

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

**Interim Financial Statements**  
**For the three and six month periods ended June 30, 2010**  
Unaudited

**BAFFINLAND IRON MINES CORPORATION**

(Development Stage Entity)

**BALANCE SHEETS**

(Unaudited)

	<b>As At June 30 2010</b>	<b>As At December 31 2009</b>
<b>ASSETS</b>		
<b>Current</b>		
Cash and cash equivalents (Note 4)	\$ 37,451,624	\$ 45,479,118
Accounts receivable	516,773	301,290
Inventory (Note 6)	2,684,000	2,956,000
Prepaid expenses	207,695	264,977
	40,860,092	49,001,385
<b>Restricted cash (Note 5)</b>	16,500,000	16,500,000
<b>Inventory (Note 6)</b>	3,630,369	6,228,315
<b>Mining interests (Note 7)</b>	163,874,124	163,373,343
<b>Long term investments (Note 8)</b>	12,305,619	11,519,196
<b>Property, plant &amp; equipment (Note 9)</b>	10,094,942	11,509,891
	\$ 247,265,146	\$ 258,132,130
<b>LIABILITIES</b>		
<b>Current</b>		
Accounts payable	\$ 5,308,018	\$ 1,672,307
<b>Asset retirement obligation (Note 10)</b>	1,080,640	1,036,360
<b>Future income tax liability (Note 14)</b>	4,366,409	-
	10,755,067	2,708,667
<b>SHAREHOLDERS' EQUITY AND DEFICIT</b>		
<b>Common shares (Note 11)</b>	376,524,163	383,480,852
<b>Warrants (Note 11)</b>	12,093,390	12,093,390
<b>Contributed surplus (Note 11 and 12)</b>	14,030,366	13,354,094
<b>Deficit</b>	(166,137,840)	(153,504,873)
	236,510,079	255,423,463
	\$ 247,265,146	\$ 258,132,130
<b>Nature of operations and going concern (Note 1)</b>		
<b>Contingencies and commitments (Note 17)</b>		

The accompanying notes are an integral part of the financial statements

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

(Unaudited)

	For the three months ended June 30,		For the six months ended June 30,		Cumulative from January 1,
	2010	2009	2010	2009	2003
Interest and other income	\$80,002	\$17,077	\$172,961	\$150,579	\$5,672,373
Expenses					
Exploration	6,027,641	176,248	8,625,270	408,604	184,539,271
Amortization and accretion	731,809	14,590	1,459,229	29,180	2,624,977
Loss on writedown of inventory (Note 6)	64,773	-	892,773	-	3,120,283
Salaries	767,131	714,855	2,247,544	1,575,457	11,596,529
Share-based compensation (Note 12)	325,360	778,311	729,271	1,700,212	13,439,318
Office and general	767,222	140,476	1,509,357	504,391	6,012,602
Professional fees	256,204	118,621	465,341	336,828	4,149,787
Shareholder relations	22,408	44,629	70,351	123,326	1,295,124
Travel	65,725	55,086	133,706	75,696	1,257,129
Unrealized gain on revaluation of long term investments (Note 8)	(287,789)	(1,194,419)	(786,423)	(1,194,419)	(3,194,147)
Impairment of long term investments (Note 8)	-	-	-	-	10,310,563
Gain on note exchange and note sale (Note 8)	-	(282,536)	-	(941,301)	(1,829,991)
Gain on extinguishment of convertible debt	-	-	-	-	(191,986)
	<u>8,740,484</u>	<u>565,861</u>	<u>15,346,419</u>	<u>2,617,974</u>	<u>233,129,459</u>
Net loss for the period before taxes	(8,660,482)	(548,784)	(15,173,458)	(2,467,395)	(227,457,086)
Future income tax recovery (Note 14)	<u>1,944,479</u>	<u>-</u>	<u>2,540,491</u>	<u>-</u>	<u>64,673,667</u>
Net loss & comprehensive loss for the period	(6,716,003)	(548,784)	(12,632,967)	(2,467,395)	(162,783,419)
Deficit, beginning of the period	<u>(159,421,837)</u>	<u>(154,514,475)</u>	<u>(153,504,873)</u>	<u>(152,595,864)</u>	
Deficit, end of the period	<u>(\$166,137,840)</u>	<u>(\$155,063,259)</u>	<u>(\$166,137,840)</u>	<u>(\$155,063,259)</u>	
Net loss per share (Note 16)	<u>(\$0.02)</u>	<u>\$0.00</u>	<u>(\$0.04)</u>	<u>(\$0.01)</u>	

