



**BAFFINLAND IRON MINES CORPORATION  
THIRD QUARTER REPORT**

**September 30, 2010**



**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION  
FOR THE THREE AND NINE MONTH PERIODS ENDED SEPTEMBER 30, 2010**

## MANAGEMENT'S DISCUSSION AND ANALYSIS

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, 2010 ("MD&A"), and its financial position as at September 30, 2010, and should be read in conjunction with the unaudited financial statements of the Company as at and for the three and nine month periods ended September 30, 2010, and related notes thereto, and the audited financial statements and MD&A for the financial year ended December 31, 2009 and the related notes thereto (the "Audited Financials"). The Company's financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP"). Additional information relating to the Company, including the Company's Annual Information Form dated March 25, 2010 ("AIF") and subsequent press releases have been filed electronically through the System for Electronic Document Analysis and Retrieval ("SEDAR") and are available online under the Company's profile at [www.sedar.com](http://www.sedar.com). The date of this MD&A is November 2, 2010.

The Company's common shares and common share purchase warrants are listed on the Toronto Stock Exchange (the "TSX") under the trading symbols "BIM" for the common shares, "BIM.WT" for the 2007 Warrants and "BIM.WT.A" for the 2009 Warrants, respectively. See "Common Shares" for details on the Company's outstanding warrants. All figures are in Canadian dollars unless otherwise noted.

*Included in this MD&A are matters that constitute "forward-looking" information within the meaning of Canadian securities law. See "Cautionary Note Regarding Forward-Looking Information".*

## BUSINESS OF THE COMPANY

### *The Company*

Baffinland was formed under the *Business Corporation Act* (Ontario) on March 10, 1986. The Company is a publicly traded junior mining company focused on the exploration and development of the iron ore deposits located on its 100% owned Mary River Property. The Mary River Property consists of eight high grade direct shipping iron ore deposits referred to as Deposit Nos. 1, 2, 3, 4, 5, 6, 7 and 8 (the "Mary River Property" or "Property"). Deposit Nos. 1, 2 and 3 are closely adjacent to each other less than three kilometres apart; Deposit No. 4 lies about 27 kilometres to the northwest of Deposit Nos. 1, 2 and 3; and Deposit No. 5 is located less than five kilometres southeast of Deposit No. 4. The newly discovered Deposit No. 6 is located approximately 25 kilometres east-northeast of Deposit No. 1 and the newly discovered Deposit No. 7 is located some 12 kilometres north of Deposit No. 6. The newly discovered Deposit No. 8 is located approximately 95 kilometres east-south-east of Deposit No. 1.

### *Mary River Property*

The Mary River Property covers a total area of approximately 73,413 hectares consisting of: (i) three mining leases totalling 1,593 hectares, (ii) 18 mineral claims totalling 12,950 hectares, (iii) two exploration areas totalling 18,120 hectares, and (iv) 41 newly staked claims totalling 40,750 hectares in four blocks. The newly staked claims are on crown land and Inuit Owned Land (surface rights only).

The two exploration areas are subject to the terms and conditions of an exploration agreement between the Company and Nunavut Tunngavik Inc. ("NTI") dated May 2009 (the "NTI Agreement") pursuant to which the Company is obliged to pay annual fees and complete certain annual work commitments. The Company has rights to Deposit No. 5 in part through its staked mineral claims and in part through the NTI Agreement. If Deposit No. 5 achieves definitive feasibility, then NTI may participate in a joint venture or hold a net profits interest royalty in respect of a part of Deposit No. 5. Deposit Nos. 1, 2, 3 and 4 are located on the Company's mining leases. Newly discovered Deposit Nos. 6, 7 and 8 are located on mineral claims wholly-owned by the Company.

The Company has a commercial surface land lease (the "QIA Lease") with the Qikiqtani Inuit Association ("QIA"). Through the QIA Lease, both Indian and Northern Affairs Canada and QIA land use permits, the NTI Agreement and the staked claims the Company is able to access the land on which the deposits are situated.

Mineral reserve and resource estimates for Deposit Nos. 1, 2 and 3 prepared in accordance with National Instrument 43-101 - Standards of Disclosure for Mineral Projects ("NI 43-101") by Aker Solutions (formerly Aker Kvaerner E&C) ("Aker") were disclosed in the "Technical Report of the Definitive Feasibility Study - Mary River Iron Ore Project, Northern Baffin Island, Nunavut" dated February 2008 (the "2008 DFS") and total 865 million tonnes of which 365 million tonnes are proven and probable reserves grading 64.7% iron, 52 million tonnes are measured and indicated resources grading 64.6% iron and 448 million tonnes are inferred resources grading 65.5% iron. To date, the majority of the Company's work has been on Deposit No. 1, which is the best known of the deposits. These reserves and resources are based upon exploration and development drilling completed by the Company to the end of 2007.

## *Mary River Project*

The 2008 DFS also includes a detailed study of the technical and economic feasibility of Deposit No. 1 based on proven reserves of 160 million tonnes grading 64.3% iron and probable reserves of approximately 205 million tonnes grading 64.9% iron and contemplates the development of the Steensby Inlet Port and Rail Project (the "Rail Project"). The 2008 DFS indicates that, based on the shipment of 18 million tonnes of iron ore per year to the European market, the proven and probable reserves could sustain a mine life of over 20 years. Also in 2008, Baffinland completed a scoping-level study to expand production beyond the 18 million tonnes per year contemplated in the 2008 DFS to 30 million tonnes per year. In order to achieve commercial production on the Project, it is necessary for the Company to: (i) obtain significant additional equity and/or debt financing, (ii) enter into a strategic partnership, and/or (iii) implement other alternatives to advance the Project (one or more of such alternatives referred to hereinafter as "Financing Alternatives"), and there is no assurance that such Financing Alternatives will be obtained on favourable terms, or at all. Failure to achieve one or more of the Financing Alternatives could result in the delay or indefinite postponement of further exploration and development of the Project. In order for the Company to complete the recommendations in the 2008 DFS and resume development activities in respect of the Rail Project, it is necessary for the Company to achieve one or more of the Financing Alternatives. See "Risk Factors".

In July 2010, after completing an internal conceptual study related to a haulage alternative along the existing Milne Inlet tote road, the Company commissioned an internationally recognized engineering firm to complete a feasibility study for a road haulage project (the "Road Haulage DFS") that could result in early stage iron ore production (the "Road Haulage Project") at Deposit No. 1 while the Company continues to pursue the development of the Rail Project. The Road Haulage DFS is examining mining and road haulage along the existing Milne Inlet tote road and shipping using market vessels during the open water season in Milne Inlet with an expected optimized annual production rate of approximately 3 million tonnes of iron ore, with capital costs anticipated to be much lower than the Rail Project. The initial conceptual study completed by the Company has limited production occurring as early as 2013 with full production occurring during the open water season in 2014. Results of the Road Haulage DFS are expected at the end of 2010. Beginning mid-2010, the Company also accelerated the completion of its Draft Environmental Impact Statement ("Draft EIS") with intended submission by the end of 2010, and intends to work towards the completion of the full environmental assessment and permitting process by late 2012 to early 2013.

## *Recent Developments*

On September 22, 2010 an unsolicited take-over bid was made by Nunavut Iron Ore Acquisition Inc. (the "Offeror"), a corporation wholly-owned by Iron Ore Holdings, LP, to the shareholders of the Company to acquire all of the issued and outstanding common shares of the Company (other than common shares of the Company owned by the Offeror or any of its affiliates), together with the associated rights issued and outstanding under the shareholder rights plan of the Company, at a price of \$0.80 in cash per common share (the "Unsolicited Offer"). The Unsolicited Offer is not a "permitted bid" under the Company's shareholder rights plan. The Board of Directors appointed a special committee to review the Unsolicited Offer and has been working to evaluate a range of strategic alternatives that may enhance value for shareholders. Baffinland has been approached by, and has initiated contact with, a number of third parties who have expressed an interest in considering alternative transactions. At the time the Unsolicited Offer was announced, the Company was in advanced negotiations with one major multinational company for a potential transaction with respect to the Mary River Property.

On October 7, 2010, the Company released the Directors' Circular in which the Board of Directors of the Company, upon the recommendation of the Special Committee, unanimously recommended that shareholders of the Company reject the Unsolicited Offer and not tender their common shares to the Unsolicited Offer. The Directors' Circular outlines the nine reasons for the recommendation, some of which are, that the Unsolicited Offer significantly undervalues the Mary River Property, that the Unsolicited Offer is at a significant discount to precedent transaction multiples, and is highly opportunistic and conditional.

On October 28, 2010, the Offeror extended the Unsolicited Offer until November 8, 2010 and indicated that it intends to make an application to the Ontario Securities Commission requesting that the Commission hold a hearing to consider cease trading the Company's shareholder rights plan and the rights issued thereunder.

## EXPLORATION AND DEVELOPMENT OF THE MARY RIVER PROPERTY

### 2010

The Company's 2010 year-to-date activities and results include:

#### *Exploration*

- Drilling at Deposit Nos. 5, 4 and 3 to delineate high grade iron ore mineralization, totalling 6,802 metres in 44 holes;
- Results from the first two holes drilled at Deposit No. 5 intersected a combined weighted average 114.8 metres of 62.6% iron; and 74.0 metres of 65.4% iron, respectively;
- Regional exploration successfully discovered three new deposits, Deposit Nos. 6, 7 and 8 in the vicinity of Glacier Lake and the Turner River areas, respectively. At Deposit No. 6, assays from surface sampling averaged 67.1% iron which is exposed for an approximate one kilometre strike length and up to 170 metre width. Deposit No. 7 averaged 66.1% iron in surface sampling of high grade iron ore that is exposed for a 700 metre strike length and up to 100 metre width. Deposit No. 8 averaged 68.4% iron in surface sampling of a high grade iron ore that is exposed for a 400 to 600 metre strike length and up to 50 metre width; and
- Additional mineralized zones and potential drill targets were outlined; mapped and sampled at surface; the results of which are currently being evaluated.

#### *Development*

- Continuing with the preparation of the Road Haulage DFS, expected to be completed by the end of 2010;
- Continuing with the environmental assessment process including the preparation of the Draft EIS with submission anticipated in December 2010 (See "Outlook");
- Negotiating towards completion of the Inuit Impact and Benefits Agreement ("IIBA") in principle; and
- Completing certain permit driven progressive reclamation activities at the Property.

#### *Financing Alternatives*

The Company has continued to seek Financing Alternatives to develop the Mary River Project. In late 2009 it received a proposal from a major multinational company and subsequently entered into negotiations in respect of a potential transaction. The negotiations continued through 2010 and had reached an advanced stage at the time that the Unsolicited Offer was made to the shareholders of Baffinland. The potential transaction would have involved a joint venture to develop the Mary River Project. Negotiations of this transaction, which had been proceeding on an exclusive basis, were interrupted by the Unsolicited Offer, however the parties remain subject to an existing confidentiality agreement. The Special Committee of the Board has been working to evaluate a range of strategic alternatives that may enhance shareholder value.

See "Outlook" for updated activities planned for the balance of 2010.

#### *Mine Development and Exploration Expenditures*

During the nine month period ended September 30, 2010 development and exploration expenditures were incurred to execute the 2010 program. These expenditures related to the drilling program on Deposit Nos. 5, 4 and 3 and the regional exploration program which resulted in the discovery of Deposit Nos. 6, 7 and 8. These expenditures were expensed to the income statement. In the prior similar period the expenditures incurred related to the 2009 program which was focused on developing Deposit No. 1 and as such those costs were capitalized to mining interests since mining reserves have been established on Deposit No. 1. Total expenditures of \$26,090,886 were incurred during the nine month period ended September 30, 2010, compared to expenditures of \$16,688,579 for the similar prior period.

