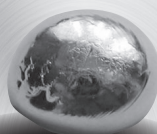




NORTH AMERICAN PALLADIUM LTD.

Pd



**SECOND QUARTER REPORT**

for the six months ended June 30, 2007





## Second Quarter 2007 Highlights

- Revenue in the second quarter of 2007 rose by 25% to \$44.5 million compared to \$35.5 million in the second quarter of 2006. Palladium revenue of \$21.9 million increased by 47% while by-product metal revenue of \$22.6 million improved by 10%. For the six months, revenue was \$112.9 million, an increase of 69%, compared to the 2006 revenue of \$67.0 million.
- Operating cash flow for the quarter (before changes in non-cash working capital)<sup>1</sup> improved by \$13.9 million to \$12.9 million compared to cash used in operations of \$1.0 million in 2006.
- The net loss for the quarter was \$9.1 million or \$0.17 per share compared to a net loss of \$11.3 million or \$0.22 per share in the same period last year. For the six months, the net loss was \$3.6 million or \$0.07 per share compared to a net loss of \$15.5 million or \$0.30 per share in 2006.
- Cash cost per ounce of palladium produced,<sup>1</sup> net of by-product metal revenues and royalties, were US\$242 in Q2 2007 compared to US\$219 in Q2 2006 due in part to the strengthening Canadian dollar.
- Palladium sales in the quarter were recorded at US\$365 per oz compared to US\$310 per oz in the comparable quarter last year, while by-product metal prices also realized considerable gains. Palladium accounted for 49% of the quarter's total revenues while nickel continued to be an important revenue source at 21% of revenue, despite softening prices.
- Spot palladium prices during the quarter averaged US\$370 per oz compared to US\$346 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 ("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 three month and six month period ended June 30, 2007, compared to those of the respective period in prior years. This MD&A has been prepared as of August 7th, 2007 and is intended to supplement and complement the unaudited consolidated financial statements and notes thereto for the six months ended June 30, 2007 (collectively, the "Financial Statements"). You are encouraged to review the Financial Statements in conjunction with your review of this MD&A. This MD&A should also be read in conjunction with the annual audited consolidated Financial Statements for the three years ended December 31, 2006, the related annual MD&A included in the 2006 annual report, 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.

## KEY RESULTS

### Operating Results

	Three Months ended June 30		Six Months ended June 30	
	2007	2006	2007	2006*
Palladium (oz)	<b>66,651</b>	57,326	<b>145,455</b>	104,341
Payable Palladium (oz)	<b>60,985</b>	52,171	<b>133,091</b>	94,955
Platinum (oz)	<b>5,904</b>	5,487	<b>12,767</b>	10,184
Gold (oz)	<b>4,739</b>	4,200	<b>9,630</b>	7,815
Copper (lbs)	<b>1,310,484</b>	1,258,978	<b>2,680,597</b>	2,472,372
Nickel (lbs)	<b>716,096</b>	619,276	<b>1,528,482</b>	1,235,313
Ore Tonnes Milled	<b>1,244,067</b>	1,101,543	<b>2,532,607</b>	2,227,253
Ore Tonnes Mined – Underground	<b>194,858</b>	193,752	<b>396,079</b>	297,297
Ore Tonnes Mined – Open Pit	<b>1,082,742</b>	920,997	<b>2,280,764</b>	1,979,940
Waste Tonnes Mined – Open Pit	<b>1,897,143</b>	2,563,092	<b>3,754,062</b>	4,946,421
Waste Strip Ratio	<b>1.75:1</b>	2.78:1	<b>1.65:1</b>	2.50:1

\* Metal production and tonnes milled includes 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.

### Financial Results

(thousands of dollars except per share amounts)

	2005				2006		2007	
	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Revenue from metal sales	17,247	25,609	31,492	35,519	41,431	50,758	<b>68,439</b>	<b>44,495</b>
Cash flow from operations, prior to changes in non-cash working capital <sup>1</sup> *	(14,956)	(7,055)	(260)	(965)	2,715	8,422	<b>23,037</b>	<b>12,865</b>
Exploration expense	1,721	3,701	2,024	2,659	2,576	4,572	<b>3,228</b>	<b>798</b>
Net income (loss)	(19,610)	(11,037)	(4,141)	(11,325)	(11,247)	(7,396)	<b>5,507</b>	<b>(9,066)</b>
Basic net income (loss) per share	(0.37)	(0.21)	(0.08)	(0.22)	(0.21)	(0.14)	<b>0.10</b>	<b>(0.17)</b>
Fully diluted net income (loss) per share	(0.38)	(0.21)	(0.08)	(0.22)	(0.21)	(0.14)	<b>0.10</b>	<b>(0.17)</b>

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

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



## RESULTS OF OPERATIONS

The Company earned revenues of \$44.5 million for the three months ended June 30, 2007 compared to revenues of \$35.5 million for the corresponding period in 2006. The improvement in operating results compared to 2006 is primarily due to higher production of palladium (16% increase) and by-product metals as well as higher average realized prices for palladium and some by-product metals. This was offset by a stronger Canadian dollar, which strengthened against the U.S. dollar to \$0.94 at June 30, 2007 compared to \$0.90 at June 30, 2006 and \$0.86 at March 31, 2007.

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 a quarter is based on current US dollar denominated commodity prices and foreign exchange rates for sales occurring in the quarter 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 price environment. Similarly, a weakening in the Canadian dollar relative to the US dollar will result in additional revenues and a strengthening in the Canadian dollar will result in reduced revenues. Effective April 1, 2007, the amount of the final pricing adjustments recognized on any commodity price changes will also be reduced by any price participation deductions as provided for in the Company's smelting and refining agreement. In the second quarter of 2007, revenues were reduced by negative adjustments of \$8.9 million (\$2.4 million due to negative price adjustments and \$6.5 million due to a negative foreign exchange adjustment) compared with a negative adjustment in the second quarter of 2006 of \$1.2 million (\$0.6 million positive price adjustment and \$1.8 million negative foreign exchange adjustment).

