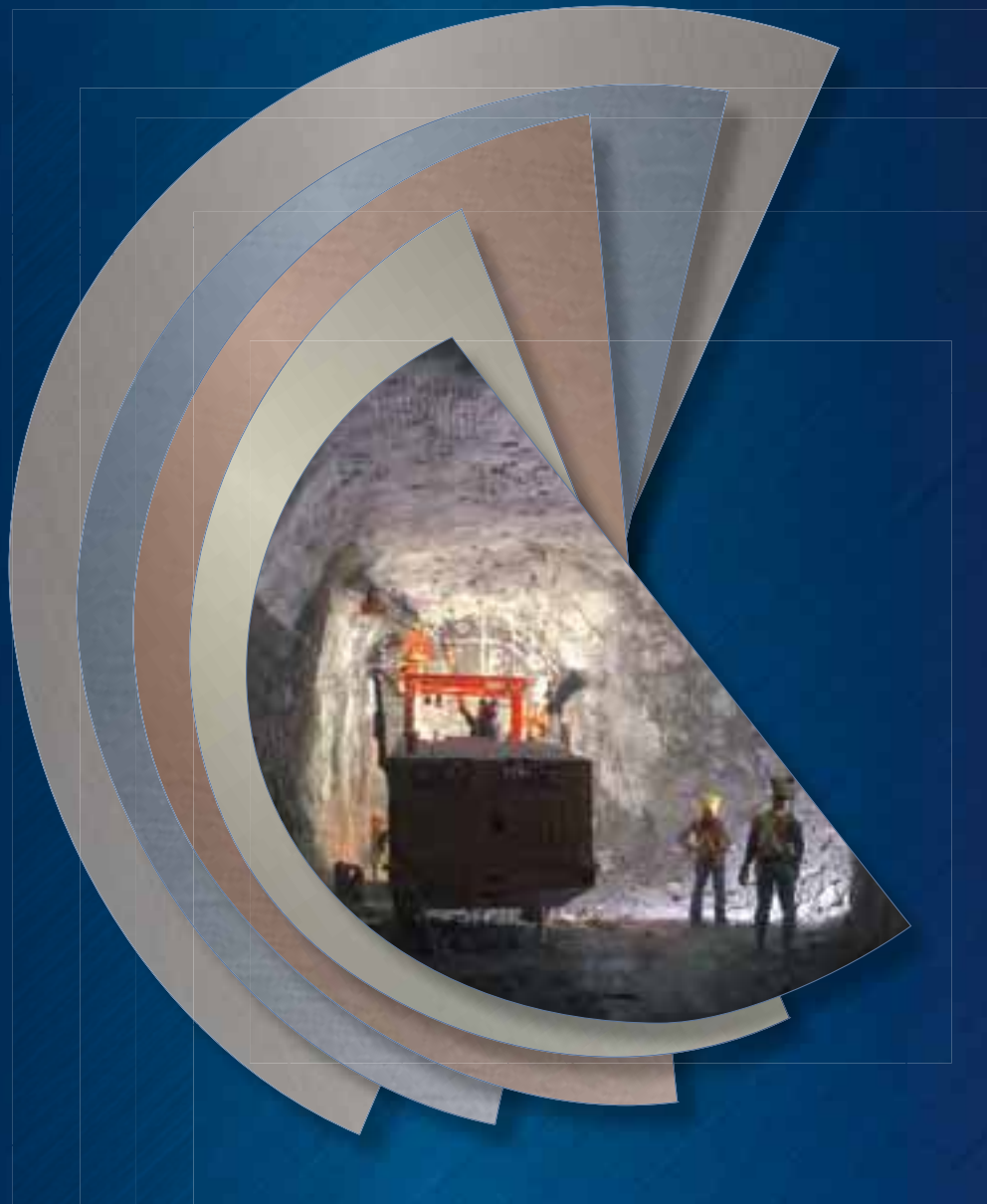




North American Palladium Ltd.

Annual Report 2007



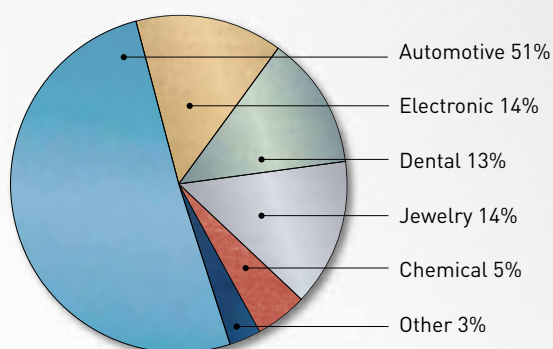
take a look
at us now

North American Palladium Ltd.

The Company's core palladium business at the Lac des Iles mine is strengthened by a significant contribution from platinum, nickel, gold and copper by-product metals. The Company is actively progressing its three

advanced exploration projects: the Offset High Grade Zone at its Lac des Iles mine, the Shebandowan West Project, located approximately 100 kilometers from the mine, and the Arctic Platinum Project in Finland.

2007 Estimated Palladium Demand
by Industry (8,226 Koz)*

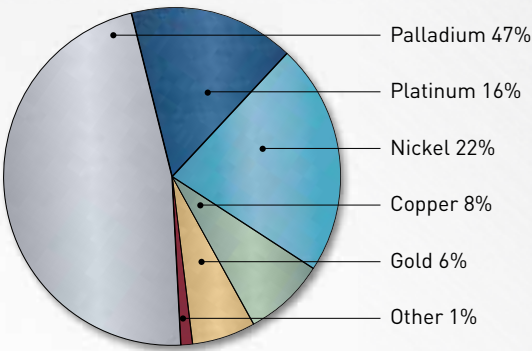


Worldwide demand for palladium has been increasing since the early 1970's, largely driven by the automotive sector due to increasing emission controls and the legislative requirement for catalytic converters.

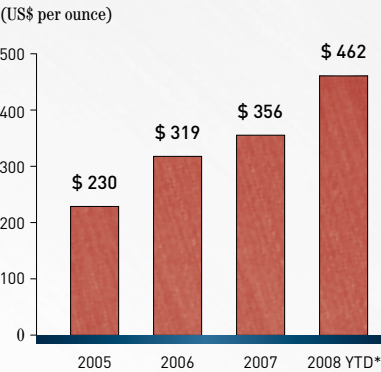
* CPM Group, 2007 Platinum Year Book

North American Palladium is Canada's largest producer of Platinum Group Metals

2007 Revenue by Commodity

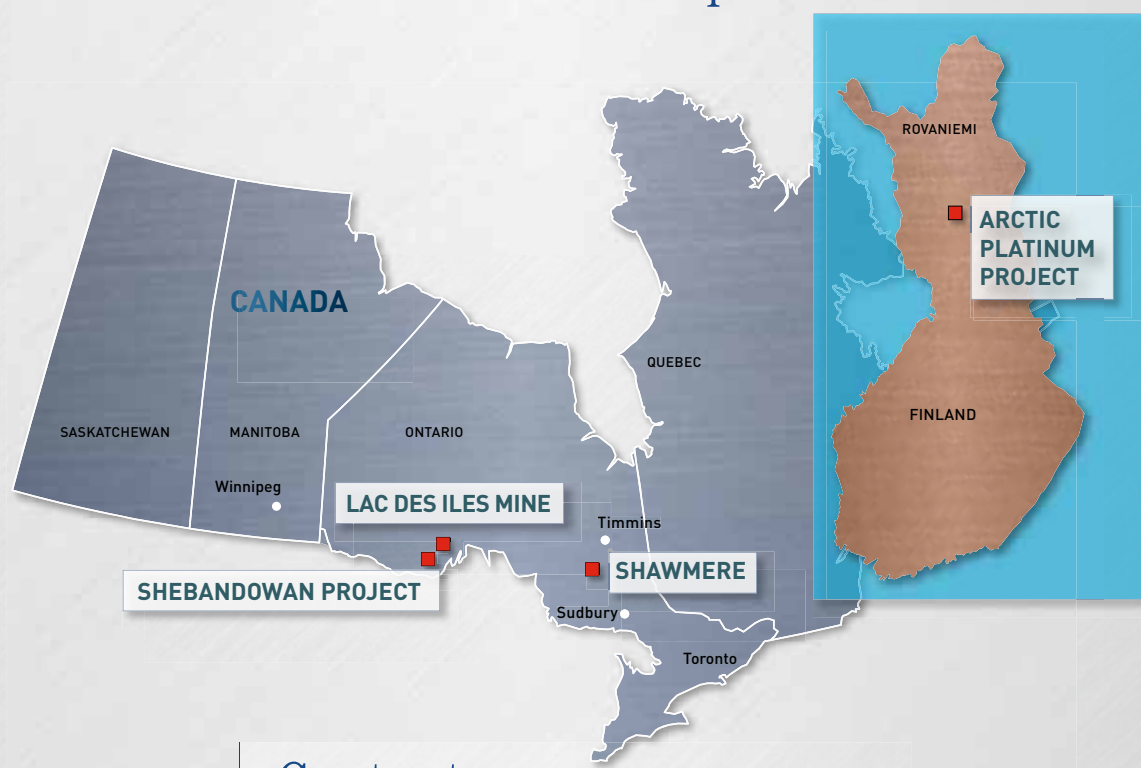


Recorded Palladium Prices



* Based on the average month end London Metal Exchange afternoon price fix for the two months ended February 29, 2008

Location Map



Contents

Notable Achievements in 2007	3
President's Message to Shareholders	5
Lac des Iles Mine	11
Advanced Exploration	
Offset High Grade Zone	15
Shebandowan West Project	17
Arctic Platinum Project	19
Exploration	21
Social Responsibility	22
Management's Discussion and Analysis	24
Auditors' Report to the Shareholders	49
Consolidated Financial Statements	50
Notes to Consolidated Financial Statements	54
Corporate Information	IBC

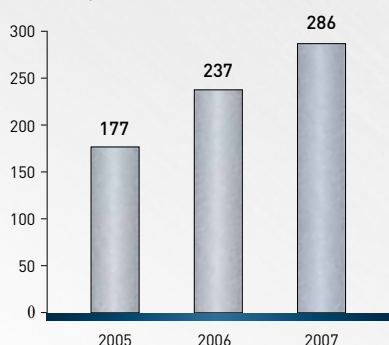
Notable Achievements 2007

- Revenue increased by 23% to \$195.9 million compared to 2006.
- Completed financing for gross proceeds of US \$85.9 million.
- Palladium production at Lac des Iles mine increased 21% to 286,334 ounces compared to 2006.
- Operating cash flow¹ of \$46.8 million increased by \$36.9 million compared to 2006.

2007 Highlights

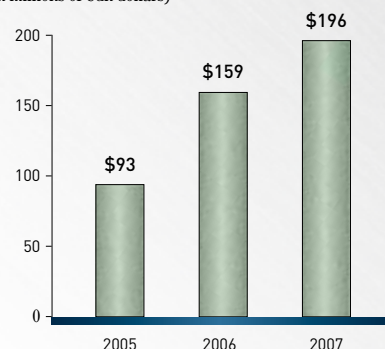
Palladium Production

(in 000's ounces)

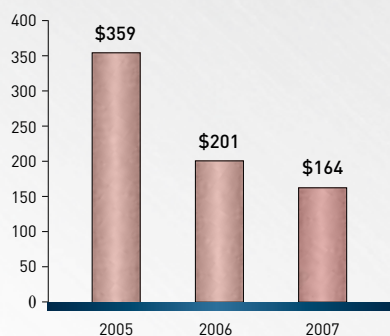


Revenue

(in millions of Cdn dollars)

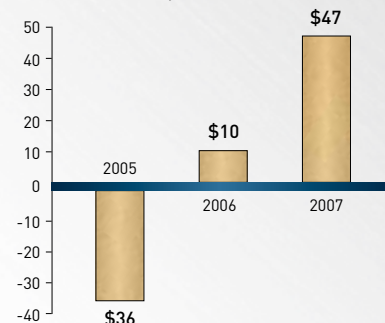


Palladium US\$ Cash Cost per Ounce¹ (net of by-products)



Operating Cash Flow¹

(in millions of Cdn dollars)



¹ Non-GAAP measure. Reference should be made to footnote 1 on page 46

Lac des Iles Mine



Mine Operations near Thunder Bay, Ontario

President's Message to Shareholders



Jim Excell
President and Chief Executive Officer

We are pleased with the financial success we achieved in 2007. In addition to increasing revenues by 23% to \$195.9 million, we improved operating cash flow¹ to \$46.8 million compared to \$9.9 million in 2006.

For North American Palladium, 2007 has been a year of significant progress. We achieved consistent production at our Lac des Iles open pit and underground mine and this resulted in the third highest mill tonnage ever processed at the mine. We also achieved near record production for all metals including palladium, platinum, gold, nickel and copper. In addition, our growth pipeline projects were all advanced during the year.

One of our primary goals last year was to achieve strong and consistent production results from our Lac des Iles mine. I am pleased to report that we accomplished this objective, with the total production of 286,334 ounces palladium surpassing the prior year's production by 21%. This past year was the first full year of production for our underground mining operation and the mine has performed very well. We processed approximately 2,200 tonnes per day from the underground mine at an average grade of 6.0 grams per tonne and this was blended with open pit ore to average 2.39 grams per tonne mill head grade.

In 2007, our cash cost per ounce of palladium produced, net of by-product credits, decreased to \$164 per ounce versus a cash cost of \$201 per ounce in 2006.

Last year, 69% of our annual revenues were generated by our precious metals' production of palladium, platinum and gold. During the year, the prices of palladium, platinum and gold increased by 12%, 37% and 32% respectively. Up to April 11th, 2008, palladium prices have increased by a further 26%.

In light of these favourable PGM market conditions, management is assessing the economic viability of a southern extension of the Lac des Iles open pit, which could prolong the open pit mine life by an additional two to three years.

We are pleased with the financial success we achieved in 2007. In addition to increasing revenues by 23% to \$195.9 million, we improved operating cash flow¹ to \$46.8 million compared to \$9.9 million in 2006. We retired debt of \$35.8 million, which is a 48% reduction over the previous year.

¹ This is a non-GAAP measure. Please see footnote 1 on page 46 of this Annual Report

North American Palladium, Toronto Office Team



From left to right, back row: Margaret Johnston, Reijo Uusitalo, Bill Glover, Linda Armstrong, Nillie Tang; front row: Dave Passfield, Fraser Sinclair, Jim Excell, Trent Mell.

A significant accomplishment in 2007 was the completion of a US\$86 million financing led by Merrill Lynch & Co., with BMO Capital Markets, HSBC Securities (Canada) Inc. and UBS Securities Canada Inc. as co-managers. This financing puts the Company on a secure financial footing from which it can continue to advance growth projects.

We also completed a NI 43-101 mineral resource estimate for our Shebandowan West Project, located approximately 100 kilometres southwest of our existing mine operations at Lac des Iles. Further exploration and geotechnical drilling were undertaken and we completed our joint venture earn-in requirements with Vale Inco in December. We have now retained SRK Consulting to prepare a preliminary economic assessment of a ramp-accessed mine scenario for Shebandowan West. The results of this report are expected in the second quarter of 2008. If plans proceed as anticipated, we envision commencing production at Shebandowan West in late 2009.

Another advanced project is the Offset High Grade Zone (OHGZ), located at the Lac des Iles mine. The OHGZ is the extension of the current underground resource that has been displaced by a fault action. A resource (largely inferred) in excess of 15 million tonnes has been identified. During 2007 a major drilling program was completed on the upper portion of the OHGZ. Results from this drilling are currently being added to the resource model and should allow upgrading of the confidence level of the resource. Micon and Nordmin have been hired to complete a scoping study to determine optimal mining methods for the OHGZ. This work is proceeding well and we expect it to be completed in the second quarter of 2008.

We are constantly examining PGM and nickel-copper opportunities, particularly with regard to the exploration potential around our Lac des Iles mine, the Haines and Conacher properties surrounding the Shebandowan West project and at various satellite deposits at the APP.

Our third and largest project, an earn-in joint venture with Gold Fields, is the Arctic Platinum Project (APP) in Finland. The APP is an advanced stage nickel-copper-PGM exploration project located approximately 60 kilometres south of the city of Rovaniemi, Finland. To date, three areas of the APP have been explored by North American Palladium: the Suhanko deposits, the Narkaus deposits and the Penikat deposits. In 2007, the Company completed a scoping study, conducted exploration in the Narkaus area, and commissioned a feasibility study.

At Suhanko, we recently completed bulk sampling of the Ahmavaara and Konttijarvi deposits in advance of pilot plant test work. A program of bench scale metallurgical testing was also completed in support of the pilot plant test program. We are currently providing ore samples for testing to a variety of smelters that we identified for our concentrate marketing strategy.



A decade ago, automobiles accounted for 29% of total palladium use. Today, demand for palladium in autos accounts for 51% of total supply. Increasingly stringent regulations for clean air and the reduction of exhaust emissions will translate into increased demand for PGMs.

The feasibility study is progressing well and we remain confident that the Company will be in a position to satisfy the conditions of the earn-in joint venture by September 2008.

Exploration is another important part of the Company's growth strategy. We are constantly examining PGM and nickel-copper opportunities, particularly with regard to the exploration potential around our Lac des Iles mine, the Haines and Conacher properties surrounding the Shebandowan West project and at various satellite deposits at the APP. From time-to-time, the Company enters into agreements with mining companies or individual prospectors to assess the prospective nature of their land holdings. We believe that we are particularly well-positioned to partner with other PGM exploration companies in Canada, given the existing infrastructure at the Lac des Iles mine and the Company's years of experience in mining nickel-copper-PGM deposits. We also believe that the consolidation in the nickel industry may result in joint venture or acquisition opportunities

for the Company as the major nickel companies seek to shed non-core assets.

We recently staked a number of claims at our Shawmere Project, located approximately 110 kilometres southwest of Timmins, Ontario, Canada. The Company intends to conduct a grassroots exploration program to assess the area's potential for hosting nickel-copper-PGM mineralization similar to that found at its Lac des Iles mine.

The demand for commodities continues to increase globally. Fabrication demand for palladium has doubled since 1990 and recent reports suggest that we are quickly approaching supply and demand equilibrium, which is in contrast to the oversupply situation experienced in recent years. Exchange Traded Funds were introduced on the London Stock Exchange in 2007 for platinum and palladium, adding to demand side pressures. Precious metals ETFs grew to over \$1 billion since their launch in 2007 and could grow to approximately \$4 billion in 2008.

A decade ago, automobiles accounted for 29% of total palladium use. Today, demand for palladium in autos accounts for 51% of total supply. Increasingly stringent regulations for clean air and the reduction of exhaust emissions will translate into increased demand for PGMs. By 2020, automobiles on China's roads are expected to swell from 24 million to 100 million – and those figures speak to the increasing demand from only one country in the world. In addition, several other emerging nations are also expected to experience strong growth in their demand for automobiles.

Adding further pressure to the supply side has been the announcement of power restrictions in South Africa. South Africa produces approximately 35% of the world supply of palladium. Restrictions on power supply to mining companies that started in early 2008 are expected to last up to five years. While the exact consequence of the South African power shortage is not known, a reduction in palladium output from South Africa is expected.

Finally, we were very fortunate last year to have attracted a new and talented group of executives to our management team. In April, Mr. Fraser Sinclair accepted the position of Vice President, Finance and Chief Financial Officer. Mr. Sinclair has overseen the financial management, strategic planning, acquisitions and growth at several publicly-traded firms over the past 20 years. Mr. Trent Mell, Vice President, General Counsel and Corporate Secretary, also joined the team in April, bringing a strong legal and business background from a leading Bay Street law firm and from large mining companies. Ms. Linda Armstrong joined North American Palladium as Director, Investor Relations in October 2007 with 20 years of experience in sales, marketing and investor relations. Our newest addition to the team is Dr. William Stone, Vice President, Exploration. Dr. Stone has over 25

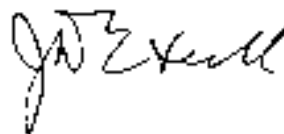
years of exploration experience including significant experience with platinum group metals and nickel-copper sulphides.

Our objectives for 2008 are clear. We are forecasting palladium production of 300,000 ounces from the Lac des Iles mine. In addition, we are working towards delivering well-engineered and financially sound projects to the Company's Board of Directors for their approval and, upon approval, execute the projects in a manner that maximizes shareholder value.

Your new management team is committed to creating shareholder value while conducting business in an ethical and responsible manner. In 2007 we strengthened the Company by raising capital to advance our projects and to grow our asset base. In putting these building blocks in place, we are now well-positioned to build new mines and expand our reserves and resources.

We look forward to building upon our successes throughout 2008 and we thank you, our loyal shareholders, our Board of Directors and our employees for your dedication and support.

Sincerely,



Jim Excell
President and Chief Executive Officer

Lac des Iles Mine



Employees at the Lac des Iles mine

Mining Operations ■ Lac des Iles Mine



In 2007, total mine production reached 286,334 ounces of palladium compared to 2006 production of 237,338 ounces, an increase of 21%.

The Company owns and operates the Lac des Iles mine located 85 kilometres from Thunder Bay, Ontario, Canada. The Lac des Iles mine consists of an open pit mine, an underground mine and two processing plants (one of which is currently idle and is being considered for refurbishment for the Shebandowan West project). The primary mineral deposit on the LDI property is called the Roby Zone, which is a disseminated magmatic nickel-copper-Platinum Group Metal (PGM) deposit. The Company began mining the Roby Zone in 1993 using open pit mining methods. In April 2006, an underground mine went into commercial production to access a higher grade portion of the Roby Zone.

In 2007, total mine production was 286,334 ounces of palladium compared to 2006 production of 237,338 ounces, an increase of 21%. Production of all by-product metals followed suit and exceeded 2006 production levels. Increased production in 2007 is attributable in part to a 10% increase in head grade to 2.39 grams per tonne versus 2.18 grams per tonne in 2006. In addition,

the mill's throughput increased 10% compared to 2006. A complete table of production results by metal can be found on page 27 of this Annual Report.

