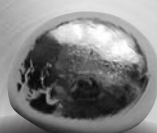




NORTH AMERICAN PALLADIUM LTD.

Pd



**FIRST QUARTER REPORT**

for the three months ended March 31, 2007



## First Quarter 2007 Highlights

- Revenues in the first quarter of 2007 rose by 117% to \$68.4 million compared to \$31.5 million in the first quarter of 2006. Palladium revenues of \$31.1 million increased by 85% while by-product metal revenues of \$37.3 million improved by 154%.
- Palladium sales in the quarter were realized at US\$352 per oz compared to US\$330 per oz in the comparable quarter last year, while by-product metal prices also realized considerable gains. Palladium accounted for 45% of first quarter total revenues while nickel continued to be an important revenue source at 28% of revenue.
- Cash cost per ounce of palladium produced,<sup>1</sup> net of by-product metal revenues and royalties, decreased to a record low of US\$15 per oz in Q1 2007 compared to US\$329 per oz in Q1 2006. Improved ore grades and metal recoveries, strong by-product metal prices and a decrease in the open pit waste to ore strip ratio accounted for the improvement.
- Operating cash flow for the quarter (before changes in non-cash working capital) <sup>1</sup> improved by \$22.9 million to \$22.5 million compared to cash used in operations of \$0.4 million in 2006.
- Net income for the quarter was \$5.5 million or \$0.10 per share compared to a net loss of \$4.1 million or \$0.08 per share in the first quarter last year.
- Spot palladium prices during the quarter averaged US\$346 per oz compared to US\$290 per oz in the comparable quarter of 2006. The Company's performance is highly correlated to prevailing palladium prices and by-product metal prices as it continues to sell all its metal production into the spot markets.

<sup>(1)</sup> Non-GAAP measure. Reference should be made to footnote 1 at the end of this MD&A.



# Management's Discussion and Analysis

The following is Management's Discussion and Analysis of the financial condition and results of operations to enable a reader to assess material changes in financial condition and results of operations for the three months ended March 31, 2007, compared to those of the respective period in prior years. All amounts are in Canadian dollars unless otherwise noted. This Management's Discussion and Analysis has been prepared as of May 9th, 2007. This Management's Discussion and Analysis is intended to supplement and complement the unaudited consolidated financial statements and notes thereto for the three months ended March 31, 2007 (collectively, the "Financial Statements"). You are encouraged to review the Financial Statements and the most recent audited financial statements and Management's Discussion and Analysis included in the 2006 Annual Report, in conjunction with your review of this Management's Discussion and Analysis.

## OVERVIEW AND STRATEGIC ACTIVITIES

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

The Company commenced the development of an underground mine at its Lac des Iles operation in the second quarter of 2004, which was completed in March 2006. The Company began full production from the underground operations on April 1, 2006 and effective this date the production from the underground operations has been reflected in the operating results of the Company.

In 2006 the Company continued its exploration of the Offset High Grade Zone ("OHGZ") at the Lac des Iles mine, where work has now been completed on an exploration drift that will expedite further definition drilling in the OHGZ in order to better define and increase confidence of the mineral resource estimate within the upper portion of the OHGZ. Drilling from this exploration drift is expected to commence early in the second quarter of 2007. The OHGZ remains open along strike and at depth. On February 23, 2007 an updated mineral resource estimate was completed by Scott Wilson Roscoe Postle Associates Inc. (available on Sedar) comprising the OHGZ and the Roby Footwall Zone. This estimate suggests an indicated resource of 3.24 million tonnes grading 5.45 grams per tonne Pd and an inferred resource of 12.80 million tonnes grading 5.25 grams per tonne Pd calculated at a cut-off grade of 3.6 grams of Pd equivalent per tonne.

On December 3, 2003, the Company entered into a 50:50 option and joint venture agreement with Inco Limited on the Haines-Conacher property that surrounds the past producing Shebandowan mine. The agreement was subsequently amended March 31, 2006 to include the mine. The nickel-copper-PGM Shebandowan Project is located approximately 100 km southwest of the Lac des Iles mine.

Successive diamond drilling programs in 2005 and 2006 were carried out on three relatively shallow mineralized zones known as the West, Road and "D" zones. Preparation of a Technical Report in compliance with National Instrument 43-101 that will disclose the results of a mineral resource estimate by an independent Qualified Person is in progress.

On March 24, 2006, the Company signed a framework agreement with subsidiaries of Gold Fields Limited to earn a 60% interest in certain mineral interests in Finland known as the Arctic Platinum Project ("APP"). The agreement is subject to a back-in right in favour of Gold Fields which, if exercised, would

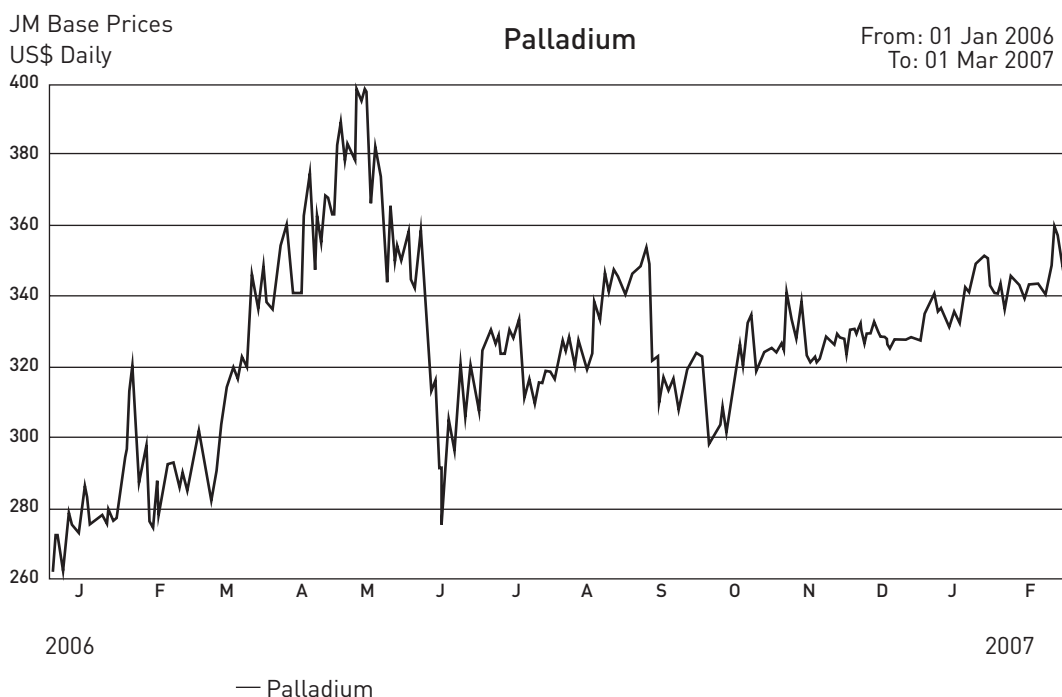


decrease the Company's interest to 50% less one share. The APP includes several advanced-stage PGM projects. In order to earn the 60% interest and become the project operator, the Company must incur US\$12.5 million in approved expenditures, complete a feasibility study, make a production decision, and pay Gold Fields up to US\$45.0 million (for a 60% interest) through the issuance of the Company's common shares (approximately 9.2 million shares) on or before August 31, 2008. As at March 31, 2007, the Company has incurred \$8.5 million (US\$7.4 million) in expenditures on the APP and these costs have been charged to exploration expense.

