



Why Palladium?



Rarity + Value



Palladium is one of the six platinum group metals (PGMs), which are platinum, palladium, osmium, ruthenium, iridium and rhodium. These metals are distinguished by their superior conductivity and ductility, resistance to oxidation and corrosion, their strength and durability, strong catalytic properties and high melting points. These unique characteristics are the reason for the PGMs being called the “noble metals” in the periodic table of elements.

Because of its unique properties, palladium is used in a variety of industries. Demand for palladium continues to be driven primarily by the autocatalyst industry. In 2005, the autocatalyst sector accounted for an estimated 49% of palladium’s demand. The largest and fastest growing increase in palladium demand was witnessed in the jewellery sector, where palladium usage increased to 19% as consumers began to seek alternatives to platinum and white gold. Palladium continues to be used in the electronics (13%), dental (11%), and chemical (4%) sectors.

NAP AT A GLANCE



NORTH AMERICAN PALLADIUM LTD. IS CANADA'S ONLY PRIMARY PRODUCER OF PALLADIUM. THE COMPANY'S LAC DES ILES OPEN PIT MINE, LOCATED 85 KILOMETRES NORTHWEST OF THUNDER BAY IN NORTHERN ONTARIO, ALSO PRODUCES, AS BY-PRODUCTS, PLATINUM, GOLD, COPPER AND NICKEL.

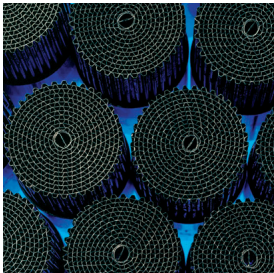


Photo courtesy of: Johnson Matthey PLC

DID YOU KNOW?

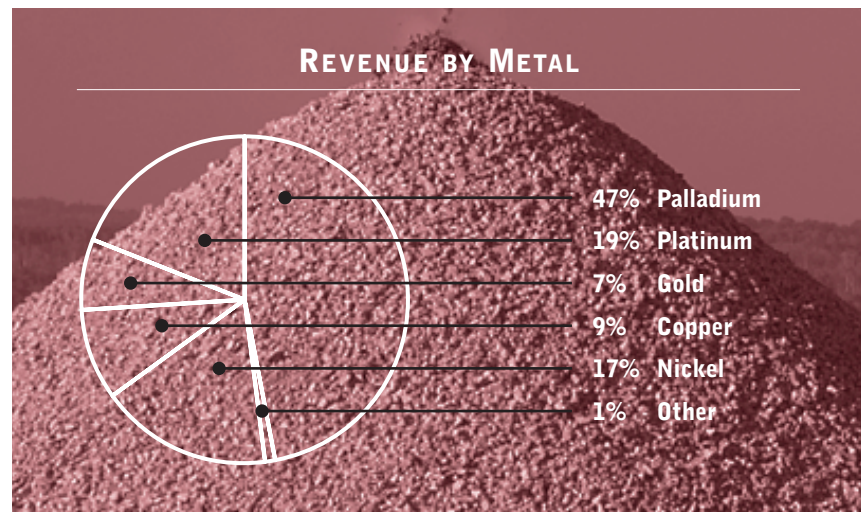
Palladium absorbs large amounts of hydrogen. It is used as a purification filter for hydrogen and a catalyst in hydrogenation.

An underground mine at Lac des Iles will begin full production by the end of the first quarter of 2006. The Lac des Iles deposit contains one of the largest open pit bulk mineable palladium reserves in the world.

The Company's mandate includes, as well as operating its

Lac des Iles mining and milling facility, the expansion of production through an aggressive exploration campaign aimed at increasing exposure to base and precious metals, both in Canada and internationally.

North American Palladium common shares trade on the TSX:PDL and the AMEX:PAL.



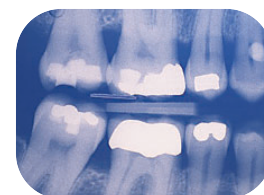
THE LAC DES ILES DEPOSIT CONTAINS ONE OF THE **LARGEST** OPEN PIT BULK MINEABLE PALLADIUM RESERVES IN THE WORLD.

OUR MAJOR LOCATIONS



DID YOU KNOW?

11% of palladium demand comes from the dental industry.



North American Palladium is active at:

- **LYNN LAKE, MANITOBA** – Option joint venture agreement with Rare Earth Metals Corp.
- **BIRD RIVER, MANITOBA** – Option joint venture agreement with Gossan Resources to earn up to a 75% interest in the Bird River property.
- **LAC DES ILES, ONTARIO** – One of the world's largest open pit bulk mineable palladium reserves; an underground mine is being brought on stream in 2006 to complement open pit production, while ongoing drilling of the Offset High Grade Zone is expanding resources.
- **SHEBANDOWAN, ONTARIO** – Option joint venture agreement with Inco Limited on ground surrounding the past-producing Shebandowan mine (nickel, copper, PGMs).
- **TYKO BULLDOZER, ONTARIO** – Two properties covering several grass roots nickel-copper-PGM prospects.
- **SHAKESPEARE, ONTARIO** – Option joint venture agreement with URSA Major Minerals on a nickel-copper-PGM property.
- **TORONTO, ONTARIO** – Corporate office.
- **ROVANIEMI, FINLAND** – Option joint venture with Gold Fields on an advanced stage PGM property.

DID YOU KNOW?

Due to its unique properties, palladium is alloyed for use in electrical components.



MESSAGE FROM THE CHAIRMAN



ANDRÉ J. DOUCHANE, Chairman



JOINT VENTURE IN NORTHERN FINLAND

- An option joint venture with Gold Fields Limited calls for further exploration and development of a mine at the Arctic Platinum Project.
- North American Palladium will be granted an option to acquire up to a 50% undivided interest and may acquire a 60% interest in certain circumstances.
- The primary project objective is to define a combined mineral resource of five million ounces greater than 3.0 grams per tonne (palladium, platinum and gold).

When a company's management looks towards the future and defines a growth strategy, it must assess the company's strengths, markets, and the true potential for growth within those specific markets. North American Palladium is a platinum group metals producer, primarily driven by the price of palladium, with strong platinum and nickel by-product production. During 2005, we predicted that palladium was set to appreciate in line with the rest of the rising metal markets. It began.

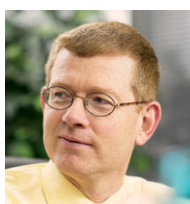
Palladium's primary use is in the auto industry where it is a key component in catalytic converters. Our views of increasing price and demand are based on tightening environmental standards in combination with increasing global car production. Palladium's uses also extend into the jewellery, bullion coin, dental, electronics, and chemical sectors. This past year saw an exponential increase in the use of palladium in jewellery, which

was primarily driven by the Chinese market where consumers are seeking alternatives to the high price platinum pieces. The one ounce Palladium Maple Leaf Coin, launched in September 2005 by the Royal Canadian Mint, was also created in response to investor demand for physical metal. In November of last year, palladium pushed past the US\$250 per ounce point, a crucial step in its upwards price recovery.

While China continues to consume over 20% of global commodity production, with no new significant near-term sources of supply entering into production, we continue to remain bullish on the sustainability of the high prices for our by-product metals, platinum, nickel, gold, and copper.

How does North American Palladium fit into this marketplace? Our strategy for growth continues to be focused on the PGM and base metal

WORK ON THE ARCTIC PLATINUM PROJECT **IS UNDER WAY** AND
WE EXPECT TO HAVE A GOOD FEEL FOR THAT PROJECT BY LATE 2006.



DIRECTORS

TOP TO BOTTOM

Louis J. Fox
Michael P. Amsden
Greg J. Van Staveren
André J. Douchane
Steven R. Berlin

sectors, within Canada and internationally. We are well positioned in this industry to begin to profit from the rising palladium price. We have a management team in place that is enthusiastic and dedicated to ensuring our growth strategy is executed. Operations at Lac des Iles are being restored to historical levels and our cost per ounce of palladium moving forward is expected to return to the US\$200 per ounce range. We have further delineated the Offset High Grade Zone resource, which is now estimated to contain over approximately 2.5 million ounces of palladium. Work on the Arctic Platinum Project is under way and we expect to have a good feel for that project by late 2006.

All in all, everything was put in place during 2005 to make North American Palladium a global competitor. The development of the underground mine and the completion of the Phase 4 stripping at Lac des Iles, the addition of high grade resources in the Offset High Grade Zone, the joint venture

with URSA Major Minerals on its nickel-PGM Shakespeare project, and the joint venture with Gold Fields on the Arctic Platinum Project have positioned the Company to become a significant producer of palladium and other precious metals. As the Company grows its PGM production, we will also look to keeping pace with our growing nickel business. It will continue to be our intention to keep the Company highly leveraged to the palladium market.

I am looking forward to 2006 and the opportunities we now have ahead. I am also confident that in 2006 all stakeholders will benefit from the hard work, dedication and perseverance of our employees this past year.

On behalf of the Board
of Directors,

André J. Douchane

CHAIRMAN

March 8, 2006

MESSAGE FROM THE PRESIDENT



JIM EXCELL, President and CEO



2006 OPERATING OBJECTIVES

- Focus on improving operations at Lac des Iles.
- Improve safety performance.
- Achieve palladium production of 280,000 ounces.
- Implement "Towards sustainable mining" initiatives at Lac des Iles.
- Increase reserves at Lac des Iles.

The year 2005 was indeed a challenging one for North American Palladium. In our 2004 Annual Report we stated to all stakeholders that 2005 would be a transitional year. However, the operational interruptions we faced at our Lac des Iles mine posed more problems than anticipated.

Lac des Iles produced just over 177,000 ounces of palladium plus by-product credits in 2005. The significant setbacks that contributed to this low output included ball mill bearing failures, low grade ore reflective of the open pit life cycle, low mill recoveries, problems with belts and chutes at the mill, and finally the shutdown of the primary crusher. We also did not achieve our stated objective of an improved safety record for 2005, as the total days lost increased slightly over 2004 results. Add to these problems the depressed spot palladium price prevalent during the first nine months of the year, and one might have been led to believe the Company was facing a bleak future.

This is not the case and I am pleased to report that operations at Lac des Iles are on track to return to higher historical levels and we are well positioned to continue growing. We are determined to improve our safety performance. Underground production is now well under way, with high grade underground ore being blended with ore from the open pit. In the mill, the flotation circuit improvements that were introduced throughout the past year have paid off and we are improving recoveries. The mine equipment maintenance planning system has advanced well and a similar system is in development for the mill. Several key personnel changes at the mine site were made during the year, and we continue to recruit quality team members, a process that takes time in today's competitive job market. Finally, the palladium price began to move in line with the rest of the metal markets. From an average of US\$189 per ounce for the first nine months of 2005, the price increased to an average of US\$260 per ounce for

WE WILL **CONTINUE** SEEKING NEW PGM AND BASE METAL
OPPORTUNITIES THAT WE CAN GROW, BOTH IN CANADA AND ABROAD.



OUR GROWTH STRATEGY

- Advance Arctic Platinum Project to production decision.
- Pursue the acquisition of top-tier, global PGM/Ni properties.
- Direct exploration and joint ventures in Canadian PGM/Ni mining camps.

November 2005 through to the end of January 2006. The operational improvements at Lac des Iles, in combination with an increased palladium spot price, will drive the Company's return to profitability.

A year ago we also told you that our strategy for growth was two-fold. We were developing a plan to focus on direct exploration and joint ventures in Canadian platinum group metal mining camps, in addition to pursuing the acquisition of top-tier, global, PGM properties to complement our existing metal production. We have achieved these goals. A feasibility study for the Shakespeare joint venture with URSA Major was completed and the permitting phase is under way while all options are being evaluated. Drilling has begun on the Arctic Platinum Project, with the objective to delineate a five million ounce resource with grades greater than three grams per tonne of combined platinum, palladium and gold. This partnership with Gold Fields Limited holds significant potential for the

Company's future and we are all very eagerly anticipating the results.

We are very pleased with these accomplishments, but we are not stopping there. We will continue seeking new PGM and base metal opportunities that we can grow, both in Canada and abroad. We are confident that global demand, especially from China with its expanding middle class, will continue to increase and place a strain on the supply side of PGM and base metal commodities. We intend to take an active part in delivering metals to this supply side.

I would like to take this opportunity to thank all stakeholders for their continued support and belief in our future. It is an exciting time for the Company, and we are determined to make the most of all our opportunities.

James D. Excell

PRESIDENT AND CHIEF EXECUTIVE OFFICER

March 8, 2006

Extraction + Production

OPEN PIT MINING OPERATIONS



IN 2005, NORTH AMERICAN PALLADIUM MINED A
TOTAL OF **15.3 MILLION** TONNES
FROM OUR LAC DES ILES OPEN PIT MINE.

The Mining Plan

Total tonnage mined from the open pit in 2005 amounted to 15.3 million tonnes or an average of 42,000 tonnes per day. Ore production totaled 3.7 million tonnes at an average grade of 1.72 grams per tonne palladium, compared to an average grade of 2.60 grams per tonne in 2004. The lower grade was anticipated in the mining plan.

At the end of 2005, the broken ore stockpile consisted of 714,589 tonnes grading an average of 1.78 grams per tonne of palladium. The majority of this stockpile we expect to treat in 2006.

Looking ahead, the 2006 mining plan is aggressive, totaling almost 16 million tonnes for the year. The expected 2006 strip ratio will be 2.1:1, a reduction from the 3.1:1 strip ratio in 2005.



