

**POLYMET MINING CORP.**  
**(a development stage company)**

**CONSOLIDATED FINANCIAL STATEMENTS**

**31 January 2011, 2010 and 2009**

**U.S. Funds**



# POLYMET MINING CORP.

## Management Report

### ***Management's Responsibility for Consolidated Financial Statements***

The accompanying Consolidated Financial Statements of PolyMet Mining Corp. (the "Company") are the responsibility of management. The Consolidated Financial Statements have been prepared by management in accordance with Canadian generally accepted accounting principles ("GAAP") and include certain estimates that reflect management's best judgments.

The Company's Board of Directors has approved the information contained in the Consolidated Financial Statements. The Board of Directors fulfills its responsibilities regarding the Consolidated Financial Statements mainly through its Audit Committee, which has a written mandate that complies with current requirements of Canadian securities legislation and the United States Sarbanes-Oxley Act of 2002. The Audit Committee meets at least on a quarterly basis.

### ***Management's Annual Report on Internal Control over Financial Reporting***

Management is also responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Consolidated Financial Statements for external reporting purposes in accordance with GAAP.

Internal control over financial reporting, no matter how well designed, has inherent limitations. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management has assessed the effectiveness of the Company's internal control over financial reporting as at 31 January 2011. In making its assessment, management has used the criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") to evaluate the Company's internal control over financial reporting.

Management identified a material weakness in its internal control over financial reporting relating to timely preparation of financial statements and key schedules for internal review. The underlying cause of the material weakness was the implementation of a new accounting and financial reporting system during the third fiscal quarter. Termination of an outsource accounting service provider and use of non-accounting personnel to undertake accounting duties exacerbated the problems of timeliness. Prior to filing its financial statements for the year ended 31 January 2011, management had taken steps to address this weakness and plans further changes to its internal controls in the light of continued problems in the year-end reporting. Based on this assessment, management has concluded that the Company did not maintain, in all material respects, effective internal control over financial reporting as at January 31, 2011.

The effectiveness of the Company's internal control over financial reporting as at 31 January 2011 has been audited by PricewaterhouseCoopers LLP, our independent auditors, as stated in their report which appears herein.

*"Joseph Scipioni"* (signed)

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Joseph Scipioni  
President and Chief Executive Officer

*"Douglas Newby"* (signed)

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Douglas Newby  
Chief Financial Officer

## **Independent Auditor's Report**

### **To the Shareholders of PolyMet Mining Corp.**

We have completed integrated audits of PolyMet Mining Corp.'s 2011, 2010 and 2009 consolidated financial statements and an audit of the effectiveness of the Company's internal control over financial reporting as at January 31, 2011. Our opinions, based on our audits, are presented below.

### **Report on the consolidated financial statements**

We have audited the accompanying consolidated financial statements of PolyMet Mining Corp., which comprise the consolidated balance sheets as at January 31, 2011 and January 31, 2010 and the consolidated statements of loss, other comprehensive loss and deficit, changes in shareholders' equity, and cash flows for each of the three years in the period ended January 31, 2011, and the related notes including a summary of significant accounting policies.

### **Management's responsibility for the consolidated financial statements**

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditor's responsibility**

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards and the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform an audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement. Canadian generally accepted auditing standards require that we comply with ethical requirements.

An audit involves performing procedures to obtain audit evidence, on a test basis, about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the company's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness of accounting principles and policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion on the consolidated financial statements.

### **Opinion**

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of PolyMet Mining Corp. as at January 31, 2011 and January 31, 2010 and the results of its operations and cash flows for each of the three years in the period ended January 31, 2011 in accordance with Canadian accepted accounting principles

**Emphasis of matter**

Without qualifying our opinion, we draw your attention to Note 1 in the consolidated financial statements which discloses conditions that indicate the existence of a material uncertainty that may cast significant doubt about the Company's ability to continue as a going concern.

**Report on internal control over financial reporting**

We have also audited PolyMet Mining Corp.'s internal control over financial reporting as at January 31, 2011, based on criteria established in Internal Control - Integrated Framework, issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

**Management's responsibility for internal control over financial reporting**

Management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in Management's Annual Report on Internal Control over Financial Reporting.

**Auditor's responsibility**

Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit. We conducted our audit of internal control over financial reporting in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects.

An audit of internal control over financial reporting includes obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control, based on the assessed risk, and performing such other procedures as we consider necessary in the circumstances.

We believe that our audit provides a reasonable basis for our audit opinion on the Company's internal control over financial reporting.

**Definition of internal control over financial reporting**

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the Company's annual consolidated financial statements will not be prevented or detected on a timely basis. It was determined that the Company did not maintain effective internal control over financial reporting as at January 31, 2011, because of a material weakness identified in the timely reporting and review of financial information. This material weakness is described in the accompanying Management's Annual Report on Internal Control over Financial Reporting. We considered this material weakness in determining the nature, timing and extent of audit tests applied in our audit of the January 31, 2011 consolidated financial statements, and our opinion regarding the effectiveness of the Company's internal control over financial reporting does not affect our opinion on those consolidated financial statements.

**Inherent limitations**

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

**Opinion**

In our opinion, PolyMet Mining Corp. did not maintain, in all material respects, effective internal control over financial reporting as at January 31, 2011 based on criteria established in Internal Control - Integrated Framework, issued by COSO.

**Chartered Accountants**

May 6, 2011

Vancouver, British Columbia, Canada

**PolyMet Mining Corp.**

(a development stage company)

**Consolidated Balance Sheets**

**As at January 31**

All figures in Thousands of U.S. Dollars

<b>ASSETS</b>	<b>2011</b>	<b>2010</b>
<b>Current</b>		
Cash and equivalents	\$ 10,361	\$ 21,282
Accounts receivable and advances	318	88
Investment (Note 13)	66	140
Prepaid expenses	636	512
	<b>11,381</b>	<b>22,022</b>
<b>Asset Held for Sale (Notes 4 and 14d)</b>	<b>3,420</b>	<b>-</b>
<b>Deferred Financing Costs (Note 14c)</b>	<b>-</b>	<b>1,794</b>
<b>Mineral Property, Plant and Equipment (Notes 3 and 4)</b>	<b>130,231</b>	<b>115,832</b>
	<b>\$ 145,032</b>	<b>\$ 139,648</b>
<b>LIABILITIES</b>		
<b>Current</b>		
Accounts payable and accrued liabilities	\$ 2,444	\$ 2,953
Current portion of long term debt (Note 5)	6,750	2,000
Current portion of asset retirement obligation (Note 6)	1,408	756
	<b>10,602</b>	<b>5,709</b>
<b>Long term</b>		
Long term debt (Note 5)	1,775	8,529
Convertible debt (Note 7)	27,633	25,253
Asset retirement obligation (Note 6)	2,404	2,590
<b>Total Liabilities</b>	<b>42,414</b>	<b>42,081</b>
<b>SHAREHOLDERS' EQUITY</b>		
<b>Share Capital - (Note 8)</b>	<b>142,373</b>	<b>132,066</b>
<b>Contributed Surplus - (Note 8d)</b>	<b>39,083</b>	<b>36,979</b>
<b>Accumulated Other Comprehensive Income (Loss)</b>	<b>(6)</b>	<b>71</b>
<b>Deficit</b>	<b>(78,832)</b>	<b>(71,549)</b>
	<b>102,618</b>	<b>97,567</b>
<b>Total Liabilities and Shareholders' Equity</b>	<b>\$ 145,032</b>	<b>\$ 139,648</b>

Nature of Business and Going Concern (Note 1)

Contingent Liabilities and Commitments (Notes 4, 6, 8 and 14)

Subsequent Event (Note 14f)

ON BEHALF OF THE BOARD:

\_\_\_\_\_  
"William Murray", Director

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"David Dreisinger", Director

- See Accompanying Notes -

**PolyMet Mining Corp.****(a development stage company)****Consolidated Statements of Loss, Other Comprehensive Loss and Deficit****For the Years Ended 31 January***All figures in Thousands of U.S. Dollars, except per share amounts*

