



**BAFFINLAND IRON MINES CORPORATION**

**THIRD QUARTER REPORT**

September 30, 2009





**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION  
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2009**

## INTRODUCTION

The following is management's discussion and analysis of the financial condition and results of operations of Baffinland Iron Mines Corporation ("Baffinland" or the "Company") for the three and nine month periods ended September 30, 2009 ("MD&A"), and its financial position as at September 30, 2009, 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, 2009, including the notes thereto. 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 23, 2009 and subsequent press releases have been filed electronically through the System for Electronic Document Analysis and Retrieval ("SEDAR") and are available online at [www.sedar.com](http://www.sedar.com). The date of this MD&A is October 27, 2009. All figures are in Canadian dollars unless otherwise noted.

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

### Cautionary Note Regarding Forward-Looking Information

Certain information included in this 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. Words and terms not otherwise defined in this section are defined in the subsequent sections of the MD&A.

Without limitation, statements about Deposit No. 5; blast furnace results from trial cargos; the re-initiation of engineering and related technical support services; an Environmental Impact Statement and associated guidelines; financing; the Company's eligibility for loan guarantees; the A&R Plan; the Company's 2009 exploration and development plans including its 2009 drill program; the completion of additional resource estimation on Deposit No. 1; progressive reclamation; regulatory compliance and maintaining core assets at site; additional metallurgical testwork for material shipped in the 2008 bulk sample program; negotiations with the QIA and the development of an IIBA; discussions and agreements by the Company with respect to Financial Security requirements for the Mary River Property; completion of the basic engineering and the definitive capital cost estimate for construction at the Mary River Property; completion of the regulatory process and estimates and review of project construction timelines and the commencement of commercial iron ore shipments; statements about the Company's goal to add one or more strategic partners; the Company's arrangement in connection with environmental bonding facility; and substantially all of the information contained in and/or derived from the Definitive Feasibility Study ("DFS"), including the timing and other related matters of such statements, constitutes forward-looking information. Actual results may vary. See "Risks and Uncertainties".

Forward-looking information is based on certain factors and assumptions regarding, among other things, the estimation of mineral reserves and resources, the realization of mineral reserve and resource estimates, iron ore prices, the timing and amount of future exploration expenditures, the estimation of initial and sustaining capital requirements, the estimation of labour and operating costs, the availability of necessary financing and materials, including financing to conduct other activities necessary to continue to develop the Mary River Property in the short and long-term, the progress of construction and development activities, the receipt of

necessary regulatory approvals, and 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. While the Company considers these assumptions to be reasonable based on information currently available to it, they may prove to be incorrect.

Without limitation, in stating that the Company plans to reinitiate engineering and related technical support services; complete an EIS; complete its 2009 drill program; complete its 2009 exploration and development plans; complete additional metallurgical testwork; continue negotiations with the QIA and develop an IIBA; complete basic engineering and definitive capital cost estimate; complete the regulatory process; estimate project construction and commercial shipment timelines; and complete the recommendations included in the Technical Report filed on SEDAR in February of 2008 (the "Technical Report"), the Company has assumed that it will be able to obtain the necessary financing and permits in order to complete such activities and that such activities will proceed without undue disruption. In estimating an initial capital cost for the Mary River Property of \$4.1 billion, the Company has assumed, among other things, certain geotechnical design criteria for the rail corridor and certain inputs for construction costs, including labour and material costs. In making statements concerning the timing of project construction and the commencement of commercial production, the Company has assumed, among other things, that iron ore prices will not change materially from the prices used in its current financial forecasts, that it will obtain in a timely fashion all of the financing, regulatory approvals and other authorizations required to enable the continued exploration and development of the Mary River Property, and the construction and mining activities required in order to complete such activities, and that such activities will proceed in the ordinary course without undue disruption. See "Risks and Uncertainties". In stating that the Company intends to add one or more strategic partners and to obtain financing, the Company has assumed that it will successfully conduct negotiations and due diligence and assumes improvements in the global economy and the financial position of potential strategic partners. There can be no assurance that such a strategic partnership can be completed or that financing can be obtained on satisfactory terms to the Company or at all.

Forward-looking information is subject to certain factors, including risks and uncertainties, which could cause actual results to differ materially from what management currently expects. These factors include risks inherent in the exploration for and development of mineral deposits, risks relating to changes in iron ore prices and the worldwide demand for and supply of iron ore, uncertainties inherent in the estimation of mineral reserves and resources, risks relating to the remoteness of the Mary River Property including access and supply risks, reliance on key personnel, construction and operational risks inherent in the conduct of mining activities, including the risk of increases in capital and operating costs and the risk of delays or increased costs that might be encountered during the construction and development process, the risk that production estimates may be inaccurate, the risk of fluctuations in the Canadian/U.S. dollar exchange rate, regulatory risks, including risks relating to the acquisition of the necessary licenses and permits, financing, capitalization and liquidity risks, including the risk that the financing necessary to fund the exploration and development activities at the Mary River Property may not be available on satisfactory terms, or at all, environmental risks, including risks relating to climate change and the potential impact of global warming on project timelines and on construction and operating costs, and insurance risks. 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. There can be no assurance that a loan guarantee/cover will be granted. See "Risks and Uncertainties".

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

## **Disclosure Controls and Procedures**

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, 2009, 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 quarter ended September 30, 2009 that have materially affected, or is reasonably likely to materially affect, the Company's internal controls over financial reporting.

## **OVERVIEW**

### **Background**

Baffinland is a Canadian company that was formed pursuant to Articles of Incorporation under the *Business Corporation Act* (Ontario) on March 10, 1986. The Company owns three mining leases covering approximately 1,600 hectares in the Mary River area, Baffin Island, Nunavut, Canada. In addition the Company has: an Exploration Agreement with the Nunavut Tunngavik Inc. covering approximately 18,000 hectares, and 18 mineral claims staked in 2008 that total approximately 13,000 hectares. The Company is a mineral exploration and development company with a sole focus on the advancement of its Mary River Property, which consists of five high-grade hematite/magnetite deposits (the "Project"). The Project is in its early stages after having been originally discovered and studied in the 1960's. Notwithstanding current global recessionary conditions, which have significantly impacted the European and North American commodity markets, iron ore market trends are still seen as favourable. Iron ore prices decreased by approximately 30% in 2009. However, since the economic downturn began in late 2008, the Company's management has closely watched market developments and a cautious optimism has developed. Prices are expected to rebound in 2010 and normalcy is expected to return to markets by 2011. Consensus industry analysts' forecasts have iron ore prices increasing between 5% and 20% in 2010. Iron ore and steel industry consolidation continues. An economic recovery in commodity prices, particularly iron ore, has been led by Asia and the developing countries of the world. The developed world, particularly the USA and Europe, were hit hard by the financial crisis, but have now also recovered with most European steel companies now operating at 70-80% capacity with demand and consumption growing. This compares to the first half of 2009 when most European steel companies were operating at 40-50% of capacity.

Since 2004, Baffinland has been engaged in a wide spectrum of activities supporting the development of the Mary River iron ore deposits. These activities have included the delineation of mineral resources and estimation of mineral reserves, extensive metallurgical testing of the iron ore, field engineering data collection, environmental and socio-economic baseline studies, and evaluation of shipping lanes. A bulk sample was shipped to two key customers in Europe in 2008. The DFS, coordinated by Aker Solutions was completed in 2008, followed by initiation of the regulatory review process and basic engineering design. As a result of the current world economic outlook and the Company's current resources, basic engineering and other technical support services were suspended in December 2008 and a review of the proposed Project timeline was initiated. Re-initiation of engineering and related technical support services will be contingent on the Company raising funds to complete such activities. As a result of a decision from the Minister of Indian and Northern Affairs Canada in reference to the regulatory review process, in 2009 the Company is pursuing the terms of reference guiding the submission of an Environmental Impact Statement, the

submission of which will be contingent on further financing. In the meantime, a modest exploration program was undertaken in 2009 to continue development on Deposit No. 1.

## **DEVELOPMENTS YEAR TO DATE**

### *Exploration Update*

The 2009 drilling program was completed at the end of August 2009. A total of 2,316 metres of core, in 13 holes was completed, compared to an original budget of 2,200 metres in eight holes. The program was completed ahead of schedule and under budget. There were no significant health, safety or environmental issues. As of September 30, 2009, the project has operated 410 days without a lost time injury.

### *Baffinland Reports High Grade Assays From the Newly Discovered Deposit No. 5*

In early October, the Company announced high grade iron assay results from the newly discovered Deposit No 5. Assays from surface sampling averaged 66.7% iron along the southeast trending strike length of Deposit No. 5 that can be traced at surface for almost four kilometres. Several zones of hematite-dominant mineralization have been outlined; the largest of which outcrops for 700 metres in strike length and up to 70 metres in width. Deleterious elements (manganese, phosphorous, sulphur and alkalis) are exceptionally low and generally below the analytical detection limit.

The zone is located less than five kilometres southeast from Baffinland's Deposit No. 4 and was the first target to be assessed following the airborne magnetic survey completed in 2008. The magnetic survey defined a target horizon that can be traced for a strike length of more than 60 kilometres. Preliminary reconnaissance work discovered Deposit No. 5 and further regional exploration is planned for 2010.

### *Guidelines for Environmental Impact Statement*

In September 2009, a final draft set of Environmental Impact Statement Guidelines ("EIS Guidelines") were issued to the Company by the Nunavut Impact Review Board ("NIRB") pursuant to the Nunavut Land Claims Agreement. A technical workshop was subsequently held by NIRB. Final Project specific EIS Guidelines are anticipated in the fourth quarter of 2009. Submission of a draft Environmental Impact Statement in 2010 is contingent on securing additional debt or equity financing.

### *Blast Furnace Test Results From Iron Ore Trial Cargo*

In September 2009, the Company reported the results of its lump iron ore trial cargo shipped to ThyssenKrupp Steel ("ThyssenKrupp") in October 2008. A 54,464 tonne lump iron ore cargo was shipped to ThyssenKrupp as part of the 113,217 tonne lump and fine iron ore trial cargos mined in 2008 as part of the Company's bulk sample program. ThyssenKrupp reported that the lump iron ore exhibited excellent physical attributes and caused no problems in handling or transportation. Mary River lump ore also exhibited excellent metallurgical characteristics and high quality in comparison to other lump iron ores.

In October 2009, the Company reported the results of its second lump iron ore trial cargo shipped to one of the world's leading steel companies. This 31,050 tonne lump cargo also exhibited excellent results as Mary River lump ore was substituted in the blast furnace burden mix one for one for iron ore pellets in a high productivity environment within the blast furnace. Mary River lump was added until it comprised 25% of the burden mixture in the blast furnace. Results were excellent and quality remained high.

The Company views the results of these blast furnace tests as the final confirmation that Mary River lump iron ore is an exceptional lump iron ore and should be an attractive alternative for pellets as a cheaper burden feed with virtually no loss of productivity.

#### *Facility for Environmental Bonding Signed*

During the three months ended September 30, 2009 the Company negotiated and entered into a definitive agreement for an environmental guarantee support facility that may earn conversion rights (the "Facility" or "Environmental Bonding Facility") with Resource Capital Fund IV L.P. ("RCF") in the amount of US\$13 million, maturing on December 31, 2012 (the "Maturity Date").

On August 31, 2009, the Company drew the equivalent of C\$10.37 million to cash back a letter of credit securing an increase in financial security of estimated future abandonment and reclamation costs to C\$16.5 million ("Financial Security") under the Company's surface rights land lease with the Qikiqtani Inuit Association (the "QIA" or "Landlord") for its Mary River Project ("Land Lease"). The increased Financial Security was requested as a result the Landlord's estimated costs associated with execution of abandonment and restoration. See "Operations - Abandonment and Restoration" for further detail.

