

PALLADON VENTURES LTD.
REPORT AND CONSOLIDATED FINANCIAL STATEMENTS
February 28, 2009 and February 29, 2008



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Chartered Accountants

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Auditors' Report

To the Shareholders of Palladon Ventures Ltd.

We have audited the consolidated balance sheets of Palladon Ventures Ltd. (the "Company") as at February 28, 2009 and February 29, 2008 and the consolidated statements of operations and comprehensive loss and deficit and cash flows for the years then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at February 28, 2009 and February 29, 2008 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

(signed) "BDO Dunwoody LLP"

Chartered Accountants

Vancouver, British Columbia
August 6, 2009

PALLADON VENTURES LTD.
CONSOLIDATED BALANCE SHEETS
February 28, 2009 and February 29, 2008

	2009	2008
Cash	\$8,014,594	\$820,381
GST recoverable	47,352	47,774
Amounts receivable	59,219	13,232
Marketable securities	27,000	166,500
Total Current Assets	8,148,165	1,047,887
Property and equipment - Notes 3 and 13	5,176,266	69,542
Reclamation deposits - Note 4	1,020,483	636,220
Mineral properties and related equipment - Schedule 1 and Note 5	28,182,884	24,028,087
Total Assets	42,527,798	25,781,736
Accounts payable and accrued liabilities	716,058	860,084
Due to related parties - Note 12	649,234	883,014
Loans payable - Notes 7 and 15	45,393,441	-
Total Current Liabilities	46,758,733	1,743,098
Loans payable - Notes 7 and 15	-	9,251,843
Total Liabilities	46,758,733	10,994,941
Share capital - Note 10	95,730,142	35,691,028
Contributed surplus - Notes 1 and 10	3,071,383	3,166,383
Non-controlling interest - Notes 2 and 6	-	4,308,306
Deficit	(103,032,460)	(28,378,922)
Total Shareholders' Equity (Deficiency)	(4,230,935)	14,786,795
Total Liabilities and Shareholders' Equity (Deficiency)	\$42,527,798	\$25,781,736

Nature of Operations and Ability to Continue as a Going Concern - Notes 1 and 15
Commitments - Notes 13 and 15
Subsequent Events - Notes 13 and 15

APPROVED BY THE DIRECTORS:

"John W. Cutler"

John W. Cutler

"Leonard J. Sojka"

Leonard J. Sojka

SEE ACCOMPANYING NOTES

PALLADON VENTURES LTD.
CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT
for the years ended February 28, 2009 and February 29, 2008

	2009	2008
General and Administrative Expenses:		
Amortization	\$702,442	\$20,780
Bank charges	1,036	1,237
Consulting - Note 12	487,999	57,463
Interest on long-term debt	3,095,467	954,647
Investor relations	3,532	1,723
Management fees - Note 12	-	56,069
Office and administration	453,240	172,671
Professional fees	300,991	219,314
Rent	153,976	173,868
Salaries and benefits - Note 12	1,178,006	938,288
Shareholder communications	59,274	9,489
Stock-based compensation	-	102,000
Telephone	14,145	17,653
Transfer agent and filing fees	34,359	64,045
Travel and promotion	123,528	211,736
Loss before other and non-controlling interest	(6,607,995)	(3,000,983)
Other:		
Unrealized gain (loss) on marketable securities	(139,500)	(2,250)
Gain on debt settlement - Note 12	-	66,248
Write-off mineral property - Note 5	(10)	(1,835,751)
Other income	-	36,706
Interest income	-	49,448
Gain (loss) on foreign exchange	(7,714,839)	1,168,268
Loss before non-controlling interest	(14,462,344)	(3,518,314)
Non-controlling interest - Note 6	292,231	(503,883)
Net loss and comprehensive loss for the period	(14,170,113)	(4,022,197)
Deficit, beginning of the year	(28,378,922)	(24,356,725)
Acquisition of non-controlling interest, Note 6	(60,483,425)	-
Deficit, end of the year	(\$103,032,460)	(\$28,378,922)
Basic and diluted loss per share	(\$0.10)	(\$0.06)
Weighted average number of shares outstanding	139,554,503	70,889,435

SEE ACCOMPANYING NOTES

PALLADON VENTURES LTD.
CONSOLIDATED STATEMENTS OF CASH FLOWS
for the years ended February 28, 2009 and February 29, 2008

	2009	2008
Operating Activities:		
Net loss for the period, before non-controlling interest	(\$14,462,344)	(\$3,518,314)
Items not involving cash:		
Amortization	702,442	20,780
Gain on debt settlement	-	(66,248)
Unrealized (gain) loss on marketable securities	139,500	2,250
Stock-based compensation	-	102,000
Unrealized foreign exchange (gain) loss	6,740,365	(1,524,061)
Accrued interest	2,306,273	-
Write-off of mineral property	10	1,835,751
	(4,573,754)	(3,147,842)
Changes in non-cash working capital items:		
Amounts receivable	(45,987)	42,474
GST recoverable	422	(22,940)
Prepaid expenses	-	69,678
Accounts payable and accrued liabilities	(144,026)	(206,125)
Cash used in operating activities	(4,763,345)	(3,264,755)
Investing activities:		
Acquisition of Non-controlling interest	(38,826,000)	-
Acquisition of equipment	(1,620,363)	(38,041)
Reclamation bonds	(156,517)	-
Mineral property costs, net of recoveries	(8,343,610)	274,451
Equipment under construction	-	(2,648,322)
Cash used in Investing activities	(48,946,490)	(2,411,912)
Financing activities:		
Advances (to) from related parties	(233,780)	(155,273)
Issuance of shares for cash, net of share issuance costs	59,944,114	7,186,268
Loans repaid	(594,937)	(532,769)
Cash provided from financing activities	59,115,397	6,498,226
Foreign exchange loss (gain) on cash held in US\$	1,788,651	(137,114)
Increase (decrease) in cash during the period	7,194,213	684,445
Cash, beginning of the period	820,381	135,936
Cash, end of the period	\$8,014,594	\$820,381
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$789,824	\$929,249
C\$ / US\$ - ave for the period		
Non-cash transactions - Note 14		

SEE ACCOMPANYING NOTES

PALLADON VENTURES LTD.

