



**BAFFINLAND IRON MINES CORPORATION  
AMENDED AND RESTATED  
3<sup>RD</sup> QUARTER REPORT  
September 30, 2007**



**AMENDED MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION  
FOR THE THIRD QUARTER ENDED SEPTEMBER 30, 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 three and nine month periods ended September 30, 2007, and its financial position as at September 30, 2007, and should be read in conjunction with the unaudited interim financial statements of the Company as at and for the three and nine months ended September 30, 2007, including the notes thereto, as well as the audited financial statements of the Company as at and for the year ended December 31, 2006, 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 28, 2007 and subsequent press releases, have 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 February 8, 2008. All figures are in Canadian dollars, unless otherwise noted.

The Company's shares are listed on the Toronto Stock Exchange (the "TSX") under the trading symbol "BIM".

### **Restatement of Interim Management discussion and analysis**

The Company has amended its previously reported interim financial statements as at and for the period ending September 30, 2007 to reclassify \$17,907,000 invested in Assets Back Commercial Papers ("ABCPs") from current to long term investments. This restatement has no impact on total assets, results of operations or loss per share of the Company.

### **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 plans to complete a definitive feasibility study, including the scheduled timing thereof and other related statements, statements about the planned Nunavut Impact Review Board process, Blue Sky Studies, an exploration targeting study and traditional knowledge studies and environmental baseline studies, statements about the planned bulk sample program and related statements, statements about the completion of a project description and draft environmental impact statement, statements about the Company's planned drilling program, statements derived from the Company's scoping study on Deposit No. 1, statements about the filing of amended permits and licences, including the scheduled timing thereof and other related statements, statements about the Company's goal to add one or more strategic investors and statements about the currently expected timing for commencement of construction and production, are forward-looking information.

Forward-looking information is based on certain factors and assumptions regarding, among other things, the estimation of mineral resources, the realization of mineral resource estimates, iron ore prices, the timing and amount of future exploration expenditures, the estimation of additional capital requirements, the availability of necessary financing and materials, the receipt of necessary regulatory approvals, and assumptions with respect to environmental risks, title disputes or claims, weather conditions 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 stating that the Company has scheduled the completion of a definitive feasibility study in February of 2008, that the Company plans to complete a Blue Sky Study, an exploration targeting study, traditional knowledge studies and environmental baseline studies, a bulk sample program in 2007 and 2008, the Company plans to submit formal applications and begin the regulatory process with respect to permits and licences during the first quarter of 2008, the Company plans to begin pre-construction staging in August 2009 to September 2009, the Company plans to begin construction by May 2010 to April 2014, the Company plans staged start-up and commissioning by May 2013 to September 2014, the Company plans its first commercial shipment by September 2014, and related statements, the Company has assumed, among other things, that iron ore prices will not change materially from the prices used in its current financial forecasts and that it will obtain the financing and regulatory approvals and other authorizations required to enable the exploration, development and mining activities required in order to complete such activities. In stating that the Company anticipates completion of its project description in the first quarter of 2008 and draft environmental impact statement in fourth quarter of 2008 and in making other statements about the Nunavut Impact Review Board process, the Company has assumed, among other things, that it will successfully negotiate and complete an environmental assessment process through the Nunavut Impact Review Board.

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 for and development of mineral deposits, risks relating to changes in iron ore prices and changes in 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, operational risks inherent in the conduct of mining activities, regulatory risks, including risks relating to the acquisition of the necessary licences and permits, financing and capitalization risks, including the risk that the financing required to fund all currently planned exploration and related activities may not be available on satisfactory terms, or at all, environmental risks and insurance risks. See "Risk Factors".

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

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

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

#### **OVERVIEW**

Baffinland is a Canadian company engaged in the natural resource industry 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 Project, which consists of five 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.

A scoping study coordinated by Aker Kvaerner E&C, a division of Aker Kvaerner Canada Inc., (“Aker Kvaerner”) was completed in May 2006 (the “Technical Report”). Aker Kvaerner is working on the definitive feasibility study, which is scheduled for completion in February 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 project. The proposed bulk sample is dependant on, among other things, obtaining the necessary permits and 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 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.

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)	Sep. 30 2007	Jun. 30 2007	Mar. 31 2007	Dec. 31 2006	Sep. 30 2006	Jun. 30 2006	Mar. 31 2006	Dec. 31 2005
<b>ASSETS</b>								
Current	52,387	67,788	36,240	13,977	8,292	14,256	18,690	20,102
Long term investments	17,907	-	-	-	-	-	-	-
Capital	12,347	9,422	5,307	846	880	156	99	101
	<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>	<u>20,203</u>
<b>LIABILITIES AND EQUITY</b>								
Current	27,853	9,824	3,762	2,670	6,409	2,042	270	694
Due to related parties	-	-	-	-	123	123	123	123
	<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>	<u>817</u>
Future income tax liability	3,971	-	2,223	3,651	450	2,900	4,400	5,000
	<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>	<u>5,817</u>
Shareholders' equity	50,817	67,386	35,562	8,502	2,190	9,347	13,996	14,386
	<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>	<u>20,203</u>
<b>WORKING CAPITAL</b>								
	24,534	57,964	32,478	11,307	1,760	12,091	18,297	19,285
Common shares outstanding (000's)	88,126	79,868	63,894	51,930	46,112	44,112	44,112	44,112