The Company may draw under the Facility until August 16, 2010 (the "Availability Period"). Amounts outstanding under the Facility at the end of the Availability Period (the "Conversion Amount") automatically become convertible and may then be converted, at RCF's election, into common shares of the Company ("Common Shares") any time after the end of the Availability Period and prior to the Maturity Date at a conversion price of C\$0.46. If the Company subsequently repays any or all amounts outstanding under the Facility after the end of the Availability Period, RCF is entitled to re-advance an amount up to the Conversion Amount for the purpose of exercising its conversion rights prior to the Maturity Date.

Amounts outstanding under the Facility bear interest at a rate of 15% per annum during the Availability Period and 10% per annum thereafter until the Maturity Date. Interest is payable quarterly in cash or, at RCF's option, in Common Shares valued based on the Market Price which will be calculated as the weighted average trading price of the Common Shares over the twenty trading days prior to the applicable calculation date (the "Market Price"). For the purpose of calculating the number of Common Shares to be issued upon the payment of interest, fees and the conversion of the Conversion Amount, a fixed exchange rate of US\$1.00=C\$1.15 will be used.

In addition to interest payments, under the Facility, the Company must pay to RCF an establishment fee of 1.5% of the Facility Amount and a commitment fee of 0.5% of the undrawn portion of the Facility. The amount may be paid in cash or Common Shares, at RCF's option, based on the Market Price of the Common Shares. On September 30, 2009, the Company issued a total of 807,127 Common Shares to RCF in satisfaction of the establishment fee, the commitment fee and interest.

The total maximum number of Common Shares issuable to RCF on the conversion of the Facility Amount and the payment of all interest and fees in Common Shares may be greater than 10% of the total number of Common Shares currently outstanding (the "10% Threshold"). Pursuant to applicable TSX requirements, the Company is required to obtain shareholder approval for issuances to RCF in excess of the 10% Threshold. The Company currently expects to call a meeting of its shareholders to request the approval for the issuance of the full amount of the Common Shares payable in connection with the Facility, which approval will require a majority of the disinterested shareholders of the Company. In the event that the Company does not obtain such shareholders' approval by April 15, 2010, a 3% additional interest penalty will apply to all interest payable for the remainder of the Facility and amounts outstanding under the Facility that may not be

converted into Common Shares as a result of the 10% Threshold will become due and payable at the end of the Availability Period.

The Company's obligations under the Facility have been secured by a first ranking charge over all of the Company's assets, including certain mining leases on its Mary River Property. The Facility is subject to certain standard terms, conditions and restrictions including restrictions on the Company's ability to pay dividends, dispose of the Property or its other assets, and incur additional indebtedness without RCF's prior approval and the ability for RCF to apply outstanding amounts under the Facility against the exercise of rights it currently holds to maintain its pro rata shareholding in the Company.

The Company may repay any amounts outstanding under the Facility from time to time without penalty and is required to repay all amounts released by the QIA from its Financial Security requirement, resulting from the general reduction in Financial Security requirements for the Mary River project and the replacement of the Facility by the Company. Repaid amounts may not be re-drawn under the Facility.

The Company has classified the C\$10.37 million proceeds drawn under the Facility into its debt and equity components using the residual fair value approach:

<b>Balance at January 1, 2009</b>	\$ -
Add: Gross proceeds from August 31, 2009 draw	10,379,700
Deduct: Legal fees accrued or paid	(300,000)
Deduct: Establishment fees (paid in shares)	(224,250)
Deduct: Fair value equity portion	(3,884,579)
Add: Accretion	27,937
<b>Convertible debt as at September 30, 2009</b>	<b><u>\$ 5,998,808</u></b>

For further information on accounting treatment and measurement of debt and equity values, see note 12 of the financial statements for the three and nine months ended September 30, 2009.

#### *Memorandum of Understanding with the Qikiqtani Inuit Association*

In March 2009, a Memorandum of Understanding ("MOU") was signed with the QIA concerning detailed provisions intended to form part of a future Inuit Impact and Benefits Agreement ("IIBA"). Subject areas included in the MOU are employment, training and education, contracting and business opportunities, workplace conditions for Inuit employees and contractors, as well as community support. These provisions are subject to review and refinement based on the outcomes of the regulatory review process currently being undertaken by the NIRB and is an important step leading to an IIBA.

#### *Regulatory Review*

In February 2009, the Minister of Indian and Northern Affairs ("INAC") referred the Project to a Part 5 review under Article 12 of the Nunavut Land Claims Association ("NLCA"). In September 2009, the NIRB issued a final draft version of Project Specific EIS Guidelines.

#### *Eligibility for Loan Guarantees with the Federal Republic of Germany*

In March 2009, the Company announced that it had been advised by KfW IPEX-Bank GmbH ("KfW IPEX-Bank") that the Project is eligible in principle for a loan guarantee from the Federal Republic of Germany.

The German Government supports projects which are of outstanding importance for the Federal Republic of Germany. These include in particular projects securing German imports of raw materials. An Interministerial Committee ("IMC") decides whether a project is eligible for coverage. The IMC is composed of the Federal Ministry of Economics and Labour, the Federal Ministry of Finance, the Federal Foreign Office and the Federal Ministry for Economic Cooperation and Development. PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft ("PwC Germany") experts attend the meetings of the IMC in an advisory capacity.

KfW IPEX-Bank requested the German Government, through PwC Germany, to confirm eligibility in principle for a loan guarantee in the amount of US\$1.2 billion, for cover of commercial and political risks (scope of cover: 90%). At this early stage, this amount of loan coverage is indicative only and is based on certain assumptions such as the negotiation of off-take contracts with German steel mills of at least 10 years duration for 40% of the annual output of 18 million tonnes per year. PwC Germany has confirmed the Project's eligibility in principle and the preparedness of the German Government to analyze and evaluate the commercial risks.

A formal application for a loan guarantee will be required in due course as soon as all relevant information on the structure of the Project is available. The final decision about such coverage will be taken following evaluation of the Project by assessing feasibility and risks. The Project due diligence will include an evaluation of the legal, economic, technical and environmental risks. KfW IPEX-Bank would arrange such cover for the Project.

#### *Restructuring and Reduced Project Activities*

In January 2009, the Company announced that recent global economic conditions necessitated a reduced scale to the Company's activities planned for 2009, including a 35% reduction in the full time workforce of the Company from 40 people to 26 people. In addition, the number of full time consultants was reduced. Executive management has accepted salary reductions in 2009, and no cash bonuses were paid to employees or executive management in respect of 2008 service.

In addition to staff reductions at the Mary River site and at Baffinland's head office in Toronto, the Company shut down small satellite offices in several locations while preserving community liaison offices in the two largest communities in North Baffin and Iqaluit.

Additionally in January 2009, the Company informed its engineering and technical service providers that due to budget constraints, the majority of their services would be suspended until such time as the Company secures additional sources of financing. Progress reports have been written to document the work completed to this point in order to facilitate an orderly resumption of work in the future.

The Company's planned activities in 2009 have been funded with existing cash reserves that include net proceeds from the two concurrent private placement transactions that closed in December 2008 (the "December Private Placements"). During the quarter, the Company entered into the Facility to fund the posting of Financial Security. Sealifts to Baffin Island in the summer and early fall of 2008 had positioned required supplies for anticipated full-scale programs in 2009. Only a portion of these supplies have been consumed in 2009.

## 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 2009	Jun. 30 2009	Mar. 31 2009	Dec. 31 2008	Sept. 30 2008	Jun. 30 2008	Mar. 31 2008	Dec. 31 2007
<b>ASSETS</b>								
Current	29,729	37,970	44,108	54,293	69,226	141,836	193,905	50,474
Restricted cash	16,500	6,203	6,203	6,203	6,203	5,407	5,407	-
Long term investments	11,915	10,986	9,792	9,792	9,792	14,407	14,407	14,907
Property plant & equipment & Mining interest	171,605	164,521	159,955	154,973	139,747	69,428	13,187	12,383
	<u>229,749</u>	<u>219,680</u>	<u>220,058</u>	<u>225,261</u>	<u>224,968</u>	<u>231,078</u>	<u>226,906</u>	<u>77,764</u>
<b>LIABILITIES AND EQUITY</b>								
Current	5,534	3,311	3,950	8,587	27,404	26,352	21,068	19,657
Asset retirement obligation	1,013	990	967	554	543	509	476	-
Convertible debt	5,999	-	-	-	-	-	-	-
	<u>12,546</u>	<u>4,301</u>	<u>4,917</u>	<u>9,141</u>	<u>27,947</u>	<u>26,861</u>	<u>21,544</u>	<u>19,657</u>
Future income tax liability	4,176	4,176	4,176	-	-	-	-	10,301
	<u>16,722</u>	<u>8,477</u>	<u>9,093</u>	<u>9,141</u>	<u>27,947</u>	<u>26,861</u>	<u>21,544</u>	<u>29,958</u>
Shareholders' equity	213,027	211,203	210,966	216,120	197,021	204,217	205,362	47,806
	<u>229,749</u>	<u>219,680</u>	<u>220,058</u>	<u>225,261</u>	<u>224,968</u>	<u>231,078</u>	<u>226,906</u>	<u>77,764</u>
<b>WORKING CAPITAL</b>								
	24,195	34,659	40,158	45,706	41,822	115,484	172,837	30,817
Common shares outstanding (000's)	256,276	255,306	233,130	233,130	148,000	148,000	147,987	95,100

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

\$000's except per share (unaudited)

	Sep. 30 2009	Jun. 30 2009	Mar. 31 2009	Dec. 31 2008	Sep. 30 2008	Jun. 30 2008	Mar. 31 2008	Dec. 31 2007
<b>INTEREST AND OTHER INCOME</b>								
	122	17	134	238	651	1,374	231	298
<b>EXPENSES</b>								
Administrative	1,513	1,867	2,479	2,157	3,144	2,511	3,903	2,319
Exploration	265	176	232	604	1,007	1,054	34,587	28,532
Other	1,206	(1,477)	(659)	-	4,615	-	500	3,195
	<u>2,984</u>	<u>566</u>	<u>2,052</u>	<u>2,761</u>	<u>8,766</u>	<u>3,565</u>	<u>38,990</u>	<u>34,046</u>
Loss before income taxes	(2,861)	(549)	(1,919)	(2,523)	(8,115)	(2,191)	(38,759)	(33,748)
Future income tax recovery	-	-	-	-	-	-	10,301	6,709
<b>NET LOSS</b>	<u>(2,861)</u>	<u>(549)</u>	<u>(1,919)</u>	<u>(2,523)</u>	<u>(8,115)</u>	<u>(2,191)</u>	<u>(28,458)</u>	<u>(27,039)</u>
Net Loss per share	(\$0.01)	(\$0.00)	(\$0.01)	(\$0.02)	(\$0.05)	(\$0.01)	(\$0.29)	(\$0.30)

## FINANCIAL HIGHLIGHTS

The net loss recorded by the Company for the three months ended September 30, 2009 was \$2,861,324. This compared to a net loss of \$8,115,335 for the third quarter of 2008 ("prior period"). The net loss for the nine month period ended September 30, 2009 was \$5,328,719 compared to \$38,764,046 for the same nine month period in the prior year. The decrease for the nine month period is primarily the result of two factors. Firstly, the timing of capitalization of expenditures to mining interests, which commenced on April 1, 2008, resulted in higher exploration expense recorded in 2008, and secondly, the Company's exploration and development activities were greatly reduced in 2009 compared to 2008.

During the three months ended September 30, 2009, the Company recorded interest and other income of \$122,388 as compared to \$650,798 for the prior period. For the nine month period ended September 30, 2009, interest and other income was \$272,967 compared to \$2,255,947. Interest and other income was lower in both the three and nine month periods in 2009 compared to the same periods in the prior year as a result of lower interest rates and lower cash balances in 2009 compared to 2008.

A loss on writedown of inventory to net realizable value was recorded in the amount of \$2,134,165 in the third quarter of 2009. The writedown is related to a portion of fuel that was relocated from Baffin Island to the mainland that is now recorded at net realizable value and obsolescence of certain supplies.