Schedule 1

CONSOLIDATED SCHEDULE OF MINERAL PROPERTIES AND RELATED EQUIPMENT

For the fiscal periods ended February 28, 2009 and February 29, 2008

	Iron Mountain Project, Utah, USA							Total Iron Mountain	Total	
	Other Properties	Mineral Property	Equipment Under Construction				Power Line			
			Ball Mill	Rail Line	Transformer	Substation				Plant
Beginning balance - February 28, 2007	\$2,335,878	\$14,403,729	\$1,219,526	\$2,485,999	\$786,637	\$649,686	\$556,428	-	\$20,102,005	\$22,437,883
Acquisition and Construction Costs	-	-	247,649	9,037	157,922	1,896,585	483,943	\$510,715	3,305,851	3,305,851
Exploration expenditures / (recovered):										
Field costs	394,555	51,909	-	-	-	-	-	-	51,909	446,464
Geological consulting	-	14,442	-	-	-	-	-	-	14,442	14,442
Security and site maintenance	-	320,843	-	-	-	-	-	-	320,843	320,843
Less proceeds from land sale	-	(515,701)	-	-	-	-	-	-	(515,701)	(515,701)
Less ore sales, net of cost	-	(145,944)	-	-	-	-	-	-	(145,944)	(145,944)
Subtotal	394,555	(274,451)	-	-	-	-	-	-	(274,451)	120,104
Write-offs	(1,835,751)	-	-	-	-	-	-	-	-	(1,835,751)
Ending balance - February 29, 2008	\$894,682	\$14,129,278	\$1,467,175	\$2,495,036	\$944,559	\$2,546,271	\$1,040,371	\$510,715	\$23,133,405	\$24,028,087
Beginning balance - February 29, 2008	\$894,682	\$14,129,278	\$1,467,175	\$2,495,036	\$944,559	\$2,546,271	\$1,040,371	\$510,715	\$23,133,405	\$24,028,087
Acquisition and Construction Costs	-	1,271,344	35,859	1,399,258	38,387	174,857	-	951,586	3,871,291	3,871,291
Exploration expenditures / (recovered):										
Field costs & claim fees & misc.	-	-	-	2,568	-	-	-	-	2,568	2,568
Consulting	-	87,143	-	18,232	-	-	106,217	-	211,592	211,592
Iron ore	-	749,301	-	-	-	-	-	-	749,301	749,301
Pre-stripping	-	2,020,241	-	-	-	-	-	-	2,020,241	2,020,241
Security and site maintenance	-	232,040	-	-	-	-	-	-	232,040	232,040
Less ore sales, net of cost	-	(200,456)	-	-	-	-	-	-	(200,456)	(200,456)
Subtotal	-	2,888,269	-	20,800	-	-	106,217	-	3,015,286	3,015,286
Write-offs	(10)	-	-	-	-	-	-	-	-	(10)
Assets placed in service	-	-	-	-	(982,946)	(2,721,128)	-	(484,729)	(4,188,803)	(4,188,803)
Advances	-	1,457,033	-	-	-	-	-	-	1,457,033	1,457,033
Ending balance - February 28, 2009	\$894,672	\$19,745,924	\$1,503,034	\$3,915,094	(982,946)	(2,721,128)	\$1,146,588	\$977,572	\$27,288,212	\$28,182,884

PALLADON VENTURES LTD.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
February 28, 2009 and February 29, 2008

Note 1 **Nature of Operations and Ability to Continue as a Going Concern**

Palladon Ventures Ltd. (“Palladon” or the “Company”) was incorporated on August 25, 1980 under the Company Act of British Columbia. The Company is publicly listed on the TSX Venture Exchange (the “Exchange”) and on the Frankfurt exchange.

Palladon is a development stage company focused on mining iron ore from its wholly-owned Iron Mountain Project located in southwest Utah. The recoverability of amounts shown for mineral properties and deferred exploration costs is dependent upon the discovery of economically recoverable reserves and confirmation of the Company’s interest in the underlying mineral properties, the ability of the Company to obtain necessary financing to complete the development of the properties, and upon future profitable production or proceeds from the disposition thereof.

The financial statements have been prepared in accordance with generally accepted accounting principles applicable to a going concern, which assumes that the Company will be able to meet its obligations and continue its operations for the next fiscal year. Realization values may be substantially different from carrying values as shown, and these financial statements do not give effect to adjustments that would be necessary to the carrying values and classification of assets and liabilities should the Company be unable to continue as a going concern.

At February 28, 2009 the Company had a working capital deficit of \$38.6 million, has not yet achieved profitable operations, has a deficit of \$103.0 million since inception, and expects to incur further losses in the development of its business, all of which cast substantial doubt about the Company’s ability to continue as a going concern. This working capital deficit includes loans payable of \$45.4 million, whose payment terms were amended after February 28, 2009 (See note 15). The Company’s ability to continue as a going concern is dependent upon its ability to generate and maintain future profitable operations and to obtain the necessary financing to meet its obligations and repay its liabilities arising from normal business operations when they come due.