	2011	2010	2009
<b>General and Administrative</b>			
Amortization	\$ 31	\$ 31	\$ 31
Asset retirement obligation accretion	383	408	443
Consulting fees	36	63	45
Exploration	193	-	-
Financing costs write-off (Note 14c))	1,830	-	-
Investor relations and financing	118	420	169
Office and corporate wages	1,198	1,387	1,247
Professional fees	365	371	512
Shareholders' information	330	248	311
Stock-based compensation (Notes 8b) and c))	(119)	915	487
Transfer agent and filing fees	99	63	158
Travel	267	332	424
Warrant amendment (Notes 2b), 7 and 8e))	-	4,920	544
	<u>4,731</u>	<u>9,158</u>	<u>4,371</u>
<b>Other Expenses (Income)</b>			
Interest income, net	19	(5)	(154)
Loss (gain) on foreign exchange	(46)	24	156
Loss on asset held for sale (Note 4)	520	-	-
Loss on refinancing of convertible debt (Note 7)	3,647	-	-
Investment loss (Note 13)	-	-	1,365
Rental income	(198)	(154)	(215)
	<u>3,942</u>	<u>(135)</u>	<u>1,152</u>
<b>Loss for the Year before tax</b>	<u>8,673</u>	<u>9,023</u>	<u>5,523</u>
Future income tax recovery (Notes 8e) and 14c))	(1,390)	-	-
<b>Loss for the Year</b>	<u>7,283</u>	<u>9,023</u>	<u>5,523</u>
<b>Other Comprehensive Income</b>			
Unrealized gain (loss) on investment	(77)	71	-
<b>Comprehensive Income (Loss)</b>	<u>7,360</u>	<u>8,952</u>	<u>5,523</u>
<b>Loss for the Year</b>	<u>7,283</u>	<u>9,023</u>	<u>5,523</u>
<b>Deficit Beginning of the Year</b>	<u>71,549</u>	<u>62,526</u>	<u>57,003</u>
<b>Deficit End of Year</b>	<u>78,832</u>	<u>71,549</u>	<u>62,526</u>
<b>Basic and Diluted Loss per Share</b>	<u>\$ (0.05)</u>	<u>\$ (0.06)</u>	<u>\$ (0.04)</u>
<b>Weighted Average Number of Shares</b>	<u>149,444,955</u>	<u>139,456,827</u>	<u>137,187,927</u>

- See Accompanying Notes -

**PolyMet Mining Corp.**  
**(a development stage company)**

**Consolidated Statements of Changes in Shareholders' Equity**

All figures in Thousands of U.S. Dollars, except for Shares

Common Shares (Note 8)

	Authorized Shares	Issued Shares	Amount	Contributed Surplus	Other Comprehensive Income	Deficit	Total
Balance – 31 January 2008	Unlimited	136,991,075	\$ 104,615	\$ 20,825	\$ -	\$ (57,003)	\$ 68,437
Loss for the year	-	-	-	-	-	(5,523)	(5,523)
Shares and warrants issued:							
Exercise of options	-	312,800	452	-	-	-	452
Fair value of stock options exercised	-	-	245	(245)	-	-	-
Convertible debt – conversion factor and warrants (Note 7)	-	-	-	691	-	-	691
Accrual of Milestones 2 and 4 Bonus Shares (Note 14)	-	-	-	3,912	-	-	3,912
Amendment to previously issued warrants (Note 8e))	-	-	-	544	-	-	544
Stock-based compensation	-	-	-	1,822	-	-	1,822
Balance – 31 January 2009	Unlimited	137,303,875	\$ 105,312	\$ 27,549	\$ -	\$ (62,526)	\$ 70,335
Loss for the year	-	-	-	-	-	(9,023)	(9,023)
Other comprehensive income for the period	-	-	-	-	71	-	71
Shares and warrants issued:							
Equity offering and issuance costs	-	9,433,962	24,501	-	-	-	24,501
Exercise of options	-	775,000	477	-	-	-	477
Fair value of stock options exercised	-	-	307	(307)	-	-	-
Exercise of warrants	-	167,954	494	-	-	-	494
Fair value of warrants exercised	-	-	254	(254)	-	-	-
Convertible debt – conversion factor and warrants (Note 7)	-	-	-	352	-	-	352
Accrual of Milestones 2 and 4 Bonus Shares (Note 14)	-	-	-	4,200	-	-	4,200
Amendment to previously issued warrants (Notes 7 and 8e))	-	-	-	4,920	-	-	4,920
Issuance of Milestone 2 Bonus Shares (Note 14)	-	1,300,000	721	(721)	-	-	-
Stock-based compensation (Note 8c))	-	-	-	1,240	-	-	1,240
Balance – 31 January 2010	Unlimited	148,980,791	\$ 132,066	\$ 36,979	\$ 71	\$ (71,549)	\$ 97,567
Loss for the year	-	-	-	-	-	(7,283)	(7,283)
Other comprehensive loss for the period	-	-	-	-	(77)	-	(77)
Shares and warrants issued:							
Equity offering and issuance costs	-	5,000,000	9,019	875	-	-	9,894
Exercise of options	-	845,000	808	-	-	-	808
Fair value of stock options exercised	-	-	480	(480)	-	-	-
Refinancing of convertible debt (Note 7)	-	-	-	3,125	-	-	3,125
Milestone 4 Bonus Share cost amortization (Note 14)	-	-	-	(89)	-	-	(89)
Future income tax charge (Notes 8e) and 14c))	-	-	-	(1,390)	-	-	(1,390)
Stock-based compensation (Note 8c))	-	-	-	63	-	-	63
Balance – 31 January 2011	Unlimited	154,825,791	\$ 142,373	\$ 39,083	\$ (6)	\$ (78,832)	\$ 102,618

- See Accompanying Notes -

**PolyMet Mining Corp.**

(a development stage company)

**Consolidated Statements of Cash Flows**

For the Years Ended 31 January

All figures in Thousands of U.S. Dollars

	2011	2010	2009
<b>Operating Activities</b>			
<b>Loss for the year</b>	\$ (7,283)	\$ (9,023)	(5,523)
<b>Items not involving cash</b>			
Amortization	31	31	31
Asset retirement obligation accretion	383	408	443
Financing costs write-off	1,830	-	-
Future income tax recovery (Notes 8e) and 14c)	(1,390)	-	-
Investment loss (Note 13)	-	-	1,365
Loss on asset held for sale (Note 4)	520	-	-
Loss on refinancing of convertible debt (Note 7)	3,647	-	-
Stock-based compensation	(119)	915	487
Warrant amendment (Notes 7 and 8e))	-	4,920	544
<b>Changes in non-cash working capital items</b>			
Accounts receivable and advances	(230)	(19)	99
Prepaid expenses	(124)	(42)	323
Accounts payable and accrued liabilities	(333)	381	(1,059)
<b>Net cash used in operating activities</b>	<b>(3,068)</b>	<b>(2,429)</b>	<b>(3,290)</b>
<b>Financing Activities</b>			
Share capital - for cash	10,702	25,472	452
Long-term debt repayment	(2,000)	(1,250)	(1,400)
Convertible debt	-	9,944	14,333
Deferred financing costs	(36)	(55)	(49)
<b>Net cash provided by financing activities</b>	<b>8,666</b>	<b>34,111</b>	<b>13,336</b>
<b>Investing Activities</b>			
Purchase of mineral property, plant and equipment	(16,519)	(17,754)	(22,776)
<b>Net cash used in investing activities</b>	<b>(16,519)</b>	<b>(17,754)</b>	<b>(22,776)</b>
<b>Net Increase (Decrease) in Cash and Cash Equivalents Position</b>	<b>(10,921)</b>	<b>13,928</b>	<b>(12,730)</b>
<b>Cash and Cash Equivalents Position - Beginning of Year</b>	<b>21,282</b>	<b>7,354</b>	<b>20,084</b>
<b>Cash and Cash Equivalents Position - End of Year</b>	<b>\$ 10,361</b>	<b>\$ 21,282</b>	<b>7,354</b>

- See Accompanying Notes -

**PolyMet Mining Corp.**

**(a development stage company)**

## **Notes to Consolidated Financial Statements**

**For the years ended 31 January 2011, 2010 and 2009**

*Tabular amounts in Thousands of U.S. Dollars except for price per share, shares and options*

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### **1. Nature of Business and Going Concern**

PolyMet Mining Corp. (the "Company") was incorporated in British Columbia, Canada on 4 March 1981 under the name Fleck Resources Ltd. The Company changed its name from Fleck Resources to PolyMet Mining Corp. on 10 June 1998. The Company is engaged in the exploration and development, when warranted, of natural resource properties. The Company's primary mineral property is the NorthMet Project, a polymetallic project in northeastern Minnesota, USA. The realization of the Company's investment in the NorthMet Project and other assets is dependent upon various factors, including the existence of economically recoverable mineral reserves, the ability to obtain the necessary financing to complete the exploration and development of the NorthMet Project, future profitable operations, or alternatively upon disposal of the investment on an advantageous basis.