Professional fees for the three months ended September 30, 2009 were \$146,433, a decrease of \$16,447 compared to the prior period. Higher fees were noted in the three months ended September 30, 2009 primarily as a result of additional listing fees paid in respect of the arrangement for the Environmental Bonding Facility. For the nine months ended September 30, 2009, professional fees were \$483,361 compared to \$792,008 in the same period in 2008 which was as a result of filing fees and higher general legal fees incurred in 2008.

Office and general expenses were \$203,983 for the third quarter compared to \$963,072 for the same period in the prior year, which were higher as a result of foreign exchange losses incurred in 2008 and a general reduction of level of the use of consultants in 2009 compared to 2008. For the nine months ended September 30, 2009, office and general expenses of \$708,374 were \$1,017,869 lower than the same period in 2008. The decrease in 2009 is as a result of recruitment fees in 2008 that were not incurred in 2009 and a general reduction of the level of consultants used in 2009 compared to 2008.

Salaries of \$628,703 for the three months ended September 30, 2009, represented a decrease of \$223,711 compared to the same period in the prior year. In the first quarter of 2009, the Company reduced its workforce by one third which resulted in lower salaries expense. For the nine months ended September 30, 2009, salaries of \$2,204,160 were \$46,692 higher. The increase in both periods was a result of severance payments for the workforce reduction which were paid in the first quarter of 2009.

Share-based compensation for the three months ended September 30, 2009 was \$384,733 compared to \$815,138 for the prior period. For the nine months ended September 30, 2009, share-based compensation of \$2,084,945 was \$3,914,000 for the same period in the prior year. The lower charge in both the three and nine month periods in 2009 are a function of the lower price for Common Shares underlying options for grant in 2009 compared to 2008. Additional share-based compensation charges related to grants to employees working at the Mary River Property in the amount of \$7,950 and \$26,642 respectively for the three and nine month periods ended September 30, 2009 has been capitalized to mining interests.

In the nine months ended September 30, 2009, the Company has received a total of \$941,301 as part of the restructuring arrangement where Asset Backed Commercial Paper was exchanged for new notes. The Company has also recorded an unrealized gain on revaluation of long term investments in the amount of \$928,503 and \$2,122,922 respectively for the three and nine months ended September 30, 2009. See "Liquidity and Capital Resources - Long term Asset-Backed Notes" for further detail.

For the three months ended September 30, 2009, amortization and accretion expense was \$14,590. An additional amount of \$727,420 for amortization and accretion was capitalized to mining interests. For the nine months ended September 30, 2009, amortization and accretion expense was \$43,770 with an additional \$2,157,736 capitalized to mining interests. Total amortization and accretion charges have increased for both the three and nine month periods ended September 30, 2009 as a result of the capital additions coming into service in the second quarter of 2008.

## OPERATIONS

### *Mine Development and Exploration*

On the basis of the completion of the DFS in February 2008, effective April 1, 2008 the Company began capitalizing mine development expenditures related to the advancement of Deposit No. 1. Total expenditures of \$16,688,579 incurred during the nine months ended September 30, 2009 were lower than in the same period in 2008. The decrease in expenditures period over period is a result of reduced 2009 programs of the Company.

The prior period expenditures were incurred to advance the bulk sample and for other metallurgical testwork, and environmental baseline studies. For the nine months ended September 30, 2009, expenditures related to ramp up and execution of the 2009 drilling program.

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

	For the nine months ended	
	September 30, 2009	September 30, 2008
	<u>2009</u>	<u>2008</u>
Mine Development/Exploration	\$13,539,807	\$84,403,361
Definitive Feasibility Study/Technical Services	513,491	12,545,309
Bulk Sample and site preparation	-	50,063,608
Health and Safety	538,115	1,824,154
Environmental and Permitting	1,631,791	10,161,576
Metallurgical Testing	465,375	667,875
<b>Total expenditures</b>	<b><u>\$16,688,579</u></b>	<b><u>\$159,665,883</u></b>

Of the aggregate expenditures in the nine months ended September 30, 2009 relating to mine development and exploration, \$16,014,934 has been capitalized to mining interests, with the remainder recorded as exploration expense.

### *Abandonment and Reclamation Plan*

The Company completed and submitted its 2009 annual update of its Abandonment and Reclamation Plan (the "A&R Plan") in respect of the Mary River Property in March 2009. The A&R Plan is the closure document that the Company would follow if there were no immediate or pending plans to advance the Project towards mine development, subject to any future revisions required to reflect material changes. The A&R Plan provides for the full cost of implementing closure assuming an unplanned shut-down completed by the Company as of March 31, 2010. This date is hypothetical as actual closure timing is currently unknown. The majority of the area covered by the A&R Plan is located on the property of the QIA with the remainder of the land owned by the Crown. The undiscounted costs of the A&R Plan for both Inuit owned land and Crown owned land are estimated to be \$12.0 million exclusive of salvage proceeds for property, plant and equipment (\$10.6 million inclusive of salvage proceeds) compared to the 2008 A&R Plan which included undiscounted costs of \$6.2 million exclusive of salvage proceeds. The increase in the estimated closure costs in the A&R Plan is a result of the additional disturbance that arose from the execution of the Company's bulk sample program in 2008, changes in the assumptions relating to how closure would be executed, and the refinement of estimates in the previous year's A&R Plan. As part of the Company's 2009 work program, the Company undertook progressive reclamation activities, including bulk sample equipment demobilization, hazardous waste disposal, sewage management and landfill planning.

The Company is a party to the Land Lease with the QIA in respect of the Mary River Property. The terms of the Land Lease provide that the Company post Financial Security from time to time for future estimated costs of abandonment and reclamation activities on Inuit owned land. During the third quarter, the Company posted an additional \$10.3 million in Financial Security with the proceeds from the draw on the Environmental Bonding Facility to bring the total Financial Security amount to \$16.5 million. Based on the outcome of the technical review and environmental audit that the QIA conducted in August 2009, Financial Security is not expected to be adjusted further in 2009, however, it may be subject to adjustment in the future at the QIA's discretion, in accordance with the terms of the Land Lease. The original Land Lease term expires in October 2009 and has been renewed for a year under the right to renew clause. See "Contractual Obligations" and "Risks and Uncertainties".

### *Mary River Property 2009 Program*

The Company has concluded its 2009 exploration and development plan that was approved in January 2009. The program was funded in part with the proceeds from the December 2008 Private Placements. The 2009 exploration and development plan included \$30 million in expenditures which were used to:

- fund the 2009 drilling program for Deposit No.1,
- complete additional resource estimation on Deposit No.1,
- continue progressive reclamation,
- maintain regulatory compliance, and
- preserve core assets at Mary River site.

Based on the work completed to date, the Company has continued its efforts to advance the Project towards full scale development. The Company has reported high grade assays from the newly discovered Deposit No. 5. Timing of development will depend on, among other things, the necessary debt and equity financing being available as needed and the timing of receipt of required permits. There can be no assurance that this financing will be obtained on favourable terms, or at all. Failure to obtain such additional financing could

result in a further delay or indefinite postponement of further exploration and development of the Mary River Property. See "Risks and Uncertainties".

#### *2009 Drilling Program Update*

Drilling at the Mary River Property commenced on June 15, 2009 and concluded on August 31, 2009 ahead of schedule. The primary goal of the 2009 program was to delineate the southern limits of Deposit No. 1 to assist in resource delineation and infrastructure planning. The Company's 2009 drilling workforce included trainees from North Baffin who were trained through a not-for-profit joint venture of which the Company is a part.

A total of 2,316 metres of core, in 13 holes was completed, compared to an original budget of 2,200 metres in eight holes. The program was completed under budget. There were no significant health, safety or environmental issues. As of September 30, the Project has operated 410 days without a lost time injury.

#### *DFS Recommendations*

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

- continuing with environmental baseline studies
- carrying out an additional geotechnical program in 2008 and onward, including drilling, laboratory testing and geophysical programs, to better define actual conditions present and adjust design and costs accordingly
- completing a near-surface drill program prior to detailed engineering
- continuing near-surface step-out drilling on Deposit Nos. 1, 2 and 3
- in order to maximise the in-pit reserves, infill drilling inside the pit limits, which may result in upgrading the inferred mineralised rock category to indicated or measured categories
- defining the overburden surface accurately within the perimeter of the final pit, allowing for a more accurate slope design and a better estimate of the required waste stripping which may affect the drill, load and haul operations
- more detailed geotechnical test work and study to define the pit slopes for different rock types, i.e., overburden, mineralised rock, and waste rock
- defining water condition within the pit and waste dumps in order to finalise the slope stability analysis for both open-pit and waste dumps
- conducting drill and blastability tests in order to estimate a more accurate drill and blast pattern
- continuing geotechnical investigations along the proposed rail alignment
- specific geotechnical investigations for the tunnels and bridge crossings
- continuing optimisation of the rail route alignment
- completing of rail equipment specifications considering cold climatic requirements
- collecting of additional data for dock and causeway at Steensby

- carrying out further optimisation of the dock design
- developing a more detailed schedule for construction considering various constraints, including possible environmental restrictions

The Company plans to continue to work on the foregoing recommendations in 2009 and into 2010, however, the degree of progress with regards to these additional plans will depend on, among other things, the ability of the Company to obtain the necessary financing and permits. The 2009 budget of \$30 million was insufficient to complete all of the activities that were contemplated in the Technical Report for 2009 and represents a significant reduction of work compared to 2008. The completion of certain Technical Report recommendations has been deferred until the Company obtains appropriate funding to complete them. At this time, management projects that the earliest possible timing for commencement of commercial production would be 2016. This projected timing assumes that certain project development activities resume in 2010 which is contingent upon obtaining adequate levels of financing. Timelines for the Project are continuously reviewed and are contingent on necessary debt and/or equity financing and timing of receipt of required permits. There is a risk that timelines will be delayed further.

Until such time that sufficient funding is available to complete the Technical Report recommendations and resume project development activities, management is preparing a work plan and budget to support a three year exploration program intended to increase direct-shipping inferred resources. Completion of this program is dependent on securing additional funding. See "Risks and Uncertainties".

#### **RELATED PARTY TRANSACTIONS**

During the three and nine month periods ended September 30, 2009, McChip Resources Inc., a related party controlled by a director and a shareholder of the Company, paid \$18,000 and \$54,000 respectively (2008 - \$18,000 and \$36,000) 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**

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 under the Environmental Bonding Facility.

During the three months ended September 30, 2009, options to purchase a total of 162,500 Common Shares were exercised for total gross proceeds to the Company of \$45,625.

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

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

In December 2008, the Company closed two concurrent private placement transactions for aggregate proceeds of approximately \$21.8 million. The first private placement consisted of issuance of 14,665,541 Common Shares and 22,176,564 Subscription Receipts to Resource Capital Fund IV LP ("Resource LP") at a price of \$0.19, for total gross proceeds of \$7.0 million, \$2.8 million of which was received in December with the

remaining \$4.2 million held in escrow. Each Subscription Receipt entitled Resource LP to acquire one Common Share for no additional consideration at any time prior to June 1, 2009 on notice being given that the Company and its shareholders have approved certain amendments to its shareholder rights plan which occurred on March 24, 2009. The proceeds on conversion of the Subscription Receipts to Common Shares were released from escrow to the Company in April, 2009.

The second private placement consisted of the issuance of 70,464,805 flow-through Common Shares at a price of \$0.21 per flow-through share for aggregate gross proceeds of approximately \$14.8 million. The Company closed the December 2008 Private Placements in reliance on a financial hardship exemption at the time from the requirement to obtain shareholder approval in respect of a private placement for greater than 25% of the outstanding Common Shares, the issuance of greater than 10% of the Common Shares to insiders of the Company and a potential change in control of the Company. As a consequence, the Company was subject to a TSX listing review which was lifted on March 5, 2009.

The issued and outstanding capital of the Company at September 30, 2009 was 256,276,090 Common Shares (on an undiluted basis). As at September 30, 2009 the Company had 5,981,988 Warrants, and options to purchase 10,274,000 Common Shares outstanding.