Revenue in the second quarter of 2007 from the sale of palladium was \$21.9 million (49% of total revenue) compared to \$14.9 million (42% of total revenue) in 2006. For the three months ended June 30, 2007, palladium sales were recorded at US\$365 per ounce in comparison to US\$310 in the corresponding period in 2006.

Revenue from by-product metal sales increased by 10% to \$22.6 million in the three months ended June 30, 2007 compared to \$20.6 million in the second quarter of 2006. Higher by-product metal revenues are a reflection of increased production and improved commodity prices but this was somewhat offset by the strengthening Canadian dollar. By-product metal prices recorded during the second quarter of 2007 compared to the first quarter of 2007 were mixed, with improvements seen in platinum (2%) and copper (10%) and reductions in gold (1%) and nickel (18%). For the current six-month period, total by-product revenues increased by 70% to \$60.0 million, as compared to \$35.3 million in 2006. In particular, nickel sales represented 21% of total revenue in the current quarter and 25% for the first six months of 2007, up from 18% and 17% for the corresponding periods in 2006. Prices recorded for by-product metals in Q2 2007 versus Q2 2006 were: platinum at US\$1,273 per oz (2006 - US\$1,223), nickel at US\$16.24 per lb (2006 - US\$9.64), gold at US\$654 per oz (2006 - US\$613) and copper at US\$3.41 per lb (2006 - US\$3.37).

During the three months ended June 30, 2007, 194,858 tonnes of ore were extracted from the Lac des Iles underground mine, with an average palladium grade of 5.36 grams per tonne, compared to 193,752 tonnes with an average palladium grade of 5.49 grams per tonne during the same period last year. For the six months ended June 30, 2007, underground production was 396,079 tonnes at an average palladium grade of 5.71 grams per tonne. Comparisons against the first half of 2006 are not meaningful as the underground mine only achieved commercial production in the second quarter of 2006. In the Lac des Iles open pit operation, 1,082,742 tonnes of ore were extracted with an average palladium grade of 1.74 grams per tonne for the three months ended June 30, 2007, compared to 920,997 tonnes at an average palladium grade of 1.66 grams per tonne. Over this period, the strip ratio substantially improved to 1.75:1, compared to 2.78:1 in the same period for 2006. For the six months ended June 30, 2007 the strip ratio improved to 1.65:1 compared to 2.50:1 in the comparable period for 2006.



During the three months ended June 30, 2007, the mill processed 1,244,067 tonnes of ore at an average of 13,671 tonnes per day, producing 66,651 ounces of palladium. Over the same period in 2006, the mill processed 1,101,543 tonnes of ore at an average of 12,105 tonnes per day, producing 57,326 ounces of palladium. The average palladium head grade was 2.26 grams per tonne in the second quarter of 2007, compared to 2.22 grams per tonne in the corresponding period of 2006. For the six months ended June 30, 2007, mill production was 2,532,607 tonnes, producing 145,555 ounces of palladium with an average palladium head grade of 2.38 grams per tonne, compared to 2,227,253 tonnes, producing 104,341 ounces of palladium at an average palladium headgrade of 2.00 grams per tonne during the same period last year. In the second quarter of 2007, palladium recoveries were 73.5% as compared to 73.1% in second quarter of 2006, while mill availability in the period improved to 89.9% compared to 83.1%. This improvement in production was achieved despite a number of power outages in May and June caused by lightning strikes, which resulted in unscheduled downtime to the primary crusher and the #1 ball mill. The mill's results reflect the continual improvement to the throughput and availability by the Company identifying and systematically resolving issues. As reported in the fourth quarter of 2006, a team of dedicated employees at the Lac des Iles site has made improvements to the flotation circuit, implemented proactive preventative maintenance programs, made changes to the mill flow sheet and the reagent mix, and improved the quality of recycled water.

Total production costs for the three months ended June 30, 2007 of \$32.4 million increased from the \$28.3 million in the prior year, reflecting the full ramp up of underground mine as well as costs associated with unplanned maintenance related to the downtime caused by the lightning strikes described above. For the six months ended June 30, total production costs increased from \$52.6 million in 2006 to \$65.7 million in 2007, mainly due to the inclusion of the underground mine production costs for the three months ended March 31, 2007, which were capitalized as pre-production costs for the corresponding period in 2006. 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, increased to US\$242 per ounce in the second quarter of 2007 compared to US\$219 per ounce in the corresponding period in 2006. The increase in unit cash costs was primarily the result of the increased costs related to the maintenance issues and impact of the strengthening Canadian dollar on both costs and by-product revenue realized. In addition there continues to be upward pressure on the cost of materials, 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.

Non-cash amortization increased to \$11.9 million in the second quarter of 2007 compared to \$7.5 million in the corresponding period in 2006. The higher amortization is attributable to the 16% increase in palladium production, as well as the adjustment in the mine plan that was effective from the fourth quarter of 2006, and that resulted in an increase in the unit of production amortization rate. For the six months, amortization increased to \$23.8 million compared to \$11.1 million in 2006 reflecting the 39% increase in palladium production, the aforementioned adjustment in rates, as well as the inclusion in the first quarter 2007 amortization of the underground mine development costs, which commenced commercial production in April 2006.