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

The accompanying notes are an integral part of the financial statements

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

(Unaudited)

	For the three months ended June 30,		For the six months ended June 30,		Cumulative from January 1,
	2010	2009	2010	2009	2003
<b>Operating activities</b>					
Loss for the period	(\$6,716,003)	(\$548,784)	(\$12,632,967)	(\$2,467,395)	(\$162,783,419)
Items not affecting cash:					
Amortization and accretion expense	731,809	14,590	1,459,229	29,180	\$2,624,977
Loss on writedown of inventory (Note 6)	64,773	-	892,773	-	\$3,120,283
Share-based compensation (Note 12)	325,360	778,311	729,271	1,700,212	\$13,439,319
Future income tax recovery	(1,944,479)	-	(2,540,491)	-	(\$64,673,667)
Unrealized gain on revaluation of long term investments (Note 8)	(287,789)	(1,194,419)	(786,423)	(1,194,419)	(\$3,194,147)
Impairment of long term investments (Note 8)	-	-	-	-	\$10,310,563
Gain on note exchange and note sale (Note 8)	-	(282,536)	-	(941,301)	(\$1,829,991)
Gain on extinguishment of convertible debt	-	-	-	-	(\$191,986)
Other non cash items	-	-	-	-	(\$275,542)
(Increase) decrease in accounts receivable	(335,368)	93,148	(215,483)	1,298,352	(\$1,057,137)
(Increase) decrease in inventory	841,000	735,728	272,000	1,153,273	(\$13,462,760)
(Increase) decrease in prepaid expenses	16,819	18,131	57,282	143,634	(\$207,695)
Increase (decrease) in accounts payable	2,737,034	(638,526)	3,382,660	(5,275,093)	\$4,083,285
	<u>(4,566,844)</u>	<u>(1,024,357)</u>	<u>(9,382,149)</u>	<u>(5,553,557)</u>	<u>(214,097,918)</u>
<b>Investing activities</b>					
Change in restricted cash	-	-	-	-	(\$16,500,000)
Purchase of property, plant & equipment	-	-	-	(1,892)	(\$17,191,324)
Capitalized mine development costs included in accounts payable	222,881	(2,505,517)	253,051	(2,505,517)	(\$6,282,010)
Capitalized mine development costs	(459,356)	(2,043,908)	(500,781)	(6,608,006)	(\$150,035,707)
Decrease in non-current inventory	613,987	-	1,705,174	-	\$4,661,860
Cash received on note exchange and sale (Note 8)	-	282,536	-	941,301	\$2,510,445
Increase in long term investments	-	-	-	-	(\$20,102,488)
	<u>377,512</u>	<u>(4,266,889)</u>	<u>1,457,444</u>	<u>(8,174,114)</u>	<u>(202,939,224)</u>
<b>Financing activities</b>					
Net cash proceeds from draw on convertible debt	-	-	-	-	10,079,700
Repayment of convertible debt	-	-	-	-	(10,324,691)
Increase in bank debt	-	-	-	-	\$16,600,000
Repayment of bank debt	-	-	-	-	(\$16,600,000)
Decrease in due to related parties	-	-	-	-	(\$132,421)
Net proceeds on conversion of subscription receipts	-	4,213,547	-	4,213,547	\$4,213,547
Net proceeds on issue of common shares and warrants	-	-	(102,789)	-	\$450,652,631
	<u>-</u>	<u>4,213,547</u>	<u>(102,789)</u>	<u>4,213,547</u>	<u>454,488,766</u>
<b>Increase (decrease) in cash and cash equivalents</b>	<b>(4,189,332)</b>	<b>(1,077,699)</b>	<b>(8,027,494)</b>	<b>(9,514,124)</b>	<b>37,451,624</b>
<b>Cash position at beginning of the period</b>	<b>\$41,640,956</b>	<b>26,098,460</b>	<b>45,479,118</b>	<b>34,534,885</b>	<b>-</b>
<b>Cash position at end of the period</b>	<b>\$37,451,624</b>	<b>\$25,020,761</b>	<b>\$37,451,624</b>	<b>\$25,020,761</b>	<b>\$37,451,624</b>