## **LIQUIDITY AND CAPITAL RESOURCES**

### *Current Market Conditions*

Late in the third quarter of 2008 the global economy began a downward slide that has resulted in a global recession that has continued in 2009. This economic slowdown has impacted and may continue to impact the ability of mining companies to secure debt and equity funding or enter into joint venture arrangements. Given the stage of development of the Project, the Company has historically relied on equity financing to raise capital and intends to continue to do so, but this ability may be impacted by the global recession. The Company is currently in the process of seeking one or more strategic partners. There is a risk that this undertaking 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 this condition has impacted the Company's viability. At present, the Company continues to have positive working capital and it has completed the 2009 drilling program. It is possible, however, that if current market conditions continue, the working capital of the Company could be negatively impacted in the short, medium or long term.

Working capital was \$24,195,244 at September 30, 2009 compared to \$45,706,373 at December 31, 2008. The decrease to working capital is as a result of activity including execution of the 2009 drilling program.

### *Financial Security for Abandonment and Restoration*

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 expires in October 2009 and will be renewed for a year to match the term of the Land Lease.

### *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"), a special purpose entity that was created 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 \$19,948,998 and a fair value of \$11,914,847 (December 31, 2008 - ABCP - \$19,948,998 with a fair value of \$9,791,925). When the ABCP matured and was not redeemed in 2007, it became the subject of an ongoing restructuring process to replace the ABCP with long term asset backed securities. The restructuring was concluded on January 21, 2009 when the ABCP was replaced with the Notes.

The Notes are classified as held for trading under the Company's Financial Instruments policy which requires them to be fair valued at each period end with changes in fair value included in the income statement in the period in which they arise. 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 on subsequent reporting dates. The fair values may change materially in subsequent periods.

At the time that the Notes were exchanged, the Company received a payment of \$658,765, which was its share of the accumulated cash in the conduit trusts up to August 31, 2008. In the second quarter of 2009 the Company received a payment of \$282,536, the balance of its share of the accumulated cash up to the closing of the restructuring. This payment was recorded as a gain on Note exchange.

The portfolio consists of five types of Notes. Four of the Notes, Classes A1, A2, B, and C 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. Additionally, these particular assets are subject to an 18 month moratorium on margin calls. This moratorium will expire in mid-2010.

A fifth Note, Class 15, tracks the performance and repayment of a particular leveraged super senior credit default swap that was not pooled with the others at the time that the restructuring closed. This asset does not have access to a credit facility nor does it enjoy a moratorium on margin calls.

Using publicly available information received from the Pan Canadian Investor Committee as well as the court appointed monitor of the restructuring, and the asset administrator, the Company has been able to determine the key characteristics of each class of the Notes it received: 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 three month period ending September 30, 2009, the Company noted the following conditions in the market that have impacted its determination of fair value. The most significant factor affecting the valuation has been the improvement in general corporate credit market conditions over this time period. This decrease in credit risk impacts the intrinsic value of the Notes due to a general lowering of default risk, relative to the March 31, 2009 valuation. 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 also results in an increased value at September 30, 2009.

Conversely, during the quarter, the valuation of the A2 notes in particular was negatively impacted by a rating downgrade. On August 11, Dominion Bond Rating Service ('DBRS') downgraded the A2 Notes to BBB

(low) with a negative outlook. DBRS cited credit quality concerns specific to five assets underlying the MAV2 Pool and disclosed additional details on the composition and performance of those assets. While none of these assets had defaulted, DBRS felt that their margins of protection against loss had been eroded, increasing the probability that one or more of these assets may default. DBRS noted that if all of these assets were to default and realize 100% losses, then the A2 Notes would realize a loss; the C Notes and B Notes would be lost in their entirety. In order to take this new disclosure into account, the required yield for the A2, B, and C Notes was increased in determining the Fair Market Valuation of the Notes held by the Company.

Under the restructuring terms, Noteholders were to receive floating interest mostly based on prevailing Banker's Acceptance rates based on the variable interest income on the pool of assets. This variable income must first pay the fixed expense of the Margin Funding Facility ("MFF") fee before any interest is paid to Noteholders. In the event of a shortfall to pay the MFF fee in any given period, the shortfall is accrued and is payable in priority in future periods. As a result, interest payments to the Company are not expected to be received on the Notes until there is a rise in the prevailing interest rates and only once accrued MFF fees are repaid. 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.

Based on the foregoing, as at September 30, 2009 the Company has estimated the fair market value of the Notes to be between \$11.0 million and \$13.0 million and as a result the Company has recorded an unrealized gain on revaluation of the Notes in the amount of \$928,503 resulting in a carrying value of \$11,914,847 at September 30, 2009.

Notes	Face Value (\$)	Maturity Date <sup>(i)</sup>	Effective Coupon <sup>(ii)</sup>	Required Yield <sup>(iii)</sup>	Fair Value September 30, 2009 (\$)	Fair Value December 31, 2008 (\$)
<b>MAV2 Notes</b>						
A-1	13,308,316	12/20/2016	2.52%	7.5%	9,266,463	7,654,949
A-2	3,337,040	12/20/2016	2.52%	10.7%	1,822,660	1,662,873
B	605,766	12/20/2016	0.00%	24.1%	111,480	52,593
C	533,540	12/20/2016	0.00%	33.2%	33,791	22,330
<b>IA Tracking Notes</b>						
Class 15	2,164,336	12/20/2012	2.68%	31.6%	680,453	399,180
<b>Total</b>	<b>19,948,998</b>				<b>11,914,847</b>	<b>9,791,925</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.

Since the fair value of the Notes are determined using a discounted cash flow approach, and are based principally on the Company's assessment of fair value in the absence of secondary market trading, the fair values reported may increase or decrease materially in subsequent periods.

### *Cash Flow from Operating Activities*

Current assets at September 30, 2009 were \$29,729,325, compared to \$54,292,945 at December 31, 2008, a decrease of \$24,023,214. Cash and cash equivalents decreased by \$15,362,116 as a result of the payment of suppliers and contractors. Accounts receivable decreased by \$1,730,613 and prepaids decreased by \$207,870. The decrease in the accounts receivable is related to receipt of bulk sample revenue that had been accrued at December 31, 2008 and the receipt of GST returns. The decrease to inventory of \$3,049,474 is due to a writedown of a portion of fuel that was relocated from Baffin Island to the mainland that is now recorded at net realizable value and a writedown of other supplies due to obsolescence in addition to regular consumption. Current liabilities at September 30, 2009 were \$5,534,081 compared to \$8,586,572 at December 31, 2008, a decrease of \$3,052,491. A higher accounts payable balance was noted at the end of 2008 compared to the end of the third quarter of 2009 as a result of timing of final settlement with third party contractors for payment of the exploration expenses related to the 2008 season.

### *Cash Flow from Investing Activities*

During the nine months ended September 30, 2009 the Company spent approximately \$16,688,579 on exploration and mine development activities of which \$16,040,833 has been capitalized to mining interests.

### *Cash Flow from Financing Activities*

In August 2009 the Company drew \$10.37 million (US\$9.5 million) under the Environmental Bonding Facility. During the nine months ended September 30, 2009, the Company also received proceeds of \$45,625 as a result of exercise of options to purchase Common Shares.

### *Total Capital Costs*

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

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

The following table provides an itemized summary for the estimated capital costs of the Project:

<b>Summary of Total Capital Costs</b>	
<b>Direct Costs</b>	<b>\$ Millions</b>
Mining .....	23
Mary River Site.....	591
Railway .....	1,215
Steensby Site .....	706
<b>Direct Costs Subtotal</b>	<b>2,535</b>
<b>Indirect Costs</b>	
Support.....	988
Owner's Costs.....	86
Gravel .....	29
Contingency.....	437
<b>Indirect Cost Subtotal</b> .....	<b>1,540</b>
<b>Initial Capital Cost Total</b> .....	<b>4,075</b>

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

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

## COMMON SHARES AND DEFICIT

Shareholders' equity at September 30, 2009 was \$213,027,329, compared to \$216,119,717 at December 31, 2008, a decrease of \$3,092,388. This occurred as a result of the following:

Contributed surplus (fair value vested portion of stock options granted)	\$	2,094,474
Common shares		470,825
Conversion of subscription receipts		(4,213,547)
Convertible debt - equity component		3,884,579
Deficit:		
Net loss for the period		(5,328,719)
	\$	<u>(3,092,388)</u>

The following Common Shares and convertible securities of the Company were outstanding at October 27, 2009:

	Expiry Date	Exercise Price (Cdn\$)	Securities Outstanding	Common Shares on Exercise
Common shares		-	256,276,090	-
Warrants	January 31, 2012	5.50	5,981,988	5,981,988
Options	Feb 25/2009 to Oct 27/2014	0.25 to 4.40	10,474,000	10,474,000

## RISKS AND UNCERTAINTIES

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

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

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

### *Iron Ore Prices*

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

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

### *Mineral Reserves and Resources*

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

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

### *Future Production Estimates May be Inaccurate*

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

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

### *Mine Development and Completion*

Feasibility studies are used to determine the economic viability of a deposit. Many factors are involved in the determination of the economic viability of a deposit, including the achievement of satisfactory mineral reserve estimates, the level of estimated metallurgical recoveries, capital and operating estimates and the estimate of future commodity prices. Capital and operating cost estimates are based on many factors, including anticipated tonnage and grades of ore to be mined, the configuration of the ore body, ground and mining conditions, expected recovery rates of the ore and anticipated environmental and regulatory compliance costs. Each of these factors involves uncertainties and, as a result, the Company cannot give any assurance that the estimates in the DFS will be correct or that the Mary River Property will produce profitable operating mine(s). If a mine is developed, actual operating results may differ from those anticipated in the DFS. There can be no assurance that delays will not be experienced. Given the reduced level of activity as a result of 2009 funding levels, the project timelines are currently under review and are expected to result in a delay to be determined based on the necessary debt and/or equity financing and timing of receipt of required permits. A delay may result in an increase in capital requirements, costs and expenditures.

### *Mining Operations*

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

### *Licenses, Permits and Leases*

The exploration of the Mary River Property requires licenses and permits from the Canadian government and the government of Nunavut and consents from third-parties. Exploration activities undertaken to date, including the bulk sample program, have been approved pursuant to the applicable federal and territorial regulatory approval processes. The Company currently has or expects to have all of the permits that it requires to execute the work program currently planned and/or underway in 2009 and does not currently anticipate that the necessary permits will not be in place to execute such programs.

If the exploration of the Mary River Property warrants the development of the Mary River Property into a commercial mine, then the Company will require additional permits to mine the Mary River Property. In order to develop a mine at the Mary River Property, the Company must secure necessary licenses, permits and third party consents after first successfully completing regulatory review in accordance with the requirements of the NLCA and any other applicable legislation including the successful negotiation of the IIBA with the QIA. The negotiation of an IIBA with the QIA commenced in late 2006 and the regulatory review of a proposed mine based on the DFS commenced in March 2008 with the filing of a Development

Proposal and associated permit applications. There can be no guarantee that the Company will be able to complete the regulatory review process(es), successfully negotiate the IIBA and obtain or maintain all necessary licenses, permits and third-party consents that may be required to explore and, if warranted, develop and mine the Mary River Property. The original Land Lease term expires in October 2009 and has been renewed for a year under the right to renew clause.

The Company's rights to the Mary River Property mineral deposits are held in the form of leases from the Canadian government. The Company's original Land Lease term with the QIA expires in October 2009 and has been renewed for a year under the right to renew clause. If the Company fails to meet the specific requirements of these leases, they may terminate, expire or not be renewed. There can be no assurance that any of the obligations required to maintain each lease will be met. There can be no assurance that the leases will be renewed. The termination, expiration or non-renewal of the Company's leases would have a material adverse effect on the Company's business prospects and financial condition.

