

FRANCONIA MINERALS CORPORATION
(An Exploration Stage Company)

Consolidated Financial Statements
December 31, 2008 and 2007
(U.S. Dollars)
(Unaudited, Prepared by Management)

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Notice to Reader

The accompanying unaudited interim consolidated financial statements of Franconia Minerals Corporation for the three month period ended December 31, 2008 have been prepared by management and approved by the Audit Committee and Board of Directors of the Corporation. These statements have not been reviewed by the Corporation's auditors.

Dated February 16, 2009

/s/ Brian Gavin

Brian Gavin President

FRANCONIA MINERALS CORPORATION
(An Exploration Stage Company)
Consolidated Balance Sheets (Note 2)
December 31,
(U.S. Dollars)
(Unaudited, prepared by Management)

	<u>December 31</u>	<u>September 30</u>
	<u>2008</u>	<u>2008</u>
ASSETS		
Current		
Cash and cash equivalents	\$ 1,454,328	\$ 261,219
Auction Rate Securities settlement (Note 5)	-	3,250,000
Prepaid expenses	<u>62,699</u>	<u>110,059</u>
	<u>1,517,027</u>	<u>3,621,278</u>
Mineral Property Interests (Note 6)	<u>26,950,325</u>	<u>26,290,782</u>
	<u>\$ 28,467,352</u>	<u>\$ 29,912,060</u>

LIABILITIES

Current		
Accounts payable and accrued liabilities	\$ <u>536,172</u>	\$ <u>1,677,497</u>

SHAREHOLDERS' EQUITY

Share Capital (Note 7)	34,150,914	34,138,491
Contributed Surplus	5,775,602	5,780,229
Deficit	<u>(11,995,336)</u>	<u>(11,684,157)</u>
	<u>27,931,180</u>	<u>28,234,563</u>
	<u>\$ 28,467,352</u>	<u>\$ 29,912,060</u>

Commitments (Note 9)
Subsequent Events (Note 10)
Contingent Liability (Note 13)

Approved on behalf of the Board:

“BRIAN GAVIN” Director
Brian Gavin

“ALLAN J. MARTER” Director
Allan J. Marter

The accompanying notes are an integral part of these consolidated financial statements.

FRANCONIA MINERALS CORPORATION
(An Exploration Stage Company)
Consolidated Statements of Operations
Quarters Ended December 31,
(U.S. Dollars)
(Unaudited, prepared by Management)

	<u>2008</u>	<u>2007</u> (Note 3)
Expenses		
General administration	\$ 315,707	\$ 482,302
General exploration	-	16,437
Property maintenance	-	7,979
	<u>315,707</u>	506,718
Loss from Operations	<u>315,707</u>	506,718
Interest Income	<u>(4,528)</u>	<u>(173,821)</u>
	<u>311,179</u>	332,897
Net Loss and Comprehensive Loss for Quarter	<u>\$ 311,179</u>	<u>\$ 332,897</u>
Deficit accumulated during development stage		
Beginning of period	11,684,157	7,291,398
	<u>11,684,157</u>	<u>7,291,398</u>
End of period	<u>\$ 11,995,336</u>	<u>\$ 7,624,295</u>
	<u>11,995,336</u>	<u>7,624,295</u>
Basic and Diluted Loss Per Share	<u>\$ (0.01)</u>	<u>\$ (0.01)</u>
	<u>(0.01)</u>	<u>(0.01)</u>
Weighted Average Number of Common Shares Outstanding	<u>59,081,050</u>	<u>58,024,774</u>

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FRANCONIA MINERALS CORPORATION
(An Exploration Stage Company)
Consolidated Statements of Shareholders' Equity
Quarter Ended December 31
(U.S. Dollars)
(Unaudited, prepared by Management)

	Common Shares	Amount	Deficit	Contributed Surplus	Total Shareholders' Equity
Balance, September 30, 2007	58,024,774	\$ 32,756,567	\$ (7,291,397)	\$ 5,649,500	\$ 31,114,670
Net loss for quarter	-	-	(332,898)	-	(332,898)
Shares issued for cash	-	-	-	-	-
Exercise of options	-	-	-	-	-
Shares issued for acquisition of mineral property interests	-	-	-	-	-
Warrants issued for acquisition of mineral property interests	-	-	-	-	-
Stock-based compensation	-	-	-	-	-
Directors and consultants	-	-	-	-	-
Balance, December 31, 2007	58,024,774	\$ 32,756,567	\$ 7,624,295	\$ 5,649,500	\$ 30,781,772
Balance, September 30, 2008	59,062,572	\$ 34,138,491	\$ (11,684,157)	\$ 5,780,229	\$ 28,234,563
Net loss for quarter	-	-	(311,179)	-	(311,179)
Shares issued for cash	-	-	-	-	-
Exercise of options	20,000	12,423	-	(4,627)	7,797
Shares issued for acquisition of mineral property interests	-	-	-	-	-
Warrants issued for acquisition of mineral property interests	-	-	-	-	-
Stock-based compensation	-	-	-	-	-
Directors and consultants	-	-	-	-	-
Balance, December 31, 2008	59,082,572	\$ 34,150,914	\$ (11,995,336)	\$ 5,775,602	\$ 27,931,180

The accompanying notes are an integral part of these consolidated financial statements.