Set forth below is certain information in respect of the Company's mine development and exploration expenditures:

	For the nine months ended	
	September 30, 2010	September 30, 2009
Mine Development/Exploration	\$18,068,390	\$13,539,807
Definitive Feasibility Study/Technical Services	394,080	513,491
Health and Safety	\$452,590	538,115
Sustainable Development	\$999,930	1,631,791
Environmental Assessment Process	\$3,703,689	-
Metallurgical Testing	\$241,018	465,375
Development costs- Road Haulage DFS	\$2,231,189	-
<b>Total expenditures</b>	<b>\$26,090,886</b>	<b>\$16,688,579</b>

Of the aggregate expenditures in the nine months ended September 30, 2010, and relating to mine development and exploration, \$20,156,008 (2009 \$673,645) has been expensed to the income statement as exploration. Development costs in the amount of \$5,934,878 relate to the environmental assessment process and have been capitalized to mining interests for the nine month period ended September 30, 2010. For the similar period in the prior year, development costs of \$16,014,934 were capitalized to mining interests relating to Deposit No. 1.

## 2009

### *Exploration Program*

The primary goal of the 2009 program was to explore and identify the southern limits of Deposit No. 1 to assist in further resource delineation and infrastructure planning for the Rail Project. A total of 2,316 metres of core, in 13 holes were drilled.

### *Bulk Sample Program*

During 2008, the Company shipped three bulk sample trial cargos, two of which were of lump cargos and one of which was a fine iron ore cargo, totalling 113,217 tonnes to two leading European steel companies for evaluation. In late 2009 and early 2010, the Company released the test results which were excellent as the inclusion of Mary River lump and fine iron ore in the blast furnaces saw improved productivity and quality of hot metal (pig iron) produced. In the view of management, the work confirms Mary River iron ore as a high quality and desired iron ore for use in all blast furnaces.

### *Environmental Bonding Facility*

In August 2009, the Company entered into a definitive agreement for an environmental guarantee support facility (the "Environmental Bonding Facility") with Resource Capital Funds ("RCF") in the maximum amount of US\$13 million, maturing on December 31, 2012. The Company drew US\$9.5 million (equivalent of C\$10.37 million) to cover an increase in financial security in relation to closure costs under the QIA Lease ("Financial Security") to C\$16.5 million. On December 10, 2009, in conjunction with the closing of the 2009 Equity Offerings, the balance of US\$9.5 million outstanding under the Environmental Bonding Facility was repaid in full and the first ranking charge over all of the Company's assets to secure the Company's obligation under the Environmental Bonding Facility was released.

### *Deposit No. 5*

In October 2009, the Company announced high grade iron assay results from surface samples from the newly discovered Deposit No. 5. Assays averaged 66.7% iron along the southeast trending strike length of Deposit No. 5 that can be traced at surface for greater than five kilometres. A magnetic survey completed in 2008 defined a target horizon that can be traced for a strike length of more than 60 kilometres.

## 2008 DFS for Rail Project

In February 2008, the Company released the results of the 2008 DFS which included a detailed study of the technical and economic feasibility of Deposit No. 1 based on proven reserves of 160 million tonnes and probable reserves of approximately 205 million tonnes and the Rail Project. The 2008 DFS indicates that, based on the shipment of 18 million tonnes of iron ore per year to the European market, the proven and probable reserves could sustain a mine life of over 20 years. Assuming FOB Steensby Inlet and average sale prices of US\$103.7 per tonne for lump iron ore and US\$84.7 per tonne for fine iron ore, the 2008 DFS indicates that the Rail Project could generate a pre-tax internal rate of return of 20.5%, with a payback period of 3.7 years and an after-tax internal rate of return of 15.9%. The 2008 DFS forecasts pre-tax cash flow over the life of the Rail Option to be \$18.1 billion, with after-tax cash flow of \$11.2 billion.

The 2008 DFS estimated, as of the date thereof, the initial capital costs for the Rail Project to be \$4.1 billion, including all direct and indirect costs, contingencies and owner's costs. Sustaining capital was estimated to be \$400 million over the life of the Rail Project, including Rail Project reclamation and closure costs. Operating costs for all of the facilities was estimated to be \$14.62 per tonne, excluding taxes and financing costs.

The 2008 DFS was based on a long-term price of US\$103.7 per dry metric tonne unit for lump iron ore and US\$84.7 for fine iron ore, which is approximately 50% below the current European-based price industry outlook for iron ore, and approximately 60% below the 2010 European-based price for iron ore with an expected lump to fine iron ore production ratio from the Mary River Project of 75% to 25%.

The following tables provide itemized summaries for the estimated operating and capital costs of the Rail Project based on the 2008 DFS:

Summary of Total Capital Costs		Summary of Operating Costs per Tonne	
Direct Costs	\$ Millions		\$/Tonne
Mining	23	Mining	4.08
Mary River Site	591	Crush / Screen / Load	4.89
Railway	1,215	Railway	1.45
Steensby Site (Port)	706	Camp / Catering	0.59
<b>Direct Costs Subtotal</b>	<b>2,535</b>	Aircraft Services	0.60
		Leased Equipment	0.40
<b>Indirect Costs</b>		G&A Onsite	2.25
Support	988	G&A Offsite	0.36
Owner's Costs	86	<b>Operating Cost Total</b>	<b>14.62</b>
Gravel	29		
Contingency	437		
<b>Indirect Cost Subtotal</b>	<b>1,540</b>		
<b>Initial Capital Cost Total</b>	<b>4,075</b>		

Since the date of the 2008 DFS, the construction execution strategy developed in the 2008 DFS has been further reviewed and improved.

The assumptions that are most sensitive in the capital cost estimate are the assumption of parity between the Canadian and US dollar during the construction period, the geotechnical design criteria for the railway alignment and assumptions regarding construction costs and labour as well as material costs. The assumptions that are most sensitive post commercial production period are iron ore prices, operating cost estimates which are at an average Canadian/U.S. dollar exchange rate of US\$0.85:C\$1.00 during the operating period and average fuel prices during the operating period of US\$60 per barrel. Although the Company considered these assumptions to be reasonable based on information available to it at the time of the 2008 DFS, they may prove to be incorrect. These capital and operating cost estimates are subject to certain factors, including risks and uncertainties, which could cause actual results to differ materially from what management currently expects. See "Risk Factors". For a complete description of the assumptions, qualifications and procedures associated with the following information, reference should be made to the full text of the 2008 DFS which is available for review on SEDAR located at [www.sedar.com](http://www.sedar.com). Alternatively, the 2008 DFS may be viewed upon prior request during normal business hours at the offices of the Company located at 120 Adelaide Street West, Toronto, Ontario, M5H 1T1.

Readers should be aware that, since the effective date of the 2008 DFS, there have been proposed modifications to the Rail Project and changes in the macro-economic conditions which may impact the assumptions and may require modifications to the 2008 DFS if an update was prepared. Upon commencement of construction there can be no certainty that the capital and operating cost estimates set out in the 2008 DFS will remain accurate.

The 2008 DFS set forth a number of recommendations to advance the development of the Rail Project. In order to advance the development of the Rail Project, the Company will be required to achieve one or more Financing Alternatives and there is no assurance that such Financing Alternatives will be achieved on favourable terms or at all which could result in the delay or indefinite postponement of further development of the Project. As a result of current funding levels, the completion of certain 2008 DFS recommendations has been deferred until the Company achieves certain Financing Alternatives. The Company is not funded to execute the development activities required through to the potential commercial production date. Timelines for the Project are continuously reviewed and are contingent on Financing and/or timing of receipt of required permits. See "Risk Factors".

## Outlook – Balance of 2010

For the remainder of 2010, the Company intends to continue to explore and develop the Property through the following activities:

### *Exploration*

- Complete assay and analytical work from the 2010 drill program on Deposit Nos. 5, 4 and 3 towards increasing inferred mineral resources at the Mary River Property, on which NI 43-101 reporting is anticipated in the first half of 2011;
- Complete assays and analytical work from the regional exploration program at the Mary River Property; and
- Review the Mary River Project and further analyse results from the 2010 program to determine prospectivity and potential of the newly discovered deposits and mineralized occurrences.

### *Development*

- Complete the Road Haulage DFS with the results expected by the end of 2010. See “Liquidity and Capital Resources – Current Market Conditions”;
- Complete and file the Draft EIS. See “Liquidity and Capital Resources – Current Market Conditions”;
- Continue to negotiate with the QIA towards achieving an IIBA in principle; and
- Continue to engage with local communities, the QIA, various levels of government and other Mary River Property stakeholders.

### *Financing Alternatives*

- The Company has been seeking one or more Financing Alternatives. At the time the Unsolicited Offer was announced, the Company was in advanced negotiations with one major multinational company for a potential transaction with respect to the Mary River Property. Since the launch of the Unsolicited Offer, the Board, together with management and financial and legal advisors, have been working to evaluate a range of strategic alternatives that may enhance shareholder value. Baffinland has been approached by, and has initiated contact with, a number of third parties who have expressed interest in considering alternative transactions. Discussions are being pursued with several of these third parties in order to generate value enhancing alternatives. While it is impossible to predict whether any transactions will emerge from these efforts and discussions, due to the strategic and intrinsic value of the Mary River Property, the Board believes that Baffinland and its assets are potentially very attractive to other parties; and
- In order to advance the exploration and development of the Mary River Property the Company will be required to achieve one or more Financing Alternatives and there is no assurance that such Financing Alternatives will be obtained on favourable terms, or at all. Failure to achieve such Financing Alternatives could result in a further delay or indefinite postponement of further exploration and development of the Mary River Property. See “Liquidity and Capital Resources – Current Market Conditions”.

The Company’s strategy to continue to pursue the exploration and development of the Mary River Property is supported by current 2010 iron ore prices which are currently approximately US\$241.72 per dry metric tonne unit for lump and US\$201.9 per dry metric tonne unit of fine iron ore. Analysts expect the current market conditions for iron ore to continue for the next five to seven years. The Company’s lump and fine iron ores are expected to grade greater than 66% iron over the first 10 years of production. See “Risk Factors”.

## LIQUIDITY AND CAPITAL RESOURCES

### *Current Conditions*

Management believes that the economy appears to be recovering from the global recession that began late in 2008. The economic slowdown negatively has impacted the ability of mining companies to secure equity and/or debt financing or enter into joint venture arrangements. In December 2009, the Company raised gross proceeds of \$44.0 million through the 2009 Equity Offerings to fund its 2010 activities and repay in full the Environmental Bonding Facility.

Given the stage of development of the Mary River Project, the Company relies on equity financing to raise capital and intends to continue to do so. This ability may continue to be negatively impacted in the medium and long term, but in particular in the short term, due to the existence of the Unsolicited Offer. The Company continues to explore Financing Alternatives. There is a risk that these undertakings may not be successful. There is also a risk that unfavourable commodity prices or financial markets could result in an impairment to the carrying value of the Company’s mining interest balance.

Management has considered how these adverse conditions have impacted the Company's financial position. As of September 30, 2010, the Company continues to have positive working capital. In July 2010, the Company announced that it plans to complete the Road Haulage DFS and accelerate the preparation of the Draft EIS in the latter part of 2010. In addition the Company is incurring additional expenditures related to the Unsolicited Offer and other activities related to Financing Alternatives. In light of these undertakings, the Company will have to secure one or more Financing Alternatives to maintain positive working capital through to the first quarter of 2011. See "Risk Factors".

Working capital at September 30, 2010 was \$18,243,794 compared to \$47,329,078 as at December 31, 2009. The decrease in working capital is as a result of the nine months spending on exploration expenditures related to the Company's 2010 activities.

To date, management has not finalized any Financing Alternatives. Management continues efforts to secure Financing Alternatives for the short and long-term development and exploration requirements of the Mary River Property.

#### *Financial Security for Abandonment and Reclamation*

The Company has restricted cash in the amount of \$16.5 million to support an irrevocable letter of credit to the QIA which provides Financial Security. The letter of credit has been deposited with the QIA in conjunction with the QIA Lease. The Company expects that the Financial Security amount may increase in the near term. See "Liquidity and Capital Resources" and "Risk Factors".