### STATEMENTS OF OPERATIONS for the three months ended

\$000's except per share (unaudited)	Sep. 30 2007	Jun. 30 2007	Mar. 30 2007	Dec. 31 2006	Sep. 30 2006	Jun. 30 2006	Mar. 31 2006	Dec. 31 2005
INTEREST AND OTHER INCOME	211	424	261	118	90	187	750	33
<b>EXPENSES</b>								
Administrative	3,835	1,835	1,520	1,297	955	1,116	1,071	412
Exploration	37,730	16,690	4,563	5,334	14,159	5,663	1,319	3,466
	<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>	<u>3,878</u>
Loss before income taxes	(41,354)	(18,101)	(5,822)	(6,513)	(15,024)	(6,592)	(1,640)	(3,845)
Future income tax recovery	20,597	2,223	1,428	2,399	4,200	1,500	600	1,000
NET LOSS	<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>	<u>(2,845)</u>
Net Loss per share	(0.26)	(0.23)	(0.07)	(0.08)	(0.24)	(0.12)	(0.02)	(0.08)

## OPERATIONS

The net loss recorded by the Company for the three month period ended September 30, 2007 was \$20,757,273 compared to a net loss of \$10,823,607 for the same period in 2006. The net loss for the nine month period ended September 30, 2007 was \$24,074,013 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 Project.

During the three month period ended September 30, 2007 the Company recorded interest and other income of \$210,983 as compared to \$90,436 for the same period in 2006. Interest and other income was higher in the third quarter of 2007 as compared to the third quarter of 2006 due to higher cash and cash equivalent balances. Year to date amount is \$130,857 lower due to a settlement received in 2006 as part of an agreement with Apollo Gold Corporation.

Exploration expenditures of \$37,730,220 during the third quarter were \$23,571,186 more than in the third quarter of 2006 due to the advancement of the bulk sample, metallurgical testwork, environmental baseline studies, and various studies related to the in-progress definitive feasibility study, which is currently expected to be completed late in the fourth quarter of 2007. Year to date expenditures were \$37,842,484 higher than the previous year for the same reasons.

The Technical Report sets forth a number of recommendations to assist the Company in completing a definitive feasibility study, including:

- a) specific targeted drilling activities on Deposit No. 1;
- b) a detailed surface mapping and sampling program on Deposit No. 1;
- c) evaluation of potential transport corridors and transport options;
- d) activities related to infrastructure, including obtaining geotechnical information to allow foundation design for facilities at port and mine site; and
- e) obtaining geotechnical information relating to pit slopes.

The Company continues to work on the foregoing recommendations and expects to complete items b and c in 2007, with work on items a, d and e continuing into 2008 and 2009. The Company currently anticipates completing a definitive feasibility study in February 2008. The Company also anticipates continuing during 2007 and 2008 its environmental baseline studies and commencing a 250,000 tonne bulk sample. 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.

Professional fees for the third quarter of 2007 were \$161,989, an increase of \$59,275 as compared to the same period of 2006. Year to date professional fees are \$278,525 higher than the same period of 2006. The increase was a result of increased legal costs as well as listing fees related to additional shares listed on the TSX during 2007.

Office and general expenses for the three and nine month periods ending September 30, 2007 were \$272,263 and \$506,810 higher, respectively, than the same periods of 2006. The primary reason for these increases is related to increased bank charges and additional administrative expenditures as well as relocation costs resulting from a significant increase in staff.

Salaries increased \$357,072 and \$881,706 for the three and nine month periods ended September 30, 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 three and nine month periods ended September 30, 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.

Stock based compensation expense for the third quarter and year to date 2007 was \$461,040 and \$1,789,205, respectively. Both are higher than the previous year amounts due to an increase in the number of options granted.

For the three month period ended September 30, 2007 amortization expenses increased by \$99,080. Year to date the increase is \$186,560. These increases were the result of capital asset additions in 2006 and 2007, which are now being amortized.

## **RELATED PARTY TRANSACTIONS**

During the nine month period ended September 30, 2007 a related party controlled by a director and a shareholder paid \$54,000 (2006 - \$54,000) 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 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, 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 consisted of one common share of the Company and one-half of one Warrant. Each whole Warrant entitles 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.

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 share purchase options were exercised for total gross proceeds 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.

As a result, during the first nine months of 2007, 36,195,684 common shares and 5,981,988 Warrants were issued for total net proceeds of \$106,123,533.

