



Management's Discussion and Analysis

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 year ended December 31, 2006, compared to those of the respective periods in prior years. All amounts are in Canadian dollars unless otherwise noted. This Management's Discussion and Analysis has been prepared as of March 7, 2007. This Management's Discussion and Analysis is intended to supplement and complement the audited consolidated financial statements and notes thereto for the year ended December 31, 2006 (collectively, the "Financial Statements"). You are encouraged to review the Financial Statements 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 within the meaning of the "safe harbor" provisions of the United States Private Securities Litigation Reform Act of 1995 and applicable Canadian securities legislation, including the Securities Act (Ontario), relating to our objectives, plans, strategies, financial condition and results of operations. Forward-looking statements may include words such as "estimated", "progressing", "may", "expect", "will", "continue", "believe" and other similar expressions, as they relate to the Company or its management, all of which are intended to identify forward-looking statements.

It is important to note that: (1) unless otherwise indicated, forward-looking statements indicate our expectations as at March 20, 2007 (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: (1) market fundamentals will result in increased palladium demand and prices and sustained by-product metal demand and prices; (2) the integrated operation of the underground mine and the open pit mine remain viable operationally and economically; (3) financing is available on reasonable terms; (4) expectations for blended mill feed head grade and mill performance will proceed as expected; (5) new mine plan scenarios will be viable operationally and economically; and (6) plans for improved mill production, for sustainable recoveries from the Lac des Iles mine, for further exploration at the Lac des Iles mine and surrounding region, and for exploration in Finland 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: (1) metal price volatility; (2) economic and political events affecting metal supply and demand; (3) fluctuations in ore grade or ore tonnes milled; (4) geological, technical, mining or processing problems; (5) future production; and (6) changes in the



life-of-mine plan and/or the ultimate pit design. For a more comprehensive review of risk factors, please refer to the “Risks and Uncertainties” section of 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 provincial securities regulatory authorities. The Company disclaims any obligation to update or revise any forward-looking statements whether as a result of new information, events or otherwise. Readers are cautioned not to put undue reliance on these forward-looking statements.

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”). 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, which was completed in March 2006. Capital costs for the underground development were \$36 million for direct and indirect costs (on budget). Mining equipment accounted for an additional \$10 million of capital costs. The Company is financing this equipment through a vendor lease program. The Company began full production from the underground operations on April 1, 2006 and effective this date the production from the underground operations has been reflected in the operating results of the Company. The underground production for the nine months averaged 2,245 tonnes per day with an average palladium grade of 5.96 grams per tonne (during the fourth quarter 2,418 tonnes per day, with an average palladium grade of 6.42 grams per tonne), which was in line with expectations.

In 2006 the Company continued its exploration of the Offset High Grade Zone at the Lac des Iles mine. Work has now commenced on an exploration drift from the current underground development to expedite further definition drilling in the zone, in order to better define and increase confidence within the upper portion of the Offset High Grade Zone. This Zone remains open along strike and down dip.

On December 3, 2003, the Company entered into an option and joint venture agreement with Inco Limited on the Haines-Conacher properties, located approximately 100 km southwest of the Lac des Iles Mine in Ontario, which surrounds the past producing Shebandowan mine. The agreement was amended on March 31, 2006 to include the mine.

Successive diamond drilling programs in 2005 and 2006 warrant follow up on three relatively shallow mineralized zones known as the West, Road and “D” zones. A National instrument 43-101 compliant report on resources by a third party is in progress.

Management believes that the mining and trucking of small tonnages daily of the high nickel-in-sulphide type mineralization to the Lac des Iles mill could have beneficial impacts on cash flow and life of mine projections for the Lac des Iles operation.



On October 18, 2005, the Company announced that it had entered into a letter of intent with Gold Fields Limited to further explore and develop a mining operation at the Arctic Platinum Project ("APP") located in Finland. The formal option and joint venture agreement was signed on March 24, 2006. The APP includes several advanced stage PGM Projects. The Company has been granted an option to earn up to a 50% and, in certain circumstances, a 60% interest in APP and become project operator. In order to exercise the option and create a joint venture, the Company must spend US\$12.5 million, complete a feasibility study and make a production decision as well as paying Gold Fields US\$36 million or US\$45 million to earn a 50% or 60% interest, respectively, through the issuance of the Company's common shares (approximately 7.3 million shares or 9.2 million shares as the case may be) on or before August 31, 2008.

The Company commenced work on the APP late in the first quarter of 2006. Three drills were mobilized into the Narkaus area to commence exploration and infill drilling on the Siika Kama, Kuohunki and Nutturalampi targets. Forty nine holes totalling 8,716 meters were drilled and the results were released on October 30, 2006. These results will be incorporated into the re-scoping study. At Suhanko, which was the subject of the 2005 feasibility carried out by Gold Fields, updated resource models are underway. The Company has contracted Aker Kvaerner ASA to complete the APP re-scoping study and P&E Mining Consultants Inc. to conduct the open pit designs and optimization. The Company expects the re-scoping study to be completed in the second quarter of 2007.