The accompanying notes are an integral part of the financial statements

**BAFFINLAND IRON MINES CORPORATION**  
**(Development Stage Entity)**  
**NOTES TO THE FINANCIAL STATEMENTS**  
**FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2010**

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

Baffinland Iron Mines Corporation (the "Company") was formed pursuant to Articles of Incorporation under the *Business Corporation Act* (Ontario) on March 10, 1986. The Company has non-producing iron ore interests located on its Mary River Property on Baffin Island, Nunavut, Canada ("Mary River Property").

These financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP") applicable to a going concern, which assumes continuity of operations and realization of assets and settlement of liabilities in the normal course of business for the foreseeable future. For the three and six month periods ended June 30, 2010, the Company reported an after-tax loss of \$6.7 million and \$12.6 million respectively, and an accumulated deficit of \$166.1 million, and as at that date, had not generated positive cash flow from operations. In addition, as the Company is in the development stage, it is subject to the risks and challenges similar to other companies in a comparable stage of development. These risks include, but are not limited to, continuing losses, and the ability to secure adequate financing to meet the minimum capital required to successfully complete the project and continue as a going concern. As a result there is significant doubt regarding the 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, cashable after 30 days at the date of original issue.

**c) Flow-through common shares**

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

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

### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### d) Mining interests and exploration expenditures

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

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

#### e) Property, plant & equipment

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

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

#### f) Use of estimates

The preparation of financial statements in accordance with Canadian GAAP requires management to make estimates and assumptions that affect the reported amount of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amount of revenues and expenses during the reported period. These estimates are reviewed periodically, and as adjustments become necessary, they are made in the period in which they become known. Actual results could differ from these estimates.

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

#### g) Income taxes

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

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

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

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

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

#### i) Fair value of financial instruments

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

#### j) Impairment of mining interests

The Company reviews mining interests for impairment when events or circumstances indicate that the assets' carrying amount may not be recoverable. When management determines that impairment exists, the impairment loss will be measured by comparing the assets' carrying amount to its fair value, 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 it's other than temporary removal from service, including it's sale, abandonment, recycling or disposal in some other manner. The Company estimates the cost associated with these activities in its Abandonment and Reclamation plan ("A&R Plan") which is reviewed and updated annually.

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

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

#### l) Financial instruments

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

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

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

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

The Company made the following classifications:

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

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

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

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

#### m) Convertible debt

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

#### n) Changes in accounting policies

##### *Section 1506*

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

#### o) Future accounting changes

##### *Section 1582*

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



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

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

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

##### *Section 1601 & 1602*

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

### 3. CAPITAL MANAGEMENT

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

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

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

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

### 4. CASH AND CASH EQUIVALENTS

	June 30 2010	December 31 2009
Cash and cash equivalents are comprised of:		
Cash	\$ 246,624	\$ 3,279,118
Guaranteed investment certificates	37,205,000	42,200,000
	<u>\$ 37,451,624</u>	<u>\$ 45,479,118</u>

