



**BAFFINLAND IRON MINES CORPORATION**

**4<sup>th</sup> QUARTER REPORT**

**December 31, 2007**



**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION  
FOR THE YEAR ENDED DECEMBER 31, 2007**

## 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 year ended December 31, 2007, and its financial position as at December 31, 2007, and should be read in conjunction with 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 March 10, 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 and other plans and intentions in order to advance the development of the Mary River iron ore deposits (the "Mary River Property"), including the timing for completion and submission of a development proposal and associated applications, completion of a "Blue Sky" scoping study, 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 2008 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 Controls and Procedures**

Disclosure controls and procedures are designed to provide reasonable assurance that all relevant information relating to the operation of the Company is gathered and provided to senior management, including the President and Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO"), on a timely basis so that decisions can be made regarding the Company's disclosure to the public. As at December 31, 2007, the CEO and the CFO of the Company have evaluated the system of disclosure controls and procedures in the Company as set out by Canadian securities laws. Based on that evaluation, the CEO and the CFO have concluded that the disclosure controls and procedures were effective in providing reasonable assurance that information required to be disclosed in the Company's annual and interim filings and other reports filed or submitted under Canadian securities laws is recorded, processed, summarized and reported within the time frames specified by those laws and that material information is accumulated and communicated to management of the Company, including the CEO and CFO, as appropriate to ensure timely disclosure of that information.

### **Internal Controls over Financial Reporting**

The Company's CEO and CFO have designed the Company's internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Company's financial statements in accordance with Canadian generally accepted accounting principles as at December 31, 2007.

During the year ended December 31, 2007, there were no changes in the Company's internal controls over financial reporting that materially affected, or are reasonably likely to materially affect, the Company's internal controls 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, 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 Kvaerner E&C, a division of Aker Kvaerner Canada Inc. ("Aker Kvaerner"), was completed in February 2008. Aker Kvaerner completed an updated technical report on the Mary River Property, which was filed in March 2008 (the "Technical Report"). Aker Kvaerner is also working on a Blue Sky Study investigating expansion to 30 million tonnes per year, which is scheduled for completion in the second quarter of 2008.

Site preparation is underway for a 250,000 tonne bulk sample with expected shipment in the 2008 ice-free period from Milne Inlet. This bulk sample is expected to provide several potential long-term customers the opportunity for extended production-scale, geological and metallurgical evaluation of Mary River lump ore in their blast furnaces. Results of this evaluation, if positive, will complete the final metallurgical confirmation of the Mary River iron deposits as a source of quality lump and fine iron ore and should form the basis for negotiation of long-term marketing contracts, which if concluded is expected to support the financing of the Mary River Property. The proposed bulk sample is dependant on, among other things, obtaining the necessary financing.

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".

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

**BALANCE SHEETS as at**

| \$000's                           | Dec. 31<br><u>2007</u> | Dec. 31<br><u>2006</u> | Dec. 31<br><u>2005</u> |
|-----------------------------------|------------------------|------------------------|------------------------|
| <b>ASSETS</b>                     |                        |                        |                        |
| Current                           | 50,474                 | 13,976                 | 20,102                 |
| Long term investments             | 14,907                 | -                      | -                      |
| Capital                           | <u>12,383</u>          | <u>846</u>             | <u>101</u>             |
|                                   | <u>77,764</u>          | <u>14,822</u>          | <u>20,203</u>          |
| <b>LIABILITIES AND EQUITY</b>     |                        |                        |                        |
| Current                           | 19,656                 | 2,669                  | 694                    |
| Due to related parties            | -                      | -                      | 123                    |
|                                   | <u>19,656</u>          | <u>2,669</u>           | <u>817</u>             |
| Future income tax liability       | <u>10,302</u>          | <u>3,651</u>           | <u>5,000</u>           |
|                                   | 29,958                 | 6,320                  | 5,817                  |
| Shareholders' equity              | <u>47,806</u>          | <u>8,502</u>           | <u>14,386</u>          |
|                                   | <u>77,764</u>          | <u>14,822</u>          | <u>20,203</u>          |
| WORKING CAPITAL                   | 30,818                 | 11,307                 | 19,285                 |
| COMMON SHARES OUTSTANDING (000's) | 95,100                 | 51,930                 | 44,112                 |

**STATEMENTS OF OPERATIONS for the three years ended**

\$000's except per share

|                            | Dec. 31<br><u>2007</u> | Dec. 31<br><u>2006</u> | Dec. 31<br><u>2005</u> |
|----------------------------|------------------------|------------------------|------------------------|
| INTEREST AND OTHER INCOME  | <u>1,194</u>           | <u>1,145</u>           | <u>155</u>             |
| <b>EXPENSES</b>            |                        |                        |                        |
| Administrative             | 12,704                 | 4,440                  | 1,649                  |
| Exploration                | <u>87,515</u>          | <u>26,474</u>          | <u>15,035</u>          |
|                            | <u>100,219</u>         | <u>30,914</u>          | <u>16,684</u>          |
| Loss before taxes          | (99,025)               | (29,769)               | (16,529)               |
| Future income tax recovery | <u>30,957</u>          | <u>8,699</u>           | <u>5,900</u>           |
| NET LOSS                   | <u>(68,068)</u>        | <u>(21,070)</u>        | <u>(10,629)</u>        |
| Net Loss per share         | <u>(\$0.91)</u>        | <u>(\$0.46)</u>        | <u>(\$0.32)</u>        |