FRANCONIA MINERALS CORPORATION
(An Exploration Stage Company)
Consolidated Statements of Cash Flows
Quarter Ended December 31
(U.S. Dollars)
(Unaudited, prepared by Management)

	<u>2008</u>	<u>2007</u> (Note 3)
Cash Flows From (Used in) Operating Activities		
Net loss for quarter	\$ (311,179)	\$ (332,897)
Items not involving cash:		
Write-off of mineral property interests	-	7,979
Stock-based compensation	-	39,186
Changes in non-cash working capital balances:		
Prepaid expenses	47,360	(49,307)
Accounts payable and accrued liabilities	(1,580,199)	(868,010)
Cash From (Used in) Operating Activities	<u>(1,844,017)</u>	<u>(1,203,049)</u>
Cash Flows from Financing Activities		
Loan proceeds	1,750,000	-
Issue of share capital, net of share issue costs	7,796	-
Cash Flows from Financing Activities	<u>1,757,796</u>	<u>-</u>
Cash Flows Used in Investing Activities		
Payments for acquisition and exploration of mineral property interests	(220,667)	(1,614,468)
Purchase of Auction Rate Securities	1,499,998	-
Cash Used in Investing Activities	<u>(1,230,694)</u>	<u>(1,614,468)</u>
Increase (Decrease) in Cash and Cash Equivalents	1,144,472	(2,817,517)
Cash and Cash Equivalents, Beginning of Period	<u>261,219</u>	<u>17,104,454</u>
Cash and Cash Equivalents, End of Period	\$ <u>1,405,691</u>	\$ <u>14,286,937</u>
Cash and Cash Equivalents consist of:		
Cash	\$ 1,319,849	\$ 2,129,101
Term deposits	-	2,957,312
Money market funds	134,479	8,018,041
	<u>\$ 1,454,328</u>	<u>\$ 13,104,454</u>
Supplemental Information		
Mineral property interest acquisition and exploration costs included in accounts payable and accrued liabilities	\$ 438,876	\$ 248,232

The accompanying notes are an integral part of these consolidated financial statements.

FRANCONIA MINERALS CORPORATION
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Notes to Consolidated Financial Statements
For the Quarters Ended December 31, 2008 and 2007
(U.S. Dollars)
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1. Nature of Operations

Franconia Minerals Corporation (the "Company") was incorporated on August 7, 1998 under the Alberta *Business Corporations Act*. The Company is a public company, and effective January 12, 2005, was listed on the TSX Venture Exchange ("TSX-V"). The Company's shares were delisted from the TSX-V and were listed and commenced trading on the Toronto Stock Exchange ("TSX") at the opening on Monday, November 19, 2007, under the symbol "FRA".

The Company is in the process of exploring its mineral property interests and has not determined whether these properties contain economically recoverable reserves of ore. The Company has not earned significant revenues from its mineral property interests and is considered to be in the exploration stage.

2. Going-Concern

These consolidated financial statements have been prepared on a going-concern basis, which assumes the realization of assets and liquidation of liabilities in the normal course of business.

The recovery of amounts shown as acquisition costs of mineral properties and the related deferred exploration costs for mineral properties is dependent upon the discovery of economically recoverable reserves, the ability of the Company to obtain financing to complete development, and upon future profitable operations from the properties or proceeds from the disposition thereof.

The Company's ability to continue as a going-concern is dependent on the Company being able to satisfy its liabilities as they become due and to obtain the necessary financing to complete the exploration and development of its mineral property interests, the attainment of profitable mining operations, and/or the receipt of proceeds from the disposition of its mineral property interests. These consolidated financial statements do not include any adjustments to the recoverability and classification of recorded asset amounts and classification of liabilities that might be necessary, should the Company be unable to continue as a going-concern.

As of December 31, 2008, the Company has working capital of \$980,855 (2007 - \$14,310,093). The Company expects to fund most of its operations for the coming year from its current working capital with any shortfalls financed through private placements. Consistent with its business plan, the Company intends to continue using various strategies to minimize its dependence on equity capital, including the securing of joint venture partners where appropriate. Management believes it will be able to raise equity capital as needed in the long term, but recognizes there will be risks involved that may be beyond their control.

3. Comparative Figures

Certain of the comparative figures are reclassified to conform to the current year's presentation.

4. Significant Accounting Policies

These consolidated financial statements have been prepared using Canadian generally accepted accounting principles ("GAAP") and are presented in United States dollars.

(a) Principles of consolidation

The consolidated financial statements include the accounts of the Company and its integrated wholly-owned subsidiary, Franconia Minerals Corporation (US) Inc. All significant inter-company transactions have been eliminated.

(b) Cash and cash equivalents

Cash and cash equivalents include cash and highly liquid investments with maturities of three months or less at the time of purchase.

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4. Significant Accounting Policies (continued)

(c) Mineral property interests

The Company defers all costs related to investments in mineral property interests on a property-by-property basis. Such costs include mineral property interest acquisition costs and exploration and development expenditures, net of any recoveries. Costs are deferred until such time as the extent of mineralization has been determined and mineral property interests are either developed or the Company's mineral rights are allowed to lapse.

All deferred mineral property interest costs are reviewed annually, on a property-by-property basis, to consider whether there are any conditions that may indicate impairment. When the carrying value of a property exceeds its net recoverable amount that may be estimated by quantifiable evidence of an economic geological resource or reserve, joint venture expenditure commitments or the Company's assessment of its ability to sell the mineral property interest for an amount exceeding the deferred costs, provision is made for the impairment in value.

