



North American Palladium Ltd.

ANNUAL REPORT

2008

re-engineering
the future

talent experience growth vision



Our vision is to become
a mid-tier precious metals company
with multiple mines operating in
mining-friendly jurisdictions.

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North American Palladium is a diversified precious metals producer with 100% ownership of the Lac des Iles mine, one of North America's largest palladium mines.

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Open pit mining operations began in 1993 with underground operations starting in 2006.

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The Company's Offset Zone deposit, the fault displaced continuation of the underground Roby Zone, is the focus of an expanded \$7.0 million exploration program in 2009. The Offset Zone could extend mine life at Lac des Iles by up to ten years.

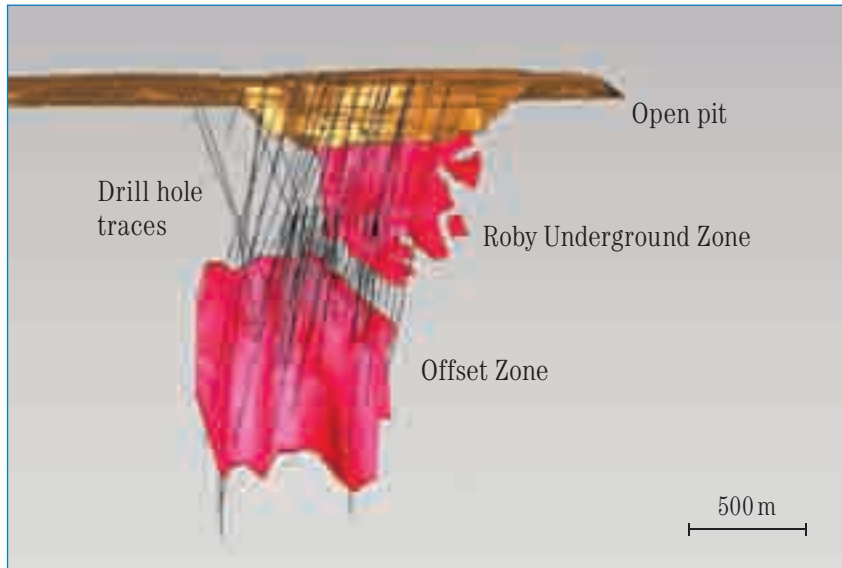
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TSX: PDL

NYSE-AMEX: PAL



North American Palladium Ltd.

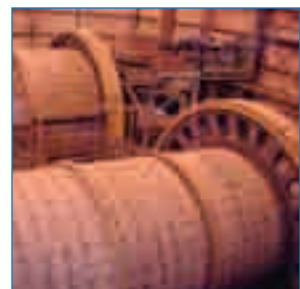


Underground and Open Pit Lac des Iles mine

North American Palladium has operated continuously at the Lac des Iles mine since 1993. Our team has both open pit and underground mining expertise that will contribute to the efficient mining of our significant resources. More than \$500 million has been invested in mine infrastructure and mineral rights at Lac des Iles, allowing us to quickly restart operations when metal prices recover.

A detailed exploration program is underway with the objectives of increasing the tonnage and grade of the upper portion of the Offset Zone, upgrading indicated resources to probable reserves, and discovering new resources.

We are completing a prefeasibility study on the Offset Zone, that will determine the optimal mining and milling configuration, and economics of developing the Offset Zone.





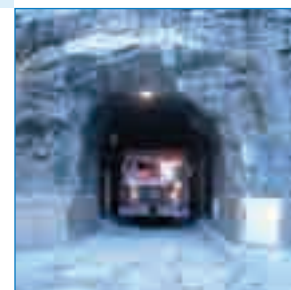
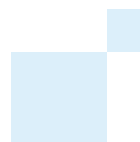
North American Palladium has the advantage of a strong balance sheet, \$86 million in working capital and a new management team that has years of experience in growing companies and increasing shareholder value.

Palladium, platinum and gold represent over 70% of our revenues.

During 2008, we reduced debt by \$31.5 million and have no long-term debt.

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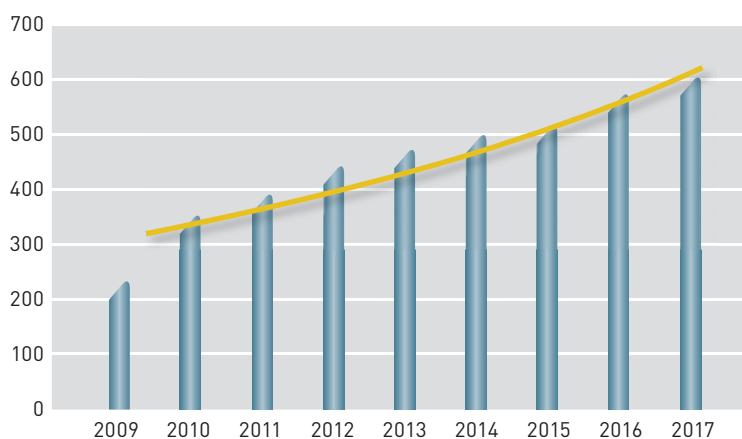
re-engineering the future



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

Part of our growth strategy going forward is to acquire high quality, near term producing gold assets.

PALLADIUM PRICE FORECAST 2009-2017*



* CPM Group

Prices are forecasted to increase from \$230 per ounce in 2009 to \$440 per ounce in 2013

“The fundamentals for these rare metals are strong for the mid to long term, most likely from 2010 onward.”

Jeffrey Christian, Managing Director, CPM Group



Letter to Shareholders



William J. Biggar
President & CEO

Dear Shareholder,

Without a doubt, 2008 will be a year that will go down in history. The global financial crisis resulted in a collapse of commodity prices that was unprecedented in its speed and severity. While it was a year frequently referred to as the biggest bear market since the Great Depression, it is at times like these that significant opportunities often arise.

Our Company is taking steps to capitalize on these opportunities to contribute to our growth as we set our sights on becoming a mid-tier precious metals producer. In March, we announced the acquisition of Cadiscor Resources Inc., a gold company preparing to restart the Sleeping Giant gold mine in Quebec, at an annual production rate of 50,000 ounces. This acquisition is an important first step in growing our precious metals business by adding additional gold to our significant palladium resources.

The outlook for palladium is indeed bright as it is a very rare metal, and forecasts by leading independent firms expect prices to increase substantially in the coming years. This gives us confidence in the future of our Lac des Iles mine and in our ability to create value for our shareholders.

RE-ENGINEERING THE MINE

When I joined North American Palladium in October of 2008, the effects of the global economic turmoil were just beginning to emerge. For the health of the Company, we acted swiftly and were one of the first mining companies to place our mine on temporary care and maintenance. This enabled us to protect our strong cash and working

The outlook for palladium is indeed bright as it is a very rare metal, and forecasts by leading independent firms expect prices to increase substantially in the coming years.

capital positions. Prior to the shutdown, we were producing, on an annualized basis, 270,000 ounces of palladium as well as 20,000 ounces of platinum, 20,000 ounces of gold, three million pounds of nickel and six million pounds of copper. Our team was strong, the mine was profitable and operations had improved substantially, with production levels that were reliable and with consistent ore grade.

We have retained key mine personnel so that a quick restart will be possible when metal prices recover to sustainable levels. A mine optimization study is underway and it will focus on achieving pre-shutdown levels of palladium production, but at a lower cash cost per ounce thereby enhancing profitability. Upon restart, we will emerge a leaner, more focused Company, with improved mine economics.

ADVANCING OUR STRENGTHS

The underground Roby Zone at the Lac des Iles mine has a remaining life of two years. The Offset Zone, which is the fault displaced extension of the Roby Zone, has the potential to add up to 10 years of additional mine life. In January 2009, we released the results of our 2007 drill program on the Offset Zone that increased resources in the indicated category by 280%. Our contained ounces at the present time, prior to the results of this year's drill program, are 3.7 million ounces of palladium, 300,000 ounces of platinum and 250,000 ounces of gold in the measured and indicated categories.

We are now more than halfway through our \$7.0 million 2009 exploration program. Our objectives are to increase



the tonnage and grade of the upper portion of the Offset Zone, upgrade indicated resources to probable reserves, and discover new resources.

A prefeasibility study is also underway to determine the optimal mining and milling configuration to exploit our significant resources upon mine restart. The results of the prefeasibility study are expected to be available in the third quarter.

Several new targets have also been identified by our exploration team on the largely unexplored 21,000 acre Lac des Iles property, and will be drilled throughout the balance of the year.

THE INFRASTRUCTURE HAS BEEN BUILT

Your Company has a total investment in infrastructure at the mine site of \$500 million. Just prior to the shutdown, we invested \$30 million in a new tailings management facility. We are ready to resume operations on three months lead time when metal prices appear favourable and sustainable.

ACQUISITIONS TO PROPEL GROWTH AND CASH FLOW

In addition to our many years of open pit and underground mining expertise, our senior management group has extensive experience building businesses and creating shareholder value. Most of the senior team joined North American Palladium in 2007 and 2008.

Fortunately, we eliminated all of our long-term debt in 2008 and we have a strong cash position. This enables the

Company to pursue attractive acquisition opportunities with the discipline required to ensure that only those transactions that can deliver enhanced shareholder value over the long-term are pursued.

Our vision is to build upon our significant palladium and platinum precious metal resources at Lac des Iles by acquiring gold resources or gold companies with a view to building a mid-tier precious metals company with multiple mines.

To our dedicated employees, shareholders and directors

In conclusion, I would like to recognize our employees for their dedication and long-standing support. Their contribution and their understanding of the need for the temporary closure of the mine, as well as their recognition of the stronger position we will be in upon restart, is admirable. The exceptional team we have at North American Palladium is driven to produce results.

I would also like to thank our Board of Directors for their support and input as we re-position the Company for the future. And I thank you, our loyal shareholders, for your support and encouragement. I look forward to the coming year and the exciting future that lies ahead.

Sincerely,



William J. Biggar
President & CEO



Lac des Iles Property



A significant drill program is underway in 2009 with the objectives of increasing the tonnage and grade of the upper portion of the Offset Zone

LAC DES ILES MINE

The Company owns and operates the Lac des Iles (“LDI”) mine, located 85 kilometres from Thunder Bay, Ontario, Canada. The LDI mine consists of an open pit mine, an underground mine and two processing plants (one of which has been idle since 2001). The primary deposits on the LDI property are the Roby Zone and the Offset Zone, both disseminated magmatic nickel-copper-PGM deposits. The Company began mining the Roby Zone in 1993 using open pit mining methods. In April 2006, the underground mine went into commercial production to access a higher grade portion of the Roby Zone. On October 29, 2008 the mine was placed on temporary care and maintenance. Prior to shutdown, on an annualized basis, the Company produced 270,000 ounces of palladium, 20,000 ounces of platinum and 20,000 ounces of gold.

MINING OPERATIONS

The underground mine lies below the open pit and extends to a depth of approximately 600 metres from the surface where it is truncated by an offset fault. Commercial production from the underground mine began on April 1, 2006. In 2008, the underground mine had a run-of-mine average head grade of 5.71 grams per tonne of palladium compared to 5.79 grams per tonne in 2007.

OPTIMIZING OUR MINING AND MILLING OPERATIONS

At the time the mine was placed on temporary care and maintenance, the open pit had a remaining mine life of less than one year at the current rate of production. If the

Company permanently shuts down the open pit, the mill will be reconfigured to process ore at a lower capacity. A redesigned mill with a capacity of 6,000 to 7,000 tonnes per day would eliminate the current need for a SAG mill and would significantly reduce operating costs for the mill. The results of a Preliminary Economic Assessment released on May 7, 2008, suggest that an underground mining operation could be mined at a rate of 6,000 tonnes per day, yielding up to 250,000 ounces of palladium, 16,000 ounces of platinum, 17,000 ounces of gold, two million pounds of nickel and four million pounds of copper annually once full production is achieved. A detailed prefeasibility study is currently underway to confirm these results.

The Company's LDI mining operation also includes a second mill with a capacity of 2,400 tonnes per day, an assay laboratory, a warehouse, an electrical shop, a three-bay truck shop to service the larger haul trucks, an operations camp, a water treatment plant, a propane storage facility, a fuel storage area, other minor outbuildings, rock storage areas, tailings storage areas and an electrical substation. Power is delivered to the site by a 65 kilometre power line, which ties directly into the Northwestern Ontario power grid.

Since becoming a publicly traded company, North American Palladium has invested over \$500 million in infrastructure and development at the LDI mine. As soon as metal prices improve and the Company determines that operations can once again become profitable, a quick restart is possible at a modest capital cost.



North American Palladium Mineral Resources

Property	Resources	Tonnes (000)	Pd (g/t)	Pt (g/t)	Au (g/t)	Cu (%)	Ni (%)	Pd (000 oz)	Pt (000 oz)
Lac des Iles	Measured								
	Roby Zone Open Pit	3,722	1.99	0.23	0.17	0.08	0.07	238	28
	Roby Zone Stockpiles	763	2.09	0.19	0.18	0.06	0.08	51	5
	Indicated Resources								
	Roby Zone Open Pit	2,565	2.20	0.24	0.18	0.08	0.07	181	20
	Roby Zone RGO Stockpile	13,365	0.97	0.12	0.08	0.03	0.06	417	52
	Roby Zone Underground	3,292	7.61	0.44	0.33	0.06	0.08	805	47
	Offset Underground	12,331	5.02	0.38	0.37	0.11	0.13	1,990	151
	Measured & Indicated	36,038	3.18	0.26	0.22	0.07	0.09	3,682	303
	Inferred								
Shebandowan	Offset Underground	4,637	4.9	0.4	0.3	0.12	0.13	730	60
	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

Notes:

- (1) CIM definitions were followed for the estimation of Mineral Resources.
- (2) Mineral Resources for the Lac des Iles mine were estimated by Scott Wilson Roscoe Postle Associates, Inc.
- (3) Mineral Resources for the Roby open pit were estimated at a cut-off grade of 1.8 g/t PdEq, within an optimized pit shell run below the current pit survey (October 2008).
- (4) Mineral Resources in Lac des Iles mine stockpiles were estimated at a cut-off grade of 1.9 g/t PdEq.
- (5) Mineral Resources for the Roby and Offset Zones underground were estimated at a cut-off grade of 5.8 g/t PdEq.
- (6) Lac des Iles mine cut-off grades were determined under the assumption that a production rate of 14,000 tpd would be resumed in the event of restarting operations.
- (7) For Lac des Iles mine, metal price assumptions of US\$350/oz palladium, US\$1,400/oz platinum, US\$850/oz gold, US\$6.50/lb nickel, and US\$2.00/lb copper were used in the estimation of PdEq and cut-off grade. A US\$/C\$ exchange rate of C\$1.11 was used.
- (8) 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 palladium, US\$750/oz platinum, US\$400/oz gold, US\$7/lb nickel and US\$1.50/lb copper.
- (9) Assumes a net inventory to North American Palladium of 50% for the Shebandowan West Project. The Company's interest is currently 50%, which could be reduced to 40% upon the exercise by Vale Inco of a claw-back right.
- (10) Palladium and platinum 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 place tonnage and grade.