Note 2 **Significant Accounting Policies**

The financial statements of the Company have been prepared in accordance with generally accepted accounting principles in Canada and are stated in Canadian dollars. Because a precise determination of many assets and liabilities is dependent on future events, the preparation of financial statements for a period necessarily involves the use of estimates that have been made using careful judgment. Actual results may differ from these estimates. The financial statements have, in management’s opinion, been properly prepared within reasonable limits of materiality and within the framework of the significant accounting policies summarized below:

a) **Principles of Consolidation**

These financial statements include the accounts of the Company and its U.S. subsidiaries Palladon Iron Corporation (“PIC”) and PIC Railroad Inc. (“PICR”). PIC was incorporated as a wholly-owned subsidiary in Utah on April 6, 2005 and holds the Iron Mountain mineral properties. During the year ended February 28, 2006, the Company sold 50% of its interest in PIC and at

February 29, 2008 held 44% (2007:44%) of its issued shares. During the quarter ended August 31, 2008 the Company purchased the 56% of PIC that it did not own, thereby establishing 100% ownership (Note 6). PICR was incorporated during the year ended February 28, 2007 as a wholly-owned subsidiary of PIC and is currently inactive.

b) Equipment and Amortization

Equipment is recorded at cost. The Company provides for amortization using the following rates:

Building	10% declining balance
Mining equipment – long lived	20% declining balance
Mining equipment	30% declining balance
Office furniture and equipment	30% declining balance

Additions are amortized at one-half the normal rate during the year of acquisition. Plant and equipment under construction is not amortized until construction is complete and the assets are available for use.

c) Mineral Properties

The Company defers the cost of acquiring, maintaining its interest, exploring and developing its mineral properties until such time as the property is placed into production, abandoned, sold or considered to be impaired in value. When operational, mineral property will be amortized on a unit of production basis. Proceeds received on the sale of interests in mineral properties and incidental sales are credited to the carrying value of the mineral properties, with any excess included in operations. Write-downs due to impairment in value are charged to operations.

The Company is in the process of exploring and developing its mineral properties and has not yet determined the amount of reserves available. Management reviews the carrying value of mineral properties on a periodic basis and will recognize impairment in value based upon current exploration results, the prospect of further work being carried out by the Company, the assessment of future probability of profitable revenues from the property or from the sale of the property. Amounts shown for properties represent costs incurred net of write-downs and recoveries, and are not intended to represent present or future values.

d) Basic and Diluted Loss Per Share

Basic loss per share is computed by dividing the loss for the year by the weighted average number of common shares outstanding during the year. Diluted loss per share reflects the dilution that could occur if potentially dilutive securities were exercised or converted to common stock. The dilutive effect of options and warrants and their equivalent is computed by application of the treasury stock method. Common equivalent shares (consisting of shares issuable on the exercise of common stock options and warrants) totalling 33,341,819 as of February 28, 2009 (February 29, 2008: 29,713,329) were not included in the computation of diluted loss per share because the effect was anti-dilutive.

e) Income Taxes

The Company uses the asset and liability method of accounting for income taxes. Under this method, current income taxes are recognized for the estimated income taxes payable for the current period. Future income tax assets and liabilities are recognized for temporary differences between the tax and accounting basis of assets and liabilities as well as for the benefit of losses available to be carried forward to future years for tax purposes only if it is more likely-than-not that they can be realized.

f) Foreign Currency Translation

Monetary items denominated in a foreign currency are translated into Canadian dollars at exchange rates prevailing at the balance sheet date and non-monetary items are translated at exchange rates prevailing when the assets were acquired or obligations incurred. Foreign currency denominated revenue and expense items are translated at exchange rates prevailing at the transaction date. Gains or losses arising from the translations are included in operations.

g) Stock-based Compensation

The Company accounts for all grants of options to employees, non-employees and directors in accordance with the fair value method for accounting for stock-based compensation. Compensation expense for employees is generally amortized using the straight line method over the period from the grant date to the date the options vest. Compensation expense for non-employees is recognized immediately for past services and pro-rata for future services over the service provision period. Compensation for non-employees is re-measured at each balance sheet date until the earlier of vesting date or the date of completion of the service. Upon exercise of share purchase options, the consideration paid by the option holder, together with the amount previously recognized in contributed surplus, is recorded as an increase to share capital.

h) Asset Retirement Obligations

The fair value of obligations associated with the retirement of tangible long-lived assets is recorded in the period the asset is put into use, with a corresponding increase to the carrying amount of the related asset. The obligations recognized are statutory, contractual or legal obligations. The liability is accreted over time for changes in the fair value of the liability through charges to accretion, which is included in depletion, depreciation and accretion expense. The costs capitalized to the related assets are amortized in a manner consistent with the depletion and depreciation of the related asset. At February 28, 2009 and February 29, 2008, the Company did not have any asset retirement obligations.

i) Impairment of Long-lived Assets

Canadian generally accepted accounting principles require that long-lived assets and intangibles to be held and used by the Company be reviewed for possible impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If changes in circumstances indicate that the carrying amount of an asset that an entity expects to hold and use may not be recoverable, future cash flows expected to result from the use of the asset and its disposition must be estimated. If the undiscounted value of the future cash flows is less

than the carrying amount of the asset, impairment is recognized. Except as provided, management believes there has been no impairment of the Company's long-term assets at February 28, 2009.

j) Comprehensive Income

Comprehensive income includes both net loss and other comprehensive income ("OCI"). OCI is the change in shareholders' equity from non-owner sources which is not included in the calculation of net loss until realized. Cumulative changes in OCI are included in Accumulated Other Comprehensive Income ("AOCI"), which is presented as a new category of shareholders' equity on the balance sheet. The Company had no OCI transactions during the periods ended February 28, 2009 and February 29, 2008, and neither opening nor closing balances for AOCI.

k) Financial Instruments Recognition, Measurement, Disclosure and Presentation

All financial instruments are classified into one of these five categories: held-for-trading, held-to-maturity investments, loans and receivables, available-for-sale financial assets or other financial liabilities. All financial instruments and derivatives are measured on the trade date at fair value upon initial recognition. Subsequent measurement depends on the initial classification of the instrument. Held-for-trading financial assets are measured at fair value, with changes in fair value recognized in net earnings (loss). Available-for-sale financial instruments are measured at fair value, with changes in fair value recorded in OCI until the instrument is derecognized or impaired. Loans and receivables, held-to-maturity investments and other financial liabilities are measured at amortized cost. All derivative instruments, including embedded derivatives, are recorded in the balance sheet at fair value unless they qualify for the normal sales and purchases exemption. Changes in the fair value of derivatives that are not exempt are recorded in the statement of operations. Transaction costs on the acquisition of financial assets and liabilities that are classified as other than held-for-trading are expensed.

