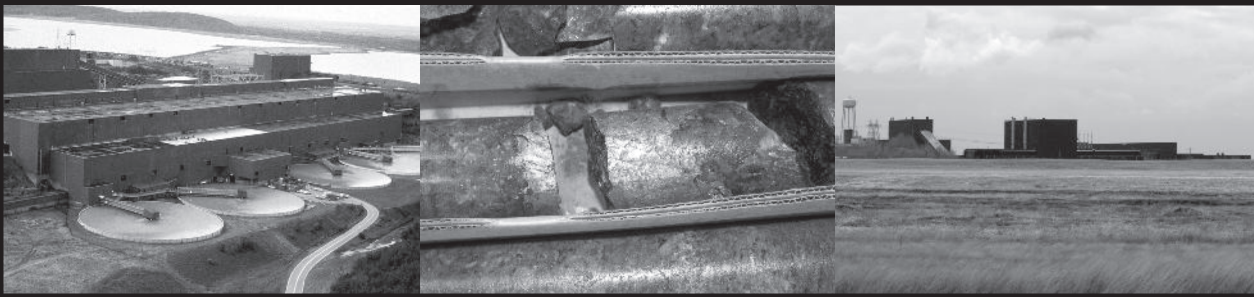
2006 Annual Report

POLYMET MINING CORP.

ADVANCING TO GO



FINANCIAL HIGHLIGHTS

As at January 31 *U.S. Funds*	2006	2005
ASSETS		
Current		
Cash	$ 11,671,427	$ 510,871
Term deposit	—	807,200
Other	118,568	286,601
	11,787,975	1,604,672
Investments	253	253
Property, Plant and Equipment	14,247,008	745,239
	$ 26,035,236	$ 2,350,164
LIABILITIES		
Current		
Accounts payable	$ 1,717,420	$ 331,012
Current portion of long term debt	1,000,000	—
	2,717,420	331,012
Long term		
Long term debt	1,420,515	—
Asset retirement obligation (NOTE 8)	2,510,687	—
	6,648,622	—
SHAREHOLDERS' EQUITY		
Share Capital	49,022,606	18,388,194
Share Subscriptions Received	—	762,804
Contributed Surplus	4,431,133	1,005,742
Deficit	(34,067,125)	(18,137,588)
	19,386,614	2,019,152
	$ 26,035,236	$ 2,350,164

IN 2005, THE CLIFFS ERIE ACQUISITION DRAMATICALLY ADVANCED THE NORTHMET PROJECT.

ACHIEVEMENT OF THIS MILESTONE, COMBINED WITH A STRONG MARKET OUTLOOK, MAKE NORTHMET A UNIQUELY ADVANTAGED PROJECT.

CLIFFS ERIE - A GIANT LEAP FORWARD



Acquisition of the plant assets is one of PolyMet's most remarkable achievements. Purchase of this former taconite processing plant in the heart of Minnesota's historic mining district and near the Company's large polymetallic deposit, gives PolyMet a profound competitive advantage.

Ownership of the plant significantly lowers capital costs of constructing the project, simplifies the permitting process, and reduces our start-up risks. The plant has well-maintained capacity for crushing, milling and flotation. Other operating infrastructure is also in place, including roads, rail, electric power and tailings basin, as well as access to an extensive network of mining suppliers and contractors.

Built in the 1950s for $350 million, the plant complex was designed for self-sufficiency, and provides a massive processing facility that would be never be replicated today.

The plant's capacity provides PolyMet with a "head start" to production when compared to other late-stage development projects around the world that are scheduled to come on stream over the next few years. Most other projects are "greenfield" sites in areas not well served by basic essential infrastructure.

Human resources and services across the mining sector are increasingly in short-supply. It is becoming more difficult to engage skilled people and secure specialized services and equipment not only because of the current metals cycle boom, but also due to low industry investment during the 1990s.

On the other hand, the NorthMet Project in Minnesota is bolstered by excellent secondary infrastructure – skilled people, ancillary services, and, importantly, existing communities in a traditional mining region. There is a reservoir of experienced workers living within the immediate area, and many others willing to relocate for the promise of an enduring, good job.

MODERN TECHNOLOGIE AND BEST PRACTICES

PolyMet's mining and plant production plans call for deployment of the most modern, environmentally-friendly processing technology in the world, and use of best mining practices coupled with progressive land reclamation. Technological advancements, particularly in hydrometallurgical processing, enable us to operate with minimal environmental impact.

There are no environmental issues that cannot be addressed through responsible mine design and best operating practices.

ECONOMIC AND SOCIAL BENEFITS

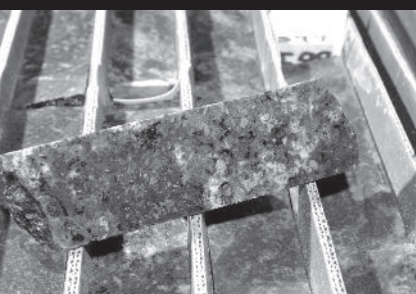
PolyMet's operation will significantly advance the area economically through creation of more than 400 full-time positions, construction-related employment topping 1000 trade workers at peak activity and substantial indirect job creation across the area.

Diversification of Minnesota's traditional iron mining-based economy will represent a boom for local government as the NorthMet Project produces an enduring new stream of tax revenue to support schools and government services.

"The Cliffs Erie plant acquisition is unquestionably a giant leap forward for PolyMet. More than 80% of the physical plant and infrastructure required for commercial production is already built... Taking ownership of this plant and related assets puts us in a globally advantageous and strong competitive position – Our NorthMet Project is one of few around the world that can come on stream within a relatively short period of time."

WARREN HUDELSON
Executive Vice President, Development

METAL SUPPLY-DEMAND EQUATION IS FUNDAMENTALLY OUT OF BALANCE



Perhaps the biggest challenge facing the world's suppliers of basic materials is simply how to meet growing demand. Growing demand from China, India and other industrializing nations such as Brazil is driving the demand side – and a long-term paucity of exploration expenditure means that there are relatively few new sources of supply to meet that demand.

Many people treat China as if it were a new phenomenon – the reality is that the Chinese economy has been growing at nearly 10% a year since 1980. What has changed more recently is that domestic Chinese sources of new supply have, at least for the time being, become tapped-out. China is now a major importer of materials from around the world. In addition, in 2003 China overtook North America in terms of copper consumption – continued growth is being applied to ever great levels of consumption. Consequently, the increase in tons as opposed to annual percentages is becoming more substantial.

The increase in metal prices since the end of 2003 has been dramatic. However, this increase needs to be put into perspective. Over the turn of the century, the prices of many metals sank to their lowest levels since the 1930s, when adjusted for inflation. This, despite the relatively robust economic activity around the globe, reflected over-expansion in the 1990s combined with slower growth owing to the economic problems of Southeast Asia in the late 1990s and the impact of the strong dollar.

Looking further back to understand where the metal markets are evolving from, the period after the fall of the Berlin Wall was one of the great periods of the world opening up to market economics. Many mineral deposits that were located in previous closed countries but had been discovered years or even decades before, became finance able. As a result, there was a surge in production from new sources. However, that tide has now run its course and may even be beginning to ebb as many parts of the world become steadily more difficult places in which to do business.

With this perspective, metal prices in inflation-adjusted terms, are not setting record highs.

Of course, high prices will encourage more exploration, some of which will be successful, resulting in the expansion of production. Meanwhile, those same prices will encourage conservation and substitution. However, the lead-time to discover and build a new large-scale mine now exceeds ten years. And, while consumption per application is likely to decline, the number of applications for raw material consumption is likely to grow faster.

Taking an even longer term view, the reality of the basic industries is that prices of raw materials decline over centuries. However, historically there have been long periods lasting for a decade or more when resource prices have risen against the centuries-long down trend. These periods have coincided with the industrialization of major economies – first Europe, then North America, then Japan.

It is against this background that NorthMet is moving rapidly towards production. The project is supported by excellent infrastructure, the political environment is stable, and its costs are all denominated in US dollars. And the acquisition of the plant provides much of the heavy equipment needed to go into production, reducing sensitivity to rising steel prices, and simplified the permitting process because much of what PolyMet is doing is a brown - as opposed to greenfields project.

"The supply and demand equation for many raw materials is fundamentally out of balance. NorthMet is one of the very few large non-ferrous metals projects that can come on stream rapidly and take advantage of the favourable price environment. However NorthMet's viability is not predicated on today's high prices. We don't need $2 copper – the decision to proceed was made at 80 cents."

DOUGLAS NEWBY
Chief Financial Officer

DEFINITIVE FEASIBILITY APPROACHING

"DEFINITIVE FEASIBILITY" DEFINED

"This is not a short, desktop study. The activities we are undertaking to complete this study include a considerable amount of diamond drilling, extensive testwork, the involvement of several engineering companies and consultants to carry out specialized tests and investigations – all of it costing tens of millions of dollars. By the time we are done, it will have taken us nearly two years."

Shortly after the new management team took over in 2003, it started working towards production of the Definitive Feasibility Study (DFS). The DFS is somewhat misnamed – the company believes the feasibility of the NorthMet project to be well established. The real purpose of the DFS is to accumulate the results of extensive testing, analysis and engineering and present them in a single, multi-volume study report that will form the basis for project construction. Importantly, the DFS is a "bankable" document that will be used by potential financing sources, product buyers, equipment suppliers and other interested parties.

Once the DFS has been completed in the third quarter of 2006, PolyMet intends to proceed seamlessly into the engineering and equipment procurement phase to secure delivery of long lead-time materials and equipment. This accelerated approach will enable the Company to keep key elements of the project design team together at a time when skilled personnel are increasingly scarce. It will also facilitate the start of construction immediately upon receipt of operating permits from the State of Minnesota.

Bateman Engineering, an international engineering company based in South Africa and with a key process technology skills-base in Australia, is overseeing the production of the DFS on behalf of PolyMet. Bateman is coordinating the activities of a number of specialist engineering companies and consultants who are also providing input to the DFS.

GEOLOGY AND RESOURCE ESTIMATE

PolyMet's on-site geological staff is carrying out and directing geological studies including the planning and execution of resource definition drilling while internationally recognized resource geologist Dr. Phil Hellman, of Hellman & Schofield Pty Ltd, is overseeing the resource estimate. This resource estimate, the publication of which is governed by strict disclosure rules, incorporates the results of all previous drilling and will form the basis of a revised mine plan from which a DFS Reserve Estimate will be produced.

PROCESSING

Mineral processing for treating NorthMet material comprises two stages. The first stage involves conventional crushing, milling and flotation to produce a bulk sulfide flotation concentrate while the second stage involves pressure oxidation of the sulfide concentrate and hydrometallurgical processes to recover the metals of economic interest. Oxidation causes the metals contained in the sulfides to go into aqueous solution from which they are sequentially extracted by hydrometallurgical methods.

During the last year PolyMet has carried out extensive metallurgical testing of NorthMet material at both bench and pilot-scale, focusing on material taken from areas to be mined during the first 10 years of operations. This testwork, which included flotation, autoclave pressure leaching and pilot-scale testing of all hydrometallurgical process stages, was conducted at the specialist testing facilities of SGS Lakefield Laboratories in Ontario, Canada, with the objective of confirming and refining process design parameters determined during earlier testwork.

PRODUCTS

Three product streams will be produced; copper metal, nickel and cobalt as precipitates, and a high grade precious metals precipitate containing platinum, palladium, gold and minor quantities of other platinum group metals.

Testwork has shown that the electro-won copper will be a high purity, LME Grade A product (99.99% Cu) suitable for sale at premium prices direct to end users and manufacturers. Nickel and cobalt precipitates and the precious metals precipitates will be shipped and sold to specialist refiners elsewhere. PolyMet has been in detailed discussions with prospective off-takers to secure sales agreements for these metals on favorable terms.

ENVIRONMENTAL ASSESSMENT

State and Federal regulations require an Environmental Impact Statement (EIS) as an essential part of the process of obtaining environmental operating permits. This process is lengthy and painstaking. PolyMet believes that the environmental concerns associated with developing this project can be resolved in an environmentally sound manner and that, ultimately, the site will be reclaimed and suitable for reuse.

The environmental investigation and permitting process was started in early 2004 and by the time it anticipates permits will be granted, the Company will have spent more than 40 months on the program. During this time, the company has been working extensively with State and Federal regulating agencies and has been proactive in communicating with organizations that have expressed an interest in the proposed mine. These have included local communities, the Sierra Club, the Minnesota Center for Environmental Advocacy, the National Wildlife Federation, First Nations communities and others.

FINANCIAL

The DFS will include an economic evaluation and risk assessment, comprising capital and operating cost estimates and detailed sensitivity studies. While the metals PolyMet proposes to produce are currently enjoying substantially higher prices than in recent years, the company has adopted much lower prices for economic modelling – a conservative approach assuring additional confidence in its projections.

Over the years, I have been involved in many detailed mining feasibility studies and, in my opinion, the NorthMet study represents the top end of the scale for thoroughness and integrity."