From time to time the Company may acquire or dispose of a mineral property interest pursuant to the terms of an option agreement. As the options are exercisable entirely at the discretion of the optionee, the amounts payable or receivable are not recorded. Option payments are recorded as mineral property interest costs or recoveries when the payments are made or received.

The amounts shown as mineral property interests represent net costs to date, less amounts written off, and do not necessarily represent present or future values.

(d) Income taxes

The Company follows the asset and liability method of accounting for income taxes. Under this method, future tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis, and losses carried forward. Future income tax assets and liabilities are measured using substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future income tax assets and liabilities of a change in tax rates is recognized in operations in the period in which the change is enacted or substantially assured. The amount of future income tax assets is limited to the amount of the benefit that is more likely than not to be realized.

(e) Foreign exchange

The Company's functional and reporting currency is the U.S. dollar. Amounts reported in foreign currency are translated into U.S. dollars on the following bases:

- (i) Monetary assets and liabilities, at the rate of exchange in effect as at the balance sheet date;
- (ii) Non-monetary assets and liabilities, at the exchange rates prevailing at the time of the acquisition of the assets or assumption of the liabilities; and
- (iii) Revenues and expenses, at the average rate of exchange for the year.

Gains and losses arising from the translation of foreign currency are included in the statement of operations for the year.

(f) Joint venture

The Company's exploration and development activities are conducted jointly with others. These consolidated financial statements reflect only the Company's proportionate interest in such activities. Joint venture accounting, which reflects the Company's proportionate interest in mineral properties, is applied by the Company only when the parties enter into formal comprehensive agreements for ownership and mining participation terms.

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4. Significant Accounting Policies (continued)

(g) Stock-based compensation

The Company accounts for stock-based compensation using a fair value based method with respect to all stock-based payments measured and recognized, to directors, employees and non-employees. For directors and employees, the fair value of the options is measured at the date of grant. For non-employees, the fair value of the options is measured on the earlier of the date at which the counterparty performance is completed or the date the performance commitment is reached or the date at which the equity instruments are granted if they are fully vested and non-forfeitable. The fair value of the options is accrued and charged either to operations or resource properties, with the offset credit to contributed surplus. For directors and employees the options are recognized over the vesting period, and for non-employees the options are recognized over the related service period. If and when the stock options are ultimately exercised, the applicable amounts of contributed surplus are transferred to share capital.

(h) Revenue recognition

Interest income derived from cash and cash equivalents and other investments is recognized on an accrual basis as earned.

(i) Loss per share

Basic loss per share is calculated using the weighted average number of common shares outstanding during the year. The Company uses the treasury stock method for calculating diluted loss per share. Under this method, the dilutive effect on loss per share is calculated presuming the proceeds of exercise of outstanding options, warrants and similar instruments would be used to repurchase common shares at the average market price during the period.

However, diluted loss per share is not presented where the effects of various conversions and exercise of options and warrants would be anti-dilutive. Shares held in escrow, other than where their release is subject to the passage of time, are not included in the calculation of the weighted average number of common shares outstanding.

(j) Asset retirement obligation

The Company recognizes an estimate of the liability associated with an asset retirement obligation (“ARO”) in the financial statements at the time the liability is incurred. The estimated fair value of the ARO is recorded as a long-term liability, with a corresponding increase in the carrying amount of the related asset. The capitalized amount is depleted on a straight-line basis over the estimated life of the asset. The liability amount is increased each reporting period due to the passage of time and the amount of accretion is charged to earnings in the period. The ARO can also increase or decrease due to changes in the estimates of timing of cash flows or changes in the original estimated undiscounted cost. Actual costs incurred upon settlement of the ARO are charged against the ARO to the extent of the liability recorded. At present, the Company has determined that it has no material AROs to record in the financial statements.

(k) Use of estimates

The preparation of financial statements in conformity with Canadian GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Significant areas requiring the use of management estimates relate to the impairment of mineral property interests, accrued liabilities, the assumptions used in the determination of the fair value of stock-based compensation and the valuation allowance for future income tax assets. The Company bases its estimates and assumptions on current facts, historical experience and various other factors that it believes to be reasonable under the circumstances. The actual results experienced by the Company may differ materially and adversely from the Company’s estimates and could affect future results of operations and cash flows.

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4. Significant Accounting Policies (continued)

(l) Financial instruments

Financial instruments must be 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 are measured in the balance sheet at fair value except for loans and receivables, held-to-maturity investments and other financial liabilities, which are measured at amortized cost. Subsequent measurement and changes in fair value will depend on their initial classification as follows: held-for-trading financial assets are measured at fair value and changes in fair value are recognized in net income; available-for-sale financial instruments are measured at fair value with changes in fair value recorded in other comprehensive income until the investment is no longer recognized or impaired, at which time the amounts would be recorded in net income.

Transaction costs other than those related to financial instruments classified as held-for-trading or available-for-sale, which are expensed as incurred, are added to the fair value of the financial asset or financial liability on initial recognition and amortized using the effective interest method.