On 25 September 2006, the Company received the results of a Definitive Feasibility Study ("DFS") prepared by Bateman Engineering (Pty) Ltd. ("Bateman") that confirms the economic and technical viability of the NorthMet Project (the "Project") and, as such, the Project has moved from the exploration stage to the development stage.

#### **Going Concern**

While these consolidated financial statements have been prepared on the basis that PolyMet Mining Corp. will continue as a going concern, which assumes that the Company will be able to meet its commitments, continue operations, realize its assets and discharge its liabilities in the normal course of business for the foreseeable future, there are conditions that cast significant doubt on the validity of that assumption. The Company has incurred losses since inception and has an accumulated deficit of \$78,832,000 at January 31, 2011.

PolyMet Mining Corp. will need to raise sufficient funds to meet its current obligations as well as fund ongoing development, capital expenditures and administration expenses, in accordance with the Company's spending plans for the next year. While in the past the Company has been successful in closing financing agreements with Glencore, there can be no assurance it will be able to do so again in the future.

On 12 November 2010, PolyMet Mining Corp. announced that it had entered into a definitive agreement with Glencore AG ("Glencore") to sell in a private placement 15 million common shares at US\$2.00 per share for gross proceeds of US\$30 million, before deducting estimated offering expenses. Completion of the sale of these shares and funding are expected to occur in three tranches subject, in each case, to certain closing conditions (Note 7).

In order to meet all of its obligations for the period to 31 January 2012, including paying off the current portion of its long-term debt, PolyMet Mining Corp. will have to successfully receive all of the remaining equity tranches, or obtain alternate financing. Management is in the latter stage of discussions with Glencore with respect to the budget and believes that agreement will be reached by 30 June 2011, which will enable the Company to access the second and third \$10 million tranches of the equity funding in a timely manner that will enable it to meet its obligations. However, this cannot be assured.

**PolyMet Mining Corp.**

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## **Notes to Consolidated Financial Statements**

**For the years ended 31 January 2011, 2010 and 2009**

*Tabular amounts in Thousands of U.S. Dollars except for price per share, shares and options*

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### **1. Nature of Business and Going Concern - Continued**

Management believes that, based upon the underlying value of the NorthMet Project, it will be able to obtain the necessary financing from Glencore or other sources to meet PolyMet Mining Corp.'s requirements on an ongoing basis; however, there can be no assurance that the necessary financing will be obtained. Factors that could affect the availability of financing include the state of international debt and equity markets, investor perceptions and expectations and the global metals markets.

These financial statements do not reflect any adjustments to the carrying values of assets and liabilities, reported expenses, and balance sheet classifications that would be necessary should the Company be unable to continue as a going concern, and these adjustments could be material.

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**PolyMet Mining Corp.**

(a development stage company)

**Notes to Consolidated Financial Statements**

**For the years ended 31 January 2011, 2010 and 2009**

*Tabular amounts in Thousands of U.S. Dollars except for price per share, shares and options*

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**2. Significant Accounting Policies and Restatements**

**(a) Significant Accounting Policies**

The consolidated financial statements of PolyMet Mining Corp. have been prepared in accordance with accounting principles generally accepted in Canada that require management to make assumptions and estimates that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities as at the date of the financial statements.

Significant estimates used in the preparation of these consolidated financial statements include, amongst other things, expected economic lives of plant and equipment, anticipated costs of asset retirement obligations including the reclamation of mine site, valuation of options, convertible debt and share purchase warrants, and the assessment of impairment in value of long lived assets. Actual results could differ from these estimates. Significant differences from United States generally accepted accounting principles are disclosed in Note 16.

**Basis of consolidation**

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, Poly Met Mining, Inc. Inter-company balances and transactions have been eliminated on consolidation.

**Cash and Cash Equivalents**

The Company considers cash and cash equivalents to include amounts held in banks and highly liquid debt investments with remaining maturities at point of purchase of three months or less.

**Mineral Property, Plant and Equipment**

Mineral property

Mineral property costs, aside from mineral property acquisition costs, incurred prior to determination of the DFS are expensed as incurred and expenditures incurred subsequent to the DFS and mineral property acquisition costs are deferred or capitalized until the property is placed into production, sold, allowed to lapse or abandoned. Acquisition costs include cash, debt and fair market value of common shares.

Upon commencement of production, mineral properties and acquisition costs relating to mines are amortized over the estimated life of the proven and probable mineral reserves to which they relate, calculated on a unit of production basis.

As a result of the DFS on the NorthMet Project, the Project entered the development stage effective 1 October 2006. The Company has deferred mineral property development expenditures related to the NorthMet Project from that date.

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

**PolyMet Mining Corp.**

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**Notes to Consolidated Financial Statements**

**For the years ended 31 January 2011, 2010 and 2009**

*Tabular amounts in Thousands of U.S. Dollars except for price per share, shares and options*

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**2. Significant Accounting Policies and Restatements - Continued**

**(a) Significant Accounting Policies**

Plant and equipment

Plant and equipment are recorded at cost and depreciated over the estimated life of the related assets calculated on a unit of production or straight-line basis, as appropriate.

Depreciation of plant and equipment is provided on a straight-line basis over the estimated economic life of the assets as follows:

Leasehold improvements – Straight-line over the term of the lease

Furniture and equipment – Straight-line over 10 years

Computers – Straight-line over 5 years

Computer software – Straight-line over 1 year

Mineral property, plant and equipment related to the NorthMet Project will begin to be amortized at the time the project commences operations.

**Assets Held for Sale**

Long-Lived assets are classified as held for sale in the period in which certain criteria are met. Assets held for sale are measured at the lower of carrying amount or fair value less cost to sell and are not depreciated as long as they remain classified as held for sale.

**Loss Per Share**

Loss per share is computed by dividing the loss for the year by the weighted average number of common shares outstanding during the year. Basic and diluted losses per share are the same for the periods reported, as the effect of potential issuances of shares under warrant or share option agreements would be anti-dilutive.

**Foreign Currency Translation**

The United States (“U.S.”) dollar is the functional currency of the Company’s business. Accordingly, amounts in these consolidated financial statements are expressed in U.S. dollars unless otherwise stated. The Company’s non-U.S. operations are considered to be integrated with the U.S. operations and have been translated into U.S. dollars using the temporal method. Under this method, monetary assets and liabilities are translated at the rate of exchange in effect at the balance sheet dates and non-monetary assets and liabilities are translated at the exchange rate in effect at the times of the transactions. Revenue and expense items are translated at rates approximating the exchange rate in effect at the time of the transactions, except for amortization which is translated at historical rates. Translation gains and losses are reflected in the consolidated statement of loss in the year incurred.

**PolyMet Mining Corp.**

(a development stage company)

## **Notes to Consolidated Financial Statements**

**For the years ended 31 January 2011, 2010 and 2009**

*Tabular amounts in Thousands of U.S. Dollars except for price per share, shares and options*

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### **2. Significant Accounting Policies and Restatements - *Continued***

#### **(a) Significant Accounting Policies - *Continued***

##### **Stock-Based Compensation and Share Purchase Warrants**

All stock-based awards made to directors, employees and non-employees are measured and recognized using a fair value based method. For directors and employees, the fair value of the options is measured at the date of the grant. For non-employees, the fair value of the options is measured on the earlier of the date at which the counterparty performance is complete or the date the performance commitment is reached or the date at which the equity instruments are granted if they are fully vested and non-forfeitable. For directors, employees and non-employees, the fair value of the options is accrued and charged either to operations or mineral property plant and equipment, with the offsetting credit to contributed surplus, on a graded method over the vesting period. If and when the stock options are ultimately exercised, the applicable amounts of contributed surplus are transferred to share capital.

The Company issues share purchase warrants in connection with certain equity transactions. The fair value of the warrants, as determined using the Black-Scholes option pricing model, is credited to contributed surplus. The recorded value of share purchase warrants is transferred to share capital upon exercise.

When the Company amends the terms of either stock options or share purchase warrants, the incremental change in the fair value of the options or warrants due to the amendment is booked to warrant amendment expense and contributed surplus.

##### **Asset Retirement Obligations**

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

The operations of the Company may in the future be affected from time to time in varying degrees by changes in environmental regulations, including those for future removal and site restoration costs.

Both the likelihood of new regulations and their overall effect upon the Company may vary greatly and are not predictable.

**PolyMet Mining Corp.**

(a development stage company)

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### **2. Significant Accounting Policies and Restatements - *Continued***

#### **(a) Significant Accounting Policies - *Continued***

##### **Impairment of Long-Lived Assets**

The Company performs impairment tests on its mineral property, plant and equipment when events or changes in circumstances indicate that the carrying values of assets may not be recoverable. These tests require the comparison of the undiscounted future cash flows to be derived from these assets with the carrying value of the assets. If a shortfall exists, the assets are written down to fair value, determined primarily using discounted cash flow models.