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

Currently, the Company is delivering and selling all of its palladium production into the spot market with one or more commodity dealers and manufacturers. For the three months ended March 31, 2007, the Company realized a weighted average cash price of US\$338 per ounce on its physical deliveries of palladium into the spot market. The Company expects the improvement in the palladium price to continue (average spot price of US\$346 per ounce for the first quarter of 2007 compared to an average price of US\$290 per ounce for same period last year) with the continuing increase in global demand for palladium. The palladium price has displayed consistent strength over recent quarters reflective of the tightening supply/demand fundamentals and historically significant pricing differentials between palladium and platinum that are giving rise to substitution, particularly in the autocatalyst sector.

Source: Johnson Matthey





In 2004, the Company commenced a hedging strategy, the objective of which was to reduce the variability of cash flows associated with revenues. During 2007 and throughout 2006, the Company chose to sell into the spot market and the Company does not currently have any commodity or foreign exchange hedging.

## PRODUCTION STATISTICS

Three Months Ended March 31	2007	2006
Palladium (oz)	<b>78,805</b>	47,015
Payable Palladium (oz)	<b>72,106</b>	42,784
Platinum (oz)	<b>6,862</b>	4,698
Gold (oz)	<b>4,890</b>	3,615
Copper (lbs)	<b>1,370,113</b>	1,213,394
Nickel (lbs)	<b>812,385</b>	616,037
Ore Tonnes Milled	<b>1,288,540</b>	1,125,710
Ore Tonnes Mined – Underground	<b>201,221</b>	103,545
Ore Tonnes Mined – Open Pit	<b>1,198,022</b>	1,075,597
Waste Tonnes Mined – Open Pit	<b>1,856,919</b>	2,366,675
Waste Strip Ratio	<b>1.55:1</b>	2.20:1

## SUMMARY OF QUARTERLY RESULTS

(thousands of dollars except per share amounts)

	2005				2006			2007
	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Revenue from metal sales	23,544	17,247	25,609	31,492	35,519	41,431	50,758	68,439
Cash flow from operations, prior to changes in non-cash working capital *	(9,900)	(17,105)	(6,892)	(362)	(3,105)	2,758	11,024	22,549
Exploration expense	1,662	1,721	3,701	2,024	2,659	2,576	4,572	3,228
Net income (loss)	(15,228)	(19,610)	(11,037)	(4,141)	(11,325)	(11,247)	(7,396)	5,507
Basic net income (loss) per share	(0.29)	(0.37)	(0.21)	(0.08)	(0.22)	(0.21)	(0.14)	0.10
Fully diluted net income (loss) per share	(0.29)	(0.38)	(0.21)	(0.08)	(0.22)	(0.21)	(0.14)	0.10

\* Includes exploration expense.

## RESULTS OF OPERATIONS

The Company realized net income for the three months ended March 31, 2007 of \$5.5 million or \$0.10 per share on revenues of \$68.4 million compared to a net loss of \$4.1 million or \$0.08 per share on revenues of \$31.5 million for the corresponding period in 2006. The improvement in operating results compared to 2006 is primarily due to increased revenue being realized from higher palladium (68% increase) and by-product metal production, as well as higher average prices for palladium and all by-product metals. Revenue in the first quarter of 2007 from the sale of palladium was \$31.1 million (45% of total revenue) compared to \$16.8 million (53% of total revenue) in 2006. For the three months ended March 31, 2007, palladium sales were recorded at US\$352 per ounce in comparison to an average of US\$330 in the corresponding period in 2006 (palladium production sold to third-party smelters takes up to six months from time of receipt at the smelter to settle the final delivery and pricing). This improvement is in line with the Company's outlook on palladium prices. The forecasted increase in global demand for palladium, the price spread between platinum and palladium and increasing demand for palladium jewelry supports the Company's view that demand for palladium should continue to strengthen.



By-product metal pricing also continued to strengthen throughout the quarter. Revenue from by-product metal sales increased by 154% to \$37.3 million in the three months ended March 31, 2007 compared to \$14.7 million in the first quarter of 2006, a reflection of both the increased production, as well as the improved price levels for all by-products. In particular, nickel sales rose to 28% of total revenue, up from 15% in the corresponding quarter of 2006. Prices for by-product metals in 2007 compared to 2006, were platinum at US\$1,244 per oz. (2006 - US\$1,073), nickel at US\$19.87 per lb (2006 - US\$6.96), gold at US\$661 per oz. (2006 - US\$581) and copper at US\$3.11 per lb (2006 - US\$2.48).

During the three months ended March 31, 2007, the mill processed 1,288,540 tonnes of ore at an average of 14,317 tonnes per day, producing 78,805 ounces of palladium, compared to 1,125,710 tonnes of ore at an average of 12,508 tonnes per day, producing 47,015 ounces of palladium in the first quarter of 2006. In the first quarter of 2007, the average palladium head grade was 2.48 grams per tonne compared to 1.79 grams per tonne in the corresponding period of 2006. The improved head grade can be attributed to production from the underground mine, which commenced commercial production in April 2006. During the three months ended March 31, 2007, 201,221 tonnes of ore extracted from the underground mine, with an average palladium grade of 6.00 grams per tonne, was part of the mill feed, while for the three months ended March 31, 2006, there was no commercial production. For the first quarter of 2007, palladium recoveries were 76.6% as compared to 72.7% in first quarter of 2006, while mill availability in the period improved to 94.5% compared to 84.9%. This improvement reflects the continued progress in improving the throughput and availability of the mill by addressing and systematically resolving the previously identified issues including flotation circuit improvements, implementation of proactive preventative maintenance programs, changes to the mill flow sheet, reagent mix and the quality of recycled water, as reported in the fourth quarter of 2006.

Total production costs for the three months ended March 31, 2007 of \$33.3 million increased from the \$24.3 million in the prior year, mainly due to the inclusion of the underground mine production costs, which for the corresponding period in 2006 were capitalized as pre-production costs. However, unit cash costs<sup>1</sup> to produce palladium (production costs including overhead and smelter treatment, refining and freight costs), net of by-product metal revenues and royalties, decreased to a record low of US\$15 per ounce in the first quarter of 2007 compared to US\$329 per ounce in the corresponding period in 2006. The decrease in unit cash costs was primarily the result of improved ore grades, higher metal recoveries and stronger commodities prices. Palladium production increased by 68% to 78,805 ounces in 2007 compared to 47,015 ounces in 2006, while revenue from by-product metals rose by 154%. In addition, there was a decrease in the open pit waste to ore strip ratio to 1.55:1 in the first quarter of 2007, compared to 2.20:1 in 2006. Notwithstanding excellent performance, there continues to be pressure on costs, particularly steel, tires (due to the current world supply constraints), power and diesel fuel.

The Company reviews and evaluates its long-lived assets for impairment when events or changes in circumstances indicate that the related carrying amounts may not be recoverable. Impairment is considered to exist if total estimated future undiscounted cash flows are less than the carrying amount of the asset. The Company's management believes an impairment charge and a corresponding reduction in the carrying value of its mining interests is not required. Assumptions underlying future cash flow estimates are subject to risk and uncertainty. Any differences between significant assumptions and market conditions such as metal prices, exchange rates, recoverable metal, and/or the Company's operating performance could have a material effect on the Company's ability to recover the carrying amounts of its long-lived assets resulting in possible impairment charges.

