



## North American **Palladium** Ltd.

### **Management's Discussion and Analysis of Financial Results First Quarter 2006**

The following is Management's Discussion and Analysis of the financial condition and results of operations to enable a reader to assess material changes in financial condition and results of operations for the three month period ended March 31, 2006, compared to those of the respective period in prior years. This Management's Discussion and Analysis covers the most recently completed quarter and has been prepared as of May 5, 2006. This Management's Discussion and Analysis is intended to supplement and complement the unaudited consolidated financial statements and notes thereto for the three months ended March 31, 2006 (collectively, the "Financial Statements"). You are encouraged to review the Financial Statements and the most recent audited annual financial statements, Management's Discussion and Analysis included in the 2005 Annual Report, in conjunction with your review of this Management's Discussion and Analysis.

#### **About Forward-Looking Statements**

Securities laws encourage companies to disclose forward-looking information so that investors can obtain a better understanding of the company's future prospects and make informed investment decisions. This MD&A contains forward-looking statements about our objectives, plans, strategies, financial condition and results of operations. Forward-looking statements may include words such as "estimated", "progressing", "expect", "will", "continue", "believe" and other similar expressions are intended to identify forward-looking statements. All such forward-looking statements are made pursuant to the "safe harbor" provisions of the United States Private Securities Litigation Reform Act of 1995 and any applicable Canadian securities legislation, including the *Securities Act* (Ontario).

It is important to note that: (1) unless otherwise indicated, forward-looking statements indicate our expectations as at May 5, 2006; (2) our actual results may differ materially from our expectations if known and unknown risks or uncertainties affect our business, or if estimates or assumptions prove inaccurate; (3) we cannot guarantee that any forward-looking statement will materialize and, accordingly, you are cautioned not to place undue reliance on these forward-looking statements; and (4) we disclaim any intention and assume no obligation to update or revise any forward-looking statement even if new information becomes available, as a result of future events or for any other reason.

In making the forward-looking statements in this MD&A, the Company has applied several material assumptions, including but not limited to, the assumption that market fundamentals will result in increased palladium demand and prices, the integrated operation of the underground mine with the open pit mine are viable operationally and economically and plans for sustainable recoveries from the Lac des Iles mine, for further explorations at the Lac des Iles mine and for exploration in Finland can proceed as expected. Other assumptions are discussed throughout this MD&A and, in particular, in “Critical Accounting Estimates” and “Risks and Uncertainties”.

Important factors that could cause actual results to differ materially from those expressed or implied by such forward-looking statements include among others metal price volatility, economic and political events affecting metal supply and demand, fluctuations in ore grade, ore tonnes milled, geological, technical, mining or processing problems and future production. For a more comprehensive review of risk factors, please refer to the Company’s most recent Annual Report under “Management’s Discussion and Analysis of Financial Results” and Annual Information Form under “Risk Factors” on file with the U.S. Securities and Exchange Commission and Canadian securities regulatory authorities.

### **Overview and Strategic Activities**

North American Palladium Ltd. (the “Company”) operates the Lac des Iles mine located 85 km northwest of Thunder Bay, Ontario. The mine is Canada’s only primary producer of platinum group metals (“PGM”) and contains one of the largest open pit bulk mineable palladium reserves in the world. In addition to palladium, the Company earns substantial revenue from by-product nickel, platinum, gold and copper. Palladium’s primary use continues to be in the auto industry where it is an important component in controlling exhaust emissions as mandated by stringent hydrocarbon emission standards for cars, light trucks and SUVs, particularly in the United States, Europe and Japan. In addition, palladium is consumed in the dental, electronics, jewelry and chemical sectors.

