

PALLADON VENTURES LTD.  
REPORT AND CONSOLIDATED FINANCIAL STATEMENTS  
February 28, 2010 and 2009



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## Auditors' Report

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### To the Shareholders of Palladon Ventures Ltd.

We have audited the consolidated balance sheets of Palladon Ventures Ltd. (the "Company") as at February 28, 2010 and 2009 and the consolidated statements of operations 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, 2010 and 2009 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 Canada LLP

Chartered Accountants

Vancouver, British Columbia  
June 28, 2010

PALLADON VENTURES LTD.

CONSOLIDATED BALANCE SHEETS

February 28, 2010 and February 28, 2009

	2010	2009
Cash	\$185,821	\$8,014,594
GST recoverable	1,157	47,352
Amounts receivable	-	59,219
Marketable securities	58,500	27,000
Total Current Assets	245,478	8,148,165
Investment in Palladon Iron Corporation - Note 6	8,800,000	-
Property and equipment - Note 3	-	5,176,266
Reclamation deposits - Note 4	34,726	1,020,483
Mineral properties and related equipment - Note 5	-	28,182,884
Total Assets	9,080,204	42,527,798
Accounts payable and accrued liabilities	65,174	716,058
Due to related parties - Note 12	649,234	649,234
Loans payable - Note 7	-	45,393,441
Total Current Liabilities	714,408	46,758,733
Total Liabilities	714,408	46,758,733
Share capital - Note 10	95,730,142	95,730,142
Contributed surplus - Note 10	3,071,383	3,071,383
Deficit	(90,435,729)	(103,032,460)
Total Shareholders' Equity (Deficiency)	8,365,796	(4,230,935)
Total Liabilities and Shareholder's Equity	\$9,080,204	\$42,527,798

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

Subsequent Event - Note 10

APPROVED BY:

*"John W. Cutler"*

John W. Cutler, *Director*

*"Leonard J. Sojka"*

Leonard J. Sojka, *CFO*

SEE ACCOMPANYING NOTES

**PALLADON VENTURES LTD.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT**  
for the years ended February 28, 2010 and February 28, 2009

	2010	2009
General and Administrative Expenses:		
Amortization	\$998,103	\$702,442
Consulting - Note 12	433,504	487,999
Interest on long-term debt	5,496,254	3,095,467
Office and administration	486,747	457,808
Professional fees	359,139	300,991
Rent	164,874	153,976
Salaries and benefits - Note 12	1,091,393	1,178,006
Shareholder communications	27,003	59,274
Telephone	9,165	14,145
Transfer agent and filing fees	27,655	34,359
Travel and promotion	115,023	123,528
Loss before other and non-controlling interest	(9,208,860)	(6,607,995)
Other:		
Unrealized gain (loss) on marketable securities	31,500	(139,500)
Gain on debt settlement - Note 6	15,475,579	-
Write-off of equipment & mineral property	(2,022,754)	(10)
Other income	61,697	-
Gain (loss) on foreign exchange	8,259,569	(7,714,839)
Income (loss) before non-controlling interest	12,596,731	(14,462,344)
Non-controlling interest - Note 6	-	292,231
Net income (loss) and comprehensive income (loss)	12,596,731	(14,170,113)
Deficit, beginning of the year	(103,032,460)	(28,378,922)
Acquisition of non-controlling interest, Note 6	-	(60,483,425)
Deficit, end of the year	(\$90,435,729)	(\$103,032,460)
Basic and diluted income (loss) per share	\$0.07	(\$0.10)
Weighted average number of shares outstanding	168,964,132	139,554,503

SEE ACCOMPANYING NOTES

**PALLADON VENTURES LTD.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
for the years ended February 28, 2010 and February 28, 2009