<sup>(1)</sup> Non-GAAP measure. Reference should be made to footnote 1 at the end of this MD&A.



Non-cash amortization increased to \$11.9 million in the first quarter of 2007 compared to \$3.6 million in the corresponding period in 2006. The higher amortization is attributable to the 68% increase in palladium production and the first quarter 2007 amortization of the underground mine development costs, which commenced with commercial production in April 2006.

Exploration expense increased to \$3.2 million in the first quarter of 2007 compared to \$2.0 million in the corresponding period last year. Included in 2007 is \$1.7 million spent on the APP as the Company continues its activities in Finland. Costs associated with the APP project are being charged to exploration expense as incurred until it is determined whether the project can be economically developed, at which time they will be capitalized. In addition, the Company continued its exploration of the OHGZ at the Lac des Iles mine, with work continuing on the exploration drift to allow more effective drilling access to the upper portion of the OHGZ. Diamond drilling is expected to commence in the second quarter of 2007. Work continues on the Shebandowan nickel-copper-PGM project and drill results from its Phase II drill campaign were announced in a press release on May 1, 2007. A Technical Report prepared in compliance with the requirements of National Instrument 43-101 will disclose the results of the mineral resource estimate and is expected to be available during the second quarter of 2007.

For the three months ended March 31, 2007, there was a \$12.9 million profit from mining operations compared to a \$3.5 million loss in the corresponding period of 2006. This improvement in earnings was mainly attributable to increased production and higher metals prices, particularly a 68% increase in palladium production and improved pricing for palladium. Palladium sales were recorded at US\$352 per ounce for 2007, compared to an average of US\$330 in the same period last year. In addition, there were significant increases in the volumes of by-product metals, along with the improved pricing for all by-products.

Other income and expense, which includes interest income and expense, accretion expense on the convertible notes and foreign exchange gains and losses, was an expense of \$5.9 million in first quarter of 2007 compared to \$1.4 million in the corresponding period of 2006. The increase in 2007 is mainly due to the recognition of non-cash accretion expenses of \$4.3 million (2006 – \$nil) relating to the convertible notes payable. For the first quarter of 2007, the Company incurred interest expense on long-term debt of \$1.5 million compared to \$0.7 million in the same period last year. The increased interest expense in the current quarter is attributable to the additional interest expense incurred on the convertible notes payable that commenced in April, 2006. To date, this expense has been settled with the issue of common shares (2007 – 68,138 shares issued; first quarter 2006 – nil), pursuant to the convertible note holders' directions. In the current quarter, there was a foreign exchange gain of \$0.6 million compared to a loss of \$0.3 million in 2006. The foreign exchange gain relates primarily to the Company's US dollar denominated credit facilities and the convertible notes. Interest income in the first quarter 2007 was \$0.1 million unchanged from 2006.

For the three months ended March 31, 2007, the Company reported a net income of \$5.5 million or \$0.10 per share compared to net loss of \$4.1 million or \$0.08 per share for the three months ended March 31, 2006.

#### **LIQUIDITY AND CAPITAL RESOURCES**

Cash provided by operations<sup>1</sup> (prior to changes in non-cash working capital) was \$22.5 million in the three months ended March 31, 2007, compared to cash used in operations of \$0.4 million in 2006. The \$22.9 million improvement was mainly attributable to increased production and higher metals prices. Particularly there was a 68% increase in production and improved pricing for palladium. Increases in the volume of by-product metals production, coupled with improved pricing for all by-products, resulted in a 154% increase in by-product revenues. This improved revenue more than offset the increase in operating

<sup>(1)</sup> Non-GAAP measure. Reference should be made to footnote 1 at the end of this MD&A.





costs that arose from the inclusion of expenses related to production from the underground mining operation that commenced commercial production in April 2006. Changes in non-cash working capital required \$16.0 million of cash in the three months ended March 31, 2007, as compared to \$10.1 million for the corresponding period of 2006. Palladium awaiting settlement increased to 132,554 ounces at March 31, 2007 compared to 129,496 ounces at December 31, 2006. The increase in the physical quantity of metal in the concentrate awaiting settlement, combined with the higher palladium and by-product prices used to value the concentrate awaiting settlement resulted in a \$21.9 million (27%) increase in the value of concentrate awaiting settlement. This was partially offset by the receipt of the first advance from Auramet Trading, LLC, ("Auramet") under the palladium and platinum advance purchase facility of \$4.4 million. After allowing for non-cash working capital changes, cash provided by operations was \$6.5 million in the three months ended March 31, 2007 compared to cash usage of \$10.4 million in the three months ended March 31, 2006.

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 on February 27, 2007. These proceeds will be used to expedite work on the Shebandowan Project.

Investing activities required \$4.5 million of cash in the first quarter of 2007, the majority of which was attributable to the ongoing lateral development for the underground mine and the 2007 expansion of the tailings management facilities. This compares with \$7.4 million of net investing activities in the same period last year, which was mainly related to the underground mine development.

The Company's debt position reduced to \$69.9 million at March 31, 2007 compared to \$74.9 million at December 31, 2006, due to the repayment of the Kaiser-Francis Oil Company ("Kaiser-Francis") credit facility from the first advance under the Auramet palladium and platinum advance purchase agreement, as well as scheduled repayments in connection with its long term debt facility.

On October 12, 2006 the Company closed a transaction with Kaiser-Francis for a US\$5.0 million short term working capital loan maturing December 31, 2006. The interest rate under the loan is the 30 day LIBOR plus 2.5% per annum. The Company paid a commitment fee of US\$37,500 and amounts not drawn under the loan were subject to a standby fee of 0.125% per annum. In connection with the loan, the Company granted to Kaiser-Francis a first priority security interest on the inventory and receivables of the Company. On December 13, 2006 the maturity date was extended to March 31, 2007, with no other changes in terms. The Company paid a commitment fee of US\$25,000 for the extension. In accordance with the terms of the Auramet palladium and platinum advance purchase agreement, the first advance received from Auramet on March 7, 2007 was used to repay this loan to Kaiser-Francis.

As at March 31, 2007, the Company had cash of approximately \$2.9 million (December 31, 2006 – \$3.2 million) and working capital of \$66.3 million (December 31, 2006 – \$50.8 million). The Company recognized its need for additional working capital to fund its expected operations over the next twelve months as the inventory of concentrate awaiting settlement continues to increase and as the lateral development of the underground mine continues. To meet this need the Company entered into a platinum and palladium advance purchase facility with Auramet by which the Company may, at its election, receive advance payments not exceeding an aggregate maximum amount of US\$25.0 million. The Company is required to pay monthly a commitment fee of 0.5% per annum, on the unused portion of the Auramet facility. As at March 31, 2007, the Company had received one advance from Auramet of US\$7.8 million, of which US\$5.0 million was used to repay the Kaiser-Francis credit facility. Metals for some of this advance were delivered in March and as at March 31, 2007 the Company had an obligation to deliver 10,000 ounces of palladium and 500 ounces of platinum in satisfaction of the outstanding balance of US\$3.8 million. The Company is continuing to review various other financing options.