TOP TO BOTTOM

Coarse ore stockpile

Fleet of 190 tonne trucks

Bill McKinney,
General Superintendent



11% OF PALLADIUM
PRODUCED IS USED IN
ELECTRONICS, INCLUDING
CELL PHONES.

ROBY PIT ORE PRODUCTION AND GRADES

Year	Tonnes (000)	Palladium (g/t)	Platinum (g/t)	Gold (g/t)	Nickel (%)	Copper (%)
2005	3,706	1.72	0.22	0.13	0.08	0.06
2004	4,574	2.60	0.23	0.21	0.09	0.08
2003	4,397	2.48	0.22	0.21	0.10	0.08
2002	7,251	1.49	0.16	0.12	0.07	0.05
2001	5,768	1.44	0.16	0.10	0.06	0.04

HISTORICAL MINE PRODUCTION

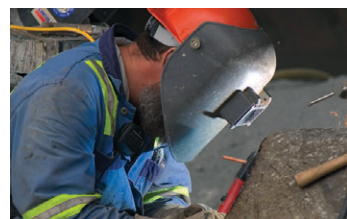
	2005	2004	2003	2002	2001
Ore Tonnes Mined	3,705,555	4,574,134	4,396,847	7,250,963	5,768,157
Waste Tonnes Mined	11,619,658	12,275,889	10,164,806	9,828,552	19,174,635
Stripping Ratio	3.1:1	2.68:1	2.31:1	1.36:1	3.32:1
Average Daily Production (tonnes)	42,191	46,038	39,895	46,793	68,336

Improving Operations

In an attempt to improve overall mining operations at Lac des Iles, numerous efforts were undertaken throughout 2005. The major equipment fleet management process underwent a concentrated review and a new long-term preventative maintenance program (Assembly Line Preventative Maintenance) was implemented. The program has already produced benefits, improving the overall maintenance

management process and increasing equipment availability by an average of 2%.

Enhancements to the blasting process have also improved material fragmentation and resulted in less oversize material being delivered to the primary crusher. The decrease in oversize material is expected to reduce the amount of rehandled material and the improvement process will continue in 2006 with further modifications to the blasting drill hole diameters planned.



TOP TO BOTTOM

Surveyor at Lac des Iles

Operations in the
Phase 4 pit

Welding in the
maintenance bay



IN 2005, THE AUTOMOBILE
INDUSTRY ACCOUNTED FOR **49%**
OF PALLADIUM DEMAND.

Photo courtesy of: Engelhard Corporation

Stoping + Development

UNDERGROUND MINING OPERATIONS



BY DECEMBER 31, THE MAIN RAMP HAD BEEN DRIVEN
1,111 METRES, AND WAS ADVANCING
TOWARDS THE NEXT MINING BLOCK, AND THE FIRST
TWO MINING LEVELS HAD BEEN ESTABLISHED.

Expanding Lac des Iles

Development of an underground mining operation at Lac des Iles continued throughout 2005. By December 31, 2005, the main ramp had been driven 1,111 metres, and was advancing towards the next mining block, and the first two mining levels had been established. The excavation of the ventilation and manway raises had been completed to the first drill level (5210 level) and equipping of the manway is ongoing. The ventilation and manway raises will be completed to the first mucking level (5180 level) during the first quarter of 2006 in time for the start of commercial production.

Maintaining access to the original mine portal proved to be a struggle for both the open pit and underground mining operations during the year, as a result of various open pit blasts that obstructed the open pit ramp, and ultimately limited underground access. After modifications to the mine plan, the main underground ramp is now being extended in order to provide continuous access to the underground operation that is above the open pit's mining activities. The extension to the ramp will be completed during the first quarter of 2006, which will resolve issues for both mining operations.



TOP TO BOTTOM

Jumbo drilling on a round in the ramp

Gilbert Girard loading a development round from a scissor lift

A Bradley Brothers employee in a diamond drill cutout



THE ROYAL CANADIAN
MINT OFFICIALLY
LAUNCHED THEIR
FIRST PALLADIUM
COIN IN SEPTEMBER
2005.

UNDERGROUND MINING OPERATIONS (CONT'D)



THE UNDERGROUND MINE WILL DELIVER
2,000 TONNES OF ORE A DAY TO THE MILL,
AT AN AVERAGE HEAD GRADE OF 6.62 GRAMS
PER TONNE OF PALLADIUM.

Moving Ahead

Permanent mine installations now in place to support underground production include the main fresh air fan and heaters, the compressor plant and distribution system, the mine office and dry area, and the electrical distribution system.

Stope design parameters have been finalized and reviewed by off-site geotechnical consultants, Bawden Engineering Ltd. Stope design has been completed for the first mining block, silling has started for the first two stopes on both the drilling and mucking levels and production blasting commenced in February.

When in full operation, which is expected to commence during the first quarter of 2006, the underground mine will deliver 2,000 tonnes of ore a day to the mill, and will be combined with 13,000 tonnes a day from the open pit, resulting in mill feed averaging approximately 2.33 grams per tonne.

Operations are being conducted with a combined contractor/Lac des Iles workforce while additional team members are recruited.



TOP TO BOTTOM

Underground definition
drilling

Dan Fors and
Rory Mutch

Contractor working
in underground

CHINA USED OVER
1 MILLION OUNCES OF
PALLADIUM FOR JEWELLERY
IN 2005.



Photo courtesy of: Andin International

Process + Recovery

MILLING OPERATIONS



TEST WORK IN THE MILLING CIRCUIT CONTINUES,
WITH THE GOAL OF **INCREASING**
SUSTAINABLE RECOVERIES.

Moving Forward

During 2005, the Lac des Iles mill experienced unexpected setbacks and operational interruptions, which in addition to the scheduled low ore grade being processed from open pit operations, cumulatively affected operations. The mill produced 177,167 ounces of palladium, compared to 308,931 ounces in 2004, while the average head grade of palladium for the year was 1.66 grams per tonne with an average recovery of 69.6%, compared to the average grade of 2.41 grams per tonne and recovery of 75.2% in 2004.

SGS Lakefield Research Limited was heavily involved in the metallurgical process review and refinement during the first eight months of the year to complete the plant work that commenced in mid-2004. Test work in the

milling circuit continues, with the goal of increasing sustainable recoveries.

The mill maintenance department undertook many positive changes throughout the second half of 2005. A preventative maintenance program was designed, to reduce costs associated with mill maintenance in addition to reducing equipment downtime through an increase in scheduled maintenance and further controls of the secondary crusher feed. The primary crusher that was brought offline at the start of 2006 was repaired ahead of the original schedule due to the team's project execution skills. Other equipment problems relating to ball mills, chutes and transfers have also been addressed.



TOP TO BOTTOM

Preparation for
assaying

Taking flotation
samples

Employee at water
tower

MILL PRODUCTION STATISTICS

Year	Ore Milled (tonnes)	Concentrate (tonnes)	Palladium (ounces)	Platinum (ounces)	Gold (ounces)	Nickel (lbs)	Copper (lbs)
2005	4,780,599	30,698	177,167	18,833	14,308	2,353,227	5,514,670
2004	5,298,544	45,652	308,931	25,128	25,679	4,320,970	7,836,183
2003	5,159,730	36,869	288,703	23,742	23,536	4,070,785	7,142,674
2002	4,851,621	27,179	219,325	19,180	16,030	2,763,654	5,295,486
2001	2,662,240	21,697	123,281	10,073	9,603	1,595,179	3,123,763

Discovery + Opportunity

EXPLORATION



THE COMPANY BELIEVES THAT THE APP
REPRESENTS ONE OF THE **WORLD'S BEST**
UNDEVELOPED PGM OPPORTUNITIES.

LDI Offset High Grade Zone

With a \$14.7 million exploration budget for 2006, North American Palladium has allocated \$3.3 million of that amount to continue advancing the Lac des Iles Offset High Grade Zone. Surface and underground drilling are planned, to expand and upgrade the known resources, as well as preliminary mineralogical and metallurgical testing. In 2005, exploration drilling on the Offset High Grade Zone totaled 18,230 metres in 15 holes. This zone is a faulted off extension of the Main High Grade Zone, which is currently under development.

The 2005 exploration program successfully extended the Offset High Grade Zone for over 600 metres along strike and 700 metres down dip. Assay results from the 2005 program

included 136.70 metres averaging 5.56 grams per tonne palladium, 0.37 grams per tonne platinum, 0.34 grams per tonne gold, 0.09% copper, and 0.12% nickel in hole 05-016, which is the strongest intercept drilled to date on either the High Grade or Offset High Grade Zone. The width of the intercept is significant as it indicates the deposit may be amenable to future lower cost large scale bulk mining techniques. Readers may view the full drilling campaign results in the press release section of the Company's website (www.napalladium.com).

In late 2005 the Company contracted Roscoe Postle Associates Inc. to complete an updated resource estimate (see accompanying table) on the Offset High Grade Zone.



TOP TO BOTTOM

Core samples at
Lac des Iles

STATEMENT OF OFFSET HIGH GRADE ZONE MINERAL RESOURCES (as of December 31, 2005)

Category	Tonnes (1,000)	Pd (g/t)	Pt (g/t)	Au (g/t)	Cu (%)	Ni (%)	Pd (000 oz)	Pt (000 oz)
Inferred Mineral Resources	14,590	5.24	0.36	0.35	0.10	0.12	2,455	170

Notes

1. CIM definitions for mineral resources were used to estimate the Lac des Iles mineral resources.
2. Resources are in addition to the reserves. Resources which are not reserves do not have demonstrated economic viability.
3. Mineral resources are calculated at a cut-off grade of 3.2 grams of palladium per tonne for the Offset High Grade Zone, assuming an average long-term palladium price of US\$275 per ounce and includes by-product metal credits.
4. Richard E. Routledge, M.Sc., P. Geo. of Roscoe Postle Associates Inc., an independent geological mining engineering consulting firm, is a qualified person under NI 43-101. Messer. Routledge prepared the Offset High Grade Zone resource estimate.



JOINT VENTURE IN NORTHERN FINLAND

- Several advanced stage PGM projects.
- Drilling to commence in 2006.
- Scoping study to be completed by mid 2007.

Arctic Platinum Project

In October, 2005 North American Palladium and Gold Fields Limited signed a letter of intent to form a joint venture to further explore and develop a mining operation at the Arctic Platinum Project ("APP") located in Finland. The APP includes several advanced stage PGM projects.

The Company believes that the APP represents one of the world's best undeveloped PGM opportunities since it covers several advanced stage exploration properties, including the Konttijarvi and Ahmavaara Open Pit Projects, collectively known as the Suhanko Project, that were the subject of a feasibility study completed by Gold Fields in 2005. The exploration target at Suhanko is for bulk tonnage, disseminated to locally semi-massive base metals and PGMs occurring near the base of the Konttijarvi-Suhanko intrusive.

During 2006, the Company plans to re-evaluate the Suhanko Project at a higher cutoff value than was used in the Gold Fields original study. This increase in the cutoff grade would lead to a smaller scale operation, but would result in a higher grade being processed.

The APP also includes the Narkaus (SK) and the Penikat (SJ) projects, both of which host significant PGM and base metal mineralization. While these projects are not as advanced as the Suhanko Project, the Company believes that these opportunities offer the potential to increase significantly the resources at APP. Drilling of selected targets will commence in early 2006 and preliminary mineralogical and metallurgical test work will also be carried out. Drilling is expected to continue through the first half of 2006 after which mineral resources will be calculated to be incorporated into a larger APP scoping study currently scheduled for completion in early to mid 2007.

A COMPLETED **FEASIBILITY STUDY**

DEFINED A DILUTED PROBABLE RESERVE

Canadian Activities

In July 2005 North American Palladium and URSA Major Minerals Corporation executed a definitive Option Joint Venture Agreement covering the Shakespeare nickel, copper and PGM deposit and adjoining Porter-Baldwin exploration property in the Sudbury area of Ontario. A completed feasibility study defined a diluted probable reserve of 11,266,000 tonnes grading 0.33% nickel, 0.35% copper, 0.02% cobalt, 0.33 grams per tonne platinum, 0.37 grams per tonne palladium and 0.19 grams per tonne gold. The permitting process has commenced and the management teams will continue to evaluate the project and its economic viability.

The Company is making progress on the ground surrounding the past nickel-copper-PGM producing Shebandowan mine in northwestern Ontario, held under an option joint venture agreement with Inco Limited.

The exploration targets here are additional massive sulphide deposits and extensions of the Shebandowan orebody.

The Bird River property, covered by an option joint venture agreement with Gossan Resources, covers a 15 kilometre portion of the Bird River sill, which in the past hosted several small nickel, copper and PGM mines. An airborne electromagnetic and magnetic survey was flown in 2005 which defined nearly two dozen priority targets.

Also in 2005 the Company positioned itself in the historic Lynn Lake mining camp in northern Manitoba through an option joint venture agreement with Rare Earth Metals Corp. to explore and evaluate the latter's grass roots Lynn gabbros properties.



Exploration team in the LDI remote office

IN THE EARLY **1900s**
PALLADIUM WAS INITIALLY
USED FOR SURGICAL
INSTRUMENTS.



Safety + Responsibility

SUSTAINABILITY



THE COMPANY WILL STRIVE TO FURTHER ITS
COMMITMENT TO SUSTAINABLE DEVELOPMENT AND
AGGRESSIVELY IMPLEMENT “TOWARDS SUSTAINABLE
MINING GUIDING PRINCIPLES”.