DON HUNTER
Project Manager

LETTER TO SHAREHOLDERS

Dear Fellow Shareholder:

During the past year we have achieved numerous critical milestones and the pace of activity at our NorthMet project is accelerating towards our targeted startup in mid-2008.

STRONG COMMODITY ENVIRONMENT

We are advancing our project in an environment of record high metal prices. This environment is likely to facilitate production financing and help us minimize dilution of our existing shareholders. The increase in prices of most natural resources has occurred against a background of doubt and disbelief amongst many observers. However, we have seen a change in 2006 as many have recognized the combination of:

- strongly rising demand, especially from China, India, Brazil and other industrializing economies;
- little spare capacity, and
- a shortage of advanced projects that can fill the potential.

With copper now selling at historic highs, China alone accounts for more than 21% of world consumption. Chinese consumption of many natural resources now far exceeds China's ability to produce them, so the effect on the western world's supply-demand balance has come into focus. China is expected to continue to import large amounts of copper just to cover its needs.

Compounding this growth in demand, there are few new sources of supply. The downturn in the industry in the late 1990s caused exploration budgets to be slashed and the pipeline of new projects is now woefully thin. This situation cannot be addressed rapidly given the fact that it takes at least a decade to advance from discovery to production.

The final element of this supply/demand equation is the extremely low worldwide level of inventories.

NORTHMET PROJECT UNIQUELY ADVANTAGED

We believe that our NorthMet project is uniquely well-positioned in the current metal market environment for several reasons, including:

- Infrastructure. In November 2005 we exercised our option to acquire a large processing plant from Cleveland Cliffs. This acquisition provides us with 80-85% of the heavy equipment needed to commence production and saves us more than US$200 million in initial capital expenditure.

  However, the infrastructure support extends beyond our property boundaries. Our project is located in the Mesabi Iron Range, which is a very large mining district that has been operating for more than 150 years. This means equipment suppliers, communication routes and skilled labor are all in place.
- Time to production. With the existing infrastructure and a well-defined deposit, we plan to be in production with 12 to 14 months of receipt of final permits.
- New domestic US supply of metal. We believe we will benefit from being a US supplier of metals. While the US is a significant producer of copper, our project will be the only US-based supplier of nickel and only the second US supplier of platinum group metals.
- Energy efficiency. Our hydrometallurgical process to recover metal is not only environmentally friendly, it is also energy efficient, using less than half as much energy to produce copper as more traditional smelters.

ACTING RESPONSIBLY

By its nature, the mining industry is the subject of considerable scrutiny from various communities. While our project will bring many new jobs to the area and generate significant tax revenue for the local community, the State and the Federal Government, there are concerns about its impact on the environment.

The modern mining industry must act responsibly, and we foresee no issues at NorthMet that cannot be addressed through best practices and responsible management. Today the technology exists to minimize the effect of mining activity and ensure that there is minimal impact on the overall environment. Significantly, our hydrometallurgical recovery processes do not require a smelter. Discharge from the plant will be benign. Sulfidic waste material that could potentially create acid drainage will be contained in lined areas and any discharge neutralized, in keeping with mining operations around the world where containment and treatment of acid drainage is done successfully and routinely. We will employ best practices, but we do not need to pioneer new technologies to ensure that NorthMet does not contaminate its environment.

Our environmentally friendly metal recovery process is also energy efficient which, in turn, makes it more environmentally friendly by reducing energy consumption.

Milestones Achieved – the Past Year

PolyMet is driven by setting and meeting or exceeding its standards and milestones. Looking forward, our most important goal is to commence commercial production in mid-2008 in a manner that is environmentally responsible, economically sound, and maximizes the benefits to all our stakeholders.

We are proud of the milestones that we have already achieved, including:

- Early exercise of the option for the Cliffs Erie plant and infrastructure. This US$8 million acquisition places the valuable plant assets on PolyMet's balance sheet, and rendered Cleveland-Cliffs, Inc. as an 6% owner of PolyMet's shares;
- Completion of diamond drilling on the NorthMet deposit. A 45-tonne metallurgical sample was obtained representing ore from the first 10 years of mine production. In-fill drilling was completed in November 2005 for inclusion in an updated resource model;
- Resource Consultant, Hellman & Schofield, completed an interim update to the resource in May 2005. The final drill data allows definition of a mineable reserve required by lenders;
- Mine designer, Australian Mine Design and Development (AMDAD), worked with the improved resource model and produced a report under Canadian National Instrument 43-101 in June 2005 which revealed an improved approach to mining the deposit. A reduced life-of-mine waste to ore ratio of 1.1:1 was designed;
- Completion of the Environmental Assessment Worksheet (EAW) and associated public hearings as a precursor to the Environmental Impact Statement (EIS) scheduled to be published early in the fourth quarter of 2006;
- Completion of a $16 million equity financing. The proceeds of this financing combined with the exercise of warrant relating to the financing are expected to carry the project through final permitting;
- Successful completion of a pilot plant test at SGS-Lakefield in Ontario that confirmed previous test work and provided samples for our prospective customers to test our products in their plants, and
- Landmark, cost-effective agreement with Minnesota's St. Louis County local government for restoration of wetlands that will offset NorthMet mine impacts. This "win-win" agreement also establishes a wetlands bank for local government public works projects.

Finally, we expect that nearly one-third of our revenues will be derived from platinum group metals (PGMs). PGMs are used extensively as autocatalysts, to reduce the emission of tailpipe gasses from cars, and as catalysts in advanced auto technologies such as hybrid cars and hydrogen fuel cells.

PROJECT MILESTONES AHEAD

Your management team is guided by its untiring determination to bring the NorthMet Project into production while simultaneously building shareholder value. Indeed, we are continuing the "Countdown to Production" with the following milestones ahead of us:

- an updated mineral resource model by Hellman & Schofield incorporating the results of last year's drilling campaign due during the second quarter of 2006. This will be reported under NI 43-101;
- a revised mine model by AMDAD based on this updated mineral resource model also due during the second quarter of 2006. This will be reported under NI 43-101;
- completion of the Definitive Feasibility Study by Bateman Engineering based on the mineral resource and mine model, due during the third quarter of 2006. This will be reported under NI 43-101;
- Publication of the draft Environmental Impact Statement (EIS) scheduled for the fourth quarter of 2006;
- Negotiation of process guarantees with Bateman Engineering;
- Selection of an engineering contractor for the procurement and construction phase of the project, and
- Determination of adequacy of the EIS and subsequent issuance of operating permits anticipated in the second quarter of 2007.

POLYMET ADVANCING ON ALL FRONTS

Once we have completed the Definitive Feasibility Study, we plan to move seamlessly into the engineering and procurement phase so that we can start construction as soon as we receive the necessary permits.

In parallel with these project developments, we are strengthening and broadening our shareholder base, increasing awareness of our Company within the investment community, and seeking to enhance liquidity and visibility in the stock market. We are asking you to approve the appointment of new, more internationally-recognized auditors and will appoint financial advisors and legal counsel experienced in production financing. We are working to implement a program to ensure we are compliant with the latest standards of corporate compliance, including Sarbanes Oxley.

PolyMet Mining is increasing its profile in Minnesota, and will continue its policy of public engagement, including full dialogue with the established mining and business community, and state and federal political leadership.

We continue to enjoy broad support for development of the NorthMet Project in Minnesota, particularly in the northeastern part of the state where the project is located and where job creation and economic development is met with enthusiasm.

Put simply, we are advancing on all fronts.

Sincerely

WILLIAM MURRAY
President and Chief Executive Officer

CHAIRMAN'S LETTER

The right place at the right time - Observing the past three years' progress of PolyMet Mining Corp. towards bringing into production its NorthMet Project, this concept frequently springs to mind.
However, this would fail to acknowledge the achievements of a team which brings together, in an exceptionally harmonious manner, an uncommon wealth of experience and expertise.
I shall mention just a few of those achievements:

First, some $25 million has been raised largely by non-brokered private placements and not always in conducive market conditions. Taken with the exercise of outstanding warrants, this ensures the Company has sufficient funds to complete its Definitive Feasibility Study and secure permitting by mid 2007.
The financing in January, 2005 enabled a winter drilling program to acquire sufficient sample material such that a metallurgical test program conducted in August at Lakefield Research Laboratories in Ontario was able to confirm, under independent supervision, metal recovery levels and provide sample material for off-take contract negotiations. The drilling program continued throughout the year and has yielded invaluable information on the deposit, on the basis of which an updated reserve estimate is imminent and a final pit design will be postulated.

The permitting process continues on schedule, with the State and Federal authorities, Forestry Services and Army Corp. of Engineers agreeing to accept the findings of one Environmental Impact Statement.
The Company has also innovated a solution for obtaining wetland credits, required for mining about 25% of the deposit, and convenes regular information meetings with authorities, special interest organizations and local communities.

In November, PolyMet exercised its option to acquire the land, buildings, crushing and milling plant which will allow it to proceed rapidly to production by mid 2008. This secures some 85% of the required tangible assets and permits, and protects the project from inflated costs deriving from the influence of worldwide base metal demand.

Copper and nickel markets continue to encourage, with medium term demand seemingly assured. Project finance discussions have commenced and off-take contract negotiations for nickel continue.
The Definitive Feasibility Study, to be available in mid-2006, will be based on the newly updated reserve data assuming an increased initial throughput to 30,000 tons of ore per day.

The stock market price and traded volume of PolyMet is beginning to reflect its potential as the story becomes better known, particularly in North America. It is worth re-iterating that NorthMet is located in a politically risk-free area, in a mining friendly state and is surrounded by vast deposits of ore to feed any excess capacity. Furthermore revenues and costs are derived in US dollars thereby eliminating any foreign exchange and consequent cost price risk. You are invited to compare these factors with other worldwide projects of a similar scale.

In closing, I would express my appreciation for the loyalty and commitment of our team, and to shareholders for their continuing support.

Sincerely,

IAN L. FORREST
Chairman and Director

FINANCIAL REVIEW

MANAGEMENT'S DISCUSSION AND ANALYSIS

THE FOLLOWING INFORMATION, PREPARED AS AT 15 APRIL 2006, SHOULD BE READ IN CONJUNCTION WITH THE AUDITED CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 JANUARY 2006 AND RELATED NOTES ATTACHED THERETO, WHICH ARE PREPARED IN ACCORDANCE WITH CANADIAN GENERALLY ACCEPTED ACCOUNTING PRINCIPLES ("GAAP"). ALL AMOUNTS ARE EXPRESSED IN UNITED STATES DOLLARS UNLESS OTHERWISE INDICATED.

DESCRIPTION OF BUSINESS AND SUMMARY OF RECENT EVENTS

PolyMet is a Venture Issuer and engaged in the exploration and development when warranted, of natural resource properties. The Company's primary mineral property and principal focus is the commercial development of its NorthMet Project, a polymetallic project in northeastern Minnesota, USA which hosts copper, nickel and platinum group metal mineralization. During 2006, the Company acquired large portions of the former LTV Steel Mining Company ("LTVSMC") plant located 10 kilometers from the NorthMet deposit.

During 2005 and 2006 the Company continued to advance its NorthMet Project including environmental and permitting matters, a phase I drilling program which extracted metallurgical ore samples, a phase II drilling program to complete the planned 90,000 feet of in-fill drill required to add definition to the resource, process design, an integrated pilot plant to demonstrate the process, upgrading resource models, a new mine plan and negotiations with prospective industry partners for strategic off-take agreements.

During the year, the Company commissioned and received two National Instrument 43-101 technical reports. The first reported a revised resource model based on a geological and drill-hole database, which has been updated and contains over 17,000, validated assayed intervals. The second described a revised mine plan showing an improved ore extraction schedule compared to previously published reports.

The goals for the 2005 drill program were met which included:

- a 40 ton bulk sample for metallurgical pilot plant test work representing the 10 year mining envelope was successfully processed at SGS Lakefield Laboratories in Ontario during the latter part of 2005;
- compilation of geotechnical information for pit slope design and pit slope stability studies by Golder Associates;
- enhancement of the comprehensive geological model through in-fill drilling, a new detailed geological and assay model which incorporates all completed work from 2005, the results of which continue to contribute to the ongoing resource evaluation and pit design work;
- confirmation of continuity of metal grades;
- collection of data supporting the environmental permitting; and
- the improvement in the confidence of the resource estimate categorization, resulting from reduced drill hole and sampling space.

On 15 November 2005 the Company, through its Minnesota subsidiary (Poly Met Mining, Inc.), completed the early exercise of PolyMet's option with Cleveland Cliffs, Inc. (NYSE:CLF) – known as "Cliffs." The Company now owns 100% of large portions of the former LTVSMC plant. It should be noted that the final deal with Cliffs involves substantially more milling and processing equipment compared to the previously announced option agreement.

The LTVSMC facility is 10 kilometers away from the NorthMet deposit. The LTVSMC facility was operated by Cliffs for many years and was acquired in 2000 by Cliffs, after LTV's bankruptcy. The process plant was placed on care-and-maintenance with a view to a potential restart. With minor modification, the crushing and milling circuits can be used as a concentrator for NorthMet ore. The plant assets now owned by PolyMet include crushing, milling, flotation capacity, comprehensive spare parts, plant site buildings, real estate, tailings impoundments and mine work shops, as well as access to extensive mining infrastructure including roads, rail, water, and power. It is planned to use surplus building space to house the new hydrometallurgical plant.