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)               | Dec. 31<br>2007         | Sep. 30<br>2007 | Jun. 30<br>2007 | Mar. 31<br>2007 | Dec. 31<br>2006 | Sep. 30<br>2006 | Jun. 30<br>2006 | Mar. 31<br>2006 |
|-----------------------------------|-------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| ASSETS                            | Restated <sup>(1)</sup> |                 |                 |                 |                 |                 |                 |                 |
| Current                           | 50,474                  | 52,387          | 67,788          | 36,240          | 13,977          | 8,292           | 14,256          | 18,690          |
| Long term investments             | 14,907                  | 17,907          | -               | -               | -               | -               | -               | -               |
| Capital                           | 12,383                  | 12,347          | 9,422           | 5,307           | 846             | 880             | 156             | 99              |
|                                   | <u>77,764</u>           | <u>82,641</u>   | <u>77,210</u>   | <u>41,547</u>   | <u>14,823</u>   | <u>9,172</u>    | <u>14,412</u>   | <u>18,789</u>   |
| LIABILITIES AND EQUITY            |                         |                 |                 |                 |                 |                 |                 |                 |
| Current                           | 19,656                  | 27,853          | 9,824           | 3,762           | 2,670           | 6,409           | 2,042           | 270             |
| Due to related parties            | -                       | -               | -               | -               | -               | 123             | 123             | 123             |
|                                   | <u>19,656</u>           | <u>27,853</u>   | <u>9,824</u>    | <u>3,762</u>    | <u>2,670</u>    | <u>6,532</u>    | <u>2,165</u>    | <u>393</u>      |
| Future income tax liability       | 10,302                  | 3,971           | -               | 2,223           | 3,651           | 450             | 2,900           | 4,400           |
|                                   | <u>29,958</u>           | <u>31,824</u>   | <u>9,824</u>    | <u>5,985</u>    | <u>6,321</u>    | <u>6,982</u>    | <u>5,065</u>    | <u>4,793</u>    |
| Shareholders' equity              | <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>9,347</u>    | <u>13,996</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>    | <u>14,412</u>   | <u>18,789</u>   |
| WORKING CAPITAL                   | 30,818                  | 24,534          | 57,964          | 32,478          | 11,307          | 1,760           | 12,091          | 18,297          |
| Common shares outstanding (000's) | 95,100                  | 88,126          | 79,868          | 63,894          | 51,930          | 46,112          | 44,112          | 44,112          |

### STATEMENTS OF OPERATIONS for the three months ended

| \$000's except per share (unaudited) | Dec. 31<br>2007 | Sep. 30<br>2007 | Jun. 30<br>2007 | Mar. 30<br>2007 | Dec. 31<br>2006 | Sep. 30<br>2006 | Jun. 30<br>2006 | Mar. 31<br>2006 |
|--------------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|
| INTEREST AND OTHER INCOME            | 298             | 211             | 424             | 261             | 118             | 90              | 187             | 750             |
| EXPENSES                             |                 |                 |                 |                 |                 |                 |                 |                 |
| Administrative                       | 5,514           | 3,835           | 1,835           | 1,520           | 1,297           | 955             | 1,116           | 1,071           |
| Exploration                          | 28,532          | 37,730          | 16,690          | 4,563           | 5,334           | 14,159          | 5,663           | 1,319           |
|                                      | <u>34,046</u>   | <u>41,565</u>   | <u>18,525</u>   | <u>6,083</u>    | <u>6,631</u>    | <u>15,114</u>   | <u>6,779</u>    | <u>2,390</u>    |
| Loss before income taxes             | (33,748)        | (41,354)        | (18,101)        | (5,822)         | (6,513)         | (15,024)        | (6,592)         | (1,640)         |
| Future income tax recovery           | 6,709           | 20,597          | 2,223           | 1,428           | 2,399           | 4,200           | 1,500           | 600             |
| NET LOSS                             | <u>(27,039)</u> | <u>(20,757)</u> | <u>(15,878)</u> | <u>(4,394)</u>  | <u>(4,114)</u>  | <u>(10,824)</u> | <u>(5,092)</u>  | <u>(1,040)</u>  |
| Net Loss per share                   | (0.30)          | (0.26)          | (0.23)          | (0.07)          | (0.08)          | (0.24)          | (0.12)          | (0.02)          |

(1) This restatement has no impact on total assets, results of operations or loss per share of the Company.

## OPERATIONS

The net loss recorded by the Company for the year ended December 31, 2007 was \$68,068,298. This compared to a net loss of \$21,069,867 for the same period in 2006. The net loss for the three month period ended December 31, 2007 was \$27,038,427, \$22,924,418 more than the same period of the previous year. In each case, the primary reason for the increased net loss was the increase in exploration expenditures associated with increased work during the period on the Mary River Property as described in the table below.

During the three month period ended December 31, 2007 the Company recorded interest and other income of \$298,514 as compared to \$118,195 for the same period in 2006. Interest and other income was higher in the fourth quarter of 2007 as compared to the fourth quarter of 2006 due to higher cash and cash equivalent balances. Year to date interest income is \$49,462 higher due to higher cash and cash equivalent balances.

Exploration expenditures of \$28,531,537 during the fourth quarter were \$23,197,755 more than in the fourth quarter of 2006 due to the advancement of the bulk sample, metallurgical testwork, environmental baseline studies, and various studies related to the in-progress DFS, which was completed in February 2008. Year to date expenditures were \$61,040,239 higher than the previous year for the same reasons. Set forth below is certain information in respect of the Company's exploration expenditures for the years 2006 and 2007.

### EXPLORATION EXPENDITURES for the period ended December 31

|                              | 2007                 | 2006                |
|------------------------------|----------------------|---------------------|
| Exploration                  | \$ 45,898,299        | \$ 17,593,831       |
| Definitive Feasibility Study | 10,728,852           | 2,473,455           |
| Engineering                  | -                    | 2,956,055           |
| Bulk Sample                  | 17,541,434           | -                   |
| Health and Safety            | 496,588              | 489,942             |
| Environmental and Permitting | 11,163,936           | 1,959,767           |
| Metallurgical Testing        | 1,685,671            | 1,001,491           |
|                              | <u>\$ 87,514,780</u> | <u>\$26,474,541</u> |

The Technical Report 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 testwork 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".

Professional fees for the fourth quarter of 2007 were \$288,112, an increase of \$147,450 as compared to the same period of 2006. Professional fees for the 2007 year were \$425,975 higher than 2006. The increase was a result of increased legal costs as well as fees related to the listing of Common Shares and Warrants on the TSX during 2007.

Office and general expenses for the three and twelve month periods ended December 31, 2007 were \$144,684 and \$651,484 higher, respectively, than the same periods of 2006. The primary reason for these increases is related to increased interest and bank charges and expenditures such as relocation costs resulting from an increase in staff.

Salaries increased \$534,971 and \$1,416,677 for the three and twelve month periods ended December 31, 2007, respectively. The increase is due to the hiring of additional staff during the period as part of the Company's expansion of its exploration and project development activities.

