



BAFFINLAND IRON MINES CORPORATION

ANNUAL REPORT

December 31, 2009



**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION
FOR THE YEAR ENDED DECEMBER 31, 2009**

INTRODUCTION

Baffinland Iron Mines Corporation ("Baffinland" or the "Company") is a Canadian company that was formed pursuant to Articles of Incorporation under the *Business Corporation Act* (Ontario) on March 10, 1986. The following is management's discussion and analysis of the financial condition and results of operations of Baffinland for the financial year ended December 31, 2009 ("MD&A"), and its financial position as at December 31, 2009, and should be read in conjunction with the audited financial statements of the Company as at and for the year ended December 31, 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. The date of this MD&A is February 18, 2010. All figures are in Canadian dollars unless otherwise noted.

The Company's common shares and common share purchase warrants are listed on the Toronto Stock Exchange (the "TSX") under the trading symbols "BIM" for the common shares and "BIM.WT" and "BIM.WT.A" for the warrants, respectively.

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

OVERVIEW

Background

The Company is a Canadian publicly traded junior mining exploration company focused on exploring and developing iron ore deposits located on its Mary River property in Northern Baffin Island, Nunavut (the "Mary River Property" or "Property"). The Property consists of five high grade direct shipping iron ore deposits referred to as Deposit Nos. 1, 2, 3, 4 and 5. Deposit Nos. 1, 2 and 3 are closely adjacent to each other, Deposit No. 4 lies about 27 kilometres to the northwest of Deposit Nos. 1, 2 and 3 and the recently discovered Deposit No. 5 is located less than five kilometres southeast of Deposit No. 4.

The Property covers a total area of approximately 32,670 hectares; consisting of three mining leases totalling 1,593 hectares, 18 mineral claims totalling 12,956 hectares and two exploration areas totalling 18,120 hectares. The mineral claims were staked by the Company in October 2008 and the exploration area is subject to terms and conditions in the Company's exploration agreement with Nunavut Tunngavik Inc., dated May, 2008. Deposits No. 1, 2, 3 and 4 are located on the Company's mining leases and Deposit No. 5 is located on the newly acquired ground. The Company has a surface rights lease, the exploration agreement and the staked claims which permit access to the land on which the deposits are situated.

Mineral resource estimates for Deposit Nos. 1, 2 and 3 prepared in accordance with National Instrument 43-101 – *Standards of Disclosure for Mineral Projects* ("NI 43-101") by Aker Solutions (formerly Aker Kvaerner E&C) ("Aker") total 865 million tonnes of which 365 million tonnes are proven and probable reserves grading 64.7% iron, 52 million tonnes are measured and indicated resources grading 64.6% iron and 448 million tonnes are inferred resources grading 65.5% iron. To date, most of the Company's work has been on Deposit No. 1, which is the best known of the deposits.

In February 2008, the Company released a definitive feasibility study managed by Aker on Deposit No. 1 (the "DFS") based on proven and probable reserves of 365 million tonnes. The DFS sets forth a number of recommendations to assist the Company in advancing the development of Deposit No. 1 to commercial production (the "Project"). In order to achieve commercial production, the Company will be required to obtain significant additional equity and/or debt financing and/or achieve strategic partnership ("Financing"), and there is no assurance that Financing will be obtained on favourable terms, or at all. Failure to obtain Financing could result in

the delay or indefinite postponement of further exploration and development of the Mary River Property. See "Risk Factors".

Towards the end of 2008, due to the adverse global economic conditions, the Company determined that it was necessary to reduce its activities and complete a limited exploration and development program in 2009. Until such time that Financing is obtained by the Company to allow it to complete the DFS recommendations and resume Project development activities, the Company plans in 2010 to (i) primarily continue exploration activities to increase and upgrade its mineral resources, and (ii) moderately advance development activities on Deposit No. 1.

Iron Ore Market and Outlook

At the beginning of 2009, world steel production had decreased more than 25%, due to the collapse in demand, which was greatly influenced and impacted by the world financial crisis. The impact on the USA and Europe was even greater with demand and output down approximately 50%. Demand for iron ore also fell, but less than expected as Chinese domestic iron ore production declined and was replaced by imported iron ore. This requirement and increasing Chinese steel production led to a dramatic increase in Chinese demand for iron ore imports from 444 million tonnes in 2008 to more than 628 million tonnes in 2009.

By mid 2009, demand for steel and iron ore returned in the USA and Europe and increased steadily throughout the year. Several European steel companies returned to full production in the fourth quarter of 2009. This renewed demand caused supply issues, particularly in Europe where the vast majority of iron ore is sold on long-term contract basis based upon the benchmark pricing system. This put further strain on the relationship between buyers and sellers of iron ore. As steel customers and demand returned, Europe found that demand in Asia had usurped iron ore cargos originally planned for Europe creating a shortage of available iron ore supply.

The benchmark system for the sale of iron ore appears to be in a state of flux and change due in part to the spot sales from VALE, BHP Billiton and Rio Tinto that occurred in addition to Chinese steel companies refusing to pay the higher benchmark price for iron ore. The annual benchmark price settlement in 2009 was down 28% to 33% for fine iron ore and down more than 45% for direct charge iron ore (pellets and lump). Spot prices dramatically increased throughout 2009 to the point where spot sales have achieved a 70% to 80% premium price to sales on a benchmark basis.

Demand for iron ore continues to be strong and according to various mining and commodity analysts, the benchmark fine iron ore prices are expected to increase by 10% to 40% in 2010. Prices for direct charge iron ores (pellets and lump) are expected to have a higher percentage increase. Historically lump iron ore is priced at a 25% to 30% premium to the fine iron ore price and pellets are priced at a 70% to 80% premium to fine iron ore prices.

MARY RIVER PROPERTY

2009 Exploration Program

The 2009 exploration program was executed from June through August of 2009. The primary goal of the program was to explore and identify, through diamond drilling, the southern limits of Deposit No. 1 to assist in further resource delineation and infrastructure planning.

A total of 2,316 metres of core, in 13 holes were drilled. There were no significant health, safety or environmental issues.

Newly Discovered Deposit No. 5

In early October 2009, 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 six 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 exposed 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.

The Company has rights to Deposit No. 5 in part through its wholly owned staked mineral claims and in part through its exploration agreement with Nunavut Tunngavik Inc. ("NTI"). Under the exploration agreement, the Company is obliged to pay annual fees and complete certain annual work commitments. If Deposit No. 5 achieves definitive feasibility, then NTI could participate in a joint venture, or hold a net profits interest royalty.

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 Company's 113,217 tonne lump and fine iron ore trial bulk sample cargos mined in 2008. 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 of the hot metal 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 less expensive burden feed with virtually no loss of productivity.

2010 Program

In the December Equity Offerings (see "Corporate Developments"), the Company raised gross proceeds of \$44 million, of which, \$23 million was raised through issuing flow-through common shares. Proceeds from the sale of flow-through common shares must be expended within prescribed timeframes and on Canadian Eligible Expenditures as defined by the Canada Revenue Agency. For its 2010 program, the Company plans to:

- Primarily continue exploration activities to identify and increase mineral resources at Deposits No. 5, 4, & 3
- Continue to pursue strategic partnering
- Proceed with the environmental assessment process including the preparation of the draft Environmental Impact Statement
- Continue negotiations towards completion of Inuit Impact and Benefits Agreement
- Preserve cash and core assets at the Mary River Property

DFS Recommendations and Project Timeline

The DFS was completed in the first quarter of 2008 and set forth a number of recommendations to advance the development of the Project, with particular emphasis on geotechnical and other field surveys and construction planning.

As a result of current funding levels, the completion of certain DFS recommendations has been deferred until the Company obtains appropriate funding. At this time, management of the Company projects that the earliest possible timing for commencement of commercial production would be 2016. This projected timing assumes that certain

project development activities take place beginning in 2010 and leading up to 2016. Currently the 2010 program includes preparation of the draft environmental impact statement with expected submission in 2011, contingent on 2011 program funding. The Company is not funded to execute the development activities required for 2011 through to the projected commercial production date of 2016. Timelines for the Project are continuously reviewed and are contingent on Financing and/or timing of receipt of required permits. There is a risk that timelines could be delayed further.

Until such time Financing is available to complete the DFS recommendations and resume project development activities, management will be completing the 2010 program described above. See "Risks and Uncertainties".

Total Capital Costs for the Project

The DFS 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 Project 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:

Summary of Total Capital Costs

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

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 the DFS was prepared, 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".

