

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION FOR THE THIRD QUARTER ENDED SEPTEMBER 30, 2006

### INTRODUCTION

The following discussion and analysis of the financial condition and results of operations for **Baffinland Iron Mines Corporation (the "Company")** for the quarter ended dated September 30, 2006, should be read in conjunction with the audited Financial Statements and related Notes, and Management's Discussion and Analysis as at December 31, 2005. The Financial Statements and related Notes of the Company have been prepared in accordance with Canadian generally accepted accounting principles (GAAP). Additional information, including the Company's 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 October 26, 2006. All figures are in Canadian dollars, unless otherwise noted. The Company's shares are listed on the TSX (symbol BIM).

### OVERVIEW

Baffinland Iron Mines Corporation is a Canadian company engaged in the natural resource industry that was formed pursuant to Articles of Amendment under the Business Corporation Act (Ontario) on February 6, 2004.

Baffinland Iron Mines Corporation 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 the sole focus on the advancement of its Mary River iron ore deposits.

A scoping study coordinated by Aker Kvaerner E&C (A Division of Aker Kvaerner Canada Inc.) was completed during the second quarter of 2006. Aker Kvaerner E&C has commenced the definitive feasibility study, targeting completion in the second half of 2007.

Planning is underway for mobilization of contractors and equipment during the 2007 sealift, to prepare a 250,000 tonne bulk sample for shipment in the 2008 ice-free period from Milne Inlet. This bulk sample will afford several potential long-term customers the opportunity for extended production-scale evaluation of Mary River lump ore in their blast furnaces. Results of this evaluation should form the basis for negotiation of long-term marketing contracts which would support the financing of the project.

The project schedule incorporates time required to negotiate the Inuit Impact and Benefits Agreement during 2006 and 2007, completion of the Environmental Impact Assessment in 2007, followed by project permitting and financing in 2008. Basic engineering and the definitive capital cost estimate for construction will also be completed in 2008. As a result construction would commence in 2009.

The Mary River iron ore property hosts five high-grade hematite/magnetite deposits, which could result in a direct ship lump iron ore product in the order of approximately 10 million tonnes per year for 25 years or more. The project is in its early stages after having been originally discovered and studied in the 1960's and was held privately until recently. 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.

During the preparation of the Company's interim financial statements for 2006 management discovered a misstatement in the calculation of future income taxes. Accordingly, the financial statements for the fiscal year ended December 31, 2005 have been restated.

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**

	Restated Dec. 31 2005	Restated Dec. 31 2004	Dec. 31 2003
\$000's (unaudited)			
<b>ASSETS</b>			
Current	20,102	4,467	2,996
Capital	101	26	-
	<u>20,203</u>	<u>4,493</u>	<u>2,996</u>
<b>LIABILITIES AND EQUITY</b>			
Current	694	269	171
Due to related parties	123	123	239
	817	392	410
Future income tax liability	5,000	1,300	-
	5,817	1,692	410
Shareholders' equity	14,386	2,801	2,586
	<u>20,203</u>	<u>4,493</u>	<u>2,996</u>
<b>WORKING CAPITAL</b>	19,285	4,075	2,586
<b>COMMON SHARES OUTSTANDING (000's)</b>	44,112	25,761	7,184

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

	Restated Dec. 31 2005	Restated Dec. 31 2004	Dec. 31 2003
\$000's except per share (unaudited)			
<b>REVENUE</b>	155	31	40
<b>EXPENSES</b>			
Administrative	1,649	1,852	9
Exploration	15,035	8,489	312
	<u>16,684</u>	<u>10,341</u>	<u>321</u>
<b>LOSS before taxes and other items</b>	(16,529)	(10,310)	(281)
Future income tax recovery	5,900	2,100	
Financing fees		312	
Lease rental payments written off	-	-	(8)
	<u>-</u>	<u>-</u>	<u>(8)</u>
<b>NET LOSS</b>	<u>(10,629)</u>	<u>(7,898)</u>	<u>(289)</u>
<b>Per share (weighted average)</b>	<u>(\$0.32)</u>	<u>(\$0.41)</u>	<u>(\$0.08)</u>