At the current rate of production, the open pit has a remaining mine life of less than two years. However, given current favourable PGM market conditions, management is assessing the economic viability of an extension of the open pit, which could prolong the mine life of the open pit by an additional two to three years.

The underground operations benefitted from continuous improvements in 2007, which was the first full year of underground mine production. The Company is presently evaluating commencing production from the upper portion of the Offset High Grade Zone as the current underground mine ceases operations.

For 2008, the Company's year-end production target is approximately 300,000 ounces of palladium. The proportion of by-product metals produced is, in aggregate, expected to increase in tandem with palladium production.

Statement of Mineral Reserves (as at December 31, 2007)

LAC DES ILES RESERVES⁽¹⁾⁽²⁾⁽⁸⁾

Property	Reserves	Tonnes (000)	Pd (g/t)	Pt (g/t)	Au (g/t)	Cu (%)	Ni (%)	Pd (000 oz)	Pt (000 oz)
Open Pit	Proven	5,102	2.44	0.21	0.20	0.07	0.09	399	35
	Probable	6,139	1.31	0.14	0.11	0.04	0.07	258	29
	Proven & Probable	11,241	1.82	0.18	0.15	0.06	0.08	658	63
Underground	Probable	2,282	6.56	0.39	0.32	0.06	0.08	481	29

NORTH AMERICAN PALLADIUM SHARE OF PROJECT RESOURCES⁽²⁾⁽³⁾⁽⁸⁾

Property	Resources	Tonnes (000)	Pd (g/t)	Pt (g/t)	Au (g/t)	Cu (%)	Ni (%)	Pd (000 oz)	Pt (000 oz)
LDI Open Pit ⁽¹⁾	Measured	8,259	1.67	0.22	0.13	0.06	0.08	444	59
	Indicated	13,775	1.18	0.15	0.09	0.04	0.06	523	68
	Measured & Indicated	22,034	1.36	0.18	0.10	0.05	0.07	966	127
	Inferred	135	2.73	0.19	0.11	0.43	0.04	12	1
LDI Underground ⁽¹⁾ Roby Zone	Indicated	1,337	7.65	0.44	0.37	0.07	0.08	329	19
	Inferred	127	7.07	0.37	0.19	0.03	0.04	29	2
Offset Zone	Indicated	3,239	5.45	0.38	0.39	0.12	0.13	568	40
	Inferred	12,794	5.25	0.38	0.37	0.11	0.12	2,160	156
Shebandowan ⁽⁴⁾⁽⁵⁾	Measured	368	1.19	0.37	0.22	0.66	0.89	14	4
	Indicated	924	1.05	0.33	0.23	0.60	0.92	31	10
	Measured & Indicated	1,292	1.09	0.34	0.23	0.62	0.91	45	14
	Inferred	171	0.97	0.27	0.18	0.61	1.11	5	2
APP ⁽⁶⁾⁽⁷⁾	Measured	27,644	1.08	0.26	0.11	0.17	0.07	960	231
	Indicated	63,857	1.06	0.24	0.12	0.20	0.08	2,176	493
	Measured & Indicated	91,501	1.07	0.25	0.12	0.19	0.08	3,148	735
	Inferred	15,239	1.04	0.25	0.11	0.17	0.07	510	122

Statement of Mineral Resources (as at December 31, 2007)

TOTAL PROJECT RESOURCES (JOINT VENTURES)⁽²⁾⁽³⁾⁽⁸⁾

Property	Resources	Tonnes (000)	Pd (g/t)	Pt (g/t)	Au (g/t)	Cu (%)	Ni (%)	Pd (000 oz)	Pt (000 oz)
Shebandowan ⁽⁴⁾	Measured	736	1.19	0.37	0.22	0.66	0.89	28	9
	Indicated	1,847	1.05	0.33	0.23	0.60	0.92	62	20
	Measured & Indicated	2,583	1.09	0.34	0.23	0.62	0.91	91	28
	Inferred	342	0.97	0.27	0.18	0.61	1.11	11	3
APP ⁽⁶⁾	Measured	46,074	1.08	0.26	0.11	0.17	0.07	1,600	385
	Indicated	106,428	1.06	0.24	0.12	0.20	0.08	3,627	821
	Measured & Indicated	152,502	1.07	0.25	0.12	0.19	0.08	5,247	1,226
	Inferred	25,398	1.04	0.25	0.11	0.17	0.07	849	204

Notes:

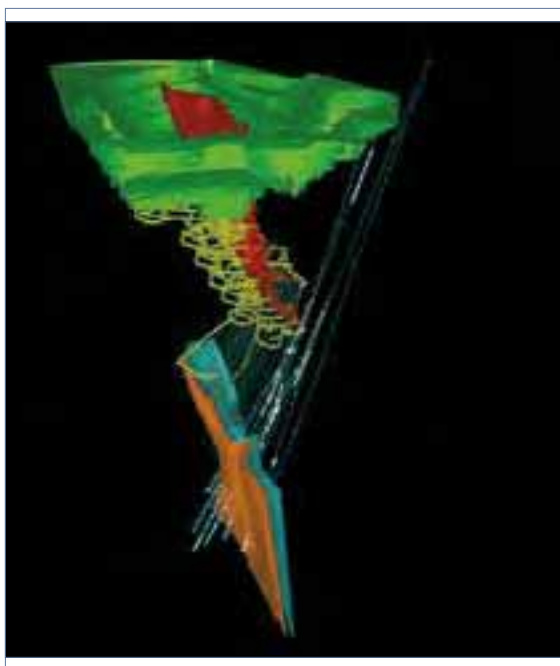
- (1) The mineral reserve and resource estimates for the LDI Property other than the OHGZ were prepared by David Penna, P.Geo. (a "qualified person" under NI 43-101), using a cut-off grade of 1.1 g/t Pd for the open pit and 4.5 g/t Pd for the underground, assuming long-term prices of US\$325/oz Pd, US\$1,000/oz Pt, US\$550/oz Au, US\$11/lb Ni and US\$2.50/lb Cu. Mr. Penna is an employee of the Company, where he holds the position of Chief Geologist at the Lac des Iles mine. The mineral resource estimates for OHGZ were prepared by Richard E. Routledge, M.Sc., P. Geo. of Scott Wilson RPA. (a "qualified person" under NI 43-101), using a 3.6 g/t Pd equivalent cut-off grade. The open pit reserves are reported as grade diluted blocks but are stated on an in-situ basis.
- (2) Due to rounding differences, total contained ounces of measured and indicated resources of Pd and Pt may not be equal to the sum of these two mineral resource categories.
- (3) Although "Measured Resources", "Indicated Resources" and "Inferred Resources" are categories of mineralization that are recognized and required to be disclosed by Canadian regulators, the SEC does not recognize them. Mineral resources that are not mineral reserves do not have demonstrated economic viability.
- (4) The mineral resource estimates for the Shebandowan West Project were prepared by F.H. Brown, CPG, Pr. Sci. Nat. (a "qualified person" under NI 43 101) using a cut-off grade of US\$60.00 NSR and 18-month trailing average metal prices of US\$300/oz Pd, US\$750/oz Pt, US\$400/oz Au, US\$7/lb Ni and US\$1.50/lb Cu.
- (5) Assumes a net inventory to North American Palladium of 50% for the Shebandowan West Project. After successful completion of its earn-in requirements, the Company's interest is 50%, which could be reduced to 40% upon the exercise by Vale Inco of a claw-back right.
- (6) The mineral resource estimates for the APP were prepared by F.H. Brown, CPG, Pr. Sci. Nat. (a "qualified person" under NI 43 101) using a cut-off grade of 1.0 g/t Pd equivalent cut-off grade and 18-month trailing average metal prices of US\$344/oz Pd, US\$1,222/oz Pt, US\$644/oz Au, US\$15.27/lb Ni and US\$3.26/lb Cu.
- (7) Assumes a net inventory to North American Palladium of 60% for the APP. Assuming successful completion of its earn-in requirements at the APP, the Company's interest is initially expected to be 60%, which could be reduced to 50% upon the exercise by Gold Fields of a claw-back right.
- (8) Pd and Pt ounces are stated as contained ounces. Disclosure of contained ounces is permitted under Canadian regulations; however, the SEC generally permits resources to be reported only as in situ tonnage and grade.



Advanced Exploration ■ Offset High Grade Zone (OHGZ)



Advanced Exploration ■ Offset High Grade Zone (OHGZ)



Offset High Grade Zone schematic

The OHGZ is located on the Lac des Iles property and was discovered by the Company's exploration team in 2001. The OHGZ is believed to be a fault displaced continuation of the Roby Zone mineralization and is located below and approximately 250 meters to the west of the Roby Zone. A mineral resource estimate was prepared by Scott Wilson Roscoe Postle Associates in October 2007. The report showed that the OHGZ has more than three times the mineral resources of the current underground mine at the Roby Zone at similar grades, while still being open along strike to the north, south and at depth.

From May to October 2007, the Company completed approximately 18,000 meters of infill drilling in the upper 300 meters of the OHGZ, with the goal of upgrading that portion of the ore body from inferred resources to measured and indicated resources. The Company has begun to receive assay results and anticipates updating its mineral resource estimate for

In 2007, the Company completed approximately 18,000 meters of infill drilling in the upper 300 meters of the OHGZ, with the goal of upgrading that portion of the ore body from inferred resources to measured and indicated resources.

the OHGZ in the second quarter of 2008. The Company's objective is to commence production from the OHGZ as the current underground mine reaches the end of its mine life in 2010.

In September 2007, the Company engaged Micon International Limited and Nordmin Engineering Ltd. to prepare a scoping study. The scoping study will examine the economic viability of several exploitation scenarios for the OHGZ, including a continuation of the ramp from the current underground mine and shaft options. A report on the results of this preliminary economic assessment is nearing completion and the Company anticipates releasing the results during the second quarter of 2008.

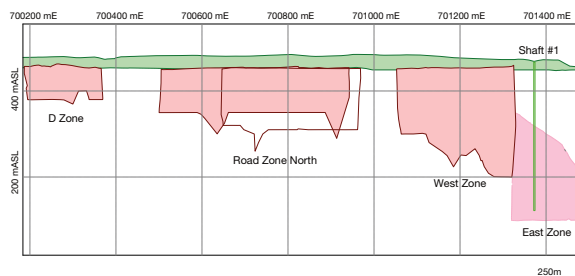
An exploration drilling program is also currently in progress to search for the deep limits of the OHGZ. To date, the OHGZ has been traced to a depth of 1,300 meters below surface, and along a strike length of approximately 600 meters.

Shebandowan West Project, Ontario, Canada



Winter drilling 2008 at the Shebandowan West Project

Advanced Exploration ■ Shebandowan West Project



Shebandowan mineral deposits

In December 2007, the Company earned a 50% interest in the former producing Shebandowan mine and the surrounding Haines and Conacher properties pursuant to a joint venture agreement with Vale Inco. The properties contain a series of PGM mineralized bodies and the land package totals approximately 7,974 hectares. These properties are located 90 kilometres west of Thunder Bay, Ontario, and approximately 100 kilometres southwest from the Company's Lac des Iles mine. The Shebandowan West Project is located within this land package and encompasses three shallow mineralized zones known as the West, Road and "D" zones. These mineralized zones are at shallow depths immediately to the west of the former Shebandowan mine in an area known as the Shebandowan West district. The Shebandowan West Project's nickel-copper-PGM mineralization is believed to represent the western extension of the Shebandowan mine ore body. The former Shebandowan mine, which was in operation from 1972 to 1998, produced 8.7 million tonnes of ore at grades of 2.07% nickel, 1.00% copper and approximately 3.0 grams per tonne PGM and gold.

The Company is considering a mine development scenario that would entail excavation of the Shebandowan West Project by means of ramp-accessed

The Shebandowan West Project's nickel-copper-PGM mineralization is believed to represent the western extension of the Shebandowan mine ore body.

underground mining methods at a rate of 500 to 1,000 tonnes per day, crushing the material on site and transporting it by truck to the Lac des Iles property for processing at the original mill. This second mill at Lac des Iles has been idle since 2001 and the Company believes that it could be refurbished quickly and at a relatively low cost. Preliminary metallurgical testing supports the possibility of producing a bulk sulphide concentrate from the Shebandowan West Project at the original mill.

A NI 43-101 technical report disclosing the results of a mineral resource estimate was filed on October 26, 2007. In December 2007, the Company retained SRK Consulting to prepare a preliminary economic assessment of the ramp-accessed mine scenario. The results of this report are expected in the second quarter of 2008.

Community consultations and baseline environmental sampling are ongoing and completion of the bulk sampling, process and design are expected to be completed during the first half of 2008. If plans proceed as expected, including completion of further technical studies and permitting, development at the Shebandowan West Project could commence production in 2009.

Arctic Platinum Project, Finland



Ore for pilot plant testing from the Suhanko deposits, Finland

Finland is the third highest ranking country in the world for Platinum Group Metal resources

Advanced Exploration ■ Arctic Platinum Project, Finland



Reijo Uusitalo
Managing Director



Bill Glover
Project Manager

Approximately 152.5 million tonnes of mineralization have been identified in the two nickel-copper-PGM open pit mines that comprise the Suhanko deposits.

In March 2006, the Company entered into a joint venture agreement with Gold Fields Limited to explore and develop an area of Finland known as the Arctic Platinum Project (APP). Under the agreement, North American Palladium is entitled to earn a 50%-60% interest in the APP.

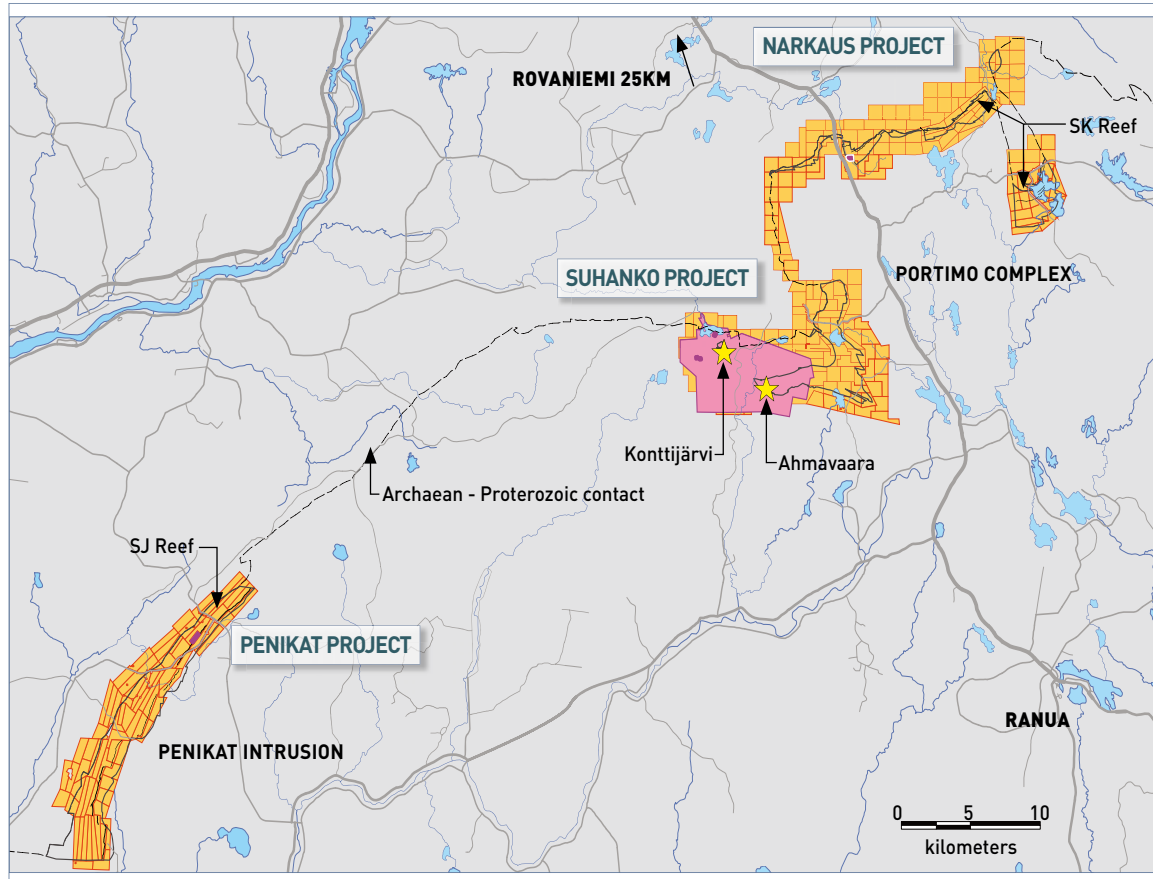
The APP is an advanced-stage nickel-copper-PGM exploration project located approximately 60 kilometres south of the city of Rovaniemi, Finland. Rovaniemi, the capital of Lapland and regional mining centre, has abundant infrastructure such as housing, transportation and electricity. The port of Kemi on the Gulf of Bothnia is located 120 km south-west of Rovaniemi and is open year round. The APP includes several advanced stage nickel-copper-PGM deposits: the Suhanko deposits, the Narkaus deposits and the Penikat deposits. To date, the Company has completed a scoping study, incurred over US\$11.6 million in expenditures and has commissioned a feasibility study. The Company believes that it will be in a position to satisfy the conditions of the earn-in on or before August 31, 2008.

Management believes the APP is a good strategic fit for the Company in view of the similarities in operating conditions and deposit class with the Lac des Iles mine. The APP contains a number of undeveloped PGM

deposits in addition to nickel-copper deposits. Platinum Group Metals along with nickel-copper mineralization were first discovered in the area by Outokumpu Oy in 1964 during a regional nickel-copper-PGM exploration program and the area was further explored by Gold Fields between 2001 and 2004. In 2005, Gold Fields prepared a feasibility study on the Suhanko deposits, which contemplated open pit mines at the Konttijarvi and Ahmavaara deposits.

The management of North American Palladium have been examining a development scenario consisting of the Ahmavaara and Konttijarvi deposits, two nickel-copper-PGM deposits that comprise the Suhanko area, which are located three kilometres from each other. Large amounts of PGMs, nickel and copper, approximately 152.5 million tonnes of mineralization, were found within these two ore bodies. The nickel-copper-PGM bearing material could be processed through a centrally located concentrator. Nickel-copper-PGM bearing concentrate could then be transported 120 kilometres by truck to the port of Kemi and shipped to smelting and refining facilities for final extraction of the contained metals. All permitting and environmental studies have been completed for the Suhanko deposits.

Arctic Platinum Project, Finland



Project location map

The Company has retained Aker Kvaerner to prepare a feasibility study for the Suhanko deposits to build upon the recommendations in a scoping study that was completed in October 2007. The Company has also contracted with a 30-year veteran of the mining industry to oversee the feasibility study and other work at the APP as the Company moves closer to satisfying its earn-in conditions.

An infill drilling campaign at the Ahmavaara deposit was completed earlier in 2007 and the assay results of the final 26 holes of the 83-hole drilling program were reported on October 22, 2007. Micon International Limited has now been engaged to conduct the update of the mineral resource estimates, which will include the results from the Ahmavaara infill drilling campaign. Micon will also conduct the open pit designs and optimization.

Bulk sampling of the Ahmavaara and Konttijärvi deposits was completed in October 2007 in advance of pilot plant test work. A program of bench scale metallurgical testing has been completed in support of a pilot plant test that commenced in December 2007 and was completed in February 2008. The pilot plant test provided samples that will be tested by smelters for suitability. Several smelting firms have been identified for the concentrate marketing strategy and will allow the Company to pilot a flowsheet. In October 2007, the Company commenced discussions with various smelters and follow-up meetings are planned now that samples are available.

Exploration



William E. Stone, *Ph.D.*
Vice President, Exploration

A high resolution airborne electromagnetic and magnetic survey has recently been completed over a large portion of the Shawmere property.

In addition to the operating mine and three advanced exploration projects, North American Palladium is constantly examining nickel-copper-PGM opportunities, particularly in the areas surrounding the Company's Lac des Iles mine.

Management believes that the Company is well-positioned to partner with other PGM exploration companies in Canada, given the existing infrastructure at the Lac des Iles mine and the Company's years of experience in mining nickel-copper-PGM deposits. From time-to-time, North American Palladium enters into agreements with junior mining companies or individual prospectors to assess the prospective nature of their land holdings. In addition, management believes that the consolidation in the nickel industry may result in joint venture or acquisition opportunities for the Company as the major nickel producers seek to shed non-core assets.

North American Palladium is also active in grassroots exploration and recently staked 39 claims containing

632 claim units at the Company's Shawmere Project, located approximately 110 kilometres southwest of Timmins, Ontario, Canada.

A high resolution airborne electromagnetic and magnetic survey has recently been completed over a large portion of the property. Field exploration will commence by the middle of 2008 including stream and lake sediment sampling, searching for outcropping occurrences of nickel-copper-PGM mineralization, prospecting, airborne anomaly follow-up and mapping over selected areas of the property.

The Company intends to continue conducting grassroots exploration work at Shawmere to assess the area's potential for hosting nickel-copper-PGM mineralization similar to that found at its Lac des Iles mine. Further exploration is also anticipated in the area surrounding the Lac des Iles mine.

Social Responsibility ■ Environmental



Environmental management is a key corporate priority

We are dedicated to

- Recognizing responsible environmental management as one of the highest corporate priorities, and integrating these considerations into all of our exploration, development, mining and closure activities.
- Monitoring environmental performance through vigorous testing and identifying areas for improvement.
- Fostering a culture of environmental awareness and responsibility through education and communication with employees, contractors and suppliers.
- Focusing on consistent environmental compliance, employing current environmental best practices.
- Ensuring that our operations have formal environmental management systems that are reviewed regularly.
- Providing appropriate resources to ensure we meet environmental standards.