Offset Zone

The Offset Zone is located on the LDI property and was discovered by the Company's exploration team in 2001. The Offset Zone is the fault displaced continuation of the Roby Zone mineralization and is located below and approximately 250 metres to the southwest of the Roby Zone. A mineral resource estimate prepared by Scott Wilson RPA in January 2009 estimated that the Offset Zone has significantly more mineral resources, at similar grades, than the current underground mine at the Roby Zone.

The mineral resource estimate by Scott Wilson RPA, upgraded the indicated resource by 280%, from 3.2 million tonnes at 4.85 grams per tonne of palladium to 12.3 million tonnes at 5.02 grams per tonne of palladium. The report also showed that, as a result of the 2007 under-

ground drill program, approximately 73% of the resources are now classified in the indicated category.

A significant drill program is underway in 2009 with the objectives of increasing the tonnage and grade of the upper portion of the Offset Zone, upgrading indicated resources to probable reserves and discovering new resources. The program also aims to increase confidence in the existing mineral resources by increasing the density of the drilling. Thus far, the Offset Zone has been traced to a depth of 1,300 metres below surface, and along a strike length of approximately 600 metres. It remains open in all directions. The Company's 2009 drill program on the Offset Zone is approximately three times greater than the expenditure incurred during the 2007 drill program.



A detailed prefeasibility study is also underway with the objective of assessing the optimal mining and milling configuration for the Offset Zone and the remaining two years of the Roby Zone. The prefeasibility report is expected to be available in the third quarter of 2009.

GROWTH VIA ACQUISITIONS AND EXPLORATION ACTIVITIES

The LDI property covers 21,000 acres and has been under-explored. The Company's new exploration team has recently identified several potential targets that will be drilled in 2009. Grassroots exploration is an important ongoing part of the Company's growth strategy.

North American Palladium is also considering corporate transactions with gold companies, with a view to creating a mid-tier precious metals company producing palladium, platinum and gold in mining-friendly jurisdictions. In March 2009, the Company announced the proposed acquisition of Cadiscor Resources Inc., a Quebec based company with two well advanced gold projects, one of which, the Sleeping Giant, was a former producing mine. The Sleeping Giant mine has contained mineralization of 225,000 ounces of gold and, for the past five years, produced on average 58,000 ounces of gold per year. The transaction is scheduled to close in mid May 2009, and it is anticipated that mining operations will resume at Sleeping Giant with production of approximately 50,000 ounces of gold per year.

Shebandowan Joint Venture

The Company holds a 50% interest with Vale Inco in the former producing Shebandowan mine and the surrounding Haines and Conacher properties (the "Shebandowan Joint Venture"). The property is located approximately 100 kilometres southwest of the LDI mine.

The Shebandowan West Project, in which North American Palladium would have a 100% interest, encompasses three shallow mineralized zones within the Shebandowan Joint Venture 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. The Shebandowan West Project's nickel-copper-PGM mineralization is believed by management to represent the western extension

of the Shebandowan mine ore body. The Shebandowan mine, which was in operation from 1972 to 1998, produced 8.7 million tons of ore at grades of 2.07% nickel, 1.00% copper and approximately 3.0 grams per tons Platinum Group Metals and gold. A Technical Report in compliance with NI 43-101 disclosing the results of a mineral resource estimate by an independent Qualified Person was filed on October 26, 2007.

Preliminary discussions have been held with Vale Inco about drilling certain deep targets on the Shebandowan Joint Venture lands with a view to identifying larger nickel targets than those identified at the Shebandowan West Project.



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, 2008, compared to those of the respective periods in the prior years. This MD&A has been prepared as of February 23, 2009 and is intended to supplement and complement the audited consolidated financial statements and notes thereto for the year ended December 31, 2008 (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

Palladium is a precious metal, along with gold, silver and platinum. It is one of the six platinum group metals ("PGMs"), which also include platinum, rhodium, ruthenium, iridium and osmium. Palladium is used in the manufacture of catalytic converters in the automotive industry, the manufacture of jewellery and electronics, and in dental and chemical applications. As a precious metal, there is also investment demand for palladium in bar format by exchange traded funds and institutional investors.

Supply

Palladium is typically produced as a by-product metal from platinum mines and nickel mines. According to the CPM Group, a leading commodities market research and consulting firm, most of the world's palladium is supplied by Russia (36%), the Republic of South Africa (31%) and North America (10%). The CPM Group estimates that global supply of palladium decreased by approximately 1% in 2008 to 8,452,000 ounces. Of this total, mine production accounts for approximately 6,762,000 ounces (an estimated decrease of 4% from the prior year) and secondary recovery of palladium accounts for approximately 1,690,000 ounces.

Demand

The CPM Group estimates that global fabrication demand for palladium (excluding investor demand) decreased by approximately 1% in 2008 to 7,741,000 ounces, primarily as a result of reduced demand in the U.S. and European automotive industries. The year 2008 marked the first time since 2001 that overall palladium demand has declined.

The CPM Group also estimates that 53% of the global demand for palladium in 2008 stemmed from the automotive industry for use in auto catalysts, 15% from electronics, 10% from dental applications, 9% from Chinese demand, and 13% from other uses such as jewellery, chemical catalysts and petroleum refining catalysts.

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, to a lesser extent, 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 worldwide, resulting in steady growth in the use of catalytic converters. Catalytic converters are now included in over 96% of new cars worldwide. With the palladium price currently substantially below that of platinum automakers have increasingly been switching their catalyst formulations from those based on platinum to palladium. The use of palladium in diesel auto catalysts also has increased due to continuing technological improvements. Until a few years ago there was no palladium used in diesel auto catalysts, since the residual sulfur in diesel fuel coats the palladium and renders it inert. Technological innovations now allow some of the platinum in diesel catalysts to be substituted with palladium, a trend that has been underway for several years. Palladium can now comprise up to approximately 30% of the PGM content of a diesel catalytic converter.

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. Palladium is also used in the manufacture of jewellery and may be used either on its own or as an alloy in white gold. 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 as a precious metal along with the other precious metals (i.e., platinum, gold and silver). Strong investor sentiment for these precious metals has provided support for palladium pricing. Increased participation by a greater variety of market participants, the resulting improvement in liquidity, and the introduction of new investment vehicles are all influencing investment demand for palladium. Palladium exchange traded funds ("ETFs") were introduced in 2007 by the same firms that have introduced platinum ETFs.

COMPANY OVERVIEW

Overview of North American Palladium's Business

North American Palladium Ltd. is Canada's only primary producer of PGMs. Prior to the temporary shut down of the Lac des Iles mine, the Company produced 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, gold, nickel, and copper, all of which are by-products of the Company's palladium mining operations. North American Palladium's principal properties and projects are at Lac des Iles, including the Lac des Iles mine and the Offset High Grade Zone ("Offset Zone").

Lac des Iles mine

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 was decommissioned in June 2001). The primary deposits on the property are the Roby Zone and the Offset Zone. 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.

The Offset Zone is located on the Lac des Iles property and was discovered by the Company's exploration team in 2001. The Offset Zone is considered to be the fault displaced continuation of the Roby Zone mineralization and is located below and approximately 250 metres to the west of the Roby Zone. An updated mineral resource estimate was prepared by Scott Wilson Roscoe Postle Associates Inc. ("Scott Wilson RPA") in January 2009. The report showed that the Offset Zone has significantly more mineral resources than the current underground mine at the Roby Zone at similar grades, and remains open along strike to the north, south and at depth. A detailed prefeasibility report is underway with the objectives of converting indicated resources to probable reserves, and assessing the optimal mining and milling configuration and economics of developing the upper portion of the Offset Zone. The report is expected to be completed by the end of the second quarter of 2009.

On October 21, 2008, the Company announced that, due to declining metal prices, it was temporarily placing its Lac des Iles mine on a care and maintenance basis effective October 29, 2008. The closure resulted in the layoff of approximately 350 employees.

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 kilometres 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 was 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 for processing at the original mill on the Lac des Iles property. In light of the sharp decline in metal prices in the fall of 2008, the Company ceased all activities with the Shebandowan Joint Venture, including at the Shebandowan West Project. A decision on when and whether to resume activities will largely depend on the long term outlook for nickel prices.



Arctic Platinum Project

The Company was party to an agreement with Gold Fields Limited that would have entitled it to a 60% interest in a series of mining licenses and claims known as the Arctic Platinum Project ("APP").

In order to satisfy the requirements of its earn-in, the Company had to satisfy a number of conditions on or before August 31, 2008, including: (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 9,227,033 common shares to Gold Fields BV to earn a 60% interest or if Gold Fields exercised a claw-back right, issue 7,381,636 common shares to earn a 50% interest. The Company had completed the re-scoping study, incurred over US\$18.8 million in expenditures and commissioned a feasibility study.

The Company received a draft feasibility study in the summer of 2008 which showed that lower commodity prices coupled with the increased price of steel and diesel fuel, the strength of the euro relative to the U.S. dollar and other variables had adversely impacted the economics of the project. As a result of these findings, the Company determined that it would not deliver a positive feasibility study for the Arctic Platinum Project prior to the August 31, 2008 deadline. The Company advised Gold Fields of the outcome and the parties discussed strategic alternatives for the project. The parties failed to reach an agreement and the Company's option over the APP has since lapsed. All interests in APP have now reverted back to Gold Fields Limited.

Year Ended December 31, 2008 Highlights

- Revenue after pricing adjustments for the year ended December 31, 2008 of \$125.5 million decreased by \$70.4 million (36%) compared to \$195.9 million in 2007. On October 29, 2008, due to dramatically declining metal prices, the Company's Lac des Iles mine was temporarily placed on a care and maintenance basis that resulted in a 26% decrease in palladium production in 2008.
- The net loss for the year ended December 31, 2008 of \$160.7 million was due to a non-cash asset impairment charge, the temporary closure of the Lac des Iles mine and a significant decline in the price of palladium, platinum, nickel and copper. The Company recorded a \$90.0 million non-cash impairment charge on its investment in the Lac des Iles mine due to prevailing market conditions. The net loss for the year ended December 31, 2008 also included negative mark-to-market commodities pricing adjustments of \$38.6 million and a \$3.9 million write down of ore and concentrate inventories due to lower metal prices.
- The net loss for the year ended December 31, 2008 was \$160.7 million or \$1.94 per share compared to a net loss of \$28.7 million or \$0.51 per share in 2007. The net loss for the year includes the \$90.0 million or \$1.09 per share non-cash impairment charge on the Company's investment in the Lac des Iles mine.
- Operating cash flow for the year ended December 31, 2008 of \$6.9 million compared to operating cash flow of \$25.5 million in 2007.
- Palladium production of 212,046 ounces decreased 26% compared to last year due primarily to the Lac des Iles mine being placed on a temporary care and maintenance basis in October 2008.
- Palladium sales settled during the year ended December 31, 2008 were realized at an average price of US\$378 per ounce compared to US\$346 per ounce last year, an increase of 9%. Palladium sales not settled as at December 31, 2008 were provisionally valued at US\$183 per ounce compared to US\$364 as at December 31, 2007, a decrease of 50%. 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 45% of the year's total revenues while platinum and nickel continued to be important sources of revenue, each at 16% of the year's total revenue.



- Cash cost per ounce of palladium produced¹, net of by-product metal revenues and royalties, was US\$283 for 2008 compared to US\$164 the previous year. The significant increase in cash cost per ounce is attributable to the reduction of by-product revenue due to lower commodity prices.
- Concentrate awaiting settlement as at December 31, 2008 was \$43.1 million and included 125,747 ounces of palladium provisionally valued at US\$183 per ounce.
- The Company's total outstanding debt position at December 31, 2008 was \$7.6 million, a reduction of \$31.5 million (81%) compared to total outstanding debt of \$39.1 million at December 31, 2007 due primarily to the repayment of \$25.7 million of convertible notes during 2008.
- Net working capital as at December 31, 2008 was \$86.1 million compared to \$128.4 million as at December 31, 2007.

Key Results

Key Operating Statistics

Year Ended December 31	2008*	2007	2006**
Palladium (oz)	212,046	286,334	237,338
Payable Palladium (oz)	195,083	263,046	217,022
Platinum (oz)	16,311	24,442	22,308
Gold (oz)	15,921	20,092	17,237
Copper (lbs)	4,623,278	5,536,044	5,155,588
Nickel (lbs)	2,503,902	3,066,973	2,721,042
Ore Tonnes Milled	3,722,732	5,006,383	4,570,926
Palladium Head Grade (g/t)	2.33	2.39	2.18
Palladium Recoveries (%)	75.3	74.8	74.0
Ore Tonnes Mined – Underground	615,630	768,841	721,179
Ore Tonnes Mined – Open Pit	3,060,788	4,374,225	3,926,911
Waste Tonnes Mined – Open Pit	6,989,845	7,231,026	8,888,037
Waste Strip Ratio	2.28:1	1.65:1	2.26:1

* The 2008 key operating statistics reflect the period from January 1 to October 29, 2008 when the Company's Lac des Iles mine was temporarily placed on a care and maintenance basis.

** 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

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

	2008	2007*	2006*
Revenue after pricing adjustments	\$ 125,491	\$ 195,932	\$ 159,200
Asset impairment charge	(90,000)	—	—
Income (loss) from mining operations	(127,759)	505	453
Net income (loss)	(160,679)	(28,680)	(34,109)
Net loss per share (dollars)			
Basic and diluted	\$ (1.94)	\$ (0.51)	\$ (0.65)
Cash flow from (used in) operations prior to changes in non-cash working capital ¹	(467)	42,884	3,760
Total assets	146,904	305,374	265,157
Total long-term debt, including current portion	\$ 7,552	\$ 39,081	\$ 74,906
Cash dividends declared	Nil	Nil	Nil

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

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



RESULTS OF OPERATIONS

Revenue

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. Since April 1, 2007, the amount of the final pricing adjustments recognized on any commodity price changes are also reduced by any price participation deductions as provided for in the Company's smelting and refining agreement.