Set forth below is certain selected financial information in respect of the eight most recently completed quarters 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 (unaudited)	Sep. 30 2006	Jun. 30 2006	Restated	Restated	Restated	Restated	Restated	Restated
			Mar. 31 2006	Dec. 31 2005	Sep. 30 2005	Jun. 30 2005	Mar. 31 2005	Dec. 31 2004
<b>ASSETS</b>								
Current	8,292	14,256	18,690	20,102	5,813	13,435	3,509	4,467
Capital	880	156	99	101	58	23	24	26
	<u>9,172</u>	<u>14,412</u>	<u>18,789</u>	<u>20,203</u>	<u>5,871</u>	<u>13,458</u>	<u>3,533</u>	<u>4,493</u>
<b>LIABILITIES AND EQUITY</b>								
Current	6,409	2,042	270	694	30	99	149	269
Due to related parties	123	123	123	123	123	123	123	123
	<u>6,532</u>	<u>2,165</u>	<u>393</u>	<u>817</u>	<u>153</u>	<u>222</u>	<u>272</u>	<u>392</u>
Future income tax liability	450	2,900	4,400	5,000	1,200	4,200	900	1,300
	<u>6,982</u>	<u>5,065</u>	<u>4,793</u>	<u>5,817</u>	<u>1,353</u>	<u>4,422</u>	<u>1,172</u>	<u>1,692</u>
Shareholders' equity	2,190	9,347	13,996	14,386	4,518	9,036	2,361	2,801
	<u>9,172</u>	<u>14,412</u>	<u>18,789</u>	<u>20,203</u>	<u>5,871</u>	<u>13,458</u>	<u>3,533</u>	<u>4,493</u>
<b>WORKING CAPITAL</b>	1,760	12,091	18,297	19,285	5,660	13,213	3,237	4,075
Common shares outstanding (000's)	46,112	44,112	44,112	44,112	35,362	35,362	25,776	25,761

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

\$000's except per share (unaudited)	Sep. 30 2006	Jun. 30 2006	Restated	Restated	Restated	Restated	Restated	Restated
			Mar. 31 2006	Dec. 31 2005	Sep. 30 2005	Jun. 30 2005	Mar. 31 2005	Dec. 31 2004
<b>REVENUE</b>	90	187	750	33	54	52	16	9
<b>EXPENSES</b>								
Administrative	955	1,116	1,071	412	481	306	450	182
Exploration	14,159	5,663	1,319	3,466	7,383	3,477	709	1,739
	<u>15,114</u>	<u>6,779</u>	<u>2,390</u>	<u>3,878</u>	<u>7,864</u>	<u>3,783</u>	<u>1,159</u>	<u>1,921</u>
LOSS before income taxes and undnotated	(15,024)	(6,592)	(1,640)	(3,845)	(7,810)	(3,731)	(1,143)	(1,912)
Future income tax recovery	4,200	1,500	600	1,000	3,000	1,500	400	2,100
Financing fees	-	-	-	-	-	-	-	312
<b>NET LOSS</b>	<u>(10,824)</u>	<u>(5,092)</u>	<u>(1,040)</u>	<u>(2,845)</u>	<u>(4,810)</u>	<u>(2,231)</u>	<u>(743)</u>	<u>500</u>

## **OPERATIONS**

The net loss recorded by the Company for the quarter ended September 30, 2006 was \$10,823,607 compared to a net loss of \$4,810,078 for the same period in 2005. The net loss for the nine month period ended September 30, 2006 was \$9,171,221 higher than the same period of the previous year.

During the quarter ended September 30, 2006 the Company recorded interest and other income of \$90,436 as compared to \$54,061 for the same period in 2005. When compared to the third quarter of 2005, the Company had significantly more cash and equivalents on hand during the third quarter of 2006 which has generated additional interest income. Year to date interest and other income was higher primarily due to a payment received as part of an agreement with Apollo Gold Corporation.

Exploration expenditures of \$14,159,032 were \$6,776,327 more during the third quarter of 2006 as compared to the same period of 2005 due to the advancement of metallurgical testwork, environmental baseline studies, and various studies related to the definitive feasibility study which is expected to be completed late in the fourth quarter of 2007. Year to date exploration expenditures are approximately 83% higher than the prior year. Additional geotechnical and drilling evaluation work was performed during the first nine months of 2006 as compared to the same period of 2005.

Management salaries increased by \$183,461 for the three month period ended September 30, 2006 when compared to the same period of the previous year. The increase is due to the addition of senior staff. Management salaries for the nine month period ended September 30, 2006 were higher than the same period of the previous year for the reason noted above.

Office and general for the three and nine month period ending September 30, 2006 was \$9,782 and \$237,222, \$63,527 lower and \$36,276 higher than the same period of 2005 respectively.

Shareholder relations expense increased by \$90,688 for the three month period ended September 30, 2006 when compared to the same period of the previous year. The increase is due to the engagement of an investor relations consulting firm as well as, an increase in the number of events and investor presentations attended during the third quarter of 2006.

Professional fees increased by \$86,720 as compared to the same period of 2005. The primary reason for the increase in professional fees for the three and nine month period ended September 30, 2006 is additional fees related to the Company listing its shares on the TSX.

For the three and nine month period ended September 30, 2006 travel expense increased by \$24,636 and \$99,158 respectively. This increase is a result of increased activity related to the definitive feasibility study.