Our Responsibility

At the beginning of 2006, North American Palladium became a member of the Mining Association of Canada. Throughout 2006, the Company will strive to further its commitment to sustainable development and aggressively implement "Towards Sustainable Mining Guiding Principles". This initiative is focused on implementing best practices in environmental and social responsibility, with a strong emphasis on tailings management, energy use and greenhouse gas emissions management, external outreach and corporate crisis management planning.

On the health and safety front, 2005 was a year for initiating system improvements, as the safety record did not improve

year over year. Procedures were presented to the team members for re-design, based on the premise that systems are most effective when the employees are actively engaged in the actual planning process. This focus will continue to be supported through 2006 as other elements of the safety system are optimized. The Lac des Iles mine is committed to working with its workforce, Joint Health and Safety Committee, supervisors and outside agencies to ensure the best possible methods of working safely and efficiently are established.



TOP TO BOTTOM

View of Lac des Iles
Michelle Darling, Bruce
Reith and John Macey

Process control
testing

BECAUSE IT IS NON-CORROSIVE,
PALLADIUM IS
OFTEN USED IN NON-MAGNETIC
WATCH PARTS.



STATEMENT OF MINERAL RESERVES (as of December 31, 2005)

Open Pit

Category	Tonnes (1,000)	Pd (g/t)	Pt (g/t)	Au (g/t)	Cu (%)	Ni (%)	Pd (000 oz)	Pt (000 oz)
Proven Mineral Reserves	8,584	2.03	0.22	0.16	0.07	0.06	560	60
Probable Mineral Reserves	4,970	2.31	0.23	0.17	0.07	0.07	369	37
Total Proven and Probable Mineral Reserves	13,554	2.13	0.22	0.16	0.07	0.06	929	97

Underground

Category	Tonnes (1,000)	Pd (g/t)	Pt (g/t)	Au (g/t)	Cu (%)	Ni (%)	Pd (000 oz)	Pt (000 oz)
Probable Mineral Reserves	3,542	6.62	0.40	0.34	0.07	0.08	754	46

Notes

1. CIM definitions for mineral reserves were used to estimate the Lac des Iles mineral reserves.
2. Mineral reserves are calculated at a cut-off grade of 1.1 grams and 4.5 grams of palladium per tonne for the open pit and for the underground respectively, assuming an average long-term palladium price of US\$275 per ounce and includes by-product metal credits.
3. Graham G. Clow, P. Eng. and Luke Evans, M.Sc., P. Eng. of Roscoe Postle Associates Inc., an independent geological mining engineering consulting firm, are qualified persons under NI 43-101. Messers. Clow and Evans prepared the open pit and underground reserve estimate.
4. As of December 31, 2004 the RGO Stockpile was classified as Proven Mineral Reserves. As of December 31, 2005 the RGO Stockpile is being classified as Measured Mineral Resources; at a grade of 0.97 grams per tonne palladium, it is below the current open pit cut-off grade of 1.1 grams per tonne palladium.
5. Approximately 5.0 million tonnes averaging 1.94 grams per tonne palladium was reclassified from Proven and Probable Mineral Reserves to Measured and Indicated Mineral Resources due to a change in the ultimate pit design. The ultimate pit design used in 2004 has been changed to an interim ultimate pit design that addresses south pit slope instability concerns. LDI is currently investigating alternative designs and expects to complete a final ultimate pit design later in 2006.

STATEMENT OF MINERAL RESOURCES (as of December 31, 2005)

Open Pit

Category	Tonnes (1,000)	Pd (g/t)	Pt (g/t)	Au (g/t)	Cu (%)	Ni (%)	Pd (000 oz)	Pt (000 oz)
Measured Mineral Resources	21,375	1.38	0.17	0.11	0.05	0.06	948	117
Indicated Mineral Resources	7,626	1.86	0.21	0.13	0.06	0.05	456	51
Total Measured and Indicated Mineral Resources	29,001	1.51	0.18	0.11	0.05	0.06	1,404	168
Inferred Mineral Resources	185	2.72	0.18	0.13	0.05	0.04	16	1

Underground

Category	Tonnes (1,000)	Pd (g/t)	Pt (g/t)	Au (g/t)	Cu (%)	Ni (%)	Pd (000 oz)	Pt (000 oz)
Indicated Mineral Resources	333	7.46	0.42	0.37	0.08	0.08	80	4
Inferred Mineral Resources	41	7.85	0.37	0.15	0.02	0.03	10	0

Notes

1. CIM definitions for mineral resources were used to estimate the Lac des Iles mineral resources.
2. Resources are in addition to the reserves. Resources which are not reserves do not have demonstrated economic viability.
3. Mineral resources are calculated at a cut-off grade of 1.1 grams and 4.5 grams of palladium per tonne for the open pit and for the underground respectively, assuming an average long-term palladium price of US\$275 per ounce and includes by-product metal credits.
4. Graham G. Clow, P. Eng. and Luke Evans, M.Sc., P. Eng. of Roscoe Postle Associates Inc., an independent geological mining engineering consulting firm, are qualified persons under NI 43-101. Messers. Clow and Evans prepared the open pit and underground resource estimate.

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following is Management's Discussion and Analysis of the financial condition and results of operations to enable a reader to assess material changes in financial condition and results of operations for the year ended December 31, 2005, compared to those of the respective periods in prior years. This Management's Discussion and Analysis has been prepared as of March 29, 2006. This Management's Discussion and Analysis is intended to supplement and complement the audited consolidated financial statements and notes thereto for the year ended December 31, 2005 (collectively, the "Financial Statements"). You are encouraged to review the Financial Statements 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") and contains one of the largest open pit bulk mineable palladium reserves in the world. 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.

Based on a positive feasibility study, the Company commenced the development of an underground mine at its Lac des Iles operation in the second quarter of 2004. The underground mine development is focused on the Main High Grade Zone below the ultimate open pit depth. Capital costs for the underground development are estimated at \$40 million for direct and indirect costs and working capital. Mining equipment accounts for an additional \$12 million of capital costs and the Company is financing this equipment through a vendor lease program. By the end of the year 2005, the main ramp had been advanced 1,111 metres. The underground development is progressing toward production of 2,000 tonnes per day at the end of the first quarter of 2006.

At Lac des Iles, the Company continues to receive positive results from the ongoing exploration program on the deep Offset High Grade Zone. The 2005 exploration program successfully extended the zone to a total of 600 metres along strike and 700 metres down dip. An updated resource estimate was completed in February, 2006, by Roscoe Postle Associates Inc. indicating an inferred mineral resource of 2,455,000 ounces of palladium at a cutoff grade of 3.2 grams per tonne.

On October 18, 2005, the Company announced that it had entered into a letter of intent to form a Joint Venture with Gold Fields Limited to further explore and develop a mining operation at the Arctic Platinum Project ("APP") located in Finland. The APP includes several advanced stage PGM Projects. The Company has been granted an option to earn up to a 50% and, in certain circumstances, a 60% interest in APP and will become the project operator. In order to exercise the option, the Company must spend US\$12.5 million, complete a feasibility study and make a production decision as well as paying Gold Fields US\$36 million or US\$45 million to earn a 50% or 60% interest, respectively, through the issuance of the Company's common shares (approximately 7.3 million shares or 9.2 million shares as the case may be) on or before August 31, 2008. The transaction is subject to certain conditions including the executing of a formal agreement and receipt of all necessary regulatory approvals, which is expected during the first quarter of 2006.

The Company announced on September 29, 2005, that the shareholders of URSA Major Minerals Incorporated ("URSA") approved the option and joint venture agreement on the Shakespeare nickel, copper, PGM property located near Sudbury, Ontario and the Company paid \$1.5 million to URSA to complete its option earn-in. The property is proposed to be a 60% North American Palladium, 40% URSA Joint Venture with the Company becoming the operator upon successful completion of a viable feasibility study and arranging financing for commercial production. In January, 2006, URSA announced the results of the feasibility study and will now proceed with permitting of the project and reviewing development options to further improve the economics of the project.

In prior periods the Company hedged the price of its palladium production under a contract with a major automotive manufacturer (the "Palladium Sales Contract"). The hedge price was based on the monthly average spot price for palladium with a floor price of US\$325 per ounce for 100% of production. The Palladium Sales Contract for

physical deliveries expired on June 30, 2005. For 2005 all palladium production (except 6,403 ounces delivered under the Palladium Sales Contract) was delivered into either a sales contract with a leading catalytic converter manufacturer or a global commodity dealer. These contracts provided for pricing at either the monthly average price in the month prior to delivery of palladium or the spot price on the day of delivery. Without the benefit of the floor price under the Palladium Sales Contract, the Company's profitability in 2005 was significantly impacted by the depressed spot palladium price evident for much of the year.

The Company does expect the recent improvement in the palladium price to continue (4th quarter 2005 average price of US\$239, in comparison to US\$189 per ounce average during the first three quarters of the year), and is optimistic that the fundamentals for palladium demand will improve with the expected draw-down of surplus inventories held by automotive manufacturers; the wide market price spread between platinum and palladium and increasing demand for palladium jewelry, all of which should accelerate consumption of palladium.

In 2004, the Company commenced a hedging strategy for a portion of its by-product metal production that it implements from time to time. The objective of this hedging strategy is to reduce the variability of cash flow associated with revenues derived from the sale of nickel, platinum, gold and copper. The Company uses fixed-price forward platinum contracts and cash settled gold, nickel and copper price swap contracts to insulate its earnings and cash flows from changes in these metal prices. These contracts allow the Company to sell its platinum production to credit-worthy metal dealers at a fixed price under the forward sales contract. In the case of gold, nickel and copper, the Company receives a fixed metal price in exchange for paying the floating price received under its physical sales contracts to acceptable counterparts under the metal price swap contracts. In October, 2005, the Company made a decision to unwind various by-product metal hedges: namely, platinum, gold, and nickel through the buy-back of forward sales or cash settled metal price swaps. This decision was taken to reposition the Company's exposure to its by-product metals in advance of the expected increase in metal production at Lac des Iles in 2006.

PRODUCTION STATISTICS

Year Ended December 31	2005	2004	2003
Palladium (oz)	177,167	308,931	288,703
Payable palladium (oz)	161,469	281,743	261,247
Platinum (oz)	18,833	25,128	23,742
Gold (oz)	14,308	25,679	23,536
Copper (lbs)	5,514,670	7,836,183	7,142,674
Nickel (lbs)	2,353,227	4,320,970	4,070,785
Ore tonnes milled	4,780,599	5,298,544	5,159,730
Ore tonnes mined	3,705,555	4,574,134	4,396,847
Waste tonnes mined	11,619,658	12,275,889	10,164,806
Waste strip ratio	3.14:1	2.68:1	2.31:1

SELECTED ANNUAL INFORMATION

(thousands of dollars)	2005	2004	2003
Revenue from metal sales	\$ 92,606	\$ 185,204	\$ 192,141
Net income (loss)	(53,611)	(92,110)	38,378
Basic net income (loss) per share (dollars)	(1.03)	(1.79)	0.76
Cash dividends declared	nil	nil	nil
Operating cash flow	(39,000)	52,059	59,802
Total Assets	238,357	297,897	393,692
Long-term debt, including current portion	\$ 46,272	\$ 50,171	\$ 58,761

SUMMARY OF QUARTERLY RESULTS

(thousands of dollars except per share amounts)	2004				2005			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Revenue from metal sales	53,156	51,712	45,154	35,182	26,206	23,544	17,247	25,609
Net income (loss)	6,121	2,834	6,598	(107,663)	(7,736)	(15,228)	(19,610)	(11,037)
Net income (loss) per share	0.11	0.06	0.13	(2.09)	(0.15)	(0.29)	(0.37)	(0.21)
Fully diluted net income (loss) per share	0.11	0.06	0.13	(2.09)	(0.15)	(0.29)	(0.38)	(0.21)

Results of Operations

The Company generated gross revenue from metal sales of \$92.6 million in 2005, compared to \$185.2 million in 2004. Revenue in 2005 from the sale of palladium before the mark-to-market effect of price changes was \$38.6 million compared to \$112.9 million in 2004. This revenue decrease was due to a 43% decrease in palladium production with similar volume impact from by-product metals. In addition, without the benefit of the floor price under the Palladium Sales Contract (US\$325), production for 2005 was sold into the spot market (except for 6,403 ounces which was recognized at the floor price) and revenue was significantly impacted by the depressed palladium prices evident for much of the year, as well as further weakening in the US dollar. For 2005, revenue from palladium sales was realized at an average of US\$230 per ounce in comparison to 2004 in which all of the revenue was at the floor price under the Palladium Sales Contract. In both 2005 and 2004, improved by-product metal pricing offset some of the negative impact experienced from lower spot palladium prices.

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. The price adjustment relating to palladium settled and awaiting settlement for 2005 was a positive adjustment of \$4.8 million compared to a small positive adjustment of \$0.9 million in 2004. Revenue from by-product metal sales decreased by 31% to \$49.2 million in 2005 compared to \$71.4 million in 2004 reflecting decreased production, partially offset by improved price levels for nickel, gold and copper. Realized prices for by-product metals in 2005 compared to 2004, were platinum at US\$815 per ounce (2004 – US\$831), nickel at US\$6.60 per lb (2004 – US\$6.11), gold at US\$442 (2004 – US\$417) and copper at US\$1.50 per lb (2004 – US\$1.24) partially offsetting the higher realized metal prices was a strengthening Canadian dollar, which averaged US\$0.83 in 2005, compared to US\$0.77 in 2004.