The Company has made the following designations of its financial instruments: cash and marketable securities as held-for trading; amounts receivable as loans and receivables; accounts payable and accrued liabilities, loans payable and due to related parties as other financial liabilities. At February 28, 2009 and February 29, 2008, the Company had neither available-for-sale nor held-to-maturity financial instruments.

l) Newly Adopted Accounting Pronouncements

Going-concern

In June 2007, the Canadian Institute of Chartered Accountants ("CICA") amended Handbook section 1400, "General Standards of Financial Statement Presentation," which requires management to make an assessment of the Company's ability to continue as a going-concern. When financial statements are not prepared on a going-concern basis, that fact shall be disclosed together with the basis on which the financial statements are prepared and the reason why the Company is not considered a going-concern. Effective March 1, 2008 the Company adopted this standard and the adoption had no impact on the Company's financial position or results of operations.

Capital Disclosures

In December 2006, the CICA issued Section 1535 “Capital Disclosures,” which specifies the disclosure of information that enables users of an entity’s financial statements to evaluate its objectives, policies and processes for managing capital, summary quantitative data about what the entity manages as capital, whether it has complied with any capital requirements and, if it has not complied, the consequences of non-compliance. The mandatory effective date is for annual interim financial statements for years beginning on or after October 1, 2007. Effective March 1, 2008, the Company adopted this standard and the related disclosures are included in Note 8.

Financial Instruments Disclosures and Financial Instruments Presentation

Sections 3862 and 3863 replace Section 3861, “Financial Instruments Disclosure and Presentation,” and establish standards for presentation of financial and non-financial derivatives and specify information that should be disclosed about them. These new sections place increased emphasis on disclosure about the nature and extent of risk arising from financial instruments and how the entity manages those risks. The effective date is for annual and interim financial statements for years beginning on or after October 1, 2007. Effective March 1, 2008 the Company adopted these standards (see Note 9).

Business Combinations, Consolidated Financial Statements, and Non-controlling Interests

In January 2009, the CICA issued Handbook Sections 1582 – *Business Combinations* (“Section 1582”), 1601 – *Consolidated Financial Statements* (“Section 1601”) and 1602 – *Non-controlling Interests* (“Section 1602”) which replaces CICA Handbook Section 1581 – *Business Combinations* and 1600 – *Consolidated Financial Statements*. Section 1582 establishes standards for the accounting for business combinations that is equivalent to the business combination accounting standard under International Financial Reporting Standards (“IFRS”). Section 1582 is applicable for the Company’s business combinations with acquisition dates on or after January 1, 2011. Early adoption of this Section is permitted. Section 1601 together with Section 1602 establishes standards for the preparation of consolidated financial statements. Section 1601 is applicable for the Company’s interim and annual consolidated financial statements for its fiscal year beginning January 1, 2011. Early adoption of this section is permitted. If the Company chooses to early adopt any of these Sections, the other two sections must also be adopted at the same time.

During the year ended February 28, 2009 the Company early adopted Handbook Section 1601, Consolidations, Handbook Section 1602, Non-controlling Interests, and Handbook Section 1582, Business Combinations. These sections replace the former CICA Handbook Section 1581, “Business Combinations” and Section 1600, “Consolidated Financial Statements” and establish a new section for accounting for a non-controlling interest in a subsidiary. CICA Handbook Section 1582 establishes standards for the accounting for a business combination, and states that all assets and liabilities of an acquired business will be recorded at fair value. Obligations for contingent consideration and contingencies will also be recorded at fair value at the acquisition date. Acquisition-related costs will be expensed as incurred and restructuring charges will be expensed in the periods after the acquisition date.

CICA Handbook Section 1602 establishes standards for accounting for a non-controlling interest in a subsidiary in the preparation of consolidated financial statements subsequent to a business combination. This standard states that changes in a parent's ownership interest in a subsidiary that do not result in a loss of control are accounted for as equity transactions.

The new Sections 1582, 1601 and 1602 have been applied effective March 1, 2008 and except for presentation of the non-controlling interest, no restatement of the comparative periods was required. Under the new policy the non-controlling interest is presented as a component of shareholders' equity.

m) Future Accounting Pronouncements

Goodwill and Intangible Assets

The CICA issued new Handbook Section 3064, "Goodwill and Intangible Assets", which will replace Section 3062, "Goodwill and Other Intangible Assets". The new standard establishes revised standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. The new standard also provides guidance for the treatment of preproduction and start-up costs and requires that these costs be expensed as incurred. The new standard applies to annual and interim financial statements relating to fiscal years beginning on or after October 1, 2008. The Company is currently assessing the impact of these new accounting standards. The Company believes they will not have any significant impact on its consolidated financial statements.

International Financial Reporting Standards ("IFRS")

In 2006, the Canadian Accounting Standards Board ("AcSB") published a new strategic plan that will significantly affect financial reporting requirements for Canadian companies. The AcSB strategic plan outlines the convergence of Canadian GAAP with IFRS over an expected five year transitional period. In February 2008, the AcSB announced that 2011 is the changeover date for publicly-listed companies to use IFRS, replacing Canada's own GAAP. The date is for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The transition date of January 1, 2011 will require the restatement for comparative purposes of amounts reported by the Company for the year ended February 28, 2011. The Company has begun an internal diagnostic review to understand, identify and assess the overall effort required to produce financial information under IFRS, however, at this time, the financial reporting impact of the transition to IFRS cannot be reasonably estimated.