Social Responsibility ■ Health and Safety



North American Palladium's Mine Rescue Team.

Our employees' health and safety is a top priority.

We work diligently to ensure that we meet all regulatory requirements and demonstrate our commitment to the health and safety of our employees.

Our commitment to safety starts with:

- Our dedicated team of managers and supervisors who make safety an integral part of each workday.
- Our Joint Health and Safety Committee that focuses on identifying safety concerns and making improvements.
- Crew safety meetings held to address worker concerns and communicate safe work essentials.
- Procedures that are developed and communicated for activities that may have related hazards.
- A Mine Rescue Team that is fully trained to respond in emergency situations.
- Ongoing training of mine and mill employees to ensure all practices are current.

Management's Discussion and Analysis

The following is management's discussion and analysis ("MD&A") 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, 2007, compared to those of the respective periods in the prior years. This MD&A has been prepared as of March 18, 2008 and is intended to supplement and complement the audited consolidated financial statements and notes thereto for the year ended December 31, 2007 (collectively, the "Financial Statements"). You are encouraged to review the Financial Statements in conjunction with your review of this MD&A and the most recent Form 40-F/Annual Information Form on file with the US Securities and Exchange Commission and Canadian provincial securities regulatory authorities. All amounts are in Canadian dollars unless otherwise noted.

INDUSTRY OVERVIEW

Platinum Group Metals

Palladium is one of the six platinum group metals ("PGMs"), along with platinum, rhodium, ruthenium, iridium and osmium. Economically, the three most significant PGMs are palladium, platinum and rhodium. The primary use for palladium is in the manufacture of catalytic converters in the automotive industry. It is also used in the manufacture of jewellery and electronics, and in dental and chemical applications.

Supply

Palladium is typically produced as a by-product metal from platinum mines. According to the CPM Group, most of the world's palladium is produced in Russia (35%), the Republic of South Africa (34%) and North America (12%). Global supply of palladium increased by approximately 3% in 2006 (the last year for which data is available) to 8,437,000 ounces. Of this total, mine production accounted for approximately 7,030,000 ounces (an increase of 3% from the prior year) and secondary recovery of palladium accounted for approximately 1,407,000 ounces.

Demand

Global fabrication demand for palladium (excluding investor demand) increased by 11.0% in 2006 to approximately 7,722,000 ounces, primarily as a result of the strong performance of the industries that use palladium and the relative attractiveness and affordability of palladium compared to substitutes (such as platinum, rhodium and gold). The year 2006 represented the third consecutive year of double-digit growth in palladium demand, and the fifth consecutive year of growth in palladium demand overall.

Approximately 50% of the global demand for palladium in 2006 stemmed from the automotive industry. The majority of the balance of palladium demand in 2006 stemmed from electronics (16%), jewellery (4%), Chinese demand for electronics and jewellery (10%), dental applications (13%) and other chemical applications (5%).

The primary use for palladium in the automotive industry is in the manufacture of catalytic converters, which reduce harmful vehicle exhaust emissions by converting them into less harmful carbon dioxide, nitrogen and water vapour. Palladium, platinum and rhodium are the primary components in catalytic converters. The demand for palladium in the automotive industry has more than doubled in the last ten years due to the larger number of vehicles being manufactured and the tightening of emissions standards that require the use of catalytic converters. Catalytic converters are now included in over 96 percent of new cars. With the palladium price currently substantially below that of platinum, automakers have a strong financial incentive to switch their catalyst formulations for gasoline vehicles from those based on platinum to palladium.

Palladium is also used in the manufacture of jewellery and may be used either on its own or as an alloy in "white gold". In the electronics industry, palladium is used mainly in the production of multi-layer ceramic capacitors, which are used in electrical components for cellular telephones, personal and notebook computers, fax machines and home electronics. In the dental industry, palladium is widely used in alloys for dental restoration. Additionally, various

chemical applications use palladium, including the manufacture of paints, adhesives, fibers and coatings. Palladium is also used in the manufacture of polyester.

An important macroeconomic trend has been increased investor demand for palladium by virtue of its association with other precious metals (e.g., platinum and rhodium). Strong investor sentiment for these precious metals has provided support for a favorable palladium pricing environment.

COMPANY OVERVIEW

Overview of North American Palladium's Business

North American Palladium is Canada's only primary producer of PGMs, producing an estimated 4% of annual global palladium production. While the bulk of the Company's revenue is derived from the sale of palladium, the Company also generates a considerable portion of its revenue from the sale of platinum, nickel, gold, and copper, all of which are by-products of the Company's palladium mining operations. North American Palladium's principal properties and projects are the Lac des Iles property (including the Lac des Iles mine and the Offset High Grade Zone ("OHGZ")), the Shebandowan West Project and the Arctic Platinum Project ("APP").

Lac des Iles Property

Lac des Iles mine

The Company owns and operates the Lac des Iles mine located 85 kilometers from Thunder Bay, Ontario, Canada. The Lac des Iles mine consists of an open pit mine, an underground mine and two processing plants (one of which is currently idle). The primary deposit on the property is the Roby Zone, a PGM deposit. The Company began mining the Roby Zone in 1993 using open pit mining methods. In April 2006, an underground mine went into commercial production to access a higher grade portion of the Roby Zone.

Offset High Grade Zone

The OHGZ is located on the Lac des Iles property and was discovered by the Company's exploration team in 2001. The OHGZ is believed to be the fault-displaced continuation of the Roby Zone mineralization and is located below and approximately 250 meters to the west of the Roby Zone. A mineral resource estimate prepared by Scott Wilson Roscoe Postle Associates Inc. ("Scott Wilson RPA") in October 2007 estimated that the OHGZ has more than three times the mineral resources of the current underground mine at the Roby Zone at similar grades, while still being open along strike to the north, south and at depth.

Shebandowan West Project

On December 10, 2007, the Company earned a 50% interest in the former producing Shebandowan mine and the surrounding Haines and Conacher properties pursuant to an option and joint venture agreement with Vale Inco. The Shebandowan West Project contains a series of nickel-copper-PGM mineralized bodies and is located approximately 100 kilometers southwest of the Company's Lac des Iles mine. On October 25, 2007, the Company announced the completion of a NI 43-101 compliant mineral resource estimate for the Shebandowan West Project by an independent Qualified Person. Management is considering a mine development scenario that would entail excavation of the Shebandowan West Project by means of ramp-accessed underground mining methods at a rate of 500 to 1,000 tonnes per day, crushing the material on site and transporting it by truck to the Lac des Iles property for processing at the original mill on the Lac des Iles property. If plans proceed as expected, production at the Shebandowan West Project could commence in 2009.

Arctic Platinum Project

The APP is comprised of a series of advanced-stage nickel-copper-PGM exploration projects located approximately 60 kilometers south of the city of Rovaniemi, Finland. The Company is party to an agreement with subsidiaries of Gold Fields Limited of South Africa ("Gold Fields") entitling it to earn up to a 60% interest in the APP. Management believes

that the Company will satisfy the conditions of its earn-in right by August 31, 2008, which will include completion of a re-scoping study and exploration program, completion of a feasibility study, and the preparation of the initial form of development proposal and associated budget.

To date, three areas of the APP have been explored by North American Palladium: (i) the Suhanko deposits, (ii) the Narkaus deposits, and (iii) the Penikat deposits. At Suhanko, the Company is studying a development scenario consisting of two open pit mines at two deposits located three kilometers from each other. Under this scenario, the nickel-copper-PGM bearing material would be processed through a centrally-located concentrator at a nominal throughput rate of five million tonnes per year. Additionally, management believes that the economics of the development scenario might be enhanced by the development of two higher grade deposits at Narkaus. A scoping study on the Suhanko deposits completed by Aker Kvaerner in October 2007 indicated that the mineral resources could potentially support a 20-year mine life at 7.5 million tonnes per annum. To this end, the Company has retained Aker Kvaerner to prepare a feasibility study for the Suhanko deposits.

Year Ended December 31, 2007 Highlights

- Revenue for the year ended December 31, 2007 of \$195.9 million increased by \$36.7 million (23%).
- Operating cash flow for the year (before changes in non-cash working capital)¹ improved by \$36.9 million to \$46.8 million compared to operating cash flow of \$9.9 million in 2006.
- The net loss for the year ended December 31, 2007 was \$28.7 million or \$0.51 per share compared to a net loss of \$34.1 million or \$0.65 per share in 2006. The net loss for the year includes a net negative impact of \$19.0 million (2006 – negative impact of \$3.7 million) due to foreign exchange gains and losses.
- Palladium production of 286,334 ounces increased 21% compared to last year.
- Palladium sales for the year were recorded at an average price of US\$356 per ounce compared to US\$319 per ounce last year. The Company's performance is highly correlated to prevailing palladium and by-product metal prices as it continues to sell all its metal production into the spot markets.
- Palladium accounted for 47% of the year's total revenues while platinum and nickel continued to be important sources of revenue, at 16% and 22% of the year's total revenue respectively.
- Cash cost per ounce of palladium produced,¹ net of by-product metal revenues and royalties, was US\$164 for 2007 compared to US\$201 the previous year, primarily due to the increased production volumes and stronger by-product prices, partially offset by the impact of the strengthening Canadian dollar on both costs and by-product revenue realized.
- On December 10, 2007, the Company earned a 50% interest in the former producing Shebandowan mine and the surrounding Haines and Conacher properties pursuant to an option and joint venture agreement with Vale Inco.
- The Company's debt position at December 31, 2007 was \$39.1 million and reflects a reduction of \$35.8 million (48%) compared to the debt position at December 31, 2006 of \$74.9 million.
- In December 2007 the Company completed an equity offering of 18.7 million units at a price of US\$4.00 per unit. In connection with the offering the Company granted the underwriter's an over-allotment option of 15% at the same price. This option was subsequently exercised in January 2008, increasing the gross proceeds of the offering to US\$85.9 million.

¹ Non-GAAP measure. Reference should be made to footnote 1 at the end of this MD&A.

Key Results

Operating Results

Year ended December 31	2007	2006*	2005
Palladium (oz)	286,334	237,338	177,167
Payable Palladium (oz)	263,046	217,022	161,469
Platinum (oz)	24,442	22,308	18,833
Gold (oz)	20,092	17,237	14,308
Copper (lbs)	5,536,044	5,155,588	5,514,670
Nickel (lbs)	3,066,973	2,721,042	2,353,227
Ore Tonnes Milled	5,006,383	4,570,926	4,780,599
Ore Tonnes Mined – Underground	768,841	721,179	–
Ore Tonnes Mined – Open Pit	4,374,225	3,926,911	3,705,555
Waste Tonnes Mined – Open Pit	7,231,026	8,888,037	11,619,658
Waste Strip Ratio	1.65:1	2.26:1	3.14:1

* Metal production, tonnes milled and underground ore tonnes mined include pre-production activities from the underground mine that was not recorded as revenue but rather offset against the underground mine's 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)	2007	2006	2005
Revenue after pricing adjustments	\$ 195,932	\$ 159,200	\$ 92,606
Net loss	(28,680)	(34,109)	(53,611)
Add back (deduct):			
Exploration costs	12,138	11,831	7,927
Non-Cash Items:			
– Amortization	46,908	30,103	18,297
– Accretion of convertible notes	12,947	10,090	–
– Other non-cash items ¹	15,653	3,828	(1,146)
Net income (loss) before exploration and non-cash items ¹	\$ 58,966	\$ 21,743	\$ (28,533)
Net loss per share (dollars)			
• Basic	\$ (0.51)	\$ (0.65)	\$ (1.03)
• Fully diluted	\$ (0.51)	\$ (0.65)	\$ (1.03)
Cash dividends declared	Nil	Nil	Nil
Cash flow from operations prior to changes in non-cash working capital	46,828	9,912	(36,460)
Total Assets	305,374	265,157	238,357
Total Long-term debt, including current portion	39,081	74,906	46,272

¹ Non-GAAP measure. Reference should be made to footnote 1 at the end of this MD&A.

RESULTS OF OPERATIONS

Revenue

For the year ended December 31, 2007 the Company had revenue of \$195.9 million compared to revenue of \$159.2 million in 2006. The loss from mining operations for the year ended December 31, 2007 was \$19.4 million, an increase of \$1.3 million (7%), compared to the loss of \$18.1 million last year.

Revenue is affected by sales volumes, commodity prices and currency exchange rates. Sales of metals in concentrate are recognized in revenue when concentrate is delivered to a third party smelter for treatment, however, final pricing is not determined until the refined metal is sold, which can be up to six months later. Accordingly, revenue in the year is based on current US dollar denominated commodity prices and foreign exchange rates for sales occurring in the year and ongoing pricing adjustments from prior sales that are still subject to final pricing. These final pricing adjustments result in additional revenues in a rising commodity price environment and reductions to revenue in a declining commodity price environment. Similarly, a weakening in the Canadian dollar relative to the US dollar will result in additional revenues and a strengthening in the Canadian dollar will result in reduced revenues. Effective April 1, 2007, the amount of the final pricing adjustments recognized on any commodity price changes will also be reduced by any price participation deductions as provided for in the Company's smelting and refining agreement. The Canadian dollar strengthened by 17% against the US dollar to \$1.01 at December 31, 2007 compared to \$0.86 at December 31, 2006.

Recorded Metal Prices and Average Exchange Rates

	2007	2006	2005
Palladium – US\$/oz	\$ 356	\$ 319	\$ 230
Platinum – US\$/oz	\$ 1,364	\$ 1,140	\$ 815
Gold – US\$/oz	\$ 726	\$ 610	\$ 442
Nickel – US\$/lb	\$ 15.58	\$ 11.68	\$ 6.60
Copper – US\$/lb	\$ 3.30	\$ 3.02	\$ 1.50
US/C\$ exchange rate (Bank of Canada)	US \$0.93	US \$0.88	US \$0.83

For the year ended December 31, 2007, revenue before pricing adjustments of \$201.4 million increased \$55.5 million (38%) from 2006, reflecting higher volumes and improved pricing of \$68.7 million, partially offset by the impact of unfavourable foreign exchange rates of \$13.2 million. Negative pricing adjustments from settlements and the mark-to-market of concentrate awaiting settlement for the year ended December 31, 2007 reduced revenue by \$5.4 million (\$14.2 million negative foreign exchange adjustment, partially offset by a \$8.8 million favourable commodity price adjustment). This compares with favourable adjustments for the year ended December 31, 2006 of \$13.4 million (\$11.7 million favourable commodity price adjustment and a \$1.7 million positive foreign exchange adjustment). For the year ended December 31, 2007, revenue after pricing adjustments was \$195.9 million, an increase of \$36.7 million (23%), compared to revenue of \$159.2 million last year.

For the year ended December 31, 2007, palladium sales were recorded at US\$356 per ounce, up 12% compared to US\$319 in the 2006. Revenue in 2007 from the sale of palladium before pricing adjustments increased to \$95.1 million from \$70.6 million, and after pricing adjustments increased by 21% to \$91.8 million (47% of total revenue) compared to \$75.6 million (48% of total revenue) in 2006.

For the year ended December 31, 2007, total by-product revenues after pricing adjustments increased by 25% to \$104.1 million, as compared to \$83.6 million in 2006. In particular, platinum, gold and nickel sales saw strong growth of 27%, 32% and 28% respectively, reflecting increased sales volumes and higher commodity prices.

Operations

For the year ended December 31, 2007, palladium ounces produced increased by 21%. The mill processed 5,006,383 tonnes of ore or an average of 13,716 tonnes per day, producing 286,334 ounces of palladium compared to 4,570,926 tonnes of ore or an average of 12,523 tonnes per day, producing 237,338 ounces of palladium in 2006. In 2007, the average palladium head grade was 2.39 grams per tonne compared to 2.18 grams per tonne in 2006. The improved head grade can be attributed in part to a full year of production from the underground mine, which commenced commercial production in April 2006. For the year ended December 31, 2007, 768,841 tonnes of ore was extracted from the underground mine, with an average palladium grade of 5.79 grams per tonne. During the nine months ended December 31, 2006, 617,634 tonnes of ore was extracted from the underground mine, with an average palladium grade of 5.96 grams per tonne. For 2007 the palladium recoveries were 74.8%, compared to 74.0% in 2006.

In the Lac des Iles open pit, for the year ended December 31, 2007, 4,374,225 tonnes of ore were extracted with an average palladium grade of 1.79 grams per tonne compared to 3,926,911 tonnes at an average palladium grade of 1.63 grams per tonne the previous year. For the year ended December 31, 2007 the strip ratio improved to 1.65 compared to 2.26 in 2006.

The mill's increased results reflect continued improvement to the throughput and availability due to Company personnel identifying and systematically resolving issues.

Operating Expenses

For the year ended December 31, 2007, total production costs of \$125.1 million increased by \$12.6 million (11%) compared to 2006, mainly due to the inclusion of the underground mine production costs for the three months ended March 31, 2007 of \$8.1 million, which for the corresponding period in 2006, were capitalized as pre-production costs. Unit cash costs¹ 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\$164 per ounce for the year ended December 31, 2007 compared to US\$201 per ounce in 2006. The decrease in unit cash costs was primarily due to the impact of increased production and improved pricing for by-products, partially offset by the strengthening Canadian dollar on both costs and by-product revenue realized.

Smelter treatment, refining and freight charges for the year ended December 31, 2007 of \$22.4 million increased by \$7.0 million (45%) compared to 2006. The increase is attributable to higher sales volumes (\$2.1 million) and higher costs associated with the Company's new smelter agreement (\$4.9 million) that came into effect April 1, 2007.

Non-cash amortization increased by \$16.8 million (56%) to \$46.9 million for the year ended December 31, 2007 compared to \$30.1 million last year. The higher amortization is attributable to the 21% increase in palladium production (\$3.8 million), the adjusted mine plan, effective from the fourth quarter of 2006, which resulted in an increase in the unit of production amortization rate (\$9.1 million), and the inclusion of the amortization of the underground mine development costs for the first quarter of 2007 (\$3.9 million), which commenced commercial production in April 2006.

The Company reviews and evaluates its long-lived assets for impairment annually. Impairment is considered to exist if total estimated future undiscounted cash flows are less than the carrying amount of the asset. During 2007, the Company engaged Scott Wilson RPA an independent geotechnical consulting company to complete a Mineral Resource and Mineral Reserve audit and to prepare an independent Technical NI 43-101 Report on the Lac des Iles mine as of June 2007. This was updated by a senior geologist with Lac des Iles Mines Ltd. (a qualified person) to December 31, 2007. As a result of these events the Company completed a detailed review of its life-of-mine operating plan for the Lac des Iles mine, the Company's only operating mine, and compared the carrying value of the Company's

¹ Non-GAAP measure. Reference should be made to footnote 1 at the end of this MD&A.

mining interests to the estimated recoverability. The Company's management believes an impairment charge and a corresponding reduction in the carrying value of its mining interests is not required. 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 impairment charges.

Administrative expenses for the year ended December 31, 2007 of \$7.8 million increased by \$1.1 million (15%) compared to 2006. The increase is due primarily to increased director's fees and expenses (\$0.5 million), increased staff costs (\$0.3 million) and higher capital taxes (\$0.3 million).

Exploration expense for the year ended December 31, 2007 of \$12.1 million was up \$0.3 million (3%) compared to last year's expenditure of \$11.8 million. Included in the 2007 expenditure is \$5.9 million (2006 - \$6.8 million) spent on the APP as the Company continues its evaluation activities in Finland. Costs associated with the APP project are being charged to exploration expense as incurred until it is determined whether the project can be economically developed, at which time the costs will be capitalized. In addition, the Company continued its exploration of the OHGZ at the Lac des Iles mine. Diamond drilling commenced in the second quarter of 2007 and the goal of this program is to provide detailed information as to the metals distribution for the upper portion of the OHGZ.

Work continues on the Shebandowan West nickel-copper-PGM project and drill results from its Phase II drill campaign were announced in a press release on May 1, 2007. A technical report prepared in compliance with the requirements of National Instrument 43-101 disclosing the results of the mineral resource estimate was press released on October 26, 2007. On December 10, 2007, the Company announced that it has exercised its option to form an operating joint venture with Vale Inco Limited over the Shebandowan property.

Asset retirement costs for the year ended December 31, 2007 of \$1.0 million compared to a charge of \$0.6 million last year with the increase reflecting the increased palladium production.

For the year ended December 31, 2007, the result of the revenue and operating expense performance described above was a loss from mining operations of \$19.4 million, an increase of \$1.3 million (7%) compared to last year's loss of \$18.1 million.

Other Income (Expenses)

For the year ended December 31, 2007, other income and expenses was a net expense of \$10.2 million, down by \$7.2 million compared to a net expense of \$17.4 million last year. The decrease in 2007 is due mainly to a \$8.4 million foreign exchange gain (2006 - \$1.8 million foreign exchange loss), which relates primarily to the translation of the Company's US dollar denominated convertible notes and credit facilities, offset partially by a \$3.0 million increase in interest and other financing charges. The increased interest and other financing charges are due primarily to a full year interest and accretion expense (increase of \$3.1 million) relating to the convertible notes payable that were issued in March and June 2006.

Net Income (Loss)

For the year ended December 31, 2007, there was a tax recovery of \$0.9 million (2006 recovery of \$1.4 million). For the year ended December 31, 2007 the net loss was \$28.7 million or \$0.51 per share compared to a net loss of \$34.1 million or \$0.65 per share the previous year.