During 2005, the mill processed 4,780,599 tonnes of ore or an average of 13,098 tonnes per day compared to 5,298,544 tonnes of ore or an average of 14,477 tonnes per day in 2004. In 2005, the average palladium head grade was 1.66 grams per tonne compared to 2.41 grams per tonne in 2004. For 2005, the palladium recoveries were 69.6% as compared to 75.2% in 2004. The lower recovery in 2005 was a result of the lower head grade, as well as a change in the mineralogy of the ore reflective of the open pit mining plan. Also contributing to the lower recoveries were intermittent operating difficulties at the mill during the year. While palladium production decreased 43% from the prior year, a drop in concentrate grade resulted in an increase in the ratio of tonnes of concentrate treated, resulting in higher charges for smelter treatment, refining and freight costs as compared to 2004. As a result of ongoing flotation circuit improvements, enhanced preventative maintenance programs, changes made to the mill flow sheet, reagent mix and the quality of recycled water, recoveries and concentrate grade improved in the fourth quarter and are anticipated to continue to improve in 2006.

Total production costs for 2005 of \$99.3 million were comparable to \$102.9 million in the prior year, however, unit cash costs to produce palladium (production costs including overhead and smelter treatment, refining and freight costs), net of by-product metal revenues and royalties, increased to US\$359 per ounce in 2005 compared to US\$159 per ounce in 2004. The increase in unit cash costs was caused by a combination of lower ore grades and

metal recoveries, which led to a 43% decrease in palladium production to 177,167 ounces in 2005 compared to 308,931 ounces in 2004, combined with a 31% decrease in revenue from by-product metals. In addition, throughout the year there was an increased waste to ore strip ratio of 3.14:1 in 2005, compared to 2.68:1 in 2004 and continuing pressure on costs, particularly steel, tires, power, diesel fuel and ongoing mill repairs.

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

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

The Company performed an impairment test as at December 31, 2005, and decided that a write-down of mining assets was unnecessary. The impairment test completed during the fourth quarter of 2004, resulted in a non-cash charge of \$108.0 million (net of tax – \$103.4 million or \$2.01 per share) to write down the carrying value of mining interests. An assessment of impairment was required as a result of changes in key assumptions (refer to note 5 to the Financial Statements) which were primarily affected by a continuation of low palladium prices and a weakening U.S. dollar.

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

Non-cash amortization decreased to \$18.3 million in 2005 compared to \$36.7 million in 2004. The lower amortization amount is attributable to the 43% decrease in palladium production and the reduction in the unit of production amortization rate to approximately C\$68 per palladium ounce compared to approximately C\$133 per palladium ounce in 2004 as a result of the asset impairment charge recorded in 2004, which lowered the book value of mining interests.

For 2005, there was a \$55.9 million loss from mining operations compared to an \$88.1 million loss from mining operations in 2004, after allowing for the \$108.0 million impairment charge. This decrease in earnings was mainly attributable to the 43% reduction in production, as well as the reduced palladium revenue as a result of not having the benefit of the floor price of US\$325 under the Palladium Sales Contract and having to sell into the spot market (except for 6,403 ounces) with its depressed palladium prices evident for much of the year, as well as a further weakening in the US dollar.

Other income and expense, which includes interest income and expense, and foreign exchange gains and losses, was an expense of \$0.6 million in 2005 compared to \$2.2 million in 2004. In the current year there was a foreign exchange gain of \$0.3 million compared to a loss of \$0.3 million in 2004. The foreign exchange gain relates primarily to the Company's US dollar denominated credit facilities which have benefited from the strengthening of the Canadian dollar compared to the US dollar.

In 2005, the Company incurred interest expense on long-term debt of \$2.5 million compared to \$1.8 million in 2004. The increased interest expense in the current year reflects the increase in interest rates year-over-year.

In 2005, the Company had a tax recovery of \$2.9 million as a result of losses and allowing for the recovery of future mining tax liability from previous years. The Company's 2004 provision for income tax expense of \$1.8 million was significantly lower than the statutory income tax rate of approximately 39%, due to the fact that no tax benefit or tax asset has been recorded on the impairment charge of \$108.0 million.

For the year ended December 31, 2005, the Company reported a net loss of \$53.6 million or \$1.03 per share compared to net loss of \$92.1 million or \$1.79 per share for the year ended December 31, 2004.

After adjusting for the impairment charge, the insurance recovery, and foreign exchange, the adjusted net income was \$7.3 million (\$0.14 per share) for the year ended December 31, 2004, compared to the net loss of \$53.6 million (\$1.03 per share) for the year ended December 31, 2005.

Liquidity and Capital Resources

Cash used in operations (prior to changes in non-cash working capital) was \$39.0 million in 2005, compared to cash provided by operations of \$52.1 million in 2004. The \$91.1 million decrease in operating cash flow was mainly attributable to the 43% reduction in palladium production, as well as the reduced palladium revenue as a result of not having the benefit of the floor price of US\$325 under the Palladium Sales Contract, combined with a 31% decrease in revenue from by-product metals, as well as a further weakening in the US dollar. In addition, throughout the year there was an increase in operating costs from an increase in the waste to ore strip ratio 3.14:1 in 2005, compared to 2.68:1 in 2004 and continuing pressure on costs, particularly steel, tires, power, diesel fuel and ongoing mill repairs. Changes in non-cash working capital provided \$29.6 million of cash in the current year as compared to \$29.7 million in 2004. Palladium awaiting settlement declined to 65,905 ounces at December 31, 2005, compared to 114,186 ounces at December 31, 2004. The reduction in the physical quantity of metal in the concentrate awaiting settlement combined with the lower palladium price and a weaker US dollar all used to value the concentrate awaiting settlement resulted in a 45% reduction in the value of concentrate awaiting settlement. After allowing for non-cash working capital changes, cash used by operations was \$9.4 million in 2005 compared to cash provided of \$81.8 million in 2004.

Investing activities required \$35.4 million of cash in 2005. Two major projects were undertaken during the year, the upgrade of the tailings management facility for \$5.8 million and the ongoing underground mine development, which commenced in mid 2004 and will extend into early 2006, required \$23.9 million excluding \$6.5 million of mining equipment purchased under capital leases. This compares with \$26.5 million of net investing activities in 2004.

The Company's debt position was reduced to \$46.3 million at December 31, 2005, compared to \$50.2 million at December 31, 2004 and the year-end cash and cash equivalents balance were reduced to \$15.0 million compared to \$65.8 million for the prior year.

The Company will require additional funding in 2006 to meet its ongoing obligations. Management has been successful in the past in securing financing in the capital markets and has no reason to believe it will be unable to continue to do so in the near future, but cannot guarantee that this will occur.

On March 3, 2006, the Company announced it had entered into an arranged private placement of convertible notes and common share purchase warrants. This offering consists of up to US\$58.5 million aggregate principal amount of convertible notes convertible into common shares of the Company at a premium of 13% to the market price of the common shares on the date of closing. The notes will bear an interest rate of 6.5% per annum. Upon issuing the notes to the investors, the Company shall issue common share purchase warrants equal to 50% of the common shares issuable if such convertible notes were converted by the holders immediately following the closing of the transaction. The holder of the warrants shall be entitled for a period of four years following the date of issuance,

to purchase one common share for each warrant held at an exercise price equal to 125 percent of the market price. The convertible notes will contain customary covenants, including certain restrictions on the Company incurring debt, obligations or involving the payment of money in excess of certain restricted amounts. The convertible notes will contain full-ratchet anti-dilution protection, subject to the restrictions pursuant to the rules of the TSX. The transaction closed on March 28, 2006.

CONTRACTUAL OBLIGATIONS

As at December 31, 2005 (thousands of dollars)	Total	Payments Due by Period		
		1 Year	1–3 Years	4–5 Years
Senior credit facility	\$ 24,324	\$ 6,664	\$ 13,328	\$ 4,332
Kaiser-Francis credit facility	13,407	13,407	—	—
Capital lease obligations	8,541	2,323	4,069	2,149
Operating leases	1,053	675	375	3
Other purchase obligations	5,175	5,175	—	—
	\$ 52,500	\$ 28,244	\$ 17,772	\$ 6,484

There are no payments due after five years.

FIXED-PRICE COPPER SWAP CONTRACTS (THE "COPPER HEDGE POSITION")

As of December 31, 2005	
Copper tonnes hedged	150 (or approximately 5% of 2006's expected production)
Maturity date of copper swap contracts	March, 2006
Weighted-average estimated fixed copper price up to maturity date	US\$2,851 per tonne (US\$1.29 per lb.) ¹
Payment obligations	The Company will pay on a monthly basis the floating copper price (average monthly LME 3-month copper price) for the respective volume of copper metal swapped and receive a fixed price from the counterpart for the period up to the maturity date
Unrealized mark-to-market loss at December 31, 2005	US\$240,000

¹ Weighted-average estimated copper price is based on the aggregate value of contracted fixed prices for the expected copper volumes for each respective delivery month divided by the total volume of copper under the swap contract.

The Company entered into a Master Swap Agreement with a counterpart, which governs the term of its forward fixed price swap. The counterpart has a long-term credit rating assigned by Standard & Poor's of "A" or better, or equivalent rating from other international credit rating agencies.

Related Party Transactions

The Company engaged Louis J. Fox in November, 1999, to provide services in connection with the negotiation of palladium end-user supply contracts, project capital financing, smelting and refining agreements, metals price forecasting and marketing other metals. The services agreement was negotiated at arms-length prior to Mr. Fox becoming a director of the Company. Mr. Fox received a fee in connection with the negotiations related to the Palladium Sales Contract. The amount paid to Mr. Fox in 2005 was \$218,000 compared to \$581,000 in 2004. The Palladium Sales Contract expired on June 30, 2005 and no further fees are payable to Mr. Fox in connection with this contract.

In December 2001, Kaiser-Francis provided a US\$20 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 is based on the 30-day LIBOR plus 2.50% and the stand-by fee is 0.125% per annum. The amount paid to Kaiser-Francis for interest and standby fee was \$836,000 in 2005 compared to \$585,000 in 2004. Kaiser-Francis holds approximately 50% of the common shares of the Company.

Fourth Quarter and Management's Outlook

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

Production for the fourth quarter 2005 was approximately 37,000 ounces of palladium with an average palladium head grade of 1.47 g/t. This was a reduction from the third quarter's palladium production of 39,500 ounces and the previous year's production of 63,000 ounces during the same period. Intermittent operating disruptions with the primary crusher led to a decrease in mill throughput, availability, and head grade as the Company utilized the crushed ore stockpile which was of lower grade than the forecasted run of mine ore. Mill availability during the fourth quarter lowered to 80.8% from 91.7% during the third quarter and from 84.9% in the comparative period in 2004. Overall, the net loss in the fourth quarter was \$11.0 million, lower than the third quarter's loss of \$19.6 million, primarily due to increased revenue being realized from higher average prices of palladium experienced during the last quarter, and higher than the fourth quarter 2004's small profit of \$0.3 million (prior to the non-cash write down of mining assets), mainly due to lower realized palladium revenue because of palladium sales in 2004 being done under the Palladium Sales Contract floor price of US\$325/oz. During 2005, the spot price of palladium per ounce ranged from a high of US\$295/oz to a low of US\$172/oz and averaged US\$201/oz compared to an average of US\$230/oz during 2004.

During 2005, North American Palladium continued to develop the underground mine. The underground mine is expected to commence commercial production at the end of March, 2006, providing 2,000 tonnes per day in combination with the open pit production of 13,000 tonnes per day. Palladium production in 2006 is expected to be approximately 280,000 ounces with a cash cost, net of by-product credits, in the US\$200/oz ounce range as the expected average blended head grade in 2006 increases to 2.33g/tonne, in line with the historical averages of the mine.

The Company's aggressive exploration program will continue in 2006, with approximately \$15.0 million being allocated to exploration activities. The main focus will be on the APP in Finland. Drilling is due to commence in late February with the drilling results to be incorporated into a scoping study scheduled to begin later in 2006. The Company will focus on the further definition of the Offset High Grade Zone at Lac des Iles and grassroots projects such as the Shebandowan project. In addition, a key strategy moving forward will be to continue the pursuit of quality Ni/PGM opportunities.

The PGM markets continue to benefit from strong global fundamentals, particularly from the expectation of further economic growth in China, India, Brazil and the United States. The Company strongly believes that the fundamentals are in place for increased metal demand, which will ultimately lead to higher palladium prices.

Critical Accounting Policies and Estimates

1. CHANGE IN ACCOUNTING POLICY

Hedging Relationships

In 2003, the CICA finalized amendments to Accounting Guideline AcG-13, "Hedging Relationships" that clarified certain of the requirements in AcG-13 and provided additional documentation and application guidance. AcG-13 is applicable for the Company's 2004 fiscal year. As a result of the adoption of AcG-13, the Company has marked-to-market its forward foreign exchange contracts beginning January 1, 2004. The impact of this change was an

increase to derivative income of \$0.2 million in the first six months of 2004. Commencing July 1, 2004, these foreign exchange contracts were designated as a hedge of U.S. dollar revenue and are accounted for in revenue as realized.

2. CRITICAL ACCOUNTING ESTIMATES

Critical accounting estimates represent estimates that are highly uncertain and for which changes in those estimates could materially impact the Company's financial statements. The following accounting estimates are 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, new discoveries, changes in mining methods and rates, process changes, investments in new equipment and technology, metal prices and other factors. Based on year-end ore reserves and the current mine plan, the Company reviews annually its accounting estimates and makes adjustments accordingly.