The Company has classified its financial instruments as follows:

- | | |
|--|------------------------------|
| • Cash and cash equivalents | Held-for-trading |
| • Auction Rate Securities settlement | Loans and receivables |
| • Accounts payable and accrued liabilities | Other financial liabilities |
| • Auction Rate Securities loan | Other financial liabilities. |

(m) Comprehensive income

The Company has no items of other comprehensive income (loss) in any period presented. Therefore, net loss as presented in the Company's statements of operations equals comprehensive loss.

(n) Financial instruments – disclosures and presentation

CICA disclosure standards outline the disclosure requirements for financial instruments and non-financial derivatives. The guidance prescribes an increased importance on risk disclosures associated with recognized and unrecognized financial instruments, and how such risks are managed. Specifically, it requires disclosure of the significance of financial instruments for a company's financial position. In addition, the guidance outlines revised requirements for the disclosure of qualitative and quantitative information regarding exposure to risks arising from financial instruments. The Company has included disclosures recommended by the new Handbook Section in Note 12.

(o) Future accounting changes

The following changes will apply for the Company's interim and annual consolidated financial statements commencing October 1, 2008. The Company is in the process of assessing the impact of these changes on its consolidated financial statements.

(i) Goodwill and intangible assets

In February 2008, the CICA issued Handbook Section 3064, "Goodwill and Intangible Assets", replacing Section 3062, "Goodwill and Other Intangible Assets", and Section 3450, "Research and Development Costs". This section establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. Standards concerning goodwill are unchanged from the standards included in the previous Section 3062.

(ii) 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

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4. Significant Accounting Policies (continued)

GAAP. The new standards will be effective for the Company for interim and annual financial statements beginning on October 1, 2011. Implementation of the change will require the restatement for comparative purposes of amounts reported by the Company for the year ending September 30, 2011. While the Company has begun assessing the adoption of IFRS for 2011, the financial reporting impact of the transition to IFRS cannot be reasonably estimated at this time.

5. Auction Rate Securities Settlement

During 2008, the Securities and Exchange Commission's Division of Enforcement announced preliminary settlements in principle with UBS Securities LLC and UBS Financial Services, Inc. ("UBS") and with Citigroup Global Markets, Inc. ("Citi") that would restore liquidity to customers who invested in auction rate securities ("ARS"). The Company is one such customer, and as such, opted to participate in both settlement offers.

The UBS settlement requires that UBS will liquidate at par all ARS investors with account values up to \$10,000,000 no later than January 2, 2009. At September 30, 2008, the Company held ARS investments with UBS of \$2,450,000. During August 2008, a loan of \$1,000,000 was obtained from UBS, secured by the ARS holdings. At the Settlement Date of January 2, 2009, the loan was repaid from the investment holdings, and the Company received the remaining \$1,431,000 of its investment in cash. This amount was included in cash and cash equivalents.

The Citi Settlement required that Citi liquidate at par all ARS from its customers, no later than November 7, 2008. At that date, the Company held ARS investments with Citi of \$3,550,000, against which it had borrowed \$3,500,000. The Settlement proceeds were used to repay the loan, leaving \$50,000 which, along with accrued interest, remains on deposit at December 31, 2008 in a (completely liquid) Money Market Fund.

6. Mineral Property Interests

	Total	Birch Lake	Red Knoll
Balance, September 30, 2007	\$ 14,681,145	\$ 12,914,012	\$ 1,767,133
Expenditures			
Acquisition	5,473	5,473	-
Exploration	1,849,248	1,809,060	40,188
Balance, December 31, 2007	<u>16,535,866</u>	<u>14,728,545</u>	<u>1,807,321</u>
Balance, September 30, 2008	26,290,782	26,290,782	
Expenditures			
Acquisition	20,192	20,192	-
Exploration	639,351	639,351	-
Abandoned	<u>-</u>	<u>-</u>	<u>-</u>
Balance, December 30, 2008	<u>\$ 26,950,325</u>	<u>\$ 26,950,325</u>	\$ -

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6. Mineral Property Interests (continued)

(a) Birch Lake Property

On November 12, 2002, the Company entered into the Birch Lake Option Agreement (“BLOA”) to hold the option to enter into an Earn-in and Joint Venture Agreement (“BLJV Agreement”) with Beaver Bay Joint Venture (“BBJV”), an entity related by virtue of common shareholders and a common director. BBJV’s property is part of the Duluth Complex in the state of Minnesota (Note 8(a)).

On October 27, 2003, the Company exercised its option to enter into the BLJV Agreement to acquire up to an 82% interest in BBJV. Under the terms of the BLOA, the Company made a payment of \$35,000 and issued 546,144 common shares at a deemed price of \$0.20 (Cdn. \$0.30) per share. In 2006, certain amendments to the BLOA expanded the area of interest to include the American Copper & Nickel Company Inc. (“ACNC”) lands (see Note 6(b)) and modified the terms of the BLJV Agreement.