## CONTRACTUAL OBLIGATIONS

As at March 31, 2007

(thousands of dollars)

	Total	Payments Due by Period		
		1 Year	1–3 Years	4–5 Years
Senior credit facility	\$ 15,778	\$ 6,578	\$ 9,200	\$ -
Capital lease obligations	5,613	2,033	3,355	225
Convertible notes payable	48,458	28,788	19,670	-
Interest obligations	2,917	1,520	1,372	25
Operating leases	4,212	1,549	2,075	588
Other purchase obligations	1,745	1,745	-	-
	\$ 78,723	\$ 42,213	\$ 35,672	\$ 838

There are no payments due after five years.

## RELATED PARTY TRANSACTIONS

In December 2001, Kaiser-Francis provided a US\$20.0 million non-revolving credit facility to finance the Company's working capital requirements. In the second quarter of 2004, the Kaiser-Francis credit facility was extended to June 30, 2006. Interest was based on the 30-day LIBOR plus 2.50% and the standby fee is 0.125% per annum. The amount paid to Kaiser-Francis for interest and standby fee on this facility was \$0.6 million in 2006 compared to \$0.8 million in 2005. This facility was repaid on June 23, 2006 pursuant to the terms of the Series II convertible note issued on that date.

On October 12, 2006 the Company closed a transaction with Kaiser-Francis for a US\$5.0 million short term working capital loan maturing December 31, 2006. On December 13, 2006, the maturity date was extended to March 31, 2007. Interest on this new facility is based on the 30-day LIBOR plus 2.5% and the standby fee is 0.125% per annum. This facility was repaid on March 7, 2007, pursuant to the terms of the platinum and palladium advance purchase agreement with Auramet. Kaiser-Francis holds approximately 50% of the common shares of the Company.

## MANAGEMENT'S OUTLOOK

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

Production for the first quarter of 2007 was 78,805 ounces of palladium with an average palladium head grade of 2.48 grams per tonne. This was a further improvement on the 2006 fourth quarter's palladium production of 73,242 ounces with an average head grade of 2.52 grams per tonne and a 68% increase over the previous year's production of 47,015 ounces, with a headgrade of 1.79 grams per tonne, during the same period. The improved head grade compared to the same period last year can be attributed to production from the underground mine, which commenced production in April 2006. During the first quarter, the underground mine averaged 2,236 tonnes per day at an average head grade of 6.00 grams per tonne. In addition mill availability reached 94.5% during the quarter, about 10% above the same period last year, and a continuation of the fourth quarter results reflecting the determined efforts throughout the early part of last year to resolve the previous operating challenges. This excellent performance, along with the continued strength of the metals markets, resulted in a profit of \$5.5 million in the first quarter and a \$12.9 million improvement compared to the fourth quarter's loss of \$7.4 million. Palladium production in 2007 is expected to continue to improve to approximately 290,000 ounces, with a full year of production from the underground mine and an expected average blended head grade increase in 2007 in line with the historical averages of the mine.



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

The Company believes that the surplus pressures of the early 2000's have abated and that there is evidence to support the view that the palladium market is moving towards more of a demand-driven pricing environment. This is being evidenced by increasing global catalytic demand, fueled by growing low tolerance emission legislation, and rapid technological advances which exploit pricing differentials between palladium and platinum.

### **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) Comprehensive Income and Equity**

The Company adopted CICA Handbook Section 1530, "Comprehensive Income", and Section 3251, "Equity", effective January 1, 2007. Section 1530 establishes standards for reporting comprehensive income. These standards require that an enterprise present comprehensive income and its components, in a separate financial statement that is displayed with the same prominence as other financial statements. Section 3251 establishes standards for the presentation of equity and changes in equity during the reporting period. The requirements in Section 3251 are in addition to Section 1530. The Company has determined that there is no impact in the determination of Comprehensive Income and Equity for the three months ended March 31, 2007.

#### **(b) Financial Instruments- Recognition and Measurement**

In January 2005, the CICA released new Handbook section 3855, "Financial Instruments – Recognition and Measurement", effective for annual and interim periods beginning on or after October 1, 2006. This new section establishes standards for the recognition and measurement of all financial instruments, provides a characteristics-based definition of a derivative financial instrument, provides criteria to be used to determine when a financial instrument should be recognized, and provides criteria to be used when a financial instrument is to be extinguished. The Company has adopted this effective January 1, 2007 which had no impact on retained earnings.

The CICA has also reissued section 3860 of the CICA Handbook as section 3861, Financial Instruments – Disclosure and Presentation, which establishes standards for presentation of financial instruments and non financial derivatives and identifies the information that should be disclosed. The revisions come into effect for fiscal years beginning on or after October 1, 2006. The Company has adopted this effective January 1, 2007. The effect of these new standards was immaterial.

#### **(c) Impairment assessments of long-lived assets**

Each year, the Company reviews the mining plan for the remaining life of mine. Significant changes in the mine plan can occur as a result of mining experience, mineral reserve estimates based on assessed geological and engineering analysis, new discoveries, changes in mining methods and production rates, process changes, investments in new equipment and technology, metal prices, estimates of future



production costs and other factors. Based on year-end ore reserves and the current mine plan, the Company reviews annually its accounting estimates and makes adjustments accordingly.

The Company assesses long-lived assets for recoverability on an annual basis. When the carrying value of a long-lived asset is less than its net recoverable value, as determined on an undiscounted basis, an impairment loss is recognized to the extent that its fair value, measured as the discounted cash flows over the life of the asset.

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

**(d) 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.

**(e) 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.

**(f) Mine Restoration Obligation**

Asset retirement obligations are recognized when incurred and recorded as liabilities at fair value. The amount of the liability is subject to re-measurement at each reporting period. The liability is accreted over time through periodic charges to earnings. In addition, the asset retirement obligation is capitalized as part of mining interests and amortized over the estimated life of the mine. The estimated asset retirement obligation may change materially based on future changes in operations, costs of reclamation and closure activities, and regulatory requirements.

**RECENT ACCOUNTING PRONOUNCEMENTS ISSUED BUT NOT YET ADOPTED**

**(a) Financial Instruments - Recognition and Measurement**

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



## **(b) Capital Disclosures**

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

## **OTHER INFORMATION**

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

## **OUTSTANDING SHARE DATA**

As of May 9th, 2007, there were 53,595,398 common shares of the Company outstanding and options outstanding pursuant to the 1995 Corporate Stock Option Plan entitling holders thereof to acquire 388,633 common shares of the Company at an average strike price of \$9.98.

## **RISKS AND UNCERTAINTIES**

The price of palladium is the most significant factor influencing the profitability of the Company. In the three months ended March 31, 2007, sales of palladium accounted for approximately 45% (March 31, 2006 – approximately 53%) of the Company's revenue. Many factors influence the price of palladium, including global supply and demand, speculative activities, international political and economic conditions and production levels and costs in other PGM producing countries, particularly Russia and South Africa. The possible development of a substitute alloy or synthetic material, which has catalytic characteristics similar to platinum group metals, may result in a future decrease in demand for palladium and platinum.