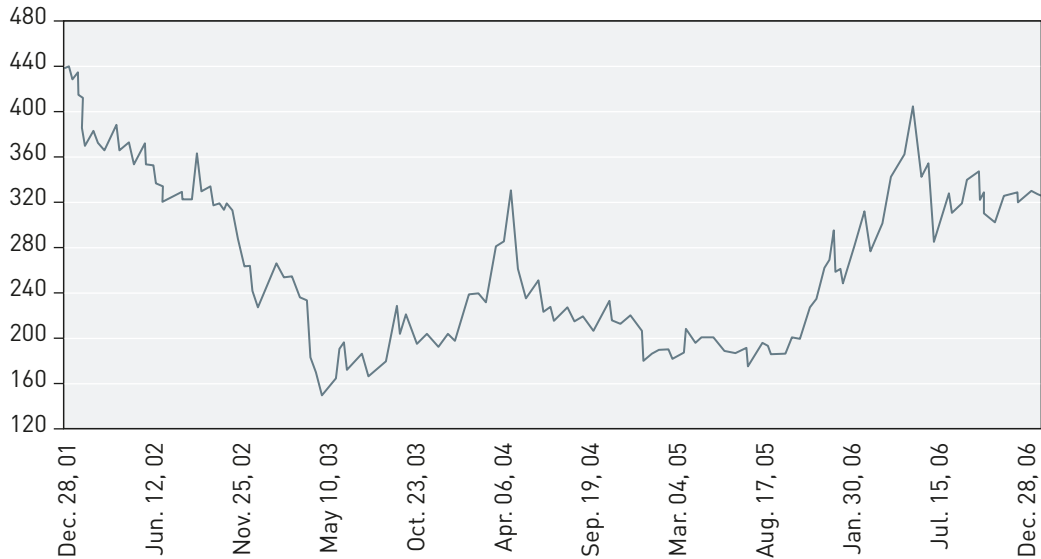
On September 29, 2005, the Company entered into an option and joint venture agreement with URSA Major Minerals Incorporated ("URSA") on the Shakespeare nickel, copper, PGM property located near Sudbury, Ontario. In March 2006, URSA presented to the Company the completed feasibility study on a contemplated open-pit mine and 4,500 tonne per day concentrator. Although the feasibility study was positive, the rate of return indicated in the study did not meet the Company's investment criteria and, consequently, the Company terminated its involvement in the project in September 2006.

Currently, the Company is delivering and selling all of its palladium production into the spot market with one or more commodity dealers and manufacturers. For 2006 the Company realized a weighted average cash price of US\$319 per ounce on its delivery of palladium into the spot market. The Company expects the improvement in the palladium price to continue (average price of US\$320 per ounce for 2006, in comparison to US\$201 per ounce average for 2005) with the forecasted increasing global demand for palladium, the wide market price spread between platinum and palladium and increasing demand for palladium jewelry, all of which should accelerate consumption of palladium.



London Palladium Cash Price US\$/Troy Oz

Dec. 28, 2001 - Dec. 28, 2006



Last: \$323.50 Dec. 28, 06

The Company does not currently have any commodity or foreign exchange hedging or other derivative instruments. In prior periods the Company hedged the price of its palladium production under a contract with a major automotive manufacturer (the "Palladium Sales Contract"). The hedge price was based on the monthly average spot price for palladium with a floor price of US\$325 per ounce for 100% of production. The Palladium Sales Contract for physical deliveries expired on June 30, 2005. For 2005 all palladium production (except 6,403 ounces delivered under the Palladium Sales Contract) was delivered into either a sales contract with a leading catalytic converter manufacturer or a global commodity dealer. These contracts provided for pricing at either the monthly average price in the month prior to delivery of palladium or the spot price on the day of delivery. These contracts expired on December 31, 2005 and currently the Company is selling its monthly palladium production into the spot market.

In 2004, the Company adopted a hedging strategy for a portion of its by-product metal production that it implements from time to time. The objective of this hedging strategy was to reduce the variability of cash flow associated with revenues derived from the sale of nickel, platinum, gold and copper. The Company used fixed-price forward platinum 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 production to credit-worthy metal dealers at a fixed price under the forward sales contract. In the case of gold, nickel and copper, the Company received 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. During 2006, the Company chose to sell into the spot market and not hedge any of its by-product metal production.



