,598)	(\$138,603,319)
Items not effecting cash:					
Amortization and accretion expense	46,559	50,410	385,052	99,480	1,026,215
Stock-based compensation	932,001	699,118	3,098,862	1,328,165	9,034,168
Future income tax recovery	-	(2,223,255)	(10,301,427)	(3,650,963)	(57,957,276)
Impairment of long term investments	-	-	500,000	-	5,695,488
Other non cash items	-	-	-	-	(275,542)
Decrease (increase) in accounts receivable	(1,343,731)	(1,192,925)	368,219	(1,127,018)	(2,794,449)
Decrease (increase) in inventory	3,555,245	(2,143,066)	5,209,440	(2,143,066)	(3,437,446)
(Increase) decrease in prepaid expenses	(3,255,433)	574,716	(3,006,806)	(15,441)	(3,529,443)
Increase (decrease) in accounts payable	5,283,336	6,062,290	6,695,498	7,154,884	26,351,559
Capitalized mining costs included in accounts payable	(25,867,779)	-	(25,867,779)	-	(25,867,779)
	<u>(22,840,824)</u>	<u>(14,050,694)</u>	<u>(53,567,652)</u>	<u>(18,626,557)</u>	<u>(190,357,824)</u>
<b>Investing activities</b>					
Change in restricted cash	-	-	(5,407,000)	-	(5,407,000)
Purchase of capital assets	(2,403,751)	(4,165,916)	(3,071,050)	(8,675,569)	(16,094,786)
Capitalized mining costs	(27,849,875)	-	(27,849,875)	-	(27,849,875)
Increase in long term investments	-	-	-	-	(20,102,488)
	<u>(30,253,626)</u>	<u>(4,165,916)</u>	<u>(36,327,925)</u>	<u>(8,675,569)</u>	<u>(69,454,149)</u>
<b>Financing activities</b>					
Increase in bank debt	-	-	-	-	16,600,000
Repayment of bank debt	-	-	-	-	(16,600,000)
Decrease in due to related parties	-	-	-	-	(132,421)
Net proceeds on issue of common shares and warrants	(18,489)	47,002,585	183,828,468	77,828,038	392,019,205
	<u>(18,489)</u>	<u>47,002,585)</u>	<u>183,828,468)</u>	<u>77,828,038)</u>	<u>391,886,784)</u>
<b>Increase (decrease) in cash</b>	<b>(53,112,939)</b>	<b>28,785,975)</b>	<b>93,932,891)</b>	<b>50,525,912)</b>	<b>132,074,811)</b>
<b>Cash position at beginning of period</b>	<b>185,187,750)</b>	<b>34,191,220)</b>	<b>38,141,920)</b>	<b>12,451,283)</b>	<b>-)</b>
<b>Cash position at end of period</b>	<b>\$132,074,811)</b>	<b>\$62,977,195)</b>	<b>\$132,074,811)</b>	<b>\$62,977,195)</b>	<b>\$132,074,811)</b>

**BAFFINLAND IRON MINES CORPORATION**  
**(Development Stage Entity)**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE SIX MONTH PERIOD ENDED JUNE 30, 2008**  
**(Unaudited)**

**1. NATURE OF OPERATIONS AND GOING CONCERN**

Baffinland Iron Mines Corporation (the "Company") was formed pursuant to Articles of Incorporation under the *Business Corporation Act* (Ontario) on March 10, 1986.

The Company has non-producing iron ore interests located on Baffin Island, Nunavut, Canada.