### 5. RESTRICTED CASH

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

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

### 6. INVENTORY

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

	June 30 2010	December 31 2009
<b>Current</b>		
Fuel	\$ 1,370,000	\$ 1,091,000
Supplies	1,314,000	1,865,000
	<u>\$ 2,684,000</u>	<u>\$ 2,956,000</u>
<b>Non-current</b>		
Fuel	\$ 3,486,900	\$ 6,082,900
Supplies	143,469	145,415
	<u>\$ 3,630,369</u>	<u>\$ 6,228,315</u>

In 2009, a portion of fuel was relocated from Baffin Island to Montreal. Write downs were recorded to net realizable value for the three and six month periods ended June 30, 2010 in the amounts of \$0.1 million and \$0.9 million respectively.

### 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 (Note 17).

Mining interests is comprised of:

<b>Balance at January 1, 2009</b>	\$ 140,531,497
Asset retirement obligation incurred	399,851
Development costs capitalized	22,441,995
<b>Balance at December 31, 2009</b>	<u>163,373,343</u>
Asset retirement obligation incurred	-
Development costs capitalized	500,781
<b>Balance at June 30, 2010</b>	<u>\$ 163,874,124</u>

### 8. LONG TERM INVESTMENTS

The Company owns long term asset backed notes (the "Notes") that were issued by Master Asset Vehicle II ("MAV 2") as a result of the restructuring of the Company's previous investment in Third Party Asset Backed Commercial Paper ("ABCP"). The Notes have a face value of \$17,742,030 and a fair value of \$12,305,619 as at June 30, 2010 (December 31, 2009 - face value of \$17,750,092 and fair value of \$11,519,196). On January 21, 2009 the Company received the Notes which replaced the ABCP. As part of the exchange, the Company received two payments totalling \$941,301 that represented the Company's share of cash that accumulated to the assets during the restructuring period. The payments were recorded as a gain on note exchange during the six month period ended June 30, 2009.

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

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

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

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

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

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

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

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

Based on the foregoing, as at June 30, 2010 the Company has estimated the fair market value of the Notes to be between \$11.5 million and \$13.2 million and as a result for the six month period ended June 30, 2010, the Company has recorded an unrealized gain on revaluation of the Notes in the amount of \$786,423 (2009 - \$1,194,419) to arrive at a carrying value of \$12,305,619 (2009 - \$11,519,196).

Notes	Face Value (\$)	Maturity Date (i)	Effective Coupon <sup>(ii)</sup>	Required Yield <sup>(iii)</sup>	Fair Value June 30, 2010	Fair Value December 31, 2009
<b>MAV2 Notes</b>						
A-1	13,265,684	20/12/2016	2.25%	6.8%	<b>\$10,145,596</b>	\$9,571,012
A-2	3,337,040	20/12/2016	2.25%	10.8%	<b>\$2,022,188</b>	\$1,838,803
B	605,766	20/12/2016	0.00%	24.2%	<b>\$132,500</b>	\$104,046
C	533,540	20/12/2016	0.00%	29.5%	<b>\$5,335</b>	\$5,335
<b>Total</b>	<b>17,742,030</b>				<b>\$12,305,619</b>	<b>\$11,519,196</b>

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

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

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

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

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

The movement in the balance in the six months ended June 30, 2010 is noted:

<b>Balance at December 31, 2008 / January 21, 2009</b>	<b>\$9,791,925</b>
Unrealized gain on revaluation	2,407,724
Sale of Class 15 Note	(680,453)
<b>Balance at December 31, 2009</b>	<b>\$11,519,196</b>
Unrealized gain on revaluation	786,423
<b>Balance at June 30, 2010</b>	<b>\$12,305,619</b>

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

### 9. PROPERTY, PLANT & EQUIPMENT

Property, plant & equipment is comprised of:

	June 30, 2010			December 31, 2009		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Infrastructure and equipment	\$ 13,935,974	\$ 6,641,424	\$ 7,294,550	\$ 13,935,974	\$ 5,252,964	\$ 8,683,010
Furniture & fixtures	98,245	69,842	28,403	98,245	63,302	34,943
Leasehold improvements	139,410	105,749	33,661	139,410	91,940	47,470
Computer equipment	324,271	94,330	229,941	324,271	88,190	236,081
Infrastructure and equipment not in use	2,508,387	-	2,508,387	2,508,387	-	2,508,387
	<u>\$ 17,006,287</u>	<u>\$ 6,911,345</u>	<u>\$ 10,094,942</u>	<u>\$ 17,006,287</u>	<u>\$ 5,496,396</u>	<u>\$ 11,509,891</u>

"Infrastructure and equipment not in use" is not amortized. For the three and six month periods ended June 30, 2010 there was no amortization and accretion expense capitalized given that the exploration is currently being conducted on Deposit Nos 5, 4 & 3. In the prior three and six month similar period, amortization and accretion expense in the amount of \$697,380 and \$1,394,760 respectively, related to property, plant & equipment used in development activities of the Project, was capitalized to mining interests.

### 10. ASSET RETIREMENT OBLIGATION

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

	June 30 2010
<b>Balance at January 1, 2009</b>	<b>\$ 554,552</b>
Asset retirement obligation incurred	399,851
Accretion	81,957
<b>Balance at December 31, 2009</b>	<b>1,036,360</b>
Asset retirement obligation incurred	-
Accretion	44,280
<b>Balance at June 30, 2010</b>	<b>\$ 1,080,640</b>

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

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

### 11. COMMON SHARES AND WARRANTS

**Authorized:** Unlimited common shares

**Issued:**

	Number of shares	Amount \$
<b>December 31, 2008</b>	233,129,899	349,643,327
Net future income tax liability recorded on renunciation of flow through expenditures	-	(4,175,900)
Conversion of Subscription Receipts April, 2009	22,176,564	4,213,547
Exercise of share purchase options	255,227	121,538
Interest and fee payments paid in shares for convertible debt	1,476,840	689,657
Share financing - flow through private placement December, 2009	41,860,000	17,497,480
Share financing - public offering December, 2009	43,885,669	15,491,203
<b>December 31, 2009</b>	<b>342,784,199</b>	<b>383,480,852</b>
Net future income tax liability recorded on renunciation of flow through expenditures	-	(6,906,900)
Exercise of share purchase options	150,000	93,000
Share financing expenses- offering December 2009	-	(142,789)
<b>June 30, 2010</b>	<b>342,934,199</b>	<b>376,524,163</b>

During the first quarter of 2010, the Company renounced the flow through expenditures and recorded the associated future tax income liability in respect of the \$23.0 million of proceeds from the sale of flow through shares in the December 2009 Equity Offerings (the "2009 Equity Offerings").

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

The second of the 2009 Equity Offerings was a private placement under which a total of 41,860,000 common shares and 20,930,000 common share purchase warrants were issued. Each common share unit was sold for a price of \$0.55 and was comprised of one common share and one half common share purchase warrant. Each common share unit was sold for a price of \$0.55 and was comprised of one common share and one half common share purchase warrant. Each common share was issued as a "flow-through share" under the Income Tax Act (Canada). Total gross proceeds on the private placement were \$23.0 million.

On December 10, 2009 as part of both of the 2009 Equity Offerings, RCF exercised in full their pre-existing participation rights to participate in respect of the 2009 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 2009 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 shares valued at \$327,088 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.