Average Realized Metal Prices and Exchange Rates – Year ended December 31

	2008	2007	2006
Palladium – US\$/oz	\$ 378	\$ 346	\$ 318
Platinum – US\$/oz	\$ 1,547	\$ 1,297	\$ 1,121
Gold – US\$/oz	\$ 862	\$ 695	\$ 592
Nickel – US\$/lb	\$ 10.13	\$ 16.73	\$ 9.88
Copper – US\$/lb	\$ 3.29	\$ 3.22	\$ 2.92
Average exchange rate (Bank of Canada) – CDN\$1 = US\$	US\$ 0.96	US\$ 0.93	US\$ 0.88

For the year ended December 31, 2008, revenue before pricing adjustments of \$148.4 million decreased by \$52.9 million (26%) compared to 2007, reflecting the impact of lower sales volumes (\$54.1 million) and an unfavourable foreign exchange rate impact (\$0.7 million) offset partially by higher average realized metal prices (\$1.9 million). The lower sales volume is mainly a result of the temporary closure of the Company's Lac des Iles mine on October 29, 2008 and the consequent reduction in production. During 2008, the spot price of palladium per ounce ranged from a high of US\$582 to a low of US\$164. Palladium sales that were settled during the year ended December 31, 2008, realized an average of US\$378 per ounce, an increase of 9% compared to a realized average of US\$346 in 2007. The Canadian dollar strengthened to an average of US\$0.96 against the US dollar during 2008 compared to US\$0.93 during 2007.

Recorded Spot Metal Prices and Exchange Rates – Mark-to-Market – Year ended December 31

	2008	2007	2006
Palladium – US\$/oz	\$ 183	\$ 364	\$ 322
Platinum – US\$/oz	\$ 898	\$ 1,530	\$ 1,115
Gold – US\$/oz	\$ 869	\$ 836	\$ 635
Nickel – US\$/lb	\$ 4.90	\$ 11.70	\$ 15.11
Copper – US\$/lb	\$ 1.32	\$ 3.03	\$ 2.85
Exchange rate (Bank of Canada) – CDN\$1 = US\$	US\$ 0.82	US\$ 1.01	US\$ 0.86

Negative pricing adjustments from settlements and the mark-to-market of concentrate awaiting settlement for the year ended December 31, 2008 reduced revenue by \$22.9 million (\$38.6 million negative commodity price adjustment, partially offset by a \$15.7 million favourable foreign exchange adjustment). This compares with unfavourable pricing adjustments for the year ended December 31, 2007 of \$5.4 million (\$14.2 million unfavourable foreign exchange adjustment partially offset by an \$8.8 million positive commodity price adjustment). The Canadian dollar weakened by 19% against the US dollar to \$0.82 at December 31, 2008 compared to US\$1.01 at December 31, 2007.

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



For the year ended December 31, 2008, revenue after pricing adjustments of \$125.5 million decreased \$70.4 million (36%), compared to 2007. Revenue after pricing adjustments from the sale of palladium in 2008 decreased by 39% to \$56.3 million (45% of total revenue) compared to \$91.8 million (47% of total revenue) in 2007.

For the year ended December 31, 2008, total by-product revenues before pricing adjustments were \$76.4 million, a decrease of \$29.8 million (28%) as compared to \$106.2 million in 2007, reflecting decreased sales volumes (\$26.0 million), lower overall average realized metal prices (\$3.2 million), and an unfavourable foreign exchange rate impact (\$0.6 million). The impact of higher average realized prices for platinum (\$6.3 million), gold (\$3.0 million), and copper and other metals (\$1.7 million) was more than offset by the 39% (\$14.2 million) decrease in average realized nickel prices.

For the year ended December 31, 2008, total by-product revenues after pricing adjustments were \$69.2 million, a decrease of \$34.9 million (34%) as compared to \$104.1 million in 2007. Platinum, nickel and copper revenue declined by \$10.8 million (35%), \$22.5 million (53%) and \$2.8 million (19%) respectively, while gold revenue increased by \$1.4 million (11%) due to higher gold prices.

Operations

For the year ended December 31, 2008, palladium ounces produced decreased by 26%. The mill processed 3,722,732 tonnes of ore or an average of 12,577 tonnes per operating day, producing 212,046 ounces of palladium compared to 5,006,383 tonnes of ore or an average of 13,716 tonnes per operating day, producing 286,334 ounces of palladium in 2007. The 26% reduction in mill throughput in 2008 was due primarily to the Lac des Iles mine being temporarily placed on a care and maintenance basis on October 29, 2008. In 2008, the average palladium head grade was 2.33 grams per tonne compared to 2.39 grams per tonne in 2007. For the year ended December 31, 2008, 615,630 tonnes of ore was extracted from the underground mine, with an average palladium grade of 5.71 grams per tonne compared to 768,841 tonnes of ore, with an average palladium grade of 5.79 grams per tonne in 2007. For 2008 the palladium recoveries were 75.3%, compared to 74.8% in 2007.

In the Lac des Iles open pit, for the year ended December 31, 2008, 3,060,788 tonnes of ore were extracted with an average palladium grade of 1.85 grams per tonne compared to 4,374,225 tonnes at an average palladium grade of 1.79 grams per tonne the previous year. For the year ended December 31, 2008, the strip ratio increased to 2.28 compared to 1.65 in 2007.

Operating Expenses

For the year ended December 31, 2008, total production costs of \$115.0 million decreased by \$9.9 million (8%) compared to 2007, due mainly to a \$16.5 million reduction of costs as a result of the mine being placed on a care and maintenance basis in October 2008 and the capitalization of \$3.0 million of major spare parts and insurance spares to mining interests following adoption of Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3031, offset partially by severance and other mine closure costs of \$7.9 million. 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\$283 per ounce for the year ended December 31, 2008 compared to US\$164 per ounce in 2007. The increase in unit cash costs was primarily due to decreased by-product revenues as a result of lower by-product commodity prices offset by the weakening Canadian dollar.

For the year ended December 31, 2008, inventory pricing adjustments were \$3.9 million (2007 – \$0.1 million) and reflect the write down of ore and concentrate inventories to net realizable value as a result of the decline in metal prices.

Smelter treatment, refining and freight charges for the year ended December 31, 2008 of \$19.3 million decreased by \$3.1 million (14%) compared to 2007. The decrease is attributable to lower sales volumes (\$4.8 million) and a favourable foreign exchange adjustment (\$0.4 million) relating to refining costs, offset partially by higher costs associated with the Company's new smelter agreement (\$2.1 million) that came into effect April 1, 2007.

Non-cash amortization decreased by \$10.9 million (23%) to \$36.0 million for the year ended December 31, 2008 compared to \$46.9 million in 2007. The lower amortization is attributable to the 26% decrease in palladium production (\$13.1 million),



offset by a decrease in the amortization capitalized to inventory (\$2.2 million) due to the write down of ore and concentrate inventory to net realizable value.

The Company reviews and evaluates its long-lived assets for impairment when events or changes in circumstances arise that may result in impairments in the carrying value of those assets. 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, 2008, to account for production at the mine. In light of the volatile current market conditions, for the purposes of its review and evaluation, the Company utilized the average of commodity price forecasts released since October 2008. Based on this review, management has concluded that an impairment of \$90.0 million exists and has been provided for as at December 31, 2008. 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.

For the year ended December 31, 2008, the Company reported a loss on disposal of equipment of \$2.5 million, which reflects primarily the unamortized value (\$1.2 million) of component parts of equipment replaced in the period following the adoption of the CICA Handbook Section 3031, and the disposal of old and obsolete equipment (\$1.0 million).

For the year ended December 31, 2008, asset retirement costs were \$0.3 million compared to \$1.0 million in 2007. The reduction in the asset retirement costs for 2008 is the result of a recovery of accretion charges (\$0.2 million) due to the net effect of a revaluation of the asset retirement cost and obligation based on the revised estimated cash flows within the Company's most recent mine plan and decreased amortization due to the 26% decrease in palladium production (\$0.1 million) during the year. A further reduction of asset retirement costs in 2008 is attributable to the initial revision of the mine plan in 2007 to reflect a shorter period for accreting the asset retirement obligation. As a result, an additional charge (\$0.3 million) was recognized in the three months ended June 30, 2007 to adjust the previously recorded accretion to the reduced term.

For the year ended December 31, 2008, the Company recorded a loss from mining operations, before an insurance recovery of \$13.8 million, of \$141.6 million compared to income of \$0.5 million in 2007. The insurance recovery relates to an insurance claim filed by the Company in connection with the failure of the Lac des Iles mine primary crusher in 2002. In June 2008, a final settlement of \$14.5 million was received and an amount of \$13.8 million has been included as income from mining operations and \$0.7 million received for costs has been included as a reduction of general and administrative expenses.

Other Expenses

For the year ended December 31, 2008, other expenses totaled \$35.2 million, an increase of \$5.1 million compared to other expenses of \$30.1 million in 2007. An increase in exploration expenses of \$11.0 million and an unfavourable foreign exchange impact of \$9.4 million were partially offset by a \$15.2 million decrease in interest and other financing charges and a \$0.1 million decrease in general and administrative expenses.

General and administrative expenses for the year ended December 31, 2008 of \$7.7 million decreased \$0.1 million compared to \$7.8 million incurred in 2007. Significant items contributing to the decrease include the Ontario Government's elimination of the capital tax (\$1.8 million) and the insurance recovery of costs (\$0.7 million), offset by the windup of APP (\$0.8 million), severance costs (\$0.6 million) and corporate development expenditures (\$0.5 million).

Exploration expense for the year ended December 31, 2008 of \$23.1 million increased \$11.0 million compared to 2007 expenditure of \$12.1 million. The increase is due primarily to expenditures on the Shebandowan West nickel copper-PGM

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



project of \$8.9 million (2007 – \$1.1 million) and on the Arctic Platinum Project of \$9.4 million (2007 – \$5.9 million). In addition, the Company spent \$1.8 million (2007 – \$3.5 million) on continued exploration of the Offset Zone at the Lac des Iles mine and the Mine Block Intrusion and North LDI on the large under-explored Lac des Iles mine property.

Interest and other financing charges decreased by \$15.2 million for the year ended December 31, 2008 due primarily to lower interest and accretion expenses relating to the convertible notes payable of \$11.7 million, which were fully repaid on December 1, 2008, and increased interest income of \$2.0 million.

The unfavourable foreign exchange impact of \$9.4 million for the year ended December 31, 2008, compared to 2007, is due to a 2008 foreign exchange loss of \$1.0 million (2007 – foreign exchange gain of \$8.4 million). The 2008 foreign exchange loss of \$1.0 million, is due primarily to the translation of the Company's US dollar denominated convertible notes, capital leases and credit facilities (\$2.3 million) partially offset by a foreign exchange gain (\$1.8 million) related to the Arctic Platinum Project in Finland reflecting the strengthening of the Canadian dollar against the euro.

Income and Mining Taxes

For the year ended December 31, 2008, the Company's income and mining tax recovery was \$2.2 million compared to a \$0.9 million income and mining tax recovery in 2007. This recovery relates primarily to the recovery of future mining taxes resulting from current period losses, recovery of current mining taxes resulting from the settlement of an exposure previously accrued for in a prior year, and the recovery of future income tax liability arising on the renunciation of exploration expenditures to investors.

Net Loss

For the year ended December 31, 2008, the net loss was \$160.7 million or \$1.94 per share, compared to a net loss of \$28.7 million or \$0.51 per share in 2007.

Summary of Quarterly Results

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

	2007*				2008*			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Revenue – before pricing adjustments	\$ 60,305	\$ 53,450	\$ 42,674	\$ 44,938	\$ 51,052	\$ 52,403	\$ 35,331	\$ 9,642
Pricing adjustments:								
Commodities	9,141	(2,421)	237	1,799	15,178	581	(47,203)	(7,189)
Foreign exchange	(1,007)	(6,534)	(6,419)	(231)	4,558	(743)	2,992	8,889
Revenue – after pricing adjustments	\$ 68,439	\$ 44,495	\$ 36,492	\$ 46,506	\$ 70,788	\$ 52,241	\$ (8,880)	\$ 11,342
Cash flow from operations ¹ , prior to changes in non-cash working capital**	15,108	15,743	6,479	5,554	8,153	18,061	(10,691)	(15,990)
Exploration expense	3,228	798	2,933	5,179	7,054	7,115	4,231	4,670
Net income (loss)	5,507	(9,066)	(14,033)	(11,088)	12,595	10,387	(71,242)	(112,419)
Net income (loss) per share	\$ 0.10	\$ (0.17)	\$ (0.25)	\$ (0.19)	\$ 0.16	\$ 0.13	\$ (0.85)	\$ (1.31)
Fully diluted net income (loss) per share	\$ 0.10	\$ (0.17)	\$ (0.25)	\$ (0.19)	\$ 0.15	\$ 0.13	\$ (0.85)	\$ (1.31)

* 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

- Revenue after pricing adjustments for the fourth quarter of 2008 of \$11.3 million decreased \$35.2 million (76%) compared to the same period last year.
- The net loss for the quarter ended December 31, 2008 of \$112.4 million was due to a non-cash asset impairment charge, the temporary closure of the Lac des Iles mine and a significant decline in the price of palladium, platinum, nickel and copper. The Company recorded a \$90.0 million non-cash impairment charge on the value of its investment in the Lac des Iles mine due to prevailing market conditions. On October 29, 2008, due to dramatically declining metal prices, the Company's Lac des Iles mine was temporarily placed on a care and maintenance basis that resulted in a 70% decrease in palladium production in the fourth quarter 2008 compared to the same period last year.
- The net loss for the three months ended December 31, 2008 was \$112.4 million or \$1.31 per share compared to a net loss of \$11.1 million or \$0.19 per share in the same period last year. The net loss for the quarter is due primarily to the \$90.0 million or \$1.05 per share non-cash impairment charge on the value of the Company's investment in the Lac des Iles mine.
- Cash used in operations for the fourth quarter of 2008 was \$16.6 million compared to cash provided by operations of \$10.5 million in the same period last year.
- Palladium production for the three months ended December 31, 2008 was 21,373 ounces, compared to 71,595 ounces in 2007 and reflects the Lac des Iles mine being placed on a temporary care and maintenance basis on October 29, 2008.
- Palladium sales settled during the fourth quarter of 2008 were realized at an average price of US\$207 per ounce compared to US\$348 per ounce in the comparable quarter last year. Palladium accounted for 66% of the quarter's total revenues while platinum and gold were important sources of revenue, at 14% and 21% 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\$464 for the fourth quarter 2008 compared to US\$221 in the same period last year, primarily due to the reduction of by-product revenue due to lower commodity prices offset by the weakening Canadian dollar.

FOURTH QUARTER FINANCIAL RESULTS

Revenue

On October 29, 2008, due to a dramatic decline in the prices of the Company's main metals, palladium and platinum, the Lac des Iles mine was temporarily placed on a care and maintenance basis.