	2010	2009
<b>Operating Activities:</b>		
Income (loss) before non-controlling interest	\$12,596,731	(\$14,462,344)
Items not involving cash:		
Amortization	998,103	702,442
Gain on debt settlement - Note 6	(15,475,579)	-
Unrealized (gain) loss on marketable securities	(31,500)	139,500
Unrealized foreign exchange (gain) loss	(9,191,459)	6,740,365
Accrued interest	5,289,474	2,306,273
Write-off of equipment & mineral property	2,022,754	10
	(3,791,476)	(4,573,754)
Changes in non-cash working capital items:		
Amounts receivable	59,219	(45,987)
GST recoverable	46,196	422
Accounts payable and accrued liabilities	(650,884)	(144,026)
Cash (used in) provided from operating activities	(4,336,945)	(4,763,345)
<b>Investing activities:</b>		
Acquisition of Palladon Iron Corporation	-	(38,826,000)
Acquisition of equipment	-	(1,620,363)
Reclamation bonds	(76,841)	(156,517)
Mineral property costs, net of recoveries	(3,199,787)	(8,343,610)
Cash (used in) provided from investing activities	(3,276,628)	(48,946,490)
<b>Financing activities:</b>		
Advances (to) from related parties	-	(233,780)
Issuance of shares for cash, net of share issuance costs	-	59,944,114
Loans repaid	(206,780)	(594,937)
Cash (used in) provided from financing activities	(206,780)	59,115,397
Foreign exchange loss (gain) on cash held in US\$	(8,420)	1,788,651
Increase (decrease) in cash during the period	(7,828,773)	7,194,213
Cash, beginning of the year	8,014,594	820,381
Cash, end of the year	\$185,821	\$8,014,594
<b>Supplemental disclosure of cash flow information:</b>		
Cash paid for interest	\$499,123	\$789,824

Non-cash transactions - Note 13

SEE ACCOMPANYING NOTES



**PALLADON VENTURES LTD.**

**Schedule 1**

**CONSOLIDATED SCHEDULE OF MINERAL PROPERTIES AND RELATED EQUIPMENT**  
For the fiscal year ended February 28, 2009

	Iron Mountain Project, Utah, USA							Power Line	Total Iron Mountain	Total
	Other Properties	Mineral Property	Equipment Under Construction				Plant			
			Ball Mill	Rail Line	Transformer	Substation				
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-off	(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	-	-	\$1,146,588	\$977,572	\$27,288,212	\$28,182,884

## PALLADON VENTURES LTD.

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS February 28, 2010 and February 28, 2009

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.

Until March 15, 2010, Palladon owned Palladon Iron Corporation (“PIC”), subsequently renamed CML Metals Corporation (“CML”). On that date Palladon and Luxor Capital Partners, LP (“Luxor”) entered into a Satisfaction and Settlement Agreement whereby Palladon transferred ownership of 78.26% of PIC to Luxor in exchange for the full discharge of all liabilities due to Luxor and waiver of all intercompany advances due by PIC to Palladon. Because of the de minimis business activity at PIC subsequent to Palladon’s fiscal year ended February 28, 2010, the Satisfaction and Settlement Agreement is reflected in these financial statements as of February 28, 2010. The effect of the Satisfaction and Settlement Agreement is to deconsolidate the PIC balance sheet from Palladon and to instead reflect an investment in Palladon Iron Corporation. The operations of PIC for the year ended February 28, 2010 are included in the consolidated statements of operations and deficit. The Company’s sole business activity is to manage its investment in Palladon Iron Corporation.

Palladon Iron Corporation is a development stage company focused on mining iron ore from its wholly-owned Iron Mountain Project located in southwest Utah. PIC may incur further losses in the development of its business. PIC’s ability to continue as a going concern may depend 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.

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, 2010, the Company had a working capital deficit of \$468,930, has not yet achieved profitable operations and has accumulated a deficit of \$90,435,729 since inception. Palladon may incur further losses in the management of its investment in PIC, which casts substantial doubt about the Company’s ability to continue as a going concern. The Company’s ability to continue as a going concern is dependent upon its ability to realize value from its investment in PIC, and to fund operations going forward.

The financial statements of the Company have been prepared in accordance with Canadian generally accepted accounting principles 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.

Note 2     **Significant Accounting Policies**

a)    Principles of Consolidation

These financial statements include the accounts of the Company. The operations of former U.S. subsidiaries Palladon Iron Corporation and PIC Railroad Inc. (“PICR”) were consolidated through February 28, 2010. Because of the de minimis business activity at PIC subsequent to Palladon’s fiscal year ended February 28, 2010 until the date of the Satisfaction and Settlement Agreement dated March 15, 2010, the Satisfaction and Settlement Agreement is reflected in these financial statements as of February 28, 2010. The effect of the Satisfaction and Settlement Agreement is to deconsolidate the PIC balance sheet from Palladon and to instead reflect an investment in Palladon Iron Corporation. The fiscal 2010 activity at PIC is included in the consolidated statements of operations and deficit. The Company’s sole business activity is to manage its 21.74% investment in Palladon Iron Corporation, which is recorded at fair value.

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.

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 – other	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. Effective as of February 28, 2010, the Company does not own any equipment.

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.

Note 2     **Significant Accounting Policies** – (cont'd)

The Company was in the process of exploring and developing its mineral properties and had 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 carrying 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 Income (Loss) Per Share

Basic income (loss) per share is computed by dividing the income (loss) for the period by the weighted average number of common shares outstanding during the period. Diluted income (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 150,000 as of February 28, 2010 (February 28, 2009: 33,341,819) were not included in the computation of diluted income (loss) per share because the effect was not significant in 2010 and was anti-dilutive in 2009.