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

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

(b) Amortization of mining interests

The Company amortizes a large portion of its mining interests using the unit of production method based on proven and probable reserves. As a result of the asset impairment charge recorded in 2004, the unit of production amortization rate in 2005 reduced by approximately 49%. Changes in reserves as at June 30, 2003, caused amortization rates to increase by approximately 25%. Changes in reserve estimates are calculated periodically and could affect amortization expense prospectively.

(c) Forward Metal Sales and Metal Price Swap Contracts

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

North American Palladium uses fixed-price forward platinum sales contracts and cash settled gold, nickel and copper price swap contracts to insulate its earnings and cash flows from changes in these metal prices. These contracts allow the Company to sell its platinum to credit-worthy metal dealers at a fixed price under the forward sales contract. In the case of gold, nickel and copper, the Company receives a fixed metal price in exchange for paying the floating price received under its physical sales contracts to acceptable counterparts under the metal price swap contracts. In October, 2005, the Company made a decision to unwind various by-product metal hedges namely, platinum, gold, and nickel through the buy-back of forward sales or cash settled metal price swaps. This decision was taken to reposition the Company's exposure to its by-product metals in advance of the expected increase in metal production at Lac des Iles in 2006.

Recent Accounting Pronouncements Issued But Not Yet Adopted

FINANCIAL INSTRUMENTS – RECOGNITION AND MEASUREMENT

In January 2005, the CICA released new Handbook Section 3855, "Financial Instruments – Recognition and Measurement", effective for annual and interim periods beginning on or after October 1, 2006. This new section establishes standards for the recognition and measurement of all financial instruments, provides a characteristics-based definition of a derivative financial instrument, provides criteria to be used to determine when a financial

instrument should be recognized, and provides criteria to be used when a financial instrument is to be extinguished. The Company has not yet determined the affect these new standards will have on its financial position and results of operations.

COMPREHENSIVE INCOME AND EQUITY

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

HEDGES

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

Non-GAAP Measure

North American Palladium has included in this document a non-GAAP performance measure for cash cost per ounce. This non-GAAP measure does not have any standardized meaning nor is it necessarily comparable with similar measures presented by other companies. North American Palladium believes that certain investors use this information to evaluate the Company's performance. This data is intended to provide additional information and should not be considered in isolation or as a substitute for measures of performance prepared in accordance with GAAP.

RECONCILIATION OF CASH COST PER OUNCE TO FINANCIAL STATEMENTS

Year ended December 31 (thousands of dollars except per ounce amounts)	2005	2004
Production costs including overhead	\$ 99,322	\$ 102,936
Smelter treatment, refining and freight costs	15,777	23,602
	115,099	126,538
Less: by-product metal revenue	(49,208)	(71,416)
	65,891	55,122
Divided by ounces of palladium	154,196	270,448
Cash cost per ounce (C\$)	427	204
C\$ exchange rate	1.19062	1.2795
Cash cost per ounce (US\$)	\$ 359	\$ 159

RECONCILIATION BETWEEN NET INCOME IN ACCORDANCE WITH CANADIAN GAAP AND ADJUSTED NET INCOME

The adjusted net income reported in this analysis has not been calculated in accordance with Canadian GAAP, the accounting principles under which our consolidated financial statements are prepared, and there is no standard definition in such principles for such adjusted net income or loss. Accordingly, it is unlikely that comparisons can be made among different companies in terms of such adjusted results reported by them.

The following table provides a reconciliation between our adjusted net income and net income (loss) as reported in accordance with Canadian GAAP for the years ended December 31, 2005 and December 31, 2004:

(thousands of dollars except per share amounts)	Net Income Year Ended December 31		Basic Net Income Per Share Year Ended December 31	
	2005	2004	2005	2004
Canadian GAAP net income (loss) as reported	\$ (53,611)	\$ (92,110)	\$ (1.03)	\$ (1.79)
Impairment charge net of tax	—	103,376	—	2.01
Foreign exchange (gain) loss net of tax	(268)	340	(0.01)	0.01
Insurance recovery net of tax	—	(4,352)	—	(0.09)
Adjusted net income	\$ (53,879)	\$ 7,254	\$ (1.04)	\$ 0.14

OTHER INFORMATION

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

OUTSTANDING SHARE DATA

As of February 21, 2006, there were 52,216,770 common shares of the Company outstanding and options outstanding pursuant to the 1995 Corporate Stock Option Plan entitling holders thereof to acquire 544,085 common shares of the Company at an average strike price of \$10.43.

Risks and Uncertainties

The price of palladium is the most significant factor influencing the profitability of the Company. In 2005, sales of palladium accounted for approximately 47% of the Company's revenue. Many factors influence the price of palladium, including global supply and demand, speculative activities, international political and economic conditions and production levels and costs in other PGM producing countries, particularly Russia and South Africa. The possible development of a substitute alloy or synthetic material, which has catalytic characteristics similar to platinum group metals, may result in a future decrease in demand for palladium and platinum.

Currency fluctuations may affect cash flow since production currently is sold in United States dollars, whereas the Company's administration, operating and exploration expenses are incurred 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 September 30, 2006. Management believes it will be successful in negotiating an extension and/or new agreement with the smelting firm, but cannot guarantee that this will occur.

Disclosure Controls and Procedures

Management is responsible for the information disclosed in this management's discussion and analysis and has in place the appropriate information systems, procedures and controls to ensure that information used internally by management and disclosed externally is, in all material respects, complete and reliable. As of the financial year ended December 31, 2005, an evaluation was carried out under the supervision of, and with the participation of, the Company's management, including the Chief Executive Officer and Chief Financial Officer, on the effectiveness of the Company's disclosure controls and procedures. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the design and operation of these disclosure controls and procedures were effective as of December 31, 2005 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.

Forward-Looking Statements – Certain statements included in this 2006 annual report, financial statements for the year ended December 31, 2005 and management's discussion and analysis are forward-looking statements which are made pursuant to the "safe harbor" provisions of the United States Private Securities Litigation Reform Act of 1995. They include estimates and statements that describe the Company's future plans, objectives and goals, including words to the effect that the Company or management expects a stated condition or result to occur. When used herein, words such as "continue", "proposed", "appears", "indicating", "predicting", "estimate", "expect", "plan", "should", "may", "will" and other similar expressions are intended to identify forward-looking statements. In particular statements relating to the estimated future metal prices, cash flows, expenses, capital costs, ore production, mine life, financing, construction and commissioning, and exploration prospects are forward-looking statements. Such forward-looking statements involve inherent risks and uncertainties and are subject to factors, many of which are beyond our control, that may cause actual results or performance to differ materially from those currently anticipated in such statements. Important factors that could cause actual results to differ materially from those expressed or implied by such forward-looking statements include among others: metal price volatility, changes in the US/CDN dollar exchange rate, economic and political events affecting metal supply and demand, fluctuations in ore grade, ore tonnes milled, geological, technical, mining or processing problems, recoverability of metals, future profitability and production, availability of financing on acceptable terms and unexpected problems during the development, construction and start-up phases of the underground mine. For a more comprehensive review of risk factors, please refer to the Company's most recent Annual Report under "Management's Discussion and Analysis of Financial Results" and Annual Information Form under "Risk Factors" on file with the U.S. Securities and Exchange Commission and Canada provincial securities regulatory authorities. The Company disclaims any obligation to update or revise any forward-looking statements whether as a result of new information, events or otherwise. Readers are cautioned not to put undue reliance on these forward-looking statements.

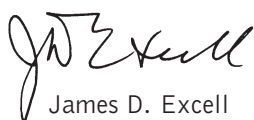
MANAGEMENT'S RESPONSIBILITY

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

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

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

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



James D. Excell

PRESIDENT AND CHIEF EXECUTIVE OFFICER



Ian M. MacNeily

VICE PRESIDENT, FINANCE AND CHIEF FINANCIAL OFFICER

Toronto, Canada

March 29, 2006

AUDITORS' REPORT

To the Shareholders of North American Palladium Ltd.

We have audited the consolidated balance sheets of North American Palladium Ltd. as at December 31, 2005 and 2004 and the consolidated statements of earnings (loss) and deficit and cash flows for each of the years in the two-year period ended December 31, 2005. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2005 and 2004 and the results of its operations and its cash flows for each of the years in the two-year period ended December 31, 2005, in accordance with Canadian generally accepted accounting principles.

The consolidated financial statements as at and for the year ended December 31, 2003, were audited by another firm of chartered accountants, who expressed an opinion without reservation on those statements in their auditors' report, dated February 20, 2004.



KPMG LLP

CHARTERED ACCOUNTANTS

Toronto, Canada,
March 29, 2006

CONSOLIDATED BALANCE SHEETS

(EXPRESSED IN THOUSANDS OF CANADIAN DOLLARS)

December 31	2005	2004
Assets		
CURRENT ASSETS		
Cash and cash equivalents	\$ 15,031	\$ 65,755
Concentrate awaiting settlement, net – NOTE 3	37,453	68,259
Inventories – NOTE 4	8,599	8,954
Crushed and broken ore stockpiles	7,267	9,256
Other assets	2,344	1,615
	70,694	153,839
Mining interests, net – NOTE 5	159,523	136,009
Mine restoration deposit – NOTE 7	7,247	5,973
Crushed and broken ore stockpiles	239	1,379
Deferred financing costs – NOTE 6	654	697
	\$ 238,357	\$ 297,897
Liabilities and Shareholders' Equity		
CURRENT LIABILITIES		
Accounts payable and accrued liabilities	\$ 16,392	\$ 20,231
Taxes payable	386	521
Current portion of obligations under capital leases – NOTE 8	2,323	1,481
Current portion of long-term debt – NOTE 9	6,664	6,815
Kaiser-Francis credit facility – NOTE 10	13,407	—
	39,172	29,048
Mine restoration obligation	7,894	7,592
Obligations under capital leases – NOTE 8	6,218	3,182
Long-term debt – NOTE 9	17,660	24,851
Kaiser-Francis credit facility – NOTE 10	—	13,842
Future mining tax liability – NOTE 17	202	1,549
	71,146	80,064
Shareholders' Equity		
Capital stock – NOTE 12	325,592	322,904
Contributed surplus	874	573
Deficit	(159,255)	(105,644)
Total shareholders' equity	167,211	217,833
	\$ 238,357	\$ 297,897

Commitments – NOTES 1, 14 Contingencies – NOTE 16 Subsequent Events – NOTE 20

SEE ACCOMPANYING NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

On behalf of the Board:



André J. Douchane
DIRECTOR



Greg Van Staveren
DIRECTOR

CONSOLIDATED STATEMENTS OF EARNINGS (LOSS) AND DEFICIT

(EXPRESSED IN THOUSANDS OF CANADIAN DOLLARS, EXCEPT SHARE AND PER SHARE AMOUNTS)

Year ended December 31	2005	2004	2003
Revenue from metal sales – NOTE 15	\$ 92,606	\$ 185,204	\$ 192,141
Operating expenses			
Production costs, excluding amortization and asset retirement costs	99,322	102,936	103,654
Smelter treatment, refining and freight costs – NOTE 1	15,777	23,602	19,048
Insurance recovery – NOTE 16(b)	—	(7,148)	—
Amortization – NOTE 5(b)	18,340	36,710	28,590
Administrative	6,616	5,557	3,788
Exploration expense	7,927	2,479	1,942
Loss on disposal of capital assets	—	277	788
Asset retirement costs	476	905	921
Write-down of mining interests – NOTE 5(c)	—	108,000	2,315
Total operating expenses	148,458	273,318	161,046
Income (loss) from mining operations	(55,852)	(88,114)	31,095
Other income (expenses)			
Interest on long-term debt – NOTES 9 AND 10	(2,509)	(1,756)	(3,158)
Write off of deferred financing costs	—	(788)	—
Foreign exchange gain (loss)	268	(340)	18,138
Interest income	1,641	494	474
Derivative income	—	213	—
Interest expense	(41)	(29)	(17)
Total other income (expenses)	(641)	(2,206)	15,437
Income (loss) before income taxes	(56,493)	(90,320)	46,532
Provision for income taxes – NOTE 17	(2,882)	1,790	8,154
Net income (loss) for the year	(53,611)	(92,110)	38,378
Deficit, beginning of year	(105,644)	(13,534)	(51,912)
Deficit, end of year	\$ (159,255)	\$ (105,644)	\$ (13,534)
Net income (loss) per share			
Basic	\$ (1.03)	\$ (1.79)	\$ 0.76
Diluted – NOTE 12(b)	\$ (1.03)	\$ (1.79)	\$ 0.75
Weighted average number of shares outstanding – basic	52,006,548	51,379,542	50,763,566
Weighted average number of shares outstanding – diluted – NOTE 12(b)	52,006,548	51,379,542	50,832,904

SEE ACCOMPANYING NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

CONSOLIDATED STATEMENTS OF CASH FLOWS

(EXPRESSED IN THOUSANDS OF CANADIAN DOLLARS, EXCEPT SHARE AND PER SHARE AMOUNTS)

Year ended December 31	2005	2004	2003
Cash provided by (used in)			
OPERATIONS			
Net income (loss) for the year	\$ (53,611)	\$ (92,110)	\$ 38,378
Operating items not involving cash			
Future income tax expense – NOTE 17	(3,286)	643	7,392
Amortization	18,340	36,710	28,590
Accrued interest on mine closure deposit	(74)	(40)	(63)
Unrealized foreign exchange gain	(1,433)	(3,687)	(18,519)
Provision for asset retirement costs	476	905	921
Write off of deferred financing costs	—	788	—
Write-down of mining interests	—	108,000	2,315
Loss on disposal of capital assets	—	277	788
Stock based compensation	588	573	—
	(39,000)	52,059	59,802
Changes in non-cash working capital – NOTE 18(a)	29,587	29,731	(5,235)
	(9,413)	81,790	54,567
Financing Activities			
Repayment of long-term debt	(6,798)	(44,290)	(45,134)
Issuance of common shares	4,340	9,415	1,506
Mine restoration deposit	(1,200)	(1,200)	(1,200)
Repayment of obligations under capital leases	(2,253)	(1,751)	(1,046)
Deferred financing costs	—	(504)	—
Increase in long-term debt	—	36,809	—
	(5,911)	(1,521)	(45,874)
Investing Activities			
Additions to mining interests	(35,415)	(28,728)	(11,707)
Proceeds on disposal of mining interests	15	451	114
Restricted cash equivalents	—	1,813	3,314
	(35,400)	(26,464)	(8,279)
Increase (decrease) in cash and cash equivalents	(50,724)	53,805	414
Cash and cash equivalents, beginning of year	65,755	11,950	11,536
Cash and cash equivalents, end of year	\$ 15,031	\$ 65,755	\$ 11,950

Supplementary information – NOTE 18(b) AND (c)

SEE ACCOMPANYING NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEARS ENDED DECEMBER 31, 2005, 2004 AND 2003

(EXPRESSED IN THOUSANDS OF CANADIAN DOLLARS, EXCEPT SHARE AND PER SHARE AMOUNTS)

NOTE 1.