To acquire an undivided 60% legal and beneficial interest in the project, the Company must have:

- (i) Incurred \$10,000,000 in cumulative exploration expenditures as follows:
 - (b) Total of \$2,000,000 no later than January 2, 2008 (completed); and
 - (c) Complete the total of \$10,000,000 no later than January 2, 2010 (completed).
- (ii) Paid an aggregate of \$6,000,000 in cash and stock payments as follows:

<u>Dates</u>	<u>Cash</u>	<u>In Shares</u>
October 27, 2003 (Effective Date)	\$ 150,000 *	\$ 125,000 *
December 17, 2004/March 1, 2006	50,000 *	125,000 *
On/before April 15, 2006	100,000 *	- *
On/before June 30, 2006	50,000 *	125,000 *
On/before January 2, 2007	175,000 *	150,000 *
On/before January 2, 2008	225,000 *	225,000 *
On/before January 2, 2009	250,000 *	250,000 *
On/before January 2, 2010	3,000,000 *	1,000,000 *
Total	\$ 4,000,000 *	\$ 2,000,000 *

* Completed

The number of common shares to be issued was calculated using the weighted average trading price of the Company’s common shares converted to U.S. dollars for the month immediately preceding the month in which the payment is made. During 2008, the Company issued 892,798 common shares (2007 – 113,359) (Note 7(b) (ii)) in accordance with the agreement.

To comply with the terms of the BLJV Agreement, the Company needed to contribute to the joint venture its 60% of required expenditures plus an additional 20% of required expenditures. The additional 20% of required expenditures paid will be recoverable by payment to the Company of 70% of the cash flow from commercial production until 100% of such amounts, including interest, have been recovered by the Company.

During 2008, the Company fulfilled its obligations and reached its current 60% ownership by spending \$10,000,000 in exploration on the property, and by paying \$3,250,000 in cash (for a total of \$4,000,000) and \$1,250,000 (for a total of \$2,000,000) in common shares to the BBJV in accordance with the terms of the BLOA. As a result, the Company vested its 60% interest in the project, and on June 18, 2008, signed the BLJV Agreement, through its wholly-owned subsidiary, Franconia Minerals Corporation (US) Inc.

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6. Mineral Property Interests (continued)

(a) Birch Lake Property (continued)

To acquire an undivided 70% legal and beneficial interest in the project, the Company must incur an additional \$10,000,000 in work expenditures by July 18, 2013. The Company will be said to have a 70% interest in the project with a final payment of \$1,000,000 being made to BBJV. The Company will need to contribute to the joint venture its 70% of required expenditures plus an additional 15% of required expenditures. Again, the additional 15% of required expenditures paid will be recoverable by payment to the Company of 70% of the cash flow from commercial production until 100% of such amounts, including interest, have been recovered by the Company.

The BLJV Agreement replaces the BLOA and allows the Company to advance its ownership interest in the project to the aforementioned 70% by spending an additional \$10,000,000 on exploration and acquisition at Birch Lake, this amount includes expenditures already incurred since spending the initial \$10,000,000, on or before July 18, 2013 and making an additional cash payment of \$1,000,000 to BBJV within 90 days of spending the additional funds on exploration and acquisition.

The Company may further earn up to an 82% interest in the project upon earning the 70% interest and notifying BBJV of their intention and by funding BBJV's portion of development costs of a mine to commercial production. The Company will recover these costs from BBJV's share of cash flow from commercial production.

(b) American Copper & Nickel Company Inc. – Birch Lake

On December 22, 2003, Lehmann Exploration Management, a company controlled by a shareholder and officer, as operator of BBJV, entered into a binding letter of intent to acquire from ACNC, two federal leases and ownership of certain mineral rights. The federal leases are subject to a royalty to the U.S. government on production, and are also subject in part to overriding royalties to certain private parties not to exceed 1%. All the mineral rights acquired from ACNC are subject to payment to ACNC of a royalty of 7.5% of net distributable earnings from the subject rights.

(c) Marlow Timberland LLC – Birch Lake

On April 18, 2008, the Company signed an agreement with Marlow Timberland LLC to acquire 228 acres of surface lands in Lake County, Minnesota, for \$570,000. This land now forms part of the Birch Lake Project.

Realization of Assets

The investment in and expenditures on mineral property interests comprise a significant portion of the Company's assets. Realization of the Company's investment in these assets is dependent upon the establishment of legal ownership, the attainment of successful production from the mineral property interests or from the proceeds of their disposal.

Resource exploration and development is highly speculative and involves inherent risks. While the rewards if an ore body is discovered can be substantial, few properties that are explored are ultimately developed into producing mines. There can be no assurance that current exploration programs will result in the discovery of economically viable quantities of ore.

The amounts shown for acquisition costs and deferred exploration expenditures represent costs incurred to date and do not necessarily reflect present or future values. These costs will be depleted over the useful lives of the properties upon commencement of commercial production or written off if the properties are abandoned or the claims allowed to lapse.

Title to Mineral Property Interests

Although the Company has taken steps to verify the title to mineral properties in which it has an interest, in accordance with industry standards for the current stage of exploration of such properties, these procedures do not guarantee the Company's title. Property title may be subject to unregistered prior agreements or transfers and title may be affected by undetected defects.

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6. Mineral Property Interests (continued)

Environmental

The Company is subject to the laws and regulations relating to environmental matters in all jurisdictions in which it operates, including provisions relating to property reclamation, discharge of hazardous material and other matters. The Company may also be held liable should environmental problems be discovered that were caused by former owners and operators of its properties and properties in which it has previously had an interest. The Company conducts its mineral exploration activities in compliance with applicable environmental protection legislation. The Company is not aware of any existing environmental problems related to any of its current or former properties that may result in material liability to the Company.

Environmental legislation is becoming increasingly stringent and costs and expenses of regulatory compliance are increasing. The impact of new and future environmental legislation on the Company's operations may cause additional expenses and restrictions.