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### **3. Resource Property Agreements**

#### **NorthMet, Minnesota, U.S.A. - Lease**

Pursuant to an agreement dated 4 January 1989, subsequently amended and assigned, the Company leases certain lands in St. Louis County, Minnesota from RGGGS Land & Minerals Ltd., L.P. The original term of the renewable lease was 20 years and called for total lease payments of \$1,475,000. The Company has renewed the lease by making annual payments of \$150,000 on or before each anniversary through January 2011.

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

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

Pursuant to the leases, PolyMet holds mineral rights and the right to mine. PolyMet intends to acquire surface rights through a land exchange with the United States Forest Service, which costs have been included in the capital cost estimate of the Project.

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**4. Mineral Property, Plant and Equipment**

Details are as follows:

	<b>31 January 2011 Net Book Value</b>	31 January 2010 Net Book Value
<b>31 January 2011</b>		
Mineral Property Acquisition and Interest Costs	<b>\$40,794</b>	\$38,613
Mine Plan and Development	<b>29,305</b>	25,470
Environmental	<b>25,994</b>	19,537
Consulting and Wages	<b>21,756</b>	18,788
Operations	<b>9,362</b>	7,641
Mine Equipment	<b>949</b>	3,790
Asset Retirement Obligation	<b>1,865</b>	1,781
NorthMet Project	<b>130,025</b>	115,620
Leasehold improvements	<b>7</b>	17
Computers	<b>163</b>	142
Furniture and equipment	<b>36</b>	53
	<b>130,231</b>	\$115,832

**Erie Plant, Minnesota, U.S.A.**

On 15 November 2005, the Company exercised an option to acquire 100% ownership of large portions of the former LTV Steel Mining Company ore processing plant in north eastern Minnesota under the Asset Purchase Agreement with Cliffs Natural Resources Inc. (NYSE:CLF) ("Cliffs").

The consideration for the purchase was \$1 million in cash, \$2.4 million in notes payable and the issuance of 6,200,547 common shares (at fair market value of \$7,564,000) in the capital stock of the Company. The final instalment of the notes payable was paid on 30 June 2008 (Note 5).

On 20 December 2006, the Company closed a transaction (the "Asset Purchase Agreement II") in which it acquired, from Cliffs, property and associated rights sufficient to provide it with a railroad connection linking the mine development site and the Erie Plant. The transaction also included a 120-railcar fleet, locomotive fuelling and maintenance facilities, water rights and pipelines, large administrative offices on site and an additional 6,000 acres to the east and west of and contiguous to its existing tailing facilities.

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**4. Mineral Property, Plant and Equipment - Continued**

The purchase price totalling 2 million shares and \$15 million in cash and debt was in four tranches:

- 2 million shares of PolyMet, paid at closing;
- \$1 million in cash, paid at closing;
- \$7 million in cash, payable in quarterly instalments of \$250,000 commencing 31 December 2006 with the balance payable upon receipt of production financing. Interest is payable quarterly starting 31 December 2006 at the *Wall Street Journal* Prime Rate, and
- \$7 million in cash, payable in quarterly instalments of \$250,000 commencing on 31 December 2009 with a balloon payment of any unpaid balance due on 31 December 2011. No interest was payable until 31 December 2009 after which it is payable quarterly at the *Wall Street Journal* Prime Rate, accordingly the debt was fair valued, for balance sheet purposes, by discounting it at 8.25%.

The Company has assumed certain ongoing site-related environmental and reclamation obligations as a result of the above purchases. These environmental and reclamation obligations are presently contracted under the terms of the purchase agreements with Cliffs. Once the Company obtains its permit to mine and Cliffs is released from its obligations by the State agencies, the environmental and reclamation obligations will be direct with the governing bodies. The present value of the asset retirement obligation in the amount of \$3,812,000 (Note 6) less accretion of \$1,942,000 charged to deficit has been recorded as an increase in the carrying amount of the NorthMet Project assets and will be amortized over the life of the asset.

Interest and loan accretion on the long-term and convertible debt to 31 January 2011 in the amount of \$6,770,000 (2010 - \$4,608,000) has been capitalized as part of the cost of the NorthMet Project assets.

As the above assets are not in use no amortization of these assets has been recorded to 31 January 2011.

At 31 January 2011 certain equipment with a carrying value of approximately \$3.42 million was reclassified to assets held for sale. In writing this asset down to fair value less cost to sell, the Company recorded a loss of \$520,000.

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**5. Long Term Debt**

Pursuant to the Asset Purchase Agreements (Note 4) the Company's wholly owned subsidiary Poly Met Mining, Inc. ("PolyMet US") signed three notes payable to Cliffs in the amounts of \$2,400,000, \$7,000,000 and \$7,000,000, respectively. The first note was interest bearing at the annual simple rate of four percent (4%) and the final payment was made in June 2008. The second note is interest bearing at the *Wall Street Journal* Prime Rate and is being paid in quarterly instalments equal to \$250,000 with the first payment on 31 December 2006, with the balance repayable upon receipt of commercial financing, for total repayment of \$7,000,000. The third note is interest bearing at the *Wall Street Journal* Prime Rate and is being paid in quarterly instalments equal to \$250,000 commencing on 31 December 2009 for total repayment of \$7,000,000 with final payment due on December 31, 2011. No interest was payable on the third note until 31 December 2009. Accordingly it was fair valued, for balance sheet purposes, by discounting it at 8.25%. If PolyMet were to default on individual elements of the transactions with Cliffs, the assets associated with the default could revert to Cliffs' control. As at 31 January 2011, the outstanding long term debt was as follows:

	<u>31 January 2011</u>		<u>31 January 2010</u>	
Notes Payable	\$	<b>8,500</b>	\$	<b>10,499</b>
Accrued interest		<b>25</b>		<b>30</b>
Total debt		<b>8,525</b>		<b>10,529</b>
Less current portion		<b>(6,750)</b>		<b>(2,000)</b>
Long term debt	\$	<b>1,775</b>	\$	<b>8,529</b>

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**6. Asset Retirement Obligation**

As part of the consideration for the Cliffs Purchase Agreements (Note 4), the Company indemnified Cliffs for the liability for final reclamation and closure of the acquired property.

Federal, state and local laws and regulations concerning environmental protection affect the Company's operations. Under current regulations, the Company is contracted to indemnify Cliffs requirement to meet performance standards to minimize environmental impact from operations and to perform site restoration and other closure activities. The Company's provisions for future site closure and reclamation costs are based on known requirements. It is not currently possible to estimate the impact on operating results, if any, of future legislative or regulatory developments. The Company's estimate of the present value of the obligation to reclaim the NorthMet Project is based upon existing reclamation standards at 31 January 2011 and under Canadian GAAP. Once the Company obtains its permit to mine the environmental and reclamation obligations will be direct with the governing bodies.

The Company's estimate of the fair value of the asset retirement obligation at 31 January 2011 was \$3,812,000 (2010 - \$3,346,000). These were based upon a 31 January 2011 undiscounted future cost of \$24.4 million (2010 - \$21.6 million) for the first Cliffs transaction and \$2.1 million (2010 - \$2.0 million) for Cliffs II, an annual inflation rate of 2.00%, credit-adjusted risk free interest rates of 10.00% to 12.00% and a mine life of 20 years and a reclamation period of 9 years.

In March 2010, Cliffs entered into a consent decree with the Minnesota Pollution Control Agency ("MPCA") relating to alleged violations on the Cliffs Erie Property. This consent decree required submission of Field Study Plan Outlines, which has been approved by the MPCA, and Short Term Mitigation Plans, which have not yet been formally approved. As part of its prior transactions with Cliffs (Note 4), PolyMet has agreed to indemnify Cliffs for certain on-going site environmental liabilities. As such, the Company has included its best estimate of the liabilities related to this consent decree in its asset retirement obligation for the period ended 31 January 2011.