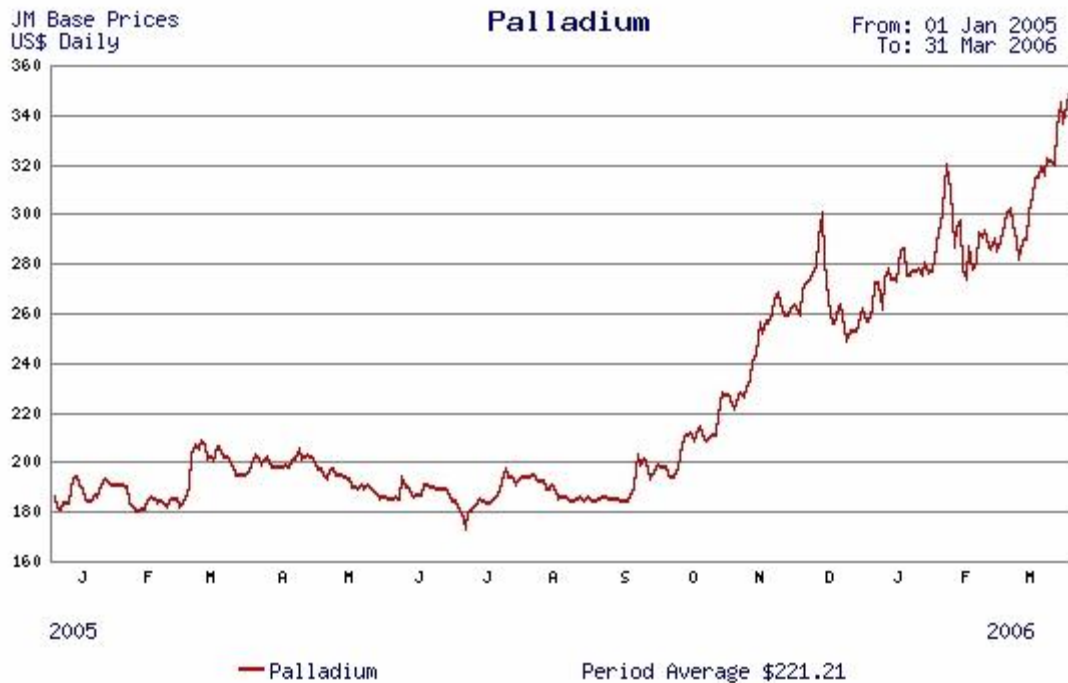
The Company commenced the development of an underground mine at its Lac des Iles operation in the second quarter of 2004. The underground mine development is focused on the Main High Grade Zone below the ultimate open pit depth. Capital costs for the underground development are estimated at \$40 million for direct and indirect costs and working capital. Mining equipment accounts for an additional \$12 million of capital costs and the Company is financing this equipment through a vendor lease program. At the time of writing, the underground mine has progressed to the 5155m level (approximately 155 metres below surface) with one stope in production and two others progressing towards production in the near term.

At March 31, 2006, the underground mine operations achieved commercial production, by delivering an average of 80% of the expected commercial production target of 2,000 tonnes per day for thirty consecutive days ending March 31, 2006.

On October 18, 2005, the Company announced that it had entered into a letter of intent to form a joint venture with Gold Fields Limited to further explore and develop a mining operation at the Arctic Platinum Project (“APP”) located in Finland (see press release dated October 18 2005). The APP includes several advanced stage PGM Projects. The Company has been granted an option to earn up to a 50% interest and, in certain circumstances, a 60% interest in APP and will become the project operator. In order to exercise the option, the Company must spend US\$12.5 million, complete a feasibility study and make a production decision, as well as paying Gold Fields up to US\$45 million (for a 60% interest) through the issuance of the Company’s common shares (approximately 9.2 million shares) on or before August 31, 2008. The formal agreement governing the joint venture was signed on March 24, 2006.

The Company announced on September 29, 2005, that the shareholders of URSA Major Minerals Incorporated (“URSA”) approved the option and joint venture agreement on the Shakespeare nickel, copper, PGM property located near Sudbury, Ontario and the Company paid \$1.5 million to URSA to complete its option earn-in. The property is proposed to be a 60% North American Palladium, 40% URSA Joint Venture with the Company becoming the operator upon successful completion of a viable feasibility study and arranging financing for commercial production. In March 2006, URSA presented to the Company the completed feasibility study which contemplates an open-pit mine and 4,500 tonne per day concentrator. The Company and URSA are currently evaluating opportunities to reduce the estimated capital costs of the project and URSA has engaged Golder Associates Limited to manage the permitting process of the proposed mine site.

Currently, the Company is delivering and selling all of its palladium production into the spot market with one or more commodity dealers and manufacturers. The Company expects the improvement in the palladium price to continue (first quarter 2006 ending price of US\$330 per ounce, in comparison to US\$190 per ounce average during the first quarter of 2005), and is optimistic that the demand for palladium will continue to improve given the strong global fundamentals for PGM’s.