Summary of Quarterly Results

	2006*				2007			
(thousands of dollars except per share amounts)	Q1	Q2	Q3	Q4	Q1*	Q2	Q3	Q4
Revenue – before pricing adjustments	\$24,356	\$36,698	\$38,704	\$46,061	\$60,305	\$53,450	\$42,674	\$44,938
Pricing adjustments:								
Commodities	6,952	566	2,927	1,229	9,141	(2,421)	237	1,799
Foreign exchange	184	(1,745)	(200)	3,468	(1,007)	(6,534)	(6,419)	(231)
Revenue – after pricing adjustments	\$31,492	\$35,519	\$41,431	\$50,758	\$68,439	\$44,495	\$36,492	\$46,506
Cash flow from operations ⁽¹⁾ , prior to changes in non-cash working capital**	(260)	(965)	2,716	8,421	23,037	12,865	4,068	6,858
Exploration expense	2,024	2,659	2,576	4,572	3,228	798	2,933	5,179
Net income (loss)	(4,141)	(11,325)	(11,247)	(7,396)	5,507	(9,066)	(14,033)	(11,088)
Net income (loss) per share	\$(0.08)	\$(0.22)	\$(0.21)	\$(0.14)	\$0.10	\$(0.17)	\$(0.25)	\$(0.19)
Fully diluted net income (loss) per share	\$(0.08)	\$(0.22)	\$(0.21)	\$(0.14)	\$0.10	\$(0.17)	\$(0.25)	\$(0.19)

* Certain prior period amounts have been reclassified to conform to a classification adopted in the current period.

** Includes exploration expense.

FOURTH QUARTER

Fourth Quarter Highlights

- Palladium production for the three months ended December 31, 2007 was 71,595 ounces, a decrease of 2% compared to the same period last year.
- Revenue after pricing adjustments for the fourth quarter of 2007 of \$46.5 million decreased \$4.3 million (8%) compared to the same period last year.
- Operating cash flow for the quarter (before changes in non-cash working capital)¹ declined by \$1.5 million to \$6.9 million compared to operating cash flow of \$8.4 million in 2006.
- The net loss for the three months ended December 31, 2007 was \$11.1 million or \$0.19 per share compared to a net loss of \$7.4 million or \$0.14 per share in the same period last year.
- Palladium sales in the quarter were recorded at US\$364 per ounce compared to US\$322 per ounce in the comparable quarter last year, while by-product metal prices, with the exception of nickel, also realized considerable gains. Palladium accounted for 51% of the quarter's total revenues while platinum and nickel continued to be important sources of revenue, at 17% and 15% of the quarter's total revenue respectively.
- Cash cost per ounce of palladium produced,¹ net of by-product metal revenues and royalties, was US\$223 for the fourth quarter 2007 compared to US\$108 in the same period last year, primarily due to the lower production in 2007 and the impact of the strengthening Canadian dollar on both costs and by-product revenue realized.

¹ Non-GAAP measure. Reference should be made to footnote 1 at the end of this MD&A.

FOURTH QUARTER FINANCIAL RESULTS

Revenue

The Company earned revenue of \$46.5 million for the three months ended December 31, 2007 compared to revenue of \$50.8 million for the corresponding period in 2006. The loss from mining operations for the three months ended December 31, 2007 was \$8.2 million, compared to income from mining operations of \$0.5 million in the same period last year.

Revenue before pricing adjustments for the fourth quarter of 2007 decreased \$1.1 million compared to the fourth quarter of 2006 and reflects a \$7.0 million decrease due to a lower US\$ exchange rate, offset partially by the net increase due to improved commodity prices and sales volumes of \$5.9 million. Positive pricing adjustments from the mark-to-market of concentrate awaiting settlement in the fourth quarter of 2007 increased revenue in the quarter by \$1.6 million (\$1.8 million favourable commodity price adjustment offset partially by a \$0.2 million negative foreign exchange adjustment). This compares to positive pricing adjustments in the fourth quarter of 2006 of \$4.7 million (\$3.5 million positive foreign exchange adjustment and a \$1.2 million positive commodity price adjustment).

For the three months ended December 31, 2007, palladium sales were recorded at US\$364 per ounce, up 13% compared to US\$322 in the same period last year. Revenue from palladium sales before pricing adjustments in the fourth quarter of 2007 of \$22.0 million increased by \$0.5 million (2%) compared to the same period last year, but after pricing adjustments was lower by \$0.4 million (\$1.9 million negative foreign exchange adjustment offset partially by positive commodity price adjustments of \$1.0 million).

Revenue from by-product metal sales after pricing adjustments in the three months ended December 31, 2007 decreased by \$3.9 million (15%) to \$22.7 million compared to \$26.6 million in the same period last year.

Recorded Metal Prices and Average Exchange Rates

	Q4 2007	Q4 2006
Palladium – US\$/oz	\$364	\$322
Platinum – US\$/oz	\$1,530	\$1,115
Gold – US\$/oz	\$836	\$635
Nickel – US\$/lb	\$11.70	\$15.11
Copper – US\$/lb	\$3.03	\$2.85
US/CDN.\$ exchange rate (Bank of Canada)	US\$1.02	US\$0.88

Operations

During the three months ended December 31, 2007, the mill processed 1,165,769 tonnes of ore at an average of 12,671 tonnes per day, producing 71,595 ounces of palladium. During the same period in 2006, the mill processed 1,179,644 tonnes of ore at an average of 12,822 tonnes per day, producing 73,242 ounces of palladium. The average palladium head grade was 2.58 grams per tonne in the fourth quarter of 2007, compared to 2.52 grams per tonne in the corresponding period of 2006. In the fourth quarter of 2007, palladium recoveries were 75.2% as compared to 76.9% in fourth quarter of 2006, while mill availability in the period was 86.9% compared to 89.5% last year. The slight (2%) reduction in ounces produced in the fourth quarter of 2007 can be attributed to lower mill tonnage reflecting increased scheduled maintenance downtime in 2007 in order to reline the SAG and ball mills. The higher tonnage throughput for the year ended December 31, 2007 resulted in a rescheduling of planned maintenance activities.

During the three months ended December 31, 2007, 202,230 tonnes of ore were extracted from the Lac des Iles underground mine, with an average palladium grade of 5.98 grams per tonne, compared to 222,519 tonnes with an

average palladium grade of 6.42 grams per tonne during the same period last year. In the Lac des Iles open pit operation for the three months ended December 31, 2007, 994,152 tonnes of ore were extracted with an average palladium grade of 1.92 grams per tonne compared to 924,529 tonnes of ore extracted at an average palladium grade of 1.63 grams per tonne in the same period last year. Over this period, the strip ratio substantially improved to 1.74, compared to 2.13 in the same period for 2006.

Operating Expenses

Total production costs for the three months ended December 31, 2007 of \$30.5 million reflected a \$0.9 million (3%) increase over the \$29.6 million in same period of 2006. Unit cash costs¹ 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\$223 per ounce in the fourth quarter of 2007 compared to US\$108 per ounce in the corresponding period in 2006. The increase in unit cash costs was primarily due to the higher production costs, reduced nickel revenue (price per lb. US\$11.70 in 2007 vs. US\$15.11 in 2006) and the impact of the strengthening Canadian dollar on both costs and by-product revenue.

Smelter treatment, refining and freight charges for the three months ended December 31, 2007 of \$5.9 million increased by \$1.5 million (32%) compared to 2006. The increase is attributable to higher sales volumes (\$0.4 million) and higher costs associated with the Company's new smelter agreement that came into effect on April 1, 2007 (\$1.1 million.)

Non-cash amortization increased to \$10.9 million in the fourth quarter of 2007 compared to \$10.0 million in the corresponding period in 2006. The higher amortization is attributable to the adjustment in the mine plan that was effective from the fourth quarter of 2006, which resulted in an increase in the unit of production amortization rate.

Administrative expenses for the three months ended December 31, 2007 of \$2.1 million increased by \$0.6 million (37%) compared to 2006, as a result of higher staff costs.

Exploration expense was \$5.2 million in the fourth quarter of 2007 compared to \$4.6 million in the corresponding period last year, an increase of \$0.6 million (13%). The increase is due mainly to the ongoing exploration at Shebandowan and the APP.

For the three months ended December 31, 2007, the loss from mining operations was \$8.2 million, a decline of \$8.7 million compared to last year's profit of \$0.5 million, and reflects the revenue and operating expense issues described above.

Other Income (Expenses)

For the three months ended December 31, 2007, other income and expense was an expense of \$2.9 million compared to an expense of \$8.0 million in the corresponding period of 2006, a decrease of \$5.1 million. The decrease in 2007 reflects a favourable foreign exchange impact compared to last year of \$2.6 million, which relates primarily to the translation of the Company's US dollar denominated convertible notes and credit facilities, and a reduction of interest and other financing charges of \$2.5 million. The reduced interest and other financing charges are due primarily to lower interest and accretion expenses of \$2.1 million relating to the convertible notes payable and reflects the scheduled repayment of the notes.

Net Income (Loss)

The Company reported a net loss of \$11.1 million or \$0.19 per share compared to net loss of \$7.4 million or \$0.14 per share for the three months ended December 31, 2006.

¹ Non-GAAP measure. Reference should be made to footnote 1 at the end of this MD&A.

LIQUIDITY

Sources and Uses of Cash

Year ended December 31	2007	2006	2005
Cash generated (consumed) by operations before working capital changes	\$ 46,828	\$ 9,912	\$ (36,460)
Changes in non-cash working capital	(21,352)	(43,701)	28,187
Cash generated (consumed) by operations	25,476	(33,789)	(8,273)
Cash provided (used) by financing	61,323	41,295	(7,051)
Cash used in investing	(15,346)	(19,384)	(35,400)
Increase (decrease) in cash and cash equivalents	\$ 71,453	\$ (11,878)	\$ (50,724)

Cash provided by operations¹ (prior to changes in non-cash working capital) for the year ended December 31, 2007 was \$46.8 million, compared to cash provided by operations of \$9.9 million in 2006. The \$36.9 million improvement was mainly attributable to increased non-cash amortization expense (\$16.8 million), the impact of an unrealized foreign exchange loss (\$11.6 million), a decreased net loss (\$5.4 million) and a higher non-cash add back for accretion expense relating to the convertible notes payable (\$2.9 million). For the year ended December 31, 2007, non-cash working capital required \$21.4 million compared to \$43.7 million in 2006, a reduction of \$22.3 million. The higher non-cash working capital requirement in 2006 reflected the build up of concentrate awaiting settlement from increased production, which included the grade improvement from the commercial start up of the underground mine in April 2006. In 2007, while production continued to increase, this was partially offset by the lower foreign exchange rate.

Palladium awaiting settlement decreased to 125,802 ounces at December 31, 2007 compared to 129,496 ounces at December 31, 2006. The decrease in the physical quantities of metal in the concentrate awaiting settlement, combined with the higher prices used to value the concentrate awaiting settlement, offset by the strengthening Canadian dollar resulted in a \$3.0 million (4%) decrease in the value of concentrate awaiting settlement as at December 31, 2007, compared to December 31, 2006. After allowing for non-cash working capital changes, cash provided by operations was \$25.5 million for the year ended December 31, 2007 compared to cash usage of \$33.8 million in 2006.

Financing activities for the year ended December 31, 2007 provided cash of \$61.3 million and reflects equity financings of \$75.3 million less the scheduled repayment of debt. On February 27, 2007, the Company completed a private placement of 550,000 flow-through common shares at \$11.00 per share for gross proceeds of \$6.0 million. These proceeds are being used to expedite work on the Shebandowan Project. In December 2007 the Company completed an equity offering of 18.7 million units at a price of US\$4.00 per unit. In connection with the offering the company granted the underwriter's an over allotment option of 15% at the same price. This option was subsequently exercised in January 2008, increasing the gross proceeds of the offering to US\$85.9 million.

The Company's total debt position reduced to \$39.1 million at December, 2007 compared to \$74.9 million at December 31, 2006. During 2007, five principal payments related to Tranche I convertible notes totaling US\$17.5 million and three principal payments related to the Tranche II convertible note totaling US\$4.5 million were made. At the noteholder's option, these payments were settled in a non-cash transaction by the issuance of 3,120,997 common shares which, in accordance with the terms of the convertible notes loan agreement, are valued at 90% of the five day volume weighted average price on the AMEX exchange immediately prior to the payment date. As at December 31,

¹ Non-GAAP measure. Reference should be made to footnote 1 at the end of this MD&A.

2007, US\$26.5 million of principal amount of the convertible notes remained outstanding. The Company expects that the noteholders will continue to elect to receive interest and principal payments in common shares, however, should noteholders call for cash payments the Company has the right to defer payment of principal to the Series I and Series II note due dates of August 1, and December 1, 2008 respectively. The reduction in debt also includes scheduled long term debt repayments (\$6.2 million), scheduled capital lease repayments (\$2.0 million) and the repayment of the Kaiser-Francis Oil Company ("Kaiser-Francis") credit facility (\$5.8 million) from the first advance under the Auramet palladium and platinum advance purchase agreement (see Capital Resources below).

In addition, the strengthening of the Canadian dollar resulted in an unrealized foreign exchange translation gain on US dollar denominated debt at December 31, 2007 of \$8.4 million.

On October 12, 2006 the Company closed a transaction with Kaiser-Francis for a US\$5.0 million short term working capital loan maturing December 31, 2006. The interest rate under the loan was the 30-day LIBOR plus 2.5% per annum. The Company paid a commitment fee of US\$37,000 and amounts not drawn under the loan were subject to a standby fee of 0.125% per annum. In connection with the loan, the Company granted to Kaiser-Francis 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 change in terms. The Company paid a commitment fee of US\$25,000 for the extension. In accordance with the terms of the Auramet palladium and platinum advance purchase agreement, the first advance received from Auramet on March 7, 2007 was used to repay this loan to Kaiser-Francis.

Investing activities required \$15.3 million of cash in 2007, the majority of which was attributable to the ongoing lateral development and sustaining capital for the underground mine (\$9.2 million) and the 2007 expansion of the tailings management facilities (\$4.3 million). This compares with \$19.4 million of net investing activities last year, which was mainly related to the underground mine development and sustaining capital (\$12.1 million) and the 2006 expansion of the tailings management facilities (\$4.7 million).

CAPITAL RESOURCES

As at December 31, 2007 the Company had cash and cash equivalents of \$74.6 million compared to \$3.2 million at the same time last year.

To meet working capital requirements and lateral development of the underground mine, the Company entered into a palladium and platinum advance purchase facility with Auramet Trading, LLC on January 19, 2007 pursuant to which the Company may, at its election, receive advance payments not exceeding an aggregate maximum amount of US\$25.0 million. The Company is required to pay a monthly commitment fee of 0.5% per annum, on the unused portion of the Auramet facility. As at December 31, 2007, the Company had no advances outstanding under this facility and the maximum amount of US\$25.0 million was available. Under the current agreement with Auramet no advances can be received after June 2008 and any amounts advanced must be repaid by December 2008.

The Company anticipates that current capital resources are sufficient to meet the needs of the existing operations at the Lac des Iles mine as well as the development of the Shebandowan West project, Phase I of the OHGZ project and further evaluation of APP. The Company is currently pursuing options for the renewal or replacement of the Auramet working capital facility together with financing options to provide funding for the development of the APP project in Finland.

Contractual Obligations

As at December, 2007

(thousands of dollars)	Payments Due by Period			
	Total	1 Year	2-3 Years	4-5 Years ⁽²⁾
Senior credit facility	\$ 9,875	\$ 5,918	\$ 3,957	\$ —
Capital lease obligations	3,496	1,672	1,824	—
Convertible notes payable ⁽¹⁾	25,710	25,710	—	—
Interest obligations	1,421	1,158	263	—
Operating leases	3,257	1,224	2,008	25
Other purchase obligations	10,808	10,808	—	—
	\$ 54,567	\$ 46,490	\$ 8,052	\$ 25

¹ To date noteholders have elected to receive principal and interest payments in common stock.

² There are no payments due after five years.

RELATED PARTY TRANSACTIONS

On June 23, 2006, the Company repaid the balance of a US\$20.0 million non-revolving credit facility that had been extended by Kaiser-Francis in December 2001 to finance the Company's working capital requirements. This facility bore interest based on the 30-day LIBOR plus 2.50% and was subject to a standby fee of 0.125% per annum. The amount paid to Kaiser-Francis for interest and standby fee on this facility in 2006 was \$0.6 million. Repayment of this facility was made pursuant to the terms of the Series II convertible note issued on June 23, 2006.

On October 12, 2006 the Company closed a transaction with Kaiser-Francis for 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 was based on the 30-day LIBOR plus 2.50% and the standby fee was 0.125% per annum. This facility was repaid on March 7, 2007. As of February 22, 2008 Kaiser-Francis reported that it held approximately 41% of the issued and outstanding common shares of the Company.

On December 13, 2007 the Company completed a public offering of 18,666,667 units at a price of US\$4.00 per unit (\$4.04 per unit) for total gross proceeds of approximately US\$74.7 million. Each unit consisted of one common share and one half of a common share purchase warrant of the Company. Each whole warrant will entitle the holder to purchase one common share at a price of US\$5.05 per share at any time on or prior to December 13, 2009. Pursuant to the terms of the securities purchase agreement dated March 24, 2006 between the Company, Kaiser-Francis and IP Synergy Finance Inc. ("IP Synergy") relating to the Company's convertible notes due 2008, Kaiser-Francis and IP Synergy each had a right to subscribe at the public offering price for up to 12.5% of the total securities being offered by the Company in this offering. If either Kaiser-Francis or IP Synergy subscribed for less than its 12.5% share, the unused right was to be offered to the non-declining party, Kaiser-Francis or IP Synergy, as the case may be. IP Synergy elected not to participate in this offering pursuant to its pre-existing participation right, and, in accordance with the terms of the securities purchase agreement, Kaiser-Francis elected to subscribe for 25% of this offering.

On January 9, 2008, the Company issued an additional 2,800,000 units under a 30-day overallotment option granted to the underwriters at an exercise at a price of US\$4.00 per unit, for total gross proceeds of US\$11.2 million. Kaiser-Francis also exercised its pre-existing right under the securities purchase agreement to subscribe for 25% of the overallotment units.

REVIEW OF OPERATIONS AND PROJECTS

Lac des Iles Property

The Lac des Iles mine consists of an open pit mine, an underground mine, a processing plant with a nominal capacity of approximately 15,000 tonnes per day, and the original mill (which is currently idle) with a capacity of approximately 2,400 tonnes per day. The primary deposit on the property is the Roby Zone, a disseminated magmatic nickel-copper-PGM deposit.

Mining Operations

The Company began mining the Roby Zone in 1993 using open pit mining methods. Ore and waste from the open pit is mined using conventional hydraulic 27 cubic meter and 23 cubic meter shovels, 190 tonne trucks, 187 millimeter blast hole drills and a fleet of conventional ancillary equipment. Mine waste is stockpiled outside of design pit limits.

Development of the underground mine commenced in the second quarter of 2004 in order to access the higher grade portion of the Roby Zone. The underground deposit lies below the ultimate pit bottom of the open pit and extends to a depth of approximately 660 meters below the surface where it is truncated by an offset fault. Commercial production from the underground mine commenced on April 1, 2006. For the year ended December 31, 2007, the underground mine had an average head grade of 5.79 grams per tonne palladium compared to 5.96 grams per tonne in 2006.

The chosen mining method for the underground mine is sublevel retreat longitudinal longhole stoping with no fill. The mining block interval is 70 meters floor to floor including a 15 meter to 25 meter sill pillar below each haulage level. Stopes are 45 meters to 55 meters high by the width of the ore body. Total intake ventilation for the mine is designed to be 205 cubic meters per minute. There is one intake ventilation raise/secondary egress situated outside the ultimate open pit limits and air exhausts up the main ramp.

The open pit has a remaining mine life of less than two years at the current rate of production. In light of favourable PGM market conditions, management is currently assessing the economic viability of a southern extension of the open pit, which could prolong the mine life of the open pit by an additional two to three years. The Company is contemplating commencing production from the upper portion of the OHGZ as the current underground mine ceases operations.

Milling Operations

In 2001, a new concentrator facility was commissioned which utilizes a conventional flotation technology to produce a palladium rich concentrate that also contains platinum, nickel, gold and copper.

Ore is first crushed in a gyratory crusher and conveyed to a coarse ore stockpile. With the commissioning of the secondary crusher in 2004, the coarse ore stream can be split so that a portion is crushed in the secondary crusher producing a fine material feed which is then combined with the coarse feed. This mixture of coarse and fine material feeds to the SAG mill to increase mill throughput. In 2005, modifications were made to the secondary crusher, including the installation of a slide gate and better control feed distribution. The ore is ground to a nominal P80 (the size of an opening through which 80% of the product will pass) of 74 microns in a conventional semi-autogenous mill/ball mill/pebble crusher (SABC) circuit. The ground ore then feeds a flotation circuit that is comprised of rougher/scavengers and four stages of cleaning. The flotation circuit in the old concentrator is currently connected to the new concentrator to provide additional cleaner flotation capacity. The final concentrate is thickened and dewatered using two pressure filters.

In 2007, the concentrator processed 5,006,383 tonnes of ore or 13,716 tonnes per calendar day at an average palladium head grade of 2.39 grams per tonne and an average palladium recovery of 74.8%. In 2006, the concentrator processed 4,570,926 tonnes of ore or 12,523 tonnes per calendar day at an average palladium head grade of 2.18 grams per tonne and an average palladium recovery of 74.0%. In 2007, the Company produced 286,334 ounces of palladium compared to 237,338 ounces in 2006.

Production costs per tonne of ore milled were \$24.98 in 2007 compared to \$24.60 in 2006. Cash costs, which include direct and indirect operating costs, smelting, refining, transportation and sales costs and royalties, net of credits for by-products, were US\$164 per ounce of palladium in 2007 as compared to US\$201 per ounce of palladium in 2006.

Offset High Grade Zone

The OHGZ is located on the Lac des Iles property and was discovered by the Company's exploration team in 2001. The OHGZ is believed to be the fault-displaced continuation of the Roby Zone mineralization and is located below and approximately 250 meters to the west of the Roby Zone. A mineral resource estimate prepared by Scott Wilson RPA in October 2007 estimated that the OHGZ has more than three times the mineral resources of the current underground mine at the Roby Zone at similar grades, while still being open along strike to the north, south and at depth.