Exploration expense was \$0.8 million in the second quarter of 2007 compared to \$2.7 million in the corresponding period last year and \$4.0 million for the first six months of 2007, compared to \$4.7 million during the same period last year. Included in the 2007 year to date expense is \$1.8 million spent on the Arctic Platinum Project ("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 Offset High Grade Zone ("OHGZ") at the Lac des Iles mine. Diamond drilling commenced in the second quarter of 2007 and the goal of this program is to provide detailed information as to the metals distribution for the upper portion of the OHGZ. Work continues on the Shebandowan 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 third quarter of 2007.

For the three months ended June 30, 2007, there was a \$9.2 million loss from mining operations compared to a \$9.1 million loss in the corresponding period of 2006. This loss was mainly attributable to increased production costs for the unplanned maintenance, increased amortization as a result of the increased production and, in particular, the reduction in revenue as a result of the strengthening Canadian dollar, partially offset by the improved production and higher metals prices compared to the second quarter of 2006.

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 \$0.3 million in second quarter of 2007 compared to \$2.7 million in the corresponding period of 2006. The decrease in 2007 is mainly due to \$4.4 million foreign exchange gain which relates primarily to the Company's US dollar denominated credit facilities and the convertible notes. For the six months ended June 30, 2007, other income and expense was an expense of \$6.2 million, compared to \$4.1 million in the same period for 2006. The main reason for the year to date increase is the recognition of non-cash accretion expenses of \$4.3 million relating to the convertible notes payable in the first quarter of 2007, (2006 - \$nil). For the second quarter of 2007, the Company incurred interest expense on long-term debt of \$1.2 million compared to \$1.4 million in the same period last year. The reduced interest expense in the current quarter is attributable to the reduced borrowings on the long term debt and the favourable exchange impact since most of the long term debt is US dollar denominated. For the six months ended June 30, 2007, interest expense is \$2.7 million, an increase from the \$2.1 million for the same period in 2006, as a result of the additional interest expense incurred on the convertible notes payable which commenced in April, 2006. To date, this expense has been settled with the issue of common shares (2007 - 183,396 shares issued; 2006 - 43,772 shares issued), pursuant to the convertible note holders' directions. Interest income in the second quarter of 2007 was \$0.2 million and \$0.3 million for the six months compared to \$0.4 million and \$0.5 million for the comparable periods in 2006.

For the three months ended June 30, 2007, the Company reported a net loss of \$9.1 million or \$0.17 per share compared to net loss of \$11.3 million or \$0.22 per share for the three months ended June 30, 2006. For the six months ended June 30, 2007 the net loss was \$3.6 million compared to a net loss of \$15.5 million in the same period last year.

Compared to the first quarter of 2007, revenue declined by \$23.9 million. The decrease reflects a combination of lower production volumes (66,651 oz of palladium in Q2 2007 vs. 78,805 oz palladium in Q1 2007), lower commodity prices and the strengthening of the Canadian dollar. Despite the lower production volumes in the second quarter of 2007, the Company has reiterated its year 2007 production target of approximately 290,000 ounces of palladium. The negative mark-to-market adjustment in the second quarter of 2007 was \$8.9 million (\$2.4 million negative price adjustment and a negative foreign



exchange adjustment of \$6.5 million) compared to a positive mark-to-market adjustment in the first quarter of 2007 of \$8.1 million (\$9.1 million positive price adjustments and \$1.0 million negative foreign exchange adjustment).

## LIQUIDITY AND CAPITAL RESOURCES

Cash provided by operations<sup>1</sup> (prior to changes in non-cash working capital) was \$12.9 million in the three months ended June 30, 2007, compared to cash used in operations of \$1.0 million in 2006. The \$13.9 million improvement was mainly attributable to increased production and higher metals prices from palladium, partially offset by the strengthening Canadian dollar and increased costs reflecting the full ramp up of underground mine as well as the costs associated with the unplanned maintenance related to the lightning strikes. For the six months ended June 30, 2007, cash provided by operations<sup>1</sup> was \$35.9 million, an improvement of \$37.1 million from the prior year when cash used from operations was \$1.2 million. This was a result of the improved revenue from all metals as a result of the increased volumes and pricing achieved in the six months ended June 30, 2007, which more than offset the increase in operating 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 \$9.5 million of cash in the three months ended June 30, 2007, as compared to \$16.2 million for the corresponding period of 2006. For the six months non-cash working capital required \$30.4 million compared to \$26.3 million in 2006. Palladium awaiting settlement increased to 142,883 ounces at June 30, 2007 compared to 129,496 ounces at December 31, 2006. The increase in the physical quantities of metal in the concentrate awaiting settlement, combined with the higher prices used to value the concentrate awaiting settlement, offset by the strengthening Canadian dollar resulted in a \$16.8 million (20%) increase in the value of concentrate awaiting settlement as at June 30, 2007, compared to December 31, 2006. After allowing for non-cash working capital changes, cash provided by operations was \$3.4 million in the three months ended June 30, 2007 compared to cash usage of \$17.1 million in the three months ended June 30, 2006 and for the six months ended June 30, 2007, cash provided by operations was \$5.5 million, compared to cash usage of \$27.6 million in 2006.

As at June 30, 2007 the Company had a liability of \$8.9 million (US\$8.4 million) from Auramet Trading, LLC, ("Auramet") under the palladium and platinum advance purchase facility.

On February 27, 2007, the Company completed a private placement of 550,000 flow-through common shares at \$11.00 per share for gross proceeds of \$6.0 million. These proceeds will be used to expedite work on the Shebandowan Project.

Investing activities required \$4.1 million of cash in the second 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 \$3.7 million of net investing activities in the same period last year, which was mainly related to the underground mine development. For the six months ended June 30, 2007, investing activities required \$8.6 million compared to \$11.1 million in the comparable period last year.