## **RELATED PARTY TRANSACTIONS**

Related party expenditures during the quarter ended September 30, 2006 were nil (2005 - \$45,000). In 2005, this amount was paid to a related company controlled by a director and a shareholder for an administrative fee which included rent, accounting, corporate, and office services. This was incurred in the normal course of business at market rates. The contract to provide these services lapsed on August 31, 2005.

The \$123,347 due to related parties as at September 30, 2006 (2005 - \$123,347) is payable to two directors of the Company. The balance is non-interest bearing and has no set terms of repayment.

## **CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

### **Use of estimates**

The preparation of financial statements in accordance with Canadian GAAP required 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 equivalents, accounts receivable, prepaid expenses, 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 has adopted the accounting recommendations, EIC 126 - Accounting by Mining Enterprises for Exploration Costs, issued by the CICA regarding the expensing of exploration expenditures as they are incurred. During the three month period ended September 30, 2006, \$14,159,032 (2005 - \$7,382,705) of exploration expenditures were incurred on the Company's Baffin Island project. To date exploration expenditures are \$44,985,450.

### **Stock Based Compensation**

The Company has adopted the accounting recommendations of the CICA Handbook Section 3870 - Stock Based Compensation and Other Stock Based Payments. Compensation expense and contributed surplus will be recognized when stock options are granted to the extent of 25% with the remaining 75% being recognized equally over the remaining vesting period. The expense recorded for the three and nine month period ended September 30, 2006 amounted to \$416,919 and \$1,509,924 (2005 - \$291,615 and \$575,865) respectively.

Option pricing models used in calculating stock-based compensation require the use of highly subjective estimates and assumptions including the expected stock price volatility. Changes to these estimates and assumptions may materially affect the calculations.

Please refer to the notes of the interim financial statements of the Company dated September 30, 2006 for further information on the Company's financial policies and estimates.

## CAPITAL STOCK

During the quarter ended September 30, 2006 a private placement was completed resulting in 2,000,000 shares being issued for net proceeds of \$5,000,000.

The issued and outstanding capital of the Company at September 30, 2006 is 46,111,865 common shares.

Details of stock option grants during 2005 and 2006 to date are as follows:

Grant Date	Number of Options	Exercise Price	Expiry Date
March 11, 2005	646,000	\$2.30	March 10, 2010
July 5, 2005	190,000	\$1.18	July 4, 2010
October 13, 2005	50,000	\$1.50	October 12, 2010
January 3, 2006	611,000	\$2.15	January 2, 2011
January 27, 2006	300,000	\$2.75	January 26, 2011
July 10, 2006	205,000	\$1.99	July 9, 2011

During the year ended December 31, 2005 options on 75,000 common shares granted on March 11, 2005 were cancelled.

On October 26, 2006 the company completed a private placement and issued on a flow-through basis 5,818,180 common shares for net proceeds of approximately \$15,499,995. The common shares issued are subject to a four month hold period.

## LIQUIDITY AND CAPITAL RESOURCES

Working capital was \$1,759,756 at September 30, 2006 compared to \$19,284,399 at December 31, 2005.

Current assets at September 30, 2006 were \$8,292,349 compared to \$20,101,958 at December 31, 2005, a decrease of \$11,809,609. Cash and equivalents decreased by \$12,193,565, accounts receivable increased by \$480,319. During the third quarter and for the year 2006 the Company has spent \$14,159,032 and \$21,140,757, respectively on exploration as it continues to gather information for various studies that are in progress.

Current liabilities at September 30, 2006 were \$6,532,593 compared to \$817,559 at December 31, 2005, an increase of \$5,715,034. The accounts payable increase is a result of increased activity pertaining to the Company's Mary River Iron ore property.

	Sept. 30, 2006	Dec. 31, 2005
Cash and equivalents are composed of:		
Cash	\$5,912,235	\$7,112,847
Restricted cash related to flow through financings	1,287,027	12,279,980
	<u>\$7,199,262</u>	<u>\$19,392,827</u>

The Company is dependent on obtaining future financings for the exploration and development of our properties and for the acquisition of any new projects. There is no assurance that such financings will be available when we require them, or under terms that are favourable to us.