PolyMet will refurbish and reactivate the LTVSMC crushing, concentrating, flotation and tailings facilities to produce a "bulk concentrate" containing the copper, nickel and precious metals. This bulk concentrate will feed new hydrometallurgical metal recovery processing facilities. The metal recovery process eliminates the need to use smelters for metal recovery and is thus dramatically cleaner and more energy efficient compared to older processes.

Prior to closing the LTVSMC acquisition, the regionally-based state agency Iron Range Resources (IRR), made a substantial non-cash or "in-kind" contribution to the PolyMet project whereby IRR waived an option it held on the LTVSMC tailings basin near Hoyt Lakes, MN. The agency was created to strengthen the north-eastern Minnesota economy and the referenced option was acquired in 2001 as a part of a strategic move by the state of Minnesota to use the LTVSMC bankruptcy to stimulate new enterprise on the LTVSMC lands. This option pre-dated PolyMet Mining's plan to purchase the plant assets from successor Cliffs.

Under the asset acquisition agreement PolyMet signed a note for $2.4 million from Cliffs in addition to the $1,000,000, which has already been paid. PolyMet also issued 6,200,547 common shares of PolyMet, in addition to the 1,000,000 shares issued to Cliffs as part of the option payment. Upon receipt of certain operating permits, PolyMet will assume from Cliffs ongoing site-related environmental and reclamation obligations and PolyMet has indemnified Cliffs for certain on-going liabilities at the LTCSMC facility prior to receipt of permits. The remaining cash component of the payment of $2.4 million plus interest will be paid from working capital in ten quarterly installments of $250,000.

With a total of 7,200,547 shares, Cliffs is now an approximate 6.7% shareholder in PolyMet. Cliffs continues to have the right to participate on a pro-rata basis in future equity financings. PolyMet has the first right of refusal to acquire Cliff's shares should Cliffs wish to dispose of its interest.

PolyMet's NorthMet Project is in the closing stages of its Definitive Feasibility Study ("DFS") and is scheduled to begin commercial operations in mid 2008. The Company has decided to expand the scope of the DFS to cover an initial mining rate of 32,000 short tons (29,500 metric tonnes) per day, which is the size, which is being permitted. At this production rate, the project will provide full-time employment for at least 400 people. The NorthMet project will produce London Metal Exchange- or Comex-grade copper cathode on site and concentrates for sale off-site comprising: nickel- and cobalt-hydroxides and a platinum, palladium and gold precipitate.

The NorthMet Project commenced environmental permitting activities in February 2004 and is currently undergoing intense state and federal environmental review. The Company submitted an environmental assessment worksheet ("EAW") to the State of Minnesota regulators in August 2005. This EAW step provides essential information to advance the state's environmental review process and leads directly to the environmental impact statement ("EIS") and permits to build. The EIS process was simplified on 14 March 2005 when the Company reached a memorandum of understanding ("MOU") with federal and state regulators to cooperate in preparing a single EIS on the NorthMet Project. Signatories to the MOU include the U.S. Army Corps of Engineers ("USACE"), U.S. Forest Service ("USFS"), Minnesota Department of Natural Resources ("MDNR") and the

Company's U.S. based subsidiary, Poly Met Mining, Inc. The MOU provides that the lead state and federal agencies will be the MDNR and USACE, respectively, and that the USFS will be involved as a cooperating agency. Since a large component of the company's plan involves the reactivation of the "brown fields" LTVSMC plant and infrastructure, the permitting process has been dramatically simplified compared to a "green fields" project.

The Minnesota Pollution Control Agency will also be substantially involved in air and water permitting.

The lead agencies will jointly develop a scope of work for EIS preparation and evaluate MDNR's selection of a third party contractor which will be hired by the state at the Company's expense to prepare the EIS.

The Company is continuing to negotiate with several major companies for the off-take of the nickel-cobalt hydroxide, an agreement of which is expected prior to the completion of the DFS.

SELECTED ANNUAL FINANCIAL INFORMATION

As at January 31 *U.S. Funds*	2006	2005	2004
Revenue	$ —	$ —	$ —
Loss Before the Undernoted	5,030,850[(1)]	2,221,628[(2)]	288,699
Loss per Share	0.07	0.04	0.00
Loss for the Year	15,929,537[(3)]	3,776,337[(4)]	146,800[(5)]
Loss per Share	(0.22)	(0.07)	(0.00)
Total Assets	26,035,236[(6)]	2,350,164[(7)]	1,024,937
Long Term Debt	1,420,515[(8)]	—	—
Total Shareholders' Equity	19,386,614	2,019,152	925,565

(1) includes stock based compensation of $3,523,324
(2) includes stock based compensation of $992,658 and $233,856 for bonus shares expensed as consulting fees
(3) includes pre-feasibility costs of $11,120,145
(4) includes pre-feasibility costs of $1,622,983
(5) includes a gain on sale of resource properties of $219,925
(6) increase as compared to 31 January 2005 primarily a result of $22,209,231 in net cash proceeds from four private placements, the exercise of warrants and options and $10,991,082 in capitalized costs from the exercise of the Cliffs Option to acquire property, plant and equipment and the $2,510,687 capitalized present value of the related asset retirement obligations ("ARO") offset by Loss for the Year of $15,929,537
(7) increase as compared to 31 January 2004 primarily a result of net cash and term deposits of $3,414,090 from two private placements, the exercise of warrants and options and includes $229,320 in capitalized share issuance costs to maintain the Cliffs Option offset by Loss for the Year of $3,776,337
(8) debt financing of $2,400,000 to Cliffs representing the remaining unpaid cash portion of the consideration for the exercise of the Cliffs option. The current portion of the debt is $1,000,000 with the remaining balance of $1,420,515 million (including interest) representing the long term portion, which includes $20,515 of interest accrued as at 31 January 2006

This financial information has been reported in accordance with Canadian GAAP and denominated in United States dollars, the Company's reporting currency. There are no material differences between Canadian and United States GAAP for the Company.

RESULTS OF OPERATIONS

a) Loss for the Year:

During the year the Company incurred a loss of $15,929,537 ($0.22 loss per share) compared to a loss of $3,776,337 ($0.07 loss per share) in 2005. The increase in the net loss for the year was primarily attributable to the increased level of work, the Company's accounting policy of expensing the costs of pre-feasibility work related to the NorthMet Project of $11,120,145 (2005 – $1,622,983), and an increase in general and administrative costs including non-cash stock compensation expense of $3,523,324 (2005 – $992,658).

The "Loss Before the Undernoted" in the year ended 31 January 2006 excluding non-cash stock based compensation expenses was $1,507,526 compared to $1,228,970 for the year ended 31 January 2005. The Company reported an increase in expenditures for: Administration fees and wages of $207,650 (2005 – $105,449) resulting from increased compensation paid to employees; Conferences $26,138 (2005 – $Nil) where the Company attended several conferences in 2006 and none in 2005; Office and telephone of $101,127 (2005 – $47,175) as a result of the Company's head office relocation and increased activity at the Company's Minnesota office; Shareholders' information of $53,364 (2005 – $35,277) as a result of increased shareholder material for conferences; Transfer agent and filing fees of $64,914 (2005 – $24,765) resulting from an increase in activity pursuant to four private placements and the exercise of warrants and stock options; and Travel and automotive of $348,244 (2005 – $220,530) a result of increased travel both related to the NorthMet Property and investor relations activity.

b) Cash Flows:

Cash used in operating activities in the year ended 31 January 2006 was $10,845,532 compared to cash used in the year ended 31 January 2005 of $2,575,732. The increase is in relation to the above, described expenditures.

Cash used in investing activities for the year ended 31 January 2006 of $203,143 consisted of $1,000,000 (2005 – $Nil) cash payment for the exercise of the Cliffs Option and $10,343 (2005 – $15,838) for the purchase of office and computer equipment less $807,200 of cash provided by cashing-in the term deposit made in the previous year.

Cash from financing activities for the year ended 31 January 2006 was $22,209,231 from the proceeds of four private placements, the exercise of options and share purchase warrants compared to $3,414,090 for the year ended 31 January 2005 which was from the proceeds of two private placements, the exercise of share purchase warrants and stock options, and proceeds from share subscriptions.

Total cash for the year ended 31 January 2006 increased by $11,160,556 for a balance of $11,671,427 compared to the year ended 31 January 2005 where cash increased $15,320 to a balance of $510,871.

c) Capital Expenditures

During the year ended 31 January 2006 the Company capitalized the cash portion of $1,000,000 (2005 – $500,000), debt financing portion of $2,400,000 (2005 – $Nil), and share issue component of $7,564,444 (2005 – $229,320) for the exercise of the Cliffs option for an aggregate cost of $10,954,444 (2005 – $729,320). The Company also capitalized $20,515 of accrued interest on the debt financing and capitalized $2,510,687 related to the present value of the related ARO.

Exploration expenses incurred during the feasibility of mining operation, periodic option payments and administrative expenses are expensed as incurred. Mineral property acquisition costs and exploration and development expenditures incurred subsequent to the determination of the feasibility of mining operation will be capitalized at that time. Acquisition costs include cash and fair market value of common shares.

In addition to the exercise of the Cliffs option the Company purchased office and computer equipment of $10,343 (2005 – $15,838).

SUMMARY OF QUARTERLY RESULTS

Three Months Ended	Jan. 31 2006	Oct. 31 2005	July 31 2005	Apr. 30 2005	Jan.31 2005	Oct.31 2004	July 31 2004	Apr. 30 2004
Total Revenues	—	—	—	—	—	—	—	—
Loss Before the Undernoted	(1,975,508)	(2,189,615)	(502,667)	(363,060)	(702,774)	(298,088)	(1,007,443)	(213,323)
Other Expenses: Pre-feasibility Costs	(4,273,367)	(3,771,607)	(1,167,445)	(1,907,726)	(671,874)	(639,728)	(271,197)	(40,184)
Net Loss	(6,289,064)	(5,756,810)	(1,596,957)	(2,286,826)	(1,285,524)	(969,558)	(1,240,001)	(281,254)
Income (loss) per share	(0.09)	(0.07)	(0.02)	(0.04)	(0.02)	(0.02)	(0.03)	(0.01)

Significant items to report for the quarterly results are as follows:

The Loss before the Undernoted included stock based compensation expense for the quarters ended:

1) 31 January 2005 – $1,601,550
2) 31 October 2005 – $1,605,205
3) 31 July 2005 – $129,693
4) 30 April 2005 – $186,876
5) 31 January 2005 – $213,425
6) 31 January 2004 – $26,011
7) 31 July 2004 – $753,232
8) 30 April 2004 – $Nil

FINANCING ACTIVITIES

During the year ended 31 January 2006 the Company completed:

i) a non-brokered private placement for 3,544,657 units at a price of CDN$1.40 per unit. Each unit consisted of one common share and one half of one share purchase warrant. One full Warrant entitles the holders, on exercise, to purchase one additional common share of the Company at a price of CDN$2.00 per Warrant Share at any time until the close of business on the day which is 18 months from the date of Closing, provided that if the closing price of the Issuer's shares as traded on the Exchange is over CDN$2.50 per share for 20 consecutive trading days, the Warrants will terminate 30 days thereafter;

ii) a non brokered private placement for 9,000,000 units at a price of CDN$0.55 per unit. Each unit consisted of one common share and one half of one share purchase warrant. One full Warrant entitles the holders, on exercise, to purchase one additional common share of the Company at a price of CDN$0.70 per Warrant Share at any time until the close of business on the day which is 24 months from the date of Closing, provided that if the closing price of the Issuer's shares as traded on the Exchange at or exceed CDN$1.00 per share for 30 consecutive trading days, the Warrants will terminate 30 days thereafter;

iii) a non brokered private placement for 6,672,219 units at a price of CDN$0.90 per unit. Each unit consisted of one common share and one half of one share purchase warrant. One full Warrant entitles the holders, on exercise, to purchase one additional common share of the Company at a price of CDN$1.25 per Warrant Share at any time until the close of business on the day which is 30 months from the date of Closing, provided that if the closing price of the Issuer's shares as traded on the Exchange is over CDN$2.50 per share for 20 consecutive trading days, the Warrants will terminate 30 days thereafter;

iv) a brokered private placement for 9,277,777 units at a price of CDN$0.90 per unit. Each unit consisted of one common share and one half of one share purchase warrant. One full Warrant entitles the holders, on exercise, to purchase one additional common share of the Company at a price of CDN$1.25 per Warrant Share at any time until the close of business on the day which is 30 months from the date of Closing, provided that if the closing price of the Issuer's shares as traded on the Exchange is over CDN$2.50 per share for 20 consecutive trading days, the Warrants will terminate 30 days thereafter.