Source: Johnson Matthey

#### Production Statistics

	Three months ended March 31	
	2006 *	2005
<b>Palladium (oz)</b>	<b>47,015</b>	52,572
Payable Palladium (oz)	<b>42,784</b>	47,924
Platinum (oz)	<b>4,698</b>	5,382
Gold (oz)	<b>3,615</b>	4,131
Copper (lbs)	<b>1,213,394</b>	1,562,040
Nickel (lbs)	<b>616,037</b>	778,200
Ore Tonnes Milled	<b>1,125,710</b>	1,156,322
Ore Tonnes Mined – Underground	<b>103,545</b>	--
Ore Tonnes Mined – Open Pit	<b>1,075,597</b>	1,268,875
Waste Tonnes Mined – Open Pit	<b>2,366,675</b>	3,341,433
Waste Strip Ratio – Open Pit	<b>2.20:1</b>	2.63:1

\* Metal production and tonnes milled includes production from the underground pre-production that has not been recorded as revenue, but offset against the underground capital development costs. Metal production from the underground pre-production included 9,004 oz of palladium and other associated by-product metals.

### Selected Annual Information

(thousands of dollars except per share amounts)	2005	2004	2003
Revenue from metal sales	92,606	185,204	192,141
Net income (loss)	(53,611)	(92,110)	38,378
Basic net income (loss) per share (dollars)	(1.03)	(1.79)	0.76
Cash dividends declared	nil	nil	nil
Operating cash flow	(39,000)	52,059	59,802
Total assets	238,357	297,897	393,692
Long-term debt, including current portion	46,272	50,171	58,761

### Summary of Quarterly Results

(thousands of dollars except per share amounts)	2004			2005				2006
	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Revenue from metal sales	51,712	45,154	35,182	26,206	23,544	17,247	25,609	31,492
Net income (loss)	2,834	6,598	(107,663)	(7,736)	(15,228)	(19,610)	(11,037)	(4,141)
Basic net income (loss) per share	0.06	0.13	(2.09)	(0.15)	(0.29)	(0.37)	(0.21)	(0.08)
Fully diluted net income (loss) per share	0.06	0.13	(2.09)	(0.15)	(0.29)	(0.38)	(0.21)	(0.08)

### Results of Operations

The Company realized a net loss for the three months ended March 31, 2006 of \$4,141,000 (\$0.08 per share) on revenues of \$31,492,000 compared to the net loss of \$7,736,000 (\$0.15 per share) on revenues of \$26,206,000 for the corresponding period in 2005 and to 2005 fourth quarter's revenues of \$25,609,000 and loss of \$11,037,000 (\$0.21 per share). The improvement in operating results is primarily due to increased revenue being realized from the higher average prices for palladium and all by-product metals during the quarter.

Production for the first quarter of 2006 was approximately 47,000 ounces of palladium (which includes 9,004 ounces of pre-production from the underground mine) with an average palladium head grade of 1.79 g/t. This was an improvement from the fourth quarter's palladium production of 37,000, ounces but below the previous year's production of 53,000 ounces during the same period. Operating disruptions with the primary crusher (which led to having to utilize a crushing contractor) and the #1 conveyor

resulted in a decrease in mill throughput and availability. In addition, in early February, as previously reported, there was seepage at the tailings management facility (“TMF”), which resulted in the closure of the mill for five days. Despite these problems, mill availability during the first quarter of 2006 improved to 86.0% from 80.8% during the fourth quarter of 2005 and was marginally below the 86.3% in the comparative period of 2005.

While production for the first quarter of 2006 declined 29% compared to the year earlier period, the strengthening metals market resulted in an increase in revenue with palladium being recognized at the quoted March 31st price of US\$330 per ounce. Palladium production sold to third-party smelters takes up to six months from time of receipt at the smelter to settle the final delivery and pricing. The price adjustment relating to palladium settled and awaiting settlement in first quarter of 2006 resulted in an increase of \$4,429,000 palladium revenue being recorded, mainly from fourth quarter 2005 production when revenue was recorded at US\$256 which has now been adjusted to the quoted March 31, 2006 market price of US\$330. The adjustment for mark to market in the corresponding period in 2005 was \$326,000. During the first quarter of 2005 revenue on 6,403 ounces was recorded at the floor of US\$325 under the Palladium Sales Contract, while the remainder was recorded at the quoted market price of US\$199 for a blended average price of US\$224 per ounce. By-product metal production reflected a similar volume decline as palladium production, however, the strengthening metals market resulted in improved prices and revenues for all the by-product metals.