Average Realized Metal Prices and Exchange Rates – Quarter ended December 31

	2008	2007
Palladium – US\$/oz	\$ 207	\$ 348
Platinum – US\$/oz	\$ 873	\$ 1,406
Gold – US\$/oz	\$ 802	\$ 755
Nickel – US\$/lb	\$ 5.78	\$ 13.62
Copper – US\$/lb	\$ 2.21	\$ 3.35
Average exchange rate (Bank of Canada) – CDN\$1 = US\$	US\$ 0.82	US\$ 1.01

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



Revenue before pricing adjustments for the fourth quarter of 2008 of \$9.6 million decreased \$35.3 million compared to the fourth quarter of 2007 and reflects the impact of reduced sales volumes (\$39.0 million) and lower commodity prices (\$7.4 million), offset partially by a favourable foreign exchange rate impact (\$11.1 million). Palladium sales settled during the three months ended December 31, 2008, realized an average of US\$207 per ounce, down 41% compared to an average of US\$348 in the same period last year. Revenue from palladium sales before pricing adjustments in the fourth quarter of 2008 of \$4.9 million decreased by \$17.1 million (78%) compared to the same period last year.

Positive pricing adjustments from settlements and the mark-to-market of concentrate awaiting settlement in the fourth quarter of 2008 increased revenue in the quarter by \$1.7 million (\$8.9 million favourable foreign exchange adjustment offset partially by a \$7.2 million negative commodity price adjustment). This compares to positive pricing adjustments in the fourth quarter of 2007 of \$1.6 million (\$1.8 million positive commodity price adjustment and a \$0.2 million negative foreign exchange adjustment).

Revenue after pricing adjustments for the three months ended December 31, 2008 of \$11.3 million decreased by \$35.2 million compared to the same period last year. Revenue after pricing adjustments from palladium sales for the three months ended December 31, 2008 was \$7.5 million compared to \$23.8 million in the same period last year.

For the three months ended December 31, 2008, total by-product revenues before pricing adjustments of \$4.8 million decreased by \$18.2 million (79%), reflecting the impact of lower sales volumes (\$20.3 million) and lower average realized metal prices (\$3.5 million), offset by a favourable foreign exchange rate impact (\$5.6 million).

Revenue after pricing adjustments from by-product metal sales in the three months ended December 31, 2008 decreased by \$18.9 million (83%) to \$3.8 million compared to \$22.7 million in the same period last year.

Operations

During the three months ended December 31, 2008, the mill processed 265,950 tonnes of ore at an average of 12,089 tonnes per operating day, producing 21,373 ounces of palladium. During the same period in 2007, the mill processed 1,165,769 tonnes of ore at an average of 12,671 tonnes per operating day, producing 71,595 ounces of palladium. The average palladium head grade was 2.91 grams per tonne in the fourth quarter of 2008, compared to 2.58 grams per tonne in the corresponding period of 2007. In the fourth quarter of 2008, palladium recoveries were 76.0% as compared to 75.2% in the fourth quarter of 2007, while mill availability in the period was 87.9% compared to 86.9% last year. The 70% reduction in ounces produced in the fourth quarter of 2008 reflects the Lac des Iles mine being placed on a temporary care and maintenance basis on October 29, 2008.

During the three months ended December 31, 2008, 46,446 tonnes of ore were extracted from the Lac des Iles underground mine, with an average palladium grade of 6.72 grams per tonne, compared to 202,230 tonnes with an average palladium grade of 5.98 grams per tonne during the same period last year. In the Lac des Iles open pit operation for the three months ended December 31, 2008, 216,845 tonnes of ore were extracted with an average palladium grade of 2.55 grams per tonne compared to 994,152 tonnes of ore extracted at an average palladium grade of 1.92 grams per tonne in the same period last year. Over this period, the strip ratio increased to 2.04 compared to 1.74 in the same period for 2007.

Operating Expenses

Total production costs for the three months ended December 31, 2008 of \$22.4 million reflected an \$8.0 million (26%) decrease over the \$30.4 million in same period of 2007 due mainly to a \$17.3 million reduction of costs as a result of the mine being placed on a care and maintenance basis in October offset partially by severance and other mine closure costs of \$7.9 million. 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\$464 per ounce in the fourth quarter of 2008 compared to US\$221 per ounce in the corresponding period in 2007. The increase in unit cash costs is primarily due to decreased by-product revenues as a result of lower by-product commodity prices offset by the weakening Canadian dollar.

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



For the three months ended December 31, 2008, the inventory pricing adjustments were \$1.6 million (2007 – \$0.1 million write down) and reflect the write up of ore and concentrate inventories to net realizable value due to the weakening of the Canadian dollar partially offset by the decrease in metal prices.

Smelter treatment, refining and freight charges for the three months ended December 31, 2008 of \$1.3 million decreased by \$4.7 million (79%) compared to 2007. The decrease is attributable to lower sales volumes (\$4.3 million) due to the mine being placed on a care and maintenance basis and a foreign exchange adjustment of \$0.4 million relating to refining costs.

Non-cash amortization decreased by \$7.7 million (71%) to \$3.2 million in the fourth quarter of 2008 compared to \$10.9 million in the corresponding period in 2007. The lower amortization is attributable to the 70% decrease in palladium production (\$7.5 million), and an increase in the amortization capitalized to inventory (\$0.2 million) due to the write-down of ore and concentrate inventory to net realizable value.

The Company reviews and evaluates its long-lived assets for impairment when events or changes in circumstances arise that may result in impairments in the carrying value of those assets. Impairment is considered to exist if total estimated future undiscounted cash flows are less than the carrying amount of the asset. Based on this review, management has concluded that an impairment of \$90.0 million exists and has been provided for as at December 31, 2008. 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.

For the three months ended December 31, 2008, the loss on disposal of equipment was \$0.9 million and reflects the disposal of old and obsolete equipment.

For the three months ended December 31, 2008, asset retirement costs were a recovery of \$0.1 million compared to an expense of \$0.2 million in 2007. The reduction in the asset retirement costs for 2008 is the result of a recovery of accretion charges (\$0.2 million) due to the net effect of a revaluation of the asset retirement cost and obligation based on the revised estimated cash flows within the Company's most recent mine plan and decreased amortization due to the 70% decrease in palladium production (\$0.1 million).

For the three months ended December 31, 2008, the loss from mining operations was \$104.6 million, a decline of \$103.6 million compared to last year's loss of \$1.0 million.

Other Expenses

For the three months ended December 31, 2008, other expenses totaled \$8.4 million compared to an expense of \$10.1 million in the corresponding period of 2007, a decrease of \$1.7 million. The decrease in 2008 reflects a reduction of interest and other financing charges of \$2.7 million, lower exploration expenses of \$0.5 million and lower general and administrative expenses of \$0.2 million, offset partially by the net negative impact of a foreign exchange loss compared to last year of \$1.7 million, which relates primarily to the translation of the Company's US dollar denominated loans. The reduced interest and other financing charges are due primarily to lower interest and accretion expenses of \$2.6 million relating to the convertible notes payable and reflects the scheduled repayment of the notes which were fully repaid on December 1, 2008.

Administrative expenses for the three months ended December 31, 2008 of \$1.8 million decreased by \$0.2 million (11%) compared to 2007, due mainly to the recovery of capital taxes.

Exploration expense was \$4.7 million in the fourth quarter of 2008 compared to \$5.2 million in the corresponding period last year, a decrease of \$0.5 million (10%). The decrease is due primarily to lower expenditures on APP of \$0.1 million (2007 – \$2.8 million) partially offset by increased expenditures on the Shebandowan West nickel copper-PGM project of \$2.6 million (2007 – \$0.5 million).

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



Income and Mining Taxes

For the three months ended December 31, 2008, the Company's income and mining tax recovery was \$0.6 million compared to a \$0.1 million income and mining tax recovery in 2007. This recovery relates primarily to the recovery of current mining taxes resulting from the settlement of an exposure previously accrued for in prior periods.

Net Loss

For the three months ended December 31 2008, the Company reported a net loss of \$112.4 million or \$1.31 per share compared to a net loss of \$11.1 million or \$0.19 per share for the three months ended December 31, 2007.

LIQUIDITY

Sources and Uses of Cash

Year ended December 31	2008	2007	2006
Cash generated (consumed) by operations			
before working capital changes	\$ (467)	\$ 42,884	\$ 3,760
Changes in non-cash working capital	7,317	(17,408)	(37,549)
Cash generated (consumed) by operations	6,850	25,476	(33,789)
Cash provided (used) by financing	2,001	61,323	41,295
Cash used in investing	(40,389)	(15,346)	(19,384)
Increase (decrease) in cash and cash equivalents	\$ (31,538)	\$ 71,453	\$ (11,878)

For the year ended December 31 2008, cash used in operations¹ (prior to changes in non-cash working capital) was \$0.5 million, a deterioration of \$43.4 million compared to 2007 when cash provided by operations¹ was \$42.9 million. This deterioration is due primarily to the increased net loss (\$132.0 million), the impact of an unrealized foreign exchange gain (\$24.4 million), lower non-cash amortization expense (\$12.9 million), and a lower non-cash add back for accretion expense relating to the convertible notes payable (\$9.6 million), offset by the non-cash asset impairment charge (\$90.0 million), the impact of an unrealized commodity price adjustment (\$47.0 million), and loss on disposal of equipment (\$2.5 million).

For the year ended December 31, 2008, non-cash working capital declined by \$7.3 million compared to an increase of \$17.4 million in 2007, a decrease of \$24.7 million. The decrease of \$24.7 million is due primarily to a lower concentrate awaiting settlement balance (\$25.2 million), and lower inventories and stockpiles (\$7.0 million), offset by a decrease in accounts payable and accrued liabilities (\$6.0 million).

Palladium awaiting settlement decreased slightly to 125,747 ounces at December 31, 2008, compared to 125,802 ounces at December 31, 2007. The lower prices used to value the concentrate awaiting settlement combined with a slight decrease in the physical quantities of metal in the concentrate awaiting settlement, offset partially by the weakening in the Canadian dollar, resulted in a \$36.0 million (46%) decrease in the value of concentrate awaiting settlement as at December 31, 2008, compared to December 31, 2007.

After allowing for non-cash working capital changes, cash provided by operations was \$6.9 million for the year ended December 31, 2008, compared to cash provided by operations of \$25.5 million in 2007.

Financing activities for the year ended December 31, 2008 provided cash of \$2.0 million and includes equity financings of \$10.5 million less the scheduled repayment of debt of \$8.2 million (2007 – \$14.0 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 underwriters an over allotment option of 15% at US\$4.00 per unit. This option was subsequently exercised in January 2008, increasing the gross proceeds of the offering to US\$85.9 million. In 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 were used to expedite work on the Shebandowan Project.

The Company's total debt position decreased to \$7.6 million at December 31, 2008, compared to \$39.1 million at December 31, 2007. During 2008, five principal payments related to Tranche I convertible notes totaling US\$17.5 million and six principal payments related to the Tranche II convertible note totaling US\$9.0 million were made. At the noteholder's option, these payments were settled in a non-cash transaction by the issuance of 7,598,772 common shares which, in accordance

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



with the terms of the convertible notes loan agreement, are valued at 90% of the five day volume weighted average price on the NYSE-Alternext exchange, (AMEX prior to December 1, 2008) immediately prior to the payment date. As at December 1, 2008, the convertible notes had been fully repaid. For the year ended December 31, 2008, the reduction in debt also includes scheduled long term debt repayments (US\$4.0 million and \$2.0 million) and scheduled capital lease repayments (\$1.9 million). In addition, the weakening of the Canadian dollar resulted in an unrealized foreign exchange translation loss on US dollar denominated debt at December 31, 2008 of \$2.3 million.

Investing activities required \$40.4 million of cash in 2008, the majority of which was attributable to the 2008 expansion of the tailings management facilities (\$26.7 million) and the ongoing lateral development and sustaining capital for the underground mine (\$3.5 million). The investing activities amount also includes \$8.5 million of purchased major spare parts following the implementation of the CICA Handbook Section 3031 as fully described in note 2 of the December 31, 2008 financial statements. This compares with \$15.3 million of investing activities last year, which was mainly related to the underground mine development and sustaining capital (\$9.2 million) and the 2007 expansion of the tailings management facilities (\$4.3 million).

CAPITAL RESOURCES

As at December 31, 2008, the Company had cash and cash equivalents of \$43.1 million compared to \$74.6 million at the same time last year. The funds are invested in guaranteed investment certificates and short term interest bearing deposits at a major Canadian chartered bank.

In addition to cash and cash equivalents as at December 31, 2008 of \$43.1 million, the Company had concentrate awaiting settlement of \$43.1 million comprised of 125,747 ounces of palladium provisionally valued at US\$185 per ounce (115,786 ounces of palladium provisionally valued at spot of US\$183 per ounce and 9,961 ounces of palladium at contract value of US\$206), 6,895 ounces of platinum provisionally valued at US\$898 per ounce, 6,222 ounces of gold provisionally valued at \$869 per ounce, 0.4 million pounds of nickel provisionally valued at US\$4.90 per pound, and 0.8 million pounds of copper provisionally valued at US\$1.32 per pound. Final price adjustments on concentrate awaiting settlement will increase or decrease the Company's revenue in subsequent quarters depending on metal prices at the time final settlement is made.

To meet working capital requirements and for 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 could, at its election, receive advance payments not exceeding an aggregate maximum amount of US\$25.0 million. Under the terms of this facility no advances were to be received after June 2008 and any amounts advanced had to be repaid by December 2008. As at December 31, 2008, the Company had no advances outstanding under this facility and the Company has elected not to renew the facility.

The Company anticipates that current cash resources and the final settlement of concentrate awaiting settlement will provide sufficient capital to meet the needs of the Company for the foreseeable future.

Contractual Obligations

As at December 31, 2008

Payments Due by Period

(expressed in thousands of Canadian dollars)	Total	1 Year	2-3 Years	4-5 Years*
Senior credit facility	\$ 4,430	\$ 4,430	\$ —	\$ —
Capital lease obligations	3,122	1,992	976	154
Interest obligations	277	216	58	3
Operating leases	1,899	794	1,020	85
Other purchase obligations	1,966	1,966	—	—
	\$ 11,694	\$ 9,398	\$ 2,054	\$ 242

* There are no payments due after five years.



RELATED PARTY TRANSACTIONS

On October 12, 2006, the Company closed a transaction with Kaiser-Francis Oil Company ("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 2.5% and the standby fee was 0.125% per annum. This facility was repaid on March 7, 2007. As of January 20, 2009, Kaiser-Francis reported that it held approximately 44% 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 entitles 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, a related party, 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 over-allotment option granted to the underwriters at an exercise price of US\$4.00 per unit, (\$4.04 per unit) for total net proceeds of US\$10,391 (issue costs US\$725). Kaiser-Francis also exercised its pre-existing right under the securities purchase agreement to subscribe for 25% of the over-allotment 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 has been idle since 2001) with a nominal capacity of approximately 2,400 tonnes per day. The primary deposits on the property are the Roby Zone, a disseminated magmatic nickel copper-PGM deposit and the Offset Zone.