Under the terms of the existing permits and authorizations held by the Company, most notably the water license and Land Lease with the QIA, an A&R Plan has been established and is subject to revision at the end of the first quarter each year. The A&R Plan establishes the work to be completed under both temporary and final closure scenarios, including an estimated cost associated with this work. The Company may be required to post Financial Security to assure such estimated costs from time to time. As of September 30, 2009, the Company has provided a \$16.5 million letter of credit to the QIA as Financial Security. This Financial Security amount is subject to increase or decrease at the QIA's discretion in accordance with the terms of the lease with the QIA. There is a risk that the Company will not be able to provide future amounts of additional Financial Security. See "Operations - Abandonment and Restoration".

### *Regulatory and Environmental Risks*

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

### *Climate Change*

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

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

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

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

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

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

#### ***Infrastructure***

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

#### ***Competition***

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

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

The Company does not currently have sufficient funding to commence or complete the development of the Mary River Property. The Company's historical capital needs have been met by the issuance of Common Shares. The Company will require substantial additional funds to further explore and develop the Mary River Property. The Company has limited financial resources and no current source of recurring revenue, and there is no assurance that additional funding will be available to the Company to carry out the completion of its planned exploration activities, for additional exploration or for the substantial capital that will be required in order to place the property into commercial production. In order to finance the development of the Mary River Property, the Company will have to pursue one or more financing alternatives including issuing

additional equity, borrowing sufficient funds from third party lenders, or completing arrangements with one or more strategic partners. Given the reduced level of activity as a result of 2009 funding levels, the project timelines are currently under review and are expected to result in a delay to be determined based on the necessary debt and/or equity financing and timing of receipt of required permits.

There can be no assurance that the Company will be able to obtain adequate financing in the future or that the terms of such financing will be favourable. Failure to obtain such additional financing could result in a further delay or indefinite postponement of further exploration and development of the Mary River Property. The terms of any additional financing obtained by the Company could result in substantial dilution to the shareholders of the Company. The latter part of 2008 saw the development of adverse market conditions which have continued into recessionary conditions in 2009. The continuation of such adverse market conditions could have negative implications for the Company in terms of the ability to continue as a going concern and to continue the development of the Property.

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

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

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

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

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

#### ***Exchange Rate Fluctuations***

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

### *Insurance*

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

The Company carries pollution liability insurance to cover certain environmental exposures. This coverage is reviewed by management at least annually to ensure that the level of coverage remains appropriate. Notwithstanding the insurance coverage, there is a risk that environmental liabilities could be incurred that would not be covered by the policy that could materially adversely affect the financial condition of the Company.

### *Reliance on Key Personnel*

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

### *Limited History*

With the exception of the 2008 bulk sample program, the Company has no history of mining iron ore and the Mary River Property is still in the exploration and development stage. The future development of the Mary River Property will require the construction and operation of a mine and related infrastructure. The costs, timing and complexities of mine construction and development are increased by the remote northern location of the Mary River Property. It is common in new mining operations to experience unexpected problems and delays during construction, development, and mine start-up. In addition, delays in the commencement of mineral production often occur. Accordingly, there are no assurances that the Company's activities will result in profitable mining operations, that the Company will successfully establish mining operations or profitably produce iron ore, or that the Company will meet any of its current timelines or schedules.

## CONTRACTUAL OBLIGATIONS

The following table lists, as of September 30, 2009, information with respect to the Company's contractual obligations (excludes expenses of a fixed nature expected to be incurred in the normal course of business):

	<b>Payments Due By Period</b>				
	<b>Total</b>	<b>Less than 1 year</b>	<b>1-3 Years</b>	<b>3-4 Years</b>	<b>After 5 Years</b>
Office Lease	\$ 158,474	\$ 36,573	\$ 121,900	\$ -	\$ -
Land Lease Obligation <sup>(1)</sup>	633,600	-	633,600	-	-
Asset retirement obligation <sup>(2)</sup>	12,043,000	-	-	-	12,043,000
<b>Total</b>	<b>\$ 12,835,074</b>	<b>\$ 36,573</b>	<b>\$ 755,500</b>	<b>\$ -</b>	<b>\$ 12,043,000</b>

(1) The Land Lease Obligation relates to rent to be paid to the QIA.

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

The Company's original Land Lease term expires in October 2009 and has been renewed for a year under the right to renew clause.

The terms of the Land Lease provide that the Company must post Financial Security. The Company has posted a letter of credit in the amount of \$16.5 million that is held on the balance sheet as restricted cash. See "Operations - Abandonment and Reclamation" and "Risks and Uncertainties".

## OUTLOOK (2009)

The Company intends to continue to explore and develop the Mary River Property through the following activities, which include the continuation of work related to the DFS recommendations:

- complete an updated resource estimate for Deposit No. 1 by the fourth quarter of 2009;
- continue to engage with local communities, the QIA, various levels of government and other Mary River Property stakeholders with respect to current activities and future Mary River Property plans;
- continue to negotiate with the QIA towards the development of an IIBA. The Company signed a MOU with the QIA on March 31, 2009 representing an interim agreement on items expecting to contribute to a future IIBA;
- subject to a decision from the Minister of INAC regarding the NIRB Screening Report, pursue the terms of reference guiding the submission of an Environmental Impact Statement, the submission of which will be contingent on further financing. During the first quarter of 2009, a decision was issued by the Minister of INAC to proceed with a Part 5 review in accordance with the NLCA and in June

2009, the NIRB issued draft Terms of Reference for an EIS. Final Terms of Reference are anticipated in the fourth quarter of 2009;

- continue to complete certain progressive reclamation activities at the Mary River Property during 2009 including: bulk sample equipment demobilization, hazardous waste disposal, sewage management and landfill planning. During the third quarter, hazardous waste and surplus equipment were removed from Milne Inlet. Most of the barrel fuel stored at Steensby Inlet has been removed to secure storage in Quebec; and
- the addition of one or more strategic partners. Due to the uncertainties with regard to strategic partnering and until such time that sufficient funding or strategic partnering is achieved to allow the Company to complete the Technical Report recommendations and resume project development activities, management is preparing a three year exploration program intended to increase direct-shipping inferred resources. Completion of this exploration program is also dependent on securing additional funding. See "Risks and Uncertainties".

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

## **OTHER INFORMATION**

### **Off-Balance Sheet items**

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 would be required to the carrying values of assets and liabilities and to the reported expenses and balance sheet classifications. These adjustments could be material.

### **Development Stage Entity**

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

### **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 and share-based compensation.

#### *Mining interests*

Costs, including interest, related to property acquisitions and development costs are capitalized to mining interests. Effective April 1, 2008 development expenditures related to Deposit No. 1 at the Property are being capitalized since mineral reserves have been established. Development costs together with the cost of mining interests will be charged to operations on a units-of-production method based on estimated recoverable reserves upon commencement of commercial production. 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 operations.

#### *Property, plant & equipment and amortization*

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

#### *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 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 will be 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.

### *Future 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.

### *Share-based compensation*

The share-based compensation expense is recognized in equal instalments over the vesting period of the options issued. The expense is determined using an option pricing model that takes into account the exercise price, the term of the options, the current Common Share trading price, the expected volatility of the underlying Common Shares, the expected dividend yield and the risk free rate for the term of the option.

### *Convertible debt*

The Company classifies the proceeds received from convertible loans 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 through charges to the income statement using the effective interest rate method. On conversion into Common 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 and equity component, if applicable is recognized in the income statement. Transaction costs are netted against the instrument to which they relate.

## **Changes in accounting policies**

### *Section 3064 – Goodwill and Intangible Assets*

This new standard ensures that intangible assets meet the definition of an asset, and eliminates the “matching” principle, whereby certain costs were being deferred and expensed to match with revenue earned. The new standard applies for interim and annual financial statements for years beginning on or after October 1, 2008.

The adoption of this standard did not have an impact on the Company’s financial statements.

### *Emerging Issues Committee - EIC 173*

In January 2009, the CICA issued EIC-173 - Credit Risk and the Fair Value of Financial Assets and Financial Liabilities. The EIC provides guidance on how to take into account credit risk of an entity and counterparty when determining the fair value of financial assets and financial liabilities, including derivative instruments.

This standard is effective for the Company’s fiscal year beginning January 1, 2009. Adoption of this standard did not have a significant effect on the Company’s financial statements.

#### *Emerging Issues Committee - EIC 174*

In March of 2009, the CICA issued EIC - 174, "Mining Exploration Costs". The EIC provides guidance on accounting for capitalization and impairment of exploration costs. This standard is effective for the Company's fiscal year beginning January 1, 2009.

The application of this EIC did not have an effect 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 2006, the Canadian Accounting Standards Board ("AcSB") published a new strategic plan that will significantly affect financial reporting requirements for Canadian companies. The AcSB strategic plan outlines the convergence of Canadian GAAP and IFRS over an expected five year transitional period. In February 2008 the AcSB announced that January 1, 2011 is the changeover date for publicly-listed companies to use IFRS, replacing Canadian GAAP, affecting interim and annual financial statements relating to fiscal years after this time. The transition date of January 1, 2011 will require the restatement for comparative purposes of amounts reported by the Company for the year ended December 31, 2010. In light of the timing of transition, the Company has: formalized the project team and resources, and continues to monitor and will add resources as required; defined the governance structure including definition of reporting requirements to, among others, the Audit Committee; and conducted a detailed evaluation of accounting issues, including proposed new policies and decisions on alternative accounting policies and/or treatments.

The project team has made an assessment of what the key areas of impact for the Company will be, among others: IFRS 1 - first time adoption, property, plant and equipment, asset retirement obligations, financial instruments, impairment of assets, presentation of financial statements.

The Company will provide disclosures of the key elements of its plan and progress on this transition as the information becomes available during the transition period.

### **Capital Disclosures**

Baffinland's capital structure consists of its shareholders' equity and convertible debt. The Company is a development stage entity and therefore, its objective when managing the capital structure is to fund the continuing development and exploration 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 three and nine months ended September 30, 2009. 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 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 (see Note 9), accounts receivable, and convertible debt. 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 reputable financial institutions with typical maturities of less than 90 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 liquidity to meet liabilities when due. As at September 30, 2009, the Company had a cash balance of \$19,172,769 (December 31, 2008 - \$34,534,885) to settle current liabilities of \$5,534,081 (December 31, 2008 - \$8,586,572).

### *Interest rate risk*

The Company has cash balances and convertible debt. The Company's current policy is to invest excess cash in highly rated short-term deposit certificates issued by Canadian banking institutions. The Company periodically monitors the investments it makes and is satisfied with the credit ratings of its banks. The convertible debt has fixed interest rates over the term of the loan.

### *Foreign currency risk*

The Company's functional currency is the Canadian dollar and major purchases are transacted in Canadian dollars. The Company has US dollar denominated convertible debt and 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 financial markets, the Company believes the following movements are "reasonably possible" over a one year period:

- Cash and cash equivalents include deposits which are at variable interest rates. Given the low current prevailing interest rates on short term cash investments, downward sensitivity is not meaningful. If interest rates were to rise by 1%, net loss would not be materially affected for the three month period ended September 30, 2009
- The Company does not hold significant balances in foreign currencies to give rise to exposure to foreign exchange risk.
- Price risk is remote since the Company is not presently a producing entity.