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

The Company is dependent on one mine for its metal production. The business of mining is generally subject to risks and hazards, including environmental hazards, industrial accidents, metallurgical and other processing problems, unusual and unexpected rock formations, pit slope failures, flooding and periodic interruptions due to inclement weather conditions or other acts of nature, mechanical equipment and facility performance problems and the availability of materials and equipment. These risks could result in damage to, or destruction of, the Company's properties or production facilities, personal injury or death, environmental damage, delays in mining, monetary losses and possible legal liability. Although the Company maintains insurance in respect of the mining operations that is within ranges of coverage consistent with industry practice, such insurance may not provide coverage of all the risks associated with mining. Currently the Company sells all of its concentrate to one smelting firm under a contract that expires on May 31, 2007. Management is currently negotiating with the smelter and believes it will be successful in negotiating an extension and/or new agreement with the smelting firm, but cannot guarantee that this will occur.



## **DISCLOSURE CONTROLS AND PROCEDURES**

Management is responsible for the information disclosed in this management's discussion and analysis and has in place the appropriate information systems, procedures and controls to ensure that information used internally by management and disclosed externally is, in all material respects, complete and reliable. As at the period ended March 31, 2007, the Chief Executive Officer 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 effectiveness of these controls is evaluated annually through regular internal audits. Our external auditors have not conducted a review or audit of the controls or the documentation relating to this initiative.

## **INTERNAL CONTROL OVER FINANCIAL REPORTING**

As at the period ended March 31, 2007, the Chief Executive Officer and Chief Financial Officer certify that they have designed, or caused to be designed under their supervision, internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the financial statements for external purposes in accordance with GAAP.

The Company is dependent upon the services of a small number of members of senior management. During the most recent interim period, certain vacancies within key senior management positions existed within the Company. Such vacancies within the company had the potential to materially affect the Company's internal control over financial reporting with respect to certain disclosures and the accounting for complex and non-routine accounting transactions. In response to this potential weakness in controls, the Company contracted to retain certain services of the former senior management personnel, external consultants and counsel, and internally reallocated key reporting duties amongst its senior personnel until such time as the vacancies could be filled. As a result of these actions, these weaknesses have not resulted in a misstatement in our interim or annual financial statements.

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

## **<sup>1</sup>NON-GAAP MEASURES**

Cash cost per ounce and operating cash flow are not recognized measures under Canadian GAAP. Such non-GAAP financial measures do not have any standardized meaning prescribed by Canadian GAAP and are therefore unlikely to be comparable to similar measures presented by other issuers. Management uses these measures internally. The use of these measures enables management to better assess performance trends. Management understands that a number of investors and others who follow the Company's performance assess performance in this way. Management believes that these measures better reflect the Company's performance for the current period and are a better indication of its expected performance in future periods. This data is intended to provide additional information and should not be considered in isolation or as a substitute for measures of performance prepared in accordance with Canadian GAAP. The following table reconciles these non-GAAP measures to the most directly comparable Canadian GAAP measure:



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

Three Months Ended March 31

(thousands of dollars except per ounce amounts)	2007	2006
Production costs including overhead	\$ 33,252	\$ 24,311
Smelter treatment, refining and freight costs	5,262	2,714
	38,514	27,025
Less: by-product metal revenue	(37,333)	(14,717)
	1,181	12,308
Divided by ounces of palladium	70,634	32,057
Cash cost per ounce (C\$)	17	384
C\$ exchange rate	1.1530	1.1671
Cash cost per ounce (US\$)	15	329

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

Three Months Ended March 31

(thousands of dollars)	2007	2006
Operating Cash Flow	\$ 22,549	\$ (362)
Changes in Non-cash Working Capital	(16,001)	(10,082)
Cash Provided by Operating Activities	\$ 6,548	\$ (10,444)

CAUTIONARY STATEMENT ON FORWARD-LOOKING INFORMATION

Certain information included in this MD&A, including any information as to our future financial or operating performance and other statements that express management's expectations or estimates of future performance, constitute 'forward-looking statements' within the meaning of the 'safe harbor' provisions of the United States Private Securities Litigation Reform Act of 1995 and Canadian securities laws. The words 'expect', 'believe', 'will', 'intend', 'estimate' and similar expressions identify forward-looking statements. Forward-looking statements are necessarily based upon a number of estimates and assumptions that, while considered reasonable by management, are inherently subject to significant business, economic and competitive uncertainties and contingencies. These statements are based on certain factors and assumptions, including but not limited to, the assumption that market fundamentals will result in increased palladium demand and prices and sustained by-product metal demand and prices; the integrated operation of the Company's underground mine and the open pit mine remain viable operationally and economically; financing is available on reasonable terms; expectations for blended mill feed head grade and mill performance will proceed as expected; new mine plan scenarios will be viable operationally and economically; and plans for mill production, sustainable recoveries from the Lac des Iles mine, exploration at Lac des Iles and elsewhere will all proceed as expected. The Company cautions the reader that such forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause the actual financial results, performance or achievements of North American Palladium to be materially different from the Company's estimated future results, performance or achievements expressed or implied by those forward-looking statements and that the forward-looking statements are not guarantees of future performance. These risks, uncertainties and other factors include, but are not limited to: metal price volatility; economic and political events affecting metal supply and demand; changes in the regulatory environment; fluctuations in ore grade or ore tonnes milled; geological, technical, mining or processing problems; future production; changes in the life-of-mine plan or the ultimate pit design; availability and increasing costs associated with mining inputs and labour; the speculative nature of exploration and development, including the risks of diminishing quantities or grades of mineral reserves; adverse changes in our credit rating; and the risks involved in the exploration, development and mining business. These factors are discussed in greater detail in the Company's most recent Form 40-F/Annual Information Form on file with the U.S. Securities and Exchange Commission and Canadian provincial securities regulatory authorities. The Company disclaims any obligation to update or revise any forward-looking statements, whether as a result of new information, events or otherwise. Readers are cautioned not to put undue reliance on these forward-looking statements.



# Consolidated Balance Sheets

(expressed in thousands of Canadian dollars)

	March 31 2007	December 31 2006
	(unaudited)	
<b>ASSETS</b>		
<b>Current Assets</b>		
Cash	\$ 2,922	\$ 3,153
Concentrate awaiting settlement, net – Note 3	103,947	82,050
Taxes recoverable	-	145
Inventories	13,635	14,164
Current portion of crushed and broken ore stockpiles	7,508	7,134
Other assets	1,771	2,602
	<b>129,783</b>	<b>109,248</b>
Mining interests, net	138,476	146,617
Mine restoration deposit	8,041	8,041
Crushed and broken ore stockpiles	368	289
Deferred financing costs – Note 10	-	962
	<b>\$ 276,668</b>	<b>\$ 265,157</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current Liabilities</b>		
Accounts payable and accrued liabilities	\$ 20,148	\$ 21,526
Advance purchase facility – Note 9 (a)	4,415	-
Taxes payable	1,301	-
Future mining tax liability	200	149
Current portion of obligations under capital leases	2,033	2,104
Current portion of convertible notes payable – Note 4	28,788	22,148
Current portion of long-term debt – Note 5	6,578	6,662
Kaiser Francis credit facility – Note 5	-	5,827
	<b>63,463</b>	<b>58,416</b>
Mine restoration obligation	8,293	8,211
Obligations under capital leases	3,580	4,111
Convertible notes payable - Note 4	19,670	23,062
Long-term debt – Note 5	9,200	10,992
Future mining tax liability	375	381
	<b>104,581</b>	<b>105,173</b>
<b>SHAREHOLDERS' EQUITY</b>		
Common share capital and common share purchase warrants – Note 6	346,245	339,743
Equity component of convertible notes payable, net of issue costs – Note 4	12,336	12,336
Contributed surplus	1,363	1,269
Deficit	(187,857)	(193,364)
Total shareholders' equity	172,087	159,984
	<b>\$ 276,668</b>	<b>\$ 265,157</b>