CORPORATE DEVELOPMENTS

December Equity Offerings

On December 10, 2009, the Company closed two equity offerings for gross proceeds to the Company of \$44 million (the "December Equity Offerings"). A portion of the funds were used to repay the Environmental Bonding Facility discussed below and the balance of the funds will be used towards completing the 2010 program.

Environmental Bonding Facility

On August 31, 2009, the Company entered into a definitive agreement for the environmental guarantee support facility (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"). The Company drew US\$9.5 million (equivalent of C\$10.37 million) to cover an increase in financial security to C\$16.5 million under the Company's surface rights land lease for its Mary River Property. On December 10, 2009, in conjunction with the closing of the December Equity Offerings the balance of US\$9.5 million outstanding under the Facility was fully repaid (equivalent of C\$10.2 million). The first ranking charge over all of the Company's assets to secure the Company's obligation under the Facility has been released.

As a result of the full repayment of the Facility, the debt and equity portions of the loan that were recorded during the third quarter of 2009 have been reversed in the Company's financial statements.

Abandonment and Reclamation Plan

In the first quarter of 2009, the Company completed and submitted its 2009 annual update of its Mary River Property Abandonment and Reclamation Plan (the "A&R Plan"). The A&R Plan relates to both crown and Inuit land on which the Mary River Property is situated and would be implemented in the scenario where there were no immediate or pending plans to advance into mine development, subject to any future revisions required to reflect material changes. The undiscounted costs of the A&R Plan are estimated to be \$12.0 million (2008 - \$6.2 million). The increase from 2008 is a result of, among other things, the additional disturbance that arose from the execution of the Company's bulk sample program in 2008. 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, reclamation of borrow areas and landfill planning. The Company will undertake its annual review of the A&R Plan in the first quarter of 2010. See also "Risks and Uncertainties" and "Contractual Obligations".

Financial Security under QIA Land Lease

The Company holds a surface rights commercial land lease with the Qikiqtani Inuit Association (the "QIA") in respect of a portion of the Mary River Property (the "Land Lease"). The terms of the Land Lease provide that the Company must post financial security from time to time to guarantee the QIA's estimate of future abandonment and reclamation costs for environmental impact on Inuit owned land ("Financial Security"). The Company has currently posted Financial Security of \$16.5 million that is held on the balance sheet as restricted cash. This Financial Security amount is subject to increase or decrease based on a review of management's annual A&R plan, or environmental audit undertaken by the QIA. The current Land Lease term expires in October 2010 and will be renegotiated in the coming months. See "Contractual Obligations" and "Risks and Uncertainties".

Environmental Assessment Process

In March 2008, Baffinland initiated the environmental assessment process when it submitted its Development Proposal and associated applications to the Nunavut Impact Review Board ("NIRB"). In February 2009, in response to the recommendations of the NIRB screening report, the Minister of Indian and Northern Affairs Canada referred the Project to Part 5 review under Article 12 of the Nunavut Land Claims Agreement. The NIRB conducted a scoping review on the components of the biophysical and/or socio-economic environment that may be impacted by the Project. In November 2009, Baffinland received the Final Environmental Impact Statement Guidelines for the Project, which outline the information Baffinland must include in the Draft Environmental Impact Statement submission. The Company will be preparing a draft environmental impact statement in 2010. The Company plans to submit the Draft Environmental Impact Statement early in 2011, contingent on obtaining 2011 program funding.

Inuit Impact and Benefits Agreement

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"). The provisions included in the

MOU are subject to review and refinement based on the outcomes of the regulatory review process currently being undertaken by the NIRB. Negotiations with respect to the remaining sections of the IIBA are expected to continue in 2010.

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. At this early stage, the 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 for 40% of the annual output of 18 million tonnes per year.

OPERATIONS RESULTS

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 \$19,865,834 incurred during the year ended December 31, 2009 were lower than in the same period in 2008. The significant decrease in expenditures year over year is a result of reduced funding and therefore reduced programs.

The 2008 expenditures were incurred to advance the bulk sample program and for other metallurgical testwork, and environmental baseline studies. For the year ended December 31, 2009, expenditures related to 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 three months ended		For the year ended	
	December 31, 2009	December 31, 2008	December 31, 2009	December 31, 2008
Mine Development/Exploration	\$1,948,182	\$11,569,465	\$15,487,991	\$96,042,925
Definitive Feasibility Study/Technical Services	84,182	6,121,723	597,674	18,667,032
Bulk Sample and site preparation	-	5,159,689	-	43,513,348
Health and Safety	133,998	\$436,046	\$672,110	2,260,199
Environmental and Permitting	725,674	\$2,755,173	\$2,357,467	12,916,749
Metallurgical Testing	285,217	\$1,187,692	\$750,592	1,855,567
Total expenditures	\$3,177,253	\$27,229,788	\$19,865,834	\$175,255,820

Of the aggregate expenditures in the year ended December 31, 2009 relating to mine development and exploration, \$19,038,457 has been capitalized to mining interests, with the remainder recorded as exploration expense.

Net Realizable Value of the Mary River Property

Management's policy on impairment of mining interests is to review the carrying cost of the assets when there is an event or circumstance that indicates that the assets carrying amount may not be recoverable. Changes to market conditions that commenced towards the end of 2008 gave rise to a declining market capitalization of the Company. Notwithstanding that those conditions have begun to improve as the date hereof, management conducted its impairment test on the Project for the year ended December 31, 2009 and determined that the expected future cash flows of the Project exceed the current carrying value and therefore it is not impaired at this time. As part of the exercise, management reviewed the key assumptions within the DFS, iron ore prices, fuel prices, and foreign exchange rates. There is a risk that in the future, unfavourable trends on these commodity prices, poor market conditions or inability to obtain Financing could result in an impairment to the carrying value of the Property which would be recorded as an impairment in the financial statements.

OUTLOOK (2010)

The Company intends to continue to explore and develop the Mary River Property through the following activities, which include limited work included in the DFS recommendations:

- execute a three drill exploration program on Deposits No. 5, 4 and 3 to identify and increase the mineral resources of the Mary River Property
- proceed with the environmental assessment process including the preparation of the Draft Environmental Impact Statement with an anticipated submission date of early 2011 (contingent on obtaining 2011 program funding)
- continue to negotiate with the QIA towards achieving an IIBA in principle
- 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 complete certain permit driven progressive reclamation activities at the Mary River Property during 2010
- continue efforts relating to the addition of one or more strategic partners

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

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 continued into 2009. This economic slowdown impacted the ability of mining companies to secure equity and/or debt funding or enter into joint venture arrangements. In the latter part of 2009, the economy began to recover and in December, 2009, the Company raised gross proceeds of \$44 million through the December Equity Offerings to repay the Environmental Bonding Facility and fund its 2010 exploration plan. Given the stage of development of the Project, the Company relies on equity financing to raise capital and intends to continue to do so, but this ability may continue to be impacted by economic conditions. The Company continues to search for 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 these adverse conditions have impacted the Company's viability. At present, the Company continues to have positive working capital and is fully funded to execute the 2010 exploration plan. It is possible, however, that as a result of worsening economic conditions, the working capital of the Company could be negatively impacted in the short, medium or long term.

Working capital was \$47,329,078 at December 31, 2009 compared to \$34,927,613 at December 31, 2008. The increase to working capital is primarily a result of the December Equity Offerings.

Financial Security for Abandonment and Reclamation

The Company has restricted cash in the amount of \$16.5 million to support an irrevocable letter of credit to the QIA which provides Financial Security. The letter of credit is held in conjunction with 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") as a result of the restructuring of the Company's previous investment in Third Party Asset Backed Commercial Paper ("ABCP"). The Notes have a face value of \$17,750,092 and a fair value of \$11,519,196 (December 31, 2008 - face value of \$19,948,998 and fair value of \$9,791,925). On January 21, 2009 the Company received the Notes which replaced the ABCP. As part of the exchange, the Company received two payments totalling \$941,301 that represented the Company's share of cash that accumulated to the assets during the restructuring period. The payments were recorded as a gain on note exchange.

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

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

The remaining portfolio consists of four types of Notes, which are supported by a pool of leveraged super senior credit default swaps, unlevered collateralized debt obligations as well as traditional assets and cash. The leveraged assets supporting these Notes have access to a 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 which will expire in mid-2010.