### *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
Long term investment	Held for trading
Accounts payable	Other financial liabilities
Convertible debt	Other financial liabilities

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

**Interim Financial Statements**  
**Third Quarter, September 30, 2009**  
Unaudited

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

	As At September 30 2009	As At December 31 2008
	<u>2009</u>	<u>2008</u>
<b>ASSETS</b>		
<b>Current</b>		
Cash and cash equivalents (Note 5)	\$ 19,172,769	\$ 34,534,885
Accounts receivable	583,605	2,314,218
Subscription receipts receivable	-	4,213,547
Inventory (Note 7)	9,853,286	12,902,760
Prepaid expenses	119,665	327,535
	<u>29,729,325</u>	<u>54,292,945</u>
Restricted cash (Notes 6 & 18)	16,500,000	6,203,300
Mining interests (Note 8 )	159,304,788	140,531,497
Long term investments (Note 9)	11,914,847	9,791,925
Property, plant & equipment (Note 10)	12,300,317	14,441,174
	<u>\$ 229,749,277</u>	<u>\$ 225,260,841</u>
<b>LIABILITIES</b>		
<b>Current</b>		
Accounts payable	\$ 5,534,081	\$ 8,586,572
Asset retirement obligation (Note 11)	1,013,159	554,552
Convertible debt (Note 12)	5,998,808	-
Future income tax liability (Note 15)	4,175,900	-
	<u>16,721,948</u>	<u>9,141,124</u>
<b>SHAREHOLDERS' EQUITY AND DEFICIT</b>		
Common shares (Note 13)	350,114,152	349,643,327
Subscription receipts (Note 13)	-	4,213,547
Warrants (Note 13)	3,023,371	3,023,371
Contributed surplus (Note 13 and 14)	13,929,810	11,835,336
Convertible debt - equity component (Note 12)	3,884,579	-
Deficit	(\$157,924,583)	(152,595,864)
	<u>213,027,329</u>	<u>216,119,717</u>
	<u>\$ 229,749,277</u>	<u>\$ 225,260,841</u>

Nature of operations and going concern (Note 1)  
Contingencies and commitments (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,
	2009	2008	2009	2008	2003
Interest and other income	\$122,388	\$650,798	\$272,967	\$2,255,947	\$5,332,535
Expenses					
Exploration	265,041	1,006,986	\$673,645	36,648,639	175,760,269
Amortization and accretion	14,590	53,229	\$43,770	438,281	1,140,383
Loss on writedown of inventory (Note 7)	2,134,165	-	\$2,134,165	-	2,134,165
Salaries	628,703	852,414	\$2,204,160	2,158,468	8,617,362
Share-based compensation (Note 14)	384,733	815,138	\$2,084,945	3,914,000	12,630,573
Office and general	203,983	963,072	\$708,374	1,726,243	4,564,695
Professional fees	146,433	129,986	\$483,261	792,008	3,475,203
Shareholder relations	61,524	62,793	\$184,850	174,301	1,209,113
Travel	73,043	267,440	\$148,739	354,405	1,081,870
Unrealized gain on revaluation of long term investments (Note 9)	(928,503)	-	(\$2,122,922)	-	(2,122,922)
Impairment of long term investments	-	4,615,075	\$0	5,115,075	10,310,563
Gain on note exchange (Note 9)	-	-	(\$941,301)	-	(941,301)
	\$2,983,712	8,766,133	\$5,601,686	51,321,420	217,859,973
Net loss for the period before taxes	(2,861,324)	(8,115,335)	(5,328,719)	(49,065,473)	(212,527,438)
Future income tax recovery (Note 15)	-	-	-	10,301,427	57,957,276
Net loss & comprehensive loss for the period	(2,861,324)	(8,115,335)	(5,328,719)	(38,764,046)	(154,570,162)
Deficit, beginning of period	(155,063,259)	(141,957,739)	(152,595,864)	(111,309,028)	
Deficit, end of period	(\$157,924,583)	(\$150,073,074)	(\$157,924,583)	(\$150,073,074)	
Net loss per share (Note 17)	(\$0.01)	(\$0.05)	(\$0.02)	(\$0.30)	

**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 January 1, 2003
	September 30,		September 30,		
	2009	2008	2009	2008	
<b>Operating activities</b>					
Loss for the period	(\$2,861,324)	(\$8,115,335)	(\$5,328,719)	(\$38,764,046)	(\$154,570,162)
Items not affecting cash:					
Amortization and accretion expense	14,590	53,229	43,770	438,281	\$1,140,383
Loss on writedown of inventory (Note 7)	2,134,165	-	2,134,165	-	2,134,165
Share-based compensation	384,733	815,138	2,084,945	3,914,000	\$12,630,573
Future income tax recovery	-	-	-	(10,301,427)	(\$57,957,276)
Unrealized gain on revaluation of long term investments (Note 9)	(928,503)	-	(2,122,922)	-	(2,122,922)
Impairment of long term investments (Note 9)	-	4,615,075	-	5,115,075	\$10,310,563
Other non cash items	-	-	-	-	(\$275,542)
Gain on note exchange (Note 9)	-	-	(941,301)	-	(941,301)
(Increase) decrease in accounts receivable	(108,145)	(428,637)	1,190,207	(60,418)	(1,123,969)
(Increase) decrease in inventory	302,443	(12,056,908)	1,455,715	(6,847,468)	(11,447,045)
(Increase) decrease in prepaid expenses	64,236	3,345,914	207,870	339,107	(119,665)
Increase (decrease) in accounts payable	(2,190,148)	1,052,120	(7,465,241)	7,747,617	1,121,331
	<u>(3,187,953)</u>	<u>(10,719,404)</u>	<u>(\$8,741,511)</u>	<u>(38,419,279)</u>	<u>(201,220,867)</u>
<b>Investing activities</b>					
Change in restricted cash	(10,296,700)	(796,300)	(10,296,700)	(6,203,300)	(16,500,000)
Purchase of property, plant & equipment	-	(936,720)	(1,892)	(4,007,769)	(17,191,324)
Capitalized mine development costs included in accounts payable	4,412,748	(27,329,346)	4,412,748	(54,519,125)	4,412,748
Capitalized mine development costs	(6,901,412)	(41,970,245)	(16,014,935)	(68,498,119)	(154,018,145)
Cash received on note exchange (Note 9)	-	-	941,301	-	941,301
Increase in long term investments	-	-	-	-	(20,102,488)
	<u>(12,785,364)</u>	<u>(71,032,611)</u>	<u>(\$20,959,478)</u>	<u>(133,228,313)</u>	<u>(202,457,908)</u>
<b>Financing activities</b>					
Net cash proceeds from draw on convertible debt (Note 12)	10,079,700	-	10,079,700	-	10,079,700
Increase in bank debt	-	-	-	-	16,600,000
Repayment of bank debt	-	-	-	-	(16,600,000)
Decrease in due to related parties	-	-	-	-	(132,421)
Net proceeds on issue of common shares and warrants	45,625	1,977	45,625	183,830,445	408,690,717
Net proceeds on conversion of subscription receipts	-	-	4,213,548	-	4,213,548
	<u>10,125,325</u>	<u>1,977</u>	<u>14,338,873</u>	<u>183,830,445</u>	<u>422,851,544</u>
<b>Increase (decrease) in cash and cash equivalents</b>	<b>(5,847,992)</b>	<b>(81,750,038)</b>	<b>(15,362,116)</b>	<b>12,182,853</b>	<b>19,172,769</b>
<b>Cash position at beginning of the period</b>	<b>25,020,761</b>	<b>132,074,811</b>	<b>34,534,885</b>	<b>38,141,920</b>	<b>-</b>
<b>Cash position at end of the period</b>	<b>\$19,172,769</b>	<b>\$50,324,773</b>	<b>\$19,172,769</b>	<b>\$50,324,773</b>	<b>\$19,172,769</b>

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 MONTHS ENDED SEPTEMBER 30, 2009**

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

Baffinland Iron Mines Corporation (the "Company") was formed pursuant to Articles of Incorporation under the *Business Corporation Act* (Ontario) on March 10, 1986. The Company has non-producing iron ore interests located on Baffin Island, Nunavut, Canada. To date the Company has not earned revenue and is considered to be in the development stage.

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 three and nine months ended September 30, 2009, the Company reported an after-tax loss of \$2.9 million and \$5.3 million, respectively, and an accumulated deficit of \$157.9 million and as at that date had not generated positive cash flow from operations. The Company is in the development stage and is subject to the risks and challenges similar to other companies in a comparable stage of development. These risks include, but are not limited to, continuing losses, dependence on key individuals, 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 going concern assumption. The Company did secure funding of \$17.6 million in December of 2008 to meet its exploration and development requirements planned for 2009, its contractual obligations and to continue as a going concern. While the Company has been successful in raising 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 was inappropriate. These adjustments could be material.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**a) Basis of Financial Presentation**

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

**b) Cash and cash equivalents**

Cash and cash equivalents are highly liquid investments, such as term deposits with major financial institutions or government treasury bills, typically having a maturity of 90 days or less at the date of original issue and which are readily convertible into cash.

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

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

#### c) Flow-through shares

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

#### d) Mining interests and exploration expenditures

Costs including interest related to property acquisitions and development are capitalized. Effective April 1, 2008 development expenditures related to Deposit No. 1 at the Mary River Property (the "Property") are being capitalized since mineral reserves have been established. Development costs together with the cost of mining interests will be charged to operations on a units-of-production method based on estimated recoverable reserves upon commencement of commercial production. 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. Expenditures that are incurred to explore Deposit's No's 2, 3, 4 or 5 are expensed as incurred.

#### 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.

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

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

#### f) Use of estimates (cont'd)

Accounts which require management to make material estimates in determining amounts recorded include 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 term of the options, the current share price, the expected volatility of the underlying shares, the expected dividend yield and the risk free rate for the term of the option.

#### 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, which will be determined using a discounted cash flow model.

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

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

#### 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 Property and will change as the Company proceeds with the development of the Property. Changes in estimates are accounted for prospectively from the period in which these estimates are revised.

#### l) 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. 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
Convertible debt	Other financial liabilities

#### m) Convertible debt

The Company classifies the proceeds received from convertible loans 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 and equity component, if applicable is recognized in the income statement. Transaction costs are netted against the carrying value of the instrument to which they relate.

#### n) Changes in accounting policies

##### *Section 3064*

The new Section 3064 - Goodwill and Intangible Assets ensures that intangible assets meet the definition of an asset, and eliminates the "matching" principle, whereby certain costs were being deferred and expensed to match with revenue earned. The new standard applies for interim and annual financial statements for years beginning on or after October 1, 2008.

The adoption of this standard did not have an impact on the Company's financial statements.

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

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

#### *Emerging Issues Committee - EIC 173*

In January 2009, the CICA issued EIC-173 - Credit Risk and the Fair Value of Financial Assets and Financial Liabilities. The EIC provides guidance on how to take into account credit risk of an entity and counterparty when determining the fair value of financial assets and financial liabilities, including derivative instruments.

This standard is effective for the Company's fiscal year beginning January 1, 2009. Adoption of this EIC did not have a significant effect on the Company's financial statements.

#### *Emerging Issues Committee - EIC 174*

In March of 2009, the CICA issued EIC - 174, "Mining Exploration Costs". The EIC provides guidance on accounting for capitalization and impairment of exploration costs. This standard is effective for the Company's fiscal year beginning January 1, 2009.

The application of this EIC did not have an effect 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 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 does not expect the adoption of this new standard to have an impact on its 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 does not expect the adoption of these new standards to have an impact on its financial statements.

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

### 3. CAPITAL MANAGEMENT

Baffinland's capital structure consists of its shareholders' equity and convertible debt. The Company is a development stage entity and therefore, its objective when managing the capital structure is to fund the continuing development and exploration 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, 2009 compared to the previous year. The Company is not subject to externally imposed capital requirements.

### 4. FINANCIAL RISK FACTORS

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

#### **Credit risk**

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 9) 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 reputable financial institutions with typical maturities of less than 90 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, 2009, the Company had a cash balance of \$19,172,769 (December 31, 2008 - \$34,534,885) to settle current liabilities of \$5,534,081 (December 31, 2008 - \$8,586,572).

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

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

#### **Interest rate risk**

The Company has cash balances and convertible debt. The Company's current policy is to invest excess cash in highly rated short-term deposit certificates issued by Canadian banking institutions. The Company periodically monitors the investments it makes and is satisfied with the credit ratings of its banks. The convertible debt has fixed interest rates over the term of the loan.

#### **Foreign currency risk**

The Company's functional currency is the Canadian dollar and major purchases are transacted in Canadian dollars. The Company has US dollar denominated convertible debt and 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.