#### *Long Term Asset-Backed Notes*

The Company owns long term asset backed notes (the "Notes") that were issued by Master Asset Vehicle II ("MAV 2") as a result of the restructuring of the Company's previous investment in Third Party Asset Backed Commercial Paper ("ABCP"). The Notes have a face value of \$17,742,030 and a fair value of \$12,899,207 as at September 30, 2010 (December 31, 2009 – face value of \$17,750,092 and fair value of \$11,519,196). On January 21, 2009 the Company received the Notes which replaced the ABCP. As part of the exchange, the Company received two payments totalling \$941,301 that represented the Company's share of cash that accumulated to the assets during the restructuring period. The payments were recorded as a gain on note exchange.

The secondary market for the Notes continues to develop, however, it is not yet an "active market" given the limited bid activity and small number of disclosed transactions since the note exchange occurred. Until an active market develops for the Notes, the fair value will be determined using a discounted cash flow approach based on the use of inputs observed from market conditions. The fair values may change materially in subsequent periods.

During the fourth quarter of 2009, the Company sold its entire holdings of the Class 15 notes for proceeds of \$1,569,144 which resulted in a gain on sale of \$888,690.

The remaining portfolio consists of four types of Notes, which are supported by a pool of leveraged super senior credit default swaps, unlevered collateralized debt obligations as well as traditional assets and cash. The leveraged assets supporting these notes have access to credit facility that can be drawn upon in the event that a margin call is triggered and more collateral must be posted.

Using publicly available information the Company has been able to determine the key characteristics of each class of the Notes: par value, credit rating, interest rate and projected interest payments, and maturity date. The Company then estimates the return that a prospective investor would require for each class of Notes ("Required Yield"). Lastly, it calculates the net present value of the cash flows for each class of the Notes using the Required Yield as the discount factor.

During the nine months ended September 30, 2010, the Company has seen continued improvement in general corporate credit market conditions which have had the most impact on the valuation of the Notes. This decrease in credit risk impacts the intrinsic value of the Notes due to a general lowering of default risk, relative to the previous valuations. There is also a decrease in the likelihood that credit risk limits built into the Notes will be exceeded (specifically, the spread-based margin triggers). Accordingly, the Required Yield on the Notes has been somewhat reduced to reflect easing in the credit markets. Accretion of the Notes to par value at maturity assuming they do not default resulted in an increased value at September 30, 2010.

Noteholders are to receive floating interest mostly based on prevailing banker's acceptance rates based on the variable interest income on the pool of assets, however, the payments to noteholders are subordinated to the margin funding facility fee. As a result, interest payments to the Company are not expected to be received on the Notes until there is an increase in the prevailing interest rates. This anticipated near-term lack of income on the Notes has been factored in the valuation. The Company will record interest received on a cash basis until such time that the payment of interest becomes likely.

Based on the foregoing, as at September 30, 2010 the Company has estimated the fair market value of the Notes to be between \$12.2 million and \$13.8 million, and as a result, the Company has recorded an unrealized gain on revaluation of the Notes, for the three and nine month periods ended September 30, 2010, in the amounts of \$593,588 and \$1,380,011 respectively (2009 – \$928,503 and \$2,122,922) to arrive at a carrying value as at September 30, 2010 of \$12,899,207 (December 31, 2009 - \$11,519,196).

The fair value of the Notes may increase or decrease materially in subsequent periods.

#### *Cash Flow from Operating Activities*

Current assets at September 30, 2010 were \$25,145,558 compared to \$49,001,385 at December 31, 2009, a decrease of \$23,855,827. During the nine month period ended September 30, 2010, cash and cash equivalents decreased by \$24,056,427 as a result of corporate and Mary River Property site activity. Accounts receivable increased by \$307,779 primarily due to GST receivable. Prepaids decreased by \$143,179 and inventory increased by \$36,000. Current liabilities at September 30, 2010 were \$6,901,764 compared to \$1,672,307 at December 31, 2009, an increase of \$5,229,457 primarily due to the second quarter commencement of the 2010 exploration activities, accrued severance for a senior executive, and the accrual of interest payable to Canada Revenue Agency associated with the issuance of flow-through common shares as part of the 2009 Equity Offerings. As of September 30, 2010, the Company estimates that of the \$23.0 million of flow-through funds that were raised as part of the 2009 Equity Offerings, that it has \$3 million remaining on hand to be expended on flow-through eligible expenditures and expects to have fully expended the funds by the end of December 31, 2010 in accordance with Canada Revenue Agency requirements.

#### *Cash Flow from Investing Activities*

During the nine month period ended September 30, 2010 the Company spent approximately \$26,090,886 on exploration and mine development activities of which \$5,934,878 has been capitalized to mining interests.

#### *Cash Flow from Financing Activities*

Net cash outflows from financing occurred as a result of costs recorded in the nine month period ended September 30, 2010 that related to the 2009 Equity Offerings partially offset by exercise of share purchase options.

### **RELATED PARTY TRANSACTIONS**

During the three and nine month periods ended September 30, 2010, McChip Resources Inc., a related party controlled by a director and a shareholder of the Company, paid \$12,000 and \$36,000 (2009 - \$18,000 and \$54,000) to the Company for lease and operating costs. These cost recoveries were included in office and general expenses and were in the normal course of business and are measured at the cost amount, which is the consideration established and agreed to between the related parties.

### **COMMON SHARES**

During the three month period ended September 30, 2010, there were no options granted to purchase common shares. In the nine month period ended September 30, 2010, the Company granted 3,029,000 options to purchase common shares, with a five year term at an average exercise price of \$0.57 per common share. For the nine month period ended September 30, 2010 fair values of \$1,054,575 was estimated for the share options using the Black Scholes fair value option-pricing model. During the third quarter of 2010 37,500 warrants with a \$0.70 exercise price were exercised.

On December 10, 2009, the Company closed the 2009 Equity Offerings. The first offering was a public offering under which a total of 23,959,100 common shares and 11,979,550 common share purchase warrants were issued. Each common share unit was sold for a price of \$0.48 and was comprised of one common share and one half common share purchase warrant. Total gross proceeds on the public offering were \$11.5 million.

The second of the 2009 Equity Offerings was a private placement under which a total of 41,860,000 common shares and 20,930,000 common share purchase warrants were issued. Each common share unit was sold for a price of \$0.55 and was comprised of one common share and one half common share purchase warrant. Each common share was issued as a “flow-through share” under the Income Tax Act (Canada). Total gross proceeds on the private placement were \$23.0 million. During the first quarter of 2010, the Company renounced the flow-through expenditures and recorded the associated future tax income liability in respect of the \$23.0 million of proceeds from the sale of flow-through common shares as part of the 2009 Equity Offerings.

On December 10, 2009 as part of both of the 2009 Equity Offerings, RCF exercised in full its pre-existing participation rights to participate in respect of the 2009 Equity Offerings, pursuant to which RCF was issued an aggregate of 19,926,569 common shares and 9,963,285 common share purchase warrants. Each common share unit was sold for a price of \$0.48 and was comprised of one common share and one half common share purchase warrant. Total gross proceeds from the exercise of the Participation Rights were \$9.6 million.

Each common share purchase warrant issued as part of the 2009 Equity Offerings entitles the holder to acquire one common share for a price of \$0.70 until December 9, 2012 (“2009 Warrants”). The Company also has warrants outstanding with a exercise price of \$5.50 until January 31, 2012 (“2007 Warrants”).

On December 10, 2009, the Company also issued 669,713 common shares valued at \$327,088 to RCF for the final interest and commitment fee payment with respect to the Environmental Bonding Facility.

On September 30, 2009, the Company issued 807,127 common shares valued at \$362,490 to RCF in satisfaction of the establishment fee, quarterly commitment fee and quarterly interest related to the August 31, 2009 draw of funds of \$10.37 million (US\$9.5 million) under the Environmental Bonding Facility.

During the year ended December 31, 2009, options to purchase a total of 332,500 common shares were exercised for total gross proceeds to the Company of \$51,625.

The following common shares and convertible securities of the Company were outstanding at November 2, 2010:

	<b>Expiry Date</b>	<b>Exercise Price (Cdn\$)</b>	<b>Securities Outstanding</b>	<b>Common Shares on Exercise</b>
Common shares		-	343,599,149	-
Warrants - 2007 issue	January 31, 2012	5.50	5,981,988	5,981,988
Warrants - 2009 issue	December 10, 2012	0.70	42,334,135	42,334,135
Share purchase options	Jan 3/2011 to April 30/2015	0.25 to 4.40	-	10,972,000

### Change in Shareholders' Equity

Shareholders' equity at September 30, 2010 was \$226,123,979, compared to \$255,423,463 at December 31, 2009, a decrease of \$29,299,484 as follows:

Contributed surplus (fair value vested portion of stock options granted)	\$ 955,312
Renunciation of flow through shares	(6,956,689)
Exercise of share purchase options and warrants	17,800
Deficit:	
Net loss for the period	(23,315,907)
	<u>\$ (29,299,484)</u>

## FINANCIAL SUMMARY BY QUARTER

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)

	Sept. 30 2010	Jun. 30 2010	Mar. 31 2010	Dec. 31 2009	Sept. 30 2009	Jun. 30 2009	Mar. 31 2009	Dec. 31 2008
<b>ASSETS</b>								
Current	25,146	40,860	45,572	49,001	22,832	28,721	33,823	43,514
Restricted cash	16,500	16,500	16,500	16,500	16,500	6,203	6,203	6,203
Long term investments	12,899	12,306	12,018	11,519	11,915	10,986	9,792	9,792
Non-current inventory, Property plant & equipment & Mining interest	180,510	177,599	178,526	181,112	178,502	173,770	170,240	165,751
	<u>235,055</u>	<u>247,265</u>	<u>252,616</u>	<u>258,132</u>	<u>229,749</u>	<u>219,680</u>	<u>220,058</u>	<u>225,261</u>
<b>LIABILITIES AND EQUITY</b>								
Current	6,902	5,308	2,348	1,672	5,534	3,311	3,950	8,587
Asset retirement obligation	1,105	1,081	1,056	1,036	1,013	990	967	554
Convertible debt	-	-	-	-	5,999	-	-	-
	<u>8,007</u>	<u>6,389</u>	<u>3,404</u>	<u>2,709</u>	<u>12,546</u>	<u>4,301</u>	<u>4,917</u>	<u>9,141</u>
Future income tax liability	924	4,366	6,311	-	4,176	4,176	4,176	-
	<u>8,931</u>	<u>10,755</u>	<u>9,715</u>	<u>2,709</u>	<u>16,722</u>	<u>8,477</u>	<u>9,093</u>	<u>9,141</u>
Shareholders' equity	<u>226,124</u>	<u>236,510</u>	<u>242,901</u>	<u>255,423</u>	<u>213,027</u>	<u>211,203</u>	<u>210,966</u>	<u>216,120</u>
	<u>235,055</u>	<u>247,265</u>	<u>252,616</u>	<u>258,132</u>	<u>229,749</u>	<u>219,680</u>	<u>220,058</u>	<u>225,261</u>
<b>WORKING CAPITAL</b>	18,244	35,553	43,224	47,329	17,298	25,410	29,873	34,927
Common shares outstanding (000's)	343,098	342,934	342,934	342,784	256,276	255,306	233,130	233,130

### STATEMENTS OF OPERATIONS for the three months ended:

\$000's except per share (unaudited)

	Sep. 30 2010	Jun. 30 2010	Mar. 31 2010	Dec. 31 2009	Sep. 30 2009	Jun. 30 2009	Mar. 31 2009	Dec. 31 2008
<b>INTEREST AND OTHER INCOME</b>	82	80	93	167	122	17	134	238
<b>EXPENSES</b>								
Administrative	3,270	3,000	4,507	1,135	1,513	1,867	2,479	2,157
Exploration	11,531	6,028	2,598	154	265	176	232	604
Other	(594)	(288)	(499)	(1,366)	1,206	(1,477)	(659)	-
	<u>14,207</u>	<u>8,740</u>	<u>6,606</u>	<u>(78)</u>	<u>2,984</u>	<u>566</u>	<u>2,052</u>	<u>2,761</u>
Income / (Loss) before income taxes	(14,125)	(8,660)	(6,513)	245	(2,861)	(549)	(1,919)	(2,523)
Future income tax recovery	3,442	1,944	596	4,176	-	-	-	-
<b>NET INCOME (LOSS)</b>	<u>(10,683)</u>	<u>(6,716)</u>	<u>(5,917)</u>	<u>4,421</u>	<u>(2,861)</u>	<u>(549)</u>	<u>(1,919)</u>	<u>(2,523)</u>
Net Income/(Loss) per share	(\$0.03)	(\$0.02)	(\$0.02)	\$0.01	(\$0.01)	(\$0.00)	(\$0.01)	(\$0.02)

## FINANCIAL HIGHLIGHTS

The net loss for the three and nine month periods ended September 30, 2010 were \$10,682,940 and \$23,315,907, respectively, compared to \$2,861,324 and \$5,328,719 respectively for the prior similar periods. The loss is greater in 2010 primarily as a result of expensing exploration related to Deposit Nos. 2, 3, 4, 5, 6, 7, and 8. In 2009 costs related to developing Deposit No. 1 were capitalized to mining interests.