The Company's debt position reduced to \$65.6 million at June 30, 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. In addition the first two principle payments related to Tranche I of the convertible notes totaling US\$7.8 million were made. These payments were settled in a non-cash transaction by the issuance of 983,376 common shares. In addition, the strengthening Canadian dollar resulted in an unrealized foreign exchange gain from revaluation of both the long term debt and the convertible notes at June 30, 2007 of \$4.6 million.

On October 12, 2006 the Company closed a transaction with Kaiser-Francis for a US\$5.0 million short term working capital loan maturing December 31, 2006. The interest rate under the loan was the 30-day

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





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 Kaiser-Francis a first priority security interest on the inventory and receivables of the Company. On December 13, 2006 the maturity date was extended to March 31, 2007, with no other change in terms. The Company paid a commitment fee of US\$25 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 June 30, 2007, the Company had cash of approximately \$4.5 million (December 31, 2006 – \$3.2 million) and working capital of \$64.7 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, on January 19, 2007 the Company entered into a platinum and palladium advance purchase facility with Auramet Trading, LLC 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 June 30, 2007, the Company had outstanding advances from Auramet of \$8.9 million (US \$8.3 million). Metals in settlement of this advance will be delivered in July and August and as at June 30, 2007 the Company had an obligation to deliver 22,000 ounces of palladium and 1,000 ounces of platinum in satisfaction of these outstanding advances. The Company is continuing to review various other financing options.

#### CONTRACTUAL OBLIGATIONS

As at June 30, 2007 (thousands of dollars)	Total	Payments Due by Period		
		1 Year	1-3 Years	4-5 Years
Senior credit facility	\$ 13,434	\$ 6,218	\$ 7,216	\$ -
Capital lease obligations	4,686	1,835	2,851	-
Convertible notes payable	38,583	29,324	9,259	-
Interest obligations	2,404	1,441	963	-
Operating leases	3,744	1,515	1,876	353
Other purchase obligations	1,911	1,911	-	-
	\$ 64,762	\$ 42,244	\$ 22,165	\$ 353

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 nil in 2007, compared to \$0.6 million in 2006. 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 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. Kaiser-Francis holds approximately 48% of the common shares of the Company.

#### REVIEW OF OPERATIONS AND PROJECTS

##### Lac des Isles – Operations and Exploration Activity

The Company commenced the development of an underground mine at its Lac des Isles operation in the second quarter of 2004. Commercial production from the underground operations commenced on April 1, 2006 and, as of this date, production from the underground operations has been reflected in



the operating results of the Company. The development and mining of the underground is proceeding according to plan. As with all new underground operations, the mine has encountered some localized changes in ground conditions, water inflows, etc. However, these have been identified and mitigated so as not to affect safety and current production levels.

The Company continues its exploration of the Offset High Grade Zone ("OHGZ"), located approximately 250 metres to the southeast of the current underground mine at Lac des Iles. Drilling from the exploration drift commenced 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. (see press release dated April 2, 2007) comprising the OHGZ and the Roby Footwall Zone. This estimate suggests an indicated mineral 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. At this time, no mineral reserve estimates have been made for the OHGZ and, consequently, no decision has been made to extend the current underground mine to the OHGZ and/or build a shaft to access the OHGZ. However, early in the third quarter of 2007, the Company engaged two consulting firms to conduct a Preliminary Economic Assessment of three potential exploitation/operating scenarios for the OHGZ. The Company expects to receive the Preliminary Economic Assessment by the end of 2007.

In the Lac des Iles open pit, management is currently considering the viability of a Phase V pushback of the pit, with a view to extending its mine life. Pursuit of this option would likely require sustained favourable economic conditions during the pushback. The expanded open pit could provide supplemental mill feed for a possible OHGZ underground mine and allow the mine to operate at current production levels for additional years beyond the current planned mine life.

#### **Other Exploration Activity**

In addition to the operations and exploration activities around the Lac des Iles mine site, the Company continues to pursue new PGM and nickel-copper opportunities. The Company is party to an option and joint venture agreement with Inco Limited (now CVRD Inco) entitling it to earn a 50% interest in the Haines-Conacher property and the past producing Shebandowan mine (the "Shebandowan Project"). The Shebandowan Project is a nickel-copper-PGM property 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 is underway, which will disclose the results of a mineral resource estimate by an independent Qualified Person. Management is confident that it will satisfy the conditions of the earn-in before the end of 2007. The Company is currently assessing the capital expenditure requirements to refurbish its old mill at Lac des Iles to process ore from Shebandowan. The old mill could add up to 2,500 tpd to the milling capacity at the Lac des Iles site.

The Company is also active satisfying the conditions of its 60% earn-in right at the Arctic Platinum Project ("APP") in Finland (subject to a back-in right in favour of Gold Fields which, if exercised, would decrease the Company's interest to 49.9%). 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 issue Gold Fields approximately 9.2 million common shares (for a 60% interest) on or before August 31, 2008. As at June 30, 2007, the Company has incurred \$8.5 million (US\$8.0 million) in expenditures on the APP and these costs have been charged as exploration expenses.