#### **Price risk**

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

#### **Sensitivity analysis**

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

- Cash and cash equivalents include deposits which are at variable interest rates. Given the low current prevailing interest rates on short term cash investments, downward sensitivity is not meaningful. If interest rates were to rise by 1%, net loss would not be materially affected for the three month period ended September 30, 2009.
- 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)

### 5. CASH AND CASH EQUIVALENTS

	September 30 2009	December 31 2008
Cash and cash equivalents are comprised of:		
Cash	\$ 2,972,769	\$ 5,027,138
Guaranteed investment certificates	16,200,000	29,507,747
	<u>\$ 19,172,769</u>	<u>\$ 34,534,885</u>

### 6. RESTRICTED CASH

The Company has provided \$16,500,000 (2008 - \$6,203,300) in cash to support an irrevocable letter of credit which provides Financial Security for future abandonment and reclamation costs. See Note 12.

### 7. INVENTORY

Inventory consists of supplies inventory 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 2009	December 31 2008
Fuel	\$ 7,622,115	\$ 9,435,769
Supplies	\$ 2,231,171	3,466,991
	<u>\$ 9,853,286</u>	<u>\$ 12,902,760</u>

A portion of fuel was relocated from Baffin Island to the mainland and as such this fuel has been written down to net realizable value in the three months ended September 30, 2009. A total write down of \$2.1 million was recorded in the income statement which includes \$353,000 as a writedown of other supplies due to obsolescence.

### 8. MINING INTERESTS

The Company has a 100% interest in three mining leases in the Mary River area of Baffin Island, Nunavut, Canada. The term of the leases are 21 years and are due for renewal in 2013. Effective April 1, 2008, the Company is capitalizing costs related to Deposit No. 1 at the Property. The Company also has a surface rights commercial lease that permits it to access the lands. The original term of the lease expires in October 2009 and has been renewed for one year under the right of renewal clause. Interest related to the convertible debt in the amount of \$166,176 has been capitalized to mining interests.

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

### 8. MINING INTERESTS (cont'd)

Mining interests is comprised of:

<b>Balance at January 1, 2008</b>	\$	1
Asset Retirement Obligation asset incurred		464,447
Development costs capitalized		140,067,049
<b>Balance at December 31, 2008</b>		<b>140,531,497</b>
Asset Retirement Obligation asset incurred		399,851
Development costs capitalized		18,373,440
<b>Balance at September 30, 2009</b>	<b>\$</b>	<b>159,304,788</b>

### 9. LONG TERM INVESTMENTS

The Company owns long term asset backed notes (the "Notes") that were issued by Master Asset Vehicle II ("MAV 2"), a special purpose entity that was created 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 \$19,948,998 and a fair value of \$11,914,847 (December 31, 2008 - ABCP - \$19,948,998 with a fair value of \$9,791,925). When the ABCP matured and was not redeemed in 2007, it became the subject of an ongoing restructuring process to replace the ABCP with long term asset backed securities. The restructuring was concluded on January 21, 2009 when the ABCP was replaced with the Notes.

The Notes are classified as held for trading under the Company's Financial Instruments policy which requires them to be fair valued at each period end with changes in fair value included in the income statement in the period in which they arise. 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 on subsequent reporting dates. The fair values may change materially in subsequent periods.

At the time that the Notes were exchanged, the Company received a payment of \$658,765, which was its share of the accumulated cash in the conduit trusts up to August 31, 2008. In the second quarter of 2009 the Company received a payment of \$282,536, the balance of its share of the accumulated cash up to the closing of the restructuring. This payment was recorded as a gain on Note exchange.

The portfolio consists of five types of Notes. Four of the Notes, Classes A1, A2, B, and C 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. Additionally, these particular assets are subject to an 18 month moratorium on margin calls. This moratorium will expire in mid-2010.

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

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

A fifth Note, Class 15, tracks the performance and repayment of a particular leveraged super senior credit default swap that was not pooled with the others at the time that the restructuring closed. This asset does not have access to a credit facility nor does it enjoy a moratorium on margin calls.

Using publicly available information received from the Pan Canadian Investor Committee as well as the court appointed monitor of the restructuring, and the asset administrator, the Company has been able to determine the key characteristics of each class of the Notes it received: 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 three month period ending September 30, 2009, the Company noted the following conditions in the market that have impacted its determination of fair value. The most significant factor affecting the valuation has been the improvement in general corporate credit market conditions over this time period. This decrease in credit risk impacts the intrinsic value of the Notes due to a general lowering of default risk, relative to the March 31, 2009 valuation. 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, has also results in an increased value at September 30, 2009.

Conversely, during the quarter, the valuation of the A2 notes in particular was negatively impacted by a rating downgrade. On August 11, Dominion Bond Rating Service ("DBRS") downgraded the A2 Notes to BBB (low) with a negative outlook. DBRS cited credit quality concerns specific to five assets underlying the MAV2 Pool and disclosed additional details on the composition and performance of those assets. While none of these assets had defaulted, DBRS felt that their margins of protection against loss had been eroded, increasing the probability that one or more of these assets may default. DBRS noted that if all of these assets were to default and realize 100% losses, then the A2 Notes would realize a loss; the C Notes and B Notes would be lost in their entirety. In order to take this new disclosure into account, the required yield for the A2, B, and C Notes was increased in determining the Fair Market Valuation of the Notes held by the Company.

Under the restructuring terms, Noteholders were to receive floating interest mostly based on prevailing Banker's Acceptance rates based on the variable interest income on the pool of assets. This variable income must first pay the fixed expense of the Margin Funding Facility ("MFF") fee before any interest is paid to Noteholders. In the event of a shortfall to pay the MFF fee in any given period, the shortfall is accrued and is payable in priority in future periods. As a result, interest payments to the Company are not expected to be received on the Notes until there is a rise in the prevailing interest rates and only once accrued MFF fees are repaid. 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.

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

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

Based on the foregoing, as at September 30, 2009 the Company has estimated the fair market value of the Notes to be between \$11.0 million and \$13.0 million and as a result the Company has recorded an unrealized gain on revaluation of the Notes in the amount of \$928,503 and \$2,122,922 respectively for the three and nine months ended September 30, 2009 resulting in a carrying value of \$11,914,847 at September 30, 2009.

Notes	Face Value (\$)	Maturity Date <sup>(i)</sup>	Effective Coupon <sup>(ii)</sup>	Required Yield <sup>(iii)</sup>	Fair Value September 30, 2009 (\$)	Fair Value December 31, 2008 (\$)
<b>MAV2 Notes</b>						
A-1	13,308,316	12/20/2016	2.52%	7.5%	9,266,463	7,654,949
A-2	3,337,040	12/20/2016	2.52%	10.7%	1,822,660	1,662,873
B	605,766	12/20/2016	0.00%	24.1%	111,480	52,593
C	533,540	12/20/2016	0.00%	33.2%	33,791	22,330
<b>IA Tracking Notes</b>						
Class 15	2,164,336	12/20/2012	2.68%	31.6%	680,453	399,180
<b>Total</b>	<b>19,948,998</b>				<b>11,914,847</b>	<b>9,791,925</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.

Since the fair value of the Notes are determined using a discounted cash flow approach, and are based principally on the Company's assessment of fair value in the absence of secondary market trading, the fair values reported may increase or decrease materially in subsequent periods.

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

### 10. PROPERTY, PLANT & EQUIPMENT

Property, plant & equipment is comprised of:

	September 30, 2009			December 31, 2008		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Infrastructure and equipment	\$ 14,136,016	\$ 4,662,101	\$ 9,473,915	\$ 13,999,395	\$ 2,563,121	\$ 11,436,274
Furniture & fixtures	98,245	60,102	38,143	98,245	50,292	47,953
Leasehold improvements	139,410	85,040	54,370	137,518	64,340	73,178
Computer equipment	327,271	83,770	243,501	327,271	70,510	256,761
Infrastructure and equipment not in use	2,490,388	-	2,490,388	2,627,008	-	2,627,008
	<u>\$ 17,191,330</u>	<u>\$ 4,891,013</u>	<u>\$ 12,300,317</u>	<u>\$ 17,189,437</u>	<u>\$ 2,748,263</u>	<u>\$ 14,441,174</u>

Amounts included in "infrastructure and equipment not in use" are not amortized. Amortization expense related to property, plant & equipment used in development activities at the Property are capitalized to mining interests. For the three months and nine months ended September 30, 2009 capitalized amortization was \$704,220 and \$2,098,980 respectively (2008 - \$612,719 and \$1,060,819).

### 11. ASSET RETIREMENT OBLIGATION

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

	September 30 2009
<b>Balance at January 1, 2008</b>	\$ -
Asset retirement obligation incurred	464,447
Accretion	90,105
<b>Balance at December 31, 2008</b>	<b>554,552</b>
Asset retirement obligation incurred	399,851
Accretion	58,756
<b>Balance at September 30, 2009</b>	<b>\$ 1,013,159</b>

On March 31, 2009, the Company recorded additional asset retirement obligations that arose from the annual update of the A&R Plan. The increase in the estimated closure costs in the A&R Plan is as a result of refinement of estimates in the previous year's A&R Plan, execution and management of activities by independent contractors rather than the Company and additional disturbance that arose from the execution of the Company's bulk sample program in 2008. The total undiscounted closure costs, exclusive of salvage values, are estimated to be \$12.0 million (2008 - \$6.2 million). This has been discounted using a credit adjusted risk free rate of 10.5%. A substantial portion of these obligations are not expected to be paid until 2042 which is the estimated time at which the current iron ore reserves will be depleted.

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

### 12. CONVERTIBLE DEBT

During the three months ended September 30, 2009 the Company entered into a definitive agreement regarding the environmental guarantee support facility that may earn conversion rights (the "Facility" or "Environmental Bonding Facility") with Resource Capital Fund IV L.P. ("RCF") in the amount of US\$13 million, maturing on December 31, 2012 ("Maturity Date").

On August 31, 2009, the Company drew the equivalent of C\$10.37 million, which proceeds have been used to cover an increase in financial security to C\$16.5 million under the Company's surface rights land lease for its Mary River Project. The increased financial security was required as a result of the significant amount of 2008 activity that took place at the Mary River Property, which included the Company's 113,217 tonne bulk sample program.

The Company may draw under the Facility until August 16, 2010 (the "Availability Period"). Amounts outstanding under the Facility at the end of the Availability Period (the "Conversion Amount") automatically become convertible and may then be converted, at RCF's election, into common shares of the Company ("Common Shares") any time after the end of the Availability Period and prior to the Maturity Date at a conversion price of C\$0.46. If the Company subsequently repays any or all amounts outstanding under the Facility after the end of the Availability Period, RCF is entitled to re-advance an amount up to the Conversion Amount for the purpose of exercising its conversion rights prior to the Maturity Date.

Amounts outstanding under the Facility will bear interest at a rate of 15% per annum during the Availability Period and 10% per annum thereafter until the Maturity Date. Interest is payable quarterly in cash or, at RCF's option, in Common Shares valued based on the Market Price which will be calculated as the weighted average trading price of the Common Shares over the twenty trading days prior to the applicable calculation date (the "Market Price"). For the purpose of calculating the number of Common Shares to be issued upon the payment of interest, fees and the conversion of the Conversion Amount, a fixed exchange rate of US\$1.00=C\$1.15 will be used.

In addition to interest payments, under the Facility, the Company must pay to RCF an establishment fee of 1.5% of the Facility Amount and a commitment fee of 0.5% of the undrawn portion of the Facility. The amount may be paid in cash or Common Shares, at RCF's option, based on the Market Price of the Common Shares. On September 30, 2009, the Company issued a total of 807,127 Common Shares to RCF in satisfaction of the establishment fee, the commitment fee and interest. Interest and the commitment fee will be paid on a quarterly basis.