Production Statistics

Year Ended December 31	2006	2005	2004
Palladium (oz)	237,338	177,167	308,931
Payable Palladium (oz)	217,022	161,469	281,743
Platinum (oz)	22,308	18,833	25,128
Gold (oz)	17,237	14,308	25,679
Copper (lbs)	5,155,588	5,514,670	7,836,183
Nickel (lbs)	2,721,042	2,353,227	4,320,970
Ore Tonnes Milled	4,570,926	4,780,599	5,298,544
Ore Tonnes Mined – Underground	721,179	-	-
Ore Tonnes Mined – Open Pit	3,926,911	3,705,555	4,574,134
Waste Tonnes Mined – Open Pit	8,888,037	11,619,658	12,275,889
Waste Strip Ratio	2.26:1	3.14:1	2.68:1

Selected Annual Information

(thousands of Canadian dollars, except per share amounts)	2006	2005	2004
Revenue from metal sales	\$ 159,200	\$ 92,606	\$ 185,204
Net loss	(34,109)	(53,611)	(92,110)
Less:			
Exploration expense	(11,831)	(7,927)	(2,479)
Amortization	(30,103)	(18,297)	(36,296)
Accretion of convertible notes	(10,090)	-	-
Write-down of mining interests	-	-	(108,000)
Other non-cash items ¹	(4,231)	2,546	127
Net income (loss) before exploration and non-cash items ¹	22,146	(29,933)	54,538
Basic net loss per share (dollars)	(0.65)	(1.03)	(1.79)
Cash dividends declared	nil	nil	nil
Cash flow from operations prior to changes in non-cash working capital	10,315	(37,860)	52,059
Total assets	265,157	238,357	297,897
Long-term debt, including current portion	\$ 74,906	\$ 46,272	\$ 50,171

Summary of Quarterly Results

(thousands of Canadian dollars, except per share amounts)	2005				2006			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Revenue from metal sales	26,206	23,544	17,247	25,609	31,492	35,519	41,431	50,758
Cash flow from operations, prior to changes in non-cash working capital *	(3,963)	(9,900)	(17,105)	(6,892)	(362)	(3,105)	2,758	11,024
Exploration expense	843	1,662	1,721	3,701	2,024	2,659	2,576	4,572
Net loss	(7,736)	(15,228)	(19,610)	(11,037)	(4,141)	(11,325)	(11,247)	(7,396)
Net loss per share	(0.15)	(0.29)	(0.37)	(0.21)	(0.08)	(0.22)	(0.21)	(0.14)
Fully diluted net loss per share	(0.15)	(0.29)	(0.38)	(0.21)	(0.08)	(0.22)	(0.21)	(0.14)

* includes exploration expense



RESULTS OF OPERATIONS

The Company realized a net loss in 2006 of \$34.1 million or \$0.65 per share on revenues of \$159.2 million compared to the net loss of \$53.6 million or \$1.03 per share on revenues of \$92.6 million in 2005. The improvement in operating results compared to 2005, is primarily due to increased revenue being realized from higher palladium (34% increase) and by-product production, as well as the higher average prices for palladium and all by-product metals. Revenue in 2006 from the sale of palladium was \$75.6 million compared to \$43.4 million in 2005. For 2006 revenue from palladium sales was realized at an average of US\$319 per ounce in comparison to the average of US\$230 in 2005. This improvement supports the Company's expectations regarding the improvement in the palladium price. The Company believes that the increasing global demand for palladium, the wide market price spread between platinum and palladium and increasing demand for palladium jewelry should accelerate consumption of palladium and expects that this improvement will be sustained and continue upward. Palladium production sold to a third-party smelter takes six months from the time of receipt at the smelter to settle the final delivery and pricing.

By-product metal pricing also continued to strengthen throughout 2006. However, this was offset to some degree by the stronger Canadian dollar. Revenue from by-product metal sales increased by 70% to \$83.6 million in 2006 compared to \$49.2 million in 2005 reflecting increased production, as well as the improved price levels for all by-products. Realized prices for by-product metals in 2006 compared to 2005, were platinum at US\$1,140 per ounce (2005 - US\$815), nickel at US\$11.68 per lb (2005 - US\$6.60), gold at US\$610 (2005 - US\$442) and copper at US\$3.02 per lb (2005 - US\$1.50). Partially offsetting the higher realized metal prices was a strengthening Canadian dollar, which averaged US\$0.88 in 2006, compared to US\$0.83 in 2005.

During 2006, the mill processed 4,570,926 tonnes of ore or an average of 12,523 tonnes per day, producing 237,338 ounces of palladium compared to 4,780,599 tonnes of ore or an average of 13,097 tonnes per day, producing 177,167 ounces of palladium in 2005. In 2006, the average palladium head grade was 2.18 grams per tonne compared to 1.66 grams per tonne in 2005. The improved head grade can be attributed to production from the underground mine, which commenced commercial production in April 2006. During the nine months ended December 31, 2006, 617,634 tonnes of ore were extracted from the underground mine, with an average palladium grade of 5.96 grams per tonne. For 2006, the palladium recoveries were 74.0% as compared to 69.6% in 2005. This improvement was achieved through continued progress in improving the throughput and availability of the mill by addressing and systematically resolving previously identified issues. These included flotation circuit improvements, implementation of proactive preventative maintenance programs, changes made to the mill flow sheet, reagent mix and the quality of recycled water.