Diamond drills were mobilized into the Narkaus area in 2006 to commence exploration and infill drilling on the Siika-Kama, Kuohunki and Nutturalampi targets. Forty-nine holes totaling 8,716 metres were completed and the results from this program were released on October 30, 2006 and on June 1, 2007. Revised resource models have been completed for Suhanko, which was the subject of a previous feasibility study carried out by Gold Fields in 2005. A program of in-fill drilling was completed at the Ahmavaara deposit in 2007 and Phase I results were released July 12, 2007. The results of approximately 12,000 metres of a Phase II drilling program will be released in the third quarter of 2007, following

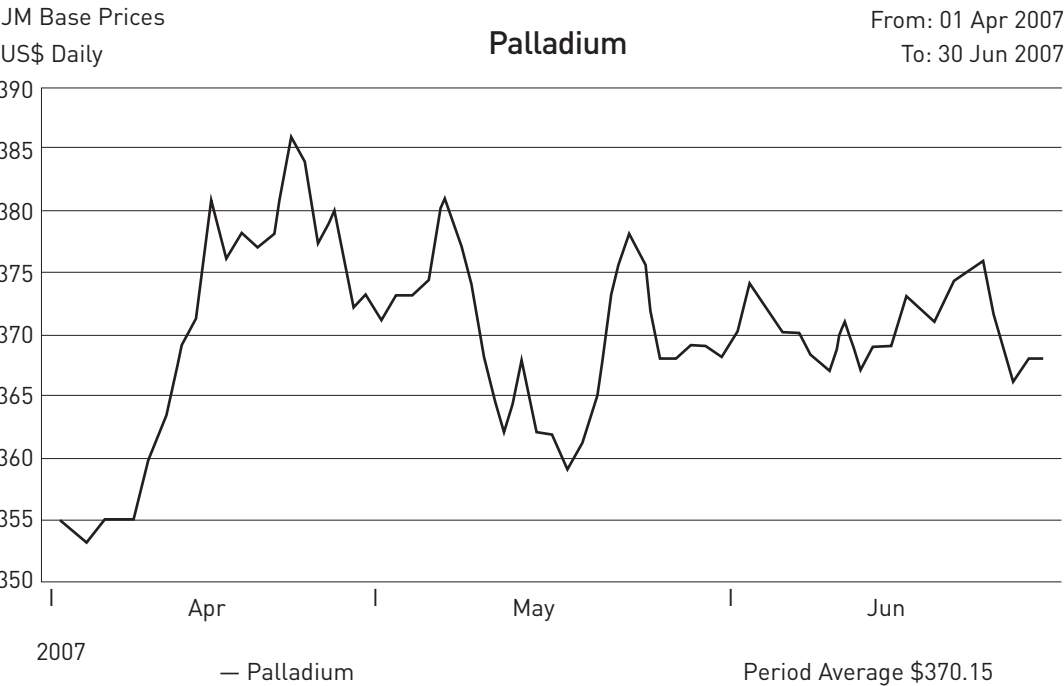


receipt of assay results and completion of the Company's quality assurance/quality control procedures. The results of the 2007 in-fill drilling programs will be incorporated into an updated mineral resource estimate. The Company expects that the results of the re-scoping study will be disclosed following completion of its due diligence review.

**Metals Marketing**

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 June 30, 2007, the Company realized a weighted average cash price of US\$356 per ounce on its physical deliveries of palladium into the spot market. The Company expects that palladium prices will continue to be at or near current levels for 2007. The average spot price was US\$370 per ounce for the second quarter of 2007 (reaching a high of US\$388), compared to an average price of US\$346 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, as indicated in the chart below from Johnson Matthey.

Source: Johnson Matthey



For the three months ended June 30, 2007, the Company recorded by-products metals revenue of \$22.6 million representing 51% of revenue in the quarter. Of the by-product metals revenue, nickel was \$9.3 million or 21% of revenue for the three months ended June 30, 2007.

During 2007 and throughout 2006, the Company sold metal into the spot market. The Company does not currently enter into commodity or foreign exchange hedging arrangements.

**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 second quarter of 2007 was 66,651 ounces of palladium with an average palladium head grade of 2.26 grams per tonne, and represents a 16% increase over the previous year's second quarter production of 57,326 ounces, with a headgrade of 2.22 grams per tonne. This continues the trend of improved volumes and head grade year over year reflecting the impact of the underground mine which



has been in commercial production since the second quarter of last year. During the second quarter, the underground mine averaged 2,141 tonnes per day at an average head grade of 5.36 grams per tonne.

The year-over-year production volume increases were achieved despite the impact of power outages in May and June resulting from lightning strikes that produced unscheduled downtime to the primary crusher and #1 ball mill, reducing throughput. The Company has implemented changes in its operating procedures to minimize the risk of damage from further disruptions in electrical supply. Operations were otherwise on target with mill availability for the quarter, averaging approximately 90% compared to 83% in the same period last year. The Company is on course to meeting its year end production target of approximately 290,000 ounces, with a full year of production from the underground mine.

The Company's intensive core drilling 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 study scheduled to be completed by the end 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. 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 technological advances which could 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) Impairment assessments of long-lived assets**

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

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

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

##### **(b) Amortization of mining interests**

The Company amortizes a large portion of its mining interests using the unit of production method based on proven and probable reserves.

##### **(c) 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.

**(d) Mine Restoration Obligation**

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

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

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

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

**(b) Capital Disclosures**

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

**OUTSTANDING SHARE DATA**

As of August 7th, 2007, there were 55,481,475 common shares of the Company outstanding and options outstanding pursuant to the 1995 Corporate Stock Option Plan entitling holders thereof to acquire 376,633 common shares of the Company at an average strike price of \$9.94.

**RISKS AND UNCERTAINTIES**

The price of palladium is the most significant factor influencing the profitability of the Company. In the six months ended June 30, 2007, sales of palladium accounted for approximately 47% (June 30, 2006 – approximately 47%) of the Company's revenue. Many factors influence the price of palladium, including global supply and demand, speculative activities, international political and economic conditions and production levels and costs in other PGM producing countries, particularly Russia and South Africa. The possible development of a substitute alloy or synthetic material, which has catalytic characteristics similar to platinum group metals, may result in a future decrease in demand for palladium and platinum.