The issued and outstanding capital of the Company at September 30, 2007 is 88,125,729 common shares.

Subsequent to September 30, 2007, the Company completed a flow-through private placement for an aggregate of 6,961,839 shares at a price of \$5.30 per share, for total gross proceeds to the Company of approximately \$36.9 million.

## LIQUIDITY AND CAPITAL RESOURCES

Working capital was \$24,534,137 at September 30, 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. As described below, included in working capital is \$16,949,920 of short-term investments in asset backed commercial paper, for which there is currently no market. On December 24, 2007 the Company received \$16,754,432 of its \$16,949,920 million invested in Skeena Capital Trust ("Skeena") Series A Notes.

In July and August of 2007, Baffinland invested a total of \$43.8 million in the following asset backed commercial paper notes with three separate trusts managed under the Coventree Capital Group Inc. ("Coventree"):

<b>Maturity Date</b>	<b>Issuer</b>	<b>Value Date</b>	<b>Nominal Value</b>
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 on August 13, 14 and 15, 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 \$43,844,320, \$6,987,400 was collected prior to September 30, 2007 with an additional \$16,754,432 received in December 2007. As at September 30, 2007 \$36,856,920 remains outstanding. The investment in the amount \$16,949,920 invested in Skeena has been classified as a short term asset with the remaining balance of \$17,907,000 has been recorded as a long term asset on the balance sheet.

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 estimates the fair values of the Montreal Proposal ABCPs using a valuation technique which incorporates a probability weighted approach applied to discounted future cash flows considering the best available market data and management's intentions for such investments as at September 30, 2007 and as a result the Company has recorded a \$2,000,000 impairment charge as a reduction in fair value is considered to be other than temporary.

On August 21, 2007, the Company announced that it had arranged a non-revolving, six-month term \$21 million senior secured credit facility to provide liquidity to the Company. The funds received by the Company on the repayment of its \$6,987,400 investment in the Lafayette Structured Credit Trust were used to reduce the credit facility to \$14 million. The interest rate on the credit facility is prime plus one percent, and it matures on February 24, 2008. As security for its obligations under the credit facility Baffinland has provided a general security agreement covering all of its assets. As at September 30, 2007, \$9,600,000 has been drawn on the facility. Subsequent to September 30, 2007 the credit facility was repaid and cancelled.

Current assets at September 30, 2007 were \$52,387,137 compared to \$13,976,396 at December 31, 2006, an increase of \$38,860,741. Cash and cash equivalents increased by \$9,678,963 and short term investments increased by \$16,949,920. The increase in short term investments resulted from the reclassification of cash that was invested in asset backed commercial paper. Accounts receivable increased by \$2,264,799 and prepaids decreased by \$255,426. The increase in accounts receivable is related to an increase in GST receivable due to increased expenditures. Inventory increased by \$9,772,486 as a result of supplies purchased and shipped to site during the third quarter. During the nine months of 2007 the Company spent approximately \$58,983,243 on exploration activities as it continues to gather information for various studies relating to the Mary River Property.

Current liabilities at September 30, 2007 were \$27,853,000 compared to \$2,669,565 at December 31, 2006, an increase of \$25,183,435. The increase in current liabilities is a result of the senior secured credit facility put in place in August 2007, as well as increased accounts payable due to increased exploration activity at the Mary River Property.

The Company intends to use contractors and consultants to complete its currently proposed work programs for 2007, and as a result it expects that capital spending for 2007 will be limited to camp equipment and supplies. During the first nine months of 2007 the Company spent \$11,733,739 on capital assets to be utilized at the Mary River site. The Company currently expects that a majority of the Company's expenditures for the balance of 2007 will be related to the completion of a definitive feasibility study, an environmental impact assessment study and preparation for the proposed bulk sample.

The Company's operating and capital expenditures are expected to increase in subsequent years with the advancing of exploration and development activities. The amounts and timing of expenditures will depend on the progress of ongoing exploration and development and on the Company's ability to finance such activities.

The Company's historical capital needs have been met by the issuance of common shares and Warrants. The Company will require substantial additional funds to further explore and, if warranted, develop the Mary River Property. In addition, the Company's non-revolving senior secured credit facility, which has a current balance of \$9,600,000, matures on February 24, 2008. Subsequent to September 30, 2007 the credit facility was repaid and cancelled.

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 is typically required in order to place a property into commercial production. 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, including without limitation, the delay or indefinite postponement of the currently planned definitive feasibility study and the currently planned bulk sample. The terms of any additional financing obtained by the Company could result in substantial dilution to the shareholders of the Company. Various factors including the Company's exploration results could cause significant fluctuations in the price and volume of trading in the common shares and Warrants of the Company.