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

During the year ended December 31, 2009, the Company has seen continued improvement in general corporate credit market conditions over this time period which has had the most impact on the valuation. This decrease in credit risk impacts the intrinsic value of the Notes due to a general lowering of default risk, relative to previous valuations. There is also a decrease in the likelihood that credit risk limits built into the Notes will be exceeded (specifically, the spread-based margin triggers). Accordingly, the Required Yield on the Notes has been somewhat reduced to reflect easing in the credit markets. Accretion of the Notes to par value at maturity assuming they do not default, has also resulted in an increased value at December 31, 2009.

Conversely, during the year, the valuation of the A2 Notes in particular was negatively impacted by a rating downgrade by DBRS based on credit quality concerns on some of the assets underlying the MAV2 Pool. 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; and 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.

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

Based on the foregoing, as at December 31, 2009 the Company has estimated the fair market value of the Notes to be between \$10.6 million and \$12.5 million resulting in a carrying value of \$11,519,196. During the year ended December 31, 2009 the Company recorded an unrealized gain on revaluation of the Notes in the amount of \$2,407,724. For the year ended December 31, 2008, an impairment charge of \$5,115,075 was recorded.

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

Cash Flow from Operating Activities

Current assets at December 31, 2009 were \$49,001,385 compared to \$43,514,185 at December 31, 2008, an increase of \$5,487,200. Cash and cash equivalents increased by \$10,944,233 as a result of the proceeds of the December Equity Offerings. Accounts receivable decreased by \$2,012,928 and prepaids decreased by \$62,588. 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 increase to inventory of \$832,000 is due to expected use of fuel and supplies in 2010. Current liabilities at December 31, 2009 were \$1,672,307 compared to \$8,586,572 at December 31, 2008, a decrease of \$6,914,265. A higher accounts payable balance was noted at the end of 2008 compared to the end 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 year ended December 31, 2009 the Company spent approximately \$19,865,834 on exploration and mine development activities of which \$19,038,457 has been capitalized to mining interests. The Company received cash in respect of its holdings of its long term asset-backed notes, \$941,301 was received as part of settlement on the note exchange and \$1,569,144 was received when a portion of the Notes was sold. See also "Long Term Asset-Backed Notes".

The increase to non-current inventory is the reclassification of inventory that is not expected to be consumed in 2010. In addition, a writedown of a portion of fuel was recorded in the year for fuel that was relocated from Baffin Island to Montreal that is now recorded at net realizable value.

Restricted cash was increased by \$10,296,700 with the proceeds of the draw on the Environmental Bonding Facility.

Cash Flow from Financing Activities

In August 2009, the Company drew \$10.37 million (US\$9.5 million) under the Environmental Bonding Facility. The Company received net proceeds of \$42.1 million as a result of the December Equity Offerings of which \$10.2 million (US\$9.5 million) was used to repay the Environmental Bonding Facility in full. During the year ended December 31, 2009, the Company also received proceeds of \$51,625 as a result of exercise of options to purchase common shares.

RELATED PARTY TRANSACTIONS

During the year ended December 31, 2009, McChip Resources Inc., a related party controlled by a director and a shareholder of the Company, paid \$72,000 (2008 - \$72,000) 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 December 10, 2009, the Company closed the December Equity Offerings. The first offering was a public offering under which a total of 23,959,100 common shares and 11,979,550 common share purchase warrants were issued. Each common share unit was sold for a price of \$0.48 and was comprised of one common share and one half common share purchase warrant. Total gross proceeds on the public offering were \$11.5 million.

The second of the December Equity Offerings was a private placement under which a total of 41,860,000 common shares and 20,930,000 common share purchase warrants were issued. Each common share unit was sold for a price of \$0.55 and was comprised of one common share and one half common share purchase warrant. Each common share was issued as a "flow-through share" under the Income Tax Act (Canada). Total gross proceeds on the private placement were \$23.0 million.

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

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

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

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

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

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.

In December 2008, the Company completed 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 RCF at a price of \$0.19, for total gross proceeds of \$7.0 million, \$2.8 million of which was received in December 2008 with the remaining \$4.2 million held in escrow. Each subscription receipt entitled RCF 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 December 31, 2009 was 342,784,199 Common Shares (on an undiluted basis). As at December 31, 2009 the Company had 48,854,823 Warrants, and options to purchase 10,229,000 Common Shares outstanding.

The following Common Shares and convertible securities of the Company were outstanding at February 18, 2009:

	Expiry Date	Exercise Price (Cdn\$)	Securities Outstanding	Common Shares on Exercise
Common shares		-	342,784,199	-
Warrants - 2007 issue	January 31, 2012	5.50	5,981,988	5,981,988
Warrants - 2009 issue	December 9, 2012	0.70	42,872,835	42,872,835
Options	Feb 25/2009 to Dec 15/2014	0.25 to 4.40		10,229,000

Change in Shareholder's Equity

Shareholders' equity at December 31, 2009 was \$255,423,463, compared to \$216,119,717 at December 31, 2008, a increase of \$39,303,746 which is broken down as follows:

Contributed surplus (fair value vested portion of stock options granted)	\$ 1,518,758
Common shares	33,837,525
Warrants	9,070,019
Conversion of subscription receipts	(4,213,547)
Convertible debt - equity component	3,884,579
Convertible debt - equity component - reversal on repayment of loan	(3,884,579)
Deficit:	
Net loss for the period	(909,009)
	<u>\$ 39,303,746</u>

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 completed and further planned by the Company will result in a profitable commercial mining operation.

Capitalization, Commercial Viability and Dilution

The operating and capital expenditures are expected to substantially increase in subsequent years with the advancing of exploration and development activities. The Company does not currently have sufficient funding to commence or complete the development of the Mary River Property. The Company's historical capital needs have been met by the issuance of 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 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. The Company has experienced a delay from the timelines identified in the DFS. Given the reduced level of activity in 2009 and 2010, the project timelines are continuously under review and a further delay could result based on the necessary Financing and/or 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. While the economy appears to have begun recovering, 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.

Licenses, Permits and Leases

The exploration of the Mary River Property requires certain licenses, permits and authorizations from third-parties. Exploration activities undertaken to date, 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 for the upcoming season.

If the exploration of the Mary River Property warrants its development 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 authorizations after first successfully completing an environmental assessment in accordance with the requirements of the Nunavut Land Claims Agreement. Negotiations regarding an IIBA with the QIA must also be completed. 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 authorizations that may be required to continue to explore and develop and ultimately mine the Mary River Property.

The Company's rights to the Mary River Property mineral deposits are held in the form of leases from the federal government and the QIA. The Company's current Land Lease term with the QIA expires in October 2010, and the mineral leases are subject to an additional 21 year renewal in August, 2013. 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 or 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. 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 "Corporate Developments - Abandonment and Reclamation".

Mineral Reserves and Resources

The activities of the Company are directed towards the search, evaluation and development of iron ore deposits on and around the Mary River Property. 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 Project 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 mineral 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 Project 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 and 2010 funding levels, management has estimated that there has been a project timeline delay from the original timeline contemplated in the DFS. The project timelines are continuously reviewed and are dependent on the receipt of necessary Financing and/or timing of receipt of required permits. Any further delays may result in an increase in capital requirements, costs and expenditures.

Mining Operations

Mining operations generally involve a high degree of risk and potential future mining operations will be subject to the risks inherent in the mining industry, including fluctuations in fuel prices, commodity prices, exchange rates, metal prices, costs of constructing and operating a mine and processing facilities in a specific environment, the availability of economic sources of energy and the adequacy of water supplies, adequate access to the site, unanticipated transportation costs, delays and repair costs resulting from equipment failure, changes in the regulatory environment (including regulations relating to prices, royalties, duties, taxes, restrictions on production, quotas on exportation of minerals, as well as the costs of protection of the environment), and 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.

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 be enacted or that existing rules and regulations will 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.

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 steel 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, 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.

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 these measures cannot be quantified at this time, the likely effect will be to increase costs for fossil fuels, electricity and transportation, supplemental costs for emissions in excess of permitted levels and increase costs for monitoring and reporting.

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. 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.

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.

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 achieve commercial production at 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. There can be no assurance that the Company will ever achieve profitability.