Shareholder relation expenses for the year ended December 31, 2007 decreased when compared to the same period of the previous year as a result of a reduction in the number of investor programs completed during 2007. Due to the production of investor materials during the fourth quarter shareholder relation expense was \$44,310 higher in the fourth quarter of 2007 when compared to the same period in 2006.

Stock based compensation expenses for the fourth quarter and the year ended December 31, 2007 were \$157,037 lower and \$122,244 higher than the same periods in 2006, respectively. The variances are related to the timing of option grants and the increase in the number of staff over the period.

For the fourth quarter and the year ended December 31, 2007, amortization expenses increased by \$246,220 and \$432,780 respectively. These increases were the result of capital asset additions in 2006 and 2007, which are now being amortized.

The writedown of the Company's long term investments is related to an impairment of certain asset backed commercial paper. The Company recorded a \$5,195,488 impairment charge in 2007. See "Liquidity and Capital Resources".

#### **RELATED PARTY TRANSACTIONS**

During the year ended December 31, 2007 a related party controlled by a director and a shareholder paid \$72,000 (2006 - \$72,000) in lease and operating costs to the Company.

#### **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.

As a result, during the year ended December 31, 2007, 43,170,023 Common Shares and 5,981,988 Warrants were issued for total net proceeds of \$142,684,038.

The issued and outstanding capital of the Company at December 31, 2007 was 95,100,068 Common Shares (on a non-fully diluted basis). As at December 31, 2007 the Company had 5,981,988 Warrants outstanding.

## LIQUIDITY AND CAPITAL RESOURCES

Working capital was \$30,818,092 at December 31, 2007 compared to \$11,306,831 at December 31, 2006. The increase was primarily related to the completion of the equity offerings described above, net of cash used during 2007.

In July and August of 2007, Baffinland 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>     |
|                      |                                   |                   | \$43,844,320         |

Coventree announced in August 2007 that it was experiencing a market disruption and as a result was unable to meet its repayment obligations until its liquidity providers funded such repayments. Of the approximately \$43.8 million that the Company invested in ABCP with Coventree, \$23,741,832 has been repaid and \$19,907,000 remains outstanding as at December 31, 2007.

Following the disruptions in the Canadian non-bank sponsored ABCP market and the subsequent "Montreal Proposal", a committee was formed to oversee the proposed restructuring of the various conduits that had issued the non-bank ABCP (the "Committee"). There is currently no certainty regarding the outcome of the Montreal Proposal and the restructuring activities of the Committee, and therefore there is a significant amount of uncertainty in estimating the amount and timing of cash flows associated with the Company's remaining ABCP (being the \$19,907,000 in total invested by the Company with the Structured Investment Trust III). The Company, after consultation with its financial advisors, estimated the fair value of this ABCP to be between approximately \$13.7 million and \$16.6 million using a valuation technique which incorporates a discounted cash flow approach considering the best available market data for such investments as at December 31, 2007. As a result of such estimation, 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. The remaining balance of outstanding asset backed commercial paper of \$14,907,000 has been recorded as a long term asset on the balance sheet. The assumptions used to value this investment are as follows:

|                            |   |
|----------------------------|---|
| Estimated yield on assets  | Bankers' Acceptances ("BA")<br>+0.50% to +0.70% |
| Administration Costs       | -0.06%  |
| Margin Facility Price      | -1.60%  |
| Margin Facility Cost       | -0.86%  |
| Floating Interest Rate     | BA's -0.42% to -0.22%                           |
| Term of Notes              | 7 years   |
| Swap Rate                  | 4.16%   |
| Effective Fixed Rate       | 3.74% - 3.94%                                   |
| Investor Yield Requirement | 7% - 10%  |

On August 21, 2007, the Company announced that it had arranged a non-revolving, six-month term \$21 million senior secured credit facility with the Bank of Nova Scotia to provide liquidity to the Company. The funds received by the Company on the repayment of its ABCP were used to repay principal, any accrued interest, standby fees and legal fees on the credit facility. The credit facility was repaid in full and terminated on December 24, 2007.

Current assets at December 31, 2007 were \$50,474,153 compared to \$13,976,396 at December 31, 2006, an increase of \$36,497,757. Cash and cash equivalents increased by \$25,690,637. Accounts receivable increased by \$2,773,731 and prepaids decreased by \$613,497. The increase in accounts receivable is related to an increase in GST receivable due to increased expenditures. The decrease in prepaids is a result of work completed in 2007. Inventory increased by \$8,646,886 as a result of supplies purchased and shipped to the Mary River Property during the third quarter of 2007. During the year ended December 31, 2007 the Company spent approximately \$87,514,780 on exploration activities and it continues to gather information for various studies relating to the Mary River Property.

Current liabilities at December 31, 2007 were \$19,656,061 compared to \$2,669,565 at December 31, 2006, an increase of \$16,986,496. The increase in current liabilities is a result of increased accounts payable due to increased exploration activity at the Mary River Property.

The Company used contractors and consultants to complete its work programs for 2007 and the DFS, and as a result capital spending for 2007 was limited to camp equipment and supplies. During the year ended December 31, 2007 the Company spent \$12,064,217 on capital assets to be utilized at the Mary River site. The Company currently expects that a majority of the Company's expenditures for 2008 will be related to the completion of the DFS, an environmental impact assessment study, completion of the proposed bulk sample and other activities to advance the exploration and development of the Mary River Property.

The DFS estimates the initial capital costs for the development of the Mary River Property to be \$4.1 billion, 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.