## CAPITAL STOCK AND DEFICIT

Shareholders' equity and deficit at September 30, 2007 was \$50,817,251, compared to \$8,501,995 at December 31, 2006, an increase of \$42,315,256. This occurred as a result of the following:

Contributed surplus (fair value vested portion of stock options granted)	\$1,780,205
Net proceeds on common share and warrant offerings	81,564,922
Deficit:	
Net loss for the period	<u>(41,029,871)</u>
	<u>\$42,315,256</u>

The following common shares and convertible securities were outstanding at February 8, 2008:

	Expiry Date	Exercise Price (Cdn\$)	Securities Outstanding	Common Shares on Exercise
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, including, but not limited to: risks inherent in the exploration for and development of mineral deposits, risks relating to changes in iron ore prices and changes in the worldwide demand for, and supply of, iron ore, uncertainties inherent in the calculation of mineral reserves and resources, risks relating to the remoteness of the Mary River Property, including access and supply risks, reliance on key personnel, operational risks inherent in the conduct of mining activities, financing risks, regulatory risks, including risks relating to the acquisition of the necessary licences and permits, environmental risks and insurance 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.

### *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 ore reserves, to develop ore blending strategies 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.

The Mary River Property is the Company's only property. Accordingly, 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.

### *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.

### *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. 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 obtain permits the Company must first successfully complete environmental assessment processes through the Nunavut Impact Review Board (the "NIRB"), the Canadian Environmental Assessment Agency ("CEAA") and to successfully negotiate the Inuit Impact and Benefits Agreement ("IIBA"). The company requires additional permits and amendments to existing permits in order to expand exploration and geotechnical field activities in 2008, 2009, and 2010 in support of project advancement to construction. There can be no guarantee that the Company will be able to complete the environmental assessment processes, successfully negotiate an 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 are held in the form of leases held by 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.

The Company is currently negotiating a surface lease with the Qikiqtani Inuit Association ("QIA"). There can be no assurance that these negotiations will be successful. The company is currently operating with an extension to the existing QIA land permit.

### *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, some of which include: the particular attributes of the deposit, such as size, grade and proximity to infrastructure; metal prices, which can be cyclical, and government regulations, including regulations relating to prices, taxes, royalties, land tenure, land use, importing and exporting of minerals 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 combination of these factors may result in the Company not receiving an adequate return on invested capital.

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 at the Mary River Property will be upgraded to proven and probable ore reserves. The scoping study on Deposit No. 1 conducted for the Company is preliminary in nature and includes inferred mineral resources that are considered too speculative geologically to have the economic considerations applied to them that would enable them to be categorized as mineral reserves, and there is no certainty that the results described in the scoping study will be realized

### *Capitalization and Commercial Viability*

The Company's operating and capital expenditures are expected to increase in subsequent years with the advancing of exploration and development activities. The amounts and timing of expenditures will depend on the progress of ongoing exploration and development and on the Company's ability to finance such activities.

The Company's historical capital needs have been met by the issuance of common shares and Warrants. The Company will require substantial additional funds to further explore and, if warranted, develop the Mary River Property. In addition, the Company's non-revolving senior secured credit facility, which has a current balance of \$9,600,000, matures on February 24, 2008. 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 is typically required in order to place a property into commercial production. 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, including without limitation, the delay or indefinite postponement of the currently planned definitive feasibility study and the currently planned bulk sample. The terms of any additional financing obtained by the Company could result in substantial dilution to the shareholders of the Company. Various factors including the Company's exploration results could cause significant fluctuations in the price and volume of trading in the common shares and Warrants of the Company.

The Company currently has \$34,856,920 invested in asset backed commercial paper. Subsequent to September 30, 2007 the company collected \$16,754,432 of its \$16,949,920 million invested in Skeena Capital Trust ("Skeena") Series A Notes. The remaining balance of these investments are currently illiquid, and there can be no certainty that the Company will receive the return of all or any portion of this investments, or as to the timing of any resolution of the Company's claims in connection therewith. Although the Company currently records these investments at cost, their value may be impaired if and when a market for these investments is established. As a result the Company has recorded a \$2,000,000 reduction in the carrying amount of these investments.

It is a goal of the Company to add one or more strategic investors in addition to Mitsubishi Corporation. However, there can be no assurance that an additional strategic investor will invest in the Company or that such investment will be on favourable terms. Any future equity investment by a strategic investor would likely result in a dilution to the existing shareholders of the Company.

### ***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.

### ***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.

### ***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.

### ***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 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.

### *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.

### *Mining Operations*

Mining operations generally involve a high degree of risk. Such operations are 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. Hazards, such as unusual or unexpected rock formations, pressures or other conditions may be encountered in the drilling and removal of ore.

### *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 and crushed, the configuration of the ore body, ground and mining conditions, expected recovery rates of the ore, geotechnical conditions, availability of suitable construction materials and construction resources 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 Mary River Project will become an operating mine. If a mine is developed, actual operating results may differ from those anticipated in a feasibility study. 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.