Exchange Rate Fluctuations

Iron ore is priced and sold in U.S. dollars, and many, but not all, of the Company's expected operating and capital costs are also priced in U.S. dollars. As a result, the Company expects to be affected by changes in the Canadian dollar/U.S. dollar exchange rate. The Canadian dollar/U.S. dollar exchange rate has varied significantly over the last several years. The Company does not currently use foreign currency options and forward foreign exchange contracts to purchase 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 December 31, 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):

	Payments Due By Period				
	Total	Less than 1 year	1-3 Years	3-4 Years	After 5 Years
Office Lease	\$ 121,878	\$ 121,878	-	-	-
Land Lease Obligation ⁽¹⁾	-	-	-	-	-
Asset retirement obligation ⁽²⁾	12,043,000	-	-	-	12,043,000
Total	\$ 12,164,878	\$ 121,878	\$ -	\$ -	\$ 12,043,000

(1) Under the current one year term of the Land Lease, the Company has met the rent payment obligation with a payment of \$633,600 related to the period from November 1, 2009 to October 31, 2010. The Company will be renegotiating the Land Lease in 2010. See "Corporate Developments - Financial Security under QIA Land Lease" and "Risks and Uncertainties".

(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.

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)

	Dec. 31 2009	Sept. 30 2009	Jun. 30 2009	Mar. 31 2009	Dec. 31 2008	Sept. 30 2008	Jun. 30 2008	Mar. 31 2008
ASSETS								
Current	49,001	22,832	28,721	33,823	43,514	69,226	141,836	193,905
Restricted cash	16,500	16,500	6,203	6,203	6,203	6,203	5,407	5,407
Long term investments	11,519	11,915	10,986	9,792	9,792	9,792	14,407	14,407
Non-current inventory, Property plant & equipment & Mining interest	181,112	178,502	173,770	170,240	165,751	139,747	69,428	13,187
	<u>258,132</u>	<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>
LIABILITIES AND EQUITY								
Current	1,672	5,534	3,311	3,950	8,587	27,404	26,352	21,068
Asset retirement obligation	1,036	1,013	990	967	554	543	509	476
Convertible debt	-	5,999	-	-	-	-	-	-
	<u>2,708</u>	<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>
Future income tax liability	-	4,176	4,176	4,176	-	-	-	-
	<u>2,708</u>	<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>
Shareholders' equity	<u>255,423</u>	<u>213,027</u>	<u>211,203</u>	<u>210,966</u>	<u>216,120</u>	<u>197,021</u>	<u>204,217</u>	<u>205,362</u>
	<u>258,132</u>	<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>
WORKING CAPITAL								
	47,329	17,298	25,410	29,873	34,927	41,822	115,484	172,837
Common shares outstanding (000's)	342,784	256,276	255,306	233,130	233,130	148,000	148,000	147,987

STATEMENTS OF OPERATIONS for the three months ended:

\$000's except per share (unaudited)

	Dec. 31 2009	Sept. 30 2009	Jun. 30 2009	Mar. 31 2009	Dec. 31 2008	Sept. 30 2008	Jun. 30 2008	Mar. 31 2008
INTEREST AND OTHER INCOME								
	167	122	17	134	238	651	1,374	231
EXPENSES								
Administrative	1,135	1,513	1,867	2,479	2,157	3,144	2,511	3,903
Exploration	154	265	176	232	604	1,007	1,054	34,587
Other	(1,366)	1,206	(1,477)	(659)	-	4,615	-	500
	<u>(78)</u>	<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>
Income / (Loss) before income taxes	245	(2,861)	(549)	(1,919)	(2,523)	(8,115)	(2,191)	(38,759)
Future income tax recovery	4,176	-	-	-	-	-	-	10,301
NET INCOME (LOSS)	<u>4,421</u>	<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>
Net Income/(Loss) per share	<u>\$0.01</u>	<u>(\$0.01)</u>	<u>(\$0.00)</u>	<u>(\$0.01)</u>	<u>(\$0.02)</u>	<u>(\$0.05)</u>	<u>(\$0.01)</u>	<u>(\$0.29)</u>

BALANCE SHEETS as at

\$000's	Dec. 31 2009	Dec. 31 2008	Dec. 31 2007
ASSETS			
Current	49,001	43,514	50,474
Long term investments	11,519	9,792	14,907
Non-current inventory, Property plant & equipment & Mining interest	197,612	171,955	12,383
	<u>258,132</u>	<u>225,261</u>	<u>77,764</u>
LIABILITIES AND EQUITY			
Current	1,672	8,587	19,656
Asset retirement obligation	1,035	554	-
Future income tax liability	-	-	10,302
Shareholders' equity	255,423	216,120	47,806
	<u>258,132</u>	<u>225,261</u>	<u>77,764</u>
WORKING CAPITAL	47,329	34,927	30,818
COMMON SHARES OUTSTANDING (000's)	342,784	233,130	95,100

STATEMENTS OF OPERATIONS for the three years ended

\$000's except per share

	Dec. 31 2009	Dec. 31 2008	Dec. 31 2007
INTEREST AND OTHER INCOME	<u>440</u>	<u>2,494</u>	<u>1,194</u>
EXPENSES			
Administrative	9,125	11,714	7,509
Exploration	827	37,253	87,515
Other	(4,429)	5,115	5,195
	<u>5,523</u>	<u>54,082</u>	<u>100,219</u>
Loss before taxes	(5,085)	(51,588)	(99,025)
Future income tax recovery	4,176	10,301	30,957
NET LOSS	<u>(909)</u>	<u>(41,287)</u>	<u>(68,068)</u>
Net Loss per share	<u>(\$0.00)</u>	<u>(\$0.29)</u>	<u>(\$0.91)</u>

FINANCIAL HIGHLIGHTS

The net loss for the year ended December 31, 2009 was \$909,009 compared to \$41,286,836 for the prior year. The net income recorded by the Company for the three months ended December 31, 2009 was \$4,419,712. This compared to a net loss of \$2,522,791 for the fourth quarter of 2008 ("prior period"). The decrease for both periods is primarily due to the timing of capitalization of expenditures to mining interests, which commenced on April 1, 2008, which resulted in higher exploration expense recorded in 2008 as compared to 2009. The net income in the fourth quarter of 2009 arose primarily from an income tax recovery related to the mining interest balance.

For the year ended December 31, 2009, interest and other income was \$439,844 compared to \$2,494,398. During the three months ended December 31, 2009, the Company recorded interest and other income of \$166,878 as compared to \$238,451 for the prior period. Interest and other income was lower in both the three month and one year period in 2009 compared to the same periods in the prior year as a result of lower average interest rates and lower average cash balances in 2009 compared to 2008.

A loss on writedown of inventory to net realizable value was recorded in the amount of \$2,227,510 in the third quarter of 2009. The writedown is related to a portion of fuel that was relocated from Baffin Island to Montreal that is now recorded at net realizable value and obsolescence of certain supplies.

For the year ended December 31, 2009, professional fees were \$692,504 compared to \$1,008,033 in the same period in 2008 which was as a result of filing fees and higher general legal fees incurred in 2008. Professional fees for the three months ended December 31, 2009 were \$209,243, a decrease of \$6,783 compared to the prior period.

For the year ended December 31, 2009, office and general expenses of \$646,924 were \$1,374,252 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. There was a foreign exchange gain recorded in the fourth quarter of 2009, which is offset by higher foreign exchange losses incurred in 2008.

For the year ended December 31, 2009, salaries of \$2,935,783 were \$143,515 lower than the prior year. Salaries of \$731,622 for the three months ended December 31, 2009, represented a decrease of \$89,208 compared to the prior period. In the first quarter of 2009, the Company reduced its workforce which resulted in lower salaries expense in 2009 compared to 2008.

For the year ended December 31, 2009, share-based compensation was \$2,164,419 compared to \$4,610,323 for the prior year. Share-based compensation for the three months ended December 31, 2009 was \$79,474 compared to \$696,323 for the prior period. The lower charge in both the periods in 2009 are a function of the lower price for Common Shares underlying options for grants 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 \$42,542 and \$7,950 respectively for the year and three month periods ended December 31, 2009, respectively, have been capitalized to mining interests.

For the year ended December 31, 2009, amortization and accretion expense was \$69,135 compared to \$455,450 in the prior year, with an additional \$2,867,652 capitalized to mining interests in 2009 and \$1,741,755 capitalized to mining interests in 2008. For the three months ended December 31, 2009, amortization and accretion expense was \$25,365 compared to \$17,169 in the prior period with an additional \$709,915 capitalized to mining interests for the 2009 period and \$680,937 capitalized in the 2009 period. Total amortization and accretion charges have increased for both the year and three month periods ended December 31, 2009 as a result of a full year of amortization being recorded in 2009 compared to a partial year of amortization for the property plant and equipment additions coming into service in the second quarter of 2008.