Commitments – Notes 1 and 9





# Consolidated Statements of Operations, Comprehensive Income and Deficit

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

	Three months ended March 31	
	2007	2006
<b>Revenue from metal sales – Note 8</b>	<b>\$ 68,439</b>	<b>\$ 31,492</b>
<b>Operating expenses</b>		
Production costs, excluding amortization and asset retirement costs	33,252	24,311
Smelter treatment, refining and freight costs	5,262	2,714
Amortization	11,908	3,597
Administrative	1,696	2,179
Exploration expense	3,228	2,024
Asset retirement costs	179	123
Total operating expenses	55,525	34,948
<b>Income (Loss) from mining operations</b>	<b>12,914</b>	<b>(3,456)</b>
<b>Other expenses (income)</b>		
Interest on long-term debt, capital leases and convertible notes payable	1,542	695
Write-off of deferred financing costs	-	504
Foreign exchange (gain) loss	(626)	281
Interest income	(83)	(83)
Amortization of deferred financing costs	222	11
Accretion expense relating to convertible notes payable – Note 4	4,262	-
Interest expense	540	-
Total other expenses	5,857	1,408
<b>Income (Loss) before income taxes</b>	<b>7,057</b>	<b>(4,864)</b>
Income tax expense (recovery)	1,550	(723)
<b>Income (Loss) and Comprehensive Income (Loss) for the period</b>	<b>5,507</b>	<b>(4,141)</b>
Deficit, beginning of period	(193,364)	(159,255)
Deficit, end of period	\$ (187,857)	\$ (163,396)
<b>Income (Loss) per share</b>		
Basic	\$ 0.10	\$ (0.08)
Diluted	\$ 0.10	\$ (0.08)
<b>Weighted average number of shares outstanding</b>		
Basic	53,209,708	52,214,834
Diluted	53,218,636	52,214,834



# Consolidated Statements of Cash Flows

(expressed in thousands of Canadian dollars)  
(unaudited)

	Three months ended March 31	
	2007	2006
<b>Cash provided by (used in)</b>		
<b>Operations</b>		
Income (Loss) for the period	\$ 5,507	\$ (4,141)
Operating items not involving cash		
Accretion expense relating to convertible notes payable	4,262	-
Amortization	11,908	3,597
Amortization of deferred financing costs	222	11
Accrued interest on convertible notes	574	-
Unrealized foreign exchange gain	(557)	(46)
Asset retirement costs	179	123
Future income tax expense (recovery)	45	(835)
Write-off of deferred financing costs	-	504
Stock based compensation and employee benefits	409	425
	22,549	(362)
Changes in non-cash working capital – Note 7	(16,001)	(10,082)
	6,548	(10,444)
<b>Financing Activities</b>		
Issuance of convertible notes	-	41,037
Increase in long term debt and credit facility	-	2,311
Deferred financing costs	-	(2,137)
Issuance of common shares	5,703	475
Repayment of long-term debt	(7,480)	(1,670)
Repayment of obligations under capital leases	(543)	(578)
Mine restoration deposit	-	(300)
	(2,320)	39,138
<b>Investing Activities</b>		
Additions to mining interests	(4,459)	(7,435)
Decrease in cash and cash equivalents	(231)	21,259
Cash and cash equivalents, beginning of period	3,153	15,031
Cash and cash equivalents, end of period	\$ 2,922	\$ 36,290



# Notes to the Consolidated Financial Statements

for the three months ended March 31, 2007

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

(unaudited)

## 1. NATURE OF OPERATIONS

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

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

### Arctic Platinum Project

On March 24, 2006, the Company signed a framework agreement with subsidiaries of Gold Fields Limited to earn a 60% interest in certain mineral interests in Finland known as the Arctic Platinum Project ("APP"). The agreement is subject to a back-in right in favour of Gold Fields which, if exercised, would decrease the Company's interest to 50% less one share. The APP includes several advanced-stage platinum group metal (PGM) projects. In order to earn the 60% interest and become the project operator, the Company must incur US\$12,500 in approved expenditures, complete a feasibility study, make a production decision, and pay Gold Fields up to US\$45,000 (for a 60% interest) through the issuance of the Company's common shares (approximately 9.2 million shares) on or before August 31, 2008. As at March 31, 2007, the Company has incurred \$8,529 (US\$7,397) in expenditures on the APP and these costs have been charged to exploration expense.

### Shebandowan Project

On December 3, 2003, the Company entered into an option and joint venture agreement with Inco Limited on the Haines-Conacher property which surrounds the past producing Shebandowan mine. The agreement was subsequently amended March 31, 2006 to include the mine. The nickel-copper-PGM Shebandowan Project is located approximately 100 km southwest of the Lac des Iles mine. Successive diamond drilling programs in 2005 and 2006 were carried out on three relatively shallow mineralized zones known as the West, Road and "D" zones. Preparation of a Technical Report in compliance with National Instrument 43-101 that will disclose the results of a mineral resource estimate by an independent Qualified Person is in progress.

## 2. BASIS OF PRESENTATION

These interim consolidated financial statements have been prepared using the same accounting policies and methods as were used for the consolidated financial statements for the year ended December 31, 2006, except for new accounting pronouncements which have been adopted effective January 1, 2007 and are disclosed in note 10 to these financial statements. Accordingly, these unaudited consolidated financial statements should be read in conjunction with the audited annual consolidated financial statements for 2006.

## 3. CONCENTRATE AWAITING SETTLEMENT

The value of concentrate awaiting settlement represents the value of platinum group metals and base metals from production shipped to and received by a third-party smelter between September 2006 and March 2007, which are in-process at the balance sheet date, net of refining and smelter treatment charges. At March 31, 2007, concentrate awaiting settlement included 132,554 ounces of palladium (December 31, 2006 – 129,496 ounces). Concentrate awaiting settlement is revalued and adjusted



at each reporting period to reflect changes in metal prices and foreign exchange rates. Concentrate awaiting settlement was entirely from one domestic customer at March 31, 2007 and the Company expects full realization will occur on such receivables.

#### 4. CONVERTIBLE NOTES PAYABLE

	March 31, 2007	December 31, 2006
Series I convertible notes (principal amount US\$35 million, maturing August 1, 2008)	\$ 35,126	\$ 32,048
Series II convertible note (principal amount US\$13.5 million, maturing December 1, 2008)	13,973	13,162
	49,099	45,210
Less: transaction costs	(641)	-
	48,458	45,210
Less: current portion	(28,788)	(22,148)
	\$ 19,670	\$ 23,062

On March 29, 2006, the Company issued US\$35,000 (\$41,037) aggregate principal amount of Series I convertible notes (the "Series I Notes") due August 1, 2008 through a private placement of convertible notes and common share purchase warrants. The offering (the "Offering") consists of up to US\$58,500 principal amount of notes. The Offering was to Kaiser-Francis Oil Company ("KFOC") and an institutional investor (the "Purchasers"). The Offering is governed by a securities purchase agreement dated March 24, 2006 (the "SPA") among the Company and the Purchasers.