From May to October 2007, the Company completed approximately 18,000 meters of infill drilling in the upper 300 meters of the OHGZ, with the objective of upgrading that portion of the mineral resources to the measured and indicated categories. The Company has begun to receive assay results and anticipates updating its mineral resources estimate for the OHGZ in the second quarter of 2008. The Company's objective is to commence production from the OHGZ as the current underground mine reaches the end of its mine life in 2010.

In September 2007, the Company engaged two consulting firms, Micon International Limited and Nordmin Engineering Ltd., to prepare a scoping study. The scoping study will examine the economic viability of several exploitation scenarios for the OHGZ, including a continuation of the ramp from the current underground mine and shaft options. A report on the results of this preliminary economic assessment is nearing completion and the Company anticipates releasing the results during the second quarter of 2008.

An exploration drilling program is also currently in progress to search for the deep limits of the OHGZ. To date, the OHGZ has been traced to a depth of 1,300 meters below surface, and along a strike length of approximately 600 meters.

Shebandowan West Project

On December 10, 2007, the Company earned a 50% interest in the former producing Shebandowan mine and the surrounding Haines and Conacher properties pursuant to an option and joint venture agreement with Vale Inco. In order to earn its 50% interest, the Company incurred \$3.0 million in exploration expenditures and made \$0.2 million in cash payments. The properties contain a series of nickel-copper-PGM mineralized bodies and the land package totals approximately 7,842 hectares. These properties are located 90 kilometers west of Thunder Bay, Ontario, and approximately 100 kilometers southwest from the Company's Lac des Iles mine. Vale Inco retains an option to increase its interest from 50% to 60%, exercisable in the event that a feasibility study on the properties results in a mineral reserve and mineral resource estimate of the equivalent of 200 million pounds of nickel and other metals. As currently envisaged, the Shebandowan West Project will not trigger Vale Inco's back-in right.

The Shebandowan West Project encompasses three shallow mineralized zones known as the West, Road and "D" zones, all of which are located at shallow depths immediately to the west of the former Shebandowan mine in an area known as the Shebandowan West district. The Shebandowan West Project's nickel-copper-PGM mineralization is believed by management to represent the western extension of the Shebandowan mine orebody. The former Shebandowan mine,

which was in operation from 1972 to 1998, produced 8.7 million tonnes of ore at grades of 2.07% nickel, 1.00% copper and approximately 3.0 g/t PGM and gold.

Management is considering a mine development scenario that would entail excavation of the Shebandowan West Project by means of ramp-accessed underground mining methods at a rate of 500 to 1,000 tonnes per day, crushing the material on site and transporting it by truck to the Lac des Iles property for processing at the original mill on the Lac des Iles property. The original mill at Lac des Iles has been idle since 2001 and the Company believes that it could be refurbished quickly and at a relatively low cost. Preliminary metallurgical testing supports the possibility of producing a bulk sulphide concentrate from the Shebandowan West Project at the original mill.

A Technical Report in compliance with National Instrument 43-101 disclosing the results of a mineral resource estimate by an independent Qualified Person was filed on October 26, 2007. In December 2007, the Company retained SRK Consulting to prepare a preliminary economic assessment of the ramp-accessed mine scenario. The results of this report are expected in the second quarter of 2008.

Community consultations and baseline environmental sampling are ongoing and completion of bulk sampling, process and design are expected to be completed during the first half of 2008. If plans proceed as expected, production at the Shebandowan West Project could commence in 2009.

Arctic Platinum Project

The Company is party to an agreement with Gold Fields entitling it to earn up to a 60% interest in a series of mining licenses and claims known as the APP. The agreement is subject to a back-in right in favor of Gold Fields which, if exercised, would decrease the Company's interest to a 50% share. Upon satisfaction of the earn-in requirements, North American Palladium will have a casting vote at meetings of the joint venture partners, other than with respect to matters requiring a special majority vote.

In order to exercise the option, on or before August 31, 2008, the Company must: (i) complete a re-scoping and exploration program; (ii) complete a feasibility study; (iii) make a production decision and prepare the initial formal development proposal and associated budget based on the feasibility study; (iv) incur expenditures of US\$12.5 million on the APP; and (v) issue 7,381,636 Common Shares to Gold Fields BV in order to earn a 50% interest or 9,227,033 Common Shares to earn a 60% interest. To date, the Company has completed the re-scoping study, incurred over US\$11.6 million in expenditures and has commissioned a feasibility study. The Company believes that it will satisfy the conditions of the earn-in on or before August 31, 2008.

The APP is an advanced-stage PGM-nickel-copper exploration project located approximately 60 kilometers south of the city of Rovaniemi, Finland. To date, three areas of the APP have been explored by North American Palladium: the Suhanko deposits, the Narkaus deposits and the Penikat deposits.

The Suhanko Deposits

The Suhanko deposits are located approximately 60 kilometers south of the city of Rovaniemi, which has a population of approximately 4,400 and, as the capital of the Province of Lapland, is a major regional centre. The town is serviced by rail, road and air with multiple flights daily to and from Helsinki. The port of Kemi on the Gulf of Bothnia is kept open throughout the winter and is located 120 kilometers southwest of Rovaniemi.

Suhanko is comprised of several deposits over a total strike length of approximately 17 kilometers that have been demonstrated by Gold Fields to contain a number of nickel-copper-PGM deposits. Since the discovery of nickel-copper-

PGM mineralization at the Yli-Portimo deposit in 1964, exploration in the Suhanko project area in the intervening years has resulted in the discovery of the following other deposits: Konttijarvi, Little Suhanko, Vaaralampi, Niittilampi, Ahmavaara, Suhanko North, and Tuumasuo. Exploration and delineation work in connection with the Company's preparation of a feasibility study has focused on only the Konttijarvi and Ahmavaara deposits, with the total sizes of the remaining deposits being essentially undetermined.

The Narkaus Deposits

The Narkaus deposits are located approximately 30 kilometers northeast of the Suhanko deposits and contains a sequence of favorable rocks that have been demonstrated to be present along an aggregate strike length of approximately 20 kilometers. To date, significant nickel-copper-PGM mineralization has been discovered at a number of deposits, including the Siika-Kama, Kuohunki, Nutturalampi and Kilvenjärvi deposits. The Company continues to explore deposits in the Narkaus deposit area with a view to potentially improving the overall economics of the larger Suhanko deposit area.

The Penikat Deposits

The Penikat deposits are a separate intrusion located approximately 35 kilometers to the southwest of the Suhanko deposits. Traditional reef-style nickel-copper-PGM mineralization has been discovered in three distinct reefs over a strike length of approximately 27 kilometers. To date, exploration has concentrated on evaluating the shallow portions (essentially above a depth of 100 meters from surface) of one of these reefs where significant concentrations of nickel-copper-PGM mineralization located in the northern portion of the intrusion have been discovered. The exploration potential of the remaining two reefs, along with the depth extensions of the explored reef, remains essentially untested.

The Suhanko Deposits

Management has been examining a development scenario consisting of two nickel-copper-PGM open pit mines at two of the deposits that comprise the Suhanko area, the Ahmavaara and Konttijarvi deposits, which are located three kilometers from each other. The nickel-copper-PGM bearing material would be processed through a centrally-located concentrator at a nominal throughput rate of 5.0 million tonnes per year. PGM-nickel-copper bearing concentrate would be transported 125 kilometers by truck to a port facility located at Kemi, Finland and shipped to smelting and refining facilities for final extraction of the contained metals.

On October 30, 2007, the Company released the results of a scoping study by Aker Kvaerner on the two main mineral deposits in the Suhanko area, Ahmavaara and Konttijarvi, which indicated that the mineral resources could potentially support a 20-year mine life at approximately 7.5 million tonnes per annum. The Company has retained Aker Kvaerner to prepare a definitive feasibility study for the Suhanko project to build upon the recommendations in the scoping study. The Company has also contracted with a 30-year veteran of the mining industry to oversee the feasibility study and other work at the APP as the Company moves closer to satisfying its earn-in conditions.

An infill drilling campaign at the Ahmavaara deposit was completed earlier in 2007 and the assay results of the final 26 holes of the 83-hole drilling program were reported on October 22, 2007. Micon International Limited has now been engaged to conduct the update of the mineral resource estimates, which will include the results from the Ahmavaara infill drilling campaign. Micon will also conduct the open pit designs and optimization.

Bulk sampling of the Ahmavaara and Konttijarvi deposits was also completed in October 2007 in advance of pilot plant test work. A program of bench scale metallurgical testing has been completed in support of a pilot plant test that

commenced in December 2007 and was completed in February 2008. The pilot plant test provided samples that will be tested by smelters that have been identified for the concentrate marketing strategy and will allow the Company to pilot a flowsheet. In October 2007, the Company commenced discussions with various smelters, and follow-up meetings are planned now that samples are available. Initial smelting proposals in support of the feasibility study are anticipated by May 2008.

Grassroots Exploration Properties

In addition to its operating mine and three advanced exploration projects, the Company is constantly examining PGM and nickel opportunities, particularly in the areas surrounding the Company's Lac des Iles mine.

Management believes that the Company is well positioned to partner with other PGM and nickel exploration companies in Canada, given the existing infrastructure at the Lac des Iles mine and the Company's years of experience in mining PGM-nickel deposits. From time to time, the Company enters into confidentiality agreements with junior mining companies or individual prospectors to assess the prospective nature of their land holdings. In addition, management believes that the consolidation in the nickel industry may result in joint venture or acquisition opportunities for the Company as the major nickel companies seek to shed non-core assets.

The Company is also active in grassroots exploration and recently staked 39 claims containing 632 claim units at the Company's Shawmere Project, located approximately 110 kilometers southwest of Timmins, Ontario, Canada. The Company intends to conduct a grassroots exploration program to assess the area's potential for hosting PGM-nickel-copper mineralization similar to that found at its Lac des Iles mine.

Metal Sales

In 2007, the Company sold palladium both into the spot market and to Auramet Trading, LLC, a precious metals merchant ("Auramet"), under a palladium and platinum advance purchase facility that the Company entered into in January 2007. The facility provides for the sale, at the Company's option, of an average of 10,000 ounces of palladium and 500 ounces of platinum per month. Under the terms of the facility, the Company may receive advance payments not exceeding, at any time, an aggregate maximum of US\$25 million. The purchase price may be fixed or provisional. For fixed pricing, the Company may price at either: (i) Auramet's current market bid price at the time of the transaction, or (ii) market limit orders, as defined under the terms of the agreement. In the case of provisional pricing, it is determined based on the afternoon fixing of the London Bullion Marketing Association immediately preceding the purchase. In each case, such pricing will reflect the forward value corresponding to the scheduled delivery date. Each advance payment is subject to a discount and, upon the delivery of the precious metals to Auramet, the Company is paid the difference between the advance payment and the purchase price. To secure the obligations of the Company under the agreement, the Company has granted to Auramet a security interest in the concentrates mined at the Lac des Iles mine, together with the proceeds arising from the sale of the concentrate, and, by way of security, an assignment of its smelting and refining agreement.

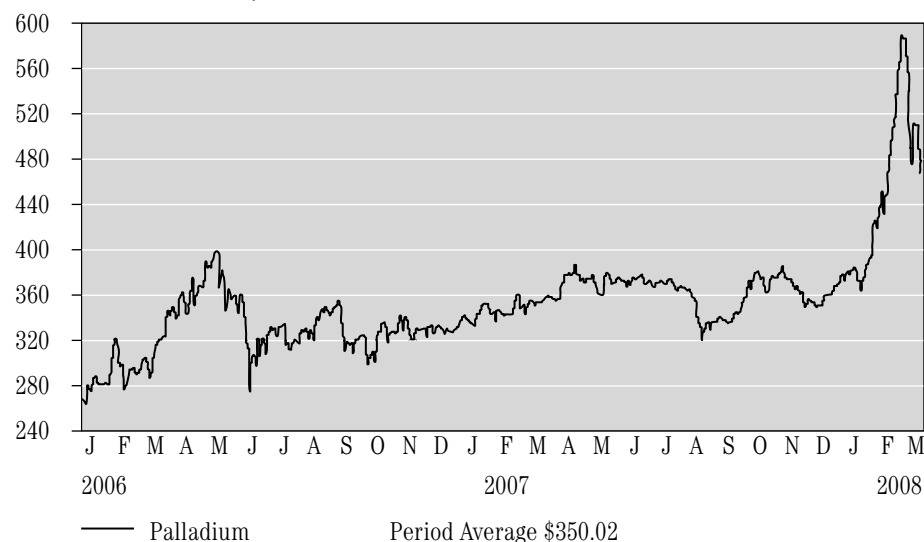
In 2006, all palladium production was sold into the spot market with one or more commodity dealers and manufacturers. From January 2000 to June 2005, the Company sold all of its palladium production to an automotive manufacturer under a contract with a US\$325 per ounce floor price for 100% of its palladium production and a US\$550 per ounce ceiling price on 50% of its palladium production.

For the year ended December 31, 2007, the Company recorded a weighted average cash price of US\$356 per ounce on its physical deliveries of palladium into the spot market. The Company expects that palladium prices will continue to trade higher in 2008 than in 2007. The average spot price was US\$360 per ounce for the fourth quarter of 2007 (reaching a high of US\$379), compared to an average price of US\$321 per ounce for same period last year. Since January 1, 2005, the price of palladium has shown strong growth as a result of strong demand, most notably in the automotive industry, as indicated in the chart below from Johnson Matthey.

LONDON PALLADIUM CASH PRICE US\$/TROY OZ

Jan. 01, 2006 - Mar. 18, 2008

JM Base Prices US\$ Daily



Source: Johnson Matthey

MANAGEMENT'S OUTLOOK

There is no significant 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, the corresponding world spot prices of such metals and the prevailing US\$ exchange rate.

Production for the year ended December 31, 2007 was 286,334 ounces of palladium with an average palladium head grade of 2.39 grams per tonne, and represents a 21% increase over the previous year's production of 237,338 ounces, with a head grade of 2.18 grams per tonne. This continues the trend of improved volumes and head grade year over year reflecting the impact of the underground mine which has been in commercial production since the second quarter of last year. The Company's 2008 year end production target is approximately 300,000 ounces of palladium. The proportion of by product metals produced is, in aggregate, expected to increase in tandem with palladium production.

The Company's intensive core exploration program will continue in 2008, with an important component being the continuation of activities on the APP in Finland. In addition, the Company continues to focus on the further definition of the OHGZ at Lac des Iles and the development of the Shebandowan West Project. A key strategy moving forward will be to continue the pursuit of opportunities to acquire good quality PGM-Ni-Cu projects.

Recorded Metal Prices

	2005	2006	2007	YTD 2008*
Palladium – US\$/oz	\$ 230	\$ 319	\$ 356	\$ 462
Platinum – US\$/oz	\$ 815	\$ 1,140	\$ 1,364	\$ 1,903
Gold – US\$/oz	\$ 442	\$ 610	\$ 726	\$ 941
Nickel – US\$/lb	\$ 6.60	\$ 11.68	\$ 15.58	\$ 13.18
Copper – US\$/lb	\$ 1.50	\$ 3.02	\$ 3.30	\$ 3.48

* Based on the average month end London Metal Exchange (“LME”) afternoon price fix for the two months ended February 29, 2008.

The Company believes that the surplus pressures of the early 2000's have abated and that there is evidence to support the view that the palladium market is moving towards more of a demand driven pricing environment. This is being evidenced by increasing global catalytic demand, fueled by growing low tolerance emission legislation, and technological advances which could exploit pricing differentials between palladium and platinum. Electrical power supply problems in South Africa that produces approximately 35% of the world's supply of palladium is another catalyst for higher palladium and platinum prices.

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 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 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 charges.

(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 to which they relate or on a straight-line basis over their estimated useful lives, ranging from three to seven years.

(c) 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 which are subject to final assay adjustments.

(d) 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

(a) Financial Instruments – Recognition and Measurement

In December 2006, the CICA released new Handbook sections 3862, "Financial Instruments – Disclosures", and 3863, "Financial Instruments – Presentation", effective for fiscal years beginning on or after October 1, 2007. Section 3862, describes the required disclosures related to the significance of financial instruments on the Company's financial position and performance and the nature and extent of risks arising for financial instruments to which the entity is exposed and how the entity manages those risks. This section complements Handbook sections 3855, "Financial Instruments – Recognition and Measurements"; 3863, "Financial Instruments – Presentation"; and 3865, "Hedges". Section 3863, establishes standards for presentation of financial instruments and non financial derivatives. This section complements Handbook section 3861, "Financial Instruments – Disclosure and Presentation". The Company has not yet determined the effect these new standards will have on its financial position and results of operations.

(b) Capital Disclosures

In December 2006, the CICA released new Handbook section 1535, "Capital Disclosures", which establishes standards for disclosing information about a Company's capital and how it is managed, to enable users of financial statements to evaluate the Company's objectives, policies and procedures for managing capital. This section will apply to interim and annual financial statements relating to fiscal years beginning on or after January 1, 2008. The Company has not yet determined the effect these new standards will have on its financial position and results of operations.

(c) Inventories

In June 2007, the CICA released new Handbook section 3031, "Inventories," effective for interim and annual financial statements beginning on or after January 1, 2008. Section 3031 supersedes the existing CICA section 3030, "Inventories," and provides additional guidance on the determination of cost and its subsequent recognition as an expense, including any write-down to net realizable value, and disclosures made within the financial statements. The Company has not yet determined the effect these new standards will have on its financial position and results of operations.

OUTSTANDING SHARE DATA

As of March 18, 2008, there were 80,633,812 common shares of the Company outstanding and options outstanding pursuant to the 1995 Corporate Stock Option Plan entitling holders thereof to acquire 391,433 common shares of the Company at an average strike price of \$9.82. As of the same date, there were also 12,724,202 warrants outstanding, each warrant entitling the holder thereof to purchase one common share at an average strike price of US\$5.81.

RISKS AND UNCERTAINTIES

The price of palladium is the most significant factor influencing the profitability of the Company. In the twelve months ended December 31, 2007, sales of palladium accounted for approximately 47% (December 31, 2006 – approximately 48%) 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 will affect financial results since the prices of the Company's products are denominated in United States dollars, whereas the Company's administration, operating and exploration expenses are incurred mainly in Canadian dollars. As a result, any strengthening of the Canadian dollar relative to the United States dollar has a negative impact on the Company's 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 was renegotiated during the second quarter of 2007 for a three year term that expires on March 31, 2010. This agreement may be extended on an annual basis for an additional two years by mutual agreement of both parties if such agreement is reached no later than six months prior to the anniversary date of March 31, 2010.

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.

For the twelve months ended December 31, 2007, the President and Chief Executive Officer and Vice President, Finance and Chief Financial Officer certify that they have designed, or caused to be designed under their supervision, disclosure controls and procedures 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.

The disclosure controls and procedures are evaluated annually through regular internal reviews which are carried out under the supervision of, and with the participation of, the Company's management, including the President and Chief Executive Officer and Vice President, Finance and Chief Financial Officer. Based on that evaluation, the President and Chief Executive Officer and Vice President, Finance and Chief Financial Officer concluded that the design and operation of these disclosure controls and procedures were effective as of December 31, 2007.

INTERNAL CONTROL OVER FINANCIAL REPORTING

For the year ended December 31, 2007, the President and Chief Executive Officer and Vice President, Finance 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 Canadian GAAP and including a reconciliation to U.S. GAAP.

There have been no changes in the Company's internal controls over the financial reporting that occurred during the most recent interim period ended December 31, 2007 that have materially affected or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Management is responsible for establishing and maintaining adequate internal controls over financial reporting. Internal control over financial reporting, no matter how well designed, has inherent limitations and can only provide reasonable assurance with respect to the preparation and fair presentation of published financial statements. Under the supervision and with the participation of the President and Chief Executive Officer and the Vice President, Finance and Chief Financial Officer, management conducted an evaluation of the effectiveness of its internal control over financial reporting based on the framework in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on that evaluation, the President and Chief Executive Officer and Vice President, Finance and Chief Financial Officer concluded that the design and operation of these internal controls over financial reporting were effective as at December 31, 2007.

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.

¹ Non-GAAP Measures

This management's discussion and analysis refers to cash cost per ounce and operating cash flow which are not recognized measures under Canadian GAAP. Such non-GAAP financial measures do not have any standardized meaning prescribed by Canadian GAAP and are therefore unlikely to be comparable to similar measures presented by other issuers. Management uses these measures internally. The use of these measures enables management to better assess performance trends. Management understands that a number of investors and others who follow the Company's performance assess performance in this way. Management believes that these measures better reflect the Company's performance for the current period and are a better indication of its expected performance in future periods. 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 Canadian GAAP. The following tables reconcile these non-GAAP measures to the most directly comparable Canadian GAAP measure:

(a) Reconciliation of Cash Cost per Ounce to Financial Statements

(thousands of dollars except per ounce amounts)	Three months ended		Twelve months ended	
	December 31		December 31	
	2007	2006	2007	2006
Production costs including overhead	\$ 30,530	\$ 29,553	\$ 125,065	\$ 112,458
Smelter treatment, refining and freight costs	5,939	4,487	22,444	15,438
	36,469	34,040	147,509	127,896
Less by-product metal revenue	(22,701)	(26,574)	(104,126)	(83,556)
	13,768	7,466	43,383	44,340
Divided by ounces of palladium	62,446	59,333	251,531	193,067
Cash cost per ounce (C\$)	220	126	172	230
CDN.\$ exchange rate	0.988	1.165	1.050	1.141
Cash cost per ounce (US\$)	\$ 223	\$ 108	\$ 164	\$ 201

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

	Three months ended		Twelve months ended	
	December 31		December 31	
	2007	2006	2007	2006
Operating cash flow	\$ 6,858	\$ 8,421	\$ 46,828	\$ 9,912
Changes in non-cash working capital	3,663	(13,995)	(21,352)	(43,701)
Cash provided by operating activities	\$ 10,521	\$ (5,574)	\$ 25,476	\$ (33,789)

* Certain prior period amounts have been reclassified to conform to the classification adopted in the current period.