Note 3 **Property and Equipment – Note 13**

	Declining Balance Rate	February 28, 2009		
		Cost	Accumulated Amortization	Net
Land	-	\$164,313	\$0	\$164,313
Building	10%	219,878	17,778	202,101
Mining equipment - long lived	20%	4,188,803	452,230	3,736,573
Mining equipment - other	30%	850,191	153,022	697,169
Office furniture and equipment	30%	489,683	113,573	376,110
Total		<u>\$5,912,869</u>	<u>\$736,603</u>	<u>\$5,176,266</u>

	February 29, 2008		
	Cost	Accumulated Amortization	Net
Office furniture and equipment	<u>\$103,524</u>	<u>\$33,982</u>	<u>\$69,542</u>

Note 4 **Reclamation Deposits**

The Company has an insurance policy of US\$1,299,100 as security for possible future reclamation work on the Iron Mountain property, for which the Company has deposited US\$650,000 as collateral with the insurer. During the year ended February 28, 2009 additional security deposits of US\$159,907 were paid. At February 28, 2009 total security deposits held by third parties were \$1,020,483 (US\$809,907) (2008: \$636,220 (US\$650,000)).

Note 5 **Mineral Properties**

Title to mineral properties 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 conveyancing history characteristic of many mineral properties. The Company has investigated title to all of its mineral properties and, to the best of its knowledge, title to all of its properties is in good standing.

(a) Iron Mountain

During the year ended February 28, 2006, the Company completed the purchase of the Iron Mountain properties, including Comstock / Mountain Lion and Rex properties located in Utah, US. The purchase price of the property was US\$10 million, of which \$50,000 was paid on signing, with \$1.3 million as a credit at closing for the amount of the reclamation bond obligation assumed by the Company (Note 4), and \$8.65 million paid in cash at closing. Prior to entering into the purchase agreement, the Company and Western Utah Copper Company (WUCC) entered

into a Joint Venture Agreement, which provided that the Company shall have a 65% interest in the property, and WUCC shall have a 35% interest. Concurrently with the acquisition, the parties negotiated the buyout of WUCC's interest for US\$3.5 million plus the forgiveness of approximately US\$1.5 million in loans and accrued interest receivable previously made by the Company to WUCC. The Iron Mountain properties are held by the Company's subsidiary, Palladon Iron Corp.

During the years ended February 28, 2009 and February 29, 2008, incidental sales of iron ore were realized and credited against the carrying cost of the properties. During the year ended February 28, 2009 the Company engaged a contract mine operator (Note 13d) to commence mining activities, based on a contract to sell iron ore (Note 13a). No iron ore was shipped with respect to the contract. Subsequent to February 28, 2009 all mining activity at the site was stopped.

(b) Other properties

(i) Argentina

By agreement dated October 1, 2002, and amended April 11, 2003, the Company entered into an option agreement with Deseado LLC ("Deseado") to earn up to a 51% interest in approximately 100,000 hectares of mineral properties located in the Santa Cruz, Rio Negro and Chubut provinces of Argentina.

By an agreement signed in May 2005 and amended December 15, 2005, the Company entered into an option agreement to acquire 60% interest in an Argentina property known as the La Sarita project.

During the year ended February 29, 2008 the Company decided not to continue with further development of the Argentina properties and wrote off costs incurred of \$1,835,751. During the year ended February 28, 2009 the remaining \$10 carrying value was written off.

(ii) Maestro Properties

By agreement dated May 7, 2004 the Company entered into an option agreement for the right to acquire a 100% interest in five mineral exploration properties covering 5,480 acres in Utah and Nevada. During the year ended February 28, 2007, the Company granted an option to another public company having then a director in common, to acquire a 75% interest in the properties by issuing 450,000 shares (received) to the Company and 850,000 shares to the underlying optionor, and incurring exploration expenditure of US\$5 million over five years. At February 28, 2009 the carrying amount of the properties was \$894,672.

(iii) Murdock Railroad Property

During the year ended February 28, 2005 the Company completed an arrangement for securitizing certain default loans payable to the Company. In that arrangement the debtor conveyed to the Company an undivided 50% interest in certain land holdings, known as the Murdock Railroad Property, located in Beaver County, Utah. The Company's interest in the land holdings has been recorded at a nominal value of \$10.

(iv) Other Properties

The Company has a 1% net smelter royalty (maximum US\$10 million) and a 2% net smelter royalty with respect to certain mineral properties located in Beaver County, Utah, USA. These properties are carried at a nominal value of \$10.

Note 6 **Acquisition of Non-controlling Interest – Note 14**

During the year ended February 28, 2009, the Company achieved 100% ownership of PIC by purchasing the non-controlling interest for consideration of US\$65,000,000, of which US\$40,000,000 was paid on closing of a private placement (Note 10) and US\$25,000,000 was deferred until June 26, 2009 plus interest at 11.6% per annum. In conjunction with the purchase agreement, the terms of the already outstanding loan payable to Luxor were amended to revise the due date to be the same June 26, 2009 date as for the deferred purchase consideration (Note 7).