Total production costs for 2006 of \$112.5 million increased from the \$99.3 million in the prior year. However, unit cash costs to produce palladium (production costs including overhead and smelter treatment, refining and freight costs), net of by-product metal revenues and royalties, decreased to US\$201 per ounce in 2006 compared to US\$359 per ounce in 2005. The decrease in unit cash costs was caused by a combination of improved ore grades and metal recoveries, which led to a 34% increase in palladium production to 237,338 ounces in 2006 compared to 177,167 ounces in 2005, combined with the 70% increase in revenue from by-product metals. In addition, throughout the year there was a decrease



in the open pit waste to ore strip ratio of 2.26:1 in 2006, compared to 3.14:1 in 2005. However, there continues to be pressure on costs, particularly steel, tires, power and diesel fuel.

In 2004, the Company included in income from mining operations \$7.1 million it received as an interim payment against a claim filed with its insurance company relating to losses incurred in connection with the failure of the primary crusher in 2002. There were no further settlements received in 2005 or 2006. However, the Company is continuing to pursue the balance of the insurance claim and will record any additional recovery in income if and when received.

The Company reviews and evaluates its long-lived assets for impairment when events or changes in circumstances indicate that the related carrying amounts may not be recoverable. Impairment is considered to exist if total estimated future undiscounted cash flows are less than the carrying amount of the asset. Future cash flows are estimated based on quantities of recoverable minerals, expected palladium and other commodity prices and expected foreign exchange rates (considering current, historical and expected future prices and foreign exchange rates and related factors), production levels and cash costs of production and future capital and reclamation expenditures, all based on life-of-mine plans and projections. The term "recoverable minerals" refers to the estimated amount of palladium and other commodities that will be obtained from proven and probable reserves after taking into account losses during mining, ore processing and concentrate treatment.

During the first quarter of 2006, the ultimate pit design implemented in 2004 was changed to an interim pit design that addressed previously disclosed south pit wall instability issues. The Company engaged an independent geotechnical consultant to review the slope stability issues and his recommendations were used by P&E Mining Consultants in designing a reconfigured open pit. The Company then commenced a detailed review of its life-of-mine operating plan for the Lac des Iles mine. As a result of the review a revised mine plan has been adopted and the carrying value of the Company's mining interests have been reviewed based upon this revised mine plan. The Company's management believes an impairment charge and a corresponding reduction in the carrying value of its mining interests is not required.

The impairment test completed during the fourth quarter of 2004, resulted in a non-cash charge of \$108.0 million (net of tax - \$103.4 million or \$2.01 per share) to write down the carrying value of mining interests. An assessment of impairment was required as a result of changes in key assumptions (refer to note 5(c) to the Financial Statements) which were primarily affected by a continuation of low palladium prices and a weakening U.S. dollar.

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 charges.

Non-cash amortization increased to \$30.1 million in 2006 compared to \$18.3 million in 2005. The higher amortization is attributable to the 34% increase in palladium production. As well, amortization of the investment in the underground development costs commenced with commercial production in April 2006. The asset impairment charge that was recorded in 2004, lowered the book value of mining interests and resulted in a reduction in the unit of production amortization rate for subsequent years.

Exploration expense increased to \$11.8 million in 2006 compared to \$7.9 million in 2005. Included in 2006 is \$6.8 million spent on exploration on the APP as the Company continues its activities in Finland.



Costs associated with the APP project are being charged to exploration expense as they occur. If it is determined that the project can be economically developed, these costs will begin to be capitalized. In addition, the Company continued its exploration of the Offset High Grade Zone at the Lac des Iles mine, where in November, work commenced on the exploration drift in order to expedite further definition drilling in this zone in the first quarter of 2007, as well as the Shebandowan nickel, copper project.

For 2006, there was an \$18.1 million loss from mining operations compared to a \$55.8 million loss from mining operations in 2005. This improvement in earnings was mainly attributable to the 34% increase in production, as well as the improved pricing for palladium, where sales was realized at an average of US\$319 per ounce for 2006, in comparison to the 2005 average of US\$230. In addition there were similar increases in the volumes of by-product metals, along with the improved pricing for all by-products.