Currency fluctuations 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 Canadian dollar relative to the United States dollar has a negative impact on the Company's revenue and profitability.

The Company is dependent on one mine for its metal production. The business of mining is generally subject to risks and hazards, including environmental hazards, industrial accidents, metallurgical and other processing problems, unusual and unexpected rock formations, pit slope failures, flooding



and periodic interruptions due to inclement weather conditions or other acts of nature, mechanical equipment and facility performance problems and the availability of materials and equipment. These risks could result in damage to, or destruction of, the Company's properties or production facilities, personal injury or death, environmental damage, delays in mining, monetary losses and possible legal liability. Although the Company maintains insurance in respect of the mining operations that is within ranges of coverage consistent with industry practice, such insurance may not provide coverage of all the risks associated with mining. Currently the Company sells all of its concentrate to one smelting firm under a contract that was renegotiated during the second quarter of 2007 for a three-year term that expires on March 31, 2010. This agreement may be extended on an annual basis for an additional two years by mutual agreement of both parties if such agreement is reached no later than six months prior to the anniversary date of March 31, 2010.

#### **DISCLOSURE CONTROLS AND PROCEDURES**

Management is responsible for the information disclosed in this management's discussion and analysis and has in place the appropriate information systems, procedures and controls to ensure that information used internally by management and disclosed externally is, in all material respects, complete and reliable. As at the period ended June 30, 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 reviews. 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 June 30, 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.

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 reviews. Our external auditors have not conducted a review or audit of the controls or the documentation relating to this initiative.

#### **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).

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

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





current period and are a better indication of its expected performance in future periods. This data is intended to provide additional information and should not be considered in isolation or as a substitute for measures of performance prepared in accordance with Canadian GAAP. The following 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 June 30

(thousands of dollars except per ounce amounts)	2007	2006
Production costs including overhead	\$ 32,438	\$ 28,289
Smelter treatment, refining and freight costs	5,733	4,237
	38,171	32,526
Less: by-product metal revenue	(22,638)	(20,578)
	15,533	11,948
Divided by ounces of palladium	60,435	48,977
Cash cost per ounce (C\$)	257	244
C\$ exchange rate	1.0631	1.1151
Cash cost per ounce (US\$)	242	219

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

	2007	2006	2007	2006
	Three months ended June 30		Six months ended June 30	
Operating Cash Flow	\$ 12,865	\$ (965)	\$ 35,902	\$ (1,225)
Changes in Non-cash Working Capital	(9,486)	(16,159)	(30,390)	(26,343)
Cash Provided by Operating Activities	\$ 3,379	\$ (17,124)	\$ 5,512	\$ (27,568)

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

**CAUTIONARY STATEMENT ON FORWARD-LOOKING INFORMATION**

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



# Consolidated Balance Sheets

(expressed in thousands of Canadian dollars)

	<b>June 30 2007</b>	December 31 2006
	(unaudited)	
<b>ASSETS</b>		
<b>Current Assets</b>		
Cash	\$ 4,505	\$ 3,153
Concentrate awaiting settlement, net – Note 3	98,814	82,050
Taxes recoverable	252	145
Inventories	14,606	14,164
Current portion of crushed and broken ore stockpiles	8,862	7,134
Other assets	1,436	2,602
	<b>128,475</b>	109,248
Mining interests, net	130,757	146,617
Mine restoration deposit	8,151	8,041
Crushed and broken ore stockpiles	383	289
Deferred financing costs – Note 10	-	962
	<b>\$ 267,766</b>	<b>\$ 265,157</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current Liabilities</b>		
Accounts payable and accrued liabilities	\$ 17,306	\$ 21,526
Advance purchase facility – Note 9 (a)	8,868	-
Future mining tax liability	186	149
Current portion of obligations under capital leases	1,835	2,104
Current portion of convertible notes payable – Note 4	29,324	22,148
Current portion of long-term debt – Note 5	6,218	6,662
Kaiser Francis credit facility – Note 5	-	5,827
	<b>63,737</b>	58,416
Mine restoration obligation	8,707	8,211
Obligations under capital leases	2,851	4,111
Convertible notes payable – Note 4	9,259	23,062
Long-term debt – Note 5	7,216	10,992
Future mining tax liability	1,439	381
	<b>93,209</b>	105,173
Shareholders' Equity		
Common share capital and common share purchase warrants – Note 6	357,625	339,743
Equity component of convertible notes payable, net of issue costs – Note 4	10,138	12,336
Contributed surplus – Note 6	3,717	1,269
Deficit	(196,923)	(193,364)
Total shareholders' equity	174,557	159,984
	<b>\$ 267,766</b>	<b>\$ 265,157</b>