These unaudited financial statements have been prepared using Canadian generally accepted accounting principles ("Canadian GAAP") applicable to a going concern, which assumes continuity of operations and realization of assets and settlement of liabilities in the normal course of business. For the six month period ended June 30, 2008, the Company reported a loss after tax of \$30.6 million, an accumulated deficit of \$142.0 million as at that date and has not generated cash flow from operations. The Company is in the development stage and is subject to the risks and challenges similar to other companies in a comparable stage of development. These risks include, but are not limited to, continuing losses, dependence on key individuals, successful development and the ability to secure adequate financing to meet the minimum capital required to successfully complete the project and continue as a going concern. There is no assurance that these initiatives will be successful and as a result there is substantial doubt regarding the going concern assumption. These financial statements do not reflect the adjustments to the carrying values of assets and liabilities and the reported expenses and balance sheet classifications that would be necessary were the going concern assumption inappropriate. These adjustments could be material.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The unaudited financial statements have been prepared in accordance with Canadian GAAP for interim financial information. Accordingly, they do not include all of the information and notes to the financial statements required by Canadian GAAP for annual financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included.

The interim financial statements have been prepared by management in accordance with the accounting policies described in the Company's annual audited financial statements for the year ended December 31, 2007 and the new accounting standards described below. For further information, refer to the audited financial statements and notes thereto for the year ended December 31, 2007.

## NOTES TO THE FINANCIAL STATEMENTS (cont'd)

### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

#### **International Financial Reporting Standards ("IFRS")**

On February 13, 2008 the CICA Accounting Standards Board announced the adoption of IFRS for publicly accountable enterprises. IFRS will replace Canadian GAAP. The implementation will apply to interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. We are currently assessing the impact of the convergence of Canadian GAAP with IFRS on our results of operations, financial position and disclosures.

#### **Asset retirement obligations**

Future costs to retire an asset including dismantling, remediation and on-going treatment and monitoring of the site are recognized and recorded as a liability at fair value. The liability is accreted over time through periodic charges to earnings. The asset retirement costs are capitalized as part of the assets carrying value and amortized over the assets useful life.

#### **Capital Disclosures and Financial Instruments - Disclosures and Presentation**

On December 1, 2006, the CICA issued three new accounting standards: Capital Disclosures (Handbook Section 1535), Financial Instruments - Disclosures (Handbook Section 3862), and Financial Instruments - Presentation (Handbook Section 3863). These new standards became effective for the Company on January 1, 2008.

#### **Capital Disclosures**

Handbook Section 1535 specifies the disclosure of (i) an entity's objectives, policies and processes for managing capital; (ii) quantitative data about what the entity regards as capital; (iii) whether the entity has complied with any capital requirements; and (iv) if it has not complied, the consequences of such noncompliance. The Company has included disclosures recommended by the new Handbook section in note 3 to these interim financial statements.

#### **Financial Instruments**

Handbook Sections 3862 and 3863 replace Handbook Section 3861, Financial Instruments - Disclosure and Presentation, revising and enhancing its disclosure requirements, and carrying forward unchanged its presentation requirements. These new sections place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks. The Company has included disclosures recommended by the new Handbook section in note 4 to these interim financial statements.

## NOTES TO THE FINANCIAL STATEMENTS (cont'd)

### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont'd)

#### **Mining interests and exploration and development costs**

The Company expenses exploration expenditures as incurred. However, costs related to property acquisitions are capitalized. Effective April 1, 2008 development expenditures related to Deposit 1 on the property are being capitalized since mineral reserves have been established. Development costs together with the cost of mining interests will be charged to operations on a units-of-production method based on estimated recoverable reserves upon commencement of commercial production. If the mining interests are abandoned, management determines that the value of the mining interests are impaired, the costs will be reduced to fair value through a charge to operations.

### 3. CAPITAL MANAGEMENT

The Company manages its capital structure and makes adjustments to it, based on the funds available to the Company, in order to support the exploration and development of mineral properties. The Board of Directors does not establish quantitative return on capital criteria for management, but rather relies on the expertise of the Company's management to sustain future development of the business.

The property in which the Company currently has a 100% mining interest is in the development stage and the Company is dependent on external financing to fund its activities. In order to carry out planned exploration and development and pay for administrative costs, the Company will spend its existing working capital and raise additional amounts as needed.

Management reviews its capital management approach on an ongoing basis and believes that this approach, given the relative size of the Company, is reasonable.