### Summary of Total Capital Costs

| <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 considers 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 currently 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 and deficit at December 31, 2007 was \$47,806,239, compared to \$8,501,995 at December 31, 2006, an increase of \$39,304,244. This occurred as a result of the following:

|                          |                             |
|--------------------------|-----------------------------|
| Stock-based compensation | \$ 2,295,780                |
| Exercised stock options  | (31,500)                    |
| Capital stock            | 105,108,262                 |
| Deficit:                 |                             |
| Net loss for the period  | <u>(68,068,298)</u>         |
|                          | <u><b>\$ 39,304,244</b></u> |

The following Common Shares and convertible securities of the Company were outstanding at March 10, 2008:

|               | <u>Expiry Date</u>    | <u>Exercise Price<br/>(Cdn\$)</u> | <u>Securities<br/>Outstanding</u> | <u>Common Shares<br/>on Exercise</u> |
|---------------|-----------------------|-----------------------------------|-----------------------------------|--------------------------------------|
| Common Shares |                       |                                   | 95,100,068                        |                                      |
| Warrants      | January 31, 2012      | 5.50                              | 5,981,988                         | 5,981,988                            |
| Options       | Feb 25/09 to Jan 8/12 | 1.00 to 4.40                      | 6,792,500                         | 6,792,500                            |

#### **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 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 agricultural lands), 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. Amendments to the current licenses and permits in place for the geotechnical drilling program have been requested to better facilitate program execution. Applications pursuant to the *Navigable Waters Protection Act* with respect to water intake/discharge structures at the Mary River camp and the temporary ore loading dock required at Milne Inlet for the bulk sample program are currently under review. 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 federal and territorial environmental assessment processes with respect to the *Canadian Environmental Assessment Act* and the Nunavut Land Claims Agreement, respectively, including the successful negotiation of an Inuit Impact and Benefits Agreement (the "IIBA") with the Qikiqtani Inuit Association (the "QIA"). There can be no guarantee that the Company will be able to complete the environmental assessment process, 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 are expected to lead to melting permafrost and an increase in active layer depth on Baffin Island of more than 50%. 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 December 31, 2007, information with respect to the Company's contractual obligations:

|                      | <b>Payments Due By Period</b> |                             |                      |                      |                          |
|----------------------|-------------------------------|-----------------------------|----------------------|----------------------|--------------------------|
|                      | <b>Total</b>                  | <b>Less than<br/>1 year</b> | <b>1-3<br/>Years</b> | <b>3-4<br/>Years</b> | <b>After<br/>5 Years</b> |
| Office Lease         | 246,400                       | 92,400                      | 154,000              | -                    | -                        |
| Purchase Obligations | 2,206,781                     | 2,206,781                   | -                    | -                    | -                        |
| Total                | 2,453,181                     | 2,299,181                   | 154,000              | -                    | -                        |

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:

- submission of a development proposal and associated applications to initiate requisite federal and territorial regulatory review and approval processes in March 2008;
- completion of a 30 million tonnes per annum "Blue Sky" scoping study incorporating Deposits Nos. 1, 2 and 3 in the second quarter of 2008;
- selection of an engineering, procurement and construction management firm in June 2008;
- completion of the bulk sample program in the third quarter of 2008;
- 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;
- completion of the basic engineering and the definitive capital cost estimate for construction at the Mary River Property by early 2010;

- 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; and
- adding 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 Standard**

In January 2005, the CICA issued Handbook Section 3855, "Financial Instruments - Recognition and Measurement, Section 1530, "Comprehensive Income", and Section 3865, "Hedges". These new standards are effective for interim and annual financial statements relating to fiscal years commencing on or after October 1, 2006 on a prospective basis. The Company has adopted these new standards effective January 1, 2007.

The Company has evaluated the impact of these new standards on its financial statements and determined that no adjustments are currently required.

### **Canadian Accounting Pronouncements Issued and Not Yet Adopted**

#### **Section 1535**

The new Section 1535, "Capital Disclosures", requires that an entity disclose information that enables users of its financial statements to evaluate an entity's objectives, policies and processes for managing capital, including disclosures of any externally imposed capital requirements and the consequences of non-compliance. The new standard applies to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007, specifically January 1, 2008 for the Company.

This standard will impact the Company's disclosures provided but will not affect the Company's results or financial position.

#### **Section 3031**

The new Section 3031, "Inventories", relates to the accounting for inventories and revises and enhances the requirements for assigning costs to inventories. The new standard applies to interim and annual financial statements relating to fiscal years beginning on or after January 1, 2008, and will be effective for the Company as of this date.

This standard is not expected to have a significant effect on the Company's financial statements.

**Sections 3862 and 3863**

The new 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 new standards apply to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007, specifically January 1, 2008 for the Company.

This standard will impact the Company's disclosures but will not affect the Company's results or financial position.

**Disclosure of Changes in Accounting Policies**

On January 1, 2007, the Company adopted Section 1506 of the CICA Handbook Accounting Changes, which prescribes the criteria for changing accounting policies, together with the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and corrections of errors. This standard did not affect the Company's financial position or results of operations.

**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 (CICA). 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.

**Subsequent Events**

Subsequent to December 31, 2007 the Company signed a land lease with the QIA covering an estimated surface area of approximately 10,567 hectares on Baffin Island, Nunavut. Baffinland has provided a \$5,400,000 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 February 2009.

On March 5, 2008 the Company entered into an agreement with a syndicate of underwriters led by Raymond James Ltd. under which the underwriters have agreed to purchase 47,945,205 Common Shares at a price of \$3.65 per Common Share, representing aggregate gross proceeds of approximately \$174,999,998. In addition, the underwriters will have an option exercisable until the 30<sup>th</sup> day following the closing of the offering, to purchase up to an additional 7,191,780 Common Shares.

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

**Financial Statements**  
December 31, 2007 and 2006

**Auditors' Report**

To the Shareholders of  
Baffinland Iron Mines Corporation

We have audited the balance sheets of Baffinland Iron Mines Corporation as at December 31, 2007 and 2006 and the statements of operations and comprehensive loss and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2007 and 2006 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

*PricewaterhouseCoopers LLP*

Chartered Accountants, Licensed Public Accountants  
Toronto, Ontario, Canada  
March 10, 2008