Commitments – Notes 1 and 9



# Consolidated Statements of Operations and Deficit

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

	Three months ended June 30		Six months ended June 30	
	2007	2006	2007	2006
<b>Revenue from metal sales – before pricing adjustments</b>	<b>\$ 53,451</b>	<b>\$ 36,698</b>	<b>\$ 113,755</b>	<b>\$ 61,054</b>
Pricing adjustments – commodities	(2,421)	566	6,720	7,518
Pricing adjustments – foreign exchange	(6,535)	(1,745)	(7,541)	(1,561)
<b>Revenue from metal sales – Note 8</b>	<b>44,495</b>	<b>35,519</b>	<b>112,934</b>	<b>67,011</b>
<b>Operating expenses</b>				
Production costs, excluding amortization and asset retirement costs	32,438	28,289	65,690	52,600
Smelter treatment, refining and freight costs	5,733	4,237	10,995	6,951
Amortization	11,923	7,538	23,831	11,135
Administrative	2,321	1,584	4,017	3,763
Exploration expense	798	2,659	4,026	4,683
Loss on disposal of equipment	-	194	-	194
Asset retirement costs	498	132	677	255
Total operating expenses	53,711	44,633	109,236	79,581
<b>Income/(loss) from mining operations</b>	<b>(9,216)</b>	<b>(9,114)</b>	<b>3,698</b>	<b>(12,570)</b>
<b>Other expenses (income)</b>				
Interest on long-term debt, capital leases and convertible notes payable	1,162	1,423	2,704	2,118
Foreign exchange loss (gain)	(4,355)	(955)	(4,981)	(674)
Interest income	(187)	(380)	(270)	(463)
Accretion expense relating to convertible notes payable – Note 4	3,250	2,460	7,512	2,460
Interest expense	216	-	756	-
Deferred financing costs	219	144	441	659
Total other expenses	305	2,692	6,162	4,100
<b>Loss before income taxes</b>	<b>(9,521)</b>	<b>(11,806)</b>	<b>(2,464)</b>	<b>(16,670)</b>
Income tax expense (recovery)	(455)	(481)	1,095	(1,204)
<b>Loss for the period</b>	<b>(9,066)</b>	<b>(11,325)</b>	<b>(3,559)</b>	<b>(15,466)</b>
Deficit, beginning of period	(187,857)	(163,396)	(193,364)	(159,255)
Deficit, end of period	\$ (196,923)	\$ (174,721)	\$ (196,923)	\$ (174,721)
<b>Loss per share</b>				
Basic	\$ (0.17)	\$ (0.22)	\$ (0.07)	\$ (0.30)
Diluted	\$ (0.17)	\$ (0.22)	\$ (0.07)	\$ (0.30)
<b>Weighted average number of shares outstanding</b>				
Basic	54,410,210	52,371,162	53,749,822	52,293,401
Diluted	54,410,210	52,371,162	53,749,822	52,293,401



# Consolidated Statements of Cash Flows

(expressed in thousands of Canadian dollars)  
(unaudited)

	Three months ended June 30		Six months ended June 30	
	2007	2006	2007	2006
<b>Cash provided by (used in)</b>				
<b>Operations</b>				
Loss for the period	\$ (9,066)	\$ (11,325)	\$ (3,559)	\$ (15,466)
Operating items not involving cash				
Accretion expense relating to				
convertible notes payable	3,250	2,460	7,512	2,460
Amortization	11,923	7,538	23,831	11,135
Amortization of deferred financing costs	219	144	441	155
Interest settled on convertible notes	1,007	395	1,581	395
Accrued interest on mine restoration deposit	(110)	(84)	(110)	(84)
Unrealized foreign exchange (gain) loss	3,478	(582)	3,409	(526)
Asset retirement costs	498	132	677	255
Future income tax expense (recovery)	1,050	(295)	1,095	(1,130)
Write-off of deferred financing costs	-	-	-	504
Stock based compensation and				
employee benefits	616	458	1,025	883
Loss on disposal of equipment	-	194	-	194
	12,865	(965)	35,902	(1,225)
Changes in non-cash working capital – Note 7	(9,486)	(16,159)	(30,390)	(26,343)
	3,379	(17,124)	5,512	(27,568)
<b>Financing Activities</b>				
Advances under purchase facility	4,453	-	8,868	-
Issuance of common shares	-	3,446	5,703	3,921
Repayment of long-term debt	(1,562)	(1,625)	(9,042)	(3,295)
Repayment of obligations under				
capital leases	(539)	(597)	(1,082)	(1,175)
Mine restoration deposit	-	(300)	-	(600)
Issuance of convertible notes	-	-	-	41,037
Increase in long term debt and credit facility	-	-	-	2,311
Deferred financing costs	-	(227)	-	(2,364)
	2,352	697	4,447	39,835
<b>Investing Activities</b>				
Additions to mining interests	(4,148)	(3,649)	(8,607)	(11,084)
Increase (decrease) in cash and cash equivalents	1,583	(20,076)	1,352	1,183
Cash and cash equivalents, beginning of period	2,922	36,290	3,153	15,031
Cash and cash equivalents, end of period	\$ 4,505	\$ 16,214	\$ 4,505	\$ 16,214



# Notes to the Consolidated Financial Statements

for the six months ended June 30, 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, Canada. The Company also has 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. 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 issue Gold Fields approximately 9.2 million of the Company's common shares (for a 60% interest) on or before August 31, 2008. As at June 30, 2007, the Company has incurred \$8,545 (US\$8,038) 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 CVRD Inco 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 disclosing the results of a mineral resource estimate by an independent Qualified Person is in progress.

## 2. BASIS OF PRESENTATION

These unaudited consolidated financial statements have been prepared using disclosure standards appropriate for interim financial statements and do not contain all the explanatory notes, descriptions of accounting policies or other disclosures required by Canadian generally accepted accounting principles for annual financial statements. Such notes, descriptions of accounting policies and other disclosures are included in the Company's audited annual consolidated financial statements included in the Company's annual report to shareholders for the year ended December 31, 2006. 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 October 2006 and June 2007, which are in-process at the balance sheet date, net of refining and smelter treatment



charges. At June 30, 2007, concentrate awaiting settlement included 142,683 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. All of the concentrate awaiting settlement is being processed by one domestic customer at June 30, 2007 and the Company expects full realization will occur on such receivables.