For the three and nine month periods ended September 30, 2010, interest and other income were \$81,948 and \$254,909, respectively, compared to \$122,388 and \$272,967 for the prior similar periods. Interest and other income was lower in the three and nine month period in 2010 as compared to the same periods in the prior year as a result of higher cash balances due to the amount and timing of capital raises.

For the three and nine month periods ended September 30, 2010, amortization and accretion expense of \$768,848 and \$2,228,077, respectively were \$754,258 and \$2,184,307 higher than the prior similar periods. Overall amortization and accretion expense is similar period over period however in 2009 the charge was capitalized to mining interests in accordance with the Company's accounting policy. For the three and nine month periods ended September 30, 2010, the total amortization and accretion was expensed to the income statement.

A loss on write-down of inventory to net realizable value was recorded for the three and nine month periods ended September 30, 2010 in the amount of \$nil and \$892,773 respectively compared to \$2,134,165 and \$2,134,165 for the prior similar periods. The write-down is related to a portion of fuel that was relocated from Baffin Island to Montreal recorded at net realizable value, and subsequently sold to a third party.

For the three and nine month periods ended September 30, 2010, salaries of \$710,803 and \$2,958,347 respectively were \$82,100 and \$754,187 higher than the prior similar periods primarily due to the accrual of severance for a senior officer of the Company.

Share based compensation for the three and nine month periods ended September 30, 2010 was \$226,041 and \$955,312, respectively, compared to \$384,733 and \$2,084,945 for the prior similar periods. The lower charge in the 2010 periods compared to the 2009 periods is a function of the lower price for common shares underlying options for grants in 2010 compared to 2009.

For the three and nine month periods ended September 30, 2010, office and general expense of \$244,308 and \$1,753,665, respectively, were \$40,325 and \$1,045,291 higher than the prior similar periods. The increased expense in 2010 compared to 2009 is as a result of capital taxes not incurred in the prior period, and the accrual of interest charges payable to the Canada Revenue Agency associated with the issue of flow-through common shares as part of the 2009 Equity Offerings.

For the three and nine months periods ended September 30, 2010, professional fees were \$1,272,521 and \$1,737,862 respectively compared to \$146,433 and \$483,261 in the prior similar periods. The increase in professional fees is due to increased legal and consulting fees associated with the pursuit of Financing Alternatives.

## CONTRACTUAL OBLIGATIONS

The Company's one year term of the QIA Lease that was set to expire on October 31, 2010 was extended to November 15, 2010. The Company expects that a lease, for a two year period, substantially in the form of the existing lease will be executed during the extension period. See "Risks Factors".

Following are the Company's contractual obligations as of September 30, 2010 (excludes expenses of a fixed nature expected to be incurred in the normal course of business):

	Payments Due By Period				
	Total	Less than 1 year	2-3 Years	3-4 Years	After 5 Years
Office Lease <sup>(1)</sup>	\$ 788,149	\$ 146,088	\$ 306,722	\$ 321,900	\$ 13,439
Land Lease Obligation <sup>(2)</sup>	\$ 1,267,200	633,600	633,600	-	-
Asset retirement obligation <sup>(3)</sup>	12,000,000	-	-	-	12,000,000
<b>Total</b>	<b>\$ 14,055,349</b>	<b>\$ 779,688</b>	<b>\$ 940,322</b>	<b>\$ 321,900</b>	<b>\$ 12,013,439</b>

(1) The Office Lease for the head office has been renewed for a five year period to 2015.

(2) This value represents an undiscounted cash estimate of future abandonment and reclamation costs under the Company's Abandonment & Reclamation Plan. The discounted value is included on the balance sheet under Asset retirement obligation.

## **OTHER INFORMATION**

### **Off-Balance Sheet Arrangements**

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

### **Going Concern**

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

### **Development Stage Entity**

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

### **Critical Accounting Policies and Estimates**

The preparation of financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of certain assets and liabilities at the date of the financial statements and the reported amounts of certain revenues and expenses during the period. Actual results could differ significantly from those estimates. Specific items requiring estimates are mining interests, capital assets, amortization, asset retirement obligations, future income taxes, convertible debt and share-based compensation. There is a full disclosure and description of the Company’s critical accounting policies in the annual MD&A for the year ended December 31, 2009. There have been no material changes to the critical accounting estimates as described in the Company’s audited financial statements for the fiscal year ended December 31, 2009.

### **Changes in accounting policies**

#### *Section 1506*

Section 1506 - Accounting Changes – This existing section has been amended to exclude from its scope changes in accounting policies upon the complete replacement of an entity's primary basis of accounting. Amendments apply to interim and annual financial statements relating to years beginning on/after July 1, 2009. The adoption of these changes to the standard did not have significant impact on the Company's financial statements.

### **Future accounting changes**

#### *Section 1582*

The new Section 1582 - Business Combinations, which replaces Section 1581 - Business Combinations, establishes standards for the measurement of a business combination and the recognition and measurement of assets acquired and liabilities assumed. The new standard applies to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011. Earlier application is permitted. The Company is currently assessing the impact of the adoption of this new standard on its consolidated financial statements.

#### *Section 1601 & 1602*

The new Sections 1601 - Consolidated Financial Statements and Section 1602 - Non-Controlling Interests, together replace Section 1600 - Consolidated Financial Statements. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 establishes the accounting for a non-controlling interest in a subsidiary, in the consolidated financial statements, subsequent to a business combination. These standards apply to interim and annual consolidated financial statements relating to fiscal years beginning on or after January 1, 2011. Earlier adoption is permitted as of the beginning of a fiscal year. The Company is currently assessing the impact of the adoption of these new standards on its financial statements.

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

In February 2008, the CICA Accounting Standards Board confirmed that Canadian GAAP for publicly accountable enterprises will be converged with IFRS in calendar year 2011. IFRS uses a conceptual framework similar to Canadian GAAP, but there may be significant differences on recognition, measurement and disclosure that may materially impact the Company's financial statements.

The adoption date of January 1, 2011 will require the restatement for comparative purposes of amounts reported by the Company for both the interim and annual periods for the financial year ended December 31, 2010. The March 31, 2011 interim financial statements, including comparative amounts, will be the Company's first financial statements prepared in accordance with IFRS.

During the three month period ended September 30, 2010, the Company continued its analysis of the areas impacted by the conversion and identified the modifications of accounting policies and internal controls over financial reporting required for the changeover plan. During the fourth quarter of 2010, the Company will finalize its opening balance sheet adjustments and the external audit firm will conclude their audit thereof.

During the fourth quarter, the Company will also complete its review of the impact on presentation and disclosure of the financial statements. The Company has determined the changes required for the primary statements relating to the balance sheet, income statement, statement of comprehensive income, cash flow statement, and changes in equity.

The Company is continuing the completion of its review of accounting differences between Canadian GAAP and IFRS which may impact the Company's financial statements as follows:

#### 1. Asset retirement obligation IAS 37:

The primary differences between IFRS and Canadian GAAP for asset retirement obligation provisions include the basis for estimation for undiscounted cash flows, the discount rate used, the frequency of liability re-measurement, and the recognition of a liability when a constructive obligation exists.

Canadian GAAP requires the estimate of undiscounted cash flows to be based on the amount that a third party would require to assume the obligation, whereas IFRS focuses on the use of management's best estimate of the expenditures required to settle the obligation.

The discount rate used to determine the present value of the expenditures for Canadian GAAP is the credit-adjusted risk free rate for the entity. IFRS requires that the discount rate used be a pre-tax rate that reflects current market assessments of the time value of money and the risk specific to the liability. The rate is not intended to reflect risks for which future cash flow estimates have already adjusted for in the estimated future cash flows.

In accordance with Canadian GAAP, the Company's provision is re-measured when there is a change in the amount or timing of cash flows required to settle the obligation. IFRS requires the re-measurement of the liability at each reporting date.

Under IFRS the recognition principle is broadened to include both legal and constructive obligations, whereas Canadian GAAP only requires the recognition of legal obligations.

The Company expects that it will record an adjustment with respect to its asset retirement obligation upon transition to IFRS.

#### 2. Share based payments IFRS 2

IFRS requires that each tranche of granted awards is accounted for as a separate arrangement rather valuing the grant as a whole.

The Company does not expect that there will be a material impact on transition to IFRS.

#### 3. Exploration and Evaluation IFRS 6

IFRS requires that detailed criteria be applied in determining the probability that future economic benefits are expected to flow to the Company. The detailed criteria will determine when and if exploration and evaluation expenditures can be capitalized. This capitalization process is prior to the period of development.

The Company does not expect there to be an adjustment on transition to IFRS. The Company's existing policy under Canadian GAAP of expensing all exploration and evaluation expenditures prior to development is in compliance with IFRS.

#### 4. Foreign currency translation IAS 21

IFRS requires functional currency to be assessed independently for each subsidiary within a consolidated group and introduces the concept of primary and secondary indicators.

The Company does not expect that there will be a material impact on the transition to IFRS.

#### 5. Property, plant and equipment IAS 16

IFRS introduces the concept on componentization of assets to separate any significant parts of an asset and amortize the component separately from the main asset.

The Company does not expect that there will be a material impact on transition to IFRS.

#### 6. Other IFRS accounting differences

The Company has reviewed several other accounting areas such as, financial instruments, inventory, leases, business combinations, impairment, joint ventures, and pensions and determined that these areas are not expected to have a material impact on transition to IFRS.

The Company is presently reviewing the detailed requirement of interim reporting and disclosure items.

The Company will continue to monitor results from the existing conversion plan, as well as ongoing changes to IFRS, and adjust its transition and implementation plans accordingly. The Company's transition remains aligned to its implementation schedule and it is on track to meet the timelines for the changeover.

### **Capital Disclosures**

As at September 30, 2010, Baffinland's capital structure consists of its shareholders' equity. During the three months ended September 30, 2010, there was no change to the capital structure. The Company is a development stage entity and therefore, its objective when managing the capital structure is to fund the continuing exploration and development of its wholly owned Mary River Property. The Company maintains its capital structure by raising funds externally as the need arises. The capital is invested in highly liquid, highly rated financial instruments.

In order to carry out planned exploration and development and to pay for administrative costs, the Company will spend its existing working capital and raise additional amounts as needed. There are no assurances that Financing Alternatives will be achievable on terms acceptable to the Company, or at all.

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

There were no changes in the Company's approach to capital management during the three months ended September 30, 2010 compared to the previous year. The Company is not subject to externally imposed capital requirements.

### **Financial Instruments**

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

#### *Credit risk*

Credit risk is the risk of loss associated with a counterparty's or the Company's inability to fulfil its payment obligations. The Company's credit risk is attributable to its long term investment in asset-backed notes and accounts receivable. When valuing its financial instruments, the Company is required to take into account the credit quality of both the counterparty and the Company itself as appropriate.

The Company has no significant concentration of credit risk arising from operations. Cash equivalents consist of guaranteed investment certificates, which have been invested with Canadian chartered banks with typical maturities of less than 12 months and fully cashable after 30 days and management believes the risk of loss to be remote. Accounts receivable typically consists of goods and services tax due from the Federal Government of Canada. Management believes that the credit risk with respect to accounts receivable is low.