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

As at December 31,

|   | <u>2007</u>          | <u>2006</u>          |
|---|----------------------|----------------------|
| <b>ASSETS</b>                           |                      |                      |
| <b>Current</b>                          |                      |                      |
| Cash and cash equivalents (Note 3)      | \$ 38,141,920        | \$ 12,451,283        |
| Accounts receivable                     | 3,162,710            | 388,979              |
| Inventory (Note 4)                      | 8,646,886            | -                    |
| Prepaid expenses                        | 522,637              | 1,136,134            |
|   | <u>50,474,153</u>    | <u>13,976,396</u>    |
| Mining interests (Note 5)               | 1                    | 1                    |
| Long term investments (Note 6)          | 14,907,000           | -                    |
| Capital assets (Note 7)                 | 12,382,573           | 846,126              |
|   | <u>\$ 77,763,727</u> | <u>\$ 14,822,523</u> |
| <b>LIABILITIES</b>                      |                      |                      |
| <b>Current</b>                          |                      |                      |
| Accounts payable                        | 19,656,061           | 2,669,565            |
| Future income tax liability (Note 11)   | 10,301,427           | 3,650,963            |
|   | <u>29,957,488</u>    | <u>6,320,528</u>     |
| <b>SHAREHOLDERS' EQUITY AND DEFICIT</b> |                      |                      |
| Capital stock (Note 9)                  | 149,178,093          | 47,093,202           |
| Warrants (Note 9)                       | 3,023,371            | -                    |
| Contributed surplus (Note 9)            | 6,913,803            | 4,649,523            |
| Deficit                                 | (111,309,028)        | (43,240,730)         |
|   | <u>47,806,239</u>    | <u>8,501,995</u>     |
|   | <u>\$ 77,763,727</u> | <u>\$ 14,822,523</u> |

Nature of operations and going concern (Note 1)

Contingencies and commitments (Note 14)

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**  
For the years ended December 31,

|  | 2007                     | 2006                    | Cumulative from<br>January 1<br>2003 |
|--|--------------------------|-------------------------|--------------------------------------|
|  | <u>2007</u>              | <u>2006</u>             | <u>2003</u>                          |
| Interest and other income                    | \$1,194,306              | \$1,144,844             | \$2,565,170                          |
| Expenses                                     |                          |                         |                                      |
| Exploration                                  | 87,514,780               | 26,474,541              | 137,834,014                          |
| Amortization                                 | 527,770                  | 94,990                  | 641,163                              |
| Salaries                                     | 2,191,456                | 774,779                 | 3,433,903                            |
| Stock-based compensation (Note 10)           | 2,295,780                | 2,173,536               | 5,935,306                            |
| Office and general                           | 1,077,316                | 425,822                 | 1,835,145                            |
| Professional fees                            | 869,568                  | 443,593                 | 1,983,909                            |
| Shareholder relations                        | 259,031                  | 367,902                 | 783,235                              |
| Travel                                       | 288,227                  | 158,585                 | 533,464                              |
| Writedown of long term investments (Note 6)  | 5,195,488                | -                       | 5,195,488                            |
|  | <u>100,219,416</u>       | <u>30,913,748</u>       | <u>158,175,627</u>                   |
| Net loss for the year before taxes           | (99,025,110)             | (29,768,904)            | (155,610,457)                        |
| Future income tax recovery (Note 11)         | <u>30,956,812</u>        | <u>8,699,037</u>        | <u>47,655,849</u>                    |
| Net loss and comprehensive loss for the year | (68,068,298)             | (21,069,867)            | (107,954,608)                        |
| Deficit, beginning of year                   | <u>(43,240,730)</u>      | <u>(22,170,863)</u>     |                                      |
| Deficit, end of year                         | ( <u>\$111,309,028</u> ) | ( <u>\$43,240,730</u> ) |                                      |
| Net loss per share (Note 13)                 | <u>(\$0.91)</u>          | <u>(\$0.46)</u>         |                                      |

The accompanying notes are an integral part of the financial statements

**BAFFINLAND IRON MINES CORPORATION**

(Development Stage Entity)

**STATEMENTS OF CASH FLOWS**

For the years ended December 31,

|  | 2007                  | 2006                  | Cumulative from<br>January 1<br>2003 |
|--|-----------------------|-----------------------|--------------------------------------|
| <b>Operating activities</b>                            |                       |                       |                                      |
| Loss for the year                                      | (\$68,068,298)        | (\$21,069,867)        | (\$107,954,608)                      |
| Items not effecting cash:                              |                       |                       |                                      |
| Amortization expense                                   | 527,770               | 94,990                | 641,163                              |
| Stock-based compensation                               | 2,295,780             | 2,173,536             | 5,935,306                            |
| Future income tax recovery                             | (30,956,812)          | (8,699,037)           | (47,655,849)                         |
| Writedown of long term investments                     | 5,195,488             | -                     | 5,195,488                            |
| Other non cash items                                   | -                     | -                     | (275,542)                            |
| Increase in accounts receivable                        | (2,773,731)           | (11,638)              | (3,162,668)                          |
| Increase in inventory                                  | (8,646,886)           | -                     | (8,646,886)                          |
| (Increase) decrease in prepaid expenses                | 613,497               | (804,344)             | (522,637)                            |
| Increase in accounts payable                           | 16,986,496            | 1,975,353             | 19,656,061                           |
|  | <u>(\$84,826,696)</u> | <u>(\$26,341,007)</u> | <u>(\$136,790,172)</u>               |
| <b>Investing activities</b>                            |                       |                       |                                      |
| Purchase of capital assets                             | (12,064,217)          | (839,961)             | (13,023,736)                         |
| Increase in long term investments                      | (20,102,488)          | -                     | (20,102,488)                         |
|  | <u>(32,166,705)</u>   | <u>(839,961)</u>      | <u>(33,126,224)</u>                  |
| <b>Financing activities</b>                            |                       |                       |                                      |
| Increase in bank debt                                  | 16,600,000            | -                     | 16,600,000                           |
| Repayment of bank debt                                 | (16,600,000)          | -                     | (16,600,000)                         |
| Decrease in due to related parties                     | -                     | (123,347)             | (132,421)                            |
| Net proceeds on issue of common shares<br>and warrants | 142,684,038           | 20,362,771            | 208,190,737                          |
|  | <u>142,684,038</u>    | <u>20,239,424</u>     | <u>208,058,316</u>                   |
| <b>Increase (decrease) in cash</b>                     | 25,690,637            | (6,941,544)           | 38,141,920                           |
| <b>Cash position at beginning of year</b>              | <u>12,451,283</u>     | <u>19,392,827</u>     | <u>-</u>                             |
| <b>Cash position at end of year</b>                    | <u>\$38,141,920</u>   | <u>\$12,451,283</u>   | <u>\$38,141,920</u>                  |