Other income and expense, which includes interest income and expense, accretion expense on the convertible note and foreign exchange gains and losses, was an expense of \$17.4 million in 2006 compared to \$0.7 million in 2005. The increase in 2006 was mainly due to the recognition of non-cash accretion expenses of \$10.1 million relating to the convertible notes that were issued in 2006. For 2006, the Company incurred interest expense on long-term debt of \$5.0 million compared to \$2.5 million in 2005. The increased interest expense in 2006 was attributable to the increase in interest rates year-over-year as well as the additional interest expense incurred on the convertible notes that commenced in April, 2006. To date, this expense of \$2.0 million has been settled with the issue of common shares (242,158 shares), pursuant to the elections made by the convertible note holders. In 2006 there was a foreign exchange loss of \$1.8 million compared to a gain of \$0.3 million in 2005. The foreign exchange loss relates primarily to the Company's US dollar denominated credit facilities and the convertible notes. Interest income for 2006 declined to \$0.8 million from \$1.6 million in 2005 as a result of a lower average cash position in 2006.

For the year ended December 31, 2006, the Company reported a net loss of \$34.1 million or \$0.65 per share compared to net loss of \$53.6 million or \$1.03 per share for the year ended December 31, 2005.

LIQUIDITY AND CAPITAL RESOURCES

Cash provided by operations (prior to changes in non-cash working capital) was \$10.3 million in 2006, compared to cash used in operations of \$37.9 million in 2005. The \$48.2 million improvement in operating cash flow¹ was mainly attributable to the 34% increase in palladium production, as well as the improved pricing for palladium. In addition there were similar increases in the volumes of by-product metals, along with the improved pricing for all by-products that resulted in a 70% increase in by-product revenues. This improved revenue more than offset increased operating costs. The increase in costs was mainly due to the start up of commercial levels of production for the underground operation and the expensing of the related operating costs, beginning in April 2006. Changes in non-cash working capital required \$44.1 million of cash in the 2006 as compared to providing \$29.6 million in 2005. Palladium awaiting settlement increased to 129,496 ounces at December 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 higher palladium and by-product prices used to value the concentrate awaiting settlement resulted in a \$44.6 million (119%) increase in the value of concentrate awaiting settlement. After allowing for non-cash working capital changes, cash used by operations was \$33.8 million in 2006 compared to \$8.3 million in 2005.

Investing activities required \$19.4 million of cash in 2006, the majority of which was attributable to the ongoing lateral development for the underground mine and the 2006 expansion of the tailings



management facilities. This compares with \$35.4 million of net investing activities in 2005, where the two major projects undertaken were the upgrade of the tailings management facility for \$5.8 million and the ongoing underground mine development, which required \$23.9 million excluding \$6.5 million of mining equipment purchased under capital leases.

The Company's debt position increased to \$74.9 million at December 31, 2006 compared to \$46.3 million at December 31, 2005, due to the issuance of US\$48.5 million principal amount of convertible notes in 2006.

On March 29, 2006, the Company closed the first tranche (Series I notes) of a private placement of US\$35.0 million principal amount of convertible notes. The transaction was with two purchasers, Kaiser Francis Oil Company ("KFOC), the Company's largest shareholder, and an institutional investor. The Series I convertible notes bear interest at 6.5% per annum and mature on August 1, 2008. The principal amount of 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 had the right to sell to KFOC up to US\$13.5 million principal amount of convertible note on or before June 30, 2006, the proceeds of which were to be used to repay the loan outstanding under the KFOC standby credit facility. The Company exercised this right and on June 23, 2006 issued US\$13.5 million principal amount of Series II convertible note to KFOC to repay the outstanding credit facility. The Series II note bears interest at 6.5%, matures on December 1, 2008 and is convertible into 1,108,374 common shares of the Company at US\$12.18 per share. Warrants exercisable to purchase 554,187 common shares of the Company were issued with the Series II note, with each warrant being exercisable to purchase one common share at US\$13.48 per share until June 23, 2010.

The purchasers of the Series I notes had the option to acquire an additional US\$10.0 million aggregate principal amount of convertible notes (Series III) on or before December 31, 2006 but elected not to exercise this option.

The Company has the right to defer any principal repayments in cash until a later principal repayment date. There is no limit on the length of the deferral, other than it cannot be deferred later than the final maturity date. The Company must give five days notice of its intention to defer. For the principal repayment due April 1, 2007 on the Series I notes, both Purchasers have indicated their intention to accept repayment in shares.

On October 12, 2006 the Company obtained from KFOC a US\$5.0 million short term working capital loan maturing December 31, 2006. The interest rate under the loan is the 30-day LIBOR plus 2.5% per annum. The Company paid a commitment fee of US\$37,500 and amounts not drawn under the loan are subject to a standby fee of 0.125% per annum. In connection with the loan, the Company granted to KFOC a first priority security interest on the inventory and receivables of the Company. On December 13, 2006 the maturity date was extended to March 31, 2007, with no other changes in terms. The Company paid a commitment fee of US\$25,000 for the extension. As at December 31, 2006, the Company had drawn down US\$5.0 million (2005 nil).