### *Competition*

The mining industry is intensely competitive in all of its phases and the Company competes with many companies possessing greater financial and technical resources than it. Competition in the mining industry is primarily for mineral rich properties which can be developed and produced economically; the technical expertise to find, develop, construct and operate such properties; the labour to operate the properties; and the capital for the purpose of funding such properties. Many competitors not only explore for and mine minerals, but conduct refining and marketing operations on a world-wide basis. Such competition may result in the Company being unable to recruit or retain qualified employees or to acquire the capital necessary to fund its operations and develop the Mary River Project.

## CONTRACTUAL OBLIGATIONS

The following table lists as of September 30, 2007 information with respect to the Company's contractual obligations:

	Payments Due By Period				
	Total	Less than 1 year	1-3 Years	3-4 Years	After 5 Years
Bank Debt	9,600,000	9,600,000			
Office Lease	269,792	92,500	177,292	-	-
Purchase Obligations	3,988,734	1,781,953	2,206,781	-	-
Total	13,858,526	11,474,453	2,384,073	-	-

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:

- Conducting an exploration program at the Mary River Property to develop and expand the existing resource base. The Company recently completed a drilling program totalling 9,300 metres using six drills in 2007. The drilling program primarily focused on infill drilling on Deposit No. 1, geotechnical drilling to support the definitive feasibility study and further exploration drilling on Deposit No. 3.
- The company is currently planning an expanded drill program for 2008 - 2010 to include 10 drills. The primary focus will be geotechnical drilling at the port, mine site and along the railway corridor. In addition, infill drilling programs are anticipated to continue on Deposits No. 1, No. 2 and No. 3
- Defining the metallurgical characteristics of potential production from the Mary River Property and determining the level of customer acceptance of such product through metallurgical test-work.
- Completing a definitive feasibility study for Deposit No. 1 at 18 million tonnes per annum ("mtpa"), which is currently scheduled for February 2008. In support of these studies, work will continue on metallurgical testwork, market studies, environmental studies, transportation and shipping alternatives.
- In addition to a definitive feasibility study, completing studies of the satellite deposits, a blue sky study for Deposits No.1, No. 2 and No. 3 at 25 mtpa and an exploration targeting study.
- Initiating basic engineering in 2008 and completing a definitive capital cost estimate for construction in 2009 at the Mary River Property.
- Continuing the consultation process with the local communities on Baffin Island and in Nunavut with respect to the Company's existing operations, development plans, and negotiation towards an IIBA with the Qikiqtani Inuit Association ("QIA").

- Submitting regulatory permit applications with a detailed project description to the regulators in order to initiate the regulatory review. Submission of regulatory applications is currently scheduled for completion in the first quarter of 2008.
- Completing additional traditional knowledge studies and environmental baseline studies.
- Exploring the potential for integrated local participation in any development of the Mary River Property by continuing to develop and improve communication with local communities to both explore and maximize current and future training employment and business opportunities.
- Adding an additional strategic investor.

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, then 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 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.

## **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

### **New Accounting Standard**

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.

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

### **Going Concern**

Management has prepared the interim 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 from these estimates.

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

The carrying value of cash and cash equivalents, short term investments, 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 its Mary River iron ore property.

**Exploration Expenditures**

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

**Stock Based Compensation**

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

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

**Restated Interim Financial Statements**  
Third Quarter, September 30, 2007  
(Unaudited)

**BAFFINLAND IRON MINES CORPORATION**

(Development Stage Entity)

**BALANCE SHEETS**

(Unaudited)

	Restated As At September 30 2007	As At December 31 2006
<b>ASSETS</b>		
<b>Current</b>		
Cash and cash equivalents	\$ 22,130,246	\$ 12,451,283
Short term investments (Note 4)	16,949,920	-
Accounts receivable	2,653,777	388,979
Inventory (Note 5)	9,772,486	-
Prepaid expenses	880,708	1,136,134
	<u>52,387,137</u>	<u>13,976,396</u>
Mining interests (Note 6)	1	1
Long Term Investments (Note 4)	17,907,000	-
Capital assets (Note 7)	12,347,195	846,126
	<u>\$ 82,641,333</u>	<u>\$ 14,822,523</u>
<b>LIABILITIES</b>		
<b>Current</b>		
Bank Debt (Note 8)	\$ 9,600,000	\$ -
Accounts payable	18,253,000	2,669,565
	<u>27,853,000</u>	<u>2,669,565</u>
Future income tax liability (Note 11)	3,971,082	3,650,963
	<u>31,824,082</u>	<u>6,320,528</u>
<b>SHAREHOLDERS' EQUITY AND DEFICIT</b>		
Capital stock (Note 9)	125,634,753	47,093,202
Warrants (Note 9)	3,023,371	-
Contributed surplus (Note 9)	6,429,728	4,649,523
Deficit	<u>(84,270,601)</u>	<u>(43,240,730)</u>
	<u>50,817,251</u>	<u>8,501,995</u>
	<u>\$ 82,641,333</u>	<u>\$ 14,822,523</u>
<b>Nature of operations and going concern (Note 1)</b>		
<b>Contingencies and commitments (Note 14)</b>		