There were no changes in the Company's approach to capital management during the six months ended June 30, 2008 compared to the year ended December 31, 2007. The Company is not subject to externally imposed capital requirements.

### 4. FINANCIAL RISK FACTORS

The Company's risk exposures and the impact on the Company's financial instruments are summarized below:

#### **Credit risk**

The Company's credit risk is primarily attributable to asset backed commercial paper (see note 9) and accounts receivables. The Company has no significant concentration of credit risk arising from operations. Cash equivalents consist of guaranteed investment certificates, which have been invested with reputable financial institutions with original maturities of less than 90 days and management believes the risk of loss to be remote. Accounts receivable consist of goods and services tax due from the Federal Government of Canada. Management believes that the credit risk concentration with respect to accounts receivable is remote.

## NOTES TO THE FINANCIAL STATEMENTS (cont'd)

### 4. FINANCIAL RISK FACTORS (cont'd)

#### **Liquidity risk**

The Company's approach to managing liquidity risk is to ensure that it will have sufficient liquidity to meet liabilities when due. As at June 30, 2008, the Company had a cash balance of \$132,074,811, (December 31, 2007 - \$38,141,920) to settle current liabilities of \$26,351,559 (December 31, 2007 - \$19,656,061).

#### **Interest rate risk**

The Company has cash balances and no interest-bearing debt. The Company's current policy is to invest excess cash in investment-grade short-term deposit certificates issued by Canadian banking institutions. The Company periodically monitors the investments it makes and is satisfied with the credit ratings of its banks.

#### **Foreign currency risk**

The Company's functional currency is the Canadian dollar and major purchases are transacted in Canadian dollars. The Company funds certain exploration and administrative expenses on a transaction by transaction basis using US dollar currency converted from its Canadian dollar bank accounts held in Canada. Management believes the foreign exchange risk derived from currency conversions is negligible and therefore does not hedge its foreign exchange risk.

#### **Price risk**

The Company is exposed to price risk with respect to iron ore prices. The price of iron ore has increased substantially in recent years, and future significant price declines could cause continued exploration and development of the Mary River Property to be uneconomical.

#### **Sensitivity analysis**

The Company has designated its cash and cash equivalents as held-for-trading, which are measured at fair value. Accounts receivable are classified as loans and receivables, which are measured at amortized cost. Accounts payable and accrued liabilities are classified as other financial liabilities, which are measured at amortized cost.

As of June 30, 2008, the carrying amount of accounts receivable equals fair market value.

## NOTES TO THE FINANCIAL STATEMENTS (cont'd)

### 4. FINANCIAL RISK FACTORS (cont'd)

Based on management's knowledge and experience of the financial markets, the Company believes the following movements are "reasonably possible" over a six month period:

- Cash and cash equivalents include deposits which are at variable interest rates. Sensitivity to a plus or minus 1% change in rates would affect net loss by \$1,136,000 for the six month period ended June 30, 2008.
- The Company does not hold significant balances in foreign currencies to give rise to exposure to foreign exchange risk.
- Price risk is remote since the Company is not a producing entity.

### 5. CASH AND CASH EQUIVALENTS

	June 30 2008	December 31 2007
Cash and cash equivalents are comprised of:		
Cash	\$ 10,629,934	\$ 20,329,740
Guaranteed Investment Certificates	121,444,877	17,812,180
	<u>\$ 132,074,811</u>	<u>\$ 38,141,920</u>

### 6. RESTRICTED CASH

The Company has provided \$5,407,000 in cash to support an irrevocable letter of credit which provides security for future reclamation and abandonment costs.