CAUTIONARY STATEMENT ON FORWARD-LOOKING INFORMATION

Certain information included in this MD&A, including any information as to our future financial or operating performance and other statements that express management's expectations or estimates of future performance, constitute 'forward-looking statements' within the meaning of the 'safe harbor' provisions of the United States Private Securities Litigation Reform Act of 1995 and Canadian securities laws. The words 'expect', 'believe', 'will', 'intend', 'estimate' and similar expressions identify forward-looking statements. Forward-looking statements are necessarily based upon a number of estimates and assumptions that, while considered reasonable by management, are inherently subject to significant business, economic and competitive uncertainties and contingencies. These statements are based on certain factors and assumptions, including but not limited to, the assumption that market fundamentals will result in increased palladium demand and prices and sustained by-product metal demand and prices; the integrated operation of the Company's underground mine and the open pit mine remain viable operationally and economically; financing is available on reasonable terms; expectations for blended mill feed head grade and mill performance will proceed as expected; new mine plan scenarios will be viable operationally and economically; and plans for mill production, sustainable recoveries from the Lac des Iles mine, exploration at Lac des Iles and elsewhere will all proceed as expected.

The Company cautions the reader that such forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause the actual financial results, performance or achievements of North American Palladium to be materially different from the Company's estimated future results, performance or achievements expressed or implied by those forward-looking statements and that the forward-looking statements are not guarantees of future performance. These risks, uncertainties and other factors include, but are not limited to: metal price volatility; economic and political events affecting metal supply and demand; changes in the regulatory environment; fluctuations in ore grade or ore tonnes milled; geological, technical, mining or processing problems; future production; changes in the life-of-mine plan or the ultimate pit design; availability and increasing costs associated with mining inputs and labour; the speculative nature of exploration and development, including the risks of diminishing quantities or grades of mineral reserves; adverse changes in our credit rating; and the risks involved in the exploration, development and mining business. These factors are discussed in greater detail in the Company's most recent Form 40-F/Annual Information Form 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 except as required by law. Readers are cautioned not to put undue reliance on these forward-looking statements.

Management's Responsibility for Financial Statements

The accompanying consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles (GAAP). Financial statements include certain amounts based on estimates and judgments. When an alternative method exists under Canadian GAAP, management has chosen that which it deems most appropriate in the circumstances in order to ensure that the consolidated financial statements are presented fairly, in all material respects, in accordance with Canadian generally accepted accounting principles. The financial information presented elsewhere in the annual report is consistent with that in the consolidated financial statements.

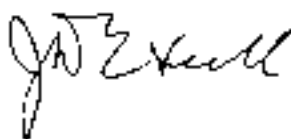
The Company maintains adequate systems of internal accounting and administrative controls. Such systems are designed to provide reasonable assurance that transactions are properly authorized and recorded, the Company's assets are appropriately accounted for and adequately safeguarded and that the financial information is relevant and reliable.

The Board of Directors of the Company is responsible for ensuring that management fulfills its responsibilities for financial reporting, and is ultimately responsible for reviewing and approving the consolidated financial statements and the accompanying management's discussion and analysis. The Board of Directors carries out this responsibility principally through its Audit Committee.


The Audit Committee is appointed by the Board of Directors and all of its members are non-management directors. The Audit Committee meets periodically with management and the external auditors to discuss internal controls, auditing matters and financial reporting issues, and to satisfy itself that each party is properly discharging its responsibilities. The Audit Committee also reviews the consolidated financial statements, management's discussion and analysis, the external auditors' report, examines the fees and expenses for audit services, and considers the engagement or reappointment of the external auditors. The Audit Committee reports its findings to the Board of Directors for its consideration when approving the consolidated financial statements for issuance to the shareholders. KPMG LLP, the external auditors, have full and free access to the Audit Committee.

Toronto, Canada

March 18, 2008



James D. Excell
President and CEO



G. Fraser B. Sinclair
Vice President Finance, and CFO

Auditors' Report


TO THE SHAREHOLDERS OF NORTH AMERICAN PALLADIUM LTD.

We have audited the consolidated balance sheets of North American Palladium Ltd. ("the Company") as at December 31, 2007 and 2006 and the consolidated statements of operations, comprehensive loss and deficit, cash flows and shareholders' equity for each of the years in the three-year period ended December 31, 2007. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. With respect to the consolidated financial statements for the year ended December 31, 2007, we also conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2007 and 2006 and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2007 in accordance with Canadian generally accepted accounting principles.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2007, based on the criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 18, 2008 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

A handwritten signature in black ink that reads "KPMG LLP". The signature is written in a cursive, stylized font. Below the signature is a horizontal line that starts under the "K" and ends under the "P", with a small upward tick at the end.

KPMG LLP

Chartered Accountants, Licensed Public Accountants

Toronto, Canada,

March 18, 2008.

Consolidated Balance Sheets

[expressed in thousands of Canadian dollars]

December 31	2007	2006
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 74,606	\$ 3,153
Concentrate awaiting settlement, net – Note 3	79,087	82,050
Taxes recoverable	62	145
Inventories – Note 4	17,873	14,164
Crushed and broken ore stockpiles	8,072	7,134
Other assets	2,563	2,602
	182,263	109,248
Mining interests, net – Note 5	114,464	146,617
Mine restoration deposit – Note 6	8,272	8,041
Crushed and broken ore stockpiles	375	289
Deferred financing costs – Note 7	–	962
	\$ 305,374	\$ 265,157
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Accounts payable and accrued liabilities	\$ 20,757	\$ 21,526
Future mining tax liability – Note 19	168	149
Current portion of obligations under capital leases – Note 8	1,672	2,104
Current portion of convertible notes payable – Note 9	25,710	22,148
Current portion of long-term debt – Note 10	5,918	6,662
Kaiser-Francis credit facility – Note 11	–	5,827
	54,225	58,416
Mine restoration obligation – Note 2	8,878	8,211
Obligations under capital leases – Note 8	1,824	4,111
Convertible notes payable – Note 9	–	23,062
Long-term debt – Note 10	3,957	10,992
Future mining tax liability – Note 19	539	381
	69,423	105,173
Shareholders' Equity		
Common share capital and purchase warrants – Note 13	443,986	339,743
Stock options	1,673	1,269
Equity component of convertible notes payable, net of issue costs – Note 9	6,044	12,336
Contributed surplus	6,292	–
Deficit	(222,044)	(193,364)
Total shareholders' equity	235,951	159,984
	\$ 305,374	\$ 265,157

Commitments – Notes 1 and 15

Contingencies – Note 6 and 18

Subsequent events – Note 21

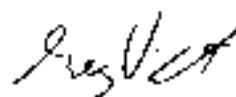
See accompanying notes to the consolidated financial statements

On Behalf of the Board



André J. Duchane

Director



Gregory J. Van Staveren

Director

Consolidated Statements of Operations, Comprehensive Loss and Deficit

(expressed in thousands of Canadian dollars, except share and per share amounts)

Year ended December 31	2007	2006	2005
Revenue – before pricing adjustments	\$ 201,367	\$ 145,819	\$ 85,233
Pricing adjustments:			
Commodities	8,756	11,674	7,727
Foreign exchange	(14,191)	1,707	(354)
Revenue – after pricing adjustments – Note 16	195,932	159,200	92,606
Operating expenses			
Production costs, excluding amortization and asset retirement costs	125,065	112,458	99,322
Smelter treatment, refining and freight costs	22,444	15,438	15,777
Amortization – Note 5(b)	46,908	30,103	18,297
Administrative	7,773	6,734	6,616
Exploration	12,138	11,831	7,927
Loss on disposal of equipment	–	194	–
Asset retirement costs	1,010	554	476
Total operating expenses	215,338	177,312	148,415
Loss from mining operations	(19,406)	(18,112)	(55,809)
Other income (expenses)			
Interest and other financing costs – Note 17	(18,633)	(15,647)	(952)
Foreign exchange gain (loss)	8,422	(1,759)	268
Total other income (expenses)	(10,211)	(17,406)	(684)
Loss before taxes	(29,617)	(35,518)	(56,493)
Income and mining tax recovery – Note 19	(937)	(1,409)	(2,882)
Net loss and comprehensive loss for the year	(28,680)	(34,109)	(53,611)
Deficit, beginning of year	(193,364)	(159,255)	(105,644)
Deficit, end of year	\$ (222,044)	\$ (193,364)	\$ (159,255)
Net loss per share			
Basic	\$ (0.51)	\$ (0.65)	\$ (1.03)
Diluted – Note 13(f)	\$ (0.51)	\$ (0.65)	\$ (1.03)
Weighted average number of shares outstanding – basic	55,792,203	52,562,939	52,006,548
Weighted average number of shares outstanding			
– diluted – Note 13(f)	55,792,203	52,562,939	52,006,548

See accompanying notes to the consolidated financial statements

Consolidated Statements of Cash Flows

[expressed in thousands of Canadian dollars]

Year ended December 31	2007	2006	2005
Cash provided by (used in)			
Operations			
Net loss for the year	\$ (28,680)	\$ (34,109)	\$ (53,611)
Operating items not involving cash			
Accretion expense relating to convertible notes payable	12,947	10,090	—
Amortization	46,908	30,103	18,297
Amortization of deferred financing costs	751	1,090	43
Interest on convertible notes settled in shares	2,644	1,974	—
Accrued interest on mine restoration deposit	(231)	(194)	(74)
Unrealized foreign exchange loss (gain)	10,779	(822)	(33)
Asset retirement costs	1,010	554	476
Future income tax recovery – Note 19	(937)	(739)	(3,286)
Stock based compensation and employee benefits	1,637	1,771	1,728
Loss on disposal of equipment	—	194	—
	46,828	9,912	(36,460)
Changes in non-cash working capital – Note 20(a)	(21,352)	(43,701)	28,187
	25,476	(33,789)	(8,273)
Financing Activities			
Issuance of common shares and warrants, net of issue costs – Note 13	75,318	3,955	3,200
Repayment of long-term debt	(12,016)	(6,566)	(6,798)
Repayment of obligations under capital leases	(1,979)	(2,278)	(2,253)
Mine restoration deposit	—	(600)	(1,200)
Issuance of convertible notes	—	41,037	—
Increase in long-term debt and credit facility	—	8,111	—
Deferred financing costs	—	(2,364)	—
	61,323	41,295	(7,051)
Investing Activities			
Additions to mining interests	(15,346)	(19,384)	(35,415)
Proceeds on disposal of mining interests	—	—	15
	(15,346)	(19,384)	(35,400)
Increase (decrease) in cash and cash equivalents	71,453	(11,878)	(50,724)
Cash and cash equivalents, beginning of year	3,153	15,031	65,755
Cash and cash equivalents, end of year	\$ 74,606	\$ 3,153	\$ 15,031
Cash and cash equivalents consisting of:			
Cash	\$ 4,444	\$ 3,153	\$ 15,031
Short-term investments	70,162	—	—
	\$ 74,606	\$ 3,153	\$ 15,031

Supplementary information – Note 20(b), (c), (d) and (e)

See accompanying notes to the consolidated financial statements

Consolidated Statements of Shareholders' Equity

[expressed in thousands of Canadian dollars]

	Number of shares	Capital stock	Stock options	Warrants	Equity component of convertible notes payable	Contributed surplus	Deficit	Total shareholders' equity
Balance, December 31, 2006	52,947,693	\$331,705	\$1,269	\$8,038	\$12,336	\$—	\$(193,364)	\$159,984
Common shares issued:								
For principal repayments on convertible notes payable	3,120,997	26,180	—	—	(6,292)	6,292	—	26,180
For interest payments on convertible notes payable	341,528	2,644	—	—	—	—	—	2,644
Private placement of flow-through shares (net)	550,000	5,686	—	—	—	—	—	5,686
Tax effect of flow-through shares	—	(1,114)	—	—	—	—	—	(1,114)
Pursuant to unit offering, net of issue costs	18,666,667	64,461	—	—	—	—	—	64,461
Warrants Issued:								
Pursuant to unit offering, net of issue costs	—	—	—	5,155	—	—	—	5,155
Stock options exercised	5,000	17	—	—	—	—	—	17
Fair value of stock options exercised	—	10	(10)	—	—	—	—	—
Stock-based compensation expense	138,685	1,204	414	—	—	—	—	1,618
Net loss for the year ended December 31, 2007	—	—	—	—	—	—	(28,680)	(28,680)
Balance, December 31, 2007	75,770,570	\$430,793	\$1,673	\$13,193	\$6,044	\$6,292	\$(222,044)	\$235,951
Balance, December 31, 2005	52,197,217	\$325,592	\$874	\$—	\$—	\$—	\$(159,255)	\$167,211
Common shares issued:								
For interest payments on convertible notes payable	242,158	1,974	—	—	—	—	—	1,974
Private placement of flow-through shares (net)	270,000	3,045	—	—	—	—	—	3,045
Tax effect of flow-through shares	—	(1,067)	—	—	—	—	—	(1,067)
Warrants Issued:								
Pursuant to terms of Series I convertible notes, net of issue costs	—	—	—	6,238	9,750	—	—	15,988
Pursuant to terms of Series II convertible note, net of issue costs	—	—	—	1,800	2,586	—	—	4,386
Stock options exercised	130,755	910	—	—	—	—	—	910
Fair value of stock options exercised	—	166	(166)	—	—	—	—	—
Stock-based compensation expense	107,563	1,085	561	—	—	—	—	1,646
Net loss for the year ended December 31, 2006	—	—	—	—	—	—	(34,109)	(34,109)
Balance, December 31, 2006	52,947,693	\$331,705	\$1,269	\$8,038	\$12,336	\$—	\$(193,364)	\$159,984

See accompanying notes to the consolidated financial statements

Notes to the Consolidated Financial Statements

for the years ended December 31, 2007, 2006 and 2005

(expressed in thousands of Canadian dollars, except per share amounts and metal prices)

1. NATURE OF OPERATIONS

North American Palladium Ltd. ("NAP" or "the Company") is a Canadian company in the business of exploring and mining Platinum Group Metals ("PGMs") and certain base and precious metals. Its principal asset is the Lac des Iles mine located in the Thunder Bay District in Ontario. The Company also has a number of base metal exploration projects located in Canada and an advanced PGM exploration project located in Finland in which it is earning an interest in under an agreement signed on March 24, 2006. The Company operates in one operating segment, mining.

The Company's financial position and operating results are directly affected by the market price of the PGMs in relation to the Company's production costs. The prices of PGMs (palladium, platinum) and by-product metals (gold, copper and nickel) fluctuate widely and are affected by numerous factors beyond the Company's control.

Arctic Platinum Project

On March 24, 2006, the Company entered into an agreement with Gold Fields Limited to further explore and develop a mining operation at the Arctic Platinum Project ("APP") located in Finland. 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, in which event a joint venture will be formed and the Company will become the project operator. In order to exercise the option, the Company must spend US\$12,500, complete a feasibility study and make a production decision as well as issue to Gold Fields, approximately 7.3 million shares or approximately 9.2 million shares, subject to adjustment, to earn a 50% or 60% interest respectively on or before August 31, 2008. As at December 31, 2007, the Company has incurred \$12,758 (US\$11,670) in expenditures on the APP and these costs have been charged to exploration expense.

Shebandowan Project

On December 3, 2003, the Company entered into an option and joint venture agreement with Vale Inco Limited (formerly Inco Limited and CVRD Inco Limited) on the Haines-Conacher property which surrounds the past producing Shebandowan mine. The agreement was subsequently amended on March 31, 2006 to include the mine. The nickel, copper and PGM Shebandowan Project is located approximately 100 km southwest of the Lac des Iles mine. Successive diamond drilling programs in 2005 and 2006 were carried out on three relatively shallow mineralized zones known as the West, Road and "D" zones. A Technical Report in compliance with National Instrument 43-101 on Shebandowan West zone, disclosing the results of a mineral resource estimate by an independent Qualified Person was filed on October 26, 2007. On December 10, 2007, the Company announced that it has exercised its option to form an operating joint venture with Vale Inco Limited over the Shebandowan property.

2. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles. All amounts are in Canadian dollars unless otherwise noted. The more significant accounting policies are summarized as follows:

Basis of Consolidation

These consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, Lac des Iles Mines Ltd. ("LDI"), North American Palladium Finland Ltd. ("NAPFL"), and North American Palladium Arctic Services Ltd. ("NAPFS"). The Company's exploration activities in respect of the Shebandowan project are conducted through a joint venture, effective December 6, 2007, which the Company accounts for using the proportionate consolidation method. All inter-company balances and transactions have been eliminated.

Revenue and Concentrate Awaiting Settlement

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 which are subject to final assay adjustments.

Although the Company sold its metals during 2007 to a limited number of customers, it is not economically dependent upon them as there are other markets throughout the world for the Company's metals.

Concentrate, Crushed and Broken Ore Stockpiles and Supplies Inventories

Concentrate and crushed and broken ore stockpiles are valued at the lower of average production cost (including an allocation of the amortization of production related assets) and net realizable value. Crushed and broken ore stockpiles represent coarse ore that has been extracted from the mine and is available for further processing. Stockpile tonnages are verified by periodic surveys. The amount of stockpiled ore that is not expected to be processed within one year is shown as a long-term asset. Supplies inventory is valued at the lower of average direct acquisition cost and replacement cost.

Mining Interests

Plant and equipment are recorded at cost with amortization generally provided either on the unit-of-production method over the proven and probable reserves to which they relate or on a straight-line basis over their estimated useful lives, ranging from three to seven years. The Company capitalizes interest on major projects where direct indebtedness has occurred. During 2007 interest in the amount of \$nil was capitalized (2006 – \$188).

The Company leases certain equipment under capital leases. These leases are capitalized based on the lower of fair market value and the present value of future minimum lease payments. The corresponding liabilities are recorded as obligations under capital leases. This equipment is being amortized on the same basis as described above.

Mining leases and claims and royalty interests are recorded at cost and are amortized on the unit-of-production method over the proven and probable reserves.

Exploration costs relating to properties are charged to earnings in the year in which they are incurred. When it is determined that a mining property can be economically developed as a result of established proven and probable reserves, future development and exploration expenditures are capitalized. Determination as to reserve potential is based on the results of feasibility studies, which indicate whether production from a property is economically feasible. Upon commencement of commercial production of a development project these costs are amortized using the unit-of-production method over the proven and probable reserves. Capitalized exploration costs, net of salvage values, relating to a property that is later abandoned or considered uneconomic for the foreseeable future, are written off in the period the decision is made.

Impairment of Long-lived Assets

Each year, the Company reviews mining plans for the remaining life of each property. 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 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 impairment whenever events or changes in circumstances indicate the carrying amount of an asset 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 is less than the carrying value. 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 capital and reclamation expenditures, all based on detailed 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. 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.

Asset Retirement Obligations

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. Total undiscounted cash flows required to settle the obligations are estimated to be approximately \$7,800 the majority of which is to be paid at the end of the mine life, which is currently expected in 2010. A credit adjusted risk-free rate of 4% has been utilized to determine the obligation recorded on the balance sheet. The estimated asset retirement obligation may change materially based on future changes in operations, costs of reclamation and closure activities, and regulatory requirements.

The following is a reconciliation of the changes in the asset retirement obligation during the year:

	2007	2006
Balance, beginning of the year	\$ 8,211	\$ 7,894
Accretion expense	667	317
Balance at the end of year	\$ 8,878	\$ 8,211

Stock-Based Compensation Plans

The Company has a stock-based compensation plan which is described in note 13 (e) and a Restricted Share Unit Plan (“RSU”) which is described in note 13 (g). The Company recognizes as an expense the cost of stock-based compensation based on the estimated fair value of new stock options granted to employees and directors. The fair value of each RSU, being the fair market value of the Company’s common shares at the grant date, is recorded as a liability on the Company’s consolidated balance sheet over the vesting period. The value of the RSU liability is adjusted to reflect changes in the market value of the Company’s common shares at each period end.

Translation of Foreign Currency

The reporting and functional currency of the Company is the Canadian dollar. Accordingly, the Company translates monetary assets and liabilities denominated in foreign currency at the rate of exchange prevailing at the consolidated balance sheet dates, non-monetary assets and liabilities denominated in foreign currency at the rate in effect at the date the transaction occurred and revenues and expenses denominated in foreign currency at the exchange rate in effect during the applicable accounting period. All resulting foreign exchange gains and losses are recorded in the consolidated statements of operations, comprehensive loss and deficit.

Income Taxes

The Company follows the asset and liability method of accounting for income taxes. Under this method, future tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities and are measured using the substantively enacted tax rates and laws that will be in effect when the differences are expected to reverse. The effect on future tax liabilities and assets of a change in tax rates is recognized in income in the period that the change occurs. The Company provides a valuation allowance for future tax assets when it is more likely than not that some portion or all of the future tax assets will not be realized.

Cash and cash equivalents

Cash and cash equivalents includes cash on account less outstanding cheques, demand deposits and short-term guaranteed investments with original maturities of three months or less and are stated at fair value.

Deferred Financing Costs

Deferred financing costs represents the costs of negotiating and securing the Company's long-term debt facilities. Effective January 1, 2007, the Company records all transaction costs for financial assets and financial liabilities as a reduction of the related asset or liability and the effective interest rate method is now used to amortize these costs to operations. As at January 1, 2007, the Company adjusted the carrying value of the related long-term debt and the convertible note payable using the effective interest method. The impact was a decrease in the carrying value of the convertible notes payable of \$855 and a decrease in the long-term debt of \$107 and a decrease in deferred financing costs of \$962.