On October 21, 2008, the Company announced that, due to depressed metal prices, it was temporarily placing its Lac des Iles mine on a care and maintenance basis effective October 29, 2008. The closure resulted in the lay off of approximately 350 employees.

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 metre and 23 cubic metre shovels, 190 tonne trucks, 187 millimetre 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 metres 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, 2008, the underground mine had an average head grade of 5.71 grams per tonne of palladium compared to 5.79 grams per tonne in 2007.

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



At the rate of production prior to being placed on temporary care and maintenance on October 29, 2008, open pit ore reserves would have been exhausted during the first half of 2009 and the current underground mining operation would have continued until late 2010 or early 2011. It is not envisaged that the open pit will return to operation. High grade ore at the current pit bottom will be accessed from the Roby underground mine.

When operations resume, it is envisaged that the Roby underground mine and higher grade stockpiles will support production, at lower tonnage levels but higher grade than historical production. The Roby underground has identified reserves for approximately two years. During this period, development work on the Offset Zone will commence with the objective of achieving a seamless changeover from the Roby underground to the Offset Zone. A preliminary economic assessment of the Offset Zone released in May 2008 indicated that the Offset Zone could extend underground mining operations to 2018, with production of 6,000 tonnes per day by 2012 and producing 250,000 ounces of palladium annually.

A detailed preliminary feasibility study currently underway will assess whether to reopen the mine as an underground operation only. As currently envisaged, the Company could continue mining the Roby Zone, using underground mining methods, for two years while developing the Offset Zone for production. The Company believes that the mine could resume operations within three months of a start-up decision.

Milling Operations

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 to the 15,000 tonne per day mill. This mill was commissioned in 2001 and utilizes a conventional flotation technology to produce a palladium rich concentrate that also contains platinum, nickel, gold and copper. This mixture of coarse and fine material feeds to the SAG mill to increase mill throughput. 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. One flotation circuit in the mine's original mill is currently connected to the new mill to provide additional cleaner flotation capacity. The final concentrate is thickened and dewatered using two pressure filters.

The detailed preliminary feasibility study currently in progress will consider a lower tonnage, higher grade operation that could yield up to 250,000 ounces of palladium from the current underground mine and the Offset Zone. If adopted, the scenario currently being contemplated would require that the mill be reconfigured from a 15,000 tonne per day operation to a 6,000 to 7,500 tonne per day operation.

For the year ended December 31, 2008, the concentrator processed 3,722,732 tonnes of ore or 12,577 tonnes per operating day at an average palladium head grade of 2.33 grams per tonne and an average palladium recovery of 75.3%. In 2007, the concentrator processed 5,006,383 tonnes of ore or 13,716 tonnes per operating day at an average palladium head grade of 2.39 grams per tonne and an average palladium recovery of 74.8%. Palladium production for the year ended December 31, 2008 was 212,046 ounces compared to production of 286,334 ounces in 2007. Production costs per tonne of ore milled were \$30.90 in 2008 compared to \$24.98 in 2007. 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\$283 per ounce of palladium in 2008 as compared to US\$164 per ounce of palladium in 2007.

Offset Zone

The Offset Zone is located on the Lac des Iles property and was discovered by the Company's exploration team in 2001. The Offset Zone is considered to be the fault displaced continuation of the Roby Zone mineralization and is located below and approximately 250 metres to the west of the Roby Zone. A mineral resource estimate prepared by Scott Wilson Roscoe Postle Associates in January 2009 estimated that the Offset Zone has significantly more mineral resources than the current underground mine at the Roby Zone at similar grades, while remaining open along strike to the north and south and at depth.



On May 7, 2008, the Company announced the results of a preliminary economic assessment prepared by Micon International Limited, which concluded that the Offset Zone could extend the Company's underground mining operation to 2018 based on a palladium price in excess of US\$350 per ounce. Micon examined the economic viability of several mining scenarios for the Offset Zone, including a continuation of the existing ramp system from the current underground mine, several shaft options and a conveying option. The study concluded that in order to achieve a production rate of 250,000 ounces of palladium per annum, the underground mine could be operated at 4,000 - 7,000 tonnes per day using a series of conveyors and access ramps at an initial estimated capital cost of \$37 million.

The Micon study proposes continuation of the longhole stoping mining method, which was the Company's mining method prior to the temporary mine closure, at the existing underground operations. Using a conveying system to bring ore to surface was found to be advantageous since it provides a great deal of flexibility in decision making and spreads capital expenditures over the life of the mine. The prefeasibility study now under way is reconsidering a staged implementation of the shaft option.

When operating at 6,000 tonnes per day, the study estimates that the Offset Zone operation could yield approximately 250,000 ounces of palladium, 16,000 ounces of platinum, 17,000 ounces of gold, 2 million pounds of nickel and 4 million pounds of copper annually. This economic assessment is preliminary in nature and includes measured, indicated and inferred mineral resources. Approximately 80% of the resources included in the 2007 preliminary economic assessment are in the inferred category. Inferred mineral resources are considered too speculative geologically to have economic considerations applied to them that would enable the resource to be categorized as mineral reserves. The study's level of accuracy is deemed to be plus or minus 25%.

An updated mineral resource estimate was prepared by Scott Wilson RPA in January 2009. As a result of the 2007 underground drill program, there is a higher confidence level in the mineral resource and approximately 73% of the resources are now classified in the indicated category. The Offset Zone is open for extensional exploration drilling along strike to the north and south end down dip.

A detailed prefeasibility report is underway with the objectives of converting mineral resources into mineral reserves, and assessing the optimal mining and milling configuration and economics of developing the Offset Zone. The report is expected to be completed by the end of the second quarter of 2009.

Drill programs are planned for 2009 and 2010 to increase confidence in existing mineral resources and to delineate more resources. Potential exists to add new resources along strike to the north and south and down dip. Thus far the Offset Zone has been traced to a depth of 1,670 metres below surface, and along a strike length of approximately 600 metres.

Exploration

In addition to the Company's mining, development and exploration activities around the Lac des Iles property, grassroots exploration is an important ongoing part of the growth strategy. In 2008, the primary projects were the Shebandowan West Project and the Arctic Platinum Project.

The Company's vision is to create a mid tier precious metals company producing gold, platinum and palladium. Traditionally, North American Palladium has examined PGM and nickel opportunities near the Company's Lac des Iles mine, given the existing infrastructure at the Lac des Iles mine and the Company's years of experience in mining PGM-nickel deposits. Management is now also considering gold opportunities that could be accretive to shareholders.

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 properties, known as the Shebandowan property, contain a series of nickel-copper-PGM mineralized bodies and the land package totals approximately 7,842 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. 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 covers a small portion of the Shebandowan property and 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 considered by management 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 g/t PGM and gold. A 43-101 Technical Report 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 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 mine's original mill. 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 if the project were to proceed. Preliminary metallurgical testing supports the possibility of producing a bulk sulphide concentrate from the Shebandowan West Project at the original mill.

The Company received a preliminary economic assessment on the project. However, in light of the sharp decline in metal prices in the fall of 2008, the Company ceased all activities with the Shebandowan Joint Venture, including at the Shebandowan West Project. A decision on when and whether to resume activities will largely depend on the long term outlook for nickel prices.

Arctic Platinum Project

The Company was party to an agreement with Gold Fields Limited that would have entitled it to a 60% interest in a series of mining leases and claims known as the Arctic Platinum Project ("APP").

In order to satisfy the requirements of its earn-in, the Company had to satisfy a number of conditions on or before August 31, 2008, including: (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 9,227,033 common shares to Gold Fields BV to earn a 60% interest or if Gold Fields exercised a claw-back right, issue 7,381,636 common shares to earn a 50% interest. As at December 31, 2008, the Company had completed the re-scoping study, incurred over US\$18.8 million in expenditures charged to exploration expense and commissioned a feasibility study.

The Company received a draft feasibility study in the summer of 2008 which showed that lower commodity prices, coupled with the increased price of steel and diesel fuel, the strength of the euro relative to the U.S. dollar and other variables had adversely impacted the economics of the project. As a result of these findings, the Company determined that it would not deliver a positive feasibility study for the APP prior to the August 31, 2008 deadline. The Company advised Gold Fields of the outcome and the parties discussed strategic alternatives for the project. The parties failed to reach an agreement and the Company's option over the APP has since lapsed. All interests in APP have now reverted back to Gold Fields Limited.

Metal Sales

The Company has been selling palladium and platinum 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 provided 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, up to June 30, 2008, the Company was able to receive advance payments not exceeding, at any time, an aggregate maximum of US\$25 million. To secure the obligations of the Company under the agreement, the Company had granted to Auramet a security interest in the concentrate 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. Under this agreement with Auramet no advances could be received after June 2008 and any amounts advanced had to be repaid by December 2008. As at December 31, 2008, the Company had no advances outstanding under this facility.

Spot Metal Prices*

	2006	2007	Q1 2008	Q2 2008	Q3 2008	Q4 2008	% Inc (Dec) vs. December 2007
Palladium – US\$/oz	\$ 322	\$ 364	\$ 445	\$ 467	\$ 199	\$ 183	(50%)
Platinum – US\$/oz	\$ 1,115	\$ 1,530	\$ 2,040	\$ 2,064	\$ 1,004	\$ 898	(41%)
Gold – US\$/oz	\$ 635	\$ 836	\$ 936	\$ 930	\$ 884	\$ 869	4%
Nickel – US\$/lb	\$ 15.11	\$ 11.70	\$ 13.52	\$ 9.83	\$ 7.15	\$ 4.90	(58%)
Copper – US\$/lb	\$ 2.85	\$ 3.03	\$ 3.81	\$ 3.89	\$ 2.90	\$ 1.32	(56%)

* Based on the London Metal Exchange (“LME”) afternoon price fix. Year end prices for 2006 and 2007 and quarter end prices for 2008.

For the year ended December 31, 2008, the Company realized a weighted average cash price of US\$378 per ounce on its physical deliveries of palladium into the spot market, compared to an average price of US\$346 per ounce for 2007. After peaking in March 2008 at US\$582 per ounce, the price of palladium has declined by 69% to US\$183 per ounce at the end of December 2008 as indicated in the chart below from Johnson Matthey.

London Palladium Cash Price US\$/Troy oz

JM Base Prices

From: 01 Jan. 2004

US\$ Daily

To: 30 Dec. 2008



OUTLOOK

Lac des Iles mine

On October 21, 2008, the Company announced that, due to declining metal prices, it was temporarily placing its Lac des Iles mine on a care and maintenance basis effective October 29, 2008. The closure resulted in the layoff of approximately 350 employees.

The price of palladium and platinum, the Company's two main metals, has changed dramatically over a very short period of time. As recently as June 2008, palladium and platinum traded at highs of US\$475 per ounce and US\$2,103 per ounce respectively. As of February 23, 2009, the spot price of palladium and platinum was US\$204 per ounce and US\$1,074 per ounce respectively.

Over 50% of palladium and platinum demand is for the manufacture of automotive catalytic converters. The outlook for the automotive industry over the near term is challenging. On the other hand, the medium to longer term outlook for the pricing



of palladium and platinum appears to be quite positive based on credible forecasts predicting renewed growth in global automotive sales, particularly in the BRIC countries.

The temporary closing of the Lac des Iles mine will cut expenses and maintain the Company's strong cash position. As at December 31, 2008, the Company had cash and cash equivalents of \$43.1 million, total debt of \$7.6 million and net working capital of \$86.1 million. In addition to the cash on hand, management expects to realize significant cash flow over the next few months as payment is received for metal sales made prior to the closure.

While in care and maintenance mode, the Company has retained senior mine management and facility security. The Company also retained its exploration and financial teams in Thunder Bay and the corporate staff in Toronto. Management estimates that corporate overhead, personnel costs and facility and maintenance expenditures at the mine will be in the range of \$5.0 million to \$6.0 million per quarter, excluding discretionary investment in exploration activities.

Going forward, management intends to focus on strategic initiatives, including:

1. Continuing the work required to complete a prefeasibility study on the Offset Zone to a depth of 1,200 metres below surface. This project has the potential to extend the life of the Lac des Iles mine significantly. Mineralization is currently known to exist to a depth of at least 1,670 metres.
2. Carrying out drilling and exploration operations at Lac des Iles to further delineate resources as well as maintaining grassroots exploration on the property adjacent to the mine; and
3. Leveraging the Company's strong balance sheet to pursue potential acquisitions and joint venture opportunities that may emerge in these difficult and volatile markets.

In the current environment, management expects that there will be many attractive strategic options to consider. The Company will pursue acquisition opportunities aggressively but with discipline to ensure that only those transactions that can deliver enhanced shareholder value over the long-term are pursued.

While the Lac des Iles mine is on care and maintenance, management will take the opportunity to re-evaluate the current mine plan and mill configuration with a view to reducing the breakeven point.

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 or when events or changes in circumstances arise that may result in impairments in the carrying value of those assets. 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 carrying value exceeds 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

In February 2008, the CICA issued Handbook Section 3064, "Goodwill and Intangible Assets", replacing section 3062, "Goodwill and Other Intangible Assets", and Section 3450, "Research and Development Costs". This section established standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. The new section is effective for years beginning on or after October 1, 2008. The Company is in the process of assessing the impact of this new section on its consolidated financial statements.

IMPACT OF INTERNATIONAL FINANCIAL REPORTING STANDARDS

The Accounting Standards Board (AcSB) announced in April 2008 that Canada will adopt International Financial Reporting Standards (IFRS) for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The adoption of IFRS will be first reflected in the Company's financial statements for the quarter ending March 31, 2011.

The transition to IFRS could have a material impact on the Company's financial position and reported results; however, it is not possible to quantify the impact at this time. During the year ended December 31, 2008, key members of the IFRS project team attended mining industry specific IFRS conversion seminars. Attendance at these conferences was used to identify existing and emerging issues relating to the conversion to IFRS in order to ensure their inclusion in the Company's preliminary conversion project scoping analysis.

The Company has initiated a preliminary review of IFRS and IAS standards, including the optional exemptions which may be elected by the company under IFRS 1. Based upon these reviews, the Company will further refine its scoping plan and initial project timeline. However, the specific impact that these standards and related exemptions will have upon the reporting and disclosures within the Company's financial statements cannot be quantified or communicated at this time.

OUTSTANDING SHARE DATA

As of February 23, 2009, there were 86,767,063 common shares of the Company outstanding and options outstanding pursuant to the 1995 Corporate Stock Option Plan entitling holders thereof to acquire 1,461,100 common shares of the Company at a weighted average exercise price of \$5.10. As of the same date, there were also 13,489,898 warrants outstanding, each warrant entitling the holder thereof to purchase one common share at a weighted average exercise price of US\$6.01.