OTHER INFORMATION

Off-Balance Sheet Arrangements

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

Going Concern

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

Development Stage Entity

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

Critical Accounting Policies and Estimates

The preparation of financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of certain assets and liabilities at the date of the financial statements and the reported amounts of certain revenues and expenses during the period. Actual results could differ significantly from those estimates. Specific items requiring estimates are mining interests, capital assets, amortization, asset retirement obligations, future income taxes 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 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 using the effective interest rate method. On conversion into shares, the carrying amount of the equity component and the carrying amount of the liability component are transferred to share capital. In the event that the instrument is settled in cash, this is treated as the extinguishment of the instrument; a gain or loss on extinguishment of the liability component, if applicable, is recognized in the income statement, the gain or loss on the equity component, if applicable, is recognized in contributed surplus. Transaction costs are netted against the carrying value of the instrument to which they relate.

Changes in accounting policies

Section 3862

In 2009, the CICA amended Section 3862 to require enhanced disclosure about the relative reliability of the date, or “inputs” that an entity uses to measure the fair values of its financial instruments. The adoption of these changes to the standard did not have a significant impact on the Company’s financial statements.

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

The transition date of January 1, 2011 will require the restatement for comparative purposes of amounts reported by the Company for the financial year ended December 31, 2010. Financial statements for the quarter ended March 31, 2011, including comparative amounts, will be prepared in accordance with IFRS. 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 drafting a portion of proposed new policies in key areas 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 and share based payments. The final impact of the conversion on the Company's financial statements cannot be measured at this time.

The Company will be prioritizing certain IFRS conversion related activities that should be completed within a reasonable time period following January 1, 2010, the Company's IFRS transition date.

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

Capital Disclosures

As at December 31, 2009, Baffinland's capital structure consists of its shareholders' equity. During the year ended December 31, 2009, the Company established, drew down on and subsequently repaid approximately US\$9.5 million from the Environmental Bonding Facility. This temporary change to capital structure was necessary for the Company to obtain funds to back financial security for land on which the Company's mining leases are situated. The Company is a development stage entity and therefore, its objective when managing the capital structure is to fund the continuing exploration and development of its wholly owned Mary River Property. The Company maintains its capital structure by raising funds externally as the need arises. The capital is invested in highly liquid, highly rated financial instruments.

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

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

There were no changes in the Company's approach to capital management during the year ended December 31, 2009 compared to the previous year. The Company is not subject to externally imposed capital requirements.

Financial Instruments

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

Credit risk

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

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

Liquidity risk

The Company's approach to managing liquidity risk is to ensure that it will have sufficient liquidity to meet liabilities when due. As at December 31, 2009, the Company had a cash balance of \$45,479,118 (December 31, 2008 - \$34,534,885) to settle current liabilities of \$1,672,307 (December 31, 2008 - \$8,586,572). Current liabilities consist of accounts payable that are predominantly due within 60 days.

Interest rate risk

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

Foreign currency risk

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

Sensitivity analysis

Based on management's knowledge and experience of 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. If interest rates were to rise by 1%, net loss would increase or decrease by approximately \$350,000 for the year ended December 31, 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

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 December 31, 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 year ended December 31, 2009 that have materially affected, or is reasonably likely to materially affect, the Company's internal controls over financial reporting.

Cautionary Note Regarding Forward-Looking Information

Certain information included in this MD&A may constitute forward-looking information within the meaning of securities laws. In some cases, forward-looking information can be identified by the use of terms such as "may", "will", "should", "project", "expect", "believe", "plan", "scheduled", "intend", "estimate", "forecast", "predict", "potential", "continue", "anticipate" or other similar expressions concerning matters that are not historical facts. Forward-looking information may relate to management's future outlook and anticipated events or results, and may include statements or information regarding the future plans or prospects of the Company.

Without limitation, statements about the Company's 2010 program including its 2010 exploration program; the identification and increase of mineral resources at Deposits No. 5, 4 and 3; achieving the necessary Financing; blast furnace results from trial cargos; the submission of the Draft Environmental Impact Statement; the negotiations of an Inuit Impact Benefits Agreement; the Company's eligibility for loan guarantees; the A&R Plan; progressive reclamation; regulatory compliance and maintaining core assets at site; Financial Security requirements; capital cost estimates for the Project; completion of the regulatory process and estimates and review of Project construction timelines and the commencement of commercial production at the Project; and substantially all of the information contained in and/or derived from the DFS, 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 and the realization of such estimates, the timing and amount of future exploration expenditures, the estimation of initial and sustaining capital requirements, the estimation of labour and operating costs, the availability of necessary Financing to develop the Mary River Property in the short and long-term, the progress of construction and development activities, the receipt of necessary regulatory approvals, iron ore prices, the feasibility of constructing and operating a direct-shipping iron ore mine at the Mary River Project, assumptions with respect to environmental risks, title disputes or claims, weather conditions, climate change and other similar matters. In addition, in making statements concerning the timing of the Project achieving commercial production, the Company has made certain assumptions relating to certain project development activities taking

place beginning in 2010 and leading up to 2016 and continuing without undue disruption. In estimating initial capital cost for the Project of \$4.1 billion, the Company has made certain assumptions set out in the DFS including, among other things, with respect to certain design criteria and certain inputs for construction costs, including labour and material costs. In stating that the Company intends to obtain the necessary Financing, the Company has assumed continued improvements in the global economy and the financial position of potential strategic partners and that it will successfully conduct negotiations and due diligence. The granting of a loan guarantee is subject to various assumptions including the acceptance of a formal application and completion of satisfactory due diligence, among other things. While the Company considers these assumptions to be reasonable based on information currently available to it, they may prove to be incorrect and there can be no assurance that such developments can be completed on satisfactory terms or at all.

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

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

BAFFINLAND IRON MINES CORPORATION
A Development Stage Entity

Financial Statements
For the years ended December 31, 2009 and 2008

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

Management is responsible for the preparation of the consolidated financial statements. The consolidated financial statements were prepared in accordance with Canadian generally accepted accounting principles and necessarily include amounts based on estimates and judgments of management.

Management maintains accounting and internal control systems to produce reliable financial statements and provide reasonable assurance that assets are properly safeguarded. PricewaterhouseCoopers LLP, Chartered Accountants, appointed by shareholders, conducted an audit on the Company's consolidated financial statements. Their report is included.

The board of directors of the Company is responsible for ensuring that management fulfills its responsibilities for financial reporting. The board of directors carries out this responsibility through its audit committee composed of three independent directors.

The audit committee meets periodically with the external auditors, with and without the presence of management, to review the consolidated financial statements and to discuss audit and internal control related matters.

On recommendation of the audit committee, the board of directors approved the Company's consolidated financial statements.

Gordon A. McCreary (signed)

Gordon A. McCreary
President & Chief Executive Officer

Gwen Gareau (signed)

Gwen Gareau
Vice President, Finance & Chief Financial Officer

February 17, 2010

Auditors' Report

**To the Shareholders of
Baffinland Iron Mines Corporation**

We have audited the balance sheets of Baffinland Iron Mines Corporation as at December 31, 2009 and 2008 and the statements of operations and comprehensive loss and deficit and cash flows for the years then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these financial statements present fairly, in all material respects, the financial position of the company as at December 31, 2009 and 2008 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants, Licensed Public Accountants

BAFFINLAND IRON MINES CORPORATION
(Development Stage Entity)
BALANCE SHEETS

	As At December 31 2009	As At December 31 2008
ASSETS		
Current		
Cash and cash equivalents (Note 4)	\$ 45,479,118	\$ 34,534,885
Accounts receivable	301,290	2,314,218
Subscription receipts receivable	-	4,213,547
Inventory (Note 6)	2,956,000	2,124,000
Prepaid expenses	264,977	327,535
	<hr/>	<hr/>
	49,001,385	43,514,185
Restricted cash (Note 5)	16,500,000	6,203,300
Inventory (Note 6)	6,228,315	10,778,760
Mining interests (Note 7)	163,373,343	140,531,497
Long term investments (Note 8)	11,519,196	9,791,925
Property, plant & equipment (Note 9)	11,509,891	14,441,174
	<hr/>	<hr/>
	\$ 258,132,130	\$ 225,260,841
	<hr/> <hr/>	<hr/> <hr/>
LIABILITIES		
Current		
Accounts payable	\$ 1,672,307	\$ 8,586,572
Asset retirement obligation (Note 10)	1,036,360	554,552
	<hr/>	<hr/>
	2,708,667	9,141,124
	<hr/>	<hr/>
SHAREHOLDERS' EQUITY AND DEFICIT		
Common shares (Note 12)	383,480,852	349,643,327
Subscription receipts	-	4,213,547
Warrants (Note 12)	12,093,390	3,023,371
Contributed surplus (Note 12 and 13)	13,354,094	11,835,336
Deficit	(153,504,873)	(152,595,864)
	<hr/>	<hr/>
	255,423,463	216,119,717
	<hr/>	<hr/>
	\$ 258,132,130	\$ 225,260,841
	<hr/> <hr/>	<hr/> <hr/>
Nature of operations and going concern (Note 1)		
Contingencies and commitments (Note 18)		