Nature of Operations

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

During 2000, the Company entered into a long-term palladium sales agreement with a major automotive manufacturer for the sale of all of its palladium production for deliveries of metal up to June 30, 2005 (note 14(a)). Commencing with the first quarter of 2005, palladium production which was available for delivery after June 30, 2005 was not subject to the palladium sales agreement under which the Company's palladium sales had a floor price of US\$325 per ounce. In 2005, the Company's revenue included only 6,403 ounces of palladium sold under this palladium sales contract floor price. For palladium delivered after June 30, 2005, the Company entered into palladium sales contracts that provided for the delivery of palladium at the monthly average price in the month prior to delivery based on the London PM fix price or spot price on the day of delivery. These contracts expired on December 31, 2005 and currently the Company is selling its monthly palladium production into the spot market.

ARCTIC PLATINUM PROJECT

On October 18, 2005, the Company announced that it had entered into a letter of intent to form a Joint Venture with Gold Fields Limited to further explore and develop a mining operation at the Arctic Platinum Project ("APP") located in Finland. The APP includes several advanced stage PGM Projects. The Company has been granted an option to earn up to a 50% interest and, in certain circumstances, a 60% interest in APP. The Company will become the project operator. In order to exercise the option, the Company must spend US\$12.5 million, complete a feasibility study and make a production decision as well as paying Gold Fields US\$36 million for a 50% interest or US\$45 million for a 60% interest through the issuance of the Company's common shares on or before August 31, 2008. The transaction is subject to certain conditions including the executing of a formal agreement and receipt of all necessary regulatory approvals, which is expected during the first quarter of 2006.

NOTE 2.

Basis of Presentation and Summary of Significant Accounting Policies

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and, except as discussed in note 19, conform in all material respects with United States generally accepted accounting principles. The more significant accounting policies are summarized as follows:

BASIS OF CONSOLIDATION

These consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, Lac des Iles Mines Ltd. ("LDI"). All intercompany balances and transactions have been eliminated.

REVENUE AND CONCENTRATE AWAITING SETTLEMENT

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

Although the Company sold its metals during 2005 to a limited number of customers, the Company is not economically dependent upon them as there are other markets throughout the world for the Company's metals.

DERIVATIVE FINANCIAL INSTRUMENTS

From time to time the Company enters into forward commodity sales contracts to hedge the affect of changes in the prices of metals it produces on the Company's revenues (note 14 (c)). Gains and losses on derivative financial instruments used to mitigate metal price risk are recognized in revenue from metal sales (note 15) over the term of the hedging contract.

From time to time the Company enters into foreign exchange forward sales contracts to manage the affect of fluctuations in the value of committed U.S. dollar denominated revenues. For those forward exchange contracts designated by the Company as hedges, the related revenue is recorded at the forward contract rate. Those foreign exchange forward sales contracts not designated by the Company as hedges are marked-to-market as at the balance sheet date and the resultant gains or losses are included in earnings for the period. The fair value of the Company's derivative financial instruments is determined based on forward prices supplied by knowledgeable, independent third parties.

The Company has from time to time used electricity swap contracts to hedge the affects of price fluctuations in its electricity purchase requirements in Ontario. The net swap settlements are recognized in the same period as the hedge transaction.

The Company does not hold financial instruments or derivative financial instruments for trading purposes. Cash flows arising in respect of hedging transactions are recognized under cash flows from operating activities.

The Company does not consider the credit risk associated with its financial instruments to be significant. Foreign currency contracts and commodity hedge contracts are maintained with high-quality counter-parties, and the Company does not anticipate that any counter-party will fail to meet its obligations.

CONCENTRATE, CRUSHED AND BROKEN ORE STOCKPILES AND SUPPLIES INVENTORIES

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

MINING INTERESTS

Plant and equipment are recorded at cost with amortization generally provided either on the unit-of-production method over the proven and probable reserves to which they relate or for certain equipment on a straight-line basis over their estimated useful lives, ranging from three to seven years. The Company capitalizes interest on major projects where direct indebtedness has occurred. During 2005, \$307 (2004 – \$36) interest was capitalized.

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

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

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

Each year, the Company reviews mining plans for the remaining life of each property. Significant changes in the mine plan can occur as a result of mining experience, new discoveries, changes in mining methods and rates, process changes, investments in new equipment and technology and other factors. Based on year-end ore reserves and the current mine plan, the Company reviews annually its accounting estimates and makes adjustments accordingly.

The Company assesses long-lived assets for recoverability whenever indicators of impairment exist. When the carrying value of a long-lived asset is less than its net recoverable value as determined on an undiscounted basis, an impairment loss is recognized to the extent that its fair value, measured as the discounted cash flows over the life of the asset is less than the carrying value. Future cash flows are estimated based on quantities of recoverable minerals, expected palladium and other commodity prices and expected foreign exchange rates (considering current, historical and expected future prices and foreign exchange rates and related factors), production levels and cash costs of production and capital and reclamation expenditures, all based on detailed life-of-mine plans and projections. The term “recoverable minerals” refers to the estimated amount of palladium and other commodities that will be obtained from proven and probable reserves after taking into account losses during mining, ore processing and concentrate treatment. Assumptions underlying future cash flow estimates are subject to risk and uncertainty. Any differences between significant assumptions and market conditions such as metal prices, exchange rates, recoverable metal, and/or the Company’s operating performance could have a material effect on the Company’s ability to recover the carrying amounts of its long-lived assets resulting in possible additional impairment charges (note 5(c)).

ASSET RETIREMENT OBLIGATIONS

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

are estimated to be approximately \$7.8 million, the majority of which is to be paid at the end of the mine life, which is currently expected to end in 2012. A credit adjusted risk-free rate of 4% has been utilized to determine the obligation recorded on the balance sheet. The estimated asset retirement obligation may change materially based on future changes in operations, costs of reclamation and closure activities, and regulatory requirements.

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

	2005	2004
Balance, beginning of the year	\$ 7,592	\$ 7,300
Accretion expense	302	292
Balance at the end of year	\$ 7,894	\$ 7,592

STOCK-BASED COMPENSATION PLANS

The Company has a stock-based compensation plan which is described in note 12(a) and a Restricted Share Unit Plan ("RSU") which is described in note 12(c). Effective January 1, 2003, the Company prospectively changed its method of accounting for stock options from the intrinsic value method to one that recognizes as an expense the cost of stock-based compensation based on the estimated fair value of new stock options granted to employees and directors. The fair value of each RSU, being the fair market value of the Company's common shares at the grant date, is recorded as a liability on the Company's consolidated balance sheet over the vesting period. The value of the RSU liability is adjusted to reflect changes in the market value of the Company's common shares at each period end.

TRANSLATION OF FOREIGN CURRENCY

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

INCOME TAXES

The Company follows the asset and liability method of tax allocation for accounting for income taxes. Under the asset and liability method of tax allocation, future tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities and are measured using the substantively enacted tax rates and laws that will be in effect when the differences are expected to reverse. The affect on future tax liabilities and assets of a change in tax rates is recognized in income in the period that the change occurs.

CASH AND CASH EQUIVALENTS

Cash and cash equivalents include cash on account, demand deposits and short-term guaranteed investments with original maturities of three months or less and are stated at cost.

DEFERRED FINANCING COSTS

Deferred financing costs represents the costs of negotiating and securing the Company's long-term debt facilities and share issue costs in connection with the filing of a shelf prospectus. The amortization of the costs of securing the long-term debt facilities is included in amortization expense on a straight-line basis over the term of the debt facility. The share issue costs will be offset against share proceeds at the time an equity financing is completed and if an equity financing is not completed before the expiration of the shelf prospectus, the share issue costs will be written off.

BASIC AND DILUTED EARNINGS (LOSS) PER SHARE

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

USE OF ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities, and disclosure of contingent assets and liabilities at the date of the financial statements and that also affect the reported amounts of revenues and expenses during the reported year. Actual results could differ from those estimates.

NOTE 3.

Concentrate Awaiting Settlement

Concentrate awaiting settlement is comprised of:

	2005	2004
Concentrate awaiting settlement, gross	\$ 41,819	\$ 76,491
Refining and smelter treatment charges	(4,366)	(8,232)
Concentrate awaiting settlement, net	\$ 37,453	\$ 68,259

The gross value of concentrate awaiting settlement represents the value of all PGMs and base metals from production shipped to and received by the third-party smelters between June and December, 2005, including 65,905 ounces of palladium (2004 – including 114,186 ounces of palladium).

All of the concentrate awaiting settlement is from two domestic customers at December 31, 2005 (2004 – two domestic customers). No reserves for doubtful accounts have been established. In the opinion of management, full realization will occur on all such receivables.

NOTE 4.

Inventories

Inventories consist of the following:

	2005	2004
Concentrate	\$ 502	\$ 587
Supplies	8,097	8,367
	\$ 8,599	\$ 8,954

NOTE 5.

Mining Interests

(a) Mining interests are comprised of the following:

	2005	2004
Plant and equipment, at cost	\$ 355,532	\$ 344,412
Underground mine development, at cost	30,784	6,920
Accumulated amortization and impairment charges	249,043	232,339
	137,273	118,993
Equipment under capital lease, at cost	14,076	7,493
Accumulated amortization and impairment charges	2,245	2,030
	11,831	5,463
Mining leases and claims, royalty interest, and development, at cost	82,561	82,537
Accumulated amortization and impairment charges	72,142	70,984
	10,419	11,553
Mining interests, net	\$ 159,523	\$ 136,009

(b) Amortization expense is comprised of:

	2005	2004	2003
Capital assets (including plant and equipment, and equipment under capital lease)	\$ 17,384	\$ 32,149	\$ 24,746
Mining leases and claims, royalty interest, exploration and development costs	913	4,147	3,054
Deferred financing costs	43	414	790
	\$ 18,340	\$ 36,710	\$ 28,590

(c) During the fourth quarters of 2005 and 2004, the Company tested its long-lived assets, including tangible mineral interests and plant and equipment for impairment, and reflected an impairment charge of nil in 2005 and a charge of \$108,000 in 2004. The impairment charge recorded in 2004 related to the Lac des Iles mine and has been recorded in mining interests on the consolidated balance sheet.

The impairment charge recorded in 2004 was substantially the result of the continued low prices for palladium, the primary metal produced at LDI. During 2004, the Company continued to negotiate potential new sales contracts to replace the long-term palladium sales agreement with a major manufacturer for the sale of all of its palladium production for deliveries of metal up to June 30, 2005. As the Company was unable to secure a replacement sales contract, the Company reassessed the expected long-term average sales price of palladium in an impairment test which was completed in the fourth quarter of 2004.

In accordance with the Company's accounting policy, the Company recorded the 2004 impairment as the difference between the carrying value of the mineral interests and the fair value of the mineral interests measured using a discounted cash flow analysis over the remaining life of LDI. The key assumptions utilized by the Company in its life-of-mine discounted cash flow model were: expected long-term average price of palladium of \$275 per ounce, gold of \$375 per ounce; platinum of \$650 per ounce, copper of \$0.90 per pound and nickel of \$3.50 per pound; life-of-mine discount rate of 5%; expected additional capital expenditures of \$56,000; and an average life-of-mine foreign exchange rate of CDN\$1.34 to U.S. \$1.00.

In 2003, the Company recorded a write-down of \$2,315 pertaining to the retirement of a damaged primary crusher.

- (d) Mining interests in the amount of \$30,784 (2004 – \$6,920) are not subject to amortization as these costs relate to underground mine development work currently in progress.

NOTE 6.

Deferred Financing Costs

	2005	2004
Financing costs	\$ 716	\$ 716
Accumulated amortization	62	19
	\$ 654	\$ 697

NOTE 7.

Mine Restoration Deposit

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

Commencing in February, 2001, the Fund, controlled by the Ministry, started to accumulate through monthly deposits of \$100. At December 31, 2005, the Company had \$7,247 (2004 – \$5,973) on deposit with the Ministry including accrued interest of \$317. The funds on deposit bear interest at current short-term deposit rates and will be returned to the Company once the mine closure is completed.

NOTE 8.