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

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

There are a total of 48,854,823 warrants outstanding as at June 30, 2010:

	Number of warrants	Amount \$
<b>December 31, 2007</b>		
Warrant issue - 2007	5,981,988	3,023,371
<b>December 31, 2008</b>	<b>5,981,988</b>	<b>3,023,371</b>
Warrant issue - 2009	42,872,835	9,070,019
<b>December 31, 2009 and June 30, 2010</b>	<b>48,854,823</b>	<b>12,093,390</b>

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	Expiry Date	Risk-free Interest rate	Expected Stock Volatility	Number issued
January 24, 2007	\$5.50	January 31, 2012	4%	60%	5,454,550
March 26, 2007	\$5.50	January 31, 2012	4%	60%	527,438
December 10, 2009	\$0.70	December 10, 2012	0.5%	85%	42,872,835
<b>Total warrants issued</b>					<b>48,854,823</b>

#### Contributed surplus

Balance, December 31, 2007	\$ 6,913,803
Share-based compensation	4,932,408
Exercise of share purchase options	(10,875)
<b>Balance, December 31, 2008</b>	<b>\$ 11,835,336</b>
Share-based compensation	2,206,961
Net loss on extinguishment of equity portion of convertible debt	(618,790)
Exercise of share purchase options	(69,413)
<b>Balance, December 31, 2009</b>	<b>13,354,094</b>
Share-based compensation	729,271
Exercise of share purchase options	(53,000)
<b>Balance, June 30, 2010</b>	<b>\$ 14,030,366</b>

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

### 12. 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.

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

	June 30, 2010		December 31, 2009	
	Number	Weighted Average	Number	Weighted Average
Outstanding, beginning	10,229,000	\$ 1.66	7,382,000	\$ 2.59
Granted in the period	3,029,000	0.57	5,697,000	0.32
Exercised in the period	(150,000)	0.27	(332,500)	0.28
Forfeited in the period	(1,030,000)	2.73	(1,167,500)	1.98
Expired in the period	(546,000)	2.30	(1,350,000)	1.14
Outstanding, ending	11,532,000	\$ 1.27	10,229,000	\$ 1.66

During the three and six month periods ended June 30, 2010, the Company granted 800,000 and 3,029,000 share options respectively with a five year term at an exercise price \$0.58 and \$0.57 respectively per common share. For the three and six month periods ended June 30, 2010, fair values of \$277,964 and \$1,054,575 were estimated for these share options granted using the Black Scholes fair value option-pricing model based on the assumptions listed in the chart below.

As at June 30, 2010 the number of share options available for exercise was 7,898,500 at a weighted average price of \$1.63 and the aggregate value of unvested share options granted is \$1,105,408.

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
March 31, 2008	5 years	5.0%	74%
September 22, 2008	5 years	3.0%	72%
January 6, 2009	4 years	1.6%	85%
March 24, 2009	4 years	1.9%	88%
June 9, 2009	4 years	1.4%	89%
October 27, 2009	4 years	0.5%	85%
December 15, 2009	4 years	0.5%	85%
February 23, 2010	4 years	2.2%	85%
April 30, 2010	4 years	2.7%	80%

No dividend yield is assumed.

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

Using the fair value method, total share-based compensation for share options issued and outstanding for the three and six months periods ended June 30, 2010 was \$325,360 and \$729,271 respectively (2009- including amounts capitalized to mining interests- \$786,261 and \$1,726,854).

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

### 13. FINANCIAL RISK FACTORS

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

#### **Credit risk**

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

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

#### **Liquidity risk**

The Company's approach to managing liquidity risk is to ensure that it will have sufficient funds to meet liabilities when due. As at June 30, 2010, the Company had a cash balance of \$37,451,624 (December 31, 2009 - \$45,479,118) to settle current liabilities of \$5,308,018 (December 31, 2009 - \$1,672,307). Current liabilities consist of accounts payable that are predominantly due within 60 days.