### 7. INVENTORY

Inventory consists of supplies inventory that are recorded at the lower of cost and replacement value, where cost is determined using the average cost method. Inventory is comprised of:

	June 30 2008	December 31 2007
Fuel	\$ 2,231,980	\$ 5,758,177
Supplies	1,205,466	2,009,750
Explosives	-	878,959
	<u>\$ 3,437,446</u>	<u>\$ 8,646,886</u>

## NOTES TO THE FINANCIAL STATEMENTS (cont'd)

### 8. MINING INTERESTS

The Company has a 100% interest in three mining leases in the Mary River area of Baffin Island, Nunavut, Canada. The term of the leases are 21 years and are due for renewal in 2013. Effective April 1, 2008, the Company is capitalizing costs related to Deposit 1 at the Mary River Project. Mining interests is comprised of:

	June 30 2008	December 31 2007
Balance at January 1	\$ 1	\$ 1
Asset Retirement Obligation asset incurred	464,447	-
Development costs capitalized	54,297,504	-
Balance at June 30	<u>\$ 54,761,952</u>	<u>\$ 1</u>

### 9. LONG TERM INVESTMENTS

#### Asset-Backed Commercial Paper ("ABCP")

As at June 30, 2008, the Company held \$14,407,000 (face value - \$19,907,000) of non-bank sponsored ABCP invested in Structured Investment Trust III Series A. This financial asset is classified as held to maturity and is measured at amortized cost. The maturity date of this ABCP was August 13, 2007. At the time the Company acquired this investment, the non-bank sponsored ABCP was rated as R-1 (High) by DBRS Limited ("DBRS"), the highest credit rating for commercial paper. In mid August 2007 a number of sponsors of non-bank managed ABCP, including those with which the Company had invested announced that they could not place ABCP due to unfavourable conditions in the Canadian capital markets.

DBRS placed certain of the ABCP vehicles ("conduits") "Under Review with Developing Implications" following the August 16, 2007 announcement that a group representing banks, asset providers and major investors had agreed in principle to a long-term proposal and interim agreement to convert the ABCP into term floating-rate notes ("FRNs") maturing no earlier than the scheduled termination dates of the underlying assets (the "Montreal Accord").

On September 6, 2007, a Pan-Canadian Investors Committee (the "Committee") consisting of a group of large ABCP investors was formed. The Committee subsequently retained Goodmans LLP and JP Morgan Chase as legal and financial advisors, respectively, to oversee the proposed restructuring process.

On December 23, 2007, the Committee announced that an agreement in principle had been reached regarding a comprehensive restructuring of the third party sponsored ABCP. The restructuring plan: (i) replaces the affected ABCP with long term notes whose maturity is similar to that of the underlying assets; (ii) pools certain series of the third party sponsored ABCP which are supported in whole or in part by underlying synthetic assets; and (iii) mitigates the margin call risk associated with many of the existing conduits (including Structured Investment Trust III - Series A) by reducing the probability of a margin call and also providing a credit facility to draw upon should a margin call occur.

## NOTES TO THE FINANCIAL STATEMENTS (cont'd)

### 9. LONG TERM INVESTMENTS (cont'd)

On March 17, 2008, the Ontario Superior Court of Justice granted an application by the Committee under the Companies' Creditors Arrangement Act (CCAA) establishing procedures for noteholder approval of the restructuring plan. Under the CCAA, the plan had to be approved by a majority of noteholders (regardless of the size of their holdings) as well as by noteholders representing not less than two thirds of the total aggregate principal amount of affected ABCP investments. At a meeting held on April 25, 2008, 96% of noteholders, by number and value endorsed the plan. The restructuring plan was then sanctioned by the Ontario Superior Court of Justice on June 5, 2008.

On June 18, 2008 proceedings were taken by a number of corporate noteholders in the Ontario Court of Appeal seeking to challenge the Ontario Superior Court of Justice decision that sanctioned the restructuring plan. The Ontario Court of Appeal heard the appeal on June 25 and 26, 2008 and has not yet issued a decision on the matter.

Given the disruption in the third party sponsored ABCP market, quoted market values of such investments are not available. Accordingly, the Company has determined the fair value of its investments in ABCP using available information regarding the proposed restructuring, market conditions and other factors as at the measurement date. Should the restructuring plan be successful, the ABCP investments will be converted into new notes with maturities matching the underlying assets. The new notes will bear interest rates commensurate with the nature of the underlying assets less the cost of the margin funding facility and other administrative expenses.