As at December 31, 2006, the Company had cash of approximately \$3.2 million (December 31, 2005 - \$15.0 million) and working capital of \$50.8 million (December 31, 2005 - \$31.5 million). The Company recognized that it would need to raise additional working capital to fund its expected operations over the next twelve months as the inventory of concentrate awaiting settlement continues to increase and as the



lateral development of the underground mine continues. To meet this need the Company entered into a platinum and palladium purchase agreement with Auramet Trading, LLC by which the Company may at its election receive advance payments not exceeding at any time, an aggregate maximum amount of US\$25.0 million.

On February 27, 2007 the Company also completed a private placement of 550,000 flow through common shares at \$11.00 per share for gross proceeds of \$6.05 million. The underwriter of the private placement was Dundee Securities Corporation which received a 6% commission. The gross proceeds will be used to expedite work on the Shebandowan Project. The Company is continuing to review various other options to raise additional funds.

CONTRACTUAL OBLIGATIONS

As at December 31, 2006 (thousands of Canadian dollars)	Payments Due by Period			
	Total	1 Year	1 – 3 Years	4 – 5 Years
Senior credit facility	\$ 17,654	\$ 6,662	\$ 10,992	\$ -
Kaiser-Francis credit facility	5,827	5,827	-	-
Capital lease obligations	6,215	2,104	3,648	463
Convertible notes payable	45,210	22,148	23,062	-
Interest obligations	2,859	1,273	1,540	46
Operating leases	4,695	1,713	2,095	887
Other purchase obligations	1,351	1,351	-	-
	<u>\$ 83,811</u>	<u>\$ 41,078</u>	<u>\$ 41,337</u>	<u>\$ 1,396</u>

There are no payments due after five years.

RELATED PARTY TRANSACTIONS

In December 2001, Kaiser-Francis provided a US\$20.0 million non-revolving credit facility to finance the Company's working capital requirements. In the second quarter of 2004, the Kaiser-Francis credit facility was extended to June 30, 2006. Interest was based on the 30-day LIBOR plus 2.50% and the stand-by fee was 0.125% per annum. The amount paid to Kaiser-Francis for interest and stand-by fee on this facility was \$0.6 million in 2006 compared to \$0.8 million in 2005. This facility was repaid on June 23, 2006 with the principal amount of the Series II convertible note issued on this date. On October 12, 2006 the Company obtained from KFOC a US\$5.0 million short term working capital loan maturing December 31, 2006. On December 13, 2006, the maturity date was extended to March 31, 2007. Interest on this new facility is based on the 30-day LIBOR plus 2.5% and the stand-by fee is 0.125% per annum. Kaiser-Francis holds approximately 50% of the common shares of the Company.

The Company engaged Louis J. Fox in November, 1999, to provide services in connection with the negotiation of palladium end-user supply contracts. The services agreement was negotiated at arms-length prior to Mr. Fox becoming a director of the Company. Mr. Fox, now a former director, received a fee in connection with the negotiations related to the Palladium Sales Contract. The amount paid to Mr. Fox in 2006 was \$nil compared to \$0.2 million in 2005. The Palladium Sales Contract expired on June 30, 2005 and no further fees are payable to Mr. Fox in connection with this contract.

FOURTH QUARTER AND 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.



Production for the fourth quarter 2006 was 73,242 ounces of palladium with an average palladium head grade of 2.52 g/t. This was an improvement on the palladium production of 59,756 ounces in the third quarter and almost double the production of 36,833 ounces in 2005 with a headgrade of 1.47 g/t, during the same period. The improved head grade can be attributed to production from the underground mine, which, commencing in April 2006, is being recognized as revenue. During the fourth quarter, the underground mine averaged 2,418 tonnes per day at an average head grade of 6.42 g/t. In addition, mill availability reached 90% during the quarter, about 10% above the same period last year, reflecting the determined efforts throughout the year to resolve the challenges, combined with the implementation of a proactive maintenance program. Overall, the net loss in the fourth quarter was \$7.4 million. This was lower than the third quarter loss of \$11.2 million, primarily due to increased revenue being realized from higher production as well as the higher average price for palladium, as well as for the by-product metals, and lower than the fourth quarter 2005 net loss of \$11.0 million again mainly due to the higher production and realized prices.

The underground mine commenced commercial production in April, 2006. The underground production for the nine months averaged 2,245 tonnes per day with an average palladium grade of 5.96 g/t (during the fourth quarter 2,418 tonnes per day, with an average palladium grade of 6.42 g/t), in line with expectations. Palladium production in 2007 is expected to continue to improve, with a full year of production from the underground and is expected to be approximately 290,000 ounces as the average blended head grade is expected to increase in line with the historical averages of the mine.