#### 4. CONVERTIBLE NOTES PAYABLE

	June 30, 2007	December 31, 2006
Series I convertible notes (principal amount US\$35 million, maturing August 1, 2008)	\$ 25,795	\$ 32,048
Series II convertible note (principal amount US\$13.5 million, maturing December 1, 2008)	13,238	13,162
	39,033	45,210
Less: transaction costs	(450)	-
	38,583	45,210
Less: current portion	(29,324)	(22,148)
	\$ 9,259	\$ 23,062

On March 29, 2006, the Company issued US\$35,000 (C\$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") consisted 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 on or before June 30, 2006. On June 23, 2006, the Company exercised this right and issued to KFOC a US\$13,500 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 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 applicable payment date. The Company has the right to defer any principal repayment in cash until a





later principal repayment date. There is no limit on the length of the deferral, other than it cannot be deferred later than the final maturity date. The Company must give five (5) business days prior notice of its intention to defer principal repayments.

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

## 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 250 basis points, or 7.87% at June 30, 2007. As at June 30, 2007, the outstanding long-term debt, including current and long-term portions (net of transaction costs) was \$13,434 (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 was 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.

## 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) The following summary sets out the activity in common shares and common share purchase warrants for the six months ended June 30, 2007:

	Shares	Amount
Common shares issued, December 31, 2006	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	70,867	611
For interest payments on convertible notes payable	183,396	1,581
For principal payments on convertible notes payable	983,376	9,977
Private placement – flow-through shares (net)	550,000	5,686
Common shares issued, June 30, 2007	54,740,332	\$ 349,587
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, June 30, 2007		\$ 357,625

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 June 30, 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 June 30, 2007, the Company has spent \$1,842 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 June 30, 2007, 16,667 restricted share units are outstanding. The fair value of the restricted share units as at June 30, 2007 is \$10.03 per unit and \$102 has been charged to compensation expense for the six months ended June 30, 2007.

#### **(d) Corporate Stock Option Plan**

The following summary sets out the activity in outstanding common share stock options for the six months ended June 30, 2007:

	Shares	Weighted-Average Exercise Price
Outstanding, beginning of period	360,133	\$ 10.24
Granted	117,500	9.16
Exercised	(5,000)	3.42
Cancelled	(96,000)	10.46
Outstanding, end of period	376,633	\$ 9.94
Options exercisable, end of period	167,800	\$ 11.09

The Company recognized a stock based compensation expense of \$272 for the six months ended June 30, 2007 (June 30, 2006 – \$326).



## (e) Contributed Surplus

The following summary sets out the changes in contributed surplus for the six months ended June 30, 2007:

	2007	2006
Opening balance	\$ 1,269	\$ 874
Stock compensation	249	143
Equity component of convertible notes	2,199	-
Balance at end of period	\$ 3,717	\$ 1,017

## 7. CHANGES IN NON-CASH WORKING CAPITAL

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

	Three Months ended June 30		Six Months ended June 30	
	2007	2006	2007	2006
Cash provided by (used in):				
Concentrate awaiting settlement	\$ (2,879)	\$ (12,819)	\$ (25,264)	\$ (24,960)
Inventories and stockpiles	(2,482)	(964)	(1,810)	(201)
Other assets	335	572	1,166	839
Accounts payable and accrued liabilities	(2,907)	(2,720)	(4,375)	(1,764)
Taxes payable	(1,553)	(228)	(107)	(257)
	\$ (9,486)	\$ (16,159)	\$ (30,390)	\$ (26,343)

## 8. REVENUE FROM METAL SALES

	Three Months ended June 30		Six Months ended June 30	
	2007	2006	2007	2006
Palladium	\$ 21,857	\$ 14,941	\$ 52,963	\$ 31,716
Nickel	9,337	6,480	28,645	11,169
Platinum	6,228	6,862	16,173	12,031
Gold	2,202	2,249	5,478	4,240
Copper	4,115	4,691	8,239	7,345
Other metals	756	296	1,436	510
	\$ 44,495	\$ 35,519	\$ 112,934	\$ 67,011

## 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, at the Company's option, 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 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 June 30, 2007 is \$8,868, (US\$8,342).

#### **(b) Forward Contracts**

The Company may enter 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 forward 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, and requires changes in accounting policy to be applied retrospectively and 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; and Section 3861, Financial Instruments-Disclosure and Presentation. The adoption of these new standards resulted in changes in the presentation for financial instruments as described below. As required by the implementation of these new standards, the prior period consolidated financial statements have not been restated. The principal changes in the accounting for financial instruments arising from the adoption of these accounting standards are described below.

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

Section 1530 requires a statement of comprehensive income, which consists of net income and other comprehensive income ("OCI"). OCI is a new requirement to temporarily present certain gains and losses from changes in fair value outside of net income. There has been no impact of this pronouncement for the period ended June 30, 2007, accordingly the Company's net income and comprehensive income are equal.

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

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

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

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

#### **Loans and receivables**

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

#### **Other liabilities**

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

**Embedded derivatives**

Derivatives embedded in other financial instruments or contracts are separated from their host contracts and accounted for as derivatives when their economic characteristics and risk are not closely related to those of the host contract; the terms of the embedded derivatives are the same as those of the free-standing derivatives; and the combined instrument or contract is not measured at fair value, with changes in fair value recognized in income. These embedded derivatives are measured at fair value with changes therein recognized in the statement of earnings. As at June 30, 2007 and December 31, 2006, the Company has separated the early repayment call and put options on the Company's convertible notes payable. The fair value of the early repayment and put option was determined to be nominal and therefore there was no impact on the financial statements as a result of the bifurcation of these embedded derivatives.

**Classification of financial instruments**

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

- (i) Concentrate awaiting settlement, net and other assets are classified as loans and receivables.
- (ii) All financial liabilities as other financial liabilities.

**Deferred Financing Costs**

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. 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 and a decrease in the long-term debt of \$107 and a decrease in deferred financing costs of \$962.

**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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