In addition to the financing during the year ended 31 January 2006 the Company issued:

v) 5,700,628 shares pursuant to the exercise of 5,700,628, share purchase warrants for total proceeds of $3,296,143;

vi) 1,795,852 shares pursuant to the exercise of stock options for total proceeds of $196,988;

During the year ended 31 January 2005 the Company issued:

vii) 5,277,574 share purchase warrants were exercised at exercise prices between CDN$0.10 – CDN$0.25 for proceeds of $828,554;

viii) stock options in the amount of 1,088,400 were exercised at prices between CDN$0.08 – CDN$0.13 per share for proceeds of $81,383;

ix) a private placement for 1,550,000 units at a price of CDN$0.80 per unit and a private placement for 1,250,000 units at a price of CDN$0.80 per unit for total proceeds of $1,733,984; and,

x) subsequent to the Company's year-end, a private placement for 9,000,000 units at CDN$0.55 per unit for net proceeds of $3,831,795 was completed of which $762,804 was deposited prior to 31 January 2005.

LIQUIDITY AND CAPITAL RESOURCES

As at 31 January 2006 the Company had working capital of $9,070,555 (2005 – $1,273,660) consisting primarily of cash $11,671,427 (2005 – $510,871). The Company will facilitate debt financing to Cliffs for the exercise of the Cliffs Option, for the current portion of $1,000,000 (2005 – $Nil) and the remaining balance of $1,420,515 long term (2005 – $Nil) from working capital.

As at 31 January 2006 the Company in addition to its obligation to Cliffs as described herein, has obligations to issue shares under the Company's Bonus Share Plan. The Company has received shareholder approval for the Bonus Shares of Milestones 1 – 4 and regulatory approval for Milestones 1 and 2.

Milestones 3 and 4 are subject to regulatory approval, which will be sought when the Company is closer to completing these Milestones. To date 1,590,000 shares have been issued for the achievement of Milestone 1. The bonus shares allocated for Milestones 1 thru 4 are valued using the Company's closing trading price on 5 November 2003 of CDN$0.19 per share, the date of the approval of the bonus plan by the board of directors.

As part of certain employment and management contracts the Company has agreed to severance allowances for key employees and management in the event of a take-over bid. These allowances will be based upon the Company's implied market capitalization at the time, calculated by multiplying the number of shares outstanding on a fully diluted basis by the take-over bid price per share. If the market capitalization is CDN$100 million, the total severance payment would be CDN$1,000,000 and would increase CDN$600,000 for every additional CDN$25 million of implied market capitalization, with no maximum.

As a result of the recent private placements as described above, the Company is funded to meet its current obligations and the financial requirements for the completion of the DFS and to service and repay its debt to Cliffs.

Should the Company wish to continue to further advance the NorthMet project to commercial production PolyMet will require additional funds. As the Company has no operating revenues, the only source of liquidity consists primarily of cash flows from proceeds of equity issues and eventual project financing.

There can be no assurance that the Company will be able to continue to raise funds, in which case it may be unable to continue to advance the NorthMet project. Should PolyMet be unable to realize on its assets and discharge its liabilities in the normal course of business, the realizable value of its assets may be materially less than the amounts recorded on the balance sheets.

SHAREHOLDER RIGHTS PLAN

Effective 4 December 2003, the Company adopted a Shareholder Rights Plan ("Rights Plan"), which was approved by the Company's shareholders' on 27 May 2004. Under the Rights Plan, the Company has issued one right for no consideration in respect of each outstanding common share of the Company to all holders of record of common shares on 4 December 2003. All common shares issued by the Company during the term of the Rights Plan will have one right represented for each common share held by the shareholder of the Company. The term of the Rights Plan is 10 years, unless the rights are earlier redeemed or exchanged. The Rights issued under the Rights Plan become exercisable only if a party acquires 20% or more of the Company's common shares without complying with the Rights Plan or without the approval of the Board of Directors of the Company.

Each Right entitles the registered holder thereof to purchase from the Company on the occurrence of certain events, one common share of the Company at the price of CDN$50 per share, subject to adjustment (the "Exercise Price"). However, if a Flip-in Event (as defined in the Rights Plan) occurs, each Right would then entitle the registered holder to receive, upon payment of the Exercise Price, that number of common shares that have a market value at the date of that occurrence equal to twice the Exercise Price. The Rights are not exercisable until the Separation Time as defined in the Rights Plan.

Shares in Escrow or Pooling Agreements – 31 January 2006

None

RELATED PARTY TRANSACTIONS

In addition to transactions disclosed elsewhere in these financial statements, the Company has conducted transactions with officers, directors and persons or companies related to directors and paid or accrued amounts as follows:

As at January 31 *U.S. Funds*	2006	2005	2004
Management fees paid to a company controlled by the president	$ 129,480	$ 141,270	$ 52,388
Consulting fees paid to officers, directors and companies controlled by directors of the Company	327,110	336,448	—
Legal fees paid to an officer of the Company	84,089	59,700	—
Office facilities charges paid to a director of the Company	39,604	23,070	—
	$ 580,283	$ 560,488	$ 52,388

The amounts charged to the Company for the services provided have been determined by negotiation among the parties and, in certain cases, are covered by signed agreements. These transactions were in the normal course of operations and were measured at the exchange value, which is the amount of consideration established and agreed to by the related parties.

FOURTH QUARTER

a) *Loss for the three months ended 31 January 2006:*

During the three months ended 31 January 2006 the Company incurred a loss of $9,344,25 (2005 – $969,558). The net loss for the three months ended 31 January 2006 was primarily costs of pre-feasibility work related to the NorthMet Project of $4,273,367 (2005 – $671,874) and stock based compensation of $1,601,550 (2005 – $213,415).

b) *Cash Flows:*

Cash used in operating activities for the three months ended 31 January 2006 was $5,557,941 compared to cash used for the three months ended 31 January 2005 of $1,716,940. The increase is in relation to the above, described expenditures.

Cash used in investing activities for the three month ended 31 January 2006 of $1,006,063 consisted of $1,000,000 (2005 – $Nil) cash payment for the exercise of the Cliffs Option and $6,063 (2005 – $3,179) for the purchase of office and computer equipment.

Cash from financing activities for the three months ended 31 January 2006 was $2,685,290 from the proceeds of a private placement, the exercise of options and share purchase warrants, compared to $611,137 for the period ended 31 January 2005 which was from the proceeds of the exercise of share purchase warrants and stock options.

c) Capital Expenditures

During the three months ended 31 January 2006 the Company capitalized the cash portion of $1,000,000 (2005 – $500,000) debt financing portion of $2,400,000 (2005 – $Nil) and share issue component of $7,564,444 (2005 – $229,320) for the exercise of the Cliffs option for an aggregate cost of $10,954,444 (2005 – $729,320). The Company also capitalized $20,515 of accrued interest on the debt financing and capitalized $2,510,687 related to the present value of the related ARO.

In addition to the exercise of the Cliffs option the Company purchased office and computer equipment of $6,063 (2005 – $3,179).

SUBSEQUENT EVENTS

On 10 April 2006, the Company provided notice to the outstanding warrants holders of approximately 8.5 million warrants that had not already been exercised at prices between CDN$1.25 and CDN$2.00 that the accelerated expiry provision of their warrants was effectively triggered and all unexercised warrants as at the close of business on May 10, 2006 will have been deemed cancelled. If all warrants are exercised the Company will receive proceeds of approximately CDN$12.0 million.

In March 2006 the Company completed its evaluation and compilation of the assay results from its 2005, diamond drilling program on the NorthMet Project. The data has been integrated into a resource model, which will contribute to the Definitive Feasibility Study ("DFS") scheduled for completion by the Company's third quarter 2006.

Subsequent to 31 January 2006 the Company issued: 6,141,573 common shares pursuant to the exercise of share purchase warrants at a prices between CDN$0.20 and CDN$1.25 per share, and 1,045,000 common shares pursuant to the exercise of stock options at prices ranging from CDN$0.10 to CDN$1.36.

CHANGES IN ACCOUNTING POLICIES INCLUDING INITIAL ADOPTION

VARIABLE INTEREST ENTITIES

Effective 1 February 2005, the Company adopted the recommendations of Canadian Institute of Chartered Accountants ("CICA") Handbook Accounting Guideline 15 (AcG-15), Consolidation of Variable Interest Entities, effective for annual and interim periods beginning on or after 1 November 2004. Variable interest entities (VIEs) refer to those entities that are subject to control on a basis other than ownership of voting interests. AcG-15 provides guidance for identifying VIEs and criteria for determining which entity, if any, should consolidate them. Adoption of this accounting policy has not affected the Company's financial statements.

IMPAIRMENT OF LONG-LIVED ASSETS

The Company has adopted CICA Section 3063 "Impairment of Long-Lived Assets". This statement establishes standards for the recognition, measurement and disclosure or the impairment of non-monetary long-lived assets, included property, plant and equipment, intangible assets with finite useful lives, deferred pre-operating costs and long-term prepaid assets. The adoption of this standard did not have a material impact on the Company's financial position or results of operations.

OTHER MD&A REQUIREMENTS

OUTSTANDING SHARE DATA

Authorized Capital:

Unlimited common shares without par value.

Issued and outstanding:

As at 15 April 2006, 107,359,746 common shares were issued and outstanding.

Outstanding options, warrants and convertible securities as at 15 April 2006:

Type of Security	Number	Exercise Price	Expiry Date
Share purchase warrants	6,748,704	$1.25	22 Sept. 2007 – 28 Feb. 2008
Share purchase warrants	1,772,328	$2.00	7 May 2008
Stock options	328,700	$0.10	18 July 2008
Stock options	450,000	$0.13	3 October 2008
Stock options	440,000	$0.21	12 February 2006
Stock options	445,000	$0.40	9 March 2009
Stock options	200,000	$0.75	28 April 2009
Stock options	1,175,000	$0.66	5 July 2009
Stock options	50,000	$0.79	18 October 2009
Stock options	765,000	$0.65	30 March 2010
Stock options	350,000	$0.85	1 May 2010
Stock options	40,000	$0.94	15 June 2010
Stock options	1,790,000	$1.36	19 September 2010
Stock options	280,000	$1.20	24 October 2010
Stock options	275,000	$1.15	5 December 2010
Stock options	3,200,000	$2.76	20 March 2011

RISK FACTORS

Risks Inherent in Mining

Exploration for economic deposits of minerals is subject to a number of risk factors. While the rewards for mining companies can be substantial if an economically viable discovery is made, few of the properties explored are ultimately developed into producing mines. The Company's ability to continue exploration and development of its properties is dependent upon its ability to raise significant additional funds in the future. Should the Company not be able to obtain such financing, a portion of its interest in properties may be lost to joint venture partners, or its properties may be lost entirely.

The Company's mineral operations are subject to governmental legislation, policies and controls relating to prospecting, development, production, environmental protection, mining taxes and labor standards. In addition, the profitability of a particular mining prospect is affected by the market for base and precious metals, which entails the assessment of many factors, some of which include changing production costs, the supply and demand for metals, the rate of inflation, the inventory of metal producing corporations, the political environment and changes in international investment patterns.

Ownership of mineral interests involves certain inherent risks due to the difficulties of determining the validity of certain claims, as well as the potential for problems arising from the frequently ambiguous transfer history characteristic of many mineral interests. The Company has investigated ownership of its mineral interests and, to the best of its knowledge; ownership interests are in good standing.

The Company may become subject to liability for certain hazards against which it cannot insure, or against which it may elect not to insure, because of high premium costs or other reasons. Payment of such liabilities would reduce funds available for acquisition of mineral properties or exploration and development.

Conflicts of Interest

Certain directors, officers or promoters of the Company are directors, officers, significant shareholders or promoters of other publicly listed companies. As a result, potential conflicts of interest may arise with respect to the exercise by such persons of their respective duties for the Company. In the event that such a conflict of interest arises at a meeting of the directors of the Company, a director who has such a conflict will abstain from voting for or against the approval of such participation or such terms. In the appropriate cases, the Company will establish a special committee of independent directors to review a matter in which several directors, or management, may have a conflict. Other than as indicated, the Company has no other procedures or mechanisms to deal with conflicts of interest.

Absence of Dividends

The Company has never declared or paid cash dividends on its Common Shares and does not anticipate doing so in the foreseeable future. There can be no assurance that the Company's board of directors will ever declare cash dividends, which action is exclusively within its discretion. Investors cannot expect to receive a dividend on the Company's Common Shares in the foreseeable future, if at all.

Dilution

The Company may in the future grant to some or all of its own and its subsidiaries' directors, officers, insiders and key employees options to purchase the Company's Common Shares as non-cash incentives to those employees. Such options may be granted at exercise prices equal to market prices at time when the public market is depressed. To the extent that significant numbers of such options may be granted and exercised, the interests of the then existing shareholders of the Company may be subject to additional dilution.

Also, the Company may in the future award certain bonus shares for achieving certain critical milestone events related to the NorthMet project, to some or all of its own and its subsidiaries' directors, officers, insiders and key employees as non-cash incentives to those employees. To the extent that significant numbers of such bonus shares may be awarded, the interests of the then existing shareholders of the Company may be subject to additional dilution.