The Company's aggressive exploration program will continue in 2007, with approximately \$15.0 million being allocated to exploration activities. The main focus will continue to be on the APP in Finland with the preliminary scoping scheduled to be completed by the end of the first half of 2007. In addition, the Company will continue to focus on the further definition of the Offset High Grade Zone at Lac des Iles and projects such as the Shebandowan project. Finally, a key strategy moving forward will be to continue the pursuit of quality Ni/PGM opportunities.

The Company believes that the surplus pressures of the early 2000's have abated and the market has moved into a demand driven pricing environment. This is being evidenced by increasing global catalytic demand fueled by growing low tolerance emission legislation and rapid technological advances which exploit pricing differentials between palladium and platinum. With Russian exports more transparent and demand in the four major consumption areas increasing, demand likely will outpace supply over the long term.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Critical accounting policies generally include estimates that are highly uncertain and for which changes in those estimates could materially impact the Company's financial statements. The following accounting policies are considered 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, mineral reserve estimates based on assessed geological and engineering analysis, new discoveries, changes in mining methods and production rates, process changes, investments in new equipment and technology, metal prices, estimates of future production costs and other factors. Based on year-end ore 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 on an annual basis. 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.

(c) Forward Metal Sales and Metal Price Swap Contracts

In the fourth quarter of 2003, the Company updated its hedge policy to allow for managing its exposure to market metal prices, particularly its platinum, gold, nickel and copper price exposure. With the adoption of this policy and from time to time, the Company will enter into forward metal sales or cash settled swaps to establish fixed metal prices in order to manage metal price volatility.

The Company 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.

(d) Revenue Recognition

Revenue from the sale of palladium and by-product metals is recognized net of royalties upon the delivery of concentrate to the smelter, which is when title transfers and the rights and obligations of ownership pass. The Company's metals are sold under contracts that provide for final prices that are determined by quoted market prices in a period subsequent to the date of sale. Variations from the provisionally priced sales are recognized as revenue adjustments as they occur until the price is finalized. Provisional pricing is based upon market prices in the month of recognition. Concentrate awaiting settlement at the smelter is net of estimated treatment and refining costs.

(e) Mine Restoration Obligation

Asset retirement obligations are recognized when incurred and recorded as liabilities at fair value. The amount of the liability is subject to re-measurement at each reporting period. The liability is accreted over time through periodic charges to earnings. In addition, the asset retirement obligation is capitalized as part of mining interests and amortized over the estimated life of the mine. The estimated asset



retirement obligation may change materially based on future changes in operations, costs of reclamation and closure activities, and regulatory requirements.

RECENT ACCOUNTING PRONOUNCEMENTS ISSUED BUT NOT YET ADOPTED

Financial Instruments - Recognition and Measurement

In January 2005, the CICA released new Handbook Section 3855, "Financial Instruments – Recognition and Measurement", effective for annual and interim periods beginning on or after October 1, 2006. This new section establishes standards for the recognition and measurement of all financial instruments, provides a characteristics-based definition of a derivative financial instrument, provides criteria to be used to determine when a financial instrument should be recognized, and provides criteria to be used when a financial instrument is to be extinguished. The Company has not yet determined the effect that these new standards will have on its financial position and results of operations.

The CICA has also reissued section 3860 of the CICA Handbook as section 3861, Financial Instruments – Disclosure and Presentation, which establishes standards for presentation of financial instruments and non financial derivatives and identifies the information that should be disclosed about them. The revisions come into effect for fiscal years beginning on or after October 1, 2006. The Company has not yet determined the affect these new standards will have on its financial position and results of operations.

COMPREHENSIVE INCOME AND EQUITY

In January 2005, the CICA released new Handbook Section 1530, "Comprehensive Income", and Section 3251, "Equity", effective for annual and interim periods beginning on or after October 1, 2006. Section 1530 establishes standards for reporting comprehensive income. These standards require that an enterprise present comprehensive income and its components, in a separate financial statement that is displayed with the same prominence as other financial statements. Section 3251 establishes standards for the presentation of equity and changes in equity during the reporting period. The requirements in Section 3251 are in addition to Section 1530. The Company has not yet determined the effect that these new standards will have on its financial position and results of operations.

HEDGES

In January 2005, the CICA released new Handbook Section 3865, "Hedges", effective for annual and interim periods beginning on or after October 1, 2006. This new section establishes standards for when and how hedge accounting may be applied. Hedge accounting is optional. The Company does not expect the adoption of this standard to have a material impact on its financial position and results of operations.

¹ NON-GAAP MEASURE

North American Palladium has included in this document non-GAAP performance measures for operating cash flows from operations prior to changes in non cash working capital, net income (loss) before exploration and non cash items and cash cost per ounce¹. Management uses these measurements as a basis for determining results from the Lac des Iles mining activities. These non-GAAP measures do not have any standardized meaning nor are they 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.