Adjustments in the year to January 31, 2011 were as follows:

	<b>Year ended January 31, 2011</b>
Balance - Beginning of period	3,346
Liabilities incurred in the current period	-
Liabilities discharged in the current period	(457)
Accretion expense, and	383
Revisions in estimated cash flows	540
Balance - End of period	3,812

## PolyMet Mining Corp.

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### Notes to Consolidated Financial Statements

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#### 7. Glencore Financing

Details of Fair Value of Glencore debentures, as amended, were as follows:

	Year ended 31 January 2011	Year ended 31 January 2010
Balance - Beginning of period	25,253	13,943
Issued	-	10,000
Discount	-	(301)
Fair value adjustment on refinancing	522	
Financing costs	-	(56)
Accretion and capitalized interest	1,858	1,667
Balance - End of period	27,633	25,253

On 31 October 2008, the Company entered into a financing with Glencore AG ("Glencore") for an aggregate of US\$50 million floating rate secured debentures due on 30 September 2011 (the "Debentures") to be issued by PolyMet US, and guaranteed by the Company. The Debentures bear interest at 12-month US dollar LIBOR plus 4%. Interest is payable in cash or by increasing the principal amount of the Debentures, at PolyMet's option, for payments on or before 30 September 2009, and at Glencore's option thereafter. At 31 January 2011, \$2,539,000 of interest had been added to the principal amount of the debt since inception. The Debentures are secured by all of the assets of PolyMet and PolyMet US, including a pledge of PolyMet's 100% shareholding in PolyMet US.

The Debentures are exchangeable into common shares of PolyMet at Glencore's option at US\$4.00 per share. The Issuer can, at its option, prepay the Debentures if PolyMet's shares trade at a 20-day volume weighted average price equal to or exceeding US\$6.00, at which time, and at Glencore's option, Glencore could exchange the Debentures for common shares of PolyMet within 30 days in lieu of payment. Repayment between 1 October 2009 and 30 September 2010 would have been at 105% of the then outstanding principal of the Debentures, repayment between 1 October 2010 and 30 September 2011 would be at 102.5% of the outstanding principal.

US\$7.5 million of the Debentures were issued on 31 October 2008, an additional US\$7.5 million of the Debentures were issued on 22 December 2008, \$5 million of the Debentures were issued on 18 June 2009 and an additional US\$5 million of the Debentures were issued on 31 August 2009.

The final US\$25 million of the Debentures, to be used primarily for detailed engineering and procurement, were to be issued upon publication of the Final Environmental Impact Statement in the State of Minnesota's Environmental Quality Board Monitor, receipt by the Company of a bona fide term sheet for construction financing and were subject to expenditures being in material compliance with budget and other customary conditions as well as agreement between Glencore and Cliffs on terms and conditions whereby Cliffs will provide its consent to Glencore as mortgagee of those parts of the Erie Plant acquired by PolyMet under Asset Agreement II.

On 31 October 2008, PolyMet issued to Glencore warrants ("Glencore Warrants") to purchase 6.25 million common shares of PolyMet at US\$5.00 if exercised before the NorthMet Project has produced a total of 20,000 metric tonnes of concentrate, or US\$6.00 thereafter. The Glencore Warrants were to expire on 30 September 2011. If the volume-weighted 20-day average price of PolyMet's common shares traded at a 50% premium to the then applicable exercise price, Glencore would have had to exercise the warrants within 30 days or the warrants would have expired.

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**7. Glencore Financing - continued**

The Company has accounted for the initial US\$7.5 million of the Debentures and the Glencore Warrants by allocating the US\$7.5 million between the debt, the exchangeable feature of the debt and the warrants based on their pro rata fair values. The debt was fair valued using the difference between 9% and 12 month LIBOR at 31 October 2008 (3.2075%) plus 4%. Costs related to the financing of \$652,000 have been recorded against the convertible debt.

The Company accounted for the second, third and fourth advances of US\$7.5 million, US\$5 million and US\$5 million, respectively, of the Debentures by allocating the principal amounts between the debt and the exchangeable feature of the debt based on their pro rata fair values. The debt was fair valued using the difference between 9% and 12 month LIBOR at 31 October 2008 (3.2075%) plus 4%. Costs related to the financings of \$43,000, \$16,000 and \$12,000, respectively, were recorded against the convertible debt.

On 17 November 2009, the Company announced that it agreed to modify certain terms of the above transaction. Under the new terms the Glencore Warrants entitled Glencore to purchase 6.25 million common shares of PolyMet at US\$3.00 at any time on or before 30 September, 2011. If the 20-day volume weighted average price of PolyMet's shares had been 150% of the exercise price or more (\$4.50), and the Final EIS had been published in the Minnesota Department of Natural Resources EQB Monitor, PolyMet could have accelerated the expiration of the Glencore Warrants to not less than 21 business days after the notice of acceleration. The incremental \$158,000 increase in the fair value of the warrants due to the warrant exchange was debited to warrant amendment expense and credited to contributed surplus.

On 17 November 2009, PolyMet agreed to modify the terms of the final \$25 million Tranche E of the \$50 million Debenture with Glencore such that Tranche E, if drawn, could be exchanged at US\$2.65 per share. The first four tranches totalling US\$25 million (excluding capitalized interest) that had already been drawn would continue to be exchangeable at US\$4.00 per share.

On 17 November 2009 PolyMet agreed to to sell 9,433,962 common shares of the Company at US\$2.65 per share for gross proceeds of US\$25 million. Closing and funding occurred in two transactions. On 24 November 2009, the Company closed the first tranche of 3,773,585 common shares at \$2.65 per share for gross proceeds of \$10 million. On 26 January 2010, the Company closed the second tranche of 5,660,377 common shares at \$2.65 per common share for gross proceeds of \$15 million. Transactions costs for these two financings totaled \$499,000.

On 12 November 2010, the Company announced that it had renegotiated its debenture financing from Glencore. The agreed amendments to the debenture financing are as follows:

- The maturity date of the Tranche A-D Debentures has been extended from 30 September, 2011 to 30 September, 2012. The Issued Debentures were issued in four tranches between October 2008 and September 2009. The total initial principal of the Debentures is US\$25 million with US\$2.539 million of accrued interest as of 31 December 2011. The Issued Debentures continue to be exchangeable into common shares of PolyMet at US\$4.00 per share, as agreed to in 2008.
- Cancellation of Glencore's commitment to purchase, and the Company's commitment to issue, US\$25 million of Tranche E Debentures which were to be issued upon publication of the Final Environmental Impact Statement, receipt of a term sheet for construction financing, and other customary conditions.

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**7. Glencore Financing - continued**

- Cancellation of warrants to purchase 6.25 million common shares of PolyMet at US\$3.00 at any time until 30 September 2011 issued to Glencore in connection with the Debentures.
- Issuance of warrants to purchase 3 million common shares of PolyMet at US\$2.00 at any time until 31 December 2015, issued to Glencore in consideration of the amendments listed above.

On 12 November 2010, the Company announced that it had entered into a definitive agreement with Glencore to sell in a private placement 15 million common shares at US\$2.00 per share for gross proceeds of US\$30 million, before deducting estimated offering expenses. Completion of the sale of these shares and funding are expected to occur in the following three tranches subject, in each case, to certain closing conditions:

- Tranche 1 of US\$10 million closed on 17 January 2011;
- Tranche 2 of US\$10 million will close on the earlier of (i) the date of the Company's funding requirement as set forth in the Company's three year operating budget to be approved by Glencore (the "Budget"), and (ii) 17 October 2011, and
- Tranche 3 of US\$10 million will close on the earlier of (i) the date of the Company's funding requirement as set forth in the Budget, ii) within ten business days following receipt by PolyMet of key permits, in a form reasonably acceptable to Glencore, that will enable the start of construction of the Project, and iii) 15 October 2012.

Glencore has a right of first refusal to provide all material financings, subject to regulatory approval, if it owns 10% or more of the issued and outstanding shares of PolyMet and, if it owns more than 5% of the issued and outstanding shares of PolyMet, Glencore has the right to participate in any equity-related financing to maintain its partially diluted ownership interest (19.6% as of 31 January 2011).

In accordance with both Canadian GAAP and US GAAP, the 12 November 2010 transactions, whereby PolyMet's existing convertible debt at that date with a book value of \$26.730 million was deemed to have been extinguished and reissued, all of the costs associated with the transaction have been recorded as a non-cash expense of \$3,647,000, comprising:

- The change in fair value of the conversion feature resulting from its term being extended from 30 September 2011 to 30 September 2012 of \$2.533 million;
  - The difference in fair value between the warrants to purchase 6.25 million common shares at \$3 per share exercisable until 30 September 2011 and the warrants to purchase 3 million common shares at \$2 per share exercisable until 31 December 2015 of \$3.217 million;
  - The amounts of discount and deferred costs remaining to accreted and amortized over the life of the debt of \$522,000, less
  - The premium of \$2.625 million resulting from the price of the common shares to be sold to Glencore compared with the market price at the time of the arrangement.
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**8. Share Capital**

**a) Share Issuances for Cash**

During the year ended 31 January 2011 the Company issued the following shares for cash:

- i) On 17 January 2011, the Company closed an equity financing with Glencore for 5,000,000 common shares at \$2.00 per share for gross proceeds of \$10 million. Transactions costs for the financing were \$106,000 and a premium of \$875,000 was recorded in contributed surplus as a result of the refinancing of Glencore debt (Note 7), and
- ii) 845,000 shares pursuant to the exercise of stock options for total proceeds of \$808,000.