#### **Interest rate risk**

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

#### **Foreign currency risk**

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

#### **Price risk**

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

#### **Sensitivity analysis**

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

- Interest income on cash balances held has been negatively affected by low prevailing interest rates. Cash and cash equivalents include deposits which earn interest at variable interest rates. It is generally expected that interest rates will rise. If interest rates were to rise by 0.50%, net loss would decrease by approximately \$70,000 for the three months ended June 30, 2010.
- The Company does not hold significant balances in foreign currencies to give rise to exposure to foreign exchange risk.
- Price risk is remote since the Company is not a producing entity.



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

### 14. INCOME TAXES

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

	For the six month periods ended	
	June 30 2010	June 30 2009
Net loss before taxes for the period	(\$15,173,458)	(\$2,467,395)
Income tax recovery at Canadian federal and provincial statutory rates	(4,552,037)	(807,293)
Change in valuation allowance	1,792,765	251,010
Permanent differences	218,781	556,283
Recovery of income taxes	(2,540,491)	-

The components of the recovery of income taxes comprise:

Future income tax recovery	(2,540,491)	-
Net income tax recovery	(2,540,491)	-

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

	June 30 2010	December 31 2009
<b>Future Income Tax Assets</b>		
Exploration & Development	\$ 4,015,000	\$ 3,917,000
Non-capital losses carried forward	5,487,000	4,113,000
Share issue expense	2,222,000	2,710,000
Long-term asset backed notes	1,067,000	1,114,000
Future income tax asset	12,791,000	11,854,000
Valuation Allowance	(12,073,000)	(10,765,000)
Net future income tax asset	718,000	1,089,000
<b>Future Income Tax Liabilities</b>		
Flow through share issuance	(4,366,409)	-
Property, plant and equipment	(718,000)	(1,089,000)
Future income tax liability	(5,084,409)	(1,089,000)
Net future income tax asset / liability recorded	(\$4,366,409)	-

For the six months ended June 30, 2010, the Company has recorded a net income tax recovery of \$2,540,491 (2009 - nil) and a valuation allowance in respect of tax losses and other attributes valued at \$12,073,000 (December 31, 2009 - \$10,765,000).

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

### **15. RELATED PARTY TRANSACTIONS**

During the three and six month periods ended June 30, 2010 McChip Resources Inc., a related party controlled by a director and a shareholder, paid \$12,000 and \$24,000 (2009 – \$18,000 and \$36,000) respectively to the Company. The payments were in relation to lease and operating costs. Cost recoveries were included in office and general expense and were in the normal course of business and are measured at the cost amount, which is the consideration established and agreed to between the related parties.

### **16. NET LOSS PER SHARE**

Net loss per share is calculated using the weighted average number of common shares outstanding during the three and six month periods ended June 30, 2010. No effect has been given to the potential exercise of share options, subscription receipts and warrants in the calculation of fully diluted loss per share as the effect would be anti-dilutive. The weighted average number of common shares outstanding for the three and six months ended June 30, 2010 was 342,934,199 and 342,925,083 (2009 – 255,306,463 and 244,279,442).

### **17. CONTINGENCIES AND COMMITMENTS**

The current term of the lease of office space expires in October, 2010. The lease has been renewed for a five year period ending October 2015 and the Company is committed to annual lease payments of \$146,100 plus operating costs.

The Company holds a surface rights commercial land lease with the Qikiqtani Inuit Association (the "QIA") covering an estimated surface area of approximately 10,567 hectares on Baffin Island, Nunavut ("Land Lease"). The Company currently pays rent annually in the amount of \$633,600 in August. The current lease term expires on October 31, 2010 and the Company will be negotiating with the QIA, the renewal of the QIA lease prior to expiry. The terms of the Land Lease provide that the Company must post financial security from time to time for future estimated costs of abandonment and reclamation activities on Inuit owned land. The Company has provided financial security to the QIA in the form of an irrevocable letter of credit. In the third quarter of 2009, the letter of credit was increased by \$10.3 million. The \$16.5 million letter of credit is recorded on the balance sheet as restricted cash.

### **18. COMPARATIVE INFORMATION**

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