In the first quarter of 2006, the underground development was completed with commercial production being achieved as of March 31, 2006. During the quarter 103,545 tonnes of ore was extracted from the underground mine, with 89,387 tonnes being processed by the mill at an average grade of 3.90 grams per tonne, producing 9,004 ounces of palladium using the average recovery rate of 72.7% achieved by the mill for the quarter. In addition, the underground operations produced 555 ounces of platinum, 685 ounces of gold, 138,702 pounds of copper and 63,279 pounds of nickel. As required under Canadian GAAP, revenue, net of associated production costs, from the first quarter’s underground mine production (the pre-production period) has been recorded as a reduction in the underground development costs as all costs associated with this development work were capitalized in the quarter. Beginning in April, production from the underground mine will be recognized as revenue and the associated development costs will be amortized over the expected life of the underground mine.

Production costs including overheads but excluding non cash amortization were \$24,311,000 during the first quarter of 2006, compared to \$23,233,000 during the first quarter of 2005. Unit costs to produce palladium (production costs including overhead and smelter treatment, refining and freight costs), net of by-product metal revenues and royalties, increased to US\$329 per ounce in the first quarter of 2006 compared to US\$253 per ounce in the first quarter of 2005, and lower than the fourth quarter 2005 cash cost per ounce of US\$417. The increase in unit cash costs is attributable to the 29% decline in metals production as well as the costs incurred during the first quarter 2006 to resolve the TMF seepage issues, repairing the primary crusher and the #1 conveyor as well as some

unplanned maintenance on the hydraulic shovels. In addition, there continues to be ongoing upward pressure on operating costs, particularly power, diesel fuel and tires.

During the first quarter of 2006, the mill processed 1,125,710 tonnes of ore or an average of 12,508 tonnes per day, with a palladium grade of 1.79 grams per tonne producing 47,015 ounces of palladium at a recovery rate of 72.7%. These production numbers include the throughput from the underground referred to above, which is not classified as revenue in the quarter. This compares to the first quarter of 2005, when the mill processed 1,156,322 tonnes of ore or an average of 12,848 tonnes per day with a palladium grade of 1.91 grams per tonne producing 52,572 ounces of palladium at a recovery rate of 74.0%. The mill production for the quarter was impacted by some residual problems associated with the primary crusher, as well as the TMF seepage in February, which resulted in five days of lost production. These issues have been resolved and expectations are that production will return to normal historical levels.

Non-cash amortization decreased to \$3,608,000 in the first quarter of 2006 compared to \$4,729,000 million in the first quarter of 2005. The lower amortization amount is attributable to the 29% decrease in palladium production. In addition in the first quarter of 2006, \$1,444,000 of amortization was capitalized to crushed and broken ore and concentrate inventories, compared to nil in the corresponding period of 2005 because of the then low price of palladium.

For the first quarter of 2006, there was a \$3,467,000 loss from mining operations compared to a \$8,991,000 loss in the corresponding period a year earlier, primarily due to improved metal prices. Included in the 2006 results was \$1,408,000 spent on exploration on the APP as the Company began activities in Finland. Costs associated with the APP project will be charged to earnings as they occur until it is determined that the project can be economically developed, at which time they will begin to be capitalized.

Other income and expense, which includes interest income and expense, and foreign exchange gains and losses, was an expense of \$1,397,000 in the first quarter of 2006 compared to an expense of \$210,000 in the first quarter of 2005. In the current year there was a foreign exchange loss of \$281,000 compared to a loss of \$64,000 in 2005. The foreign exchange loss relates primarily to the Company's US dollar denominated credit facilities as a result of the temporary weakening of the Canadian dollar at quarter end. In the first quarter of 2006, the Company incurred interest expense on long-term debt of \$695,000 compared to \$635,000 in the first quarter of 2005. The increased interest expense in the current year reflects the increase in interest rates year-over-year. During the first quarter, the Company wrote-off the costs associated with its expiring base shelf-prospectus totaling \$504,000. Interest income for the first quarter declined to \$83,000 from \$489,000 in the first quarter of 2005 as a result of a lower average cash position in 2006.