The accompanying notes are an integral part of the financial statements

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

	Three Months Ended September 30		Nine Months Ended September 30		Cumulative from January 1
	2007	2006	2007	2006	2003
Interest and other income	<u>210,983</u>	<u>\$90,436</u>	<u>\$895,792</u>	<u>\$1,026,649</u>	<u>\$2,266,656</u>
Expenses					
Exploration	37,730,220	14,159,034	58,983,243	21,140,759	109,302,477
Amortization	133,190	34,110	232,670	46,110	346,063
Salaries	603,071	245,999	1,465,005	583,299	2,707,452
Stock-based compensation (Note 10)	461,040	416,919	1,789,205	1,509,924	5,428,731
Office and general	282,045	9,782	744,032	237,222	1,501,861
Professional fees	161,989	102,714	581,456	302,931	1,695,797
Shareholder relations	102,079	115,232	194,527	347,708	718,731
Travel	91,152	29,803	183,018	114,104	428,255
Writedown of long term investments	2,000,000	-	2,000,000	-	2,000,000
	<u>41,564,786</u>	<u>15,113,593</u>	<u>66,173,156</u>	<u>24,282,057</u>	<u>124,129,367</u>
Net loss for the period before taxes	(41,353,803)	(15,023,157)	(65,277,364)	(23,255,408)	(121,862,711)
Future income tax recovery (Note 11)	<u>20,596,530</u>	<u>4,199,550</u>	<u>24,247,493</u>	<u>6,299,550</u>	<u>40,946,530</u>
Net loss and comprehensive loss for the period	(20,757,273)	(10,823,607)	(41,029,871)	(16,955,858)	(80,916,181)
Deficit, beginning of period	<u>(63,513,328)</u>	<u>(28,303,114)</u>	<u>(43,240,730)</u>	<u>(22,170,863)</u>	
Deficit, end of period	<u>(\$84,270,601)</u>	<u>(\$39,126,721)</u>	<u>(\$84,270,601)</u>	<u>(\$39,126,721)</u>	
Net loss per share (Note 13)	<u>(\$0.26)</u>	<u>(\$0.24)</u>	<u>(\$0.59)</u>	<u>(\$0.38)</u>	

The accompanying notes are an integral part of the financial statements

# BAFFINLAND IRON MINES CORPORATION

(Development Stage Entity)

## STATEMENTS OF CASH FLOWS

(Unaudited)

	Three Months Ended		Nine Months Ended		Cumulative from
	September 30		September 30		January 1
	Restated 2007	2006	Restated 2007	2006	Restated 2003
<b>Operating activities</b>					
Loss for the period	(\$20,757,273)	(\$10,823,607)	(\$41,029,871)	(\$16,955,858)	(\$80,916,181)
Items not effecting cash:					
Amortization expense	133,190	34,110	232,670	46,110	346,063
Stock-based compensation	461,040	416,919	1,789,205	1,509,924	5,428,731
Future income tax recovery	(20,596,530)	(4,199,550)	(24,247,493)	(6,299,550)	(40,946,530)
Writedown of long term investments	2,000,000	-	2,000,000	-	2,000,000
Other non cash items	-	-	-	-	(275,542)
	<u>(38,759,573)</u>	<u>(14,572,128)</u>	<u>(61,255,489)</u>	<u>(21,699,374)</u>	<u>(114,363,459)</u>
Increase in accounts receivable	(1,137,779)	(559,636)	(2,264,799)	(480,319)	(2,653,736)
Increase in inventory	(7,629,420)	-	(9,772,486)	-	(9,772,486)
(Increase) decrease in prepaid expenses	270,867	77,080	255,426	96,363	(880,708)
Increase in accounts payable	8,428,551	4,367,269	15,583,437	5,715,034	18,253,002
	<u>(38,827,354)</u>	<u>(10,687,415)</u>	<u>(57,453,911)</u>	<u>(16,368,296)</u>	<u>(109,417,387)</u>
<b>Investing activities</b>					
Purchase of capital assets	(3,058,170)	(758,148)	(11,733,739)	(825,269)	(12,693,258)
Increase in long term investments	(19,907,000)	-	(19,907,000)	-	(19,907,000)
Increase in short term investments	(16,949,920)	-	(16,949,920)	-	(16,949,920)
	<u>(39,915,090)</u>	<u>(758,148)</u>	<u>(48,590,659)</u>	<u>(825,269)</u>	<u>(49,550,178)</u>
<b>Financing activities</b>					
Increase in bank debt	16,600,000	-	16,600,000	-	16,600,000
Repayment of bank debt	(7,000,000)	-	(7,000,000)	-	(7,000,000)
Decrease in due to related parties	-	-	-	-	(132,421)
Net proceeds on issue of common shares and warrants	28,295,495	5,000,000	106,123,533	5,000,000	171,630,232
	<u>37,895,495</u>	<u>5,000,000</u>	<u>115,723,533</u>	<u>5,000,000</u>	<u>181,097,811</u>
<b>Increase (decrease) in cash</b>	(40,846,949)	(6,445,563)	9,678,963	(12,193,565)	22,130,246
<b>Cash position at beginning of period</b>	<u>62,977,195</u>	<u>13,644,825</u>	<u>12,451,283</u>	<u>19,392,827</u>	<u>-</u>
<b>Cash position at end of period</b>	<u>\$22,130,246</u>	<u>\$7,199,262</u>	<u>\$22,130,246</u>	<u>\$7,199,262</u>	<u>\$22,130,246</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 NINE MONTH PERIOD ENDED SEPTEMBER 30, 2007**  
**(Unaudited)**