The accompanying notes are an integral part of the financial statements

**BAFFINLAND IRON MINES CORPORATION**  
**(Development Stage Entity)**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE YEARS ENDED DECEMBER 31, 2007 AND 2006**

**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 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 year ended December 31, 2007, the Company reported a loss of \$68.1 million and an accumulated deficit of \$111.3 million as at that date. 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**

a) **Basis of Financial Presentation**

The financial statements of the Company, which are expressed in Canadian dollars, have been prepared in accordance with Canadian GAAP.

b) **Cash and cash equivalents**

Cash and cash equivalents are highly liquid investments, such as term deposits with major financial institutions or government treasury bills, having a maturity of three months or less at the date of original issue.

c) **Flow-through shares**

The Company has financed the majority of its exploration activities through the issuance of flow-through shares. Under the terms of the flow-through share agreements, the tax attributes of the related expenditures are renounced to subscribers. To recognize the foregone tax benefits to the Company, the carrying value of the shares issued is reduced by the tax effect of the tax benefits renounced to subscribers. The Company recognizes the foregone tax benefit at the time of the renouncement, provided there is reasonable assurance that the expenditures will be incurred.

## NOTES TO THE FINANCIAL STATEMENTS (contd)

### 2. SIGNIFICANT ACCOUNTING POLICIES (contd)

- d) **Mining interests and 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.
- e) **Capital assets:**  
Capital assets are carried at cost, less accumulated amortization. Amortization of capital assets is calculated on the following basis:
- |                        |                       |
|------------------------|-----------------------|
| Exploration equipment  | 5 years straight line |
| Furniture & fixtures   | 5 years straight line |
| Leasehold improvements | 5 years straight line |
| Computer equipment     | 30% declining balance |
- f) **Use of estimates:**  
The preparation of financial statements in accordance with Canadian generally accepted accounting principles 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 from these estimates.
- g) **Income taxes:**  
The Company accounts for income taxes in accordance with the liability method. Under the liability method, future income tax assets and liabilities are recognized for differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future tax assets and liabilities are measured using enacted or substantively enacted income tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future income tax assets and liabilities of a change in income tax rates is recognized in the period that includes the date of substantive enactment. A future income tax asset is recognized only when it is more likely than not that the income tax asset will be realized.
- h) **Accounting for 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.

## NOTES TO THE FINANCIAL STATEMENTS (contd)

### 2. SIGNIFICANT ACCOUNTING POLICIES (contd)

- i) **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.
- j) **Long Term Investments:**  
Long term investments where the Company does not have significant influence are carried at cost and are written down for any loss in value that is other than temporary.
- k) **Impairment of long-term assets:**  
The Company reviews long-lived assets for impairment when events or circumstances indicate that the assets carrying amount may not be recoverable. When management determines that an impairment exists, the impairment loss will be established by comparing the assets carrying amount to its fair value, which is determined using a discounted cash flow model.
- l) **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.
- At the present time, management has concluded that there are no asset retirement obligations associated with any of the Company's assets.
- m) **Financial Instruments, comprehensive income and hedges**

In January 2005, the CICA issued Handbook Sections 3855, "Financial Instruments - Recognition and Measurement" ("Section 3855"), 1530, "Comprehensive Income" ("Section 1530"), and 3865, "Hedges" ("Section 3865"). These new standards are effective for interim and annual financial statements relating to fiscal years commencing on or after October 1, 2006 on a prospective basis. The Company has adopted these new standards effective January 1, 2007.

Section 3855 prescribes when a financial instrument is to be recognized on the balance sheet and at what amount. It also specifies how financial instrument gains and losses are to be presented. Section 3855 requires that:

- All financial assets be measured at fair value on initial recognition and certain financial assets to be measured at fair value subsequent to initial recognition;
- All financial liabilities be measured at fair value if they are classified as held for trading. Other financial liabilities are measured at amortized cost using the effective interest method; and
- All derivative financial instruments be measured at fair value on the balance sheet, even when they are part of an effective hedging relationship.

## NOTES TO THE FINANCIAL STATEMENTS (contd)

### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (contd)

Section 1530 introduces a new requirement to temporarily present certain gains and losses from changes in fair value in other comprehensive income and accumulated other comprehensive income. Other comprehensive income would include unrealized gains and losses, such as: unrealized gains or losses on available-for-sale investments; and the effective portion of gains or losses on derivatives designated as cash flow hedges or hedges of the net investment in self-sustaining foreign operations.

Section 3865 provides alternative treatments to Section 3855 for entities which choose to designate qualifying transactions as hedges for accounting purposes. It replaces and expands on Accounting Guideline 13 "Hedging Relationships", and the hedging guidance in Section 1650 "Foreign Currency Translation" by specifying how hedge accounting is applied and what disclosures are necessary when it is applied.

The Company has evaluated the impact of these new standards on its financial statements and determined that no adjustments are currently required.

#### n) **Disclosure of changes in accounting policies**

On January 1, 2007, the company adopted Section 1506 of the CICA Handbook Accounting Changes, which prescribes the criteria for changing accounting policies, together with the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and corrections of errors. This standard did not affect the Company's financial position or results of operations.

#### o) **Canadian accounting pronouncements issued and not yet adopted**

##### **Section 1535**

The new Section 1535, Capital Disclosures, requires that an entity disclose information that enables users of its financial statements to evaluate an entity's objectives, policies and processes for managing capital, including disclosures of any externally imposed capital requirements and the consequences of non-compliance. The new standard applies to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007, specifically January 1, 2008 for the Company.

This standard will impact the Company's disclosures provided but will not affect the Company's results or financial position.

##### **Section 3031**

The new Section 3031, Inventories, relates to the accounting for inventories and revises and enhances the requirements for assigning costs to inventories. The new standard applies to interim and annual financial statements relating to fiscal years beginning on or after January 1, 2008, and will be effective for the company as of this date.

This standard is not expected to have a significant effect on the Company's financial statements.

## NOTES TO THE FINANCIAL STATEMENTS (contd)

### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (contd)

#### Sections 3862 and 3863

The new 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 new standards apply to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007, specifically January 1, 2008 for the Company.