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

The Company, at its option, had the right to sell to KFOC a Series II Note (a second tranche) in the principal amount of up to US\$13,500 (\$15,176) on or before June 30, 2006. On June 23, 2006, the Company exercised this right and issued to KFOC a US\$13,500 (\$15,176) aggregate principal amount Series II Note, due December 1, 2008. The Series II Note is convertible into 1,108,374 common shares of the Company at any time by the holder at US\$12.18 per share. Warrants exercisable to purchase 554,187 common shares were issued with the Series II Note, with each warrant being exercisable to purchase one common share at an initial exercise price of US\$13.48 until June 23, 2010. Pursuant to the terms of the Series II convertible note, on June 23, 2006 the Company used the proceeds to repay the balance outstanding on the US\$20,000 KFOC credit facility due June 30, 2006.

The Purchasers had the option to acquire an additional US\$10,000 principal amount of notes (a third tranche) on or before December 31, 2006. The Purchasers elected not to exercise this option.

The Series I and II Notes bear interest at a rate of 6.5% per annum payable bi-monthly, commencing on June 1, 2006 and August 1, 2006, respectively. Series I and II Notes are repayable in nine equal installments commencing April 1, 2007 and August 1, 2007, respectively. The interest payments and/or repayment amounts may be paid to each Purchaser, at the Purchaser's option, in any combination of cash and/or common shares. If common shares are issued for interest payments or in repayment of the convertible notes they will be issued at a 10% discount from the weighted average trading price of the common shares on the AMEX for the five consecutive trading days immediately prior to the applicable payment date. The Company has the right to defer any principal repayment in cash until a later principal repayment date. There is no limit on the length of the deferral, other than it cannot be deferred later than the final maturity date. The Company must give five (5) days of its intention to defer payment.



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

The convertible notes contain customary covenants, including restrictions on the Company incurring debt, payment of dividends, or obligations for, or involving the payment of money in excess of, certain restricted amounts. The convertible notes are unsecured but contain customary anti-dilution protection as well as adjustments in the event that the Company issues common shares or securities convertible into common shares at a purchase price per common share less than the conversion price. The warrants contain similar anti-dilution protection. These anti-dilution rights do not apply with respect to shares that are issued: (i) under a stock incentive plan; (ii) with favourable flow-through tax treatment; or (iii) in connection with certain mergers and acquisitions.

Under Canadian GAAP, the components of the convertible notes must be bifurcated and accounted for separately as debt and equity instruments. The warrants are separable from the notes and are accounted for as an equity instrument. The Series I proceeds received were allocated to the debt and equity components of the notes and to the initial warrants on a relative fair value basis as follows: US\$20,558 to the debt, US\$8,808 to the equity component and US\$5,634 to the warrants. The Series II Note proceeds were allocated as follows: US\$9,578 to the debt, US\$2,312 to the equity component and US\$1,610 to the warrants. In addition, a liability (the "Equity Premium") was recognized for the holders' option to receive common shares, in lieu of cash, at a 10% discount to the five day weighted trading price, as described above, for interest and principal payments. The Company accretes the carrying value of the convertible notes and the Equity Premium such that at each installment payment date, the carrying value of the notes and the Equity Premium will be equal to the face value of the notes and the liability related to the Equity Premium. The Company recorded accretion expense of \$4,262 during the three months ended March 31, 2007 of which \$1,082 represented the accretion relating to the Equity Premium which was included in the carrying value of the convertible notes payable as at March 31, 2007.

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

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

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

## **5. LONG-TERM DEBT AND CREDIT FACILITY**

The Company's long-term debt is comprised of a senior credit facility with an equipment finance company. The interest rate under the loan facility is LIBOR plus 2.5%, or 7.87% at March 31, 2007. As at March 31, 2007, the outstanding long-term debt, including current and long-term portions (net of transaction costs) was \$15,778 (December 31, 2006 - \$17,654). The senior credit facility is repayable in equal quarterly installments over a five-year period with a final maturity of November 24, 2009.

On October 12, 2006 the Company closed a transaction with KFOC for a US\$5,000 short-term working capital loan maturing December 31, 2006. The interest rate under the loan is the 30 day LIBOR plus 2.5% per annum. The Company paid a commitment fee of US\$37 and amounts not drawn under the



loan were subject to a standby fee of 0.125% per annum. In connection with the loan, the Company granted to KFOC a first priority security interest in the inventory and receivables of the Company. On December 13, 2006 the maturity date was extended to March 31, 2007, with no other changes in terms. The Company paid a commitment fee of US\$25 for the extension. In accordance with the terms of the Auramet palladium and platinum advance purchase facility, the first advance received from Auramet on March 7, 2007 was used to repay this loan to KFOC.

## 6. COMMON SHARE CAPITAL AND COMMON SHARE PURCHASE WARRANTS

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.

### (a) Common shares and common share purchase warrants:

	March 31, 2007	
	Shares	Amount
Common shares issued, beginning of period	52,947,693	\$ 331,705
Common shares issued:		
Pursuant to stock options exercised	5,000	17
Fair value of stock options exercised	-	10
To group registered retirement savings plan participants	24,570	215
For interest payments on convertible notes payable	68,138	574
Private placement - flow through shares (net)	550,000	5,686
Common shares issued, end of period	53,595,401	\$338,207
Common share purchase warrants, issued pursuant to terms of Series I and II convertible notes, net of issue costs – Note 6 (b)	1,990,969	8,038
Balance, end of period		\$346,245

The Company finances a portion of its exploration activities through the issue of flow through shares. Under the terms of these share issues, the tax attributes of the related expenditures are renounced to subscribers. At the time the Company renounces the tax attributes of the expenditures to the subscribers, share capital is reduced and future tax liabilities are increased by the estimated income tax benefits renounced.

In February 2007, the Company completed a private placement of 550,000 flow-through shares for gross proceeds of \$6,050 which must be spent on qualifying expenditures prior to December 31, 2008. As of March 31, 2007, the Company has spent \$nil on qualifying expenditures.

On June 23, 2006, the Company completed a private placement of 270,000 flow-through common shares. The gross proceeds of \$3,375 must be spent on Canadian exploration expenses prior to December 31, 2007. As at March 31, 2007, the Company has spent \$1,773 on Canadian exploration expenses as defined in Section 66 of the Income Tax Act (Canada).

### (b) Common Share Purchase Warrants

Pursuant to the terms of the securities purchase agreements governing the issue of the Series I and Series II convertible notes payable, warrants to purchase 1,990,969 common shares were issued and are outstanding as follows:

Number of Warrants	Exercise Price	Expiry Date
Series I - 1,436,782	US\$13.48	March 29, 2010
Series II - 554,187	US\$13.48	June 23, 2010



### (c) Restricted Share Unit Plan

Effective December 14, 2005, the Company adopted a Restricted Share Unit Plan under which eligible directors, officers and key employees of the Company are entitled to receive awards of restricted share units. Each restricted share unit means a unit equivalent in value to the fair market value of a common share of the Company on the date of the award. As at March 31, 2007, 26,666 restricted share units are outstanding. The fair value of the restricted share units as at March 31, 2007 is \$8.45 per unit and \$37 has been charged to compensation expense for the three months ended March 31, 2007.