The Company is currently without a source of revenue and will most likely be required to issue additional securities to finance its operation and may also issue substantial additional securities to finance the development of any or all of its projects.

Volatility of Common Share Price and Volume

The Company's Common Shares are listed for trading on the TSX Venture Exchange. Shareholders of the Company may be unable to sell significant quantities of the Common Shares into the public trading markets without a significant reduction in the price of the shares, if at all. The market price of the Common Shares may be affected significantly by factors such as changes in the Company's operating results, the availability of financings, fluctuations in the price of metals, the interest of investors, traders and others in small exploration stage public companies and general market conditions. In recent years the securities markets have experienced a high level of price and volume volatility, and the market price of securities of many companies, particularly small capitalization exploration companies similar to the Company, have experienced wide fluctuations, which have not necessarily been related to the operating performances, underlying asset values or future prospects of such companies. There can be no assurance that future fluctuations in the price of the Company's shares will not occur.

FORWARD LOOKING STATEMENTS

This MD&A may contain forward-looking statements including, but not limited to, comments regarding the timing and content of upcoming work programs, geological interpretations, receipt of property titles, potential mineral recovery processes etc. Forward-looking statements address future events and conditions and therefore involve inherent risks and uncertainties. Actual results may differ materially from those currently anticipated in such statements.

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS

The information provided in this report including the financial statements, is the responsibility of management. In the preparation of these statements, estimates are sometimes necessary to make a determination of future values for certain assets or liabilities. Management believes such estimates have been based on careful judgments and have been properly reflected in the accompanying financial statements.

Management maintains a system of internal controls to provide reasonable assurances that the Company's assets are safeguarded and to facilitate the preparation of relevant and timely information.

ADDITIONAL INFORMATION

Additional information related to the Company is available for view on SEDAR at www.sedar.com and at the Company's website www.polymetmining.com.

MANAGEMENT'S RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

The financial statements of PolyMet Mining Corp. have been prepared by management in accordance with Canadian generally accepted accounting principles and with the standards of the Public Company Accounting Oversight Board (United States). The financial information contained elsewhere in this report has been reviewed to ensure consistency with the financial statements.

Management maintains systems of internal control designed to provide reasonable assurance that the assets are safeguarded. All transactions are authorized and duly recorded, and financial records are properly maintained to facilitate financial statements in a timely manner. The Board of Directors is ultimately responsible for reviewing and approving the financial statements. The Board carries out this responsibility principally through its Audit Committee.

The Audit Committee of the Board of Directors has reviewed the financial statements with management and external auditors. Staley, Okada and Partners, an independent firm of chartered accountants, appointed as external auditors by the shareholders, have audited the financial statements and their report is included herein.

WILLIAM MURRAY
President and Chief Executive Officer
Vancouver, Canada
2006

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders of Polymet Mining Corp.:

We have audited the accompanying consolidated balance sheets of Polymet Mining Corp. (the "Company") as at 31 January 2006 and 2005 and the related consolidated statements of shareholders' equity, loss and cash flows for each of the years in the three-year period ended 31 January 2006. 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 the Canadian generally accepted auditing standards and with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as at 31 January 2006 and 2005, and the results of its operations and its cash flows for each of the years in the three-year period ended 31 January 2006, in accordance with Canadian generally accepted accounting principles.

Staley. Okada & Partners

STALEY, OKADA & PARTNERS
Chartered Accountants, Vancouver, BC
4 April 2006

CONSOLIDATED BALANCE SHEET

As at January 31
U.S. Funds

	2006	2005
ASSETS		
Current		
Cash	$ 11,671,427	$ 510,871
Term deposit	—	807,200
Taxes and miscellaneous receivables	40,986	45,005
Prepaid expenses	75,562	241,596
	11,787,975	1,604,672
Investments (NOTE 4)	253	253
Property, Plant and Equipment (NOTE 6, 7, 10)	14,247,008	745,239
	$ 26,035,236	$ 2,350,164
LIABILITIES		
Current		
Accounts payable	$ 1,717,420	$ 331,012
Current portion of long term debt (NOTE 7)	1,000,000	—
	2,717,420	331,012
Long term		
Long term debt (NOTE 7)	1,420,515	—
Asset retirement obligation (NOTE 8)	2,510,687	—
	6,648,622	—
Contingent Liabilities and Commitments (NOTE 16)		
SHAREHOLDERS' EQUITY		
Share Capital – STATEMENT 2 (NOTE 9)	49,022,606	18,388,194
Share Subscriptions Received – STATEMENT 2 (NOTE 9A(II))	—	762,804
Contributed Surplus – Statement 2 (NOTE 9D)	4,431,133	1,005,742
Deficit – STATEMENT 2	(34,067,125)	(18,137,588)
	19,386,614	2,019,152
	$ 26,035,236	$ 2,350,164

ON BEHALF OF THE BOARD:

WILLIAM MURRAY
Director

DAVID DREISINGER
Director

SEE ACCOMPANYING NOTES

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

As at January 31 *U.S. Funds*	Common Shares						
	Authorized Shares	Shares	Amount	Share Subscriptions Received	Contributed Surplus	Deficit	Total
Balance 31 January 2004	1,000,000,000	44,992,054	$ 15,231,768	$ —	$ 55,048	$ (14,361,251)	$ 925,565
Loss for the year	—	—	—	—	—	(3,776,337)	(3,776,337)
Shares issued for cash:							
Private placements (NOTE 9A (V))	—	2,800,000	1,733,984	—	—	—	1,733,984
Share subscriptions received (NOTE 9A (II))	—	—	—	762,804	—	—	762,804
Share issuance costs	—	—	(18,752)	—	—	—	(18,752)
Exercise of warrants (NOTE 9A (VI))	—	5,277,573	828,554	—	—	—	828,554
Exercise of options (NOTE 9A (VII))	—	1,088,400	81,383	—	—	—	81,383
Shares issued for finders' fee (NOTE 10)	—	155,626	96,375	—	—	—	96,375
Non-cash share issuance costs (NOTE 10)	—	—	(96,375)	—	—	—	(96,375)
Shares issued for property (NOTE 10H)	—	1,000,000	229,320	—	—	—	229,320
Stock-based compensation (NOTES 9C AND 9D)	—	—	—	—	992,658	—	992,658
Fair value of stock options exercised (NOTE 9D)	—	—	41,964	—	(41,964)	—	—
Balance 31 January 2005 – Shares issued	Unlimited	55,313,653	18,128,221	762,804	1,005,742	(18,137,588)	1,759,179
Shares allotted for exercise of warrants	—	224,925	26,117	—	—	—	26,117
Shares allotted for bonus (NOTE 10)	—	1,590,000	233,856	—	—	—	233,856
Balance 31 January 2005 Shares issued and allotted	Unlimited	57,128,578	$ 18,388,194	$ 762,804	$ 1,005,742	$ (18,137,588)	$ 2,019,152
Loss for the year	—	—	—	—	—	(15,929,537)	(15,929,537)
Reverse shares allotted for exercise of warrants	—	(224,925)	(26,117)	—	—	—	(26,117)
Reverse shares allotted for bonus (NOTE 10)	—	(1,590,000)	(233,856)	—	—	—	(233,856)
Issuance of shares for exercise of warrants (NOTE 8A (I))	—	224,925	26,117	—	—	—	26,117
Issuance of shares for bonus (NOTES 10 AND 16)	—	1,590,000	233,856	—	—	—	233,856
Shares issued for cash:							
Private placements (NOTE 9A (II))	—	28,494,653	20,387,824	(762,804)	—	—	19,625,020
Share issuance costs	—	—	(908,920)	—	—	—	(908,920)
Exercise of warrants (NOTE 9A (III))	—	5,700,628	3,296,143	—	—	—	3,296,143
Exercise of options (NOTE 9A (IV))	—	1,795,852	196,988	—	—	—	196,988
Shares issued for finders' fee (NOTE 10)	—	852,915	616,770	—	—	—	616,770
Non-cash share issuance costs (NOTE 10)	—	—	(616,770)	—	—	—	(616,770)
Shares issued for property (NOTE 10)	—	6,200,547	7,564,444	—	—	—	7,564,444
Stock-based compensation (NOTES 9C AND 9D)	—	—	—	—	3,523,324	—	3,523,324
Fair value of stock options exercised (NOTE 10)	—	—	97,933	—	(97,933)	—	—
Balance 31 January 2006	Unlimited	100,173,173	$ 49,022,606	$ —	$ 4,431,133	$ (34,067,125)	$ 19,386,614

SEE ACCOMPANYING NOTES

CONSOLIDATED STATEMENTS OF LOSS

As at January 31 *U.S. Funds*	2006	2005	2004
General and Administrative			
Administration fees and wages	$ 207,650	$ 105,449	$ 32,120
Amortization	4,220	1,705	275
Consulting fees	388,900	370,815	21,278
Conferences	26,138	—	—
Insurance	29,858	31,199	—
Interest expense (income), net	(148,036)	(2,221)	380
Investor relations and financing	89,542	95,669	—
Management fees	129,483	141,270	52,388
Office and telephone	101,127	47,175	9,106
Professional fees	150,606	98,624	58,806
Rent	61,516	58,713	8,767
Shareholders' information	53,364	35,277	5,032
Stock-based compensation expense (Note 9c)	3,523,324	992,658	55,048
Transfer agent and filing fees	64,914	24,765	20,221
Travel and automotive	348,244	220,530	25,278
Loss Before the Undernoted	5,030,850	2,221,628	288,699
Other Expenses (Income)			
Pre-feasibility costs – Schedule 1	11,120,145	1,622,983	91,616
Gain on foreign exchange conversion	(221,458)	(68,274)	(22,230)
Gain on sale of resource properties	—	—	(219,925)
Loss on sale of property, plant and equipment	—	—	8,640
	10,898,687	1,554,709	(141,899)
Loss for the Year	$ 15,929,537	$ 3,776,337	$ 146,800
Deficit Beginning of the Year	18,137,588	14,361,251	14,214,451
Deficit End of Year	34,067,125	18,137,588	14,361,251
Loss per Share	$ (0.22)	$ (0.07)	$ (0.00)
Weighted Average Number of Shares	73,484,490	51,946,290	35,452,260

SEE ACCOMPANYING NOTES

CONSOLIDATED STATEMENTS OF CASH FLOWS

As at January 31 *U.S. Funds*	2006	2005	2004
Operating Activities			
Loss for the year	$ (15,929,537)	$ (3,776,337)	$ (146,800)
Adjustments to reconcile loss to net cash			
Consulting – bonus shares	—	233,856	—
Amortization	4,220	1,705	275
Stock-based compensation expense	3,523,324	992,658	55,048
Gain on sale of resource properties	—	—	(219,925)
Loss on sale of property, plant and equipment	—	—	8,640
Changes in current assets and liabilities			
Miscellaneous receivables	4,019	(23,124)	(15,665)
Prepaid expenses	166,034	(236,130)	(5,466)
Accounts payable	1,386,408	231,640	20,378
Net cash used in operating activities	(10,845,532)	(2,575,732)	(303,515)
Investing Activities			
Term deposit	807,200	(807,200)	—
Purchase of property, plant and equipment (NOTE 6, 7, 10)	(1,000,000)	—	(500,000)
Purchase of equipment	(10,343)	(15,838)	(2,061)
Proceeds on disposal of equipment	—	—	33,331
Proceeds on sale of resource property	—	—	219,925
Net cash used in investing activities	(203,143)	(823,038)	(248,805)
Financing Activities			
Share capital – for cash	22,209,231	2,651,286	1,044,684
Share subscriptions received	—	762,804	—
Net cash provided by financing activities	22,209,231	3,414,090	1,044,684
Net Increase in Cash Position	11,160,556	15,320	492,364
Cash Position – Beginning of Year	510,871	495,551	3,187
Cash Position – End of Year	$ 11,671,427	$ 510,871	$ 495,551
Cash Position Consists of:			
Cash on deposit	$ 11,671,427	$ —	$ 495,551
Bank overdraft covered by term deposit	—	(251,933)	—
Restricted cash from share subscriptions received	—	762,804	—
	$ 11,671,427	$ 510,871	$ 495,551
Cash paid during the year for interest expense	$ —	$ —	$ —
Cash paid during the year for income taxes	$ —	$ —	$ —

Supplemental disclosure with respect to cash flows (NOTE 10)

SEE ACCOMPANYING NOTES

CONSOLIDATED SCHEDULES OF PRE-FEASIBILITY COSTS

As at January 31
U.S. Funds

	2006	2005	2004
Direct			
Camp and general	$ 100,987	$ 5,337	$ 4,750
Consulting fees	690,075	336,770	—
Drilling	3,075,034	441	—
Engineering	578,310	220,729	—
Environmental	2,420,531	406,524	—
Geological and geophysical	74,689	172,675	—
Land lease, taxes and licenses	187,205	78,605	76,154
Metallurgical	1,894,096	66,984	10,712
Mine planning	1,312,392	48,769	—
Permitting	137,013	181,751	—
Plant maintenance and repair	43,691	—	—
Sampling	606,122	—	—
Scoping study	—	104,398	—
Total Costs for the Year	$ 11,120,145	$ 1,622,983	$ 91,616

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

As at January 31 2006, 2005 and 2004
U.S. Funds

1. NATURE OF BUSINESS

PolyMet Mining Corp. (the "Company") was incorporated in British Columbia, Canada on 4 March 1981 under the name Fleck Resources Ltd. The Company changed its name from Fleck Resources to PolyMet Mining Corp. on 10 June 1998.