If the restrictions adversely affect the scope of exploration and development on the mineral property interests, the potential for production on the property may be diminished or negated.

7. Share Capital

(a) Authorized

Unlimited number of common shares

Unlimited number of preferred shares issuable in series

(b) Issued

(i) Private placements

(aa) In April 2007, the Company completed a brokered private placement financing of \$10,407,443 (Cdn \$11,736,403) by issuing 7,335,252 units at \$1.42 per unit (Cdn \$1.60). Each unit consisted of one common share and one-half of one common share purchase warrant. Each whole warrant entitles the holder to purchase one additional common share at an exercise price of Cdn \$1.92 at any time prior to the earlier of:

1. the date that is 15 trading days after receiving notice from the Company that the weighted average price of the common shares on the TSX-V or the TSX has been equal to or greater than Cdn \$2.40 for a period of 15 consecutive trading days commencing on April 13, 2009; and
2. April 13, 2010.

The Company paid finders and other fees of \$762,884 and issued 733,525 non-transferable broker's warrants valued at \$775,979 (Note 7(f)). The broker's warrants have an exercise price of Cdn \$1.92 and expire on April 13, 2009.

(bb) In April 2007, the Company completed a non-brokered private placement financing of \$5,320,592 (Cdn \$6,000,000) by issuing 3,750,000 units at \$1.42 (Cdn \$1.60) per unit. Each unit consisted of one common share and one-half of one common share purchase warrant. Each whole warrant entitles the holder to purchase one additional common share at an exercise price of Cdn \$1.92 at any time prior to the earlier of:

1. the date that is 15 trading days after receiving notice from the Company that the weighted average price of the common shares on the TSX-V or the TSX has been equal to or greater than Cdn \$2.40 for a period of 15 consecutive trading days commencing on April 30, 2009; and
2. April 30, 2010.

The Company paid finders' and other fees of \$322,589 and issued 268,750 broker's warrants valued at \$370,245 (Note 7(f)). These warrants have an exercise price of Cdn \$1.92 and expire on April 30, 2009.

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7. Share Capital (continued)

b) Issued (continued)

(ii) Property acquisition

In January 2008, the Company issued 161,792 shares to BBJV, an entity managed and operated by a company controlled by a director and shareholder, at their trading price on the TSX of \$1.45 (Cdn \$1.45) per share with a total fair value of \$234,157, in accordance with the terms of the agreement on the Birch Lake properties. The agreement also required the payment of \$225,000 in cash to BBJV.

In May 2008, the Company issued 100,000 units to TCAI at their trading price on the TSX of \$1.80 (Cdn \$1.80) per unit with a total fair value of \$180,000, in accordance with the terms of the agreement on the Red Knoll property. Each unit consisted of one common share and one-half of one common share purchase warrant. Each whole warrant entitles the holder to purchase one additional common share at an exercise price of Cdn \$1.75 at any time until May 23, 2009. The Company included, in mineral property interests, a fair value amount of \$23,582 for the 50,000 warrants granted in the units using the Black-Scholes option pricing method with the following assumptions: volatility of 61%; risk-free interest rate of 3.27%; dividend yield of Nil; and expected life of one year.

In June 2008, the Company issued 731,006 shares to BBJV, an entity managed and operated by a company controlled by a director and shareholder, at their trading price on the TSX of \$1.28 (Cdn \$1.31) per share with a total fair value of \$938,944. Further, the Company paid \$3,250,000 in cash to the BBJV. These amounts fulfill the Company's contribution requirements in the BLOA (Note 6(a) (ii)).

(c) Warrants

The following summarizes information about warrants outstanding (for the periods ended December 31):

<u>Expiry Date</u>	<u>Price (Cdn\$)</u>	<u>2007</u>	<u>Issued</u>	<u>Exercised</u>	<u>Expired</u>	<u>2008</u>
May 14, 2008	\$ 2.70	50,000	-	-	(50,000)	-
April 13, 2009	\$ 1.92	733,525	-	-	-	733,525
April 13, 2010	\$ 1.92	3,667,626	-	-	-	3,667,626
April 30, 2009	\$ 1.92	268,750	-	-	-	268,750
April 30, 2010	\$ 1.92	1,875,000	-	-	-	1,875,000
May 23, 2009	\$ 1.75	-	50,000	-	-	50,000
		<u>6,594,901</u>	<u>50,000</u>	<u>-</u>	<u>(50,000)</u>	<u>6,594,901</u>

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7. Share Capital (continued)

(c) Warrants (continued)

<u>Expiry Date</u>	<u>Price (Cdn\$)</u>	<u>2006</u>	<u>Issued</u>	<u>Exercised</u>	<u>Expired</u>	<u>2007</u>
December 14, 2006	\$ 0.40-0.60	284,820	-	(46,050)	(238,770)	-
January 10, 2007	\$ 0.40-0.60	4,125	-	-	(4,125)	-
June 9, 2007	\$ 0.57	50,000	-	(50,000)	-	-
January 20, 2008	\$ 0.60	75,000	-	(75,000)	-	-
April 12, 2008	\$ 0.60	125,000	-	(125,000)	-	-
May 14, 2008	\$ 2.70	-	50,000	-	-	50,000
May 20, 2008	\$ 1.85	-	2,281,043	(2,281,043)	-	-
April 13, 2009	\$ 1.92	-	733,525	-	-	733,525
April 13, 2010	\$ 1.92	-	3,667,626	-	-	3,667,626
April 30, 2009	\$ 1.92	-	268,750	-	-	268,750
April 30, 2010	\$ 1.92	-	1,875,000	-	-	1,875,000
		<u>538,945</u>	<u>8,875,944</u>	<u>(2,577,093)</u>	<u>(242,895)</u>	<u>6,594,901</u>