Obligations Under Capital Leases

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

	2005	2004
2005	\$ —	\$ 1,632
2006	2,709	1,223
2007	2,380	951
2008	2,138	763
2009	1,761	452
2010	472	—
Total minimum lease payments	9,460	5,021
Amounts representing interest at rates from 3.5% – 8.3%	919	358
Present value of minimum lease payments	8,541	4,663
Less current portion	2,323	1,481
Long-term liabilities	\$ 6,218	\$ 3,182

NOTE 9.

Long-Term Debt

	2005	2004
Equipment finance company credit facility consisting of Cdn\$8,000 and US\$14,000 (2004 – Cdn\$10,000 and US\$18,000) loans	\$ 24,324	\$ 31,666
Less: current portion	6,664	6,815
	\$ 17,660	\$ 24,851

On June 28, 2004, the Company entered into a US\$20,000 and Cdn\$10,000 senior credit facility with an equipment finance company. The US\$20,000 credit facility is repayable in equal quarterly installments of US\$1,000 commencing on September 30, 2004 and has a final maturity on June 30, 2009. The Cdn\$10,000 credit facility is repayable in equal quarterly installments of Cdn\$500 commencing February 24, 2005 and has a final maturity of November 24, 2009. The credit facility has an interest margin of 2.5% over 30 day LIBOR rate. In return for granting the loan, the lender received a first priority security in all of the Company's existing and future assets excluding its production leases and claims. The credit facility allows in certain circumstances, full repayment of outstanding loans at any time during the term of the facility.

NOTE 10.

Kaiser-Francis Credit Facility

At the time the Company entered into the new senior credit facility, certain terms under the US\$20,000 non-revolving credit facility with Kaiser-Francis Oil Company ("Kaiser-Francis") were amended. The final maturity date was extended to June 30, 2006 from May 31, 2005 and the interest rate was reset based upon the 30 day LIBOR rate plus 2.50%. Amounts not drawn under the loan are subject to a standby fee payable quarterly at 0.125% per annum. The Company paid on closing a commitment fee of 0.75% of the total commitment (US\$150). In connection with the loan, the Company has granted Kaiser-Francis a security interest in all of the assets of the Company and a pledge of the LDI shares. The security interests in all of the assets of the Company are subordinated to the security interests of the senior credit facility (note 9). As at December 31, 2005, the outstanding loan was US\$11,500 (2004 – US\$11,500).

The loan agreement includes customary representations, warranties and covenants, including a covenant by the Company not to pay dividends or make any other payment to shareholders while the loan is outstanding. The loan agreement also provides for customary events of default.

NOTE 11.

Related Party Transactions and Commitments

Kaiser-Francis is the controlling shareholder of the Company. In addition to the related party transactions with Kaiser-Francis disclosed in note 10, the Company has the following related party transaction:

In 2005, a director of the Company received a fee of \$218 (2004 – \$581, 2003 – \$400) in connection with the negotiations related to the Palladium Sales Contract entered into by the Company in 2000 (note 14(a)). The contract was negotiated at arms-length prior to such person becoming a director of the Company. The Palladium Sales Contract expired on June 30, 2005, and no further fees are payable in connection with this contract.

NOTE 12.

Capital Stock

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

(a) Common Shares:

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

	2005		2004	
	Shares	Amount	Shares	Amount
Common shares issued, beginning of year	51,709,075	\$ 322,904	50,895,338	\$ 313,489
Common shares issued:				
Pursuant to stock options exercised	118,759	697	459,380	4,637
Fair value of stock options exercised	—	287	—	—
To Group Registered Retirement Savings Plan participants	156,383	1,140	84,357	956
Private placement (net)	213,000	2,503	270,000	3,822
Tax affect of flow-through shares	—	(1,939)	—	—
Common shares issued, end of year	52,197,217	\$ 325,592	51,709,075	\$ 322,904

GROUP REGISTERED RETIREMENT SAVINGS PLAN

The Company has a group registered retirement savings plan, which all employees can participate in at their option. The Company is required to make matching contributions to a maximum of \$5 per employee per annum. The Company's matching contribution can be made either in cash or treasury shares of the Company. During 2005 the Company contributed 156,383 shares with a fair value of \$1,140 (2004 – 84,357 shares with a fair value of \$956).

PRIVATE PLACEMENT

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

On July 9, 2004, the Company completed a private placement of 270,000 flow-through common shares. The gross proceeds of \$4,050 were spent on Canadian exploration expenses prior to December 31, 2005.

Under the terms of the flow-through common share issues, the tax attributes of the related expenditures will be renounced to investors and the share capital will be reduced and future income tax liabilities will be increased by the estimated income tax benefits renounced by the Company to the investors. The tax attributes for the 2003 and 2004 expenditures were renounced in 2005.

CORPORATE STOCK OPTION PLAN

The Company has adopted, and the shareholders have approved, the ongoing 1995 Corporate Stock Option Plan (the "Plan"), under which eligible directors, officers, employees and consultants of the Company are entitled to receive options to acquire common shares. The Plan is administered by the Compensation Committee, a subcommittee of the Board of Directors, which determines the number of options to be issued, the exercise price (which may not be lower than the closing price of the Company's common shares on the Toronto Stock Exchange ("TSX") on the day prior to

the date of grant) and expiration dates of each option, the extent to which each option is exercisable provided that the term of an option shall not exceed 10 years from the date of grant, as well as establishing a limited time period should the optionee cease to be an "Eligible Person" as set forth in the conditions of the Plan. Options granted since December, 2001, vest as to 1/3 on each of the first three anniversary dates of the date of grant. Prior to December, 2001, options granted under the Plan vested as to 1/3 on the date of grant and 1/3 on each of the first two anniversary dates.

The maximum number of common shares subject to option shall not exceed 2,700,000, being approximately 5.2% of the outstanding common shares or such greater number of common shares as may be determined by the Board of Directors, and approved if required, by the shareholders of the Company and by any relevant stock exchange or other regulatory authority. As at December 31, 2005, 461,308 options were available to be granted under the Plan.

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

	2005		2004	
	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price
Outstanding, beginning of year	825,610	\$ 9.88	1,038,857	\$ 9.24
Granted	100,000	9.75	316,800	11.87
Exercised	(118,759)	5.87	(459,380)	10.10
Cancelled	(243,213)	10.51	(70,667)	7.96
Outstanding, end of year	563,638	\$ 10.43	825,610	\$ 9.88
Options exercisable at end of year	265,571	\$ 11.09	389,265	\$ 10.08

The following table summarizes information about the Company's stock options outstanding at December 31, 2005:

Exercise Price	Expiry Dates	Options Outstanding at December 31, 2005	Options Exercisable at December 31, 2005
\$ 3.42	April 7, 2011	45,088	18,921
\$ 3.70	April 1, 2011	16,700	33
\$ 4.75	February 27, 2011	7,500	5,000
\$ 7.89	December 12, 2009	22,500	22,500
\$ 8.83	December 14, 2013	10,000	—
\$ 9.67	November 30, 2013	40,000	—
\$ 9.76	November 1, 2012	15,000	5,000
\$ 10.00	November 27, 2013	50,000	—
\$ 10.01	June 6, 2010	48,000	48,000
\$ 11.90	June 23, 2012	214,100	71,367
\$ 13.55	June 6, 2006	76,250	76,250
\$ 14.44	February 13, 2006	18,500	18,500
		563,638	265,571

- (a) Prior to January 1, 2003, the Company did not recognize compensation expense for stock options. Had compensation expense for options granted in 2002 under the Company's stock option plan been determined based on the fair value at the grant dates consistent with the fair value based method of accounting for stock-based compensation, the Company's net income and earnings per share would have been reduced to the pro forma amounts indicated below:

	2005	2004	2003
Net income (loss) as reported	\$ (53,611)	\$ (92,110)	\$ 38,378
Stock-based compensation	—	160	160
Pro forma net income (loss)	\$ (53,611)	\$ (92,270)	\$ 38,218
Pro forma basic and diluted income (loss) per share	\$ (1.03)	\$ (1.80)	\$ 0.75

The fair value of options granted in 2005 has been estimated at the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions: risk free interest rate of 3.78 % (2004 – 3.7%; 2003 – 4%), expected dividend yield of nil (2004 – nil; 2003 – nil), expected volatility of 55% (2004 – 55%; 2003 – 48%), and expected option life of 4 years (2004 – 4 years; 2003 – 3 years). The estimated fair value of the options is expensed over the option's vesting period, which is 3 years. The weighted average fair market value of options granted in 2005 was \$4.51 (2004 – \$5.43; 2003 – \$2.13). Compensation expense related to the Plan for the year ended December 31, 2005 was \$582 (2004 – \$573; 2003 – \$nil).

- (b) Reconciliation of the diluted number of shares outstanding:

	2005	2004	2003
Net income (loss) available to common shareholders	\$ (53,611)	\$ (92,110)	\$ 38,378
Weighted average number of shares outstanding	52,006,548	51,379,542	50,763,566
Effect of dilutive securities stock options	—	—	69,338
Weighted average diluted number of shares outstanding	52,006,548	51,379,542	50,832,904
Diluted net income (loss) per share	\$ (1.03)	\$ (1.79)	\$ 0.75

The effect of stock options has not been included in the determination of diluted loss per share for 2005 or 2004, because to do so would be antidilutive.

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

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

As at December 31, 2005, 25,000 restricted share units have been granted and are outstanding at a weighted average value of \$9.64 per unit and \$6 has been charged to compensation expense for the year ended December 31, 2005. The market value of the restricted share units as at December 31, 2005 is \$9.81 per unit.

NOTE 13.

Fair Value of Financial Instruments

The carrying amounts of all financial instruments on the balance sheet approximate fair value due to their short-term maturities or variable interest rates. The fair value of the obligations under capital leases approximate their carrying value due to the interest rate implicit in the leases approximating interest rates available at this time for similar lease terms. As at December 31, 2005, the unrealized loss on the fair value of the Company's outstanding forward commodity sales contracts was US\$240 (2004 – US\$624).

NOTE 14.

Commitments

(a) PALLADIUM SALES CONTRACT

In 2000, the Company entered into a contract (the "Palladium Sales Contract") whereby the Company hedged the price of 100% of its palladium production. Under the Palladium Sales Contract the sales price was based on the monthly average spot price for palladium, as determined by the London Metal Exchange P.M. Fix, for the month prior to the month that the metal was received by the customer, but the price was no less than US\$325 per ounce for 100% of the metal received and no more than US\$550 per ounce for 50% of the metal received. For the remaining 50% of the metal received, there was no maximum price. The Palladium Sales Contract's term commenced effective July 1, 2000 and expired on June 30, 2005, and was not renewed.

(b) SHERIDAN PLATINUM GROUP OF COMPANIES ("SPG") COMMITMENT

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

(c) COPPER SWAP CONTRACTS

As at December 31, 2005, the Company had swap contracts for 330,693 lbs. of copper at an average fixed price of US\$1.29 per lb. maturing at various dates through March, 2006. The fair value of these swap contracts was below their carrying value by \$240 as at December 31, 2005.

(d) OPERATING LEASES AND OTHER PURCHASE OBLIGATIONS

As at December 31, 2005, the Company had outstanding operating lease commitments and other purchase obligations of \$1,053 and \$5,175, respectively (2004 – \$1,818 and \$4,222) all of which had maturities of less than four years.

(e) FLOW-THROUGH SHARES

To satisfy its commitments pursuant to the issuance of flow-through shares, the Company is required to expense \$2,503 of qualifying Canadian exploration expenses as defined in the Income Tax Act (Canada) by December 31, 2006.

NOTE 15.

Revenue from Metal Sales

	2005	2004	2003
Palladium (a)	\$ 38,621	\$ 112,879	\$ 109,443
Palladium forward contracts (b)	—	—	20,437
Adjustments for mark-to-market	4,777	909	(1,163)
Nickel	16,041	25,735	26,010
Platinum	17,144	25,735	26,010
Gold	6,568	21,476	18,847
Copper	8,284	10,665	9,826
Other metals	1,171	10,945	7,722
	\$ 92,606	2,595	1,019
		\$ 185,204	\$ 192,141

- (a) Palladium revenues include the effect of the Palladium Sales Contract (note 14(a)).
- (b) The Company entered into palladium forward contracts in 2001 for 100,800 ounces of palladium at an average price of US\$922 per ounce, the revenue from which was fully recognized by June 30, 2003. The effect of palladium forward contracts represents the difference between the fixed price realized under the palladium forward contracts and the palladium price at the time of revenue recognition.

NOTE 16.

Contingencies

- (a) The Company is a defendant in an action by another mining company claiming damages in the amount of \$20,000, punitive and exemplary damages in the amount of \$5,000 and a declaration that the Company held the Compania Minerales de Copan, S.A. de C.V. ("Copan") property in trust for the plaintiff. This action relates to a predecessor company of the Company and has been inactive for some time. No provision has been made in the accounts as at December 31, 2005 or 2004 for any possible loss from this action as management of the Company believes it has a valid defense and it has been indemnified by SPG regarding this action. In addition, certain stock options are claimed to be held by employees of Copan. These options have not been included in note 12(a) as the Company has been indemnified by SPG regarding such matters.
- (b) The Company has filed a claim with its insurance company relating to losses incurred in connection with the failure of the primary crusher in 2002. During 2004, the Company received \$7,148 as an interim payment against this claim and has included this amount in income from mining operations. The Company is pursuing the balance of its insurance claim and will record any additional recovery in income if and when received.
- (c) From time to time, the Company is involved in other litigation, investigations, or proceedings related to claims arising out of its operations in the ordinary course of business. In the opinion of the Company's management, these claims and lawsuits in the aggregate, even if adversely settled, will not have a material affect on the consolidated financial statements.