## **Liquidity and Capital Resources**

Cash used by operations (prior to changes in non-cash working capital) was \$362,000 in the first quarter of 2006, compared to cash used in operations of \$3,963,000 in the first quarter of 2005. The improvement in operating cash flow was attributable to the improved metals pricing in the quarter. Changes in non-cash working capital consumed \$10,082,000 in the first quarter of 2006 as compared to providing \$14,873,000 in first quarter of 2005. Palladium awaiting settlement increased to 72,624 ounces, which includes underground pre-production, at March 31, 2006 compared to 65,905 ounces at December 31, 2005. The increase in the physical quantity of metal in the concentrate awaiting settlement combined with the stronger metal prices resulted in a 32% increase in the value of concentrate awaiting settlement during the first quarter 2006 of \$12,039,000. After allowing for non-cash working capital changes, cash used by operations was \$10,444,000 in the first quarter of 2006, compared to cash provided of \$10,910,000 in the first quarter of 2005.

Investing activities required \$7,435,000 of cash in the first quarter of 2006 the majority of which was attributable to the ongoing underground mine development, which commenced in mid 2004 and which reached commercial production as of March 31, 2006. This compares with \$6,069,000 of net investing activities in corresponding period for 2005.

On March 29<sup>th</sup>, the Company closed the first tranche (Series 1) of a private placement of convertible notes which provided US\$35,000,000 in gross proceeds to the Company. The transaction was with two purchasers, Kaiser Francis Oil Company (“KFOC), the Company’s largest shareholder, and an institutional investor. The convertible notes bear an interest rate of 6.5% and mature October 1, 2008. The notes can be converted into common shares of the Company at US\$12.18 (2,873,563 common shares) and also have attached warrants which can be exercised to purchase 1,436,782 common shares at US\$13.48 until March 29, 2010. Under the terms of the private placement, the Company has the right to sell to KFOC up to US\$13,500,000 principal amount of convertible notes on or before June 30, 2006, the proceeds of which will be used to repay the loan outstanding under the KFOC standby loan facility. The terms of the convertible notes are more fully described in note 6 of the accompanying Financial Statements.

As at March 31, 2006, the Company had cash and cash equivalents of \$36,290,000. With the expectation of production improving throughout the year and returning to its historical levels, and the current commodity prices continuing, the Company believes it has sufficient capital resources to fund its operations in 2006.

### Contractual Obligations

as at March 31, 2006 (thousands of dollars)	Payments Due by Period			
	Total	1 Year	1 – 3 Years	4 – 5 Years
Senior credit facility	\$ 22,672	\$ 6,668	\$ 13,337	\$ 2,667
Kaiser-Francis credit facility *	15,756	15,756	--	--

Capital lease obligations	7,963	2,283	4,020	1,660
Operating leases	871	579	289	3
Convertible notes payable (US\$35 m)	40,934	--	40,934	--
Other purchase obligations	5,439	5,439	--	--
	\$ 93,635	\$ 30,725	\$ 58,580	\$ 4,330

There are no payments due after five years.

\* As previously noted, this credit facility can, at the Company's option, be repaid by issuing US\$13,500 of convertible notes on or before June 30, 2006.

## Related Party Transactions

The Company engaged Louis J. Fox in November 1999 to provide services in connection with the negotiation of palladium end-user supply contracts, project capital financing, smelting and refining agreements, metals price forecasting and marketing other metals. The services agreement was negotiated at arms-length prior to Mr. Fox becoming a director of the Company. The Palladium Sales Contract expired on June 30, 2005 and no further fees were payable to Mr. Fox in connection with this contract after this date. In the first quarter of 2005, Mr. Fox received \$121,000 under this contract.

In December 2001, KFOC provided a US\$20,000,000 non-revolving credit facility to finance the Company's working capital requirements. In the second quarter of 2004, the KFOC credit facility was extended to June 30, 2006. Interest is based on the 30-day LIBOR plus 2.50% and the stand-by fee is 0.125% per annum. The amount paid to KFOC for interest and standby fee in the first quarter of 2006 was \$277,000 (\$172,000 for the comparable period in 2005). KFOC holds approximately 50% of the common shares of the Company.

On March 29, 2006, KFOC was one of two purchasers of the Series 1 convertible notes issued by the Company. KFOC subscribed for 50% of the notes and attached warrants issued by the Company, paying US\$17,500,000 of gross proceeds to the Company.

## Management's Outlook

There is no apparent pattern of variability or seasonality affecting the Company's operations. The principal drivers of the Company's performance are its monthly production of PGM and by-product metals from its Lac des Iles mine and the corresponding world spot prices of such metals.