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

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

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

These unaudited financial statements have been prepared using Canadian generally accepted accounting principles ("Canadian GAAP") applicable to a going concern, which assumes continuity of operations and realization of assets and settlement of liabilities in the normal course of business. However, 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, 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. RESTATEMENT OF INTERIM FINANCIAL STATEMENTS**

The Company has amended its previously reported interim financial statements as at and for the period ending September 30, 2007 to reclassify \$17,907,000 invested in Assets Back Commercial Papers ("ABCPs") from current to long term investments (Note 4). This restatement has no impact on total assets, results of operations or loss per share of the Company.

**3. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

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

The interim financial statements have been prepared by management in accordance with the accounting policies described in the Company's annual audited financial statements for the year ended December 31, 2006. For further information, refer to the audited financial statements and notes thereto for the year ended December 31, 2006.

## NOTES TO THE FINANCIAL STATEMENTS (contd)

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

#### **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;
- All derivative financial instruments be measured at fair value on the balance sheet, even when they are part of an effective hedging relationship.

Section 1530 introduces a new requirement to temporarily present certain gains and losses from changes in fair value in comprehensive income and accumulated comprehensive income. 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.

## NOTES TO THE FINANCIAL STATEMENTS (contd)

### 4. INVESTMENTS

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

As at September 30, 2007, the Company held \$34,856,920 of non-bank sponsored ABCPs. \$16,949,920 is invested in Skeena Capital Trust Series A ("Skeena") and has been classified as a current asset. The remaining \$17,907,000 invested in Structured Investment Trust III has been recorded as a long term asset. These financial assets are classified as held to maturity and are measured at amortized cost. The maturity dates of the ABCPs range from August 13, 2007 to August 30, 2007. At the time the Company acquired the investments, the non-bank sponsored ABCPs were rated R-1 (High) by DBRS Limited ("DBRS"), the highest credit rating for commercial paper.

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. On October 16, 2007, the Chairman of the Committee announced the proposed restructuring of Skeena, which is the first of 22 conduits to be restructured, and agreed upon an extension of the standstill agreement until December 14, 2007 at which time the Committee expects to have proposals to restructure all of the remaining conduits.

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 estimates the fair values of the Montreal Proposal ABCPs using a valuation technique which incorporates a probability weighted approach applied to discounted future cash flows considering the best available market data and management's intentions for such investments as at September 30, 2007 and as a result the Company has recorded a \$2,000,000 impairment charge as a reduction in fair value is considered to be other than temporary.

Since the fair values of the Montreal Proposal ABCPs are determined using a probability weighted approach and are based on the Company's assessment of market conditions as at September 30, 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. See note 15 for additional disclosure.

### 5. 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.

## NOTES TO THE FINANCIAL STATEMENTS (contd)

### 6. 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.

### 7. CAPITAL ASSETS

Capital assets are comprised of:

	September 30, 2007			December 31, 2006		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Exploration equipment	\$ 5,547,602	\$ 243,510	\$ 5,304,092	\$ 715,593	\$ 54,370	\$ 661,223
Furniture & fixtures	77,693	29,313	48,380	39,816	21,993	17,823
Leasehold improvements	106,685	34,220	72,465	106,685	18,220	88,465
Computer equipment	117,350	39,021	78,329	97,425	18,810	78,615
Construction in process	6,843,929	-	6,843,929	-	-	-
	<u>\$12,693,259</u>	<u>\$ 346,064</u>	<u>\$12,347,195</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 has arranged a non-revolving \$14 million senior secured credit facility to fund working capital requirements. As at September 30, 2007 \$9,600,000 has been drawn on the facility. The facility's interest rate is prime plus one and matures on February 24, 2008. Baffinland has provided a general security agreement covering all assets as collateral. The Company is required to reduce the facility with any proceeds received from the sale of the ABCP.

## NOTES TO THE FINANCIAL STATEMENTS (contd)

### 9. CAPITAL STOCK

**Authorized:** Unlimited common shares

**Issued:**

	Number of shares	Amount \$
<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	5,818,180	9,762,771 <sup>(ii)</sup>
<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	9,382,500
Share financing - flow through private placement September, 2007	5,128,204	11,831,998 <sup>(iv)</sup>
<b>September 30, 2007</b>	<u>88,125,729</u>	<u>125,634,753</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.