In accordance with the adoption of Handbook Section 1602, Non-controlling Interests, changes in a parent's ownership in a subsidiary that do not result in a loss of control are accounted for as equity transactions. In connection with the acquisition \$60,483,425 was charged to deficit as follows:

Purchase price	\$64,499,500
Less: non-controlling interest at date of purchase	<u>(4,016,075)</u>
Excess to deficit	<u><u>\$60,483,425</u></u>

Note 7 **Loans Payable**

	<u>2009</u>	<u>2008</u>
Loan payable of US\$9,064,074 (2008: US\$9,452,327) due June 26, 2009 with interest only payable quarterly at 9.25% per annum	\$11,420,734	\$9,251,843
Loan payable of US\$26,962,466 due June 26, 2009 with interest only accruing at 11.6% per annum	<u>33,972,707</u>	-
	45,393,441	9,251,843
Less current portion	<u>(45,393,441)</u>	-
	<u><u>-</u></u>	<u><u>\$9,251,843</u></u>

Both loans are collateralized by a promissory note, a general security agreement, the shares of PIC and a mortgage on the Murdock Railway Property (Note 5). Subsequent to February 28, 2009, terms were amended to extend the due date of both loans to October 15, 2009 (Note 15)

Note 8 **Management of Capital**

The Company manages and adjusts its capital structure based on available funds in order to support its operations and the acquisition and exploration of mineral properties. The Company's primary objectives in managing capital are:

- Safeguard the entity's ability to continue as a going concern
- Maintain an optimal capital base in order to support the capital requirements of its operations, including growth opportunities and maintaining investor confidence.

The capital of the Company consists of shareholder's equity. The Board of Directors does not establish quantitative return on capital for management, but rather relies on the expertise of the Company's management to sustain future development of the business. The Company is not subject to any externally imposed capital requirements, other than as described in the subsequent paragraph. The Company relies on capital markets to support continued growth.

As described in Note 15, Palladon Ventures Ltd. has limited flexibility with respect to managing its capital structure. The Company is striving to safeguard its ability to continue as a going concern by producing an updated resource statement and subsequent feasibility study. The Company needs to raise a minimum of US\$5 million in equity capital by October 15, 2009.

Note 9 **Financial Instruments**

The Company's financial instruments consist of cash, amounts receivable, marketable securities, accounts payable, accrued liabilities, due to related parties and loans payable. Unless otherwise noted, it is management's opinion that the Company is not exposed to significant interest, currency or credit risks arising from these financial instruments.

a) Credit Risk

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation. The Company's cash and receivables are exposed to credit risk. The Company reduces its credit risk on cash by placing these instruments with institutions of high credit worthiness. As of the end of the period the Company is not exposed to any significant credit risk.

b) Liquidity Risk

The Company's exposure to liquidity risk is dependent on purchasing commitments and obligations, and the raising of funds to meet commitments and sustain operations. The Company is a development stage company and is reliant on external fundraising to support its operations. The Company manages liquidity risk by continuously monitoring actual and projected cash flows. The Board of Directors reviews and approves the Company's operating and capital budgets, as well as any material transactions not in the ordinary course of business. The majority of the Company's accounts payable and accrued liabilities have maturities of less than three months.

The Company is specifically exposed to cash repayments of the loans payable on October 15, 2009 if it cannot raise US\$5 million of equity capital on or before then. If the loans payable are extended, the Company is further exposed to repayment on or before December 31, 2010, as

disclosed in Note 15. Given these circumstances and the uncertainty that the Company can raise additional financing, commence profitable operations and further refinance or extend the loans, the Company could lose all of its interest in the Iron Mountain properties and related equipment.

c) Market Risk – Interest Rate and Foreign Exchange

The Company's activities are conducted in U.S. dollars within the United States. Financial results are translated into Canadian dollars for financial reporting purposes.

The Company is exposed to interest rate risk arising from fluctuations in interest rates on its cash and its loans payable. Fluctuations in market interest rates on cash do not have a significant impact on the Company's results of operations due to their short-term nature. In addition, the fixed interest rates of 9.25% and 11.6% that existed for the February 28, 2009 loans payable, were amended and consolidated to a fixed 12.5% as part of the June 26, 2009 extension, as described under Note 15 to these financial statements. A 1% change in interest rates can lead to an increase or decrease of monthly interest expense of \$36,000 for loans payable as measured on February 28, 2009.

The Company is also exposed to foreign exchange risk on its U.S. dollar denominated accounts payables, loans payable and cash. The Company had no forward exchange contracts to manage its foreign currency risk. As at February 28, 2009, the Company had U.S. dollar denominated assets and liabilities of: cash in the amount of US\$6.3 million; accounts payable of US\$427,000; and loans payable with a face value of US\$33.9 million, for a net liability exposure of US\$28.0 million. A \$0.01 exchange rate change as measured on February 28, 2009 can result in a foreign currency gain or loss of \$280,000.

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Notes to the Consolidated Financial Statements
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Note 10 **Share Capital**

Shares Authorized: Unlimited common shares without par value.

<u>Shares Issued:</u>		Number of Shares	Share Capital	Contributed Surplus
Balance, February 28, 2007		47,410,208	\$27,183,716	\$2,288,089
Fair value of warrants granted with loan payable		-	-	493,919
For cash:				
Private placement, at	\$0.30	26,187,410	7,856,223	-
Less share issue costs		564,750	(952,329)	282,375
Debt settlement, at	\$0.70	2,290,597	1,603,418	-
Escrow cancelled		(35,500)	-	-
Stock-based compensation		-	-	102,000
Balance, February 29, 2008		76,417,465	35,691,028	3,166,383
Exercise of warrants, at	\$0.50	3,126,000	1,563,000	-
Exercise of warrants, at	\$0.70	773,613	541,529	-
Exercise of options, at	\$0.40	300,000	120,000	-
Exercise of options, at	\$0.50	100,000	50,000	-
Transfer from contributed surplus to share capital on exercise of stock options		-	95,000	(95,000)
Private placement, at	\$0.70	87,375,169	61,162,618	-
Agent shares - non-cash	\$0.70	871,885	610,320	-
Less share issue costs		-	(4,103,353)	-
Balance, February 28, 2009		168,964,132	\$95,730,142	\$3,071,383

During the year ended February 28, 2009, pursuant to a non-brokered private placement, the Company issued 87,375,169 units at \$0.70 per unit for total proceeds of \$61,162,618. Each unit consisted of one share and 1/4 of one share purchase warrant. Each whole warrant entitles the holder to purchase one additional common share at \$1.00 per share for eighteen months. In conjunction with the placement the Company paid a sales commission consisting of \$3,493,033 in cash plus 871,885 units. The agent's warrants included in the units were valued at \$nil.