Basic and Diluted Loss Per Share

Basic loss per common share is computed by dividing the loss for the period by the weighted average number of common shares outstanding during the reporting period. Diluted loss per common share is computed using the treasury stock method whereby the weighted average number of shares outstanding is increased to include additional common shares from the assumed exercise of stock options, convertible notes and common share purchase warrants (equity instruments), if dilutive. The number of additional common shares is calculated by assuming that outstanding equity instruments were exercised and that proceeds from such exercises were used to acquire shares of common stock at the average market price during the reporting period. These common equivalent shares are not included in the calculation of the weighted average number of shares outstanding for diluted loss per common share when the effect would be anti-dilutive.

Flow-through shares

The Company finances a portion of its exploration activities through the issue of flow-through shares. The Company renounces the deductions to investors and accordingly records share issue costs related to the future tax liability of the temporary difference arising from the renunciation. As a result, share capital is reduced and future income tax liabilities are increased by the estimated tax benefits when renounced by the Company to the investors, except to the extent that the Company has unused tax benefits on loss carryforwards and tax pools in excess of book value available for deduction against which a valuation allowance has been provided. In these circumstances, the future tax liability reduces the valuation allowance, if any, and the reduction is recognized in earnings.

Use of Estimates

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amount of assets and liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the year. Significant estimates and assumptions relate to recoverability of mining operations and mineral exploration properties. While management believes that these estimates and assumptions are reasonable, actual results could vary significantly.

Derivative Financial Instruments

From time to time the Company may enter into forward commodity sales contracts to hedge the effect on revenues of changes in the price of metals it produces. Gains and losses on derivative financial instruments used to mitigate metal price risk are recognized in revenue from metal sales over the term of the hedging contract. The Company had no outstanding forward commodity sales contracts as at December 31, 2007.

From time to time the Company may enter into foreign exchange forward sales contracts to manage the effect of fluctuations in the value of committed U.S. dollar denominated revenues. The Company had no outstanding foreign exchange forward sales contracts as at December 31, 2007.

The Company does not hold financial instruments or derivative financial instruments for trading purposes.

Adoption of New Accounting Standards

In July 2006, the Accounting Standards Board issued a replacement of The Canadian Institute of Chartered Accountants' Handbook ("CICA Handbook") Section 1506, Accounting Changes ("Section 1506"). The new standard allows for voluntary changes in accounting policy only when they result in the financial statements providing reliable and more relevant information, requires changes in accounting policy to be applied retrospectively unless doing so is impracticable, requires prior period errors to be corrected retrospectively and calls for enhanced disclosures about the effects of changes in accounting policies, estimates and errors on the financial statements. Section 1506 also requires disclosures of information relevant to assessing the possible impact of the application of a new GAAP standard on the Company's financial statements in the period of initial adoption. The adoption of Section 1506 effective January 1, 2007 has had no impact on these consolidated financial statements.

Financial Instruments

As required by The Canadian Institute of Chartered Accountants ("CICA"), on January 1, 2007, the Company adopted CICA Handbook Section 1530, Comprehensive Income; Section 3251, Equity; Section 3855, Financial Instruments – Recognition and Measurement; and Section 3861, Financial Instruments – Disclosure and Presentation. The adoption of these new standards resulted in changes in the presentation for financial instruments as described below. As required by the implementation of these new standards, the prior period consolidated financial statements have not been restated. The principal changes in the accounting for financial instruments arising from the adoption of these accounting standards are described below.

(a) Section 1530, Comprehensive Income

Section 1530 requires a statement of comprehensive income, which consists of net income and other comprehensive income ("OCI"). OCI is a new requirement to temporarily present certain gains and losses from changes in fair value outside of net income. There has been no impact of this pronouncement for the year ended December 31, 2007, accordingly the Company's net income and comprehensive income are equal.

(b) Section 3251, Equity

Section 3251 describes the changes in how to report and disclose equity and changes in equity as a result of the new requirements of Section 1530, including the changes in equity for the period arising from OCI. Accumulated changes in OCI are included in the accumulated other comprehensive income ("AOCI") and are presented in the consolidated statements of shareholders equity and comprehensive income as a separate component of shareholders' equity. The Company has no AOCI as a result of the adoption of this new accounting pronouncement, accordingly there is no impact on the consolidated financial statements as a result of the adoption of this standard.

c) Section 3855, Financial Instruments – Recognition and Measurement Section 3861, Financial Instruments – Disclosure and Presentation

Under the new standards, financial assets and financial liabilities are initially recognized at fair value and their subsequent measurements are dependent on their classification as described below. Their classification depends on the purpose for which the financial instruments were acquired or issued, their characteristics and the Company's designation of such instruments. The standards require that all financial assets be classified either as held-for-trading, available for sale, held-to-maturity, or loans and receivables. The standards require that all financial assets, including all derivatives, be measured at fair value with the exception of loans and receivables, debt securities classified as held-to-maturity and available-for-sale financial assets that do not have quoted market prices in the active market. Settlement date accounting continues to be used for all financial assets, except changes in fair value between the trade date and settlement date are reflected in the consolidated statements of earnings for held-for-trading financial assets, while changes in fair value between trade date and settlement date are reflected in OCI for available-for-sale financial assets.

Loans and receivables

Loans and receivables are non-derivative financial assets that are initially recognized at fair value and thereafter are accounted for at cost or amortized cost.

Other liabilities

Other liabilities are initially recorded at fair value and thereafter are recorded at cost or amortized cost using the effective interest method and include all liabilities, other than derivatives or liabilities to which the fair value designation has been applied.

Embedded derivatives

Derivatives embedded in other financial instruments or contracts are separated from their host contracts and accounted for as derivatives when their economic characteristics and risk are not closely related to those of the host contract; the terms of the embedded derivatives are the same as those of the free-standing derivatives; and the combined instrument or contract is not measured at fair value, with changes in fair value recognized in income. These embedded derivatives are measured at fair value with changes therein recognized in the statement of earnings. As at December 31, 2007 and December 31, 2006, the Company has separated the early repayment call and put options on the Company's convertible notes payable. The fair value of the early repayment and put option was determined to be nominal and therefore there was no impact on the financial statements as a result of the bifurcation of these embedded derivatives.

Classification of financial instruments

The following is a summary of the accounting classification the Company has elected to apply to each of its significant categories of financial instruments outstanding as of January 1, 2007:

- (i) Concentrate awaiting settlement, net is classified as held for trading;
- (ii) Other assets are classified as loans and receivables; and
- (iii) All financial liabilities as other financial liabilities.

Future Accounting Standards

Financial Instruments – Recognition and Measurement

In December 2006, the CICA released new Handbook sections 3862, "Financial Instruments – Disclosures", and 3863, "Financial Instruments – Presentation", effective for fiscal years beginning on or after October 1, 2007. Section 3862, describes the required disclosures related to the significance of financial instruments on the Company's financial position and performance and the nature and extent of risks arising for financial instruments to which the entity is exposed and how the entity manages those risks. This section complements handbook sections 3855, "Financial Instruments – Recognition and Measurements"; 3863, "Financial Instruments – Presentation"; and 3865, "Hedges". Section 3863 establishes standards for presentation of financial instruments and non financial derivatives. This section complements handbook section 3861, "Financial Instruments – Disclosure and Presentation". The Company has not yet determined the effect these new standards will have on its financial position and results of operations.

Capital Disclosures

In December 2006, the CICA released new Handbook section 1535, "Capital Disclosures", which establishes standards for disclosing information about a Company's capital and how it is managed, to enable users of financial statements to evaluate the Company's objectives, policies and procedures for managing capital. This section will apply to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007. The Company has not yet determined the effect these new standards will have on its financial position and results of operations.

Inventories

In June 2007, the CICA released new Handbook section 3031, "Inventories," effective for fiscal years beginning on or after January 1, 2008. Section 3031 supersedes the existing CICA section 3030, "Inventories," and provides additional guidance on the determination of cost and its subsequent recognition as an expense, including any write-down to net realizable value, and disclosures made within the financial statements. The Company has not yet determined the effect these new standards will have on its financial position and results of operations.

3. CONCENTRATE AWAITING SETTLEMENT

Concentrate awaiting settlement is comprised of:

	2007	2006
Concentrate awaiting settlement, gross	\$ 85,869	\$ 88,034
Refining and smelter treatment charges	(6,782)	(5,984)
Concentrate awaiting settlement, net	\$ 79,087	\$ 82,050

The gross value of concentrate awaiting settlement represents the value of all PGMs and base metals from production shipped to and received by the third party smelter between May and December 2007, including 125,802 ounces of palladium which was valued at the December 31, 2007 London Metal Exchange ("LME") afternoon price fix of US\$364 (2006 – including 129,496 ounces of palladium valued at US\$322). The LME afternoon price fix as at March 18, 2008 was US\$481.

All of the concentrate awaiting settlement is due from one domestic customer at December 31, 2007 (2006 – two domestic customers). A reserve for doubtful accounts has not been established, as in the opinion of management, the amount due will be fully realized.

4. INVENTORIES

Inventories consist of the following:

	2007	2006
Concentrate	\$ 3,026	\$ 3,782
Supplies	14,847	10,382
	\$ 17,873	\$ 14,164

5. MINING INTERESTS

(a) Mining interests are comprised of the following:

	2007	2006
Plant and equipment, at cost	\$ 368,339	\$ 362,151
Underground mine development, at cost	52,174	43,015
Accumulated amortization and impairment charges	(319,388)	(277,397)
	101,125	127,769
Equipment under capital lease, at cost	14,076	14,076
Accumulated amortization and impairment charges	(7,022)	(3,991)
	7,054	10,085
Mining leases and claims, royalty interest, and development, at cost	82,561	82,561
Accumulated amortization and impairment charges	(76,276)	(73,798)
	6,285	8,763
Mining interests, net	\$ 114,464	\$ 146,617

(b) Amortization expense is comprised of:

	2007	2006	2005
Capital assets (including plant and equipment, and equipment under capital lease)	\$ 44,430	\$ 28,422	\$ 17,384
Mining leases and claims, royalty interest, and development costs	2,478	1,681	913
	\$ 46,908	\$ 30,103	\$ 18,297

(c) As at December 31, each year, the Company tests its long-lived assets, including mineral interests and plant and equipment for impairment, and reflects an impairment charge if needed.

There was no impairment charge required for 2007 (2006 – \$nil, 2005 – \$nil).

6. MINE RESTORATION DEPOSIT

The Company, in conjunction with the Ontario Ministry of Northern Development and Mines (the “Ministry”), has established a trust fund (the “Fund”) pursuant to the Company’s mine closure plan for eventual clean-up and restoration of the mine site. The mine closure plan calls for a total amount of \$7,802 to be accumulated in the Fund.

Commencing in February 2001, the Fund, controlled by the Ministry, started to accumulate through monthly deposits of \$100. At December 31, 2007, the Company had \$8,272 (2006 – \$8,041) on deposit with the Ministry including accrued interest of \$742. All current amounts required have been contributed as at December 31, 2007. The funds on deposit bear interest at current short-term deposit rates and will be returned to the Company once the mine closure is completed. The estimated asset retirement obligation may change materially based on future changes in operations, costs of reclamation and closure activities, and regulatory requirements.

7. DEFERRED FINANCING COSTS

	2007	2006
Financing costs	\$ –	\$ 1,610
Accumulated amortization	–	(648)
	\$ –	\$ 962

As at January 1, 2007, the Company adjusted the carrying value of the related long-term debt and the convertible note payable using the effective interest method. The impact was a decrease in the carrying value of the convertible notes payable of \$855 and a decrease in the long-term debt of \$107 and a decrease in deferred financing costs of \$962.

8. OBLIGATIONS UNDER CAPITAL LEASES

The following is a schedule of future minimum lease payments under capital leases together with the present value of the net minimum lease payments:

	2007	2006
2007	\$ –	\$ 2,422
2008	1,830	2,166
2009	1,499	1,775
2010	402	473
Total minimum lease payments	3,731	6,836
Amounts representing interest at rates from 3.5% – 6.8%	(235)	(621)
Present value of minimum lease payments	3,496	6,215
Less current portion	(1,672)	(2,104)
	\$ 1,824	\$ 4,111

9. CONVERTIBLE NOTES PAYABLE

	2007	2006
Series I convertible notes – maturing August 1, 2008	\$ 17,011	\$ 32,048
Series II convertible notes – maturing December 1, 2008	8,699	13,162
	25,710	45,210
Less current portion	(25,710)	(22,148)
	\$ –	\$ 23,062

On March 29, 2006, the Company issued US\$35,000 (\$41,037) aggregate principal amount of Series I convertible notes (the “Series I Notes”) due August 1, 2008 through a private placement of convertible notes and common share purchase warrants. The Offering was to Kaiser-Francis Oil Company (Kaiser-Francis) and an institutional investor (collectively the “Purchasers”). The Offering is governed by a securities purchase agreement dated March 24, 2006 (the “SPA”) among the Company and the Purchasers.

The Series I Notes were initially convertible into 2,873,563 common shares of the Company at any time by the holder at US\$12.18 per share. Warrants exercisable to purchase 1,436,782 common shares were issued with the Series I Notes, each warrant being exercisable to purchase one common share at an exercise price of US\$13.48 until March 29, 2010 (see anti-dilution provisions below).

The Company, at its option, had the right to sell to Kaiser-Francis up to US\$13,500 principal amount a Series II Note (a second tranche) on or before June 30, 2006, which would be used to repay the loan under the existing Kaiser-Francis credit facility (refer to note 11). On June 23, 2006, the Company exercised this right and issued to Kaiser-Francis US\$13,500 (\$15,176) aggregate principal amount a Series II Note, due December 1, 2008. The Series II Note was initially convertible into 1,108,374 common shares of the Company at any time by the holder at US\$12.18 per share. Warrants exercisable to purchase 554,187 common shares were issued with the Series II Note, with each warrant being exercisable to purchase one common share at an initial exercise price of US\$13.48 until June 23, 2010 (see anti-dilution provisions below).

The convertible notes and the related Series I and Series II Warrants contain “full ratchet” anti-dilution provisions. Under these provisions, if at any time prior to August 1, 2008 the Company issues securities (including common shares or warrants convertible into common shares) at a price per share (the “effective price”) less than a stated amount, the conversion/exercise price of the outstanding convertible notes and Series I and Series II Warrants is reduced downward to equal the effective price, subject to a floor price of US\$9.12 for the Series I Notes, US\$6.67 for the Series II Note, US\$10.73 for the Series I Warrants and US\$7.85 for the Series II Warrants. On account of the unit offering that closed on December 13, 2007, the conversion price of the Series I Notes, the Series II Note, the Series I Warrants and the Series II Warrants decreased to their respective floor prices.

The Series I and II Notes bear interest at a rate of 6.5% per annum payable bi-monthly. Series I and II Notes are repayable in nine equal installments commencing April 1, 2007 and August 1, 2007, respectively. The interest payments and/or repayment amounts may be paid to each Purchaser, at the Purchaser's option, in any combination of cash and/or common shares. If common shares are issued for interest payments or in repayment of the convertible notes they will be issued at a 10% discount from the weighted average trading price of the common shares on the AMEX for the five consecutive trading days immediately prior to applicable payment date. The Company has the right to defer any principal repayment 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 (5) business days prior notice of its intention to defer principal repayments. During 2007, the Purchasers elected to receive common shares in settlement of both their interest and principal repayments.

Commencing June 29, 2007 for Series I and September 23, 2007 for Series II, if the weighted average trading price of the common shares for each of any 25 consecutive trading days is 150% or more of the initial conversion price (as adjusted for any stock dividend or split, or similar transaction), the Company will have the right to force the Purchasers to convert all or any of the outstanding principal amount of the convertible notes at the conversion price.

Under Canadian GAAP, the components of the convertible notes must be bifurcated and accounted for separately as debt and equity instruments. The warrants are separable from the notes and are accounted for as an equity instrument. The Series I proceeds received were allocated to the debt and equity components of the notes and to the initial warrants on a relative fair value basis as follows: US\$20,558 to the debt, US\$8,808 to the equity component and US\$5,634 to the warrants. The Series II Note proceeds were allocated as follows: US\$9,578 to the debt, US\$2,312 to the equity component and US\$1,610 to the warrants. In addition, a liability (the "Equity Premium") was recognized for the holders' option to receive common shares, in lieu of cash, at a 10% discount to the five day weighted trading price, as described above, for interest and principal payments. The Company accretes the carrying value of the convertible notes and the Equity Premium such that at each installment payment date, the carrying value of the notes and the Equity Premium will be equal to the face value of the notes and the liability related to the Equity Premium. The Company recorded accretion expense of \$12,947 (2006 – \$10,090), of which \$3,245 (2006 – \$2,523) represented the accretion relating to the Equity Premium which was included in the carrying value of the convertible notes payable as at December 31, 2007.

The fair value of the debt was determined based on the future payments of principal and interest for a debt instrument of comparable maturity and credit quality, excluding any conversion option by the holder. The Series I Notes carry an effective interest of 42%. The Series II Note carries an effective interest rate of 28%.

The conversion option or equity component of the Notes was valued using a Binomial model. The fair value of the warrants was determined based on the Black-Scholes option pricing model. The models used in the valuation of the components of the convertible debt contain certain subjective assumptions, changes of which can cause significant variation in the estimated fair value of the debt and equity components of the notes.

The issue costs of \$2,364 have been allocated pro-rata to the debt (\$1,398) and equity components (\$589) of the Series I and II Notes and to the associated warrants (\$377) on a relative fair value basis. The financing costs related to the debt components are being amortized over the term of the convertible notes using the effective interest method.

As at December 31, 2007, the principal amount outstanding on the Series I and Series II convertible notes was US\$17,500 (2006 – US\$35,000) and US\$9,000 (2006 – US\$13,500) respectively.

10. LONG-TERM DEBT

	2007	2006
Equipment finance company credit facility consisting of		
\$4,000 and US\$6,000 (2006 – \$6,000 and US\$10,000) loans	\$ 9,928	\$ 17,654
Less: financing costs (net of amortization)	(53)	–
	9,875	17,654
Less current portion	(5,918)	(6,662)
	\$ 3,957	\$ 10,992

The Company's long-term debt is comprised of a senior credit facility with an equipment finance company. The interest rate under the loan facility is LIBOR plus 2.50%, or 7.10% at December 31, 2007 (7.82% – 2006). The senior credit facility is repayable in equal quarterly installments over a five-year period with a final maturity of November 24, 2009. In return for granting the loan, the lender received a first priority security in all of the Company's existing and future assets excluding its production leases and claims. The credit facility allows in certain circumstances, full repayment of outstanding loans at any time during the term of the facility.

11. KAISER-FRANCIS CREDIT FACILITY

At the time the Company entered into its senior credit facility (note 10), certain terms under the US\$20,000 non-revolving credit facility with Kaiser-Francis Oil Company ("Kaiser-Francis") were amended. The final maturity date was extended to June 30, 2006 from May 31, 2005 and the interest rate was reset based upon the 30 day LIBOR rate

plus 2.50%. The Kaiser-Francis credit facility was repaid on June 23, 2006 pursuant to the terms of the Series II convertible note issued on that date (note 9).

On October 12, 2006, the Company completed a transaction with Kaiser-Francis for a US\$5,000 short-term working capital loan maturing December 31, 2006. The interest rate under the loan was the 30 day LIBOR rate plus 2.50%. The Company paid a commitment fee of US\$38 and amounts not drawn under the loan were subject to a standby fee of 0.125% per annum. In connection with the loan, the Company granted to Kaiser-Francis a first priority security interest in 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 for the extension. This loan was repaid in full from the proceeds of the first advance payment, in accordance with the terms of the palladium and platinum purchase facility (note 15 (a)).

12. RELATED PARTY TRANSACTIONS AND COMMITMENTS

Kaiser-Francis is the major shareholder of the Company. In addition to the related party transactions with Kaiser-Francis disclosed in note 11, the Company had the following related party transactions:

- (a) Under the terms of the Company's convertible notes, the Company may not offer equity securities without first offering to the noteholders a pre-emptive right to each to subscribe for 12.5% of the total equity securities being offered. If either noteholder subscribes for less than its 12.5% share, the unused right shall then be offered to the non-declining party, Kaiser-Francis or the institutional investor, as the case may be. As a result of this provision of the agreement, Kaiser-Francis exercised the pre-emptive right and subscribed for 25% of the unit offering that closed on December 13, 2007.
- (b) In 2005, a now former director of the Company received a fee of \$218 in connection with the negotiations related to a Palladium Sales Contract entered into by the Company in 2000. The contract was negotiated at arms-length prior to such person becoming a director of the Company. The Palladium Sales Contract expired on June 30, 2005, and no further fees are payable in connection with this contract.

13. SHAREHOLDERS' EQUITY

(a) Authorized Capital Stock

The authorized capital stock of the Company consists of an unlimited number of common shares and an unlimited number of special shares, issuable in series, including 10,000,000 Series "A" preferred shares.

(b) Common share purchase warrants:

The changes in issued common share purchase warrants for the year are summarized below:

	2007		2006	
	Shares	Amount	Shares	Amount
Balance beginning of year	1,990,969	8,038		
Issued pursuant to terms of Series I convertible notes, net of issue costs	—	—	1,436,782	6,238
Issued pursuant to terms of Series II convertible note, net of issue costs	—	—	554,187	1,800
Issued pursuant to unit offering, net of issue costs	9,333,333	5,155		
Balance, end of year	11,324,302	\$ 13,193	1,990,969	\$ 8,038

On December 13, 2007 the Company completed a public offering of 18,666,667 units at a price of US\$4.00 per unit (\$4.04 per unit) for total net proceeds of approximately US\$68,719 (issue costs US\$5,919). Each unit consisted of one common share and one half of a common share purchase warrant of the Company. Each whole warrant will entitle the holder to purchase one common share at a price of US\$5.05 per share at any time on or prior to December 13, 2009.