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

Note 2 **Significant Accounting Policies** – (cont'd)

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 will be 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, 2010 and February 28, 2009, 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, 2010.

j) Comprehensive Income

Comprehensive income includes both net income (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 income (loss) until realized. Cumulative changes in OCI are included in Accumulated Other Comprehensive Income ("AOCI"), which is presented as a category of shareholders' equity on the balance sheet. The Company had no OCI transactions during the years ended February 28, 2010 or February 28, 2009 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, 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 income (loss).

Note 2     **Significant Accounting Policies** – (cont'd)

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; investment in Palladon Iron Corporation as available-for-sale, accounts payable and accrued liabilities, and due to related parties as other financial liabilities.

In 2009, the CICA amended Section 3862, “Amendment to Financial Instruments – Disclosures” to require disclosures about the inputs to fair value measurements, including their classification within a hierarchy that prioritizes the inputs to fair value measurement.

The three levels of the fair value hierarchy are:

- Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities;
- Level 2 – Inputs other than quoted prices that are observable for the asset or liability either directly or indirectly; and
- Level 3 – Inputs that are not based on observable market data.

The Company categorizes its financial instruments which are measured at fair value as level 1, except for its investment in PIC which is at level 2.

1) **Business Combinations, Consolidated Financial Statements, and Non-controlling Interests**

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

Note 2     **Significant Accounting Policies** – (cont'd)

accounted for as equity transactions. Under the policy, the non-controlling interest is presented as a component of shareholders' equity.

m) 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 adoption of this standard did not have any significant impact on its consolidated financial statements.

n) Future Accounting Pronouncements

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**

	Declining Balance Rate	February 28, 2010		
		Cost	Accumulated Amortization	Net
Land	-	\$ -	\$ -	\$ -
Building	10%	-	-	-
Mining equipment - long lived	20%	-	-	-
Mining equipment - other	30%	-	-	-
Office furniture and equipment	30%	-	-	-
Total		<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

	Declining Balance Rate	February 28, 2009		
		Cost	Accumulated Amortization	Net
Land	-	\$164,313	-	\$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>

During the year ended February 28, 2010, the Company wrote-off long-lived mining equipment of \$187,734 (2009: \$nil).

Note 4 **Reclamation Deposits**

At February 28, 2010, total security deposits held by third parties were \$34,726 (February 28, 2009: \$1,020,483).

Note 5 **Mineral Properties**

**Iron Mountain (Owned by former subsidiary Palladon Iron Corporation)**

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, USA. 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

Note 5 **Mineral Properties** – (cont'd)

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 former subsidiary, Palladon Iron Corporation.

During the years ended February 28, 2010 and February 28, 2009, incidental sales of iron ore were realized and credited against the carrying cost of the properties. During the year ended February 28, 2009, PIC engaged a contract mine operator to commence mining activities, based on a contract to sell iron ore. All mining activity at the site was stopped in June 2009, and PIC negotiated termination of standby charges by the contract mine operator. No iron ore was shipped with respect to the contract to sell iron ore, and on September 15, 2009, the Company announced termination of the contract.

**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 transferred a 75% interest in the properties to another public company having then a director in common, in exchange for the receipt of 450,000 transferee shares, payment of 850,000 transferee shares to the underlying optionor, and incurrence by the transferee of exploration expenditure totalling US\$5,000,000 over five years. At February 28, 2009, the carrying amount of the properties was \$857,448. The transferee is not currently developing the properties, so the Company is unable to establish their value. Accordingly, the carrying amount of \$857,448 was written off during the year ended February 28, 2010.

Note 6 **Acquisition and Disposition of Subsidiary**

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 with interest payable 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. Both loans were extended on the June 26, 2009 due date (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>\$ 60,483,425</u>

Note 6 **Acquisition and Disposition of Subsidiary** – (cont'd)

Effective February 28, 2010, as disclosed in Note 1, the Company entered into a Satisfaction and Settlement Agreement pursuant to its default on the loans payable, whereby it transferred 78.26% of its interest in PIC to Luxor in full satisfaction of all debt owed to Luxor. As a result, the Company disposed of and derecognized the net assets of PIC, and recorded its remaining interest in PIC at its fair value, in accordance with Handbook Section 1602, as follows:

Settlement of loans payable (Note 7)	\$ 42,457,716
Investment in the fair value of PIC	<u>7,311,241</u>
	<u>49,768,957</u>
Less net assets of PIC at carrying value:	
Current assets, including cash of \$20,984	89,368
Property and equipment	3,985,552
Mineral properties and related equipment	29,377,133
Other assets	876,455
Liabilities	<u>(35,130)</u>
Net assets of PIC	<u>34,293,378</u>
Gain on disposal	<u>\$ 15,475,579</u>

The \$8.8 million Investment in Palladon Iron Corporation as of year end February 28, 2010 is recorded at fair value, which value was determined by a private placement that PIC completed with arms length parties on May 10, 2010.