During the year ended 31 January 2010 the Company issued the following shares for cash:

- i) On 24 November 2009, the Company had closed an equity financing with Glencore for 3,773,585 common shares at \$2.65 per share for gross proceeds of \$10 million. On 26 January 2010, the Company closed the second tranche of the previously announced equity financing with Glencore of an additional 5,660,377 common shares at \$2.65 per common share for gross proceeds of \$15 million. Transactions costs for these two financings totaled \$499,000;
- ii) 775,000 shares pursuant to the exercise of stock options for total proceeds of \$477,000, and
- iii) 167,954 shares pursuant to the exercise of share warrants for total proceeds of \$494,000.

During the year ended 31 January 2009 the company issued 312,800 shares pursuant to the exercise of stock options for total proceeds of \$452,000.

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**8. Share Capital - Continued**

**b) Stock Options**

Effective 25 May 2007, the Company adopted a new Omnibus Share Compensation Plan ("Stock Option Plan"), which was approved by the Company's shareholders' on 27 June 2007. The Stock Option Plan covers the Company's employees, directors, officers and consultants. The options are granted for varying terms ranging from two to seven years. The maximum number of common shares under the stock option plan shall not exceed (i) 10% of the outstanding common shares of the Company at the time of granting of the options and (ii) 18,592,888 common shares of the Company, of which 3,640,000 common shares are reserved for issuance as awards other than options (Note 14a)).

Details of stock option activity are as follows:

	<b>31 January 2011 Options</b>	<b>Weighted Average Exercise Price (US\$)</b>	<b>31 January 2010 Options</b>	<b>31 January 2009 Options</b>
Outstanding - Beginning of year	<b>13,075,000</b>	2.07	12,615,000	11,312,800
Granted	<b>300,000</b>	2.17	1,585,000	1,690,000
Forfeited	<b>(900,000)</b>	1.01	(350,000)	(75,000)
Exercised	<b>(845,000)</b>	2.81	(775,000)	(312,800)
Outstanding - End of year	<b>11,630,000</b>	2.20	13,075,000	12,615,000

Note: since the exercise price of some options is denominated in Canadian funds, the weighted average price denominated in US funds changes with changes in the exchange rate.

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**8. Share Capital - Continued**

b) **Stock Options - Continued**

At the Annual and Special Meeting of the shareholders of PolyMet on 24 June 2009, the disinterested shareholders of the Company approved an extension of the expiry date by two years of all stock options outstanding as at 24 June 2009.

As at 31 January 2011, the following director, officer, consultant and employee stock options were outstanding:

Expiry Date	Exercise Price (US\$)	Exercise Price (CDN\$)	Number of options outstanding
5 July 2011	0.66	0.66	800,000
18 October 2011	0.79	0.79	50,000
30 March 2012	0.65	0.65	85,000
1 May 2012	0.85	0.85	350,000
15 June 2012	0.94	0.94	40,000
19 September 2012	1.36	1.36	1,240,000
24 October 2012	1.20	1.20	200,000
5 December 2012	1.15	1.15	200,000
20 March 2013	2.76	2.76	2,400,000
19 June 2013	2.97	2.97	325,000
1 September 2013	3.82	3.82	300,000
22 September 2013	3.51	3.51	75,000
5 January 2014	3.30	3.30	525,000
13 February 2014	2.99	2.99	1,250,000
12 March 2014	2.92	2.92	250,000
23 March 2014	2.89	2.89	50,000
4 September 2014	3.00	3.00	360,000
12 December 2014	3.05	3.05	205,000
11 January 2015	3.03	3.03	70,000
31 January 2015	2.87	2.87	100,000
15 February 2015	2.72	2.72	500,000
2 June 2015	3.92	3.92	100,000
30 July 2015	3.22	3.22	175,000
30 January 2016	0.82	0.82	595,000
17 February 2016	0.82	0.82	910,000
15 October 2016	2.67	2.67	115,000
8 January 2017	3.54	3.54	60,000
25 January 2018	2.17	2.17	300,000
Weighted average exercise price and total number of options outstanding	2.20	2.20	11,630,000

As at 31 January 2011 all options had vested and were exercisable, with the exception of 1,722,500 which vest upon completion of specific targets.

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**8. Share Capital - Continued**

b) **Stock Options - Continued**

Subsequent to year end, on 10 March 2011, the Company granted 750,000 options to certain independent directors with an average exercise price of USD\$2.04 per option. Also subsequent to year end, bonuses comprising 327,500 restricted stock for US employees and consultants and restricted stock units for Canadian employees and consultants were approved by the Board of Directors. 50% of each award to be issued upon receipt of permits and the balance to be issued upon the start of production.

c) **Stock-Based Compensation**

During the year ended 31 January 2011, the Company granted 300,000 options to directors, officers, consultants and employees with an average exercise price of USD\$2.20 per option. The fair value of these options was estimated at the date of grant using the Black-Scholes Option Pricing Model with the following weighted average assumptions:

Risk-free interest rate	1.68%
Expected dividend yield	Nil
Expected stock price volatility	64.79%
Expected option life in years	1.50

The weighted fair value of options granted during the period was US\$0.73. Option pricing models require the input of highly subjective assumptions including the estimate of the share price volatility. Changes in the subjective input assumptions can materially affect the fair value estimate, and therefore, the existing models do not necessarily provide a reliable single measure of the fair value of the Company's stock options.

During the year ended 31 January 2011, the Company recorded \$275,000 for stock based compensation in its accounts as an expense of \$93,000 and a debit to mineral property, plant and equipment of \$182,000, with the offsetting entries going to contributed surplus. During the year ended 31 January 2011, the Company also recorded a debit to contributed surplus and a credit to stock based compensation expense of \$212,000 to reverse prior accounting for stock options which had yet to vest and were forfeited in the period.

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**8. Share Capital - Continued**

c) **Stock Based Compensation - Continued**

During the year ended 31 January 2010, the Company granted 1,585,000 options to directors, officers, consultants and employees with an average exercise price of USD\$1.14 per option. The fair value of these options was estimated at the date of grant using the Black-Scholes Option Pricing Model with the following weighted average assumptions:

Risk-free interest rate	1.30% to 1.69%
Expected dividend yield	Nil
Expected stock price volatility	81.97% to 107.32%
Expected option life in years	2.33

The weighted fair value of options granted during the period was US\$0.56. Option pricing models require the input of highly subjective assumptions including the estimate of the share price volatility. Changes in the subjective input assumptions can materially affect the fair value estimate, and therefore, the existing models do not necessarily provide a reliable single measure of the fair value of the Company's stock options.

During the year ended 31 January 2010, the Company recorded \$1,240,000 for stock based compensation in its accounts as an expense of \$915,000 and a debit to mineral property, plant and equipment of \$325,000, with the offsetting entries going to contributed surplus. The total for the year included the amortization of the fair value cost of existing stock options and the impact of the two year extension of the term of all options outstanding at 24 June 2009 (\$339,000).

During the year ended 31 January 2009, the Company granted 1,690,000 options to directors, officers, consultants and employees with an average exercise price of USD\$1.81 per option. The fair value of these options was estimated at the date of grant using the Black-Scholes Option Pricing Model with the following weighted average assumptions:

Risk-free interest rate	1.54% to 3.23%
Expected dividend yield	Nil
Expected stock price volatility	56.52% to 83.90%
Expected option life in years	2.33

The weighted fair value of options granted during the period was US\$0.79. During the year ended 31 January 2009, the Company recorded \$1,822,000 for stock based compensation in its accounts as an expense of \$487,000 and a debit to mineral property, plant and equipment of \$1,335,000, with the offsetting entries going to contributed surplus.