(d) Options

The Company has a stock option plan (the "Plan") available to employees, directors, officers and consultants with grants under the Plan approved from time to time by the board of directors. Under the Plan, the Company is authorized to issue options to purchase in aggregate up to 10% of the Company's issued and outstanding common shares, up to a maximum of 5,762,977 shares. Each option can be exercised to acquire one common share of the Company. The term of the options and vesting provisions are determined by the board of directors, subject to applicable stock exchange rules. The exercise price for an option granted under the Plan shall not be less than the closing price of the Company's common stock on the stock exchange in which its shares are listed. The options generally vest at the time of granting and have a term of five years.

The Company has granted stock options to directors, officers and consultants of the Company as follows:

	<u>Number of Options</u>	<u>Weighted Average Exercise Price (Cdn\$)</u>
Outstanding, September 30, 2007 and December 31, 2007	<u>4,416,500</u>	<u>1.28</u>
Outstanding, September 30, 2008	4,236,500	1.30
Exercised	<u>(20,000)</u>	<u>.42</u>
Outstanding, December 31, 2008	<u>4,216,500</u>	<u>1.31</u>

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7. Share Capital (continued)

(d) Options (continued)

Additional information regarding options outstanding and exercisable as at December 31, 2008 and 2007 is as follows:

Options Outstanding and Exercisable, December 31, 2008

<u>Expiry Date</u>	<u>Exercise Price (Cdn\$)</u>	<u>Shares Under Option</u>	<u>Weighted Average Remaining Contractual Life (in years)</u>
August 19, 2009	0.40	280,000	0.88
April 15, 2010	0.42	1,025,000	1.54
November 23, 2011	1.45	1,400,500	3.15
August 17, 2012	1.95	1,511,000	3.88
Options outstanding and exercisable		4,216,500	2.86

Options Outstanding, December 31, 2007

<u>Expiry Date</u>	<u>Exercise Price (Cdn\$)</u>	<u>Shares Under Option</u>	<u>Weighted Average Remaining Contractual Life (in years)</u>
August 19, 2009	0.40	350,000	1.88
April 15, 2010	0.42	1,090,000	2.54
November 23, 2011	1.45	1,465,500	4.15
August 17, 2012	1.95	1,511,000	4.88
Options outstanding		4,416,500	3.86

Options Exercisable, December 31, 2007

<u>Expiry Date</u>	<u>Exercise Price (Cdn\$)</u>	<u>Shares Under Option</u>	<u>Weighted Average Remaining Contractual Life (in years)</u>
August 19, 2009	0.40	350,000	1.88
April 15, 2010	0.42	1,090,000	2.54
November 23, 2011	1.45	1,465,500	4.15
August 17, 2012	1.95	1,466,000	4.88
Options exercisable		4,349,000	3.86

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7. Share Capital (continued)

(d) Options (continued)

A summary of the status of the Company's non-vested stock options as of September 30, 2008, and changes during the previous fiscal year ended September 30, 2007, is presented below:

	<u>Stock Options</u>	<u>Weighted Average Grant Date Fair Value (Cdn\$)</u>
Granted	90,000	1.74
Vested	(45,000)	1.74
Non-vested at December 31, 2007	45,000	1.74
Granted	-	-
Vested	(45,000)	1.74
Non-vested at December 31, 2008	-	-

As at December 31, 2008 all stock options are vested.

8. Related Party Transactions

Except as disclosed elsewhere in these consolidated financial statements, the Company had the following related party transactions:

(a) Transactions with a director and companies controlled by that director

The Company has entered into various agreements with a director and companies controlled by that director, regarding the Birch Lake properties, and consulting and administration services. This director holds certain mining claims and leases in respect of the Birch Lake properties in trust for the Company (Note 6(a)).

Transactions between the Company and the director and companies controlled by that director were as follows:

- (i) Consulting fees charged during the quarter totalled \$Nil (2007 - \$8,914). These fees have been included in deferred acquisition and exploration costs.
- (ii) Land costs reimbursed in respect of Birch Lake totalled \$15,549 (2007 - \$206,991).
- (iii) Administrative costs reimbursed totalled \$Nil (2007 - \$7,722).

Of the above amounts, a total of \$15,549 (2007 - \$Nil) is included in accounts payable at December 31, 2008.

(b) Other transactions

- (i) Legal fees paid to a director's law firm totalled \$17,575 during the three months ended December 31, 2008 (2007 - \$11,864). These fees are included in general administration costs.
- (ii) Consulting fees paid to an officer totalled \$16,950 during the year (2007 - \$16,950).
- (iii) Monetary contribution of \$20,000 to a non-profit mining industry association, which shares a common director (2007 - \$20,000).
- (iv) Consulting fees paid to the Company's president totalled \$37,500 during the quarter (2007 - \$37,500). These costs have been included in general administration.