This standard will impact the company's disclosures provided but will not affect the Company's results or financial position.

### 3. CASH AND CASH EQUIVALENTS

|   | 2007                | 2006                |
|---|---------------------|---------------------|
| Cash and cash equivalents are comprised of: |                     |                     |
| Cash  | \$20,329,740        | \$12,451,283        |
| Guaranteed Investment Certificates          | 17,812,180          | -                   |
|   | <u>\$38,141,920</u> | <u>\$12,451,283</u> |

### 4. 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:

|            | 2007             | 2006     |
|------------|------------------|----------|
| Fuel       | 5,758,177        | -        |
| Supplies   | 2,009,750        | -        |
| Explosives | 878,959          | -        |
|            | <u>8,646,886</u> | <u>-</u> |

### 5. 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.

### 6. LONG TERM INVESTMENTS

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

As at December 31, 2007, the Company held \$14,907,000 of non-bank sponsored ABCPs invested in Structured Investment Trust III. 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.

## NOTES TO THE FINANCIAL STATEMENTS (contd)

### 6. LONG TERM INVESTMENTS (contd)

DBRS placed certain of the ABCPs "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 ABCPs into term floating-rate notes ("FRNs") maturing no earlier than the scheduled termination dates of the underlying assets (the "Montreal Proposal ABCPs").

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

The Montreal Proposal ABCPs last traded in the active market on or about August 13, 2007 and there are currently no market quotations available for the Montreal Proposal ABCPs.

There is currently no certainty regarding the outcome of the Montreal Proposal and therefore there is a significant amount of uncertainty in estimating the amount and timing of cash flows associated with the Montreal Proposal ABCPs. The Company estimated the fair value of the Montreal Proposal ABCP to be between \$13.7 million and \$16.6 million using a valuation technique which incorporates a discounted cash flow approach considering the best available market data for such investments as at December 31, 2007 and as a result the Company has recorded a \$5,195,488 impairment charge as a reduction in fair value since the loss is considered to be other than temporary. The assumptions incorporated to value the investment are as follows:

|                            |                                    |
|----------------------------|------------------------------------|
| Estimated yield on assets  | Bankers' Acceptances ("BA") +0.50% |
|                            | to +0.70%                          |
| Administration Costs       | -0.06%                             |
| Margin Facility Price      | -1.60%                             |
| Margin Facility Cost       | -0.86%                             |
| Floating Interest Rate     | BA's -0.42% to -0.22%              |
| Term of Notes              | 7 years                            |
| Swap Rate                  | 4.16%                              |
| Effective Fixed Rate       | 3.74% - 3.94%                      |
| Investor Yield Requirement | 7% - 10%                           |

Since the fair value of the Montreal Proposal ABCP are determined using a discounted cash flow approach and are based on the Company's assessment of market conditions as at December 31, 2007, the fair values reported may change materially in subsequent periods. In addition, the fair value estimates are dependent upon the likelihood, nature and timing of future restructuring under the terms of the Montreal Proposal.

## NOTES TO THE FINANCIAL STATEMENTS (contd)

### 7. CAPITAL ASSETS

Capital assets are comprised of:

|                         | 2007                |                          |                     | 2006              |                          |                   |
|-------------------------|---------------------|--------------------------|---------------------|-------------------|--------------------------|-------------------|
|                         | Cost                | Accumulated Amortization | Net Book Value      | Cost              | Accumulated Amortization | Net Book Value    |
| Exploration equipment   | \$ 5,551,776        | \$ 521,030               | \$ 5,030,746        | \$ 715,593        | \$ 54,370                | \$ 661,223        |
| Furniture & fixtures    | 85,901              | 33,503                   | 52,398              | 39,816            | 21,993                   | 17,823            |
| Leasehold improvements  | 119,410             | 39,980                   | 79,430              | 106,685           | 18,220                   | 88,465            |
| Computer equipment      | 120,923             | 46,650                   | 74,273              | 97,425            | 18,810                   | 78,615            |
| Construction in process | 7,145,726           | -                        | 7,145,726           | -                 | -                        | -                 |
|                         | <u>\$13,023,736</u> | <u>\$ 641,163</u>        | <u>\$12,382,573</u> | <u>\$ 959,519</u> | <u>\$ 113,393</u>        | <u>\$ 846,126</u> |

Amounts included in construction in process are not being amortized.

### 8. BANK DEBT

The Company arranged a non-revolving \$14 million senior secured credit facility to fund working capital requirements. On December 24, 2007 outstanding amounts were repaid and the facility was cancelled.

### 9. CAPITAL STOCK

**Authorized:** Unlimited common shares

**Issued:**

|  | Number<br>of shares | Amount<br>\$                    |
|--|---------------------|---------------------------------|
| <b>December 31, 2005</b>   | 44,111,865          | 34,080,431                      |
| Share financing - flow through private placement September, 2006 | 2,000,000           | 3,250,000 <sup>(i)</sup>        |
| Share financing - flow through private placement October, 2006   | <u>5,818,180</u>    | <u>9,762,771<sup>(ii)</sup></u> |
| <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>(iii)</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>(iv)</sup>      |
| Share financing - flow through private placement November, 2007  | 6,961,839           | 23,553,991 <sup>(v)</sup>       |
| Exercise of share purchase options November, 2007                | <u>12,500</u>       | <u>55,000</u>                   |
| <b>December 31, 2007</b>   | <u>95,100,068</u>   | <u>149,178,093</u>              |

- i. Net future income tax liability of \$1,750,000 recorded on renunciation of flow through expenditures.
- ii. Net future income tax liability of \$5,600,000 recorded on renunciation of flow through expenditures.
- iii. Net future income tax liability of \$17,499,614 recorded on renunciation of flow through expenditures.
- iv. Net future income tax liability of \$7,067,997 recorded on renunciation of flow through expenditures.
- v. Net future income tax liability of \$13,039,664 recorded on renunciation of flow through expenditures.

## NOTES TO THE FINANCIAL STATEMENTS (contd)

### 9. CAPITAL STOCK (contd)

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.

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.