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**8. Share Capital - Continued**

**d) Contributed Surplus**

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

Details are as follows:

	<b>31 January 2011</b>	31 January 2010
Balance – Beginning of year	\$ 36,979	\$ 27,549
Current year fair value of stock-based compensation	63	1,240
Fair value of exchangeable warrants and debt conversion (Note 7)	-	352
Change in fair value of warrants amended (Notes 7, 8a) and 8 e))	-	4,920
Issuance of Milestone 2 Bonus Shares (Note 14 a))	-	(721)
Refinancing of convertible debt (Note 7)	3,125	-
Premium on equity financing	875	-
Bonus Shares for Milestones 2 and 4 cost amortization (Note 14a))	1,593	4,200
Forfeiture of Bonus Shares for Milestone 4 (Note 14a))	(1,682)	-
Future income tax charge (Notes 8e) and 14c))	(1,390)	-
Fair value of stock options and warrants exercised during the year	(480)	(561)
Balance – End of year	\$ 39,083	\$ 36,979

**e) Share Purchase Warrants**

Details of stock purchase warrant activity are as follows:

	<b>31 January 2011</b>		31 January 2010	
	<b>Warrants</b>	<b>Weighted Average Exercise Price (US\$)</b>	<b>Warrants</b>	<b>Weighted Average Exercise Price (US\$)</b>
Warrants outstanding - beginning of period	15,202,046	3.74	15,370,000	4.74
Expired (Note 8e))	(4,942,046)	3.23	-	-
Cancelled (Note 7)	(6,250,000)	3.00	(10,260,000)	4.52
Exercised	-	-	(167,954)	3.00
Issued	-	-	4,010,000	3.00
Issued (Note 7)	3,000,000	2.00	6,250,000	3.00
Warrants outstanding – end of period	7,010,000	4.00	15,202,046	3.74

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**8. Share Capital - Continued**

e) **Share Purchase Warrants – Continued**

On 17 April 2007, the Company issued 7,500,000 warrants in connection with a non-brokered private placement financing of 15 million units at US\$2.75 per unit, with each unit comprising one common share and one-half of one warrant. Each whole warrant was exercisable into a common share at a price of US\$4.00 at any time until 13 October 2008 subject to an early trigger if the 20-day volume weighted average price of the common shares is US\$6.00 or more. In connection with the private placement, the Company has paid finders' fees including an additional 520,000 broker warrants having the same terms as the warrants described above.

On 10 October 2008, the Company announced that it had received the consent from the holders of more than two-thirds of the 8,020,000 warrants issued as part of the April 2007 private placement to exchange those warrants into:

- 4,010,000 warrants, each warrant entitling the holder to purchase one share of PolyMet common stock at US\$3.00 per share at any time until the sooner of 30 calendar days after publication of the draft Environmental Impact Statement by the State of Minnesota in the state's Environmental Quality Board Monitor and 13 October, 2009, and
- 4,010,000 warrants, each warrant entitling the holder to purchase one share of PolyMet common stock at US\$5.00 if exercised before the NorthMet Project has produced a cumulative total of 20,000 metric tonnes of concentrate, or US\$6.00 thereafter and prior to 31 August, 2011. PolyMet can accelerate the expiration of the warrants if PolyMet's volume-weighted 20-day average stock price trades at a 50% premium to the exercise price applicable at any time.

The incremental \$544,000 increase in the fair value of the warrants due to the warrant exchange was debited to warrant amendment expense and credited to contributed surplus in the year ended 31 January 2009.

In October 2009, the Company received the consent from holders of more than two-thirds of the above warrants to exchange the 4,010,000 warrants due to expire on 13 October, 2009 for 4,010,000 warrants, each warrant entitling the holder to purchase one share of PolyMet common stock at US\$3.00 per share at any time until the sooner of 30 calendar days after publication of the draft Environmental Impact Statement by the State of Minnesota in the state's Environmental Quality Board Monitor and 31 December, 2009. The incremental \$1,005,000 increase in the fair value of the warrants due to the warrant exchange was debited to warrant amendment expense and credited to contributed surplus.

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**8. Share Capital - Continued**

e) **Share Purchase Warrants – Continued**

In November 2009, the Company received the consent from holders of more than two-thirds of the above warrants to exchange the 4,010,000 warrants due to expire the earlier of 30 calendar days after publication of the draft Environmental Impact Statement by the State of Minnesota in the state's Environmental Quality Board Monitor and 31 December, 2009 for 4,010,000 warrants, each warrant entitling the holder to purchase one share of PolyMet common stock at US\$3.00 per share at any time until the sooner of 21 business days after publication of the final Environmental Impact Statement by the State of Minnesota in the state's Environmental Quality Board Monitor and 31 December 2010. The incremental \$3,757,000 increase in the fair value of the warrants due to the warrant exchange was debited to warrant amendment expense and credited to contributed surplus.

Warrants to purchase 167,954 shares of PolyMet common stock had been exercised in the year ended 31 January 2010. On 31 December 2010, the unexercised warrants, to purchase 3,842,046 shares of PolyMet common stock at \$3.00 per share, expired. The Company recorded a future income tax charge as the expiration of the warrants triggered a capital gain for tax purposes which was offset by the application of tax losses carried forward resulting in a credit of \$1,219,000.

On 31 October 2008, the Company issued 6,250,000 warrants ("Purchase Warrants") to Glencore as partial consideration under the financing agreement described in Note 7. The warrants entitled Glencore to purchase 6.25 million common shares of PolyMet at US\$5.00 if exercised before the NorthMet project has produced a total of 20,000 metric tonnes of concentrate, or US\$6.00 thereafter. The warrants would have expired on 30 September, 2011.

On 17 November 2009, the Company amended the terms such that the Purchase Warrants entitled Glencore to purchase 6,250,000 common shares of PolyMet at US\$3.00 and expire on 30 September, 2011.

On 12 November 2010, the Company cancelled warrants giving Glencore the right to purchase 6,250,000 common shares of PolyMet at US\$3.00 at any time until 30 September, 2011 and issued warrants giving Glencore the right to purchase 3,000,000 common shares of PolyMet at US\$2.00 at any time until 31 December, 2015, in consideration of the amendments to the debenture agreements (Note 7).

On 16 December, 2010 the Board of the Iron Range Resources and Rehabilitation Board ("IRRRB") approved, on the commissioner's recommendation, a secured loan to Poly Met Mining, Inc. of up to \$4 million. A legal challenge as to whether the IRRRB was authorized to make such a loan was withdrawn following passage of state legislation that clarified that the IRRRB is an economic development agency with no regulatory oversight for mine permitting activities. On 15 April, 2011 the Board of the IRRRB reapproved the loan, which is expected to close on or before 30 June, 2011.

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**8. Share Capital - continued**

e) **Share Purchase Warrants - continued**

Proceeds from the loan will be used to purchase forest land, wetlands, and lakes with high natural resource and recreational value that would become available for public use and enjoyment. These properties, which we currently have under purchase option, would be purchased for future use as part of a proposed land exchange for surface rights at the proposed NorthMet mine site currently controlled by the USFS Superior National Forest. The loan will be secured by the land to be acquired from proceeds of the loan, carry a fixed interest rate of 5% per annum, and will be repayable on 30 June, 2016. Subject to regulatory approval, we also agreed to issue warrants giving the IRRRB the right to purchase up to 400,000 shares of our common stock at US\$2.50 per share at any time until the earlier of 30 June, 2016 and one year after we receive permits.

On 31 October 2006, the Company issued 600,000 warrants to BNP Paribas Loan Services as partial consideration under the agreement described in Note 14c). These warrants had an exercise price of US\$4.00 per share and expired on 30 October 2010. The fair value of these warrants was \$1,197,000. Further, upon delivering a bona fide offer of project financing, warrants to purchase an additional 500,000 shares of the Company at a price of US\$4.00 per share at any time prior to 30 October 2010 would have vested. All of these warrants expired on 30 October 2010. The Company recorded a future income tax recovery as the expiration of the warrants triggered a capital gain for tax purposes which was offset by the application of tax losses carried forward resulting in a credit of \$171,000.

f) **Shareholder Rights Plan**

Effective 25 May 2007, the Company adopted an updated Shareholder Rights Plan ("Rights Plan"), which was approved by the Company's shareholders' on 27 June 2007 and modified by the Company's shareholders on 17 June 2008. All common shares issued by the Company during the term of the Rights Plan will have one right represented for each common share held by the shareholder of the Company. The term of the Rights Plan is 10 years, unless the rights are earlier redeemed or exchanged. The Rights issued under the Rights Plan become exercisable only if a party acquires 20% or more of the Company's common shares without complying with the Rights Plan or without the approval of the Board of Directors of the Company.