NOTE 17.

Income Taxes

The provision for income and mining taxes differs from the amount that would have resulted by applying the combined Canadian Federal and Ontario statutory income tax rates of approximately 38%.

	2005	2004	2003
Income tax provision using statutory income tax rates	\$ (21,524)	\$ (35,406)	\$ 18,147
Increase (decrease) in taxes resulting from:			
Write down of mining interests not tax benefited	—	35,694	—
Resource allowance	3,354	6,439	(3,342)
Non-taxable portion of capital gains	(162)	(2)	(2,908)
Losses not tax benefited	16,556	389	—
Increase in valuation allowance on assets previously recognized	—	2,525	—
Changes in income tax rates and laws	—	—	(3,546)
Benefit of income tax losses not previously recognized	—	(437)	(811)
Federal large corporations taxes	339	465	837
Ontario mining taxes	(1,654)	(7,979)	983
Other	209	102	(1,206)
Income tax expense	\$ (2,882)	\$ 1,790	\$ 8,154

The details of the Company's income tax expense are as follows:

	2005	2004	2003
Current income tax expense:			
Income taxes	\$ (15)	\$ 102	\$ (550)
Mining taxes	80	580	475
Federal large corporations tax	339	465	837
	\$ 404	\$ 1,147	\$ 762
Future income tax expense:			
Income taxes	(1,552)	9,202	6,884
Mining taxes	(1,734)	(8,559)	508
	\$ (3,286)	\$ 643	\$ 7,392
	\$ (2,882)	\$ 1,790	\$ 8,154

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

	2005	2004
Current future income tax asset:		
Cash and cash equivalents	\$ 526	\$ 389
Valuation allowance	(346)	(274)
Net future income tax asset, current	\$ 180	\$ 115
Long-term future income tax asset:		
Mining interests, net	42,238	34,090
Deferred financing costs	26	43
Mine restoration obligation	2,780	2,251
Future mining tax liability	45	343
Other assets	213	235
Non-capital loss carry-forwards	10,413	—
Ontario corporate minimum tax credits	327	327
Capital loss carry-forwards	927	927
Valuation allowance	(55,565)	(37,059)
Net future income tax asset, long-term	1,404	1,157
Future income tax liability, long-term:		
Long-term debt	(441)	(420)
Kaiser-Francis credit facility	(859)	(737)
Obligations under capital leases	(104)	—
	(1,404)	(1,157)
Net future income tax asset, long-term	\$ —	\$ —
Current future tax liability:		
Other assets	—	(61)
Deferred financing costs	(180)	(54)
Future tax liability, current	\$ (180)	\$ (115)
Future mining tax liability, long-term:		
Mining interests, net	\$ (202)	\$ (1,549)
Future mining tax liability, long-term	\$ (202)	\$ (1,549)

At December 31, 2005, the Company had capital loss carry-forwards of approximately \$5,100 (2004 – \$5,100), which are available to reduce capital gains of future years.

At December 31, 2005, the Company and its subsidiary had noncapital losses of approximately \$31,300 (2004 – nil), which expire in 2015. None of the benefit from these losses has been recognized in the financial statements.

NOTE 18.

Statement of Cash Flows

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

	2005	2004	2003
Cash provided by (used in):			
Concentrate awaiting settlement	\$ 30,806	\$ 26,351	\$ (9,298)
Inventories and stockpiles	3,484	1,786	3,179
Accounts receivable and other assets	(729)	(229)	296
Accounts payable and accrued liabilities	(3,839)	2,613	1,218
Taxes payable	(135)	(790)	(630)
	\$ 29,587	\$ 29,731	\$ (5,235)

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

	2005	2004	2003
Interest paid on long-term debt	\$ 2,509	\$ 1,929	\$ 3,433
Income and mining taxes paid	\$ 699	\$ 436	\$ —

(c) During 2005, mining interests were acquired at an aggregate cost of \$41,998 (2004 – \$33,058; 2003 – \$12,687) of which \$6,583 (2004 – \$4,330; 2003 – \$980) were acquired by means of capital leases.

NOTE 19.

Reconciliation to Accounting Principles Generally Accepted in the United States

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles, which differ in some respects from those in the United States. The following table presents amounts that would have been reported had the Company's consolidated financial statements been prepared on the basis of accounting principles generally accepted in the United States ("U.S. GAAP"):

(Canadian funds in thousands of dollars, except share and per share amounts)	2005	2004	2003
Statements of earnings (loss) and deficit:			
Net income (loss) under Canadian GAAP	\$ (53,611)	\$ (92,110)	\$ 38,378
Capitalized interest (a)	1,089		
Amortization of capitalized interest (a)	(62)	(95)	(39)
Concentrates and crushed and broken ore stockpiles (b)	(2,944)	295	(1,702)
Derivative financial instruments (c)	475	2,041	(2,867)
Tax liability on flow through financing (e)	(1,116)	—	—
Tax effect of differences	—	—	1,459
Net income (loss) and comprehensive income under U.S. GAAP before cumulative impact of change in accounting policy	\$ (56,169)	\$ (89,869)	\$ 35,229
Cumulative impact of change in accounting policy for asset retirement obligations (f)	—	—	(375)
Net income (loss) and comprehensive income under U.S. GAAP	\$ (56,169)	\$ (89,869)	\$ 34,854
Basic and diluted income (loss) per share under U.S. GAAP before cumulative impact of change in accounting policy	\$ (1.08)	\$ (1.75)	\$ 0.69
Basic and diluted income (loss) per share under U.S. GAAP	\$ (1.08)	\$ (1.75)	\$ 0.69

BALANCE SHEETS:

	2005	2004
Current assets (b) and (c)	\$ 70,417	\$ 155,842
Mining interests (a)	\$ 161,108	\$ 136,567
Crushed and broken ore stockpiles – long-term (b)	\$ 239	\$ 1,568
Capital stock (d)	\$ 331,137	\$ 329,002
Deficit	\$ (165,161)	\$ (108,992)

- (a) The Company capitalizes interest on major projects where direct indebtedness has occurred. Under U.S. GAAP, interest is capitalized as it arises from indebtedness incurred, directly or indirectly, to finance development and construction activities on assets that are not yet subject to amortization or depletion. For the current year interest of \$1,089, has been capitalized related to the investment in the underground development, which is expected to reach commercial production during the first quarter of 2006. The current year amortization adjustment relates to the amortization of amounts previously capitalized under U.S. GAAP.
- (b) The cost of the Company's concentrate inventory and crushed and broken ore stockpiles is determined using the average production costs including an allocation of the amortization of production related assets. At December 31, 2005, the Company recorded its concentrate inventory and crushed and broken ore stockpiles at their net realizable value and consequently any allocation of amortization of production related assets to these inventories was written off immediately. Amounts deducted under U.S. GAAP for the year ended December 31, 2005, include amounts previously included in the cost of these inventories under U.S. GAAP for periods prior to January 1, 2004, the date the Company commenced including amortization in the cost of inventories under Canadian GAAP.
- (c) Under U.S. GAAP, the Company has chosen not to designate its derivative financial instruments as hedging instruments and thus they are carried on the balance sheet at their fair value and any changes in fair value are being recorded to earnings in the period of the change.
- (d) Canadian GAAP allows for the reduction of the stated capital of outstanding common shares with a corresponding offset to deficit. This reclassification, which the Company made in 1991, is not permitted by U.S. GAAP and would result in an increase in both capital stock and deficit of \$6,098 at December 31, 2005 and 2004.
- (e) Under U.S. GAAP, the renunciation of tax deductions to holders of flow-through shares is treated as a future tax expense rather than as a cost of issuing equity as required by Canadian GAAP.
- (f) Effective January 1, 2003, the Company adopted FAS 143, "Accounting for Asset Retirement Obligations" which requires that the fair value of liabilities for asset retirement obligations be recognized in the period in which they occur. A corresponding increase to the carrying amount of the related asset is generally recorded and depreciated over the life of the asset. The amount of the liability is subject to re-measurement at each reporting period. The cumulative effect of the change through January 1, 2003 was to increase mining assets by \$6,489, increase the mine closure obligation to \$7,019 and a one time after-tax charge to net earnings of \$375.
- (g) U.S. GAAP requires that amounts totaling 5% or more of accounts payable and accrued liabilities be identified separately. As at December 31, 2005, these amounts were as follows: trade payables and accruals – \$14,606 (2004 – \$15,235); other accruals – \$1,786 (2004 – \$4,996).

- (h) U.S. GAAP does not permit the disclosure of subtotal of cash from operations before changes in non-cash working capital.
- (i) Effective January 1, 2003, the Company prospectively adopted FAS No. 123 "Accounting for Stock-based Compensation" as amended by FAS No. 148, whereby compensation expense for options granted after January 1, 2003 is measured at fair value at the grant date using the Black-Scholes valuation model and recognized over the remaining vesting period of the options granted. Previously, the Company, for purposes of preparing financial information in accordance with U.S. GAAP, accounted for its stock-based compensation plan under Accounting Principles Board Opinion 25 "Accounting for Stock Issued to Employees" (APB No. 25) which did not result in the recognition of compensation expense. Under FAS No. 148, pro forma disclosure is still required for those options granted prior to January 1, 2003, as follows:

	2005	2004	2003
Net income (loss) as reported under U.S. GAAP	\$ (56,169)	\$ (89,869)	\$ 34,854
Stock-based compensation	—	(168)	1,000
Pro forma net income (loss) under U.S. GAAP	\$ (56,169)	\$ (90,037)	\$ 35,854
Pro forma basic and diluted income (loss) per share	\$ (1.08)	\$ (1.75)	\$ 0.71

- (j) Impact of recently issued United States accounting pronouncements.

In November, 2004, the Financial Accounting Standards Board ("FASB") issued FAS No. 151, which clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted material as they relate to inventory costing and requires these items to be recognized as current period expenses. Additionally, the allocation of fixed production overheads to the cost of inventory should be based on the normal capacity of the production facilities. FAS No. 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The Company does not believe that the application of FAS No. 151 will have a material impact on the consolidated statements under U.S. GAAP.

In December, 2004, FAS No. 123 (revised) "Share-Based Payment", was issued. This statement requires an entity to recognize the grant date fair value of stock options and other equity-based compensation issued to employees. In the income statement, FAS No. 123 (revised) eliminates the ability to account for share-based compensation transactions using the intrinsic value method in APB No. 25. The Company will adopt FAS No. 123 (revised) in 2006 in accordance with the appropriate transition options and adoption period prescribed in the statement. The Company does not expect that the adoption of this standard will have a material impact on the consolidated financial statements.

In May, 2005, the FASB issued FAS No. 154, "Accounting Changes and Error Corrections, a Replacement of APB Opinion No. 20 and FAS No. 3". FAS No. 154 requires retrospective application of changes in accounting principle to prior periods' financial statements, rather than the use of the cumulative effect of a change in accounting principle, unless impracticable. If impracticable to determine the impact on prior periods, then the new accounting principle should be applied to the balances of assets and liabilities as of the beginning of the earliest period for which retrospective application is practicable, with a corresponding adjustment to equity, unless impracticable for all periods presented, in which case prospective treatment should be applied. FAS No. 154 applies to all voluntary changes in accounting principle as well as those required by the issuance of new accounting pronouncements if no specific transition guidance is provided. FAS No. 154 does not change the previously issued guidance for reporting a change in accounting estimate or correction of an error. FAS No. 154 becomes effective for accounting changes and corrections of errors made in fiscal years

beginning after December 15, 2005. The Company does not expect this policy to have a material impact on the consolidated financial statements. The Company will adopt FAS No. 154 on January 1, 2006.

In March, 2005, the FASB ratified EITF 04-06 "Accounting for Stripping Costs in the Mining Industry". The consensus reached is that stripping costs incurred during the production phase of a mine are variable production costs that should be included in the costs of the inventory produced during the period that the stripping costs are incurred. EITF 04-06 is effective for the first reporting period in fiscal years beginning after December 15, 2005, with early adoption permitted. The Company will adopt EITF 04-06 on January 1, 2006. The Company believes the adoption of this standard will not have a material impact on the consolidated financial statements.

NOTE 20.

Subsequent Events

On March 3, 2006, the Company announced it had entered into an arranged private placement of convertible notes and common share purchase warrants. This offering consists of up to US\$58.5 million aggregate principal amount of convertible notes, of which US\$13.5 million will be used to repay the outstanding credit facility with Kaiser Francis. The notes are convertible into common shares of the Company at a premium of 13% to the market price of the common shares on the date of closing. The notes will bear an interest rate of 6.5% per annum. Upon issuing the notes to the investors, the Company shall issue common share purchase warrants equal to 50% of the common shares issuable if such convertible notes were converted by the holders immediately following the closing of the transaction. The holder of the warrants shall be entitled for a period of four years following the date of issuance, to purchase one common share for each warrant held at an exercise price equal to 125 percent of the market price. The convertible notes will contain customary covenants, including certain restrictions on the Company incurring debt, obligations or involving the payment of money in excess of certain restricted amounts. The convertible notes will contain full-ratchet anti-dilution protection, subject to the restrictions pursuant to the rules of the TSX. The transaction closed on March 28, 2006, with the initial offering providing US\$35 million in gross proceeds to the Company.

NOTE 21.

Comparative Figures

Certain of the prior years' figures have been reclassified to conform to the presentation adopted in 2005.

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