The accompanying notes are an integral part of the financial statements

Richard D. McCloskey (Signed)
Richard D. McCloskey, Director

Grant Edey (signed)
Grant Edey, Director

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

	For the years ended December 31,		Cumulative from January 1,
	2009	2008	2003
Interest and other income	\$439,844	\$2,494,398	\$5,499,412
Expenses			
Exploration	827,377	37,252,610	175,914,001
Amortization and accretion	69,135	455,450	1,165,748
Loss on writedown of inventory (Note 6)	2,227,510	-	2,227,510
Salaries	2,935,783	2,979,298	9,348,985
Share-based compensation (Note 13)	2,164,419	4,610,323	12,710,047
Office and general	646,924	2,021,176	4,503,245
Professional fees	692,504	1,008,033	3,684,446
Shareholder relations	200,510	241,028	1,224,773
Travel	190,292	399,668	1,123,423
Unrealized gain on revaluation of long term investments (Note 8)	(2,407,724)	-	(2,407,724)
Impairment of long term investments (Note 8)	-	5,115,075	10,310,563
Gain on note exchange and note sale (Note 8)	(1,829,991)	-	(1,829,991)
Gain on extinguishment of convertible debt (Note 11)	(191,986)	-	(191,986)
	<u>5,524,753</u>	<u>54,082,661</u>	<u>217,783,040</u>
Net loss for the year before taxes	(5,084,909)	(51,588,263)	(212,283,628)
Future income tax recovery (Note 15)	<u>4,175,900</u>	<u>10,301,427</u>	<u>62,133,176</u>
Net loss & comprehensive loss for the year	(909,009)	(41,286,836)	(150,150,452)
Deficit, beginning of the year	<u>(152,595,864)</u>	<u>(111,309,028)</u>	
Deficit, end of the year	<u>(\$153,504,873)</u>	<u>(\$152,595,864)</u>	
Net loss per share (Note 17)	<u>(\$0.00)</u>	<u>(\$0.29)</u>	

Nature of operations and going concern (Note 1)

The accompanying notes are an integral part of the financial statements

BAFFINLAND IRON MINES CORPORATION
(Development Stage Entity)
STATEMENTS OF CASH FLOWS

	For the years ended December 31,		Cumulative from January 1,
	2009	2008	2003
Operating activities			
Loss for the year	(\$909,009)	(\$41,286,836)	(\$150,150,453)
Items not affecting cash:			
Amortization and accretion expense	69,135	455,450	1,165,748
Loss on writedown of inventory (Note 6)	2,227,510	-	2,227,510
Share-based compensation (Note 13)	2,164,419	4,610,323	12,710,048
Future income tax recovery	(4,175,900)	(10,301,427)	(62,133,176)
Unrealized gain on revaluation of long term investments (Note 8)	(2,407,724)	-	(2,407,724)
Impairment of long term investments (Note 8)	-	5,115,075	10,310,563
Gain on note exchange and note sale (Note 8)	(1,829,991)	-	(1,829,991)
Gain on extinguishment of convertible debt (Note 11)	(191,986)	-	(191,986)
Other non cash items	-	-	(275,542)
(Increase) decrease in accounts receivable	1,472,522	848,492	(841,654)
Decrease in inventory	(832,000)	(4,255,874)	(13,734,760)
(Increase) decrease in prepaid expenses	62,558	195,102	(264,977)
Increase (decrease) in accounts payable	(7,885,947)	(18,576,230)	700,625
	<u>(12,236,413)</u>	<u>(63,195,925)</u>	<u>(204,715,769)</u>
Investing activities			
Change in restricted cash	(10,296,700)	(6,203,300)	(16,500,000)
Purchase of property, plant & equipment	(1,892)	(4,165,697)	(17,191,324)
Capitalized mine development costs included in accounts payable	971,680	7,506,741	(6,535,061)
Capitalized mine development costs	(19,038,457)	(138,003,210)	(149,534,926)
Increase in non-current inventory	2,956,686	-	2,956,686
Cash received on note exchange and sale (Note 8)	2,510,445	-	2,510,445
Increase in long term investments	-	-	(20,102,488)
	<u>(22,898,238)</u>	<u>(140,865,466)</u>	<u>(204,396,668)</u>
Financing activities			
Net cash proceeds from draw on convertible debt (Note 11)	10,079,700	-	10,079,700
Repayment of convertible debt (Note 11)	(10,324,691)	-	(10,324,691)
Increase in bank debt	-	-	16,600,000
Repayment of bank debt	-	-	(16,600,000)
Decrease in due to related parties	-	-	(132,421)
Net proceeds on issue of common shares and warrants	42,110,328	200,454,356	450,755,420
Net proceeds on conversion of subscription receipts	4,213,547	-	4,213,547
	<u>46,078,884</u>	<u>200,454,356</u>	<u>454,591,555</u>
Increase (decrease) in cash and cash equivalents	10,944,233	(3,607,035)	45,479,118
Cash position at beginning of the year	<u>\$34,534,885</u>	<u>38,141,920</u>	<u>-</u>
Cash position at end of the year	<u>\$45,479,118</u>	<u>\$34,534,885</u>	<u>\$45,479,118</u>

The accompanying notes are an integral part of the financial statements

BAFFINLAND IRON MINES CORPORATION
(Development Stage Entity)
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED DECEMBER 31, 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 its Mary River Property on Baffin Island, Nunavut, Canada ("Mary River Property").

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP") applicable to a going concern, which assumes continuity of operations and realization of assets and settlement of liabilities in the normal course of business for the foreseeable future. For the year ended December 31, 2009, the Company reported an after-tax loss of \$0.9 million, and an accumulated deficit of \$153.5 million and as at that date had not generated positive cash flow from operations. In addition, as the Company is in the development stage it is subject to the risks and challenges similar to other companies in a comparable stage of development. These risks include, but are not limited to, continuing losses, 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 secured funding of \$44.0 million in December 2009 to meet its exploration and development requirements planned for 2010, and to satisfy its contractual obligations and continue as a going concern. While the Company has successfully raised financing to date, there can be no assurance that it will be able to do so in the future.

These financial statements do not reflect the adjustments to the carrying values of assets and liabilities, the reported expenses and balance sheet classifications that would be necessary if the going concern assumption 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 Canadian chartered banks or government treasury bills, typically having a maturity of 12 months and fully cashable after 30 days at the date of original issue.

c) Flow-through common shares

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

NOTES TO THE FINANCIAL STATEMENTS (cont'd)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

d) Mining interests and exploration expenditures

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 are being capitalized since mineral reserves have been established (the "Project"). Development costs together with the cost of mining interests will be charged to operations on a units-of-production method based on estimated recoverable reserves upon commencement of commercial production. Revenue earned in the pre-development phase is treated as a reduction to mine development costs. If the mining interests are abandoned or if management determines that the value of the mining interests is impaired, the costs will be reduced to fair value through a charge to the income statement. Expenditures that are incurred to explore Deposits No. 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.

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

g) Income taxes

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

h) Accounting for share-based compensation

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

NOTES TO THE FINANCIAL STATEMENTS (cont'd)

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

i) Fair value of financial instruments

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

j) Impairment of mining interests

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

k) Asset retirement obligations

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

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

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

l) Financial instruments

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

NOTES TO THE FINANCIAL STATEMENTS (cont'd)

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

l) Financial instruments (cont'd)

The Company made the following classifications:

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

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

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

The Company's long term investment is considered to be a level 3 under this new requirement. See Note 8.

m) Convertible debt

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

n) Changes in accounting policies

Section 3862

In 2009, the CICA amended Section 3862 to require enhanced disclosure about the relative reliability of the date, or "inputs" that an entity uses to measure the fair values of its financial instruments. The adoption of these changes to the standard did not have a significant impact on the Company's financial statements.