### (d) Corporate Stock Option Plan

The following summary sets out the activity in outstanding common share stock options for the three months ended March 31, 2007:

	March 31, 2007	
	Shares	Weighted-Average Exercise Price
Outstanding, beginning of period	360,133	\$ 10.24
Granted	42,500	9.00
Exercised	(5,000)	3.42
Cancelled	(84,000)	10.32
Outstanding, end of period	313,633	\$ 10.16
Options exercisable, end of period	116,767	\$ 11.08

The Company recognized a stock based compensation expense of \$111 for the three months ended March 31, 2007 (March 31, 2006 – \$176).

## 7. STATEMENT OF CASH FLOWS

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

	Three Months ended March 31	
	2007	2006
Cash provided by (used in):		
Concentrate awaiting settlement	\$ (21,897)	\$ (12,039)
Inventories and stockpiles	672	763
Other assets	831	267
Accounts payable and accrued liabilities	(1,468)	956
Advance purchase facility	4,415	-
Taxes payable	1,446	(29)
	\$ (16,001)	\$ (10,082)





## 8. REVENUE FROM METAL SALES

		Three Months ended March 31
	2007	2006
Palladium	\$ 31,106	\$ 16,775
Nickel	19,308	4,689
Platinum	9,945	5,169
Gold	3,276	1,991
Copper	4,125	2,654
Other metals	679	214
	<b>\$ 68,439</b>	<b>\$ 31,492</b>

## 9. COMMITMENTS

### (a) Palladium and Platinum Advance Purchase Facility

On January 19, 2007 the Company entered into a palladium and platinum advance purchase facility with Auramet Trading, LLC ("Auramet"), a precious metals merchant, providing for the sale of an average of 10,000 ounces of palladium and 500 ounces of platinum per month. The Company may not request Auramet to purchase metals after June 15, 2008 and all sales and payment prior to that date are required to be settled by December 31, 2008. Under the terms of the agreement the Company may receive advance payments not exceeding, at any time, an aggregate maximum of US\$25,000. The Company pays a commitment fee of 0.5% per annum, payable monthly, on the unused portion of the facility.

The purchase price may be fixed or provisional. For fixed pricing the Company may price at either: (i) Auramet's current market bid price at the time of the transaction, or (ii) market limit orders, as defined under the terms of the agreement. In the case of provisional pricing, it is determined based on the afternoon fixing of the London Bullion Marketing Association immediately preceding the purchase. In each case such pricing will reflect the forward value corresponding to the scheduled delivery date. Advance payments to the Company may not exceed specified values of fixed and provisionally priced platinum and palladium. Provisional prices must be fixed prior to the scheduled delivery date for such precious metals. Each advance payment will be subject to a discount equal to LIBOR plus 1.9% per annum for the period between the date the advance payment is made and the scheduled delivery date. Upon the delivery of the precious metals to Auramet, Auramet will pay to the Company the difference between the advance payment and the purchase price.

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

The first advance payment was used to repay the US\$5,000 working capital loan from the Corporation's major shareholder, while subsequent advance payments will be used to finance working capital requirements. The balance outstanding under the advance purchase facility at March 31, 2007 was \$4,415, (US\$3,829), which was settled by the delivery of 10,000 ounces of palladium and 500 ounces of platinum in April 2007.



## **(b) Forward Contracts**

The Company enters into forward contracts from time to time to hedge the effects of changes in the prices of metals it produces and foreign exchange on the Company's revenues. Gains and losses realized on derivative financial instruments used to mitigate metal price risk are recognized in revenue from metal sales when the hedge transaction occurs. Currently, the Company does not have any contracts in place.

## **10. ACCOUNTING CHANGES**

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

### **Financial Instruments**

As required by The Canadian Institute of Chartered Accountants ("CICA"), on January 1, 2007, the Company adopted CICA Handbook Section 1530, Comprehensive Income; Section 3251, Equity; Section 3855, Financial Instruments-Recognition and Measurement; Section 3861, Financial Instruments-Disclosure and Presentation and Section 3865, Hedges. As required by the implementation of these new standards, the prior period consolidated financial statements have not been restated. The principal changes in the accounting for financial instruments arising from the adoption of these accounting standards are described below.

#### **(a) Section 1530, Comprehensive Income**

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

#### **(b) Section 3251, Equity**

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

#### **c) Section 3855, Financial Instruments-Recognition and Measurement Section 3861, Financial Instruments-Disclosure and Presentation**

Under the new standards, financial assets and financial liabilities are initially recognized at fair value and their subsequent measurements are dependent on their classification. The standards require that all financial instruments be classified either as held-for-trading, available-for-sale financial assets, held-to-maturity investments, loans and receivables or other financial liabilities.



The standards require that all financial instruments, including all derivatives, be measured at fair value with the exception of available-for-sale financial assets that do not have quoted market prices in the active market, loans and receivables, held-to-maturity investments and other financial liabilities. Changes in fair value for held-for-trading investments are included in net income in the period they arise. Changes in fair value of available-for-sale financial assets are included in OCI until the assets are derecognized or impaired.

Non-financial derivatives are carried at fair value unless exempted from derivative treatment as a normal purchase and sale. The Company has reviewed all significant contractual arrangements and determined there are no material non-financial derivatives.

#### **Embedded derivatives**

Derivatives embedded in other financial instruments or contracts are separated from their host contracts and accounted for as derivatives when their economic characteristics and risks are not closely related to those of the host contract; the terms of the embedded derivatives are the same as those of the free-standing derivatives and the combined instrument or contract is not measured at fair value, with changes in fair value recognized in income. These embedded derivatives are measured at fair value with changes therein recognized in the statement of earnings. The Company has elected to apply this accounting treatment for all embedded derivatives in host contracts entered into on or after January 1, 2003 and has identified and measured all embedded derivatives that required separation and determined the fair value of those embedded derivatives at inception and as at January 1, 2007. As a result the Company identified the forced conversion of the call and put options related to the issuance of additional units on the Company's convertible notes payable as an embedded derivative to be bifurcated and fair valued. The fair value of these options was determined to be nominal and therefore there was no impact on the financial statements as a result of these embedded derivatives.

#### **Classification of financial instruments**

The Company has classified cash and other assets as loans and receivables, concentrate awaiting settlement as held-for-trading and all of the financial liabilities as other financial liabilities.

#### **Deferred Financing Costs**

Effective January 1, 2007, the Company records all transaction costs directly attributable to the acquisition or issuance of financial assets or financial liabilities as part of the related asset or liability's carrying value at inception. The effective interest rate method is now used to amortize these costs to operations. Previously the Company recorded such costs as deferred financing costs and amortized the related costs on a straight line basis over the term of the related asset or liability. As at January 1, 2007, the Company adjusted the carrying value of the related long-term debt and the convertible notes payable using the effective interest method. The impact was a decrease in the carrying value of the convertible notes payable of \$855, a decrease in the long-term debt of \$107 and a decrease in deferred financing costs of \$962. The adoption of the effective interest rate method had no impact on opening retained earnings.

#### **Disclosure and presentation**

There was no material effect on the Company's financial statements when the Company adopted the CICA Handbook Section 3861 on January 1, 2007.

#### **(d) Section 3865, Hedges**

CICA Handbook Section 3865 specifies circumstances under which hedge accounting is permissible and how hedge accounting may be performed. The Company currently does not have any hedges.

### **11. COMPARATIVE PERIOD FIGURES**

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



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