#### Contributed Surplus

|                                    |                     |
|------------------------------------|---------------------|
| Balance, December 31, 2005         | \$ 2,475,987        |
| Stock-based compensation           | <u>2,173,536</u>    |
| Balance, December 31, 2006         | 4,649,523           |
| Stock-based compensation           | 2,295,780           |
| Exercise of share purchase options | <u>(31,500)</u>     |
| Balance, December 31, 2007         | <u>\$ 6,913,803</u> |

## NOTES TO THE FINANCIAL STATEMENTS (contd)

### 10. 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 December 31, are presented in the following table:

|                        | 2007             |                     | 2006             |                     |
|------------------------|------------------|---------------------|------------------|---------------------|
|                        | Number           | Weighted<br>Average | Number           | Weighted<br>Average |
| Outstanding, beginning | 4,223,000        | 1.93                | 2,161,000        | 1.46                |
| Granted                | 855,000          | 2.76                | 2,062,000        | 2.43                |
| Exercised              | (17,500)         | 2.60                | -                | -                   |
| Cancelled              | -                | -                   | -                | -                   |
| Outstanding, ending    | <u>5,060,500</u> | <u>2.07</u>         | <u>4,223,000</u> | <u>1.93</u>         |

As at December 31, 2007 stock options available for exercise is 4,232,750 at a weighted average price of \$1.97 and the aggregate fair value of unvested stock options granted is \$1,524,800.

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<br>Interest rate | Expected<br>Stock Volatility |
|----------------------|----------------------------|------------------------------|
| January 3, 2006      | 5.00%                      | 81%                          |
| January 27, 2006     | 5.00%                      | 77%                          |
| July 10, 2006        | 6.00%                      | 70%                          |
| December 15, 2006    | 6.00%                      | 82%                          |
| February 6, 2007     | 5.00%                      | 81%                          |
| April 11, 2007       | 5.00%                      | 79%                          |
| May 31, 2007         | 5.00%                      | 79%                          |
| October 1, 2007      | 5.00%                      | 77%                          |

**NOTES TO THE FINANCIAL STATEMENTS (contd)**

**10. STOCK-BASED COMPENSATION (contd)**

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

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, compensation expense for stock options issued and outstanding for the year ended December 31, 2007 was \$2,295,780 (2006 - \$2,173,536).

## NOTES TO THE FINANCIAL STATEMENTS (contd)

### 11. INCOME TAXES

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

|  | <u>2007</u>         | <u>2006</u>        |
|--|---------------------|--------------------|
| Net loss for the period  | (99,025,110)        | (29,768,904)       |
| Income tax recovery at Canadian federal and provincial statutory rates | (34,993,937)        | (10,519,869)       |
| Flow through share issuances   | 3,225,832           | 1,082,738          |
| Permanent differences  | 811,293             | 768,094            |
| Recovery of income taxes   | <u>(30,956,812)</u> | <u>(8,669,037)</u> |

The components of the recovery of income taxes comprise:

|                            |                     |                    |
|----------------------------|---------------------|--------------------|
| Future income tax recovery | <u>(30,956,812)</u> | <u>(8,669,037)</u> |
| Net income tax recovery    | <u>(30,956,812)</u> | <u>(8,669,037)</u> |

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

|                                      | <u>2007</u>         | <u>2006</u>        |
|--------------------------------------|---------------------|--------------------|
| <b>Future Income Tax Assets</b>      |                     |                    |
| Exploration & Development            | 2,902,000           | 2,614,000          |
| Non-capital losses carried forward   | 1,891,000           | 907,000            |
| Other temporary differences          | 2,193,000           | 380,000            |
| Net future income tax asset          | <u>6,986,000</u>    | <u>3,901,000</u>   |
| Valuation Allowance                  | (6,986,000)         | (3,901,000)        |
| Net future income tax asset recorded | <u>-</u>            | <u>-</u>           |
| <b>Future Income Tax Liabilities</b> |                     |                    |
| Flow through share issuance          | (7,341,286)         | (3,650,963)        |
| Inventory                            | (2,829,261)         | -                  |
| Prepays                              | (130,880)           | -                  |
| Net future income tax liability      | <u>(10,301,427)</u> | <u>(3,650,963)</u> |

## NOTES TO THE FINANCIAL STATEMENTS (contd)

### 11. INCOME TAXES (contd)

As at December 31, 2007, the Company has available non-capital loss carry-forwards for Canadian federal and provincial tax purposes that will expire as follows:

|      | <u>2007</u> | <u>2006</u> |
|------|-------------|-------------|
| 2009 | 3,000       | 3,000       |
| 2010 | 51,000      | 51,000      |
| 2014 | 525,000     | 525,000     |
| 2015 | 879,000     | 879,000     |
| 2026 | 1,327,000   | 1,327,000   |
| 2027 | 3,918,000   | -           |

The Company has recorded a valuation allowance in respect of tax losses and other attributes valued at \$6,986,000 (December 31, 2006 - \$3,901,000) because management believes that the realization of the future income tax assets are not likely at this time.

### 12. RELATED PARTY TRANSACTIONS

During the period ended December 31, 2007 a related party controlled by a director and a shareholder paid \$72,000 (2006 - \$72,000) in lease and operating costs to the Company.

### 13. 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 December 31, 2007 amounted to 74,877,974 (2006 - 45,788,577).

### 14. CONTINGENCIES AND COMMITMENTS

Under the terms of existing lease agreements for office space, the Company is committed to annual lease payments of approximately \$92,400 plus operating costs. During 2007 the Company paid approximately \$249,000 (2006 - \$240,000) 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 December 31, 2007, there is two years and eight 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 is committed to pay \$2,206,781 over a six month period beginning April 1, 2008 and ending August 31, 2008.

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 2007 and 2008 are 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.

**15. SUBSEQUENT EVENT**

On March 5, 2008 the Company entered into an agreement with a syndicate of underwriters led by Raymond James Ltd. under which the underwriters have agreed to buy 47,945,205 common shares of the Company at a price of \$3.65 per common share, representing aggregate gross proceeds of \$174,999,998. In addition, the underwriters will also have an option exercisable within 30 days after the closing of the offering to purchase up to an additional 7,191,780 million Common Shares.

Subsequent to December 31, 2007 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. Baffinland has provided a \$5,400,000 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 February 2009.