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)

n) Changes in 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 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.

3. CAPITAL MANAGEMENT

As at December 31, 2009, Baffinland's capital structure consists of its shareholders' equity. During the year ended December 31, 2009, the Company established, drew down on and subsequently repaid the US\$9.5 million of convertible debt. This temporary change to capital structure was necessary for the Company to obtain funds to back financial security for land on which the Company's mining leases are situated. The Company is a development stage entity and therefore, its objective when managing the capital structure is to fund the continuing exploration and development of its wholly owned Mary River Property. The Company maintains its capital structure by raising funds externally as the need arises. The capital is invested in highly liquid, highly rated financial instruments.

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

NOTES TO THE FINANCIAL STATEMENTS (cont'd)

3. CAPITAL MANAGEMENT (cont'd)

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 year ended December 31, 2009 compared to the previous year. The Company is not subject to externally imposed capital requirements.

4. CASH AND CASH EQUIVALENTS

	December 31 2009	December 31 2008
Cash and cash equivalents are comprised of:		
Cash	\$ 3,279,118	\$ 5,027,138
Guaranteed investment certificates	42,200,000	29,507,747
	<u>\$ 45,479,118</u>	<u>\$ 34,534,885</u>

5. 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.

6. 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:

	December 31 2009	December 31 2008
Current		
Fuel	\$ 1,091,000	\$ 1,041,000
Supplies	1,865,000	1,083,000
	<u>\$ 2,956,000</u>	<u>\$ 2,124,000</u>
Non-current		
Fuel	\$ 6,082,900	\$ 8,394,769
Supplies	145,415	2,383,991
	<u>\$ 6,228,315</u>	<u>\$ 10,778,760</u>

During the third quarter, a portion of fuel was relocated from Baffin Island to Montreal and as such this fuel has been written down to net realizable value for the year ended December 31, 2009. A total write down of \$2.2 million was recorded in the income statement which includes \$353,000 as a writedown of other supplies due to obsolescence.

7. MINING INTERESTS

The Company has a 100% interest in three mining leases in the Mary River area of Baffin Island, Nunavut, Canada. The leases have terms of 21 years and are due for renewal in 2013. The Company also has a surface rights commercial land lease that permits it to access the lands. The current lease term expires in October 2010. Interest related to the convertible debt in the amount of \$493,344 has been capitalized to mining interests.

NOTES TO THE FINANCIAL STATEMENTS (cont'd)

7. MINING INTERESTS (cont'd)

Mining interests is comprised of:

Balance at January 1, 2008	\$	1
Asset Retirement Obligation asset incurred		464,447
Development costs capitalized		140,067,049
Balance at December 31, 2008		140,531,497
Asset Retirement Obligation asset incurred		399,851
Development costs capitalized		22,441,995
Balance at December 31, 2009		\$ 163,373,343

8. LONG TERM INVESTMENTS

The Company owns long term asset backed notes (the "Notes") that were issued by Master Asset Vehicle II ("MAV 2") as a result of the restructuring of the Company's previous investment in Third Party Asset Backed Commercial Paper ("ABCP"). The Notes have a face value of \$17,750,092 and a fair value of \$11,519,196 (December 31, 2008 - face value of \$19,948,998 and fair value of \$9,791,925). On January 21, 2009 the Company received the Notes which replaced the ABCP. As part of the exchange, the Company received two payments totalling \$941,301 that represented the Company's share of cash that accumulated to the assets during the restructuring period. The payments were recorded as a gain on note exchange.

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

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

The remaining portfolio consists of four types of Notes, which are supported by a pool of leveraged super senior credit default swaps, unlevered collateralized debt obligations as well as traditional assets and cash. The leveraged assets supporting these notes have access to credit facility that can be drawn upon in the event that a margin call is triggered and more collateral must be posted. Additionally, these particular assets are subject to an 18 month moratorium on margin calls which will expire in mid-2010.

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

During the year ended December 31, 2009, the Company has seen continued improvement in general corporate credit market conditions which has had the most impact on the valuation. This decrease in credit risk impacts the intrinsic value of the Notes due to a general lowering of default risk, relative to the previous valuations. There is also a decrease in the likelihood that credit risk limits built into the Notes will be exceeded (specifically, the spread-based margin triggers). Accordingly, the Required Yield on the Notes has been somewhat reduced to reflect easing in the credit markets. Accretion of the Notes to par value at maturity assuming they do not default, resulted in an increased value at December 31, 2009.

NOTES TO THE FINANCIAL STATEMENTS (cont'd)

8. LONG TERM INVESTMENTS (cont'd)

Conversely, during the year, the valuation of the A2 notes in particular was negatively impacted by a rating downgrade by DBRS based on credit quality concerns on some of the assets underlying the MAV2 Pool. 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; and 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.

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

Based on the foregoing, as at December 31, 2009 the Company has estimated the fair market value of the Notes to be between \$10.6 million and \$12.5 million resulting in a carrying value of \$11,519,196. During the year ended December 31, 2009 the Company recorded an unrealized gain on revaluation of the Notes in the amount of \$2,407,724. For the year ended December 31, 2008, an impairment charge of \$5,115,075 was recorded.

Notes	Face Value (\$)	Maturity Date (i)	Effective Coupon ⁽ⁱⁱ⁾	Required Yield ⁽ⁱⁱⁱ⁾	Fair Value December 31, 2009	Fair Value December 31, 2008
MAV2 Notes						
A-1	13,273,746	12/20/2016	2.59%	7.4%	\$9,571,012	\$7,654,949
A-2	3,337,040	12/20/2016	2.59%	11.7%	\$1,838,803	\$1,662,873
B	605,766	12/20/2016	0.00%	26.1%	\$104,046	\$52,593
C	533,540	12/20/2016	0.00%	31.8%	\$5,335	\$22,330
IA Tracking Notes						
Class 15 ^(iv)	-	-	-	-	-	399,180
Total	17,750,092				\$11,519,196	\$9,791,925

(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.

(iv) The Class 15 notes were sold during the fourth quarter of 2009.

The movement in the balance in the year is noted:

Balance at January 1, 2009 / January 21, 2009	\$9,791,925
Unrealized gain on revaluation	2,407,724
Sale of Class 15 Note	(680,453)
Balance at December 31, 2009	\$11,519,196

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

NOTES TO THE FINANCIAL STATEMENTS (cont'd)

9. PROPERTY, PLANT & EQUIPMENT

Property, plant & equipment is comprised of:

	December 31, 2009			December 31, 2008		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Infrastructure and equipment	\$ 13,935,974	\$ 5,252,964	\$ 8,683,010	\$ 13,999,395	\$ 2,563,121	\$ 11,436,274
Furniture & fixtures	98,245	63,302	34,943	98,245	50,292	47,953
Leasehold improvements	139,410	91,940	47,470	137,518	64,340	73,178
Computer equipment	324,271	88,190	236,081	327,271	70,510	256,761
Infrastructure and equipment not in use	2,508,387	-	2,508,387	2,627,008	-	2,627,008
	<u>\$ 17,006,287</u>	<u>\$ 5,496,396</u>	<u>\$ 11,509,891</u>	<u>\$ 17,189,437</u>	<u>\$ 2,748,263</u>	<u>\$ 14,441,174</u>

“Infrastructure and equipment not in use” is not amortized. Amortization expense related to property, plant & equipment used in development activities at the Project are capitalized to mining interests. For the year ended December 31, 2009 capitalized amortization was \$2,796,540 (2008 - \$1,730,492).

10. ASSET RETIREMENT OBLIGATION

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

Balance at January 1, 2008	\$ -
Asset retirement obligation incurred	464,447
Accretion	90,105
Balance at December 31, 2008	<u>554,552</u>
Asset retirement obligation incurred	399,851
Accretion	81,957
Balance at December 31, 2009	<u>\$ 1,036,360</u>

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 is not expected to be paid until 2042 which is the estimated time at which the current iron ore reserves are expected to be depleted.