During the first quarter of 2006, North American Palladium completed the development of the underground mine, by achieving commercial production in March 2006. With the underground mine commencing commercial production in April it is now expected to provide 2,000 tonnes per day, which will be combined with the expected open pit production of 13,000 tonnes per day. Despite the operating issues and the lower than expected performance for the first quarter, palladium production in 2006 is expected to improve as the average head grade returns to historical levels with the blending of the underground and open pit ores. With the expected improvement in head grade and

improved mill performance, palladium cash costs per ounce should be significantly lower in 2006 than that experienced in 2005.

The Company's aggressive exploration program will continue in 2006, with approximately \$15.0 million being allocated to exploration activities. The main focus will be on the APP in Finland. Drilling commenced in late February with the drilling results to be incorporated into a re-scoping study which has commenced. The Company will focus on the further definition of the Offset High Grade Zone at Lac des Iles and grassroots projects such as the Shebandowan project. In addition, the pursuit of quality Ni/PGM opportunities will continue to be a key strategy.

The PGM markets continue to benefit from strong global fundamentals. The Company believes that these fundamentals will lead to increased metal demand, and continued strength in palladium prices.

### **Critical Accounting Estimates**

Critical accounting estimates represent estimates that are highly uncertain and for which changes in those estimates could materially impact the Company's financial statements. The following accounting estimates are critical:

(a) **Impairment assessments of long-lived assets**

Each year, the Company reviews the mining plan for the remaining life of mine. Significant changes in the mine plan can occur as a result of mining experience, new discoveries, changes in mining methods and rates, process changes, investments in new equipment and technology, metal prices and other factors. Based on year-end mineral reserves and the current mine plan, the Company reviews annually its accounting estimates and makes adjustments accordingly.

The Company assesses long-lived assets for recoverability whenever events or changes in circumstances indicates their carrying values may not be recoverable. When the carrying value of a long-lived asset is less than its net recoverable value as determined on an undiscounted basis, an impairment loss is recognized to the extent that its fair value, measured as the discounted cash flows over the life of the asset.

Assumptions underlying future cash flow estimates are subject to risk and uncertainty. Any differences between significant assumptions and market conditions such as metal prices, exchange rates, recoverable metal, and/or the Company's operating performance could have a material effect on the Company's ability to recover the carrying amounts of its long-lived assets resulting in possible additional impairment changes.

(b) **Amortization of mining interests**

The Company amortizes a large portion of its mining interests using the unit of production method based on proven and probable reserves. As a result of the asset impairment charge recorded in 2004, the unit of production amortization rate in 2005 reduced by approximately 49%. Changes in reserve estimates are calculated periodically and could affect amortization expense prospectively.

(c) **Forward Metal Sales and Metal Price Swap Contracts**

North American Palladium has in place a hedge policy to allow for managing the Company's exposure to market metal prices, particularly its platinum, gold, nickel and copper price exposure. North American Palladium uses fixed-price forward platinum sales contracts and cash settled gold, nickel and copper price swap contracts to insulate its earnings and cash flows from changes in these metal prices. These contracts allow the Company to sell its platinum to credit-worthy metal dealers at a fixed price under the forward sales contract. In the case of gold, nickel and copper, the Company receives a fixed metal price in exchange for paying the floating price received under its physical sales contracts to acceptable counterparts under the metal price swap contracts. In October 2005, the Company made a decision to unwind various by-product metal hedges namely, platinum, gold, and nickel through the buy-back of forward sales or cash settled metal price swaps. This decision was taken to reposition the Company's exposure to its by-product metals in advance of the expected increase in metal production at Lac des Iles in 2006. As at March 31, 2006, the Company does not have any forward sales or metal swap contracts in place.

**Non-GAAP Measure**

North American Palladium has included in this document a non-GAAP performance measure for cash cost per ounce. This non-GAAP measure does not have any standardized meaning nor is it necessarily comparable with similar measures presented by other companies. North American Palladium believes that certain investors use this information to evaluate the Company's performance. This data is intended to provide additional information and should not be considered in isolation or as a substitute for measures of performance prepared in accordance with GAAP. The Company receives U.S. dollars from the sale of its metal production, with its production costs being principally in Canadian dollars. The strengthening of the Canadian dollar in relation to the U.S. dollar will have a negative impact on the Company's cash cost per ounce as calculated in U.S. dollars.