RISKS AND UNCERTAINTIES

The price of palladium is the most significant factor influencing the profitability of the Company. In the year ended December 31, 2008, the steep decline in the price of palladium led to a negative mark-to-market commodity price adjustment of \$24.0 million as a result of which palladium revenue was \$56.3 million (December 31, 2007 – \$91.8 million.) Many factors influence the price of palladium, including global supply, fabrication and investment 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. 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.

These and other risks and uncertainties 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.

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 year ended December 31, 2008, 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, 2008.

INTERNAL CONTROL OVER FINANCIAL REPORTING

For the year ended December 31, 2008, 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.

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, 2008 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, 2008.

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.

¹Non-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 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*

(expressed in thousands of dollars except per ounce amounts)	Three months ended December 31		Twelve months ended December 31	
	2008	2007	2008	2007
Production costs including overhead	\$ 22,358	\$ 30,386	\$ 115,037	\$ 124,921
Less mine shutdown costs	(7,877)	—	(7,877)	—
Smelter treatment, refining and freight costs	1,255	5,939	19,325	22,444
	15,736	36,325	126,485	147,365
Less by-product metal revenue	(3,818)	(22,701)	(69,203)	(104,126)
	\$ 11,918	\$ 13,624	\$ 57,282	\$ 43,239
Divided by ounces of palladium	20,996	62,446	189,968	251,531
Cash cost per ounce (CDN\$)	\$ 568	\$ 218	\$ 302	\$ 172
Exchange rate (CDN\$1 – US\$)	0.817	1.012	0.939	0.952
Cash cost per ounce (US\$)	\$ 464	\$ 221	\$ 283	\$ 164

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



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

	Three months ended December 31		Twelve months ended December 31	
	2008	2007	2008	2007
Operating cash flow	\$ (15,990)	\$ 5,554	\$ (467)	\$ 42,884
Changes in non-cash working capital	(573)	4,967	7,317	(17,408)
Cash provided by (used in) operating activities	\$ (16,563)	\$ 10,521	\$ 6,850	\$ 25,476

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

CAUTIONARY STATEMENT ON FORWARD-LOOKING INFORMATION

These statements are based on certain factors and assumptions, including but not limited to, the assumption that palladium demand and prices and sustained by-product metal demand and prices will increase in the future; the operation of the Company's underground mine remains viable operationally and economically if and when prices increase; financing is available on reasonable terms; expectations for blended mill feed head grade and mill performance will proceed as expected if and when prices increase; new mine plan scenarios will be viable operationally and economically if and when prices increase; 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 if and when prices increase.

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; 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 expressly required by law.



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
February 23, 2009

William J. Biggar
President and CEO

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



Auditors' Report

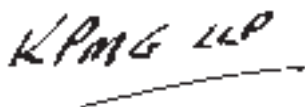
TO THE SHAREHOLDERS OF NORTH AMERICAN PALLADIUM LTD.

We have audited the consolidated balance sheets of North American Palladium Ltd. ("the Company") as at December 31, 2008 and 2007 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, 2008. 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, 2008 and 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, 2008 and 2007 and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2008 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, 2008, 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 February 23, 2009 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.



KPMG LLP

Chartered Accountants, Licensed Public Accountants

Toronto, Canada,

February 23, 2009.



Consolidated Balance Sheets

(expressed in thousands of Canadian dollars)

December 31	2008	2007
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 43,068	\$ 74,606
Concentrate awaiting settlement, net – Note 3	43,051	79,087
Taxes recoverable	638	62
Inventories – Note 4	16,590	26,320
Other assets – Note 5	3,193	2,563
	106,540	182,638
Mining interests, net – Note 6	31,640	114,464
Mine restoration deposit – Note 7	8,724	8,272
	\$ 146,904	\$ 305,374
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Accounts payable and accrued liabilities	\$ 13,996	\$ 20,757
Future mining tax liability – Note 21	–	168
Current portion of obligations under capital leases – Note 8	1,992	1,672
Convertible notes payable – Note 9	–	25,710
Current portion of long-term debt – Note 10	4,430	5,918
	20,418	54,225
Mine restoration obligation – Note 7	8,455	8,878
Obligations under capital leases – Note 8	1,130	1,824
Long-term debt – Note 10	–	3,957
Future mining tax liability – Note 21	–	539
	30,003	69,423
Shareholders' Equity		
Common share capital and purchase warrants – Note 13	485,386	443,986
Stock options	2,305	1,673
Equity component of convertible notes payable, net of issue costs – Note 9	–	6,044
Contributed surplus	12,336	6,292
Deficit	(383,126)	(222,044)
Total shareholders' equity	116,901	235,951
	\$ 146,904	\$ 305,374

Commitments – Notes 1 and 17

Contingencies – Note 7 and 20

On Behalf of the Board

André J. Douchane
Director

Gregory J. Van Staveren
Director

See accompanying notes to the consolidated financial statements.



Consolidated Statements of Operations, Comprehensive Loss and Deficit

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

Year ended December 31	2008	2007	2006
Revenue – before pricing adjustments	\$ 148,428	\$ 201,367	\$ 145,819
Pricing adjustments:			
Commodities	(38,633)	8,756	11,674
Foreign exchange	15,696	(14,191)	1,707
Revenue – after pricing adjustments – Note 18	125,491	195,932	159,200
Operating expenses			
Production costs	115,037	124,921	112,458
Inventory pricing adjustment – Note 4	3,875	144	–
Smelter treatment, refining and freight costs	19,325	22,444	15,438
Amortization – Note 6(b)	36,026	46,908	30,103
Asset impairment charge – Note 6(c)	90,000	–	–
Insurance recovery – Note 14	(13,800)	–	–
Loss on disposal of equipment	2,466	–	194
Asset retirement costs	321	1,010	554
Total operating expenses	253,250	195,427	158,747
Income (loss) from mining operations	(127,759)	505	453
Other expenses			
General and administration	7,666	7,773	6,734
Exploration	23,070	12,138	11,831
Interest and other financing costs – Note 19	3,443	18,633	15,647
Foreign exchange loss (gain)	971	(8,422)	1,759
Total other expenses	35,150	30,122	35,971
Loss before taxes	(162,909)	(29,617)	(35,518)
Income and mining tax recovery – Note 21	(2,230)	(937)	(1,409)
Net loss and comprehensive loss for the year	(160,679)	(28,680)	(34,109)
Deficit, beginning of year, as previously reported	(222,044)	(193,364)	(159,255)
Adoption of new accounting standards for inventory – Note 2	(403)	–	–
Deficit, end of year	\$ (383,126)	\$ (222,044)	\$ (193,364)
Net loss per share			
Basic and diluted – Note 13(f)	\$ (1.94)	\$ (0.51)	\$ (0.65)
Weighted average number of shares outstanding			
– basic and diluted – Note 13(f)	82,839,706	55,792,203	52,562,939

See accompanying notes to the consolidated financial statements.



Consolidated Statements of Cash Flows

(expressed in thousands of Canadian dollars)

Year ended December 31	2008	2007	2006
Cash provided by (used in)			
Operations			
Net loss for the year	\$ (160,679)	\$ (28,680)	\$ (34,109)
Operating items not involving cash			
Accretion expense relating to convertible notes payable	3,372	12,947	10,090
Amortization	34,046	46,908	30,103
Amortization of deferred financing costs	193	751	1,090
Asset impairment charge – Note 6(c)	90,000	–	–
Interest on convertible notes settled in shares	732	2,644	1,974
Accrued interest on mine restoration deposit	(135)	(231)	(194)
Unrealized foreign exchange loss (gain)	(13,635)	10,799	(822)
Unrealized commodity price adjustment	43,028	(3,964)	(6,152)
Asset retirement costs	321	1,010	554
Future income tax recovery – Note 21	(2,121)	(937)	(739)
Stock-based compensation and employee benefits	1,945	1,637	1,771
Loss on disposal of equipment	2,466	–	194
	(467)	42,884	3,760
Changes in non-cash working capital – Note 22(a)	7,317	(17,408)	(37,549)
	6,850	25,476	(33,789)
Financing Activities			
Issuance of common shares and warrants, net of issue costs – Note 12 and 13	10,475	75,318	3,955
Repayment of long-term debt	(6,291)	(12,016)	(6,566)
Repayment of obligations under capital leases	(1,866)	(1,979)	(2,278)
Mine restoration deposit	(317)	–	(600)
Issuance of convertible notes	–	–	41,037
Increase in long-term debt and credit facility	–	–	8,111
Deferred financing costs	–	–	(2,364)
	2,001	61,323	41,295
Investing Activities			
Additions to mining interests	(40,691)	(15,346)	(19,384)
Proceeds on disposal of mining interests	302	–	–
	(40,389)	(15,346)	(19,384)
Increase (decrease) in cash and cash equivalents	(31,538)	71,453	(11,878)
Cash and cash equivalents, beginning of year	74,606	3,153	15,031
Cash and cash equivalents, end of year	\$ 43,068	\$ 74,606	\$ 3,153
Cash and cash equivalents consisting of:			
Cash	\$ 2,532	\$ 4,444	\$ 3,153
Short-term investments	40,536	70,162	–
	\$ 43,068	\$ 74,606	\$ 3,153

Supplementary information – Note 22(b), (c) (d) and (e)

See accompanying notes to the consolidated financial statements.



Consolidated Statements of Shareholders' Equity

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

	Number of shares	Capital stock	Shares issuable	Stock options	Warrants	Equity component of convertible notes payable	Contributed surplus	Deficit	Total shareholders' equity
Balance, December 31, 2007	75,770,570	\$ 430,793	\$ –	\$ 1,673	\$ 13,193	\$ 6,044	\$ 6,292	\$(222,044)	\$ 235,951
Transitional adjustment on adoption of inventory standard – Note 2	–	–	–	–	–	–	–	(403)	(403)
Common shares									
Issued/issuable – Note 9:									
For principal repayments on convertible notes payable	6,111,869	28,270	2,062	–	–	(6,044)	6,044	–	30,332
For interest payments on convertible notes payable	165,185	714	18	–	–	–	–	–	732
Tax effect of flow-through shares	–	(1,452)	–	–	–	–	–	–	(1,452)
Pursuant to unit offering, net of issue costs	2,800,000	9,575	–	–	–	–	–	–	9,575
Warrants issued:									
Pursuant to unit offering, net of issue costs	–	–	–	–	899	–	–	–	899
Warrants exercised	100	1	–	–	–	–	–	–	1
Stock-based compensation expense	311,251	1,313	–	632	–	–	–	–	1,945
Net loss for the year ended December 31, 2008	–	–	–	–	–	–	–	(160,679)	(160,679)
Balance, December 31, 2008	85,158,975	\$ 469,214	\$ 2,080	\$ 2,305	\$ 14,092	\$ –	\$ 12,336	\$(383,126)	\$ 116,901

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

See accompanying notes to the consolidated financial statements.



Notes to the Consolidated Financial Statements

for the years ended December 31, 2008, 2007 and 2006
(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. The Company operates in one operating segment, mining. Its principal asset is the Lac des Iles mine, located in the Thunder Bay District in Ontario, which has been in continuous operations since 1993.

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 and platinum) and by-product metals (gold, nickel and copper) fluctuate widely and are affected by numerous factors beyond the Company's control. On October 21, 2008, the Company announced that, due to declining metal prices, it was temporarily placing its Lac des Iles mine on a care and maintenance basis effective October 29, 2008. The closure resulted in the layoff of approximately 350 employees.

The Lac des Iles mine consists of an open pit mine, an underground mine and two processing plants (one of which was decommissioned in June 2001). The primary deposits on the property are the Roby Zone and the Offset High Grade Zone ("Offset Zone"). 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.

The Offset Zone located on the Lac des Iles property was discovered by the Company's exploration team in 2001. The Offset Zone is considered to be the fault displaced continuation of the Roby Zone mineralization and is located below and approximately 250 metres to the west of the Roby Zone. An updated mineral resource estimate was prepared by Scott Wilson Roscoe Postle Associates Inc. ("Scott Wilson RPA") in January 2009. The report showed that the Offset Zone has significantly more mineral resources than the current underground mine of the Roby Zone at similar grades, and remains open along strike to the north, south and at depth. A detailed prefeasibility report is underway with the objectives of converting indicated resources to probable reserves, and assessing the optimal mining and milling configuration and economics of developing the upper portion of the Offset Zone. The report is expected to be completed by the end of the second quarter of 2009.

In addition to mining, development and exploration activities around the Lac des Iles property, the Company has historically conducted grassroots exploration activities within the Province of Ontario and elsewhere as opportunities are identified. In 2008, the primary projects were the Shebandowan West Project and the Arctic Platinum Project.

(a) Shebandowan Project

On December 10, 2007, the Company earned a 50% interest in the former producing Shebandowan mine and the surrounding Haines and Conacher properties (the "Shebandowan Joint Venture") pursuant to an option and joint venture agreement with Vale Inco. The Shebandowan West Project encompasses three shallow nickel-copper-PGM mineralized zones within the Shebandowan Joint Venture known as the West, Road and "D" zones, all of which are located at shallow depths immediately to the west of the former producing Shebandowan mine. The property is located approximately 100 kilometres 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 was 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. Due to the sharp decline in metal prices in the fall of 2008, the Company ceased all activities with the Shebandowan Joint Venture, including at the Shebandowan West Project. A decision on when and whether to resume activities will largely depend on the long term outlook for nickel prices.



(b) Arctic Platinum Project

The Company was party to an agreement with Gold Fields Limited that would have entitled it to a 60% interest in a series of mining leases and claims known as the Arctic Platinum Project ("APP").

In order to satisfy the requirements of its earn-in, the Company had to satisfy a number of conditions on or before August 31, 2008, including: (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 9,227,033 common shares to Gold Fields BV to earn a 60% interest or if Gold Fields exercised a claw-back right, issue 7,381,636 common shares to earn a 50% interest. As at December 31, 2008, the Company had completed the re-scoping study, incurred over US\$18.8 million in expenditures charged to exploration expense and commissioned a feasibility study.

The Company received a draft feasibility study in the summer of 2008 which showed that lower commodity prices, coupled with the increased price of steel and diesel fuel, the strength of the euro relative to the U.S. dollar and other variables had adversely impacted the economics of the project. As a result of these findings, the Company determined that it would not deliver a positive feasibility study for the APP prior to the August 31, 2008 deadline. The Company advised Gold Fields of the outcome and the parties discussed strategic alternatives for the project. The parties failed to reach an agreement and the Company's option over the APP has since lapsed. All interests in APP have now reverted back to Gold Fields Limited.

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") and North American Palladium Arctic Services Ltd. ("NAPFS"), and also reflect the transfer of the Company's interest in North American Palladium Finland Ltd. ("NAPFL") to Gold Fields Exploration BV for a nominal amount following the lapse of the Company's option over the Arctic Platinum Project. 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 2008 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 net realizable value.