Notwithstanding that the fact that the proposal is expected to go forward uncertainty remains as to whether a secondary market for the resulting securities will be develop after the restructuring. This impacts the ability to estimate the amount and timing of cash flows associated with the Company's ABCP investment.

Under a successful restructuring, the most significant variable in the valuation of the company's ABCP is the yield that prospective investors will require. Accordingly, the Company conducted a sensitivity analysis of the potential yield requirements to arrive at an estimated the fair value of its ABCP between \$13.2 million and \$15.2 million. Additionally, the Company used a probability weighted valuation technique to take into account two different scenarios: (1) the restructuring is successful and a market develops for the notes and (2) the restructuring is unsuccessful. Management has assigned a probability of 97% to the restructuring occurring as outlined above.

For the year ended December 31, 2007 the Company recorded a \$5,195,488 impairment charge as a reduction in fair value since the loss is considered to be other than temporary. An additional \$500,000 impairment charge was recorded in the first quarter. There have been no changes recorded during the second quarter.

## NOTES TO THE FINANCIAL STATEMENTS (cont'd)

### 9. LONG TERM INVESTMENTS (cont'd)

The assumptions incorporated to value the investment are as follows:

Notes to be received	Amount (\$)	Settlement Date	Maturity Date	Effective Coupon <sup>(i)</sup>	Required Yield <sup>(ii)</sup>
<b>MAV2 Notes</b>					
A1	13,558,400	01/09/2008	31/12/2016	3.67%	7.17%
A2	3,211,200	01/09/2008	31/12/2016	3.67%	9.17%
B	535,200	01/09/2008	31/12/2016	0.00%	24.17%
C	535,200	01/09/2008	31/12/2016	0.00%	34.17%
<b>IA Tracking Notes</b>					
Class 14	2,160,000	01/09/2008	20/12/2012	4.41%	18.91%

(i) Estimated by converting the floating rate interest to a fixed rate by employing an interest rate swap

(ii) Estimated fixed yield to maturity required by prospective investors

Since the fair value of the resulting securities are determined using a discounted cash flow approach and are based on the Company's assessment of market conditions as at June 30, 2008, the fair values reported may change materially in subsequent periods.

No estimate of the restructuring costs, which have been stated as being immaterial by the restructuring committee, nor any interest income which may have been accrued since August 13, 2007, have been included in the fair value assessment due to a lack of verifiable information. Any interest income will be recognized on a cash basis.

### 10. CAPITAL ASSETS

Capital assets are comprised of:

	June 30, 2008			December 31, 2007		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Infrastructure and equipment	\$ 11,700,059	\$ 1,280,730	\$ 10,419,329	\$ 5,551,776	\$ 521,030	\$ 5,030,746
Furniture & fixtures	85,901	41,343	44,558	85,901	33,503	52,398
Leasehold improvements	119,410	51,920	67,490	119,410	39,980	79,430
Computer equipment	128,387	55,270	73,117	120,923	46,650	74,273
Construction in process	4,061,028	-	4,061,028	7,145,726	-	7,145,726
	<u>\$ 16,094,785</u>	<u>\$ 1,429,263</u>	<u>\$ 14,665,522</u>	<u>\$ 13,023,736</u>	<u>\$ 641,163</u>	<u>\$ 12,382,573</u>

Amounts included in construction in process are not being amortized.

## NOTES TO THE FINANCIAL STATEMENTS (cont'd)

### 11. ASSET RETIREMENT OBLIGATION

The Company's asset retirement obligation is associated with its iron ore property and is as follows:

	June 30 2008	December 31 2007
Balance at January 1	\$ -	\$ -
Liabilities incurred	464,448	-
Accretion expense	45,052	-
Balance at June 30	<u>\$ 509,500</u>	<u>\$ -</u>

At June 30, 2008 the estimated total undiscounted amount required to settle the asset retirement obligation was \$5,407,000 million (2007 - \$ nil). This has been discounted using a credit adjusted risk free rate of 9.7%. A substantial portion of these obligations are not expected to be paid until 2042.