The Company is engaged in the exploration and development, when warranted, of natural resource properties. The Company's primary mineral property is the NorthMet Project, a polymetallic project in northeastern Minnesota, USA. The realization of the Company's investment in the NorthMet Project and other assets is dependant upon various factors, including the existence of economically recoverable mineral reserves, the ability to obtain the necessary financing to complete the exploration and development of the NorthMet Project, future profitable operations, or alternatively upon disposal of the investment on an advantageous basis.

2. SIGNIFICANT ACCOUNTING POLICIES

a) Consolidation

These consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, PolyMet Mining Inc. and Fleck Minerals Inc. The purchase method of accounting is used to consolidate these subsidiaries.

PolyMet Mining Inc. was incorporated in Minnesota, U.S.A. to hold the NorthMet Lease (Note 5). Fleck Minerals Inc. is currently inactive.

b) Mineral Operations

The Company is in the pre-feasibility stage of developing its mineral properties and has not yet determined whether these properties contain ore reserves that are economically recoverable.

Exploration expenses incurred prior to determination of the feasibility of a mining operation, periodic option payments and administrative expenses are expended as incurred. Mineral property acquisition costs and exploration and development expenditures incurred subsequent to the determination of the feasibility of mining operation are deferred until the property is placed into production, sold, allowed to lapse or abandoned. Acquisition costs include cash and fair market value of common shares. These capitalized costs will be amortized over the estimated life of the property following commencement of commercial production or written off if the property is sold, allowed to lapse or abandoned or when an impairment of values has occurred.

Ownership in mineral interests involves certain inherent risks due to the difficulties of determining the validity of certain claims as well as the potential for problems arising from the frequently ambiguous conveyance history characteristic of many mineral interests. The Company has investigated ownership of its mineral interests and, to the best of its knowledge, ownership of its interests are in good standing.

c) Amortization

The Company provides for amortization of its property, plant and equipment as follows:

Leasehold improvements – Straight-line over 10 years

Furniture and equipment – Straight-line over 10 years

Computers – Straight-line over 5 years

Property, plant and equipment related to the NorthMet Project will begin to be amortized at the time the project commences operations and will be over the life of the mine.

d) Investments

The Company carries its long-term portfolio investments at lower of cost or net realizable value. Investments are written down to net realizable value when there has been a loss in value of the investment, which is other than a temporary decline.

e) Loss Per Share

Basic earnings (loss) per share is computed by dividing income (loss) available to common shareholders by the weighted average number of common shares outstanding during the year. The computation of diluted earnings per share assumes the conversion, exercise or issuance would have a dilutive effect on earnings per share. The dilutive effect of convertible securities is reflected in diluted earnings per share by application of the "if converted" method. The dilutive effect of outstanding options and warrants and their equivalents is reflected in diluted earnings per share by application of the treasury stock method.

f) Conversion of Foreign Currency

The accounts of the Company are prepared in U.S. funds and the company's Canadian operations are translated into U.S. dollars as follows:

- Monetary assets and liabilities at year-end rates,
- All other assets and liabilities at historical rates, and
- Revenue and expense items at the average rate of exchange prevailing during the year.

Exchange gains and losses arising from these transactions are reflected in income or expense in the year.

g) Environmental Expenditures

The operations of the Company may in the future be affected from time to time in varying degrees by changes in environmental regulations, including those for future removal and site restoration costs. Both the likelihood of new regulations and their overall effect upon the Company vary greatly and are not predictable. The Company's policy is to meet or, if possible, surpass standards set by relevant legislation, by application of technically proven and economically feasible measures.

h) Management's Estimates

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

i) Share Capital

i) The proceeds from the exercise of stock options and warrants are recorded as share capital in the amount for which the option or warrant enabled the holder to purchase a share in the Company.

ii) Share capital issued for non-monetary consideration is recorded at an amount based on fair market value.

j) Stock-Based Compensation

All stock-based awards made to employees and non-employees are measured and recognized using a fair value based method. For employees, the fair value of the options is measured at the date of the grant. For non-employees, the fair value of the options is measured on the earlier of the date at which the counterparty performance is complete or the date the performance commitment is reached or the date at which the *j) continued*

equity instruments are granted if they are fully vested and non-forfeitable. For employees and non-employees, the fair value of the options is accrued and charged to operations, with the offsetting credit to contributed surplus, on a straight-line basis over the vesting period. If and when the stock options are ultimately exercised, the applicable amounts of contributed surplus are transferred to share capital.

k) Cash and Cash Equivalents

For purposes of reporting cash flows, the Company considers cash and cash equivalents to include amounts held in banks and highly liquid debt investments with remaining maturities at point of purchase of three months or less. The Company places its cash and cash investments with institutions of high credit worthiness. At times, such investments may be in excess of insurance limits.

l) Asset Retirement Obligations

The recommendations of Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3110, Asset Retirement Obligations ("CICA 3110"), became effective on 1 February 2004. This section requires the recognition of a legal liability for obligations relating to the retirement of property, plant and equipment and obligations arising from the acquisition, construction, development, or normal operation of those assets. Such asset retirement costs must be recognized at fair value, when a reasonable estimate of fair value can be estimated, in the year in which the liability is incurred. A corresponding increase to the carrying amount of the related asset, where one is identifiable, is recorded and amortized over the life of the asset. Where a related asset is not easily identifiable with a liability, the change in fair value over the course of the year is expensed. The amount of the liability is subject to re-measurement at each reporting year-end. The estimates are based principally on legal and regulatory requirements. It is possible that the Company's estimates of its ultimate reclamation and closure liabilities could change as a result of changes in regulations, changes in the extent of environmental remediation required, changes in the means of reclamation or changes in cost estimates. Changes in estimates are accounted for prospectively commencing in the year the estimate is revised.

m) Variable Interest Entities

Effective 1 February 2005, the Company adopted the recommendations of CICA Handbook Accounting Guideline 15 (AcG-15), Consolidation of Variable Interest Entities, effective for annual and interim periods beginning on or after 1 November 2004. Variable interest entities (VIEs) refer to those entities that are subject to control on a basis other than ownership of voting interests. AcG-15 provides guidance for identifying VIEs and criteria for determining which entity, if any, should consolidate them. Adoption of this accounting policy has not affected the Company's financial statements.

n) Impairment of Long-Lived Assets

The Company has adopted CICA Section 3063 "Impairment of Long-Lived Assets". This statement establishes standards for the recognition, measurement and disclosure or the impairment of non-monetary long-lived assets, included property, plant and equipment, intangible assets with finite useful lives, deferred pre-operating costs and long-term prepaid assets. The adoption of this standard did not have a material impact on the Company's financial position or results of operations.

o) Comparative Figures

Certain of the comparative figures have been reclassified to conform with the current year's presentation.

3. FINANCIAL INSTRUMENTS

a) Fair value

The carrying value of cash, miscellaneous receivable, investments (Note 4) accounts payable and long-term debt approximates the fair value of these financial instruments due to their short-term maturity or capacity of prompt liquidation.

b) Interest rate risk

The Company is not exposed to significant interest rate risk due to the short-term maturity of its monetary current assets and current liabilities.

c) Currency risk

The Company is exposed to foreign currency fluctuations to the extent primary expenditures incurred by the Company are not denominated in Canadian dollars. As at 31 January 2006, the Company had investments in mineral properties that require the Company to make payments in US dollars (Notes 6 and 7). The Company's ability to make these payments will be affected by currency fluctuations.

4. INVESTMENTS

Details are as follows:

As at January 31 *U.S. Funds*	Market Value	2006	2005
American Platinum Inc.	$ —	$ 1	$ 1
Aloak Corp.	25	252	252
	$ 25	$ 253	$ 253

These investments represent minority interests of less than 10% in the respective companies.

5. RESOURCE PROPERTY AGREEMENTS

NorthMet, Minnesota, U.S.A. – Lease

By an agreement dated 4 January 1989 and a subsequent amendment and assignment, the Company leases certain lands in St. Louis County, Minnesota from RGGS Land & Minerals Ltd., L.P. During the year ended 31 January 2005, United States Steel Corporation assigned the lease to RGGS Land & Minerals Ltd., L.P. The current term of the renewable lease is 20 years and calls for total lease payments of $1,475,000. All lease payments have been paid or accrued to 31 January 2006. The agreement requires future annual lease payments of $150,000 from 4 January 2006 to 2009.

The Company can, at its option, terminate the lease at any time by giving written notice to the lessor not less than 90 days prior to the effective termination date or can indefinitely extend the 20-year term by continuing to make $150,000 annual lease payments on each successive anniversary date.

The lease payments are considered advance royalty payments and shall be deducted from future production royalties payable to the lessor, which range from 3% to 5% based on the net smelter return received by the Company. The Company's recovery of the advance royalty payments is subject to the lessor receiving an amount not less than the amount of the annual lease payment due for that year.

6. PROPERTY, PLANT AND EQUIPMENT

Details are as follows:

As at January 31 *U.S. Funds*	Cost	Accumulated Amortization	Net Book Value
31 January 2006			
NorthMet Project	$ 14,224,967	$ —	$ 14,224,967
Leasehold improvements	624	27	597
Furniture and equipment	9,663	2,315	7,348
Computers	17,855	3,759	14,096
	$ 14,253,109	$ 6,101	$ 14,247,008
31 January 2005			
NorthMet Project	$ 729,320	$ —	$ 729,320
Leasehold improvements	—	—	—
Furniture and equipment	1,888	172	1,716
Computers	15,908	1,705	14,203
	$ 747,116	$ 1,877	$ 745,239

Cleveland Cliffs Option, Minnesota, U.S.A.

By a Memorandum of Understanding dated 5 December 2003 and an option agreement dated 14 February 2004, the Company obtained an option ("Cliffs Option") to acquire certain property, plant and equipment ("Cliffs Assets") from Cleveland Cliffs of Cleveland, Ohio ("Cliffs") located near the Company's NorthMet Project. Under the terms of the agreement, Cliffs will maintain available designated elements of the facility while the Company develops its feasibility study on the NorthMet project.

As consideration for the exclusive Cliffs Option, the Company paid $500,000 prior to 31 January 2004 as required and issued to Cliffs 1,000,000 common shares on 30 March 2004, valued at $229,320 to maintain the exclusive rights until 30 June 2006.

On 14 September 2005 the Company reached an agreement in principle with Cliffs on the terms for the early exercise of the Company's option to acquire 100% ownership of large portions of the former LTV Steel Mining Company ore processing plant in northeastern Minnesota (the "Asset Purchase Agreement").

On 15 November 2005 the Company completed the acquisition under the Asset Purchase Agreement ("Purchase Agreement"). The property, plant and equipment assets now owned by the Company include land, crushing, milling and flotation capacity, complete spare parts, plant site buildings, real estate, tailings impoundments and mine work shops, as well as access to extensive mining infrastructure. The final allocation of the purchase price has not been agreed to between the parties. As the assets are not in use no amortization of these assets has been recorded to 31 January 2006.

The consideration for the Asset Purchase was $3.4 million in cash ($1,000,000 paid) and the issuance of 6,200,547 common shares (issued on 15 November 2005 at fair market value of $7,564,444) in the capital stock of the Company. The remaining cash component of the payment of $2.4 million will be paid in quarterly instalments of US$250,000 for a total of $2.5 million, which includes interest of $100,000 (Note 7). Interest accrued in the amount of $20,515 has been capitalized as part of the cost of the NorthMet Project assets.

The Company has assumed certain ongoing site-related environmental and reclamation obligations. These environmental and reclamation obligations are presently contracted under the terms of the Purchase Agreement with Cliffs. Once the Company obtains its permit to mine and Cliffs is released from its obligations by the State agencies, the environmental and reclamation obligations will be direct with the governing bodies. The present value of the asset retirement obligation in the amount of $2,510,687 (Note 8) has been recorded as an increase in the carrying amount of the NorthMet Project assets and will be amortized over the life of the asset.

Under the terms of the agreement Cliffs will have the right to participate on a pro-rata basis in future cash equity financings.

7. LONG TERM DEBT

Pursuant to the Asset Purchase Agreement (Note 6) the Company's wholly owned subsidiary PolyMet Mining Inc. signed a note payable to Cliffs in the amount of $2,400,000. The note is interest bearing at the annual simple rate of four percent (4%) and shall be paid in quarterly instalments equal to $250,000 for total repayment of $2,500,000.