The total maximum number of Common Shares issuable to RCF on the conversion of the Facility Amount and the payment of all interest and fees in Common Shares may be greater than 10% of the total number of Common Shares currently outstanding (the "10% Threshold"). Pursuant to applicable TSX requirements, the Company is required to obtain shareholder approval for issuances to RCF in excess of the 10% Threshold. The Company currently expects to call a meeting of its shareholders to request the approval for the issuance of the full amount of the Common Shares payable in connection with the Facility, which approval will require a majority of the disinterested shareholders of the Company. In the event that the Company does not obtain such shareholders' approval by April 15, 2010, a 3% additional interest penalty will apply to all interest payable for the remainder of the Facility and amounts outstanding under the Facility that may not be converted into Common Shares as a result of the 10% Threshold will become due and payable at the end of the Availability Period.

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

### 12. CONVERTIBLE DEBT (cont'd)

The Company's obligations under the Facility are secured by a first ranking charge over all of the Company's assets, including certain mining leases on its Mary River Property. The Facility is subject to certain conditions precedent and other standard terms, conditions and restrictions including: restrictions on the Company's ability to pay dividends, dispose of the Property or its other assets, and incur additional indebtedness without RCF's prior approval; and the ability for RCF to apply outstanding amounts under the Facility against the exercise of rights it currently holds to maintain its pro rata shareholding in the Company.

The Company may repay any amounts outstanding under the Facility from time to time without penalty and is required to repay all amounts: released by the QIA from its Financial Security requirement, resulting from the general reduction in Financial Security requirements for the Mary River project, and resulting from the replacement of the Facility by the Company. Repaid amounts may not be re-drawn under the Facility.

The Company has classified the proceeds from the facility draw into its debt and equity components using a fair value approach:

	September 30 2009
<b>Balance at January 1, 2009</b>	\$ -
Add: Gross proceeds from August 31, 2009 draw	10,379,700
Deduct: Legal fees accrued or paid	(300,000)
Deduct: Establishment fees (paid in shares)	(224,250)
Deduct: Fair value equity portion	(3,884,579)
Add: Accretion	27,937
<b>Balance at September 30, 2009</b>	<u><u>5,998,808</u></u>

The conversion feature of the facility was valued at \$3,884,579 using a Black Scholes model assuming a \$0.46 strike price, a 3.33 year term, 85% volatility, and a 1% risk free rate.

The remainder of the Facility amount advanced was classified as convertible debt on the balance sheet and will be accreted to face value over the term of the Facility.

### 13. COMMON SHARES AND WARRANTS

Issued:	Number of shares	Amount \$
<b>December 31, 2007</b>	95,100,068	149,178,093
Share financing - public equity offering March, 2008	52,886,985	183,797,943
Exercise of share purchase options May, 2008	12,500	43,375
Share financing - flow through private placement December, 2008	70,464,805	13,837,463
Share financing - private placement December, 2008	14,665,541	2,786,453
<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 Third Quarter, 2009	162,500	70,688
Interest and fee payments paid in shares for convertible debt	807,127	362,490
<b>September 30, 2009</b>	<u><u>256,276,090</u></u>	<u><u>350,114,152</u></u>

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

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

#### Common shares

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 under the Environmental Bonding Facility.

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

In December 2008, the Company closed two private placement transactions for aggregate proceeds of approximately \$21.8 million. In the first transaction, \$14.8 million was received in respect of the issuance of flow-through common shares. The Company issued 70,464,805 shares at a price of \$0.21 per share.

In the second private placement, the Company issued 14,665,541 common shares to an investor at a price of \$0.19 per share for total gross proceeds of \$2.8 million. The investor also received 22,176,564 subscription receipts at a price of \$0.19 for total proceeds of \$4.2 million. Each subscription receipt entitled the investor to acquire one common share for no additional consideration at any time prior to June 1, 2009 on notice being given that the Company and the Shareholders have approved the Amended Rights Plan which occurred on March 24, 2009. In the second quarter, the subscription receipts were converted and the proceeds of \$4.2 million were received by the Company.

#### Contributed surplus

Balance, December 31, 2007	\$ 6,913,803
Share-based compensation	4,932,408
Exercise of share purchase options	<u>(10,875)</u>
Balance, December 31, 2008	\$ 11,835,336
Share-based compensation	2,119,537
Exercise of share purchase options	<u>(25,063)</u>
Balance, September 30, 2009	<u>\$ 13,929,810</u>

#### Share options

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

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

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

#### Warrants

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

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

There are a total of 5,981,988 warrants outstanding as at September 30, 2009. The fair value attributed to the warrants issued in January and March of 2007 was \$3,023,371 using the following assumptions under the Black-Scholes model:

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

### 14. SHARE-BASED COMPENSATION

#### Share options

A summary of the status of the Company's share option plan as at September 30, is presented in the following table:

	September 30, 2009		December 31, 2008	
	Number	Weighted Average	Number	Weighted Average
Outstanding, beginning	7,382,000	\$ 2.59	5,060,500	\$ 2.07
Granted in the period	5,372,000	0.31	2,349,000	3.73
Exercised in the period	(162,500)	-	(12,500)	2.60
Forfeited in the period	(967,500)	2.32	(15,000)	4.07
Expired in the period	(1,350,000)	1.14	-	-
Outstanding, ending	10,274,000	\$ 1.65	7,382,000	\$ 2.59

As at September 30, 2009 the number of share options available for exercise was 7,566,750 at a weighted average price of \$2.12 and the aggregate value of unvested share options granted is \$513,616.

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

### 14. SHARE-BASED COMPENSATION (cont'd)

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

Date options granted	Weighted average expected life	Risk-free Interest rate	Expected Stock Volatility
January 7, 2008	5 years	5.00%	75%
March 31, 2008	5 years	5.00%	74%
September 22, 2008	5 years	3.00%	72%
January 6, 2009	4 years	1.60%	85%
March 24, 2009	4 years	1.85%	88%
June 9, 2009	4 years	1.40%	89%

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 months and nine months ended September 30, 2009 was \$392,683 and \$2,119,537 respectively (2008 - \$815,138 and \$3,914,000). Beginning in the second quarter of 2008, share-based compensation related to share options awarded to employees working at the Property was capitalized to mining interests. For the three and nine months ended September 30, 2009 share-based compensation costs of \$7,950 and \$34,592 respectively (2008 - \$102,853 and \$234,634) were capitalized and included in mining interests.

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

### 15. INCOME TAXES

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

	<u>September 30</u> <u>2009</u>	<u>September 30</u> <u>2008</u>
Net loss for the period before taxes	(\$4,762,415)	(\$49,065,473)
Income tax recovery at Canadian federal and provincial statutory rates	(1,558,188)	(16,053,461)
Change in valuation allowance	876,027	4,471,434
Permanent differences	682,162	1,280,600
Recovery of income taxes	<u>-</u>	<u>(10,301,427)</u>

The components of the recovery of income taxes comprise:

Future income tax recovery	<u>-</u>	<u>(10,301,427)</u>
Net income tax recovery	<u>-</u>	<u>(10,301,427)</u>

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

	<u>September 30</u> <u>2009</u>	<u>December 31</u> <u>2008</u>
<b>Future Income Tax Assets</b>		
Exploration & Development	4,713,000	4,459,000
Non-capital losses carried forward	5,924,000	4,447,000
Share issue expense	2,759,000	3,527,000
Long-term asset backed notes	1,278,000	1,609,000
Property, plant and equipment	1,380,000	776,000
Future income tax asset	16,054,000	14,818,000
Valuation Allowance	(14,858,000)	(14,235,600)
Net future income tax asset	<u>1,196,000</u>	<u>582,400</u>
<b>Future Income Tax Liabilities</b>		
Flow-through share issuance:		
Mining interests	(3,697,900)	
Cash	(478,000)	-
Mining interests	<u>(1,196,000)</u>	<u>(582,400)</u>
Future income tax liability	(5,371,900)	(582,400)
Net future income tax asset / liability recorded	<u>(\$4,175,900)</u>	<u>-</u>

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

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

The Company has recorded a valuation allowance in respect of tax losses and other attributes valued at \$14,858,000 (December 31, 2008 - \$14,235,600).

### 16. RELATED PARTY TRANSACTIONS

During the three and nine months ended September 30, 2009 McChip Resources Inc., a related party controlled by a director and a shareholder, paid approximately \$18,000 and \$54,000 (2008 - \$18,000 and \$36,000) 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.

### 17. NET LOSS PER SHARE

Net loss per share is calculated using the weighted average number of common shares outstanding during the year. No effect has been given to the potential exercise of 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, 2009 was 255,328,070 and 247,894,024 respectively (2008 - 147,999,553 and 131,139,049).

### 18. CONTINGENCIES AND COMMITMENTS

Under the terms of existing lease agreements for office space, the Company is committed to annual lease payments of approximately \$146,300 plus operating costs. During the third quarter of 2009 the Company paid approximately \$85,000, (2008 - \$62,500) in lease and operating costs. The lease agreement has an initial five year term and includes a one-time right to renew the lease. The initial term of the lease expires in October, 2010.

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 Company pays rent annually in the amount of \$633,600 in August. The original Land Lease term expires October 31, 2009 and has been renewed for one year under a right to renew clause. 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 ("Financial Security"). The Company has provided Financial Security to the QIA in the form of an irrevocable letter of credit. During the three months ended September 30, 2009, the letter of credit was increased by \$10.3 million with the proceeds from a draw on the convertible debt. The \$16.5 million Letter of Credit expires in October 2009 and is held on the balance sheet as restricted cash. The Letter of Credit will be renewed for one year to match the term of the Land Lease.

## CORPORATE INFORMATION

### DIRECTORS

**Richard D. McCloskey**  
Chairman of the Board,  
Baffinland Iron Mines Corporation;  
President, McChip Resources Inc.  
Toronto, Ontario

**Brian L. Acton**<sup>2</sup>  
President and Chief Operating  
Officer,  
Oxbow Carbon & Minerals LLC  
West Palm Beach, Florida

**Donald K. Charter**<sup>2 3</sup>  
President, 3Cs Corporation  
Etobicoke, Ontario

**Graham G. Clow**<sup>2 4</sup>  
Managing Director,  
Scott Wilson Mining Group  
Toronto, Ontario

**Russell L. Cranswick**<sup>2 3</sup>  
Partner,  
Resource Capital Funds  
Denver, Colorado

**Grant A. Edey**<sup>1</sup>  
Corporate Director  
Mississauga, Ontario

**John W. Lydall**<sup>3</sup>  
Corporate Director  
Oakville, Ontario

**Gordon A. McCreary**  
President and Chief Executive  
Officer,  
Baffinland Iron Mines Corporation  
Toronto, Ontario

**Gordon Watts**<sup>1 3 4</sup>  
Consulting Mining Engineer  
Toronto, Ontario

### OFFICERS

**Derek C. Chubb**  
Vice President,  
Sustainable Development

**Rodney A. Cooper**<sup>4</sup>  
Vice President, Operations and  
Chief Operating Officer

**Gwen M. Gareau**  
Vice President, Finance and  
Chief Financial Officer

**Gordon A. McCreary**  
President and  
Chief Executive Officer

**Michael T. Zurowski**  
Executive Vice President

### CORPORATE OFFICE

Baffinland Iron Mines Corporation  
120 Adelaide Street West, Suite 1016  
Toronto, Ontario M5H 1T1  
Tel: 416-364-8820  
Fax: 416-364-0193  
Email: [info@baffinland.com](mailto:info@baffinland.com)  
Website: [www.baffinland.com](http://www.baffinland.com)

### TRANSFER AGENT

Computershare Investor Services Inc.  
Toronto, Ontario  
Tel: 416-981-9633  
Toll Free: 1-800-663-9097

### AUDITORS

PricewaterhouseCoopers LLP  
Toronto, Ontario

### STOCK EXCHANGE LISTING

Toronto Stock Exchange (TSX)  
Symbol: BIM  
Issued shares at July 31, 2009:  
Basic: 255,318,963  
Fully diluted: 271,974,951

<sup>1</sup> Member of the Audit Committee

<sup>2</sup> Member of the Compensation Committee

<sup>3</sup> Member of the Corporate Governance and Nominating Committee

<sup>4</sup> Member of the Environmental, Health and Safety Committee