Note 7 **Loans Payable**

	<u>2010</u>	<u>2009</u>
Loan payable of US\$9,064,074 due June 26, 2009 with interest only payable quarterly at 9.25% per annum	\$ -	\$ 11,420,734
Loan payable of US\$26,962,466 due June 26, 2009 with interest only accruing at 11.6% per annum	-	33,972,707
Loan payable of US\$40,341,681 due October 15, 2009 with interest at 12.5% per annum	<u>42,457,716</u>	<u>                    </u>
	42,457,716	45,393,441
Less: debt settlement	<u>(42,457,716)</u>	<u>-</u>
	<u>\$ -</u>	<u>\$ 45,393,441</u>

The loans payable were collateralized by a promissory note, a general security agreement, the shares of PIC and a mortgage.

Note 7     **Loans Payable** – (cont'd)

The Loans payable were owed to Luxor Capital Partners, LP (“Luxor”). As of February 28, 2010, the total amount was fully discharged. Events leading up to this event are as follows:

On the June 26, 2009 due date, Palladon negotiated an extension of the Luxor loans' maturity date to October 15, 2009. The interest rate on both loans was increased to 12.5%, compounded quarterly. The Company also incurred additional interest of US\$500,000, which was added to the loan.

On October 15, 2009, the Company announced a standstill agreement with Luxor that extended the October 15, 2009 due date to December 4, 2009. In connection with the standstill agreement, the Company repaid US\$200,000 of the loan amount outstanding.

On December 4, 2009, Palladon announced that effective immediately the Company and Luxor had entered into a letter of agreement (the “Letter Agreement”), subject to TSX Venture Exchange approval, to the extension agreement dated June 26, 2009, and to the standstill agreement dated October 15, 2009. The Letter Agreement granted Palladon an irrevocable option (the "Payment Option") to acquire from Luxor the entirety of its outstanding loans including interest (the “Loan Amount”), by paying US\$30 million on or before March 31, 2010.

In the event that the Company did not exercise the Payment Option on or before March 31, 2010, Luxor had agreed to reduce the outstanding Loan Amount to US\$25 million, in exchange for transfer and assignment by the Company of 50% of the equity of PIC to Luxor (the "Luxor Equity"), subject to terms and conditions to be set out in a definitive agreement. Such terms included, but were not limited to, Luxor having control of the PIC board of directors.

However, the TSX Venture Exchange did not approve the Letter Agreement. Therefore, on March 15, 2010 Palladon and Luxor entered into a Satisfaction and Settlement Agreement whereby Palladon transferred ownership of 78.26% of PIC to Luxor in exchange for the full discharge of all liabilities due to Luxor. Because of the de minimis business activity at PIC subsequent to Palladon's fiscal year ended February 28, 2010, the Satisfaction and Settlement Agreement is reflected in these financial statements as of February 28, 2010.

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 shareholders' equity. The Board of Directors does not establish quantitative return on capital for management, but rather relies on the

Note 8 **Management of Capital** – (cont'd)

expertise of the Company's management to sustain future development of the business. The Company is not subject to any externally imposed capital requirements. The Company relies on capital markets to support continued growth.

Note 9 **Financial Instruments**

The Company's financial instruments consist of cash, amounts receivable, marketable securities, investment in PIC, accounts payable and accrued liabilities, and due to related parties. 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 majority of the Company's accounts payable and accrued liabilities have maturities of less than three months.

c) **Market Risk**

The Company has market risk attributable to its marketable securities held for trading. The investments consist of shares of public companies which were received as partial consideration in an option agreement. The investments held for trading are carried on the balance sheet at the fair market value of the investments, with the change in fair value being recognized as unrealized gain (loss) on marketable securities in the statement of operations and deficit. Based on management's knowledge and experience of the financial markets, the Company does not believe it is subject to significant market risk as a result of holding these marketable securities.

d) **Foreign Exchange**

As at February 28, 2010, the Company is not subject to foreign exchange risk.