As at 31 January 2006 the outstanding long term debt was as follows:

Note Payable	$ 2,400,000
Accrued Interest	20,515
Total Debt	2,420,515
Less current portion	(1,000,000)
Long term debt	$ 1,420,515

8. ASSET RETIREMENT OBLIGATION

As part of the consideration for the Cliffs Purchase Agreement (Note 6), the Company assumed, under contract to Cliffs, the liability for final reclamation and closure of the mine.

Federal, state and local laws and regulations concerning environmental protection affect the Company's operations. Under current regulations, the Company is contracted to indemnify Cliff's requirement to meet performance standards to minimize environmental impact from operations and to perform site restoration and other closure activities. The Company's provisions for future site closure and reclamation costs are based on known requirements. It is not currently possible to estimate the impact on operating results, if any, of future legislative or regulatory developments. The Company's estimate of the present value of the obligation to reclaim the NorthMet Project is based upon existing reclamation standards at January 31, 2006 and Canadian GAAP. Once the Company obtains its permit to mine the environmental and reclamation obligations will be direct with the governing bodies.

The Company's estimates are based upon a 31 January 2006 liability estimate of $12,444,478, an annual inflation rate of 3.80%, a discount rate of 9.00% and a mine life of 28.5 years, commencing in mid-2008 and a reclamation period of 3 years. Accretion of the liability until the commencement of commercial production will be capitalized to the NorthMet Project assets.

9. SHARE CAPITAL

a) Share Issuances for Cash

During the year ended 31 January 2006 the Company issued the following shares for cash:

i) 224,925 shares pursuant to the exercise of warrants allotted at 31 January 2005;

ii) Four private placements for a total of 28,494,653 shares at prices of CDN$0.55 – CDN$1.40 for net proceeds of $20,387,824 ($762,804 was received prior to 31 January 2005). Each of the private placements included share purchase warrants (Note 9e). Cash share issue costs in the amount of $908,920 were included in respect of these private placements;

iii) 5,700,628 shares pursuant to the exercise of 5,700,628 share purchase warrants for total proceeds of $3,296,143 (Note 9e);

iv) 1,795,852 shares pursuant to the exercise of stock options for total proceeds of $196,988 (Note 9b);

During the year ended 31 January 2005, the Company increased its authorized share capital from 1,000,000,000 common shares to an unlimited number of common shares and issued the following shares:

v) Two private placements for a total of 2,800,000 shares at CDN$0.80 per share for net proceeds of $1,733,984. Each of the private placements included share purchase warrants (Note 9e). Cash share issuance costs in the amount of $18,752 were incurred in respect of these private placements;

vi) 5,277,573 shares pursuant to the exercise of 5,277,573, share purchase warrants for total proceeds of $828,554, and

vii) 1,088,400 shares pursuant to the exercise of stock options for total proceeds of $81,383.

b) Stock Options

As at January 31 *CDN Funds*	31 January 2006 Options	Weighted Average Exercise Price	31 January 2005 Options	Weighted Average Exercise Price
Outstanding – Beginning of year	4,999,552	$ 0.32	3,542,952	$ 0.11
Granted	3,580,000	1.13	2,545,000	0.52
Exercised	(1,795,852)	0.13	(1,088,400)	0.10
Outstanding – End of year	6,783,700	$ 0.80	4,999,552	$ 0.32

As at 31 January 2006, the following director, officer, consultant and employee stock options were outstanding:

Expiry Date	Exercise Price (CDN)	Number
12 February 2006	$ 0.21	500,000
18 July 2008	0.10	328,700
3 October 2008	0.13	450,000
9 March 2009	0.40	500,000
28 April 2009	0.75	200,000
5 July 2009	0.66	1,175,000
18 October 2009	0.79	50,000
30 March 2010	0.65	765,000
1 May 2010	0.85	350,000
15 June 2010	0.94	40,000
19 September 2010	1.36	1,870,000
24 October 2010	1.20	280,000
5 December 2010	1.15	275,000
		6,783,700

c) Stock-Based Compensation

i) During the year ended 31 January 2006, the Company issued 3,580,000 options to directors, officers, consultants and employees with exercise prices of CDN$0.65 – CDN$1.36 per option. The fair value of stock-based compensation in the amount of $3,523,324 has been recorded in the accounts of the Company as an expense with the offsetting entry to contributed surplus. This value is estimated at the date of grant using the Black-Scholes Option Pricing Model with the following weighted average assumptions:

Risk-free interest rate	3.66%
Expected dividend yield	Nil
Expected stock price volatility	131%
Expected option life in years	5

ii) During the year ended 31 January 2005, the Company issued 2,545,000 options to directors, officers, consultants and employees with exercise prices ranging from CDN$0.21 – CDN$0.79 per option. The fair value of stock-based compensation in the amount of $992,658 has been recorded in the accounts of the Company as an expense with the offsetting entry to contributed surplus. This amount includes the expense for the 950,000 options at CDN$0.13, granted on 3 October 2003, which were approved by the Company's shareholders on May 24, 2004. This value is estimated at the date of grant using the Black-Scholes Option Pricing Model with the following weighted average assumptions:

Risk-free interest rate	3.25%
Expected dividend yield	Nil
Expected stock price volatility	143%
Expected option life in years	4.78

d) Contributed Surplus

Contributed surplus represents accumulated stock-based compensation expense, reduced by the fair value of the stock options exercised.

Details are as follows:

As at January 31 *U.S. Funds*	2006	2005
Balance – Beginning of year	$ 1,005,742	$ 55,048
Current year fair value of stock-based compensation	3,523,324	992,658
Fair value of stock options exercised during the year and transferred to share capital	(97,933)	(41,964)
Balance – End of year	$ 4,431,133	$ 1,005,742

e) Share Purchase Warrants

The Company's share purchase warrants as at 31 January 2006 and 2005 and the changes during the years then ended are as follows:

	2006		2005	
As at January 31 *CDN Funds*	Warrants	Weighted Average Exercise Price	Warrants	Weighted Average Exercise Price
Warrants outstanding and exercisable – beginning of year	5,841,278	$ 0.42	9,718,852	$ 0.19
Issued	15,175,104	1.17	1,400,000	1.20
Exercised	(5,925,553)	(0.66)	(5,277,574)	(0.20)
Expired	(428,124)	(1.20)		
Warrants outstanding and exercisable – end of year	14,662,705	$ 1.07	5,841,278	$ 0.42

Share purchase warrants outstanding at 31 January 2006 and 2005 are as follows:

As at January 31 *CDN Funds*	Exercise Price	Number of Shares 2006	2005
23 September 2005	$ 0.17	—	1,012,355
4 December 2005	1.20	—	775,000
1 March 2006	1.20	625,000	625,000
16 November 2006	0.20	3,428,923	3,428,923
28 February 2008	1.25	3,336,110	—
22 March 2008	1.25	4,572,566	—
9 May 2007	2.00	1,772,328	—
6 September 2007	1.25	927,778	—
		14,662,705	5,841,278

During the year ended January 31, 2006 the Company completed the following financings:

(i) A non-brokered private placement for 9,000,000 units at a price of CDN$0.55 per unit. Each unit consisted of one common share and one half of one share purchase warrant. One full Warrant entitles the holders, on exercise, to purchase one additional common share of the Company at a price of CDN$0.70 per Warrant Share at any time until the close of business on the day which is 24 months from the date of Closing, provided that if the closing price of the Issuer's shares as traded on the Exchange at or exceed CDN$1.00 per share for 30 consecutive trading days, the Warrants will terminate 30 days thereafter. As at 31 January 2006 all Warrants had been exercised.

(ii) A non-brokered private placement for 6,672,219 units at a price of CDN$0.90 per unit. Each unit consisted of one common share and one half of one share purchase warrant. One full Warrant entitles the holders, on exercise, to purchase one additional common share of the Company at a price of CDN$1.25 per Warrant Share at any time until the close of business on the day which is 30 months from the date of Closing, provided that if the closing price of the Issuer's shares as traded on the Exchange is over CDN$2.50 per share for 20 consecutive trading days, the Warrants will terminate 30 days thereafter.

(iii) A brokered private placement for 9,277,777 units at a price of CDN$0.90 per unit. Each unit consisted of one common share and one half of one share purchase warrant. One full Warrant entitles the holders, on exercise, to purchase one additional common share of the Company at a price of CDN$1.25 per Warrant Share at any time until the close of business on the day which is 30 months from the date of Closing, provided that if the closing price of the Issuer's shares as traded on the Exchange is over CDN$2.50 per share for 20 consecutive trading days (Accelerated Expiry), the Warrants will terminate 30 days thereafter. In addition 927,777, share purchase warrants were issued as finders fee at a price of CDN$1.25 for a period of two years from the date of Closing and include the Accelerated Expiry provision.

iv) A non-brokered private placement for 3,544,657 units at a price of CDN$1.40 per unit. Each unit consisted of one common share and one half of one share purchase warrant. One full Warrant entitles the holders, on exercise, to purchase one additional common share of the Company at a price of CDN$2.00 per Warrant Share at any time until the close of business on the day which is 18 months from the date of Closing, provided that if the closing price of the Issuer's shares as traded on the Exchange is over CDN$2.50 per share for 20 consecutive trading days, the Warrants will terminate 30 days thereafter.

During the year ended 31 January 2005 the Company completed the following financings:

vi) A non-brokered private placement for 1,500,000 units at a price of CDN$0.80 per unit. Each unit consisted of one common share and one half of one share purchase warrant. One full Warrant entitles the holders, on exercise, to purchase one additional common share of the Company at a price of CDN$1.20 per Warrant Share at any time until the close of business on the day which is 18 months from the date of Closing. On 4 December 2005, 428,124 warrants expired, without being exercised.

vii) A non-brokered private placement for 625,000 units at a price of CDN$0.80 per unit. Each unit consisted of one common share and one half of one share purchase warrant. One full Warrant entitles the holders, on exercise, to purchase one additional common share of the Company at a price of CDN$1.20 per Warrant Share at any time until the close of business on the day which is 18 months from the date of Closing.

f) Shareholder Rights Plan

Effective 4 December 2003, the Company adopted a Shareholder Rights Plan ("Rights Plan"), which was approved by the Company's shareholders' on 27 May 2004. All common shares issued by the Company during the term of the Rights Plan will have one right represented for each common share held by the shareholder of the Company. The term of the Rights Plan is 10 years, unless the rights are earlier redeemed or exchanged. The Rights issued under the Rights Plan become exercisable only if a party acquires 20% or more of the Company's common shares without complying with the Rights Plan or without the approval of the Board of Directors of the Company.

Each Right entitles the registered holder thereof to purchase from the Company on the occurrence of certain events, one common share of the Company at the price of CDN$50 per share, subject to adjustment (the "Exercise Price"). However, upon certain events occurring (as defined in the Rights Plan), each Right would then entitle the registered holder to receive, upon payment of the Exercise Price, that number of common shares that have a market value at the date of that occurrence equal to twice the Exercise Price. The Rights are not exercisable until the Separation Time, as defined in the Rights Plan.

10. SUPPLEMENTAL DISCLOSURE WITH RESPECT TO CASH FLOWS

During the years ended 31 January 2006, 2005 and 2004, the Company entered into the following non-cash investing and financing activities :

As at January 31 *U.S. Funds*	2006	2005	2004
Issued 6,200,547 (2005 – 1,000,000; 2004– Nil) shares to Cliffs pursuant to the Company's exercise of the Cliffs Option to purchase the Cliffs Assets	$ 7,564,444	$ 229,320	—
Issued a promissory note payable to Cliffs pursuant to the Company's exercise of the Cliffs Option to purchase the Cliffs Assets	$ 2,400,000	—	—
Recorded an Asset Retirement Obligation and a corresponding increase in Cliffs Assets pursuant to the Company's exercise of the Cliffs Option to purchase the Cliffs Assets	$ 2,510,687	—	—
Transfer from contributed surplus to capital stock on exercise of stock options	$ 97,933	$ 41,964	—
Transfer from share subscriptions to share capital on issuance of the related shares	$ 762,804	—	—
Capitalized accrued interest on the promissory note payable to Cliffs	$ 20,515	—	—
Issued 852,915 (2005 – 155,626; 2004 – 60,000) shares for finders' fees on private placements	$ 616,770	$ 96,375	$ 6,541
Issued Nil (2005 – Nil; 2004 – 50,000) shares in settlement of debt	—	—	$ 3,634

11. RELATED PARTY TRANSACTIONS

In addition to transactions disclosed elsewhere in these financial statements, the Company has conducted transactions with officers, directors and persons or companies related to directors and paid or accrued amounts as follows:

As at January 31 *U.S. Funds*		2006		2005		2004
Management fees paid to a company controlled by the president	$	129,480	$	141,270	$	52,388
Consulting fees paid to officers, directors and companies controlled by directors of the Company		327,110		336,448		—
Legal fees paid to an officer of the Company		84,089		59,700		—
Office facilities charges paid to a director of the Company		39,604		23,070		—
	$	580,283	$	560,488	$	52,388

The amounts charged to the Company for the services provided have been determined by negotiation among the parties and, in certain cases, are covered by signed agreements. These transactions were in the normal course of operations and were measured at the exchange value, which is the amount of consideration established and agreed to by the related parties.