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.

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 \$8,400, 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 3% 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.

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

Deferred Financing Costs

Deferred financing costs represent 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 in 2007 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 carry-forwards 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, 2008.

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, 2008.

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

Adoption of New Accounting Standards

Inventories

The Canadian Institute of Chartered Accountants Handbook (CICA Handbook) Section 3031 establishes standards for the determination of inventory cost and its subsequent recognition as an expense, including any write-down to net realizable value. In addition in certain circumstances, write downs of inventory previously recognized may be reversed. The Company adopted this standard prospectively in accordance with the transitional provisions. On adoption of the new standard on January 1, 2008, an adjustment to supplies inventory of \$3,529 was recognized to reclassify items not meeting the definition of inventory, including major spare parts and insurance spares, to property, plant and equipment. A related increase to opening deficit of \$403, net of taxes was recognized to adjust for accumulated amortization.

Further upon adoption of this standard, the Company changed its valuation of supplies inventory from the lower of cost and replacement cost to the lower of cost and net realizable value. The change in valuation had no impact on the Company's financial statements.

Prior periods presented have not been restated as a result of the adoption of the standard.

Financial Instruments – Recognition and Measurement

On January 1, 2008, the Company adopted CICA Handbook Section 3862, "Financial Instruments – Disclosures" and Section 3863, "Financial Instruments – Presentation". These sections require the disclosure of information with regards to the significance of financial instruments for the Company's financial position and performance, the nature and extent of risks arising from financial instruments to which the Company is exposed during the period and at the balance sheet date, and how the company manages those risks. These standards replace CICA Handbook Section 3861, "Financial Instruments". The additional disclosures required as a result of adopting these standards are included in note 15.

Capital Disclosures

On January 1, 2008, the Company adopted CICA Handbook Section 1535, "Capital Disclosures". This section establishes standards for disclosing information about an entity's capital and how it is managed to enable users of financial statements to evaluate the entity's objectives, policies and procedures for managing capital. The additional disclosures required as a result of adopting these standards are included in note 16.

Future Accounting Standards

In February 2008, the CICA issued Handbook Section 3064, "Goodwill and Intangible Assets", replacing Handbook Section 3062, "Goodwill and Other Intangible Assets", and Handbook Section 3450, "Research and Development Costs". This



section established standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. The new section is effective for years beginning on or after October 1, 2008. The Company is in the process of assessing the impact of this new section on its consolidated financial statements.

The Accounting Standards Board (AcSB) announced in April 2008 that Canada will adopt International Financial Reporting Standards (IFRS) for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The adoption of IFRS will be first reflected in the Company's financial statements for the quarter ending March 31, 2011.

The transition to IFRS could have a material impact on the Company's financial position and reported results; however, it is not possible to quantify the impact at this time.

3. CONCENTRATE AWAITING SETTLEMENT

Concentrate awaiting settlement is comprised of:

	2008	2007
Concentrate awaiting settlement, gross	\$ 46,984	\$ 85,869
Refining and smelter treatment charges	(3,933)	(6,782)
Concentrate awaiting settlement, net	\$ 43,051	\$ 79,087

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 smelters between March and December 2008, including 115,786 ounces of palladium which were provisionally valued at the December 31, 2008 London Metal Exchange ("LME") afternoon price fix of US\$183 (2007 – including 125,802 ounces of palladium valued at US\$364), and 9,961 ounces of palladium that were valued at the realized price of US\$206. The LME afternoon price fix as at February 23, 2009 was US\$204.

All of the concentrate awaiting settlement is due from two domestic customers at December 31, 2008 (2007 – one domestic customer). 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:

	2008	2007
Supplies	\$ 12,363	\$ 14,847
Crushed and broken ore stockpiles	4,227	8,447
Concentrate	–	3,026
	\$ 16,590	\$ 26,320

The Company adopted the new CICA Handbook Section 3031, "Inventories," effective January 1, 2008, resulting in the prospective reclassification of \$3,529 in major spare parts and insurance spares from inventories and supplies to property, plant and equipment. Prior periods presented have not been restated as a result of the adoption of this standard.

In addition, Section 3031 of the CICA Handbook also requires the Company to disclose the amount of inventories expensed and any inventory write-downs recognized as an expense in the period.

For the year ended December 31, 2008, supplies inventory of \$31,247 (2007 – \$28,895) were expensed.

For the year ended December 31, 2008, the Company recognized write-downs of obsolete supplies inventories of \$296 (2007 – \$533).

For the year ended December 31, 2008, the Company recognized write-downs of concentrate inventory of \$241 (2007 – \$144) due to declining commodity prices.

For the year ended December 31, 2008, the Company recognized write-downs of crushed and broken ore stockpiles of \$3,634 (2007 – \$Nil) due to declining commodity prices.



5. OTHER ASSETS

Other assets consist of the following:

	2008	2007
Investments*	\$ 850	\$ 9
Prepays	839	779
GST recoverable	1,475	1,203
Other	29	572
	\$ 3,193	\$ 2,563

* Investments held for trading are classified as current assets and are stated at fair value, with any resultant gain or loss recognized in the income statement.

6. MINING INTERESTS

(a) Mining interests are comprised of the following:

	2008	2007
Plant and equipment, at cost	\$ 380,913	\$ 368,339
Underground mine development, at cost	55,486	52,174
Accumulated amortization and impairment charges	(414,824)	(319,388)
	21,575	101,125
Equipment under capital lease, at cost	11,158	14,076
Accumulated amortization and impairment charges	(5,819)	(7,022)
	5,339	7,054
Mining leases and claims, royalty interest, and development, at cost	82,561	82,561
Accumulated amortization and impairment charges	(77,835)	(76,276)
	4,726	6,285
Mining interests, net	\$ 31,640	\$ 114,464

(b) Amortization expense is comprised of amortization of the following mining interests:

	2008	2007	2006
Capital assets (including plant and equipment, and equipment under capital lease)	\$ 34,466	\$ 44,430	\$ 28,422
Mining leases and claims, royalty interest, and development costs	1,560	2,478	1,681
	\$ 36,026	\$ 46,908	\$ 30,103

(c) Asset impairment charge

The Company reviews and evaluates its long-lived assets for impairment when events or changes in circumstances arise that may result in impairments in the carrying value of those assets. Impairment is considered to exist if total estimated future undiscounted cash flows are less than the carrying amount of the asset.

At December 31, 2008, the Company recorded a non-cash impairment charge of \$90,000 (2007 – \$nil, 2006 – \$nil) to write-down the carrying value of mining interests due to certain key assumptions which were affected by declining commodity prices and the resultant decision to temporarily place the Lac des Iles mine on a care and maintenance basis. Based on these revised assumptions, the carrying values have been written down to their estimated fair values to reflect prevailing market conditions.



7. MINE RESTORATION OBLIGATION AND 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 and the Shebandowan West Property. The mine closure plan calls for a total amount of \$8,400 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, 2008, the Company had \$8,724 (2007 – \$8,272) on deposit with the Ministry including accrued interest of \$872. All current amounts required have been contributed as at December 31, 2008. 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.

At December 31, the asset retirement and the related mine restoration deposit are as follows:

	2008	2007
Mine restoration obligation, beginning of the year	\$ 8,878	\$ 8,211
Change in estimated closure costs	(527)	–
Accretion expense (recovery)	104	667
Mine restoration obligation, end of the year – Note 2	\$ 8,455	\$ 8,878
Mine restoration deposit	8,724	8,272
Excess (shortfall) of deposit over obligation	\$ 269	\$ (606)

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:

	2008	2007
2008	\$ –	\$ 1,830
2009	2,122	1,499
2010	766	402
2011	268	–
2012	157	–
Total minimum lease payments	3,313	3,731
Amounts representing interest at rates from 2.8% – 3.6%	(191)	(235)
Present value of minimum lease payments	3,122	3,496
Less current portion	(1,992)	(1,672)
	\$ 1,130	\$ 1,824

9. CONVERTIBLE NOTES PAYABLE

	2008	2007
Series I convertible notes – matured August 1, 2008	\$ –	\$ 17,011
Series II convertible notes – matured December 1, 2008	–	8,699
	–	25,710
Less current portion	–	(25,710)
	\$ –	\$ –

As at December 31, 2008, the principal amount outstanding on the Series I and Series II convertible notes was US\$Nil (December 31, 2007 – US\$17,500) and US\$Nil (December 31, 2007 – US\$9,000) respectively. The Company recorded accretion expense of \$3,372 (2007 – \$12,947), of which \$815 (2007 – \$3,245) represented the accretion relating to the Equity Premium which was included in the carrying value of the convertible notes payable. The convertible notes were fully repaid on December 1, 2008.



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.

On January 13, 2009, 1,501,638 shares were issued relating to the final December 1, 2008 convertible note principal and interest payment.

10. LONG-TERM DEBT

	2008	2007
Equipment finance company credit facility consisting of \$2,000 and US\$2,000 (2007 – \$4,000 and US\$6,000) loans	\$ 4,448	\$ 9,928
Less: financing costs (net of amortization)	(18)	(53)
	4,430	9,875
Less current portion	(4,430)	(5,918)
	\$ –	\$ 3,957

The Company's long-term debt is comprised of a senior credit facility with an equipment finance company. The interest rate under the Canadian loan facility is Canadian LIBOR plus 2.50%, or 4.55% at December 31, 2008 (7.05% – 2007). The interest rate under the US loan facility is US LIBOR plus 2.50%, or 2.94% at December 31, 2008 (7.10% – 2007). 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

On October 12, 2006, the Company closed a transaction with Kaiser-Francis for a US\$5,000 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 US LIBOR plus 2.5% and the standby fee was 0.125% per annum. This facility was repaid on March 7, 2007.

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 could 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 of 18,666,667 units that closed on December 13, 2007.
- (b) On January 9, 2008, the Company issued an additional 2,800,000 units under a 30-day over-allotment option and Kaiser-Francis also exercised its pre-existing right under the securities purchase agreement to subscribe for 25% of the over-allotment units.

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:

	2008		2007	
	Shares	Amount	Shares	Amount
Balance beginning of year	12,089,998	\$ 13,193	1,990,969	\$ 8,038
Issued pursuant to unit offering, net of issue costs	1,400,000	899	9,333,333	5,155
Increase pursuant to anti-dilution provisions	—	—	765,696	—
Warrants exercised	(100)	—	—	—
Balance, end of year	13,489,898	\$ 14,092	12,089,998	\$ 13,193

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).

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 (\$4.04), for total net proceeds of US\$10,391 (issue costs US\$725).

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 2,756,665 common shares were issued and are outstanding as follows:

Number of Warrants	Exercise Price	Expiry Date
1,805,016	US\$ 10.73	March 29, 2010
951,649	US\$ 7.85	June 23, 2010

In connection with the issue of the unit offering, warrants to purchase 10,733,233 common shares were issued and are outstanding as follows:

Number of Warrants	Exercise Price	Expiry Date
10,733,233	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 2008, the Company contributed 311,251 shares with a fair value of \$1,313 (2007 – 138,365 shares with a fair value of \$1,204).

(d) Private Placements

On June 23, 2006, the Company completed a private placement of 270,000 fow-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 February 27, 2007, the Company completed a private placement of 550,000 fow-through common shares. The gross proceeds of \$6,050 were spent on Canadian exploration expenses as defined in Section 66 of the Income Tax Act (Canada) prior to December 31, 2008.

Under the terms of the fow-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 2007 expenditures were renounced in 2008, and those from 2006 were renounced in 2007.



(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 5,700,000 being approximately 6.7% 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, 2008, 2,428,090 options (2007 – 532,757 options) were available to be granted under the Plan.

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

	2008		2007	
	Weighted Average		Weighted Average	
	Shares	Exercise Price	Shares	Exercise Price
Outstanding, beginning of year	356,433	\$ 9.89	360,133	\$ 10.24
Granted	1,110,000	3.60	132,500	9.05
Exercised	—	—	(5,000)	3.42
Cancelled	(5,333)	10.82	(131,200)	10.25
Outstanding, end of year	1,461,100	\$ 5.10	356,433	\$ 9.89
Options exercisable at end of year	263,099	\$ 10.23	191,600	\$ 10.76

The following table summarizes information about the Company's stock options outstanding at December 31, 2008:

Exercise Price	Expiry Dates	Options Outstanding at Dec. 31, 2008	Options Exercisable at Dec. 31, 2008
\$ 2.20	September 30, 2016	750,000	—
\$ 4.75	February 27, 2011	7,500	7,500
\$ 4.83	July 20, 2016	20,000	—
\$ 5.22	June 9, 2016	40,000	—
\$ 6.47	May 21, 2016	265,000	—
\$ 7.85	August 26, 2014	30,000	20,000
\$ 8.12	October 8, 2015	15,000	5,000
\$ 8.40	June 20, 2014	35,000	23,333
\$ 8.45	April 1, 2015	40,000	13,333
\$ 8.83	December 14, 2013	10,000	10,000
\$ 8.87	January 14, 2015	7,500	2,500
\$ 9.03	March 1, 2015	7,000	2,333
\$ 9.21	February 24, 2016	35,000	—
\$10.00	November 27, 2012	50,000	50,000
\$10.18	April 15, 2015	30,000	10,000
\$11.90	June 23, 2012	119,100	119,100
		1,461,100	263,099

The fair value of options granted in 2008 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 3.07% (2007 – 3.97%; 2006 – 4.05%), expected dividend yield of nil (2007 – nil; 2006 – nil), expected volatility of 79% (2007 – 54%; 2006 – 55%), and expected option life of 4 years (2007 – 4 years; 2006 – 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 2008 was \$2.08 (2007 – \$4.11; 2006 – \$3.78). Compensation expense related to the Plan for the year ended December 31, 2008 was \$632 (2007 – \$414; 2006 – \$561).

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

	2008	2007	2006
Net loss available to common shareholders	\$ (160,679)	\$ (28,680)	\$ (34,109)
Weighted average number of shares outstanding	82,839,706	55,792,203	52,562,939
Effect of dilutive securities stock options	—	—	—
Weighted average diluted number of shares outstanding	82,839,706	55,792,203	52,562,939
Diluted net loss per share	\$ (1.94)	\$ (0.51)	\$ (0.65)

The effect of stock options and warrants has not been included in the determination of diluted loss per share for 2008, 2007 or 2006, because to do so would be anti-dilutive.

At December 31, 2008, there were 13,752,997 (2007 – 14,794,088) equity instruments convertible to common shares of which 13,752,997 (2007 – 14,794,088) have been excluded from the calculation of diluted net loss per share because to do so would have been anti-dilutive. These excluded equity instruments could potentially dilute basic earnings per share in the future.