## CAPITAL STOCK AND DEFICIT

Capital stock and Deficit at September 30, 2006 was \$2,189,621 compared to \$14,385,555 at December 31, 2005, a decrease of \$12,195,934. This occurred as a result of the following:

Contributed surplus (fair value vested portion of stock options granted)	\$1,509,924
Private placement, flow through	3,250,000
Deficit:	
Loss for the period	<u>(16,955,858)</u>
	<u>(\$12,195,934)</u>

The following common shares and convertible securities were outstanding at October 26, 2006:

	Expiry Date	Exercise Price (Cdn\$)	Securities Outstanding	Common Shares on Exercise
Common shares				51,930,045
Options	Feb 25/09 to Jul 9/11	1.00 to 2.75	3,277,000	3,277,000

## RISKS AND UNCERTAINTIES

The exploration for and development of mineral deposits involve significant risks, which even a combination of careful evaluation, experience and knowledge may not eliminate. Major expenses will be required to locate and establish mineral reserves and to construct mining and transportation facilities at our Mary River site on Baffin Island. It is impossible to ensure that the exploration programs planned by the Company will result in a profitable commercial mining operation. Whether a mineral deposit will be commercially viable depends on a number of factors, some of which are: the particular attributes of the deposit, such as size, grade and proximity to infrastructure; metal prices, taxes, royalties, land tenure, land use, importing and exporting of minerals and environmental protection. The exact effect of these factors cannot accurately be predicted, but the combination of these factors may result in the Company not receiving an adequate return on invested capital. Mining companies are subject to a wide range of risks, including, but not limited to: equity dilution risk, environment risk, permitting risk, political risk, operational risk, financial risk, hedging risk, commodity price fluctuation risk, borrowing risk, interest and currency risk. To date the Company has not recorded any revenues from its mining operations nor has the Company commenced commercial production on its property. The Company's operating and capital expenditures will increase in subsequent years with the advancing of exploration, development, and commercial production. The amounts and timing of expenditures will depend on the progress of ongoing exploration and development.

Various factors including the Company's exploration results and general economic conditions could cause significant fluctuations in the price and volume of trading in the Company's common shares. Holders of Baffinland shares could suffer dilution by future share offerings.

Our financial success is dependent upon the success of our efforts on Baffin Island. Our historical capital needs have been met by the issue of common shares and special warrants. We do not have internal sources of funding to cover all of our future expenditures. We will need significant further funding to allow for the continuing exploration and development of the Company's Baffin Island iron ore project.

## CONTRACTUAL OBLIGATIONS

Under the terms of an office premises lease with a commencement date of November 1, 2005, having a term of 5 years, and a one time right to renew the lease, the Company is committed to annual lease payments of approximately \$92,400 plus operating costs.

The company signed a letter of intent in July 2006 with the Qikiqtaaluk Corporation (QC), a construction company engaged to upgrade the Mary River road. The Company is committed to pay \$946,514 over a nine month period ending March 31, 2007, \$1,820,500 over the twelve month period ending March 31, 2008 and \$1,906,476 over the five month period ending August 31, 2008.

## OUTLOOK

For 2006, the Company has budgeted 7,000 metres of diamond drilling of its 100%-owned iron ore properties on Baffin Island with 4,000 metres of this total designed as in-fill, geotechnical, and condemnation drilling of Deposit No. 1. The balance of the proposed drilling in 2006 is designed as exploration drilling of the satellite deposits. Upon completing the Scoping Study by Aker Kvaerner E&C, the Company transitioned to a Definitive Feasibility Study targeted for completion in 2007. In support of these studies, work will continue on metallurgical testwork, market studies, environmental studies, transportation, and shipping alternatives. In addition, the Company plans on expanding its community consultation program in preparation for the negotiation of an Inuit Impact and Benefits Agreement.

## DIRECTORS AND OFFICERS

Brian L. Acton	Director
Robert J. Chausse	Vice-President and CFO
Graham G. Clow	Director
Rodney A. Cooper	Vice-President Operations and COO
Edward G. Dumond	Secretary - Treasurer
John W. Lydall	Director
Richard D. McCloskey	Director - Chairman
Gordon A. McCreary	Director - President and CEO
Brian W. Penny	Director
Gordon Watts	Director
Michael T. Zurowski	Director - Executive Vice-President

**October 26, 2006**

### CAUTIONARY NOTE:

*This press release contains certain information that 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", "plan", "anticipate", "believe", "intend", "estimate", "predict", "potential", "continue" or other similar expressions concerning matters that are not historical facts. Particularly, information about the potential for a direct-shipping iron ore operation is forward-looking information.*

*Forward-looking information is based on certain factors and assumptions regarding, among other things, expected mineral resources, iron ore prices and the feasibility of constructing and operating a direct-shipping iron ore mine at the Company's Mary River project. While the Company considers these assumptions to be reasonable based on information currently available to it, they may prove to be incorrect.*

*Forward looking-information is subject to certain factors, including risks and uncertainties that could cause actual results to differ materially from what is currently expected. These factors include risks relating to exploration and development, risks relating to the worldwide price of, demand for and supply of iron ore and risks relating to the construction and operation of a mine at the Company's Mary River project. 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.*