12. INCOME TAXES

The Company's provision for income taxes differs from the amounts computed by applying the combined Canadian federal and provincial income tax rates to the net loss as a result of the following:

As at January 31 *U.S. Funds*		2006		2005
Provision for recovery of taxes at statutory rates	$	(5,553,036)	$	(1,372,240)
Tax benefit not recognized on current year losses		1,174,113		747,890
Differences in foreign tax rates		(358,166)		(58,267)
Non-deductible items and other		4,737,089		682,617
		—		—

Future income taxes reflect the net effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The significant components of the Company's future tax assets as at 31 January 2006 are as follows:

As at January 31 *U.S. Funds*		2006		2005
Non-capital loss carry forwards	$	4,113,715	$	2,891,339
Unutilized exploration expenses		6,438,780		3,910,289
Capital assets		(6,552)		(3,806)
Total gross future income tax assets		10,545,943		6,797,822
Less: valuation allowance		(10,545,943)		(6,797,822)
Net future income tax allowance		—		—

The Company has income tax loss carry forwards of approximately $4.3 million in Canada, which may be used to reduce future income taxes otherwise payable and which expire in the years 2007 to 2016.

The Company has income tax loss carry forwards of approximately $6.2 million in the United States, which may be used to reduce future income taxes otherwise payable and which expire in the years 2007 to 2026.

The tax benefit of the above noted tax assets have been offset by recognition of a valuation allowance in these financial statements.

13. DIFFERENCES BETWEEN CANADIAN AND UNITED STATES GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

These consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). The U.S. Securities and Exchange Commission requires that financial statements of foreign companies contain a reconciliation presenting the statements on the basis of accounting principles generally accepted in the U.S. Any differences in accounting principles as they pertain to the accompanying consolidated financial statements are not material except as follows:

a) Under Canadian generally accepted accounting principles, long-term portfolio investments may be reported at a cost that is in excess of market value where it is reasonable to assume that the decline in market value may be of a temporary nature. Under U.S. generally accepted accounting principles, the investments are carried at market value on an individual basis and the adjustment is credited or charged to comprehensive income.

b) Under Canadian generally accepted accounting principles, mineral properties may be carried at cost and written-off or written-down if the properties are abandoned, sold or if management decides not to pursue the properties. Under U.S. generally accepted accounting principles, the Company would periodically review and obtain independent reports in determining adjustments to the mineral properties and records properties at net realizable value. The Company has not yet obtained an independent report and accordingly for U.S. purposes, the properties have been written off. In the past the Company followed the method described above. During 2003, the Company changed the accounting policy (Note 2), therefore there are no differences between Canadian and United States generally accepted accounting principles.

The effects of the differences in accounting principles on investments, net loss and comprehensive loss are as follows:

As at January 31 *U.S. Funds*		2006		2005		2004
Investments – Canadian GAAP basis	$	253	$	253	$	253
Adjustment to market		(228)		(228)		(228)
Investments – U.S. GAAP basis	$	25	$	25	$	25
Accumulated Comprehensive Loss:						
Contra-equity account for unrealized gains (losses) on investments						
– Canadian GAAP basis		—		—		—
Unrealized holding gain (loss) on investments						
– Prior years		(228)		(228)		(228)
– Current year		—		—		—
Contra-equity account for unrealized gains (losses) on investments – U.S. GAAP basis	$	(228)	$	(228)	$	(228)
Net Loss and Comprehensive Loss:						
Net loss – Canadian and U.S. GAAP basis	$	15,929,537	$	3,776,337	$	146,800
Adjustment of portfolio investments to market		—		—		—
Net loss and comprehensive loss – U.S. GAAP basis	$	15,929,537	$	3,776,337	$	146,800
Weighted average number of shares computed under U.S. GAAP		73,484,490		53,784,877		38,452,260
Loss per share following U.S. GAAP	$	(0.22)	$	(0.07)	$	(0.00)

c) Recent U.S. Accounting Pronouncements, which relate to the Company's current operations are summarized as follows:

In May 2003, the FASB issued SFAS 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity". SFAS No. 150 establishes standards for classifying and measuring as liabilities certain financial instruments that embody obligations of the issuer and have characteristics of both liabilities and equity. The adoption of SFAS 150 did not have a material impact on the Company's financial statements.

In December 2004, the FASB issued SFAS No. 123R, "Share Based Payment". SFAS 123R is a revision of SFAS No. 123 "Accounting for Stock-Based Compensation", and supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees" and its related implementation guidance. SFAS 123R establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services. It also addresses transactions in which an entity incurs liabilities in exchange for goods or services that are based on the fair value of the entity's equity instruments or that may be settled by the issuance of those equity instruments. Public entities that file as small business issuers will be required to apply SFAS 123R in the first interim or annual reporting period that begins after December 15, 2005. The adoption of this standard is not expected to have a material effect on the Company's results of operations or financial position.

In December 2004, FASB issued SFAS No. 153, "Exchanges of Non-monetary Assets – An Amendment of APB Opinion No. 29". The guidance in APB Opinion No. 29, "Accounting for Non-monetary Transactions", is based on the principle that exchanges of non-monetary assets should be measured based on the

c) continued

fair value of the assets exchanged. The provisions of SFAS No. 153 are effective for non-monetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. Early application is permitted and companies must apply the standard prospectively. The adoption of this standard is not expected to have a material effect on the Company's results of operations or financial position.

In May 2005, the FASB issued SFAS 154, "Accounting Changes and Error Corrections," which replaces APB Opinion No. 20, "Accounting Changes," and supersedes FASB Statement No. 3, "Reporting Accounting Changes in Interim Financial Statements – an amendment of APB Opinion No. 28." SFAS 154 requires retrospective application to prior periods' financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. When it is impracticable to determine the period-specific effects of an accounting change on one or more individual prior periods presented, SFAS 154 requires that the new accounting principle be applied to the balances of assets and liabilities as of the beginning of the earliest period for which retrospective application is practicable and that a corresponding adjustment be made to the opening balance of retained earnings for that period rather than being reported in an income statement. When it is impracticable to determine the cumulative effect of applying a change in accounting principle to all prior periods, SFAS 154 requires that the new accounting principle be applied as if it were adopted prospectively from the earliest date practicable. SFAS 154 shall be effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The Company does not expect the provisions of SFAS 154 will have a significant impact on its results of operations.

In February 2006, the FASB issued SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments, an amendment of FASB Statements No. 133 and 140." This statement permits fair value re-measurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation. It establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation. In addition, SFAS 155 clarifies which interest-only strips and principal-only strips are not subject to the requirements of Statement 133. It also clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives. SFAS 155 amends Statement 140 to eliminate the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. This Statement is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. The adoption of this standard is not expected to have a material effect on the Company's results of operations or financial position.

In March 2006, the FASB issued SFAS 156, "Accounting for Servicing of Financial Assets—an amendment of FASB Statement No. 140". This statement amends FASB Statement No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities", with respect to the accounting for separately recognized servicing assets and servicing liabilities. This statement: (1) requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract in any of the following situations: (a) a transfer of the servicer's financial assets that meets the requirements for sale accounting, (b) a transfer of the servicer's financial assets to a qualifying special-purpose entity in a guaranteed mortgage securitization in which the transferor retains all of the resulting securities and classifies them as either available-for-sale securities or trading securities in accordance with FASB Statement No. 115, "Accounting for Certain Investments in Debt and Equity Securities", (c) an acquisition or assumption of an obligation to service a financial asset that does not relate to financial assets of the servicer or its consolidated affiliates; (2) requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable; (3) permits an entity to choose either of the following subsequent measurement methods for each class of separately recognized servicing assets and servicing liabilities: (a) Amortization method—Amortize servicing assets or servicing liabilities in proportion to and over the period of estimated net servicing income or net servicing loss and assess servicing assets or servicing liabilities for impairment or increased obligation based on fair value at each reporting date, or (b) Fair value measurement method—Measure servicing assets or servicing liabilities at fair value at each reporting date and report changes in fair value in earnings in the period in which the changes occur; (4) at its initial adoption, permits a one-time reclassification of available-for-sale securities to trading securities by entities with recognized servicing rights, without calling into question the treatment of other available-for-sale securities under Statement 115, provided that the available-for-sale securities are identified in some manner as offsetting the entity's exposure to changes in fair value of servicing assets or servicing liabilities that a servicer elects to subsequently measure at fair value; and (5) requires separate presentation of servicing assets and servicing liabilities subsequently measured at fair value in the statement of financial position and additional disclosures for all separately recognized servicing assets and servicing liabilities. An entity should adopt this statement as of the beginning of its first fiscal year that begins after September 15, 2006. The adoption of this standard is not expected to have a material effect on the Company's results of operations or financial position.

14. SEGMENTED INFORMATION

The Company is in the pre-feasibility stage of developing its mineral properties in the U.S. and provides for its financing and administrative functions at the head office located in Canada. Segmented information on a geographic basis is as follows:

2006	Canada	U.S.	Consolidated
Segment operating loss	$ 4,522,984	$ 11,406,553	$ 15,929,537
Identifiable assets	$ 11,654,116	$ 14,381,120	$ 26,035,236

2005			
Segment operating loss	$ 1,920,706	$ 1,855,631	$ 3,776,337
Identifiable assets	$ 1,364,099	$ 986,065	$ 2,350,164

15. SUBSEQUENT EVENTS

In addition to items disclosed elsewhere in these financial statements, the Company conducted the following transactions after 31 January 2006:

a) The Company issued 6,141,573 common shares pursuant to the exercise of share purchase warrants at a prices between CDN$0.20 and CDN$1.25 per share;

b) The Company issued 1,045,000 common shares pursuant to the exercise of stock options at prices ranging from CDN$0.10 to CDN$1.36;

c) The Company granted 3,200,000 stock options to directors, officers, consultants and employees at a price of CDN$2.76; and

d) The Company provided notice on 10 April 2006 to the outstanding warrants holders of approximately 9.7 million warrants at prices between CDN$1.25 and CDN$2.00 that the accelerated expiry provision of their warrants was effectively triggered and all unexercised warrants as at the close of business on 10 May 2006 will have been deemed cancelled.

16. CONTINGENT LIABILITIES AND COMMITMENTS

a) The Company has instituted a share bonus plan as part of its employment, management and consulting contracts for key management and project personnel. This bonus plan adds incentive for key personnel to reach certain prescribed milestones required to reach commercial production at the NorthMet Project. As at 31 July 2005, the Company had received shareholder approval of the Bonus Shares for Milestones 1 – 4 and regulatory approval for Milestones 1 and 2. Milestones 3 and 4 are subject to regulatory approval, which will be sought when the Company is closer to completing these Milestones. To date 1,590,000 shares have been issued for the achievement of Milestone 1. The bonus shares allocated for Milestones 1 thru 4 are valued using the Company's closing trading price on 5 November 2003 of CDN$0.19 per share, the date of the approval of the bonus plan by the board of directors.

The summary of the share bonus plan is as follows:

	Bonus Shares	
Milestone 1	1,590,000	(i) issued – Statement 2
Milestone 2	1,300,000	(ii)
Milestone 3	2,400,000	(iii)
Milestone 4	3,240,000	(iv)

(i) Milestone 1 –Completion of an agreement with Cliffs-Erie LLC for the option to purchase of Cliffs-Erie facility to be used as a part of mining and processing operations for the NorthMet Project. This milestone was achieved on 16 February 2004 and therefore, during the year ended 31 January 2006, the Company accrued a CDN$302,100 (US$233,856) bonus as consulting fees and allotted 1,590,000 shares. These shares were issued in March 2005.

(ii) Milestone 2 – Negotiation and completion of an off-take agreement with a senior metals producer for the purchase of raw materials to be produced from the NorthMet Project.

(iii) Milestone 3 – Completion of a "bankable feasibility study" which indicates that commercial production from the NorthMet Project is viable.

(iv) Milestone 4 – Commencement of commercial production at the NorthMet Project at a time when the company has not less than 50% ownership interest.

b) As a part of certain employment and management contracts, the Company has agreed to severance allowances for key employees and management in the event of a take-over bid. These allowances are based upon the Company's implied market capitalization at the time of the take-over bid, calculated by multiplying the number of shares outstanding on a fully diluted basis by the take-over bid price per share. The severance payments would be as follows:

Market Capitalization	Total Severance Payments Required
Less than CDN$50 million	CDN$Nil
Between CDN$50 and CDN$75 million	CDN$200,000
Between CDN$75 and CDN$100 million	CDN$400,000

Thereafter severance payments increase by CDN$600,000 for every additional CDN$25 million of implied market capitalization, with no maximum.

c) Pursuant to the Company's Asset Purchase Agreement with Cliffs (Note 6), for as long as Cliffs owns 1% or more of the Company's issued shares, Cliffs will have the right to participate on a pro-rata basis in future cash equity financings. This agreement will also include a first right of refusal in favour of the Company should Cliffs wish to dispose of its interest.

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