These transactions are in the normal course of operations and have been recorded at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

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9. Commitments

(a) Consulting contracts

The Company has entered into one-year consulting contracts, automatically renewable annually, with four (2007 - five) consultants who are also shareholders or directors of the Company. Each of these agreements provide for a consulting fee of \$450 per day and reimbursement of expenses. If these agreements were to be terminated by the Company without cause the consultants would receive severance pay from the Company in amounts ranging from \$50,000 to \$100,000 to a maximum of \$350,000 (2007 - \$400,000) in total. In addition, the Company would indemnify the consultants for any options held by them that were not exercised within 30 days of termination by payment to the consultants of the amount equal to the difference between the exercise price of the options and the average closing price of the common shares on the relevant stock exchange or trading platform during the previous 30 days.

(b) Other

In the ordinary course of business, the Company enters into contracts that contain indemnification provisions, such as loan agreements, purchase contracts, service agreements, licensing agreements, asset purchase and sale agreements, operating agreements, leasing agreements and asset use agreements. In such contracts, the Company may indemnify counterparties to the contracts if certain events occur. These indemnification provisions vary on an agreement-by-agreement basis. In some cases, there are no pre-determined amounts or limits included in the indemnification provisions and the occurrence of contingent events that will trigger payment under them is difficult to predict. Therefore, the maximum potential future amount that the Company could be required to pay cannot be estimated.

10. Subsequent Events

The Company applied to the state of Minnesota for an advance of funds in accordance with an agreement whereby the state will provide funding of up to \$2,500,000 toward expenditures on the Birch Lake property. In order to receive the full amount (consisting of a \$2,000,000 loan and a \$500,000 grant) the Company was required to incur \$10,000,000 in total expenditures on the project. This expenditure level has been reached, and in January 2009, the Company received both the \$2,000,000 proceeds from the loan, and the \$500,000 grant. The agreement provides for interest to be charged on the outstanding balance at the U.S. prime rate until the earlier of close of financing for any commercial mining operation and December 31, 2011. It also provides for the issue of one warrant to purchase one share of the Company for each dollar advanced and the warrants were issued in January 2009. The loan is to be secured by a blanket security on the Birch Lake property and other guarantees.

11. Capital Disclosures

Capital management

The Company manages its capital structure and makes adjustments to it, based on the funds available to the Company, in order to support the acquisition, exploration and development of mineral property interests. The Board of Directors does not establish quantitative return on capital criteria for management, but rather relies on the expertise of the Company's management to sustain future development of the business.

The mineral properties in which the Company currently has an interest are in the exploration stage; as such the Company is dependent on external financing to fund its activities. In order to carry out the planned exploration and pay for administrative costs, the Company will spend its existing working capital and raise additional amounts as needed. The Company will continue to assess new mineral properties and seek to acquire an interest in additional mineral properties if it feels there is sufficient geologic or economic potential and if it has adequate financial resources to do so.

Management reviews its capital management approach on an ongoing basis and believes that this approach, given the relative size of the Company, is reasonable.

There were no changes in the Company's approach to capital management during the quarter ended December 31, 2008. Neither the Company nor its subsidiary is subject to externally imposed capital requirements.

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12. Financial Risk Factors

The Company's risk exposures and the impact on the Company's financial instruments are summarized below:

(a) Credit risk

The Company's credit risk is primarily attributable to its holdings of cash and cash equivalents. The Company manages credit risk, by placing its cash with major financial institutions in conservative cash-based liquid investments.

The maximum exposure to credit risk is represented by the carrying amount of each financial asset in the balance sheet. The Company monitors its exposure to credit risk on an ongoing basis. Concentration of credit risk exists with respect to the Company's cash and cash equivalents.

Money fund accounts are fully repayable on demand and have average effective yield rates of approximately 1%.

(b) Liquidity risk

The Company's approach to managing liquidity risk is to maintain sufficient cash and cash equivalents in order to meet short-term business requirements.

(c) Market risk

(i) Interest rate risk

The Company's cash and cash equivalents primarily includes highly liquid investments that earn interest at variable interest rates. Because of the short-term nature of these financial instruments, fluctuations in market rates do not have a significant impact on estimated fair values as of December 31, 2008. Future cash flows from interest income on cash and cash equivalents will be affected by interest rate fluctuations. The Company manages interest rate risk by maintaining an investment policy for short-term investments. This policy focuses primarily on preservation of capital and liquidity.

(ii) Foreign currency risk

The Company's functional currency is the United States dollar. The Company is affected by currency transaction risk and currency translation risk. Consequently, fluctuations of the United States dollar in relation to other currencies impact the fair value of financial assets and liabilities and operating results.

Certain short-term financial liabilities are denominated in Canadian dollars. To reduce exposure to currency transaction risk, the Company maintains cash and cash equivalents in this currency to meet short-term liquidity requirements. Financial assets and liabilities subject to currency translation risk primarily include non-United States dollar cash and accounts payable.

13. Contingent Liability – Pending Litigation

The Company is the subject of a lawsuit regarding the right of a former consultant to exercise stock options, which were awarded under a number of stock option agreements. The Company has asserted that the consultant resigned his consultancy in March 2007 and that his stock option rights then forfeited. The consultant has denied that he resigned and claims that he is entitled to exercise his stock options. The Company's management, in consultation with legal counsel attending to the matter, believes the action is completely without merit, and is vigorously defending against it.