NOTES TO THE FINANCIAL STATEMENTS (cont'd)

11. CONVERTIBLE DEBT

On August 31, 2009, the Company entered into a definitive agreement regarding the environmental guarantee support facility (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 US\$9.5 million (C\$10.37 million) to cover an increase in financial security to C\$16.5 million under the Company's surface rights land lease for its Mary River Property. On December 10, 2009, the US\$9.5 million (C\$10.2 million) balance was repaid with proceeds from the December Equity Offerings (see Note 12.). The first ranking charge over all of the Company's assets to secure the Company's obligation under the facility has been released.

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

Balance at January 1, 2009	\$	-
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: Equity portion at fair value, net of allocated fees		(3,884,579)
Add: Accretion		27,937
Repayment applied to loan portion from December 10, 2009 repayment		(5,998,808)
Balance at December 31, 2009	\$	-

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. This amount has been reversed from equity since the Facility has been repaid.

On repayment of the facility the debt and equity portions including the pro rata allocated capitalized transaction costs were reversed to the income statement and contributed surplus respectively.

12. COMMON SHARES AND WARRANTS

Authorized: Unlimited common shares

Issued:

	Number of shares	Amount \$
December 31, 2007	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
December 31, 2008	233,129,899	349,643,327
Net future income tax liability recorded on renunciation of flow through expenditures	-	(4,175,900)
Conversion of Subscription Receipts April, 2009	22,176,564	4,213,547
Exercise of share purchase options	255,227	121,538
Interest and fee payments paid in shares for convertible debt	1,476,840	689,657
Share financing - flow through private placement December, 2009	41,860,000	17,497,480
Share financing - public offering December, 2009	43,885,669	15,491,203
December 31, 2009	342,784,199	383,480,852

NOTES TO THE FINANCIAL STATEMENTS (cont'd)

12. COMMON SHARES AND WARRANTS (cont'd)

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

The second of the December Equity Offerings was a private placement under which a total of 41,860,000 common shares and 20,930,000 common share purchase warrants were issued. Each common share unit was sold for a price of \$0.55 and was comprised of one common share and one half common share purchase warrant. Each common share unit was sold for a price of \$0.55 and was comprised of one common share and one half common share purchase warrant. Each common share was issued as a "flow-through share" under the Income Tax Act (Canada). Total gross proceeds on the private placement were \$23.0 million.

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

The common share purchase warrants issued as part of the December Equity Offerings entitle the holder to acquire a common share for a price of \$0.70 until December 9, 2012.

On December 10, 2009, the Company also issued 669,713 valued at \$327,088 shares to RCF for the final interest and commitment fee payment for the convertible debt.

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

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

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.

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.

NOTES TO THE FINANCIAL STATEMENTS (cont'd)

12. COMMON SHARES AND WARRANTS (cont'd)

There are a total of 48,854,823 warrants outstanding as at December 31, 2009:

	<u>Number of shares</u>	<u>Amount \$</u>
December 31, 2007		
Warrant issue - 2007	5,981,988	3,023,371
December 31, 2008	5,981,988	3,023,371
Warrant issue - 2009	42,872,835	9,070,019
December 31, 2009	48,854,823	12,093,390

The total fair value attributed to the warrants outstanding is \$12,093,390 using the following assumptions under the Black-Scholes model:

Date issued	Exercise Price	Term in years	Risk-free Interest rate	Expected Stock Volatility	Number issued
January 24, 2007	\$5.50	3	4%	60%	5,454,550
March 26, 2007	\$5.50	3	4%	60%	527,438
December 10, 2009	\$0.70	3	0.5%	85%	42,872,835
Total warrants issued					48,854,823

Contributed surplus

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

13. SHARE-BASED COMPENSATION

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. SHARE-BASED COMPENSATION (cont'd)

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

	December 31, 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	5,697,000	0.32	2,349,000	3.73
Exercised in the period	(332,500)	0.28	(12,500)	2.60
Forfeited in the period	(1,167,500)	1.98	(15,000)	4.07
Expired in the period	(1,350,000)	1.14	-	-
Outstanding, ending	10,229,000	\$ 1.66	7,382,000	\$ 2.59

As at December 31, 2009 the number of share options available for exercise was 7,580,500 at a weighted average price of \$2.12 and the aggregate value of unvested share options granted is \$490,398.

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	Expected life	Risk-free Interest rate	Expected Stock Volatility
February 6, 2007	5 years	5.00%	81%
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%
October 27, 2009	4 years	0.50%	85%
December 15, 2009	4 years	0.50%	85%

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 year ended December 31, 2009 was \$2,206,961 (2008 - \$4,932,408). Beginning in the second quarter of 2008, share-based compensation related to share options awarded to employees working at the Mary River Property was capitalized to mining interests. For the year ended December 31, 2009 share-based compensation costs of \$42,542 (2008 - \$322,085) were capitalized and included in mining interests.

NOTES TO THE FINANCIAL STATEMENTS (cont'd)

14. FINANCIAL RISK FACTORS

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

Credit risk

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

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

Liquidity risk

The Company's approach to managing liquidity risk is to ensure that it will have sufficient funds to meet liabilities when due. As at December 31, 2009, the Company had a cash balance of \$45,479,118 (December 31, 2008 - \$34,534,885) to settle current liabilities of \$1,672,307 (December 31, 2008 - \$8,586,572). Current liabilities consist of accounts payable that are predominantly due within 60 days.

Interest rate risk

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

Foreign currency risk

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

Price risk

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

Sensitivity analysis

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

- Cash and cash equivalents include deposits which are at variable interest rates. If interest rates were to change by 1%, net loss would increase or decrease by approximately \$350,000 for the year ended December 31, 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)

15. INCOME TAXES

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

	<u>December 31</u> <u>2009</u>	<u>December 31</u> <u>2008</u>
Net loss before taxes for the year	(\$5,084,909)	(\$51,588,263)
Income tax recovery at Canadian federal and provincial statutory rates	(1,638,279)	(16,878,879)
Change in valuation allowance	(2,895,546)	5,069,026
Permanent differences	357,925	1,508,426
Recovery of income taxes	<u>(4,175,900)</u>	<u>(10,301,427)</u>

The components of the recovery of income taxes comprise:

Future income tax recovery	<u>(4,175,900)</u>	<u>(10,301,427)</u>
Net income tax recovery	<u>(4,175,900)</u>	<u>(10,301,427)</u>

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

	<u>December 31</u> <u>2009</u>	<u>December 31</u> <u>2008</u>
Future Income Tax Assets		
Exploration & Development	3,917,000	4,459,000
Non-capital losses carried forward	4,113,000	4,447,000
Share issue expense	2,710,000	3,527,000
Long-term asset backed notes	1,114,000	1,609,000
Property, plant and equipment	-	776,000
Future income tax asset	11,854,000	14,818,000
Valuation Allowance	(10,765,000)	(14,235,600)
Net future income tax asset	<u>1,089,000</u>	<u>582,400</u>
Future Income Tax Liabilities		
Property, plant and equipment	<u>(1,089,000)</u>	<u>(582,400)</u>
Future income tax liability	(1,089,000)	(582,400)
Net future income tax asset / liability recorded	<u>-</u>	<u>-</u>

The Company has recorded a net income tax recovery of \$4,175,900 (December 31, 2008 - nil) and a valuation allowance in respect of tax losses and other attributes valued at \$10,765,000 (December 31, 2008 - \$14,235,600).

NOTES TO THE FINANCIAL STATEMENTS (cont'd)

15. INCOME TAXES (cont'd)

As at December 31, 2009, the Company has available non-capital loss carry-forwards for Canadian federal and provincial tax purposes that will expire as follows:

	<u>2009</u>	<u>2008</u>
2009	3,000	3,000
2010	51,000	51,000
2014	525,000	525,000
2015	879,000	879,000
2026	1,327,000	1,327,000
2027	5,132,000	5,132,000
2028	7,915,941	7,915,941
2029	7,761,801	-

16. RELATED PARTY TRANSACTIONS

During the year ended December 31, 2009 McChip Resources Inc., a related party controlled by a director and a shareholder, paid \$72,000 (2008 - \$72,000) 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 year ended December 31, 2009 was 255,002,955 (2008 - 140,053,496).

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. 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 current lease term expires on October 31, 2010. The terms of the Land Lease provide that the Company must post financial security from time to time for future estimated costs of abandonment and reclamation activities on Inuit owned land. The Company has provided financial security to the QIA in the form of an irrevocable letter of credit. During the year ended December 31, 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 is recorded on the balance sheet as restricted cash. The draw on the convertible debt was fully repaid on December 10, 2009.

19. COMPARATIVE INFORMATION

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