#### *Liquidity risk*

The Company's approach to managing liquidity risk is to ensure that it will have sufficient funds to meet liabilities when due. As at September 30, 2010, the Company had an unrestricted cash balance of \$21,422,691, (December 31, 2009 - \$45,479,118) to settle current liabilities of \$6,901,764, (December 31, 2009 - \$1,672,307). Current liabilities consist of accounts payable that are predominantly due within 60 days.

#### *Interest rate risk*

The Company's current policy is to invest excess cash in highly rated short-term deposit certificates issued by Canadian chartered banks. The Company periodically monitors the investments it makes and is satisfied with the credit ratings of its banks.

#### *Price risk*

The Company is exposed to price risk with respect to iron ore prices. The price of iron ore declined somewhat during the most recent economic downturn which commenced in the third quarter of 2008, while future significant price declines could cause continued exploration and development of the Mary River Property to become uneconomical, commodity prices, particularly iron ore began to recover by the end of 2009.

#### *Foreign currency risk*

The Company's functional currency is the Canadian dollar and major purchases are transacted in Canadian dollars. The Company funds certain transactions using US dollar currency from its US dollar bank account held with a Canadian bank. Management believes the foreign exchange risk derived from currency conversions is not significant and therefore does not hedge its foreign exchange risk.

#### *Sensitivity analysis*

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

- Interest income on cash balances held has been negatively affected by low prevailing interest rates. Cash and cash equivalents include deposits which are at variable interest rates. It is generally expected that interest rates will rise. If interest rates were to rise by 0.50%, net loss would increase by approximately \$55,000 for the three months ended September 30, 2010.
- The Company does not hold significant balances in foreign currencies to give rise to exposure to foreign exchange risk.
- Price risk is remote since the Company is not a producing entity.

#### *Fair value of financial instruments*

Effective January 1, 2007, all financial instruments have been classified into one of the following five categories: held for-trading assets or liabilities, held-to-maturity investments, loans and receivables, available-for-sale financial assets or other financial liabilities. Held-for-trading financial instruments are measured at fair value and all gains and losses are included in net income in the period in which they arise. Available-for-sale financial instruments are measured at fair value with revaluation gains and losses included in accumulated other comprehensive income until the instruments are derecognized or impaired. Loans and receivables, investments held-to-maturity and other financial liabilities are measured at amortized cost using the effective interest method.

The Company made the following classifications:

Cash and cash equivalents	Held for trading
Accounts receivable	Loans and receivables
Restricted cash	Held for trading
Subscription receipts receivable	Loans and receivables
Long term investment	Held for trading
Accounts payable	Other financial liabilities

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

Both the Chief Executive Officer and the Chief Financial Officer have evaluated the effectiveness of the Company's disclosure controls and procedures and assessed the design of the Company's internal controls over financial reporting as of September 30, 2010, pursuant to the requirements of National Instrument 52-109.

The Company has very limited administrative staffing and in many instances, the implementation of internal controls relying on segregation of duties is not always possible. The Company relies on senior management review and approval to ensure that the controls are as effective as possible. There has been no change in the Company's internal control over financial reporting during the nine months ended September 30, 2010 that have materially affected, or is reasonably likely to materially affect, the Company's internal controls over financial reporting.

## **RISK FACTORS**

Investing in the Company involves risks that should be carefully considered. In addition to the risks involved should the Company be required to value its assets and liabilities other than on a going-concern basis as discussed above, in conducting its business, the Company is subject to a number of other risks and uncertainties, as detailed in the Company's most recent annual MD&A relating to the Audited Financials and the AIF that could have a material adverse effect on, among other things, the Company's business prospects or financial condition and could result in a delay or indefinite postponement in the development of the Company's properties and projects. See also "Cautionary Note Regarding Forward-Looking Information".

## **CAUTIONARY NOTE REGARDING FORWARD-LOOKING INFORMATION**

Certain information included in this MD&A 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", "project", "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 2010 activities including its discovery of Deposit Nos 6, 7 & 8, 2010 exploration program; the identification and increase of mineral resources at Deposit Nos. 5, 4 and 3; achieving the necessary Financing Alternatives; blast furnace results from trial cargos; the completion of the Draft EIS; the commissioning and results of the Road Haulage DFS, the negotiations of an IIBA; the renewal of the QIA Lease; the A&R Plan; progressive reclamation; regulatory compliance and maintaining core assets at site; Financial Security requirements; capital cost estimates for the Mary River Project; completion of the regulatory process and estimates and review of Mary River Project construction timelines and the commencement of commercial production at the Mary River Project; and substantially all of the information contained in and/or derived from the 2008 DFS, constitutes forward-looking information. Actual results may vary. See "Risk Factors".

Forward-looking information is based on certain factors and assumptions regarding, among other things, the estimation of mineral reserves and resources and the realization of such estimates, the timing and amount of future exploration expenditures, the estimation of initial and sustaining capital requirements, the estimation of labour and operating costs, the availability of necessary financing to develop the Mary River Property in the short and long-term, the progress of construction and development activities, the receipt of necessary regulatory approvals, iron ore prices, the feasibility of constructing and operating a direct-shipping iron ore mine at the Mary River Project, assumptions with respect to environmental risks, title disputes or claims, weather conditions, climate change and other similar matters. In addition, in making statements concerning the timing of the Project achieving commercial production, the Company has made certain assumptions relating to certain project development activities taking place beginning in 2010 and leading toward commercial production and continuing without undue disruption. In estimating initial capital costs for the Project of \$4.1 billion, the Company has made certain assumptions set out in the 2008 DFS including, among other things, with respect to certain design criteria and certain inputs for construction costs, including labour and material costs. In stating that the Company desires to achieve Financing Alternatives, the Company has assumed continued improvements in the global economy and the financial position of potential strategic partners and that it will successfully conduct negotiations and due diligence. The granting of a loan guarantee is subject to various assumptions including the acceptance of a formal application and completion of satisfactory due diligence, among other things. While the Company considers these assumptions to be reasonable based on information currently available to it, they may prove to be incorrect and there can be no assurance that such developments can be completed on satisfactory terms or at all.

Forward-looking information is also subject to certain risks and uncertainties, which could cause actual results to differ materially from what management currently expects. These factors include: (i) risks inherent in the exploration for and development of mineral deposits; (ii) financing, capitalization and liquidity risks, including the risk that the Financing Alternatives necessary to fund the exploration and development activities at the Mary River Property may not be available on satisfactory terms, or at all; (iii) regulatory risks, including risks relating to the acquisition of the necessary licenses and permits; (iv) uncertainties inherent in the estimation of mineral reserves and resources; (v) risks that production estimates may be inaccurate; (vi) construction and operational risks inherent in the conduct of mining activities, including the risk of increases in capital and operating costs and the risk of delays or increased costs that might be encountered during the construction and development process; (vii) risks relating to changes in iron ore prices and the worldwide demand for and supply of iron ore; (viii) risks relating to the remoteness of the Mary River Property including access and supply risks, reliance on key personnel and the ability to attract and retain qualified personnel in the current conditions of the mining sector highly competitive demand for qualified personnel; (ix) environmental risks, including risks relating to climate change and the potential impact of global warming on Mary River Project timelines and on construction and operating costs; (x) the risk of

fluctuations in the Canadian/U.S. dollar exchange rate; (xi) insurance risks and (x) actions taken by the Offeror or by the Company's shareholders in respect of the Unsolicited Offer. 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.

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

**Interim Financial Statements**  
**For the three and nine month periods ended September 30, 2010**  
Unaudited

**BAFFINLAND IRON MINES CORPORATION**

(Development Stage Entity)

**BALANCE SHEETS**

(Unaudited)

	As At September 30 2010	As At December 31 2009
<b>ASSETS</b>		
<b>Current</b>		
Cash and cash equivalents (Note 4)	\$ 21,422,691	\$ 45,479,118
Accounts receivable	609,069	301,290
Inventory (Note 6)	2,992,000	2,956,000
Prepaid expenses	121,798	264,977
	<u>25,145,558</u>	<u>49,001,385</u>
Restricted cash (Note 5)	16,500,000	16,500,000
Inventory (Note 6)	1,825,039	6,228,315
Mining interests (Note 7)	169,308,221	163,373,343
Long term investments (Note 8)	12,899,207	11,519,196
Property, plant & equipment (Note 9)	9,376,880	11,509,891
	<u>\$ 235,054,905</u>	<u>\$ 258,132,130</u>
	<u><u>\$ 235,054,905</u></u>	<u><u>\$ 258,132,130</u></u>
<b>LIABILITIES</b>		
<b>Current</b>		
Accounts payable	\$ 6,901,764	\$ 1,672,307
Asset retirement obligation (Note 10)	1,105,038	1,036,360
Future income tax liability (Note 14)	924,124	-
	<u>8,930,926</u>	<u>2,708,667</u>
	<u>8,930,926</u>	<u>2,708,667</u>
<b>SHAREHOLDERS' EQUITY AND DEFICIT</b>		
Common shares (Note 11)	376,680,175	383,480,852
Warrants (Note 11)	12,085,140	12,093,390
Contributed surplus (Notes 11 and 12)	14,179,444	13,354,094
Deficit	(176,820,780)	(153,504,873)
	<u>226,123,979</u>	<u>255,423,463</u>
	<u>226,123,979</u>	<u>255,423,463</u>
	<u>\$ 235,054,905</u>	<u>\$ 258,132,130</u>
	<u><u>\$ 235,054,905</u></u>	<u><u>\$ 258,132,130</u></u>
Nature of operations and going concern (Note 1)		
Contingencies and commitments (Note 17)		
Subsequent events (Note 18)		

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)

	For the three months ended September 30,		For the nine months ended September 30,		Cumulative from January 1,
	2010	2009	2010	2009	2003
Interest and other income	\$81,948	\$122,388	\$254,909	\$272,967	\$5,754,321
Expenses					
Exploration	11,530,738	265,041	20,156,008	673,645	196,070,009
Amortization and accretion	768,848	14,590	2,228,077	43,770	3,393,825
Loss on writedown of inventory (Note 6)	-	2,134,165	892,773	2,134,165	3,120,283
Salaries	710,803	628,703	2,958,347	2,204,160	12,307,332
Share-based compensation (Note 12)	226,041	384,733	955,312	2,084,945	13,665,359
Office and general	244,308	203,983	1,753,665	708,374	6,256,910
Professional fees	1,272,521	146,433	1,737,862	483,261	5,422,308
Shareholder relations	3,302	61,524	73,653	184,850	1,298,426
Travel	44,200	73,043	177,906	148,739	1,301,329
Unrealized gain on revaluation of long term investments (Note 8)	(593,588)	(928,503)	(1,380,011)	(2,122,922)	(3,787,735)
Impairment of long term investments	-	-	-	-	10,310,563
Gain on note exchange and note sale (Note 8)	-	-	-	(941,301)	(1,829,991)
Gain on extinguishment of convertible debt	-	-	-	-	(191,986)
	<u>14,207,173</u>	<u>2,983,712</u>	<u>29,553,592</u>	<u>5,601,686</u>	<u>247,336,632</u>
Net loss for the period before taxes	(14,125,225)	(2,861,324)	(29,298,683)	(5,328,719)	(241,582,311)
Future income tax recovery (Note 14)	3,442,285	-	5,982,776	-	68,115,952
Net loss & comprehensive loss for the period	(10,682,940)	(2,861,324)	(23,315,907)	(5,328,719)	(173,466,359)
Deficit, beginning of the period	(166,137,840)	(155,063,259)	(153,504,873)	(152,595,864)	
Deficit, end of the period	<u>(\$176,820,780)</u>	<u>(\$157,924,583)</u>	<u>(\$176,820,780)</u>	<u>(\$157,924,583)</u>	
Net loss per share (Note 16)	<u>(\$0.03)</u>	<u>(\$0.01)</u>	<u>(\$0.07)</u>	<u>(\$0.02)</u>	

**Nature of operations and going concern (Note 1)**

The accompanying notes are an integral part of the financial statements

**BAFFINLAND IRON MINES CORPORATION**

(Development Stage Entity)

**STATEMENTS OF CASH FLOWS**

(Unaudited)