During the year ended February 29, 2008, pursuant to a non-brokered private placement, the Company issued 26,187,410 units at \$0.30 per unit for total proceeds of \$7,856,223. Each unit consisted of one common share and one-half of one share purchase warrant. Each whole warrant entitles the holder to purchase one additional common share at \$0.50 per share for two years. The Company also paid a cash finder's fee of \$669,955 and 564,750 units with the same terms as the private placement. The agent's warrants were valued at \$282,375.

The Company uses the residual method to allocate the transaction date market price to shares sold, which resulted in no allocation of value to the warrants.

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Note 10 **Share Capital** – (cont'd)

Commitments:

a) Agent Options:

At February 29, 2008 there were 721,398 agents' options outstanding relating to a private placement completed during the year ended February 28, 2007. The agents' options expired unexercised in 2009.

b) Share Purchase Options:

The Company may grant share purchase options to directors, officers or employees to acquire shares of the Company. Unless noted otherwise, the share purchase options vest when granted. Share purchase option activity for the years ended February 28, 2009 and February 29, 2008 is summarized as follows:

	Year ended February 28, 2009		Year ended February 29, 2008	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Outstanding beginning of year	2,835,000	\$0.51	3,360,000	\$0.57
Granted	-	-	600,000	0.40
Cancelled	(1,405,000)	0.51	(1,125,000)	0.74
Exercised	(400,000)	0.43	-	-
Outstanding end of year	<u>1,030,000</u>	<u>\$0.55</u>	<u>2,835,000</u>	<u>\$0.51</u>

As of February 28, 2009 there were 1,030,000 share purchase options outstanding. Each option entitles the holder to purchase one common share, as follows:

<u>Expiry Date</u>	<u>Number</u>	<u>Exercise Price</u>
April 21, 2010	200,000	\$0.75
August 8, 2010	150,000	\$0.85
August 29, 2010	50,000	\$0.75
December 15, 2011	330,000	\$0.40
October 31, 2012	300,000	\$0.40
	<u>1,030,000</u>	

The weighted average life remaining at February 28, 2009 is 2.5 years.

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Note 10 **Share Capital** – (cont'd)

c) **Share Purchase Warrants:**

Each warrant entitles the holder to purchase one common share. Activity for the years ended February 28, 2009 and February 29, 2008 is as follows:

	Warrants	Weighted Average Price
Outstanding February 28, 2007	15,734,063	\$0.68
Issued	13,376,080	0.50
Expired	(2,953,212)	0.67
Outstanding February 29, 2008	26,156,931	\$0.62
Issued	22,061,739	1.00
Exercised	(3,899,613)	0.54
Expired	(12,007,238)	0.74
Outstanding February 28, 2009	32,311,819	\$0.84

As of February 28, 2009 there were 32,311,819 warrants outstanding. Each warrant entitles the holder to purchase one common share, as follows:

<u>Expiry Date</u>	<u>Ending Warrants</u>	<u>Exercise Price</u>
May 10, 2009	10,250,080	\$0.50
December 26, 2009	22,061,739	1.00
	32,311,819	

Stock-based Compensation:

During the years ended February 28, 2009 and February 29, 2008, the Company recognized charges associated with share purchase options and certain share purchase warrants granted during the year. The amount recorded for stock-based compensation expense was \$nil (2008: \$102,000). The Company also recorded share issue costs of \$nil (2008: \$282,375) as the fair value of options and warrants granted to the agents. Their fair values were determined using the Black-Scholes model with the following assumptions:

	<u>2009</u>	<u>2008</u>
Expected dividend yield	0%	0%
Expected stock price volatility	100%	86% to 92%
Risk-free interest rate	1%	3.13% to 3.58%
Expected life in years	1 year	2 – 5 years

Note 11 **Income Taxes**

The Company is in arrears on filing its statutory income tax returns in Canada and in the United States, and is therefore unable to accurately determine the amount of its loss carry forward at this time. The Company has accumulated Canadian Exploration, Canadian Development, Canadian Oil and Gas Expenditures and Foreign Resource Expenditures (“resource expenditures”) of \$37,100,000, which are available to reduce taxable income of future years. The Company has accumulated non-capital losses of approximately \$21,806,000 in Canada and CDN\$6,117,000 in the USA, which are available to carry forward and offset future years’ taxable income. The non-capital losses expire as follows:

<u>Year</u>	<u>USA</u>	<u>Canada</u>	<u>Total</u>
2010	\$0	\$193,000	\$193,000
2011	-	663,000	663,000
2015	-	1,453,000	1,453,000
2016	-	4,745,000	4,745,000
2026	904,000	4,313,000	5,217,000
2027	1,219,000	3,527,000	4,746,000
2028	1,484,000	6,912,000	8,396,000
2029	2,510,000	-	2,510,000
	<u>\$6,117,000</u>	<u>\$21,806,000</u>	<u>\$27,923,000</u>

A reconciliation of the income tax provision computed at statutory rates to the reported tax provision is as follows:

	<u>2009</u>	<u>2008</u>
Statutory tax rate	<u>30.75%</u>	<u>33.68%</u>
Loss before income taxes	<u>(\$14,170,113)</u>	<u>(\$4,022,197)</u>
Expected income tax loss (recovery)	(4,357,000)	(1,355,000)
Increase (decrease) in income tax recovery resulting from:		
Change in statutory rates	607,000	-
Foreign income taxes at USA rate	(121,000)	(16,000)
Stock-based compensation	-	(102,000)
Other non-deductible items	185,000	54,000
Share issue costs	(861,000)	-
Effective foreign exchange gain on future income tax assets	154,000	104,000
Non-taxable portion of capital gains	597,000	(244,000)
Change in the valuation allowance for future income tax assets	3,796,000	1,559,000
Income tax recovery	<u>\$ -</u>	<u>\$ -</u>

Palladon Ventures Ltd.
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The significant components of the Company's future income tax assets, after applying enacted corporation income tax rates of 26% (2008: 26%), are as follows:

	<u>2009</u>	<u>2008</u>
Non-capital loss carry forward	\$7,592,000	\$4,947,000
Mineral properties and deferred exploration	2,618,000	2,722,000
Undeducted share issue costs	870,000	259,000
Unrealized foreign exchange on intercompany debt	362,000	(244,000)
Other	47,000	10,000
Less: valuation allowance	<u>(11,489,000)</u>	<u>(7,694,000)</u>
	<u>\$ -</u>	<u>\$ -</u>

The Company has recorded a valuation allowance against its future income tax assets based on the extent to which it is more likely than not that sufficient taxable income will not be realized in the future to utilize all the future tax assets.

Note 12 **Related Party Transactions**

The Company incurred the following transactions with related parties consisting of current and/or former directors of the Company or private companies controlled by them:

	February 28, 2009	February 29, 2008
Gain on debt settlement	-	(\$66,248)
Legal	-	18,648
Consulting	\$3,000	15,000
Salaries and benefits	486,954	404,285
Total	<u>\$489,954</u>	<u>\$371,685</u>

The charges were measured by the exchange amount which is the amount agreed upon by the transacting parties.

Amounts due to related parties are owing to former directors and to an affiliate of a former director and are unsecured, non-interest bearing and are due on demand.

Note 13 **Commitments**

- a) During the year ended February 28, 2009, PIC entered into a contract for a term expiring March 31, 2013 to supply 2,000,000 metric tonnes of iron ore during each twelve month period. Under the contract terms, the iron ore was to be delivered freight on board ("FOB") to the Port of Long Beach, California for US\$70 per metric tonne until March 31, 2009, and thereafter subject to adjustment based on the World Benchmark Price for iron ore.

No iron ore has been shipped pursuant to this contract. The Company was unable to consummate an agreement for facilities from which to ship through the Port of Long Beach, nor is shipping through the port a viable option at the present time. Furthermore, the contract terms are uneconomic if the still-being-negotiated World Benchmark Price decreases as expected. No contract claims have been made, and the customer and the Company continue to discuss resolution of this problematic contract. The Company does not believe that it will incur any losses under the contract, and therefore no loss provision has been made.

- b) The Company has entered into a five-year lease ending April 30, 2014 for office premises located in Salt Lake City, Utah. First year rent is US\$9,888 per month, increasing annually thereafter at an inflation factor, to \$11,129 per month in the final year.
- c) The Company has entered into an agreement to supply, if requested, a minimum of 12,000 tons of iron ore per year over a four-year term ending December 31, 2011.
- d) PIC entered into a contract dated June 1, 2008 with an independent mining contractor whereby the contractor agreed to mine and process iron ore at the Iron Mountain Project until May 31, 2013. Under the contract terms, PIC agreed to a fixed rate per ton for the amount of ore mined and loaded, and rental rates for use of equipment provided by the contractor, subject to a minimum standby fee of US\$500,000 per month. The rates are subject to a 2% annual increase after the first year.

Subsequent to February 28, 2009 the contractor agreed to waive the standby fee in exchange for retention of any unused advances received (See Schedule 1), plus the transfer from PIC to the contractor of certain equipment having a net carrying value of US\$190,000.

Note 14 **Non-cash Transactions**

Investing and financing activities that do not have a direct impact on current cash flows are excluded from the cash flow statements.

During the year ended February 28, 2009 the following transactions were excluded from the statement of cash flows:

- a) The Company issued 871,885 units valued at \$610,320 as partial payment of a sales commission related to a private equity placement.
- b) The Company, in relation to the purchase of the remaining non-controlling interest (Note 6), received a note payable in the amount of \$25,673,500 (US\$25,000,000).

During the year ended February 29, 2008 the following transactions were excluded from the statement of cash flows:

- a) The Company issued 2,290,597 common shares valued at \$1,603,418 for payment of amounts due to a related party.
- b) The Company acquired equipment under construction of which \$657,528 is included in accounts payable at February 29, 2008.

- c) The Company issued 564,750 shares valued at \$169,425 and 564,750 agents' warrants valued at \$282,375 for share issue costs.
- d) Argentina expenditures of \$394,555 are included in amounts due to related parties.

Note 15 **Subsequent Events**

Subsequent to February 28, 2009:

- a) On June 26, 2009 Palladon obtained an extension of its loans payable to October 15, 2009. As consideration for the extension, the Company agreed to pay US\$500,000, which will be added to the principal outstanding, and to increase the annual interest rate to 12.5%. A further extension to December 31, 2010 can be obtained if the Company raises an additional US\$5,000,000 in equity financing before October 15, 2009, of which US\$500,000 is required to be applied against the outstanding loans. The Company must also provide an operating budget for lender approval of expenditures to be made during the period July 1, 2009 to December 31, 2010. In the event that the Company has repaid 65% of the loans payable by December 31, 2010, it has the option to repay the remaining balance by the issue of shares of the Company.
- b) On May 10, 2009, 10,250,080 warrants at an exercise price of \$0.50 per share expired unexercised.