Reconciliation of Cash Cost per Ounce¹ to Financial Statements

Year Ended December 31

(thousands of dollars, except per ounce amounts)	2006	2005
Production costs including overhead	\$ 112,458	\$ 99,322
Smelter treatment, refining and freight costs	15,438	15,777
	127,896	115,099
Less: by-product metal revenue	(83,556)	(49,208)
	44,340	65,891
Divided by ounces of palladium	193,067	154,196
Cash cost per ounce ¹ (Cdn\$)	230	427
Cdn\$ exchange rate	1.14072	1.19062
Cash cost per ounce ¹ (US\$)	201	359

Reconciliation of Cash Flow from Operations, Prior to Changes in Non Cash Working Capital (Operating Cash Flow¹) to Financial Statements

Year Ended December 31

(thousands of dollars)	2006	2005	2004
Operating Cash Flow ¹	\$ 10,315	\$ (37,860)	\$ 52,059
Changes in Non-cash Working Capital	(44,104)	29,587	29,731
Cash Provided by Operating Activities	\$ (33,789)	\$ (8,273)	\$ 81,790

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. 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.

OUTSTANDING SHARE DATA

As of March 20, 2007 there were 53,595,398 common shares of the Company outstanding and options outstanding pursuant to the 1995 Corporate Stock Option Plan entitling holders thereof to acquire 313,633 common shares of the Company at an average strike price of \$7.91.

RISKS AND UNCERTAINTIES

The price of palladium is the most significant factor influencing the profitability of the Company. In 2006, sales of palladium accounted for approximately 48% (2005 – approximately 47%) 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 mainly 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 April 30, 2007. 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.

DISCLOSURE CONTROLS AND PROCEDURES

Management is responsible for the information disclosed in this management's discussion and analysis and has in place the appropriate information systems, procedures and controls to ensure that information used internally by management and disclosed externally is, in all material respects, complete and reliable. As of the financial year ended December 31, 2006, an evaluation was carried out under the supervision of, and with the participation of, the Company's management, including the Chief Executive Officer and Chief Financial Officer, on the effectiveness of the Company's disclosure controls and procedures. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the design and operation of these disclosure controls and procedures were effective as of December 31, 2006 to provide reasonable assurance that material information relating to the Company and its consolidated subsidiaries would be made known to them by others within those entities.

INTERNAL CONTROL OVER FINANCIAL REPORTING

As at the financial year ended December 31, 2006, the Chief Executive Officer and Chief Financial Officer certify that they have designed, or caused to be designed under their supervision, internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the financial statements for external purposes in accordance with GAAP.

There have been no changes in the Company's internal control over the financial reporting that occurred during the most recent interim period ended December 31, 2006 that have materially affected or are reasonably likely to materially affect, the Company's internal control over financial reporting.

For the Company, as with many other public companies not required to comply under SEC regulations in the United States, this requirement is the first major impact of Sarbanes Oxley regulations as they become adopted in Canada. Historically, we have been confident in our ability to report accurate financial information on a timely basis and we were comfortable that the control environment that existed to enable this reporting was sufficient and appropriate. The real impact of this requirement then is not to change our controls or the control environment but to require us to document the various forms that these controls take and provide a basis for measuring the effectiveness of these controls through regular audits that will need to begin in 2007. Our external auditors have not conducted a review or audit of the controls or the documentation relating to this initiative.



Forward-Looking Statements – Certain statements included in this 2006 annual report, financial statements for the year ended December 31, 2006 and management’s discussion and analysis are forward-looking statements which are made pursuant to the “safe harbor” provisions of the United States Private Securities Litigation Reform Act of 1995. They include estimates and statements that describe the Company’s future plans, objectives and goals, including words to the effect that the Company or management expects a stated condition or result to occur. When used herein, words such as “continue”, “proposed”, “appears”, “indicating”, “predicting”, “estimate”, “expect”, “plan”, “should”, “may”, “will” and other similar expressions are intended to identify forward-looking statements. In particular statements relating to the estimated future metal prices, cash flows, expenses, capital costs, ore production, mine life, financing, construction and commissioning, and exploration prospects are forward-looking statements. Such forward-looking statements involve inherent risks and uncertainties and are subject to factors, many of which are beyond our control, that may cause actual results or performance to differ materially from those currently anticipated in such statements. 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, changes in the US/Cdn dollar exchange rate, economic and political events affecting metal supply and demand, fluctuations in ore grade, ore tonnes milled, geological, technical, mining or processing problems, recoverability of metals, future profitability and production, availability of financing on acceptable terms and unexpected problems during the development, construction and start-up phases of the underground mine. 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 Canada provincial securities regulatory authorities. The Company disclaims any obligation to update or revise any forward-looking statements whether as a result of new information, events or otherwise. Readers are cautioned not to put undue reliance on these forward-looking statements.