	For the three months ended		For the nine months ended		Cumulative from
	September 30,		September 30,		January 1,
	2010	2009	2010	2009	2003
<b>Operating activities</b>					
Loss for the period	(\$10,682,940)	(\$2,861,324)	(\$23,315,907)	(\$5,328,719)	(\$173,466,359)
Items not affecting cash:					
Amortization and accretion expense	768,848	14,590	2,228,077	43,770	\$3,393,825
Loss on writedown of inventory (Note 6)	-	2,134,165	892,773	2,134,165	\$3,120,283
Share-based compensation (Note 12)	226,041	384,733	955,312	2,084,945	\$13,665,360
Future income tax recovery	(3,442,285)	-	(5,982,776)	-	(\$68,115,952)
Unrealized gain on revaluation of long term investments (Note 8)	(593,588)	(928,503)	(1,380,011)	(2,122,922)	(\$3,787,735)
Impairment of long term investments	-	-	-	-	\$10,310,563
Gain on note exchange and note sale (Note 8)	-	-	-	(941,301)	(\$1,829,991)
Gain on extinguishment of convertible debt	-	-	-	-	(\$191,986)
Other non cash items	-	-	-	-	(\$275,542)
(Increase) decrease in accounts receivable	(92,296)	(108,145)	(307,779)	1,190,207	(\$1,149,433)
(Increase) decrease in inventory	(308,000)	302,443	(36,000)	1,455,715	(\$13,770,760)
(Increase) decrease in prepaid expenses	85,897	64,236	143,179	207,870	(\$121,798)
Increase (decrease) in accounts payable	(587,964)	(2,190,148)	2,794,696	(7,465,241)	\$3,495,321
	<u>(14,626,287)</u>	<u>(3,187,953)</u>	<u>(24,008,436)</u>	<u>(8,741,511)</u>	<u>(228,724,205)</u>
<b>Investing activities</b>					
Change in restricted cash	-	(10,296,700)	-	(10,296,700)	(\$16,500,000)
Purchase of property, plant & equipment	(26,387)	-	(26,387)	(1,892)	(\$17,217,711)
Capitalized mine development costs included in accounts payable	2,181,709	4,412,748	2,434,760	4,412,748	(\$4,100,301)
Capitalized mine development costs	(5,434,097)	(6,901,412)	(5,934,878)	(16,014,935)	(\$155,469,804)
Decrease in non-current inventory	1,805,330	-	3,510,504	-	\$6,467,190
Cash received on note exchange and sale (Note 8)	-	-	-	941,301	\$2,510,445
Increase in long term investments	-	-	-	-	(\$20,102,488)
	<u>(1,473,445)</u>	<u>(12,785,364)</u>	<u>(16,001)</u>	<u>(20,959,478)</u>	<u>(204,412,669)</u>
<b>Financing activities</b>					
Net cash proceeds from draw on convertible debt	-	10,079,700	-	10,079,700	10,079,700
Repayment of convertible debt	-	-	-	-	(10,324,691)
Increase in bank debt	-	-	-	-	\$16,600,000
Repayment of bank debt	-	-	-	-	(\$16,600,000)
Decrease in due to related parties	-	-	-	-	(\$132,421)
Net proceeds on conversion of subscription receipts	-	-	-	4,213,548	\$4,213,547
Net proceeds on issue of common shares and warrants	70,799	45,625	(31,990)	45,625	\$450,723,430
	<u>70,799</u>	<u>10,125,325</u>	<u>(31,990)</u>	<u>14,338,873</u>	<u>454,559,565</u>
<b>Increase (decrease) in cash and cash equivalents</b>	<u>(16,028,933)</u>	<u>(5,847,992)</u>	<u>(24,056,427)</u>	<u>(15,362,116)</u>	<u>21,422,691</u>
<b>Cash position at beginning of the period</b>	<u>\$37,451,624</u>	<u>25,020,761</u>	<u>45,479,118</u>	<u>34,534,885</u>	<u>-</u>
<b>Cash position at end of the period</b>	<u>\$21,422,691</u>	<u>\$19,172,769</u>	<u>\$21,422,691</u>	<u>\$19,172,769</u>	<u>\$21,422,691</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 THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2010**

**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 its Mary River Property on Baffin Island, Nunavut, Canada ("Mary River Property").

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP") applicable to a going concern, which assumes continuity of operations and realization of assets and settlement of liabilities in the normal course of business for the foreseeable future. For the three and nine month periods ended September 30, 2010, the Company reported an after-tax loss of \$10.7 million and \$23.3 million respectively, and an accumulated deficit of \$176.8 million and, as at that date, had not generated positive cash flow from operations. In addition, as the Company is in the development stage, it is subject to the risks and challenges similar to other companies in a comparable stage of development. These risks include, but are not limited to, continuing losses, and the ability to secure adequate financing to meet the minimum capital required to successfully complete the project and continue as a going concern. As a result there is significant doubt regarding the applicability of the going concern assumption and ultimately the use of accounting principle pertinent to a going concern. The Company secured funding of \$44.0 million in December 2009 to meet its exploration and development program planned for 2010, to satisfy its contractual obligations and continue as a going concern. While the Company has successfully raised financing to date, there can be no assurance that it will be able to do so in the future.

These financial statements do not reflect the adjustments to the carrying values of assets and liabilities, the reported expenses and balance sheet classifications that would be necessary if the going concern assumption were inappropriate. These adjustments could be material.

On September 22, 2010, Nunavut Iron Ore Acquisition Inc., a corporation wholly-owned by Iron Ore Holdings, LP, made an unsolicited take-over offer to acquire all of the issued and outstanding common shares of the Company, together with the associated rights issued and outstanding under the shareholder rights plan of the Company, at a price of \$0.80 in cash per common share (the "Unsolicited Offer").

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**a) Basis of financial presentation**

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

**b) Cash and cash equivalents**

Cash and cash equivalents are highly liquid investments, such as term deposits with Canadian chartered banks or government treasury bills, cashable after 30 days at the date of original issue.

**c) Flow-through common shares**

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

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

### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### d) Mining interests and exploration expenditures

Exploration expenditures that are incurred to explore Deposit Nos. 2, 3, 4, 5, 6 or 7 are expensed as incurred. Development expenditures incurred (including interest on borrowings, if applicable) to advance Deposit No. 1 have been capitalized since April 2008 when mineral reserves were established on Deposit No. 1 (the "Project").

Development costs together with the cost of mining interests will be charged to operations on a units-of-production method based on estimated recoverable reserves upon commencement of commercial production. Revenue earned in the pre-development phase is treated as a reduction to mine development costs. If the mining interests are abandoned or if management determines that the value of the mining interests is impaired, the costs will be reduced to fair value through a charge to the income statement.

#### e) Property, plant & equipment

Property, plant & equipment are carried at cost, less accumulated amortization. Amortization of property, plant & equipment is calculated on the following basis:

Exploration equipment	5 years straight line
Furniture & fixtures	5 years straight line
Leasehold improvements	5 years straight line
Computer equipment	30% declining balance

#### f) Use of estimates

The preparation of financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions that affect the reported amount of assets and liabilities, 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.

Accounts which require management to make material estimates in determining amounts recorded include inventory, mining interests, long term investments, property, plant & equipment, amortization, asset retirement obligations, convertible debt, future income taxes and share-based compensation.

#### g) Income taxes

The Company accounts for income taxes in accordance with the liability method. Under the liability method, future income tax assets and liabilities are recognized for differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future tax assets and liabilities are measured using substantively enacted income tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future income tax assets and liabilities of a change in income tax rates is recognized in the period that includes the date of substantive enactment. A future income tax asset is recognized only when it is more likely than not that the income tax asset will be realized.

#### h) Accounting for share-based compensation

Share-based compensation 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 expected life of the options, the share price at time of grant, the expected volatility of the underlying shares, the expected dividend yield and the risk free rate for the expected life of the option.

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

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

#### i) Fair value of financial instruments

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

#### j) Impairment of mining interests

The Company reviews mining interests for impairment when events or circumstances indicate that the assets' carrying amount may not be recoverable. When management determines that impairment exists, the impairment loss will be measured by comparing the assets' carrying amount to its fair value.

#### k) Asset retirement obligations

The accounting for asset retirement obligations encompasses the accounting for legal obligations associated with the retirement of a long-lived tangible asset that results from the acquisition, construction, development and/or normal operation of a long-lived asset. The retirement of a long-lived asset is its' other than temporary removal from service, including its sale, abandonment, recycling or disposal in some other manner. The Company estimates the cost associated with these activities in its Abandonment and Reclamation plan ("A&R Plan") which is reviewed and updated annually.

The fair value of a liability for an asset retirement obligation is recorded in the period in which it is incurred. When the liability is initially recorded, the cost is capitalized by increasing the cost of the related long-lived asset. The capitalized cost is amortized on a unit of production basis. Changes in the liability for an asset retirement obligation resulting from the passage of time and/or revisions to either the timing or the amount of the original estimate of undiscounted cash flows are recognized in the period of change. Over time, the liability is increased to reflect an interest element (accretion expense) considered in the initial measurement of fair value. Upon settlement of the liability, a gain or loss is recorded if the actual costs incurred are different from the liability recorded.

It is possible that the Company's estimates of its asset retirement obligations could change as a result of changes in regulations, the extent of environmental remediation required and the means of reclamation or cost estimates. These estimates are also based on expected remediation requirements relating to the Mary River Property and will change as the Company proceeds with the development of the Mary River Property. Changes in estimates are accounted for prospectively from the period in which these estimates are revised.

#### l) Financial instruments

All financial instruments have been classified into one of the following five categories: held-for-trading assets or liabilities, held-to-maturity investments, loans and receivables, available-for-sale financial assets or other financial liabilities. Held-for-trading financial instruments are measured at fair value and all gains and losses are included in net income in the period in which they arise. Where quoted market values are not available for held-for trading investments, they are valued using a discounted cash flow technique that uses maximum inputs observed from market conditions to arrive at fair market value. Available-for-sale financial instruments are measured at fair value with revaluation gains and losses included in accumulated other comprehensive income until the instruments are derecognized or impaired. Loans and receivables, investments held-to-maturity and other financial liabilities are measured at amortized cost using the effective interest method.

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

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

#### l) Financial instruments (cont'd)

The Company made the following classifications:

Cash and cash equivalents	Held for trading
Accounts receivable	Loans and receivables
Restricted cash	Held for trading
Subscription receipts receivable	Loans and receivables
Long term investments	Held for trading
Accounts payable	Other financial liabilities

During 2009, Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3862, Financial Instruments - Disclosures ("Section 3862"), was amended to require disclosures about the inputs to fair value measurements, including their classification within a hierarchy that prioritizes the inputs to fair value measurement. The three levels of the fair value hierarchy are:

- Level 1 - Unadjusted quoted prices in active markets for identical assets or liabilities;
- Level 2 - Inputs other than quoted prices that are observable for the asset or liability either directly or indirectly; and
- Level 3 - Inputs that are not based on observable market data.

The Company's long term investment is considered to be a level 3 under Section 3862. See Note 8.

#### m) Convertible debt

The Company classifies the proceeds received from convertible debt into their liability and equity components using a fair value approach. The carrying amount of the liability component is accreted over the life of the instrument using the effective interest rate method. On conversion into shares, the carrying amount of the equity component and the carrying amount of the liability component are transferred to share capital. In the event that the instrument is settled in cash, this is treated as the extinguishment of the instrument; a gain or loss on extinguishment of the liability component, if applicable, is recognized in the income statement, the gain or loss on the equity component, if applicable, is recognized in contributed surplus. Transaction costs are netted against the carrying value of the instrument to which they relate.

#### n) Changes in accounting policies

##### *Section 1506*

Section 1506 - Accounting Changes - This existing section has been amended to exclude from its scope changes in accounting policies upon the complete replacement of an entity's primary basis of accounting. Amendments apply to interim and annual financial statements relating to years beginning on/after July 1, 2009. The adoption of these changes to the standard did not have significant impact on the Company's financial statements.