Note 10 **Share Capital**

**Shares Authorized:** Unlimited common shares without par value.

**Shares Issued:**

		Number of Shares	Share Capital	Contributed Surplus
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, 2010 and 2009		<u>168,964,132</u>	<u>\$95,730,142</u>	<u>\$3,071,383</u>

Subsequent to February 28, 2010, the Company issued 20,000,000 shares at CN\$0.05654 (US\$0.055) per share, for gross and net proceeds of US\$1,100,000.

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 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. The agent's warrants included in the units were thus valued at \$Nil.

**Commitments:**

a) **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, 2010 and February 28, 2009 is summarized as follows:

Note 10 **Share Capital** – (cont'd)

	Year ended February 28, 2010		Year ended February 28, 2009	
	Number of <u>Shares</u>	Weighted Average Exercise <u>Price</u>	Number of <u>Shares</u>	Weighted Average Exercise <u>Price</u>
Outstanding and exercisable beginning of year	1,030,000	\$0.55	2,835,000	\$0.51
Cancelled	(880,000)	\$0.58	(1,405,000)	\$0.51
Exercised	-	-	(400,000)	\$0.43
Outstanding and exercisable, end of year	<u>150,000</u>	\$0.40	<u>1,030,000</u>	\$0.55

As of February 28, 2010, there were 150,000 share purchase options outstanding, each of which entitles the holder to purchase one common share at \$0.40 per share until expiration on October 31, 2012.

b) **Share Purchase Warrants:**

Each warrant entitles the holder to purchase one common share. Activity for the years ended February 28, 2010 and February 28, 2009 is as follows:

	<u>Warrants</u>	Weighted Average Price
Outstanding, February 29, 2008	26,156,931	\$0.62
Issued	22,061,739	\$1.00
Exercised	(3,899,613)	\$0.54
Expired	<u>(12,007,238)</u>	\$0.74
Outstanding, February 28, 2009	32,311,819	\$0.84
Expired	<u>(32,311,819)</u>	\$0.84
Outstanding, February 28, 2010	<u>-</u>	-

Note 11 **Income Taxes**

The Company has accumulated non-capital losses of approximately \$15,200,000 in Canada, which are available to carry forward and offset future years' taxable income. The non-capital losses expire in 2030:

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

Note 11 **Income Taxes** – (cont'd)

	<u>2010</u>	<u>2009</u>
Statutory tax rate	<u>29.75%</u>	<u>30.75%</u>
Income (loss) before income taxes	<u>\$ 12,596,731</u>	<u>\$ (14,170,113)</u>
Expected income tax loss (recovery)	\$ 3,748,000	\$ (4,357,000)
Increase (decrease) in income tax recovery resulting from:		
Change in statutory rates	62,000	607,000
Foreign income taxes at USA rate	-	(121,000)
Other non-deductible items	(4,000)	185,000
Share issue costs	-	(861,000)
Effective foreign exchange gain on future income tax assets	-	154,000
Impact of Luxor transaction	1,548,000	-
Non-taxable portion of capital gains	(1,032,000)	597,000
Change in the valuation allowance for future income tax assets	<u>(4,322,000)</u>	<u>3,796,000</u>
Income tax recovery	<u>\$ -</u>	<u>\$ -</u>

The significant components of the Company's future income tax assets, after applying enacted corporation income tax rates of 25% (2009: 25%), are as follows:

	<u>2010</u>	<u>2009</u>
Non-capital loss carry forward	\$ 2,130,000	\$ 7,592,000
Capital losses	5,021,000	-
Long-term investments	(610,000)	-
Mineral properties and deferred exploration	-	2,618,000
Undeducted share issue costs	633,000	870,000
Unrealized foreign exchange on intercompany debt	-	362,000
Other	(7,000)	47,000
Less: valuation allowance	<u>(7,167,000)</u>	<u>(11,489,000)</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,	
	2010	2009
Consulting fees	\$187,491	\$3,000
Directors' fees	125,290	-
Salaries and benefits	302,735	486,954
Total	<u>\$615,517</u>	<u>\$489,954</u>

The amounts were recorded at their exchange amount, which is the amount agreed to by the parties.

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

Note 13 **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. The following transactions were excluded from the statement of cash flows:

During the year ended February 28, 2010:

- a) The Company settled \$42,457,716 of debt in exchange for its 78.26% in PIC, and increased the remaining carrying value of PIC by \$7,311,241 to reflect its fair value.

During the year ended February 28, 2009:

- a) The Company issued 871,885 units valued at \$610,320 as partial payment of a sales commission related to a private equity placement (Note 11).
- b) The Company, in relation to the purchase of the remaining non-controlling interest (Note 7), issued a note payable in the amount of \$25,673,500 (US\$25,000,000).