### 12. CAPITAL STOCK

**Authorized:** Unlimited common shares

**Issued:**

	Number of shares	Amount \$
<b>December 31, 2006</b>	51,930,045	\$ 47,093,202
Share financing - public equity offering January, 2007	10,909,100	25,182,902
Share financing - private placement March, 2007	1,054,875	2,616,090
Share financing - flow through private placement June, 2007	15,973,505	29,506,061 <sup>(i)</sup>
Exercise of share purchase options July, 2007	5,000	22,000
Share financing - private placement September, 2007	3,125,000	9,384,350
Share financing - flow through private placement September, 2007	5,128,204	11,764,497 <sup>(ii)</sup>
Share financing - flow through private placement November, 2007	6,961,839	23,553,991 <sup>(iii)</sup>
Exercise of share purchase options November, 2007	<u>12,500</u>	<u>55,000</u>
<b>December 31, 2007</b>	95,100,068	149,178,093
Share financing - public equity offering March, 2008	52,886,985	183,795,966
Exercise of share purchase options May, 2008	<u>12,500</u>	<u>43,375</u>
<b>June 30, 2008</b>	<u>147,999,553</u>	<u>\$ 333,017,434</u>

- i. Net future income tax liability of \$17,499,614 recorded on renunciation of flow through expenditures.
- ii. Net future income tax liability of \$7,067,997 recorded on renunciation of flow through expenditures.
- iii. Net future income tax liability of \$13,039,664 recorded on renunciation of flow through expenditures.

In January 2007, the Company raised gross proceeds of approximately \$30 million through the completion of a public equity offering (the "Equity Offering") of 10,909,100 units at a price of \$2.75 per unit. Each unit was comprised of one Common Share and one-half of one Common Share purchase warrant, with each whole warrant ("Warrant") entitling the holder thereof to purchase one additional Common Share at a price of \$5.50 for a period of 5 years commencing from January 31, 2007, subject to adjustment in certain events.

## NOTES TO THE FINANCIAL STATEMENTS (cont'd)

### 12. CAPITAL STOCK (cont'd)

In March 2007, an investor exercised its right to participate in the Equity Offering and to subscribe on a private placement basis for an aggregate of 1,054,875 units at a price of \$2.75 per unit, for total gross proceeds to the Company of approximately \$2.9 million. Each unit consisted of one Common Share of the Company and one-half of one Warrant. Each whole Warrant entitled the holder to purchase one additional Common Share at a price of \$5.50 per Common Share until January 31, 2012, subject to adjustment in certain events.

The fair value attributed to the warrants issued in January and March was \$3,023,371 using the following assumptions under the Black-Scholes model:

Expected volatility - 60%  
Risk-free interest rate - 4%  
Term - 3 years  
Exercise price - \$5.50  
No dividends

In June 2007, a flow-through private placement was completed for an aggregate of 15,973,505 common shares at a price of \$3.10 per share, for total gross proceeds to the Company of approximately \$49.5 million.

In September 2007, a flow-through private placement was completed for an aggregate of 5,128,204 common shares at a price of \$3.90 per share, for total gross proceeds to the Company of approximately \$20 million.

In September 2007, a private placement was completed for an aggregate of 3,125,000 common shares at a price of \$3.20 per share, for total gross proceeds to the Company of approximately \$10 million.

In November 2007, a flow-through private placement was completed for an aggregate of 6,961,839 common shares at a price of \$5.30 per share, for total gross proceeds to the Company of approximately \$36.9 million.

In March 2008, the Company raised gross proceeds of approximately \$193 million through the completion of a public equity offering of 52,886,985 common shares at a price of \$3.65 per common share.