#### o) Future accounting changes

##### *Section 1582*

The new Section 1582 - Business Combinations, which replaces Section 1581 - Business Combinations, establishes standards for the measurement of a business combination and the recognition and measurement of assets acquired and liabilities assumed. The Company does not expect the adoption of this new standard to have an impact on its financial statements.

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

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

#### o) Future accounting changes (cont'd)

##### *Section 1601 & 1602*

The new Sections 1601 - Consolidated Financial Statements and Section 1602 - Non-Controlling Interests, together replace Section 1600 - Consolidated Financial Statements. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 establishes the accounting for a non-controlling interest in a subsidiary, in the consolidated financial statements, subsequent to a business combination. These standards apply to interim and annual consolidated financial statements relating to fiscal years beginning on or after January 1, 2011. Earlier adoption is permitted as of the beginning of a fiscal year. The Company does not expect the adoption of these new standards to have an impact on its financial statements.

### 3. CAPITAL MANAGEMENT

As at September 30, 2010, Baffinland's capital structure consists of its shareholders' equity. During the nine months ended September 30, 2010, there was no change to the capital structure. The Company is a development stage entity and, therefore, its objective when managing the capital structure is to fund the continuing exploration and development of its wholly owned Mary River Property. The Company maintains its capital structure by raising funds externally as the need arises. The capital is invested in highly liquid, highly rated financial instruments.

In order to carry out planned exploration and development and to pay for administrative costs, the Company will spend its existing working capital and raise additional amounts as needed. There are no assurances that such financing will be available on terms acceptable to the Company, or at all.

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

There were no changes in the Company's approach to capital management during the nine months ended September 30, 2010 compared to the previous year. The Company is not subject to externally imposed capital requirements.

### 4. CASH AND CASH EQUIVALENTS

	September 30 2010	December 31 2009
Cash and cash equivalents are comprised of:		
Cash	\$ 417,691	\$ 3,279,118
Guaranteed investment certificates	<u>21,005,000</u>	<u>42,200,000</u>
	<u>\$ 21,422,691</u>	<u>\$ 45,479,118</u>

### 5. RESTRICTED CASH

The Company has provided \$16,500,000 (2009 - \$16,500,000) in cash to support an irrevocable letter of credit which provides financial security for future abandonment and reclamation costs.

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

### 6. INVENTORY

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

	September 30 2010	December 31 2009
<b>Current</b>		
Fuel	\$ 2,048,000	\$ 1,091,000
Supplies	944,000	1,865,000
	<u>\$ 2,992,000</u>	<u>\$ 2,956,000</u>
<b>Non-current</b>		
Fuel	\$ 1,537,900	\$ 6,082,900
Supplies	287,139	145,415
	<u>\$ 1,825,039</u>	<u>\$ 6,228,315</u>

In 2009, a portion of fuel was relocated from Baffin Island to Montreal. During the second quarter of 2010, there was a write down of \$0.9 million to record the fuel at net realizable value (2009 - \$2.1 million).

### 7. MINING INTERESTS

The Company has a 100% interest in three mining leases in the Mary River area of Baffin Island, Nunavut, Canada. Each of the leases has a term of 21 years and are due for renewal in 2013. The Company also has a surface rights commercial land lease that permits it to access the lands. See Note 17.

Mining interests is comprised of:

<b>Balance at January 1, 2009</b>	\$ 140,531,497
Asset retirement obligation incurred	399,851
Development costs capitalized	22,441,995
<b>Balance at December 31, 2009</b>	<u>163,373,343</u>
Asset retirement obligation incurred	-
Development costs capitalized	5,934,878
<b>Balance at September 30, 2010</b>	<u>\$ 169,308,221</u>

### 8. LONG TERM INVESTMENTS

The Company owns long term asset backed notes (the "Notes") that were issued by Master Asset Vehicle II ("MAV 2") as a result of the restructuring of the Company's previous investment in third party Asset Backed Commercial Paper ("ABCP"). The Notes have a face value of \$17,742,030 and a fair value of \$12,899,207 as at September 30, 2010 (December 31, 2009 - face value of \$17,750,092 and fair value of \$11,519,196). On January 21, 2009, the Company received the Notes which replaced the ABCP. As part of the exchange, the Company received two payments totalling \$941,301 that represented the Company's share of cash that accumulated to the assets during the restructuring period. The payments were recorded as a gain on note exchange during the nine month period ended September 30, 2009.

The secondary market for the Notes continues to develop, however, it is not yet an "active market" given the limited bid activity and small number of disclosed transactions since the note exchange occurred. Until an active market develops for the Notes, the fair value will be determined using a discounted cash flow approach based on the use of inputs observed from market conditions. The fair values may change materially in subsequent periods.

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

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

During the fourth quarter of 2009, the Company sold its entire holdings of the Class 15 notes for proceeds of \$1,569,144 which resulted in a gain on sale of \$888,690.

The remaining portfolio consists of four types of Notes, which are supported by a pool of leveraged super senior credit default swaps, unlevered collateralized debt obligations as well as traditional assets and cash. The leveraged assets supporting these notes have access a credit facility that can be drawn upon in the event that a margin call is triggered and more unlevered collateral must be posted.

Using publicly available information the Company has been able to determine the key characteristics of each class of the Notes: par value, credit rating, interest rate and projected interest payments, and maturity date. The Company then estimates the return that a prospective investor would require for each class of Notes ("Required Yield"). Lastly, it calculates the net present value of the cash flows for each class of the Notes using the Required Yield as the discount factor.

During the nine months ended September 30, 2010, the Company has seen continued improvement in general corporate credit market conditions which has had the most impact on the valuation. This decrease in credit risk impacts the intrinsic value of the Notes due to a general lowering of default risk, relative to the previous valuations. There is also a decrease in the likelihood that credit risk limits built into the Notes will be exceeded (specifically, the spread-based margin triggers). Accordingly, the Required Yield on the Notes has been somewhat reduced to reflect easing in the credit markets. Accretion of the Notes to par value at maturity, assuming they do not default, also resulted in an increase to the value at September 30, 2010.

Noteholders are to receive floating interest mostly based on prevailing banker's acceptance rates based on the variable interest income on the pool of assets, however, the payments to noteholders are subordinated to the margin funding facility fee. As a result, interest payments to the Company are not expected to be received on the Notes until there is an increase in the prevailing interest rates. This anticipated near-term lack of income on the Notes has been factored in the valuation. The Company will record interest received on a cash basis until such time that the payment of interest becomes likely.

Based on the foregoing, as at September 30, 2010 the Company has estimated the fair market value of the Notes to be between \$12.2 million and \$13.8 million and as a result for the nine month period ended September 30, 2010, the Company has recorded an unrealized gain on revaluation of the Notes in the amount of \$1,380,011 (2009 - \$2,122,922) to arrive at a carrying value of \$12,899,207 (2009 - \$11,519,196).

Notes	Face Value (\$)	Maturity Date (i)	Effective Coupon <sup>(ii)</sup>	Required Yield <sup>(iii)</sup>	Fair Value September 30, 2010	Fair Value December 31, 2009
<b>MAV2 Notes</b>						
A-1	13,265,684	20/12/2016	1.77%	5.7%	<b>\$10,542,845</b>	\$9,571,012
A-2	3,337,040	20/12/2016	1.77%	9.2%	<b>\$2,177,734</b>	\$1,838,803
B	605,766	20/12/2016	0.00%	20.6%	<b>\$173,293</b>	\$104,046
C	533,540	20/12/2016	0.00%	25.2%	<b>\$5,335</b>	\$5,335
<b>Total</b>	<b>17,742,030</b>				<b>\$12,899,207</b>	<b>\$11,519,196</b>

(i) The actual MAV2 Notes have legal maturity dates of 2056, but for valuation purposes a maturity date of 2016 is reflective of the maturities of the underlying assets.

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

(iii) Estimated fixed yield to maturity required by prospective investors.

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

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

The movement in the balance in the nine months ended September 30, 2010 is noted:

<b>Balance at December 31, 2008 / January 21, 2009</b>	<b>\$9,791,925</b>
Unrealized gain on revaluation	2,407,724
Sale of Class 15 Note	(680,453)
<b>Balance at December 31, 2009</b>	<b>\$11,519,196</b>
Unrealized gain on revaluation	1,380,011
<b>Balance at September 30, 2010</b>	<b>\$12,899,207</b>

The fair value of the Notes may increase or decrease materially in subsequent periods.

### 9. PROPERTY, PLANT & EQUIPMENT

Property, plant & equipment is comprised of:

	September 30, 2010			December 31, 2009		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Infrastructure and equipment	\$ 13,953,346	\$ 7,335,954	\$ 6,617,392	\$ 13,935,974	\$ 5,252,964	\$ 8,683,010
Furniture & fixtures	98,245	73,112	25,133	98,245	63,302	34,943
Leasehold improvements	139,410	111,348	28,062	139,410	91,940	47,470
Computer equipment	324,271	135,380	188,891	324,271	88,190	236,081
Infrastructure and equipment not in use	2,517,402	-	2,517,402	2,508,387	-	2,508,387
	<u>\$ 17,032,674</u>	<u>\$ 7,655,794</u>	<u>\$ 9,376,880</u>	<u>\$ 17,006,287</u>	<u>\$ 5,496,396</u>	<u>\$ 11,509,891</u>

"Infrastructure and equipment not in use" is not amortized. For the three and nine month periods ended September 30, 2010 there was no amortization and accretion expense capitalized given that exploration is currently being conducted on Deposit Nos. 2, 3, 4, 5, 6, & 7. In the prior similar periods, amortization and accretion expense in the amount of \$704,220 and \$2,098,980 respectively, related to development activities of Deposit No. 1, was capitalized to mining interests.

### 10. ASSET RETIREMENT OBLIGATION

The Company's asset retirement obligation relates to the Mary River Property and is as follows:

<b>Balance at January 1, 2009</b>	\$ 554,552
Asset retirement obligation incurred	399,851
Accretion	81,957
<b>Balance at December 31, 2009</b>	<b>1,036,360</b>
Asset retirement obligation incurred	-
Accretion	68,678
<b>Balance at September 30, 2010</b>	<b>\$ 1,105,038</b>

During the first quarter of 2010, the Company prepared its Abandonment and Reclamation Plan. As at September 30, 2010, the total undiscounted closure costs, exclusive of salvage values, remain at approximately \$12.0 million (2009 - \$12.0 million). A substantial portion of these obligations is not expected to be paid until 2042 which is the estimated time at which the current iron ore reserves are expected to be depleted.

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

### 11. COMMON SHARES AND WARRANTS

**Authorized:** Unlimited common shares

**Issued:**

	Number of shares	Amount \$
<b>December 31, 2008</b>	233,129,899	349,643,327
Net future income tax liability recorded on renunciation of flow through expenditures	-	(4,175,900)
Conversion of Subscription Receipts April, 2009	22,176,564	4,213,547
Exercise of share purchase options	255,227	121,538
Interest and fee payments paid in shares for convertible debt	1,476,840	689,657
Share financing - flow through private placement December, 2009	41,860,000	17,497,480
Share financing - public offering December, 2009	43,885,669	15,491,203
<b>December 31, 2009</b>	<b>342,784,199</b>	<b>383,480,852</b>
Net future income tax liability recorded on renunciation of flow through expenditures	-	(6,906,900)
Exercise of share purchase options	276,250	209,637
Share financing expense- offering December 2009	-	(142,789)
Exercise of warrants	37,500	39,375
<b>September 30, 2010</b>	<b>343,097,949</b>	<b>376,680,175</b>

On December 10, 2009, the Company closed the 2009 Equity Offerings. The first offering was a public offering under which a total of 23,959,100 common shares and 11,979,550 common share purchase warrants were issued. Each common share unit was sold for a price of \$0.48 and was comprised of one common share and one half common share purchase warrant. Total gross proceeds on the public offering were \$11.5 million.