**Reconciliation of Cash Cost per Ounce to Financial Statements**

<b>Three Months Ended March 31</b>		
(thousands of dollars except per ounce amounts)	<b>2006</b>	<b>2005</b>
<b>Production costs including overhead</b>	\$ 24,311	\$ 23,233
<b>Smelter treatment, refining and freight costs</b>	2,714	4,673
	<b>27,025</b>	27,906
<b>Less: by-product metal revenue</b>	(14,717)	(14,010)
	<b>12,308</b>	13,896
<b>Divided by ounces of palladium</b>	<b>32,057</b>	45,354
<b>Cash cost per ounce (C\$)</b>	<b>384</b>	306
<b>C\$ exchange rate</b>	<b>1.1671</b>	1.2097
<b>Cash cost per ounce (US\$)</b>	<b>329</b>	253

**Other Information**

Additional information regarding the Company is included in the Company's Annual Information Form and Annual Report on Form 40-F which are filed with the Canadian securities regulators and the United States Securities and Exchange Commission, respectively. A copy of the Company's Annual Information Form is posted on the SEDAR website at [www.sedar.com](http://www.sedar.com). A copy of the Annual Report or Form 40-F can be obtained from the United States Securities and Exchange Commission's website at [www.sec.gov](http://www.sec.gov).

### **Outstanding Share Data**

The following securities are outstanding as of May 5, 2006:

- (i) 52,340,873 common shares of the Company outstanding;
- (ii) stock options outstanding pursuant to the 1995 Corporate Stock Option Plan entitling the holders to acquire 446,384 common shares of the Company at an average strike price of \$8.60;
- (iii) US\$35 million principal amount of convertible notes (the "Series 1 Notes") outstanding;
- (iv) common share purchase warrants which can be exercised to purchase 1,436,782 common shares at US\$13.48 until March 29, 2010;
- (v) unit warrants which can be exercised to purchase up to US\$10 million principal amount of convertible notes (the "Series 3 Notes").

The Series 1 Notes can be converted into common shares of the Company at US\$12.18 (2,873,563 common shares). The Series 1 Notes bear interest at a rate of 6.5% per annum payable bi-monthly, commencing on June 1, 2006. The Series 1 Notes are repayable in nine equal installments commencing on June 1, 2007. The interest payments and/or repayment amounts may be paid to each purchaser, at such purchaser's option, in any combination of cash and/or common shares. Common shares issued for interest payments or in repayment of Series 1 Notes will be issued at a 10% discount from the weighted average trading price of the common shares on the American Stock Exchange for the five consecutive trading days immediately prior to applicable payment date.

The Series 3 Notes, if issued, will have the same terms as the Series 1 Notes except that the interest payments will commence on the first interest payment date after the issuance of such note and the principal repayments will commence on the first interest payment that is at least twelve months after the date of issuance of such note.

### **Risks and Uncertainties**

The price of palladium is the most significant factor influencing the profitability of the Company. Currently, sales of palladium account for approximately 50% of the Company's revenue. Many factors influence the price of palladium, including global supply and demand, speculative activities, international political and economic conditions and production levels and costs in other PGM producing countries, particularly Russia and

South Africa. The possible development of a substitute alloy or synthetic material, which has catalytic characteristics similar to platinum group metals, may result in a future decrease in demand for palladium and platinum.

Currency fluctuations may affect cash flow since production currently is sold in United States dollars, whereas the Company's administration, operating and exploration expenses are incurred in Canadian dollars. As a result, changes in the exchange rate between Canadian and United States dollars can affect revenue and profitability.

The Company is dependent on one mine for its metal production. The business of mining is generally subject to risks and hazards, including environmental hazards, industrial accidents, metallurgical and other processing problems, unusual and unexpected rock formations, pit slope failures, flooding and periodic interruptions due to inclement weather conditions or other acts of nature, mechanical equipment and facility performance problems and the availability of materials and equipment. These risks could result in damage to, or destruction of, the Company's properties or production facilities, personal injury or death, environmental damage, delays in mining, monetary losses and possible legal liability. Although the Company maintains insurance in respect of the mining operations that is within ranges of coverage consistent with industry practice, such insurance may not provide coverage of all the risks associated with mining. Currently the Company sells all of its concentrate to one smelting firm under a contract that expires on September 30, 2006. Management believes it will be successful in negotiating an extension and/or new agreement with the smelting firm, but cannot guarantee that this will occur.