In connection with the issue of the convertible notes, warrants to purchase 1,990,969 common shares were issued and are outstanding as follows:

Number of Warrants	Exercise Price	Expiry Date
1,436,782	US\$10.73	March 29, 2010
554,187	US\$7.85	June 23, 2010

In connection with the issue of the unit offering, warrants to purchase 9,333,333 common shares were issued and are outstanding as follows:

Number of Warrants	Exercise Price	Expiry Date
9,333,333	US\$5.05	December 13, 2009

(c) Group Registered Retirement Savings Plan

The Company has a group registered retirement savings plan, which all employees can participate in at their option. The Company is required to make matching contributions to a maximum of \$5 per employee per annum. The Company's matching contribution can be made either in cash or treasury shares of the Company. During 2007 the Company contributed 138,685 shares with a fair value of \$1,204, (2006 – 107,563 shares with a fair value of \$1,085).

(d) Private Placement

On February 27, 2007, the Company completed a private placement of 550,000 flow-through common shares. The gross proceeds of \$6,050 must be spent on Canadian exploration expenses prior to December 31, 2008. As at December 31, 2007, the Company has spent \$628 on Canadian exploration expenses as defined in Section 66 of the Income Tax Act (Canada).

On June 23, 2006, the Company completed a private placement of 270,000 flow-through common shares. The gross proceeds of \$3,375 were spent on Canadian exploration expenses as defined in Section 66 of the Income Tax Act (Canada) prior to December 31, 2007.

On April 21, 2005, the Company completed a private placement of 213,000 flow-through common shares. The gross proceeds of \$2,503 were spent on Canadian exploration expenses as defined in Section 66 of the Income Tax Act (Canada) prior to December 31, 2006.

Under the terms of the flow-through common share issues, the tax attributes of the related expenditures are renounced to investors and the share capital is reduced and future income tax liabilities is increased by the estimated income tax benefits renounced by the Company to the investors. The tax attributes for the 2006 expenditures were renounced in 2007, and those from 2005 were renounced in 2006.

(e) Corporate Stock Option Plan

The Company has adopted, and the shareholders have approved, the Corporate Stock Option Plan (the "Plan"), under which eligible directors, officers, employees and consultants of the Company are entitled to receive options

to acquire common shares. The Plan is administered by the Compensation Committee, a subcommittee of the Board of Directors, which determines the number of options to be issued, the exercise price (which may not be lower than the closing price of the Company's common shares on the Toronto Stock Exchange ("TSX") on the day prior to the date of grant), expiration dates of each option, the extent to which each option is exercisable provided that the term of an option shall not exceed 10 years from the date of grant, as well as establishing a limited time period should the optionee cease to be an "Eligible Person" as set forth in the conditions of the Plan. Options granted vest as to 1/3 on each of the first three anniversary dates of the date of grant.

The maximum number of common share options available for grant shall not exceed 2,700,000 being approximately 3.6% of the outstanding common shares or such greater number of common shares as may be determined by the Board of Directors, and approved if required, by the shareholders of the Company and by any relevant stock exchange or other regulatory authority. As at December 31, 2007, 532,757 options (2006 – 534,057 options) were available to be granted under the Plan.

The following summary sets out the activity in outstanding common share purchase options:

	2007		2006	
	Weighted-Average		Weighted-Average	
	Shares	Exercise Price	Shares	Exercise Price
Outstanding, beginning of year	360,133	\$ 10.24	563,638	\$ 10.43
Granted	132,500	9.05	65,000	8.15
Exercised	(5,000)	3.42	(130,755)	6.96
Cancelled	(131,200)	10.25	(137,750)	13.15
Outstanding, end of year	356,433	\$ 9.89	360,133	\$ 10.24
Options exercisable at end of year	191,600	\$ 10.76	166,432	\$ 10.70

The following table summarizes information about the Company's stock options outstanding at December 31, 2007:

Exercise Price	Expiry Dates	Options Outstanding	Options Exercisable
		at Dec. 31, 2007	at Dec. 31, 2007
\$ 4.75	February 27, 2011	7,500	7,500
\$ 7.85	August 26, 2014	30,000	10,000
\$ 8.12	October 8, 2015	15,000	–
\$ 8.40	June 20, 2014	35,000	11,667
\$ 8.45	April 1, 2015	40,000	–
\$ 8.83	December 14, 2013	10,000	6,667
\$ 8.87	January 14, 2015	7,500	–
\$ 9.03	March 1, 2015	9,000	–
\$10.00	November 27, 2013	50,000	33,333
\$10.18	April 15, 2015	30,000	–
\$11.90	June 23, 2012	122,433	122,433
		356,433	191,600

The fair value of options granted in 2007 has been estimated at the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions: risk free interest rate of 3.97% (2006 – 4.05%; 2005 – 3.78%), expected dividend yield of nil (2006 – nil; 2005 – nil), expected volatility of 54% (2006 – 55%;

2005 – 55%), and expected option life of 4 years (2006 – 4 years; 2005 – 4 years). The estimated fair value of the options is expensed over the option's vesting period, which is 3 years. The weighted average fair market value of options granted in 2007 was \$4.11 (2006 – \$3.78; 2005 – \$4.51). Compensation expense related to the Plan for the year ended December 31, 2007 was \$414 (2006 – \$561; 2005 – \$582).

(f) Reconciliation of the diluted number of shares outstanding:

	2007	2006	2005
Net loss available to common shareholders	\$ (28,680)	\$ (34,109)	\$ (53,611)
Weighted average number of shares outstanding	55,792,203	52,562,939	52,006,548
Effect of dilutive securities stock options	–	–	–
Weighted average diluted number of shares outstanding	55,792,203	52,562,939	52,006,548
Diluted net loss per share	\$ (0.51)	\$ (0.65)	\$ (1.03)

The effect of stock options and warrants has not been included in the determination of diluted loss per share for 2007, 2006 or 2005, because to do so would be anti-dilutive.

At December 31, 2007, there were 14,794,088 (2006 – 6,172,671) equity instruments convertible to common shares. These have been excluded from the calculation of diluted net loss per share because to do so would have been anti-dilutive. These equity instruments could potentially dilute basic earnings per share in the future.

(g) Other Stock-Based Compensation – Restricted Share Unit Plan

Effective December 14, 2005, the Company adopted an RSU plan under which eligible directors, officers and key employees of the Company are entitled to receive awards of restricted share units. Each restricted share unit means a unit equivalent in value to the fair market value of a common share of the Company on the date of the award. The RSU plan is administered by the Board of Directors, which will determine after considering recommendations made by the compensation committee, the number and timing of restricted share units to be awarded and their vesting periods, not to exceed three years. On each relevant full vesting date of awarded restricted share units, the participant will receive a lump sum cash payment equivalent to the market value of the equivalent number of common shares. The value of each award is charged to compensation expense over the period of vesting and a corresponding liability is established on the balance sheet. The compensation expense and liability are adjusted to reflect the changes in market value of the equivalent number of common shares during the vesting period.

As at December 31, 2007, 10,001 (2006 – 33,333) restricted share units have been granted and are outstanding at a weighted average value of \$8.72 (2006 – \$9.09) per unit and \$89 (2006 – \$180) has been charged to compensation expense. The market value of the restricted share units as at December 31, 2007 is \$3.64 (2006 – \$8.87) per unit.

14. FAIR VALUE OF FINANCIAL INSTRUMENTS

The fair value of the obligations under capital leases approximate their carrying value due to the interest rate implicit in the leases approximating interest rates available at this time for similar lease terms. The fair value of the convertible notes approximate their carrying value due to the interest rate implicit in the convertible notes approximating interest rates available at this time for similar convertible notes payable. The carrying amounts of all other financial instruments on the balance sheet approximate fair value due to their short-term maturities.

15. COMMITMENTS

(a) Palladium and Platinum Advance Purchase Facility

On January 19, 2007 the Company entered into a palladium and platinum advance purchase facility with Auramet Trading, LLC (“Auramet”), a precious metals merchant, providing for the sale of an average of 10,000 ounces of

palladium and 500 ounces of platinum per month. The Company may not request Auramet to purchase metals after June 15, 2008 and all sales and payments prior to that date are required to be settled by December 31, 2008. Under the terms of the agreement the Company may receive advance payments not exceeding, at any time, an aggregate maximum of US\$25,000. The Company pays a commitment fee of 0.50% per annum, payable monthly, on the unused portion of the facility.

The purchase price may be fixed or provisional. For fixed pricing the Company may price at either: (i) Auramet's current market bid price at the time of the transaction, or (ii) market limit orders, as defined under the terms of the agreement. In the case of provisional pricing, it is determined based on the afternoon fixing of the London Bullion Marketing Association immediately preceding the purchase. In each case such pricing will reflect the forward value corresponding to the scheduled delivery date. Advance payments to the Company may not exceed specified values of fixed and provisionally priced palladium and platinum. Provisional prices must be fixed prior to the scheduled delivery date for such precious metals. Each advance payment will be subject to a discount equal to LIBOR plus 1.90% per annum for the period between the date the advance payment is made and the scheduled delivery date. Upon the delivery of the precious metals to Auramet, Auramet will pay to the Company the difference between the advance payment and the purchase price.

To secure the obligations of the Company under the Agreement, the Company has granted to Auramet a security interest in, among other things, the concentrates (including the precious and base metals contained therein) mined at the Lac des Iles mine, together with the proceeds arising from the sale of the concentrate, and, by way of security, an assignment of its smelting and refining agreement.

The first advance payment was used to repay the US\$5,000 working capital loan from the Corporation's major shareholder, while subsequent advance payments will be used to finance working capital requirements. The balance outstanding under the advance purchase facility at December 31, 2007 is \$nil.

(b) Sheridan Platinum Group of Companies ("SPG") Commitment

The Company is required to pay a royalty to SPG equal to 5% of the Net Cash Proceeds, as defined in the agreement from mining operations until the expiration of the Lac des Iles leases.

(c) Operating Leases and Other Purchase Obligations

As at December 31, 2007, the Company had outstanding operating lease commitments and other purchase obligations of \$3,257 and \$10,808, respectively (2006 – \$4,695 and \$1,351) all of which had maturities of less than five years.

(d) Flow-through shares

To satisfy its commitments pursuant to the issuance of flow-through shares, the Company is required to spend \$6,050 of qualifying Canadian exploration expenses, as defined in the Income Tax Act (Canada), by December 31, 2008 (2006 – \$3,375, by December 31, 2007).

16. REVENUE FROM METAL SALES

	Total	Palladium	Platinum	Gold	Nickel	Copper	Other Metals
2007							
Year ended December 31							
Revenue – before pricing adjustments	\$201,367	95,146	29,183	12,315	46,862	15,589	2,272
Pricing adjustments:							
Commodities	8,756	3,443	4,516	1,825	(1,621)	180	413
Foreign exchange	(14,191)	(6,783)	(2,723)	(1,177)	(2,653)	(765)	(90)
Revenue – after pricing adjustments	\$195,932	91,806	30,976	12,963	42,588	15,004	2,595
2006							
Year ended December 31							
Revenue – before pricing adjustments	\$ 145,819	70,645	23,438	8,970	27,930	13,984	852
Pricing adjustments:							
Commodities	11,674	4,133	821	769	4,964	697	290
Foreign exchange	1,707	866	177	105	406	144	9
Revenue – after pricing adjustments	\$ 159,200	75,644	24,436	9,844	33,300	14,825	1,151
2005							
Year ended December 31							
Revenue – before pricing adjustments	\$ 85,233	38,364	16,635	5,950	15,845	7,464	975
Pricing adjustments:							
Commodities	7,727	4,980	847	662	188	853	197
Foreign exchange	(354)	54	(338)	(44)	8	(33)	(1)
Revenue – after pricing adjustments	\$ 92,606	43,398	17,144	6,568	16,041	8,284	1,171

The Company delivers all of its concentrate to one customer (2006 – two customers) under the terms of an agreement. The customer has agreed to smelt and refine all of the Company's concentrate to March 31, 2010, with an option by mutual agreement to extend for a further two years to March 31, 2012.

17. INTEREST AND OTHER FINANCING COSTS

	Note	2007	2006	2005
Interest on convertible notes payable	9	\$ 2,763	\$ 2,519	\$ –
Accretion expense relating to convertible notes payable	9	12,947	10,090	–
		15,710	12,609	–
Interest on long term debt	10	1,013	1,505	1,651
Interest on capital leases	8	460	404	22
Interest on Kaiser-Francis credit facility	11	90	569	836
		17,273	15,087	2,509
Interest on advance purchase facility	15	446	148	–
Other interest and financing costs		837	123	41
Deferred financing costs		751	1,090	43
		19,307	16,448	2,593
Interest income		(674)	(801)	(1,641)
		\$ 18,633	\$ 15,647	\$ 952

18. CONTINGENCIES

- (a) The Company is a defendant in an action by another mining company claiming actual damages in the amount of \$20,000, punitive and exemplary damages in the amount of \$5,000, and a declaration that the Company held the Compania Minerales de Copan, S.A. de C.V. ("Copan") property in trust for the plaintiff. This action relates to a predecessor company of the Company and has been inactive for sometime. No provision has been made in the accounts as at December 31, 2007 or 2006 for any possible loss from this action as management of the Company believes it has a valid defense and it has been indemnified by SPG regarding this action. In addition, certain stock options are claimed to be held by employees of Copan. These options have not been included in note 13(e) as the Company has been indemnified by SPG regarding such matters.
- (b) The Company has filed a claim with its insurance company relating to losses incurred in connection with the failure of the primary crusher in 2002. During 2004, the Company received \$7,148 as an interim payment against this claim and has included this amount in income from mining operations. The Company is pursuing the balance of its insurance claim and will record any additional recovery in income if and when received.
- (c) From time to time, the Company is involved in other litigation, investigations, or proceedings related to claims arising out of its operations in the ordinary course of business. In the opinion of the Company's management, these claims and lawsuits in the aggregate, even if adversely settled, will not have a material effect on the consolidated financial statements.

19. INCOME TAXES

The provision for income and mining taxes differs from the amount that would have resulted by applying the combined Canadian Federal and Ontario statutory income tax rates of approximately 36.1% (2006 – 36.1%, 2005 – 36.1%).

	2007	2006	2005
Income tax recovery using statutory income tax rates	\$ (10,692)	\$ (12,822)	\$ (21,524)
Increase (decrease) in taxes resulting from:			
Resource allowance	77	133	3,354
Non-taxable portion of capital gains	(1,196)	(76)	(162)
Losses not tax benefited	10,126	11,002	16,556
Losses incurred in foreign entities, taxed at a lower rate	569	701	–
Federal large corporations taxes	–	–	339
Ontario mining taxes	177	(195)	(1,654)
Other	2	(152)	209
Income and mining tax recovery	\$ (937)	\$ (1,409)	\$ (2,882)

The details of the Company's income and mining tax recovery are as follows:

	2007	2006	2005
Current income tax expense (recovery):			
Income taxes	–	(360)	(15)
Mining taxes	–	(310)	80
Federal large corporations tax	–	–	339
	–	(670)	404
Future income tax expense (recovery):			
Income taxes	(1,114)	(854)	(1,552)
Mining taxes	177	115	(1,734)
	(937)	(739)	(3,286)
	\$ (937)	\$ (1,409)	\$ (2,882)

Future tax assets (liabilities) consist of the following temporary differences:

	2007	2006
Long-term future income tax asset:		
Mining interests, net	38,476	38,185
Deferred financing costs	2,004	414
Mine restoration obligation	2,235	2,532
Future mining tax liability	106	101
Other assets	141	199
Non-capital loss carry-forwards	10,556	13,363
Ontario corporate minimum tax credits	327	327
Capital loss carry-forwards	533	847
Valuation allowance	(52,941)	(55,089)
Net future income tax asset, long-term	1,437	879
Future income tax liability, long-term:		
Long-term debt	(300)	(289)
Convertible notes payable	(447)	40
Kaiser-Francis credit facility	—	(4)
Obligations under capital leases	(122)	(72)
Net future income tax liability, long-term	(869)	(325)
Net future income tax asset, long-term	\$ 568	\$ 554
Future income tax liability, current:		
Inventories	—	(147)
Crushed and broken ore stockpiles	(564)	(399)
Deferred financing costs	(4)	(8)
Future tax liability, current	\$ (568)	\$ (554)
Future income tax assets (liabilities)	\$ —	\$ —
Future mining tax liability, current:		
Inventories	—	(40)
Crushed and broken ore stockpiles	(168)	(109)
Future mining tax liability, current	(168)	(149)
Future mining tax liability, long-term:		
Mining interests, net	(1,742)	(1,499)
Provision for mine closure costs	449	420
Mine restoration obligation	754	698
Future mining tax liability, long-term	\$ (539)	\$ (381)

At December 31, 2007, the Company had capital loss carry-forwards of approximately \$3,700 (2006 – \$5,100), which are available to reduce capital gains of future years.

At December 31, 2007, the Company and its subsidiary had non capital losses of approximately \$30,900 (2006 – \$37,500), of which \$12,200 expires in 2015, \$8,800 expires in 2026 and \$9,900 expires in 2027. The tax benefit of these losses has not been recognized in the financial statements.

At December 31, 2007, the Company and its subsidiary had undepreciated capital cost allowance of approximately \$254,000 (2006 – \$278,000) available to offset future taxable income.

20. STATEMENT OF CASH FLOWS

(a) The net changes in non-cash working capital balances related to operations are as follows:

	2007	2006	2005
Cash provided by (used in):			
Concentrate awaiting settlement	\$ (16,201)	\$ (44,194)	\$ 29,406
Inventories and stockpiles	(4,485)	(3,727)	3,484
Other assets	20	(258)	(729)
Accounts payable and accrued liabilities	(769)	5,009	(3,839)
Taxes recoverable	83	(531)	(135)
	\$ (21,352)	\$ (43,701)	\$ 28,187

(b) Cash outflows during the year for interest and income taxes were as follows:

	2007	2006	2005
Interest paid on long-term debt	\$ 1,249	\$ 2,319	\$ 2,477
Interest paid on obligations under capital leases	\$ 393	\$ 592	\$ 339
Income and mining taxes paid	\$ 263	\$ 291	\$ 699

(c) The Series I and II convertible notes bear interest at a rate of 6.5% per annum payable bi-monthly. The interest payments may be paid to each Purchaser, at the Purchaser's option, in any combination of cash and/or common shares. During 2007, in a non cash transaction, the Purchaser's elected to receive common shares in settlement of their interest expense in the amount of \$2,644 (2006 – \$1,974; 2005 – \$nil).

(d) Principal repayments for the Series I and II convertible notes may be paid to each Purchaser, at the Purchaser's option, in any combination of cash and/or common shares. During 2007, in a non cash transaction, the Purchaser's elected to receive common shares in settlement of their principal repayments in the amount of \$24,149 (2006 – \$nil).

(e) During 2007, mining interests were acquired at an aggregate cost of \$15,346 (2006 – \$19,384; 2005 – \$41,998) of which \$nil (2006 – \$nil; 2005 – \$6,583) were acquired by means of capital leases.

21. SUBSEQUENT EVENTS

On January 9, 2008, the Company issued an additional 2,800,000 units under a 30-day over-allotment option granted to the underwriters at an exercise price of US\$4.00 per unit, for total gross proceeds of US\$11,200. Kaiser-Francis also exercised its pre-existing right under the securities purchase agreement to subscribe for 25% of the over-allotment units.

22. COMPARATIVE FIGURES

Certain of the prior years' figures have been reclassified to conform to the presentation adopted in 2007.

Corporate Information

DIRECTORS

Steven R. Berlin, MBA, CPA
Tulsa, Oklahoma

C. David A. Comba, B.Sc., M.Sc.
Burlington, Ontario

André J. Douchane, B.Sc.
Chairman of the Board
Toronto, Ontario

Robert J. Quinn, B.S.B.A., L.L.B.
Houston, Texas

Gregory J. Van Staveren, C.A., CPA
Toronto, Ontario

William J. Weymark, B.Sc., P.Eng.
West Vancouver, British Columbia

OFFICERS

James D. Excell, B.A. Sc.
President and Chief Executive Officer

G. Fraser B. Sinclair, C.A., C.A. (S.A.)
Vice President, Finance and Chief Financial Officer

David J. Passfield, Mining Engineer
Vice President, Operations

William E. Stone, Ph.D.
Vice President, Exploration

Trent C.A. Mell, B.C.L., L.L.B.
Vice President, General Counsel and Corporate Secretary

Michael C. Thompson, F.C.C.A.
Senior Controller

INVESTOR RELATIONS

Linda M. Armstrong, B.A.
Director, Investor Relations
Tel: 416-360-7971 Ext. 226
Email: larmsstrong@napalladium.com
Website: www.napalladium.com

HEAD OFFICE

130 Adelaide Street West, Suite 2116
Toronto, Ontario
M5H 3P5 Canada

THUNDER BAY MINE

Lac des Iles Mines Ltd.
P.O. Box 10547
Thunder Bay, Ontario
P7B 6T9 Canada

SHARES AND WARRANTS LISTED

Toronto Stock Exchange
Symbols: PDL; PDL.WT

American Stock Exchange
Symbols: PAL; PAL.WS

TRANSFER AGENT AND REGISTRAR

Computershare Investor Services Inc.
100 University Avenue, 9th Floor
North Tower
Toronto, Ontario
M5J 2Y1 Canada

North America
Toll-free: 1-800-564-6253

Email: service@computershare.com
Website: www.computershare.com

AUDITORS

KPMG LLP
4100 Yonge Street, Suite 200
Toronto, Ontario
M2P 2H3 Canada

Tel: 416-228-7000

ANNUAL MEETING

North American Palladium's Annual Shareholders' Meeting will be held on **Thursday May 22nd**, 2008 at 10:00 a.m. at the **Ivey ING Leadership Centre**, Exchange Tower, Ground Floor, 130 King Street West, Toronto, Ontario, Canada.



North American Palladium Ltd.