The second of the 2009 Equity Offerings was a private placement under which a total of 41,860,000 common shares and 20,930,000 common share purchase warrants were issued. Each common share unit was sold for a price of \$0.55 and was comprised of one common share and one half common share purchase warrant. Each common share unit was sold for a price of \$0.55 and was comprised of one common share and one half common share purchase warrant. Each common share was issued as a "flow-through share" under the Income Tax Act (Canada). Total gross proceeds from the private placement were \$23.0 million. During the first quarter of 2010, the Company renounced the flow-through expenditures and recorded the associated future tax income liability in respect of the \$23.0 million of proceeds from the sale of flow-through shares in the December 2009 Equity Offerings.

On December 10, 2009 as part of the 2009 Equity Offerings, Resource Capital Funds ("RCF") exercised in full its pre-existing participation rights to participate in the 2009 Equity Offerings, pursuant to which RCF purchased an aggregate of 19,926,569 common shares and 9,963,285 common share purchase warrants. Each common share unit was sold for a price of \$0.48 and was comprised of one common share and one half common share purchase warrant. Total gross proceeds from the exercise of the participation rights were \$9.6 million.

Each common share purchase warrant issued as part of the 2009 Equity Offerings entitles the holder to acquire one common share for a price of \$0.70 until December 9, 2012.

On December 10, 2009, the Company also repaid the Environmental Bonding Facility and issued 669,713 common shares valued at \$327,088 to RCF for the final interest and commitment fee payment for the facility.

On September 30, 2009, the Company issued 807,127 common shares valued at \$362,490 to RCF in satisfaction of the establishment fee, quarterly commitment fee and quarterly interest related to the August 31, 2009 draw of funds of \$10.37 million (US\$9.5 million) under the Environmental Bonding Facility.

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

### 11. COMMON SHARES AND WARRANTS (cont'd)

There are a total of 48,817,323 warrants outstanding as at September 30, 2010:

	<u>Number of warrants</u>	<u>Amount \$</u>
<b>December 31, 2007</b>		
Warrant issue - 2007	5,981,988	3,023,371
<b>December 31, 2008</b>	<b>5,981,988</b>	<b>3,023,371</b>
Warrant issue - 2009	42,872,835	9,070,019
<b>December 31, 2009</b>	<b>48,854,823</b>	<b>12,093,390</b>
Warrant exercise - 2010	(37,500)	(8,250)
<b>September 30, 2010</b>	<b>48,817,323</b>	<b>12,085,140</b>

The total fair value attributed to the warrants outstanding is \$12,085,140 using the following assumptions under the Black-Scholes model:

Date issued	Exercise Price	Expiry Date	Risk-free Interest rate	Expected Stock Volatility	Number outstanding
January 24, 2007	\$5.50	January 31, 2012	4%	60%	5,454,550
March 26, 2007	\$5.50	January 31, 2012	4%	60%	527,438
December 10, 2009	\$0.70	December 10, 2012	0.5%	85%	42,835,335
<b>Total warrants outstanding</b>					<b>48,817,323</b>

### Contributed surplus

Balance, December 31, 2007	\$ 6,913,803
Share-based compensation	4,932,408
Exercise of share purchase options	(10,875)
<b>Balance, December 31, 2008</b>	<b>\$ 11,835,336</b>
Share-based compensation	2,206,961
Net loss on extinguishment of equity portion of convertible debt	(618,790)
Exercise of share purchase options	(69,413)
<b>Balance, December 31, 2009</b>	<b>13,354,094</b>
Share-based compensation	955,312
Exercise of share purchase options	(129,962)
<b>Balance, September 30, 2010</b>	<b>\$ 14,179,444</b>

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

### 12. SHARE-BASED COMPENSATION

The Company has a share option plan, pursuant to which, the Company may grant up to 10% of its outstanding common shares to directors, officers, employees, or consultants. Options vest over an 18 month period with 25% vesting on the grant and further 25% vesting on each six month anniversary of the grant. The options granted to date have a five year term. Share-based 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 share option plan is presented in the following table:

	September 30, 2010		December 31, 2009	
	Number	Weighted Average	Number	Weighted Average
Outstanding, beginning	10,229,000	\$ 1.66	7,382,000	\$ 2.59
Granted in the period	3,029,000	0.57	5,697,000	0.32
Exercised in the period	(276,250)	0.31	(332,500)	0.28
Forfeited in the period	(1,243,750)	2.56	(1,167,500)	1.98
Expired in the period	(686,000)	2.07	(1,350,000)	1.14
Outstanding, ending	11,052,000	\$ 1.27	10,229,000	\$ 1.66

During the three month period ended September 30, 2010, there were no options granted to purchase common shares. In the nine month period ended September 30, 2010, the Company granted 3,029,000 options to purchase common shares, with a five year term at an average exercise price of \$0.57 per common share. For the nine month period ended September 30, 2010 fair values of \$1,054,575 was estimated for the share options using the Black Scholes fair value option-pricing model. During the third quarter of 2010 37,500 warrants with a \$0.70 exercise price were exercised.

As at September 30, 2010 the number of options available for exercise was 8,980,000 at a weighted average price of \$1.44 and the aggregate value of unvested options granted is \$546,743.

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

Date options granted	Expected life	Risk-free interest rate	Expected Stock Volatility
March 31, 2008	5 years	5.0%	74%
September 22, 2008	5 years	3.0%	72%
January 6, 2009	4 years	1.6%	85%
March 24, 2009	4 years	1.9%	88%
June 9, 2009	4 years	1.4%	89%
October 27, 2009	4 years	0.5%	85%
December 15, 2009	4 years	0.5%	85%
February 23, 2010	4 years	2.2%	85%
April 30, 2010	4 years	2.7%	80%

No dividend yield is assumed.

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

Using the fair value method, total share-based compensation for share options issued and outstanding for the three and nine months periods ended September 30, 2010 was \$226,041 and \$955,312 respectively (2009- including amounts capitalized to mining interests- \$392,683 and \$2,119,537).

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

### 13. FINANCIAL RISK FACTORS

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

#### **Credit risk**

Credit risk is the risk of loss associated with counterparty's or the Company's inability to fulfil its payment obligations. The Company's credit risk is primarily attributable to its long term investment in asset-backed notes (see Note 8) and its accounts receivable. When valuing its financial instruments, the Company is required to take into account the credit quality of both the counterparty and the Company itself as appropriate.

The Company has no significant concentration of credit risk arising from operations. Cash equivalents consist of guaranteed investment certificates, which have been invested with Canadian chartered banks with typical maturities of less than 12 months and fully cashable after 30 days and management believes the risk of loss to be remote. Accounts receivable typically consists of goods and services tax due from the Federal Government of Canada. Management believes that the credit risk with respect to accounts receivable is low.

#### **Liquidity risk**

The Company's approach to managing liquidity risk is to ensure that it will have sufficient funds to meet liabilities when due. As at September 30, 2010, the Company had a cash balance of \$21,422,691 (December 31, 2009 - \$45,479,118) to settle current liabilities of \$6,901,764 (December 31, 2009 - \$1,672,307). Current liabilities consist of accounts payable that are predominantly due within 60 days.

#### **Interest rate risk**

The Company's current policy is to invest excess cash in highly rated short-term deposit certificates issued by Canadian chartered banks. The Company periodically monitors the investments it makes and is satisfied with the credit ratings of its banks.

#### **Foreign currency risk**

The Company's functional currency is the Canadian dollar and major purchases are transacted in Canadian dollars. Management believes the foreign exchange risk derived from currency conversions is not significant and therefore does not hedge its foreign exchange risk.

#### **Price risk**

The Company is exposed to price risk with respect to iron ore prices. The price of iron ore has declined somewhat during the most recent economic downturn which commenced in the third quarter of 2008, while future significant price declines could cause continued exploration and development of the Mary River Property to become uneconomical, commodity prices, particularly iron ore began to recover by the end of 2009.

#### **Sensitivity analysis**

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

- Interest income on cash balances held has been negatively affected by low prevailing interest rates. Cash and cash equivalents include deposits which earn interest at variable interest rates. It is generally expected that interest rates will rise. If interest rates were to rise by 0.50%, net loss would decrease by approximately \$55,000 for the three months ended September 30, 2010.
- The Company does not hold significant balances in foreign currencies to give rise to exposure to foreign exchange risk.
- Price risk is remote since the Company is not a producing entity.

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

### 14. INCOME TAXES

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

	For the nine month periods ended	
	September 30	September 30
	2010	2009
Net loss before taxes for the period	(\$29,298,683)	(\$5,328,719)
Income tax recovery at Canadian federal and provincial statutory rates	(8,789,605)	(1,558,188)
Change in valuation allowance	2,520,235	876,027
Permanent differences	286,594	682,162
Recovery of income taxes	(5,982,776)	-

The components of the recovery of income taxes comprise:

Future income tax recovery	(5,982,776)	-
Net income tax recovery	(5,982,776)	-

The Company's future income tax assets and liabilities are comprised of:

	September 30	December 31
	2010	2009
<b>Future Income Tax Assets</b>		
Exploration & Development	\$ 4,045,000	\$ 3,917,000
Non-capital losses carried forward	6,303,000	4,113,000
Share issue expense	1,985,000	2,710,000
Long-term asset backed notes	978,000	1,114,000
Future income tax asset	13,311,000	11,854,000
Valuation Allowance	(12,778,000)	(10,765,000)
Net future income tax asset	533,000	1,089,000
<b>Future Income Tax Liabilities</b>		
Flow through share issuance	(924,124)	-
Property, plant and equipment	(533,000)	(1,089,000)
Future income tax liability	(1,457,124)	(1,089,000)
Net future income tax asset / liability recorded	(\$924,124)	-

For the nine months ended September 30, 2010, the Company has recorded a net income tax recovery of \$5,982,776 (2009 - nil) and a valuation allowance in respect of tax losses and other attributes valued at \$12,778,000 (December 31, 2009 - \$10,765,000).

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

### 15. RELATED PARTY TRANSACTIONS

During the three and nine month periods ended September 30, 2010 McChip Resources Inc., a related party controlled by a director, officer and a shareholder, paid \$12,000 and \$36,000 (2009 - \$18,000 and \$54,000) respectively to the Company. The payments were in relation to lease and operating costs. Cost recoveries were included in office and general expense and were in the normal course of business and are measured at the cost amount, which is the consideration established and agreed to between the related parties.

### 16. NET LOSS PER SHARE

Net loss per share is calculated using the weighted average number of common shares outstanding during the three and nine month periods ended September 30, 2010. No effect has been given to the potential exercise of share options, subscription receipts and warrants in the calculation of fully diluted loss per share as the effect would be anti-dilutive. The weighted average number of common shares outstanding for the three and nine months ended September 30, 2010 was 342,942,609 and 342,930,989 (2009 - 255,328,070 and 247,894,024).

### 17. CONTINGENCIES AND COMMITMENTS

The office lease has been renewed for a five year period ending October 2015 and the Company is committed to annual lease payments of \$146,100 plus operating costs.

The Company holds a surface rights commercial land lease with the Qikiqtani Inuit Association (the "QIA") covering an estimated surface area of approximately 10,567 hectares on Baffin Island, Nunavut ("Land Lease"). The current lease term which was set to expire on October 31, 2010 has been extended to November 15, 2010. The Company expects that the lease will be renewed substantially in its current form within the extension period. The terms of the Land Lease provide that the Company must post financial security from time to time for future estimated costs of abandonment and reclamation activities on Inuit owned land. The Company has provided financial security to the QIA in the form of an irrevocable letter of credit. In the third quarter of 2009, the letter of credit was increased by \$10.3 million. The \$16.5 million letter of credit is recorded on the balance sheet as restricted cash.

### 18. SUBSEQUENT EVENTS

On October 7, 2010, the Company released the Directors' Circular in which the Board of Directors of the Company, upon the recommendation of the Special Committee, unanimously recommended that shareholders of the Company reject the Unsolicited Offer and not tender their common shares to the Unsolicited Offer. The Directors' Circular outlines the nine reasons for the recommendation which include, that the Unsolicited Offer significantly undervalues the Mary River Property, is at a significant discount to precedent transaction multiples and that it is highly opportunistic and conditional. On October 28, 2010, the Unsolicited Offer was extended to November 8, 2010.

### 19. COMPARATIVE INFORMATION

Certain comparative figures have been reclassified to conform to current period financial statement presentation.