#### Contributed Surplus:

Balance, December 31, 2006	\$	4,649,523
Stock-based compensation		2,295,780
Exercise of share purchase options		(31,500)
Balance, December 31, 2007	\$	6,913,803
Stock-based compensation		3,230,612
Exercise of share purchase options		(10,875)
Balance, June 30, 2008	\$	<u>10,133,540</u>

## NOTES TO THE FINANCIAL STATEMENTS (cont'd)

### 13. STOCK-BASED COMPENSATION

#### Stock options

At a special meeting of shareholders held on January 15, 2004, approval was given to an incentive stock option plan. The Company can set aside up to 10% of its shares issued and outstanding at the time of granting of options to directors, officers, employees, management company employees or consultants. There is an 18 month vesting period for the options granted; 25% are available the day of the grant with a further 25% available on each six month anniversary of the grant. The terms of the awards under the plan are determined by the Board of Directors. The options granted to date have a five year term. Compensation expense and contributed surplus will be recognized over the options vesting period which is 25% on the grant date and the remaining 75% being recognized equally over the remaining vesting period which is 18 months.

#### Stock option disclosure:

A summary of the status of the Company's stock option plan as at June 30, 2008 and December 31, are presented in the following table:

	2008		2007	
	Number	Weighted Average	Number	Weighted Average
Outstanding, beginning	5,060,500	\$ 2.07	4,223,000	\$ 1.93
Granted	1,934,000	4.28	855,000	2.76
Exercised	(12,500)	2.60	(17,500)	2.60
Cancelled	(15,000)	4.07	-	-
Outstanding, ending	<u>6,967,000</u>	<u>\$ 2.68</u>	<u>5,060,500</u>	<u>\$ 2.07</u>

As at June 30, 2008 stock options available for exercise is 5,280,250 at a weighted average price of \$2.23 and the aggregate fair value of unvested stock options granted is \$3,219,303.

The fair market value of stock options granted was estimated using the Black Scholes fair value option-pricing model and the following assumptions were used:

Date options granted	Risk-free Interest rate	Expected Stock Volatility
February 6, 2007	5.00%	81%
April 11, 2007	5.00%	79%
May 31, 2007	5.00%	79%
October 1, 2007	5.00%	77%
January 7, 2008	5.00%	75%
March 31, 2008	5.00%	74%

No dividend yield is assumed and the weighted average expected life is 5 years for all stock options granted to date.

## NOTES TO THE FINANCIAL STATEMENTS (cont'd)

### 13. STOCK-BASED COMPENSATION (cont'd)

Option pricing models require the use of subjective estimates and assumptions including the expected stock price volatility. Changes to these estimates and assumptions may materially affect the calculations. Stock-based compensation calculations have no effect on the Company's cash position.

Using the fair value method, amortization of stock based compensation for stock options issued and outstanding for the three and six months ended June 30, 2008 was \$1,063,751 (2007 - \$699,118) and \$3,230,612 (2007 - \$1,328,165) respectively. In the second quarter, \$131,750 of stock based compensation amortization related to stock options awards to employees working at the Mary River site was capitalized to mining interests.

NOTES TO THE FINANCIAL STATEMENTS (cont'd)

14. INCOME TAXES

The Company's income tax provision (recovery) has been calculated as follows:

	<u>June 30</u> <u>2008</u>	<u>June 30</u> <u>2007</u>
Net loss for the period before taxes	(40,950,138)	(23,923,561)
Income tax recovery at Canadian federal and provincial statutory rates	(13,398,250)	(8,454,235)
Change in valuation allowance	2,082,923	4,333,899
Permanent differences	1,013,900	469,353
Recovery of income taxes	<u>(10,301,427)</u>	<u>(3,650,983)</u>

The components of the recovery of income taxes comprise:

Future income tax recovery	<u>(10,301,427)</u>	<u>(3,650,983)</u>
Net income tax recovery	<u>(10,301,427)</u>	<u>(3,650,983)</u>

The components of the Company's future income tax assets and liabilities are summarized as follows:

	<u>June 30</u> <u>2008</u>	<u>December 31</u> <u>2007</u>
<b>Future Income Tax Assets</b>		
Exploration & Development	4,075,000	2,902,000
Non-capital losses carried forward	3,767,000	1,891,000
Other temporary differences	5,612,000	2,193,000
Net future income tax asset	13,454,000	6,986,000
Valuation Allowance	(13,454,000)	(6,986,000)
Net future income tax asset recorded	<u>-</u>	<u>-</u>
<b>Future Income Tax Liabilities</b>		
Flow through share issuance	-	(7,341,286)
Inventory	-	(2,829,261)
Prepays	-	(130,880)
Net future income tax liability	<u>-</u>	<u>(10,301,427)</u>

## NOTES TO THE FINANCIAL STATEMENTS (cont'd)

### 14. INCOME TAXES (cont'd)

The Company has recorded a valuation allowance in respect of tax losses and other attributes valued at \$13,454,000 (December 31, 2007 - \$6,986,000).

### 15. RELATED PARTY TRANSACTIONS

During the three and six month period ended June 30, 2008 a related party controlled by a director and a shareholder paid approximately \$19,500 (2007 - \$36,000) and \$39,000 (2007 - \$36,000) respectively. The payments to the Company were in relation to lease and operating costs. Cost recoveries were included in office and general expense and were in the normal course of business and are measured at the cost amount, which is the consideration established and agreed to between the related parties.

### 16. NET LOSS PER SHARE

Net loss per share is calculated using the weighted average number of common shares outstanding during the year. No effect has been given to the potential exercise of stock options and warrants in the calculation of fully diluted loss per share as the effect would be anti-dilutive. The weighted average number of common shares outstanding for the three and six month periods ending June 30, 2008 amounted to 147,992,685 (2007 - 63,736,513) and 122,568,999 (2007 - 68,282,346) respectively.

### 17. CONTINGENCIES AND COMMITMENTS

Under the terms of existing lease agreements for office space, the Company is committed to annual lease payments of approximately \$146,300 plus operating costs. During the first six months of 2008 the Company paid approximately \$134,600 (2007 - \$120,000) in lease and operating costs. The lease agreement has an initial five year term and includes a one time right to renew the lease. As at June 30, 2008, there are two years and two months remaining on the initial term of the lease.

The Company signed a letter of intent in July 2006 with a construction company which is engaged to upgrade the Mary River road. The Company committed to pay \$2,206,781 over a six month period beginning April 1, 2008 and ending August 31, 2008. As at June 30, 2008, there is approximately \$1,200,000 outstanding on this commitment.

The Company entered into an agreement in July 2007 with a contractor to mine a bulk sample. The total value of the services to be performed during 2008 is estimated to be approximately \$30 million. The Company may amend the scope of work to be performed by providing 90 days notice to the contractor. Upon completion of services or termination of the agreement, the Company is responsible for demobilization of the contractor's equipment.

The Company signed a land lease with the Qikiqtani Inuit Association (the "QIA") covering an estimated surface area of approximately 10,567 hectares on Baffin Island, Nunavut. The Company is required to pay annual rent of \$528,000 in 2008 and 2009. The lease expires October 31, 2009. Baffinland has also provided a \$5,407,000 irrevocable letter of credit to the QIA which provides security for future reclamation and abandonment costs. The Letter of Credit is renewable and expires in October 2009.

## NOTES TO THE FINANCIAL STATEMENTS (cont'd)

### 17. CONTINGENCIES AND COMMITMENTS (cont'd)

On April 1, 2008, the Company entered into a contract with Canarail Consultants Inc. ("Canarail"). The Company has committed to pay Canarail approximately \$22 million over the next three years for design, engineering and regulatory process support services for the railway project on Baffin Island.

On June 18, 2008, the Company signed a letter of intent with AMEC to commence the services to be performed as a result of the award of the engineering, procurement, and construction management ("ECPM") contract. The Company will be negotiating a six year contract to commence after the letter of intent has expired in December 2008. The expected value of services to be provided by AMEC over the next six years is \$146 million.