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

## NOTES TO THE FINANCIAL STATEMENTS (contd)

### 9. CAPITAL STOCK (contd)

In June 2007, a flow-through private placement was completed for an aggregate of 15,973,505 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 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 shares at a price of \$3.20 per share, for total gross proceeds to the Company of approximately \$10 million.

#### Contributed Surplus

Balance, December 31, 2005	\$ 2,475,987
Fair Value of options granted	<u>2,173,536</u>
Balance, December 31, 2006	4,649,523
Fair Value of options granted	1,789,205
Exercise of share purchase options	<u>(9,000)</u>
Balance, September 30, 2007	<u>\$ 6,429,728</u>

### 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.

A summary of the status of the Company's stock option plan as at September 30, 2007 and changes during the year ended December 31, 2006 are presented in the following table:

	2007		2006	
	Number	Weighted Average	Number	Weighted Average
Outstanding, beginning	4,223,000	1.93	2,161,000	1.46
Granted	730,000	2.57	2,062,000	2.43
Exercised	(5,000)	2.60	-	-
Cancelled	-	-	-	-
Outstanding, ending	<u>4,948,000</u>	<u>2.03</u>	<u>4,223,000</u>	<u>1.93</u>

## NOTES TO THE FINANCIAL STATEMENTS (contd)

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

#### Stock option disclosure:

As at September 30, 2007 stock options available for exercise is 3,878,750 at a weighted average price of \$1.90 and the aggregate fair value of unvested stock options granted is \$1,858,963.

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

Date options granted	Risk-free Interest rate	Expected Stock Volatility
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%

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 nine month period ended September 30, 2007 was \$1,789,205 (2006 - \$1,509,924).

## NOTES TO THE FINANCIAL STATEMENTS (contd)

### 11. INCOME TAXES

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

	<b>September 30</b>	<b>September 30</b>
	<b>2007</b>	<b>2006</b>
	<u>                    </u>	<u>                    </u>
Net loss for the period	(65,277,364)	(23,255,408)
Income tax recovery at Canadian federal and provincial statutory rates	(23,068,007)	(8,139,032)
Flow through share issuances	(1,811,763)	1,311,032
Permanent differences	632,277	528,450
Recovery of income taxes	<u>(24,247,493)</u>	<u>(6,299,550)</u>

The components of the recovery of income taxes comprise:

Future income tax recovery	<u>(24,247,493)</u>	<u>(6,299,550)</u>
Net income tax recovery	<u>(24,247,493)</u>	<u>(6,299,550)</u>

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

	<b>September 30</b>	<b>December 31</b>
	<b>2007</b>	<b>2006</b>
	<u>                    </u>	<u>                    </u>
<b>Future Income Tax Assets</b>		
Exploration & Development	-	2,614,000
Non-capital losses carried forward	2,381,000	907,000
Other temporary differences	311,000	380,000
Net future income tax asset	<u>2,692,000</u>	<u>3,901,000</u>
Valuation Allowance	(2,692,000)	(3,901,000)
Net future income tax asset recorded	<u>-</u>	<u>-</u>
<b>Future Income Tax Liabilities</b>		
Flow through share issuance	3,971,082	(3,650,963)
Net future income tax liability	<u>3,971,082</u>	<u>(3,650,963)</u>

## NOTES TO THE FINANCIAL STATEMENTS (contd)

### 11. INCOME TAXES (contd)

The Company has recorded a valuation allowance in respect of tax losses and other attributes valued at \$2,692,000 (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 September 30, 2007 a related party controlled by a director and a shareholder paid \$54,000 (2006 - \$54,000) 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 period. No effect has been given to the potential exercise of stock options in the calculation of fully diluted loss per share as the effect would be anti-dilutive. The weighted average number of common shares outstanding for the three and nine month periods ended September 30, 2007 amounted to 80,139,966 (2006 - 44,590,126) and 69,264,416 (2006 - 44,271,865), respectively.

### 14. CONTINGENCIES AND COMMITMENTS

Under the terms of existing lease agreements for office space, the Company is committed to annual lease payments of approximately \$92,500 plus operating costs. During the first nine months of 2007 the company paid approximately \$180,000 (2006 - \$180,000) 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 September 30, 2007, there is two years and eleven 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 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 EVENTS

Subsequent to September 30, 2007, the Company completed a flow-through private placement for an aggregate of 6,961,839 shares at a price of \$5.30 per share, for total gross proceeds to the Company of approximately \$36.9 million.

On December 24, 2007 the Company received \$16,754,432 of its \$16,949,920 million invested in Skeena Capital Trust ("Skeena") Series A Notes.

In December 2007 the Company repaid and cancelled the \$9,600,000 of outstanding bank debt