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

The Company has 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 is 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. 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, 2008, 5,002 (2007 – 10,001) restricted share units have been granted and are outstanding at an aggregate value of \$9 (2007 – \$19).

14. INSURANCE RECOVERY

The Company previously 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 in interim payment against this claim and in July 2008 a settlement in the amount of \$14,500 was received for the remainder of this claim. The amount of \$13,800 has been included as income from mining operations and \$700 received for legal costs has been included as a reduction of general and administration expenses.

15. FINANCIAL INSTRUMENTS

The Company has exposure to the following risks from its use of financial instruments: credit risk, market risk, currency risk, interest rate risk, commodity price risk and liquidity risk.

Credit Risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligation. The Company's exposure arises principally from its short term investments and concentrate awaiting settlement. Historically, the Company has not experienced any losses related to individual customers. All of the Company's concentrate awaiting settlement is due from two domestic customers at December 31, 2008 (2007 – one domestic customer). A reserve for doubtful accounts has not been established, as in the opinion of management, the amount due will be fully realized.



The carrying amount of financial assets represents the maximum credit exposure. The maximum exposure to credit risk at the reporting date was:

	2008	2007
Cash and cash equivalents	\$ 2,532	\$ 4,444
Short term investments	40,536	70,162
Concentrate awaiting settlement*	43,051	79,087
	\$ 86,119	\$ 153,693

* The aging of concentrate awaiting settlement at the reporting date and December 31, 2007 is all current.

Market Risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk is comprised of currency, interest rate, and commodity price risk.

Currency risk

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. Currency risk is related to the portion of the Company's business transactions denominated in currencies other than Canadian dollars. The Company is exposed to fluctuations in exchange rates due to certain of its foreign-based suppliers, long-term debt, capital leases, and revenues being in foreign currencies. The Company's primary exposure is based upon the movements of the US dollar against the Canadian dollar. The Company's foreign exchange risk management includes from time to time the use of foreign currency forward contracts to fix exchange rates on certain foreign currency exposures. As at December 31, 2008, the Company had not entered into any foreign exchange contracts.

For the Company's foreign exchange transactions, fluctuations in the respective exchange rates relative to the Canadian dollar will create volatility in the Company's cash flows and the reported amounts for revenue, production, and exploration costs on a year-to-year basis. Additional earnings volatility arises from the translation of monetary assets and liabilities denominated in currencies other than Canadian dollars at the rates of exchange at each balance sheet date, the impact of which is reported as a separate component of revenue or foreign exchange gain or loss.

The Company is exposed to the following currency risk on revenues, purchases and borrowings at December 31, 2008.

	US\$
Cash	\$ 151
Concentrate awaiting settlement	35,171
Accounts payable and accrued liabilities	(160)
Obligations under capital leases	(1,834)
Long-term debt	(2,000)
	\$ 31,328

A 1% strengthening or weakening of the Canadian dollar against the US dollar, assuming that all other variables remained the same, would have resulted in an approximate \$313 decrease or increase, respectively, in the Company's net income for the year ended December 31, 2008.

The following summary illustrates the fluctuations in the exchange rates during the year ended December 31, 2008, as compared to the Canadian dollar.

	US\$	Euro €
Exchange rates as at March 31, 2008	US\$ 1.00	€ 0.66
Exchange rates as at June 30, 2008	US\$ 0.98	€ 0.62
Exchange rates as at September 30, 2008	US\$ 0.95	€ 0.68
Exchange rates as at December 31, 2008	US\$ 0.82	€ 0.59
Average exchange rates for the year ended December 31, 2008	US\$ 0.94	€ 0.64



Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Company does not enter into derivative financial instruments for speculative purposes. It is exposed to interest rate risk due to its variable-rate long-term debt. Although the Company does not hold any specific hedging instruments, it does hold certain short term investments. Interest rate fluctuations may have an effect on the interest income the Company derives from its short term investments and which will favourably offset changes in the interest on debt instruments.

Management does not believe that the net impact of interest rate fluctuations on the current level of borrowings and short term investments will be significant and, therefore, has not provided a sensitivity analysis of this impact on net earnings.

The following table summarizes the interest rates which the Company had exposure to as at December 31, 2008.

	2008	2007
US LIBOR	0.44%	4.60%
Canadian LIBOR	2.05%	4.55%
US prime rate	3.25%	7.25%

Commodity Price Risk

Commodity price risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in commodity prices. The Company is particularly exposed to fluctuations in commodity prices for its various metal sales. 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, 2008.

As at December 31, 2008, assuming that all other variables remain the same, a strengthening or weakening of selling prices as shown in the table below, would have had an approximate favourable or unfavourable impact on earnings as follows:

Metal	Price variability	Impact
Palladium	+/- \$ 10 per oz	+/- \$ 1,400
Platinum	+/- \$ 10 per oz	+/- \$ 70
Gold	+/- \$ 10 per oz	+/- \$ 80
Nickel	+/- \$ 1 per lb	+/- \$ 550
Copper	+/- \$0.25 per lb	+/- \$ 250

Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company's approach to managing liquidity risk is to monitor the sales pipeline, to ensure sufficient cash flows are generated from operations to meet the current debt requirements. Where insufficient liquidity exists, the Company may pursue various debt and equity instruments for short-term financing of its operations.



The table below analyzes the Company's financial liabilities which will be settled into relevant maturity groupings based on the remaining balances at December 31, 2008 to the contractual maturity date.

		Total	In less than 1 year	Between 1 year and 2 years	Between 2 years and 5 years
Obligations under capital leases	\$	3,122	\$ 1,992	\$ 976	\$ 154
Long-term debt		4,430	4,430	—	—
	\$	7,552	\$ 6,422	\$ 976	\$ 154

Management monitors consolidated cash flow, in detail, on a daily basis, monthly through month-end reporting, quarterly through forecasting and yearly through the budget process. Based on the financial liabilities due and noted above, the Company expects to have sufficient operating cash flow exceeding the amounts due.

Fair Values

The Company's financial instruments consist of cash and cash equivalents, concentrate awaiting settlement, accounts payable and accrued liabilities, obligations under capital leases and long-term debt.

Cash and cash equivalents are stated at fair value. The carrying value of concentrate awaiting settlement and accounts payable approximate their fair values due to the immediate or short-term maturity of these 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 variable-rate debt approximates the carrying value of such debt since the variable interest rates are market-based, and the Company believes such debt could be refinanced on materially similar terms.

16. CAPITAL DISCLOSURE

The Company's objective is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business.

Management defines capital as the Company's outstanding debt and total shareholder's equity. The board of directors does not establish quantitative return on capital criteria for management but rather promotes year over year sustainable profitable growth.

In order to maintain or adjust the capital structure, the Company may issue new shares, issue new debt, and issue new debt to replace existing debt with different characteristics.

There were no changes in the Company's approach to capital management during the year. Neither the Company nor any of its subsidiaries are subject to externally imposed capital requirements.

17. COMMITMENTS

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

The Company is required to pay a 5% net smelter royalty to SPG from mining operations at the Lac des Iles mine.

(b) Operating Leases and Other Purchase Obligations

As at December 31, 2008, the Company had outstanding operating lease commitments and other purchase obligations of \$1,899 and \$1,966 respectively (2007 – \$3,257 and \$10,808) all of which had maturities of less than five years.



18. REVENUE FROM METAL SALES

	Total	Palladium	Platinum	Gold	Nickel	Copper	Other Metals
2008							
Year ended December 31	\$ 148,428	71,989	24,598	12,442	23,466	13,326	2,607
Revenue – before pricing adjustments							
Pricing adjustments:							
Commodities	(38,633)	(23,992)	(7,296)	(93)	(4,765)	(2,076)	(411)
Foreign exchange	15,696	8,291	2,840	2,017	1,419	907	222
Revenue – after pricing adjustments	\$ 125,491	56,288	20,142	14,366	20,120	12,157	2,418
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

Generally, the Company delivers all of its concentrate to one customer (2007 – one customer) 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. During the year ended December 31, 2008, due to a maintenance shutdown at the primary customer, temporary arrangements were made to smelt and refine the Company's concentrate at another customer.

19. INTEREST AND OTHER FINANCING COSTS

	2008	2007	2006
Interest on convertible notes payable, Note 9	\$ 672	\$ 2,763	\$ 2,519
Accretion expense relating to convertible notes payable, Note 9	3,372	12,947	10,090
	4,044	15,710	12,609
Interest on long term debt, Note 10	456	1,094	1,505
Interest on capital leases, Note 8	173	379	404
Interest on Kaiser-Francis credit facility, Note 11	–	90	569
Interest on advance purchase facility	64	446	148
Other interest and financing costs	1,157	837	123
Deferred financing costs	193	751	1,090
	6,087	19,307	16,448
Interest income	(2,644)	(674)	(801)
	\$ 3,443	\$ 18,633	\$ 15,647



20. 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, 2008 or 2007 for any possible loss from this action as management of the Company believes it has a valid defense and it has been indemnified by Sheridan Platinum Group of Companies ("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 as the Company has been indemnified by SPG regarding such matters.
- (b) 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.

21. 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 33.5% (2007 – 36.1%, 2006 – 36.1%).

	2008	2007	2006
Income tax recovery using statutory income tax rates	\$ (54,574)	\$ (10,692)	\$ (12,822)
Increase (decrease) in taxes resulting from:			
Resource allowance deemed income	4,335	77	133
Non-taxable portion of capital losses (gains)	491	(1,196)	(76)
Losses not tax benefited	47,922	9,968	10,790
Non-deductible expenses	362	158	212
Losses incurred in foreign entities, taxed at a lower rate	8	569	701
Ontario mining taxes	(778)	177	(195)
Other	4	2	(152)
Income and mining tax recovery	\$ (2,230)	\$ (937)	\$ (1,409)

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

	2008	2007	2006
Current income tax expense (recovery):			
Income taxes	\$ –	\$ –	\$ (360)
Mining taxes	(109)	–	(310)
	(109)	–	(670)
Future income tax expense (recovery):			
Income taxes	(1,452)	(1,114)	(854)
Mining taxes	(669)	177	115
	\$ (2,121)	\$ (937)	\$ (739)
	\$ (2,230)	\$ (937)	\$ (1,409)

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

	2008	2007
Long-term future income tax asset:		
Mining interests, net	\$ 58,370	\$ 38,476
Deferred financing costs	1,664	2,004
Mine restoration obligation	2,185	2,235
Future mining tax liability	6	106
Other assets	217	141
Non-capital loss carry-forwards	22,369	10,556
Ontario corporate minimum tax credits	327	327
Capital loss carry-forwards	233	533
Valuation allowance for capital loss carry-forwards	(85,334)	(52,941)
Net future income tax asset, long-term	37	1,437
Future income tax liability, long-term:		
Long-term debt	(36)	(300)
Convertible notes payable	—	(447)
Obligations under capital leases	5	(122)
Net future income tax liability, long-term	(31)	(869)
Net future income tax asset, long-term	\$ 6	\$ 568
Future income tax liability, current:		
Crushed and broken ore stockpiles	—	(564)
Deferred financing costs	(6)	(4)
Future tax liability, current	(6)	\$ (568)
Future income tax assets (liabilities)	\$ —	\$ —
Future mining tax liability, current:		
Inventories	\$ 38	—
Crushed and broken ore stockpiles	—	(168)
Valuation allowance	(38)	—
Future mining tax liability, current	—	(168)
Future mining tax liability, long-term:		
Mining interests, net	8,953	(1,742)
Provision for mine closure costs	496	449
Mine restoration obligation	719	754
Valuation allowance	(10,168)	—
Future mining tax liability, long-term	\$ —	\$ (539)

At December 31, 2008, the Company had capital loss carry-forwards of approximately \$1,600 (2007 – \$3,700), which are available to reduce capital gains of future years.

At December 31, 2008, the Company and its subsidiary had non capital losses of approximately \$85,900 (2007 – \$30,900), of which \$12,200 expires in 2015, \$8,800 expires in 2026, \$44,700 expires in 2027, and \$20,200 expires in 2028. The tax benefit of these losses has not been recognized in the financial statements.

At December 31, 2008, the Company and its subsidiary had undepreciated capital cost allowance of approximately \$256,000 (2007 – \$254,000) available to offset future taxable income.



22. STATEMENT OF CASH FLOWS

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

	2008	2007	2006
Cash provided by (used in):			
Concentrate awaiting settlement	\$ 13,134	\$ (12,113)	\$ (38,042)
Inventories and stockpiles	2,326	(4,629)	(3,727)
Other assets	(806)	20	(258)
Accounts payable and accrued liabilities	(6,761)	(769)	5,009
Taxes recoverable	(576)	83	(531)
	\$ 7,317	\$ (17,408)	\$ (37,549)

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

	2008	2007	2006
Interest paid on long-term debt	\$ 446	\$ 1,249	\$ 2,319
Interest paid on obligations under capital leases	\$ 173	\$ 393	\$ 592
Income and mining taxes paid	\$ 143	\$ 263	\$ 291

- (c) The Series I and II convertible notes bore interest at a rate of 6.5% per annum payable bi-monthly. During 2008 the Purchasers elected to receive common shares in settlement of their interest expense in the amount of \$732 (2007 – \$2,644; 2006 – \$1,974). The convertible notes were fully repaid December 1, 2008.
- (d) During 2008 the Purchasers elected to receive common shares in settlement of the principal repayments on the Series I and II convertible notes in the amount of \$30,332 (2007 – \$24,149). The convertible notes were fully repaid December 1, 2008.
- (e) During 2008, the Company capitalized to mining interests expenditures of \$40,691 (2007 – \$15,346; 2006 – \$19,384) of which \$955 (2007 – \$nil; 2006 – \$nil) related to capital leases and \$3,529 by adoption of CICA Handbook Section 3031.

23. COMPARATIVE FIGURES

Certain of the prior years' figures have been reclassified to conform to the presentation adopted in 2008.



Corporate Information

DIRECTORS

Steven R. Berlin, MBA, CPA
Tulsa, Oklahoma

William J. Biggar, B.Comm., M.B.A., C.A.
Toronto, Ontario

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, CPA, C.A.
Toronto, Ontario

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

OFFICERS

William J. Biggar, B.Comm., M.B.A., C.A.
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, Corporate Development and
General Counsel

INVESTOR RELATIONS

Linda M. Armstrong, B.A.
Director, Investor Relations
Phone 416-360-7971 Ext. 226
Toll Free 1-888-360-7590
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

NYSE Amex
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

Phone 416-228-7000
Website www.kpmg.ca

ANNUAL MEETING

North American Palladium's Annual Shareholders' Meeting will be held on **Thursday May 28th**, 2009 at 10:00 a.m. at the **TSX Broadcast Centre Gallery**, Exchange Tower, **130 King Street West**, Toronto, Ontario, Canada.



North American Palladium Ltd.