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

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**9. Supplemental Disclosure With Respect To Statements of Cash Flows**

During the years ended 31 January 2011, 2010 and 2009 the Company entered into the following non-cash investing and financing activities:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Changes in accounts payable and accrued liabilities related to Investing Activities	\$ 176	\$ 225	\$ 1,970

**10. Related Party Transactions**

The Company has conducted transactions with officers, directors and persons or companies related to directors and paid or accrued amounts as follows:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Consulting fees paid to David Dreisinger, a Director of the Company	\$ 59	\$ 59	\$ 56
	<u>\$ 59</u>	<u>\$ 59</u>	<u>\$ 56</u>

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

During the year ended 31 January 2011, the Company paid \$59,000 (2010 - \$59,000 and 2009 - \$56,000) to Dr. Dreisinger for consulting fees primarily in connection with activities related to the processing / technical side of the NorthMet project and related expenses (the latter were supported by invoices and receipts). The consulting fees were based on a monthly fee of Canadian \$5,500 plus general sales tax. Throughout the term of his engagement, Dr. Dreisinger has conducted in-person and telephonic meetings with Mr. William Murray, formerly the Company's Executive Chairman and, before that, its President and Chief Executive Officer, and other members of management at which he provided both verbal and written updates on the status of test work and made recommendations for future activities. These meetings occurred approximately every two to three weeks for the past six years.

The agreement with Dr. Dreisinger was entered into at a time when the Company's current business plans were being formulated and were month to month and oral in nature. The agreement was approved by Mr. William Murray. It was discussed with the Company's board of directors who did not consider that a formal approval and written contract was necessary at that time. The Company believes that the contract was at terms at least as good as could be obtained from third parties.

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**11. Income Taxes**

The Company's provision for income taxes differs from the amounts computed by applying the combined Canadian federal and provincial income tax rates (2011 – 28.5% and 2010 – 28.5%) to the net loss as a result of the following:

	<u>2011</u>	<u>2010</u>
Provision for recovery of taxes at statutory rates	\$ (2,075)	\$ (2,583)
Differences in foreign tax rates	(320)	(85)
Non-deductible loss on refinancing with Glencore	1,039	-
Non-deductible loss on warrant amendments	-	1,476
Other non-deductible items and other	2,545	(1,691)
Change in valuation allowance	<u>(2,579)</u>	<u>2,883</u>
Income tax (recovery)/charge	<u>\$ (1,390)</u>	<u>\$ -</u>

Future income taxes reflect the net effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The significant components of the Company's future tax assets as at 31 January 2011 are as follows:

	<u>2011</u>	<u>2010</u>
Non-capital loss carry forwards	\$ 16,278	\$ 14,573
Unutilized exploration expenses	(3,556)	730
Capital assets	<u>112</u>	<u>109</u>
Total future income taxes	12,834	15,412
Less: valuation allowance	<u>(12,834)</u>	<u>(15,412)</u>
Net future income tax assets	<u>\$ -</u>	<u>\$ -</u>

The Company has income tax loss carry forwards of approximately \$4.1 million in Canada, which may be used to reduce future income taxes otherwise payable and which expire in the years 2015 and 2026.

The Company has income tax loss carry forwards of approximately \$40.1 million in the United States, which may be used to reduce future income taxes otherwise payable and which expire in the years 2019 to 2031. Virtually all of the unutilized exploration expenses are in the United States.

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

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**12. Segmented Information**

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

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<b>2011</b>	<b>Canada</b>		<b>U.S.</b>		<b>Consolidated</b>
<b>Segment operating loss</b>	<b>\$</b>	<b>5,747</b>	<b>\$</b>	<b>1,536</b>	<b>\$ 7,283</b>
<b>Identifiable assets</b>	<b>\$</b>	<b>10,362</b>	<b>\$</b>	<b>134,670</b>	<b>\$ 145,032</b>

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2010					
Segment operating loss	\$	8,131	\$	892	\$ 9,023
Identifiable assets	\$	21,391	\$	118,257	\$ 139,648

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2009					
Segment operating loss	\$	4,963	\$	560	\$ 5,523
Identifiable assets	\$	7,221	\$	94,378	\$ 101,599

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**13. Investment**

During the quarter ended 31 July 2007, the Company acquired, for cash, common shares of a publicly traded Canadian mining company whose primary business is the operation of a recommissioned base metal mine. This investment represents less than 5% of the public mining company's outstanding common shares and was designated as available-for-sale and, as such, had been marked-to-market with the change in the fair value of the investment from acquisition to quarterly financial statements being recorded in Other Comprehensive Loss.

As at 31 January 2008, the Company determined that the investment has had an other than temporary decline in value. This determination was based on, among other factors, a significant drop in market price for the investment company's main product and a continued decline in the share price of the investment company. The initial acquisition cost of the investment was US\$2,495,000 (C\$2,618,000) and the fair value of the investment at 31 January 2008 was US\$1,445,000 (C\$1,440,000). As a result, the Company recorded an investment loss of \$1,050,000 in its income statement and reversed the amounts that had previously been recorded in Other Comprehensive Loss during the year.

As at 31 January 2009, the Company determined that the investment has had an additional other than temporary decline in value. This determination was based on, among other factors, a continued drop in market price for the investment company's main product and a continued decline in the share price of the investment company. The fair value of the investment at 31 January 2009 was US\$57,000. During the year, the Company recorded an additional investment losses totalling \$1,365,000 due to declines in value.

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**14. Contingent Liabilities and Commitments**

- a) The Company has instituted a share bonus plan as part of its employment, management and consulting contracts for key directors, management and project personnel. This bonus plan adds incentive for key personnel to reach certain prescribed milestones required to reach commercial production at the NorthMet Project. As at 31 January 2011, the Company had received shareholder approval of the Bonus Shares for Milestones 1 – 4 and regulatory approval for Milestones 1, 2 and 3. Milestone 4 is subject to regulatory approval, which will be sought in 2011. To 31 January 2011, 5,240,000 shares have been issued for the achievement of Milestones 1, 2 and 3.

The summary of the share bonus plan is as follows:

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	Bonus Shares	
Milestone 1	1,590,000	issued
Milestone 2	1,300,000	(i) issued in May 2009
Milestone 3	2,350,000	issued
Milestone 4	3,640,000	(ii) and (iii)

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- (i) Milestone 2 – Negotiation and completion of an off-take agreement with a senior metals producer for the purchase of nickel-hydroxide produced from the NorthMet Project, and / or an equity investment in the Company by such a producer or producers. The bonus shares allocated to Milestone 2 are valued at C\$0.75. This milestone was deemed to have been achieved in May 2009 and therefore the Company issued the shares to certain directors and insiders and capitalized \$714,000 to property plant and equipment.
- (ii) Milestone 4 – Commencement of commercial production at the NorthMet Project at a time when the Company has not less than 50% ownership interest.
- (iii) At the Annual General Meeting of shareholders of the Company, held on 17 June 2008, the disinterested shareholders approved the bonus shares for Milestone 4. The bonus shares allocated to Milestone 4 are valued at US\$3.80, the Company's closing trading price on 17 June 2008.

During the year ended 31 January 2011, the Company recorded a negative \$89,000 related to Milestone 4 (2010 – positive \$3,843,000; 2009 – positive \$3,583,000), these amounts were capitalized to Mineral Property, Plant and Equipment. The current year reversal includes \$1,682,000 representing the forfeiture of entitlement to bonus shares by individuals upon resignation or not continuing to stand as Directors of the Company.

The fair value of these unissued bonus shares is being amortized, over its expected life, until the estimated date of issuance.

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**14. Contingent Liabilities and Commitments - Continued**

- b) Pursuant to the Company's Asset Purchase Agreement with Cliffs (Note 4), for as long as Cliffs owns 1% or more of the Company's issued shares, Cliffs will have the right to participate on a pro-rata basis in future cash equity financings. This agreement also includes a first right of refusal in favour of the Company should Cliffs wish to dispose of its interest.
- c) On 31 October 2006 the Company entered into an agreement with BNP Paribas Loan Services ("BNPP") whereby BNPP advised and assisted PolyMet in all aspects of preparation for construction finance. As part of this agreement, BNPP was issued warrants to purchase 600,000 shares of the Company's common stock at a price of US\$4.00 per share at any time prior to 30 October 2010. The fair value of these warrants was \$1,197,000. Further, upon delivering a bona fide offer of project financing, warrants to purchase an additional 500,000 shares of the Company at a price of US\$4.00 per share at any time prior to 30 October 2010 would have vested. These warrants expired on 30 October 2010.

The Company decided to review alternatives for construction financing and decided not to renew its current agreement with BNPP which expired on 31 July 2010. As such, the \$1,830,000, of which \$1,197,000 was non-cash related to the fair value of warrants issued, recorded as a deferred financing cost asset has been written off to the consolidated statement of loss in the second quarter of this year. On 30 October, 2010 the warrants expired. As such, PolyMet recorded a future income tax charge of \$171,000 to contributed surplus, which was offset on income tax recover by the application of tax losses carried forward.

- d) On 13 October 2008, the Company entered into a collateral pledge agreement wherein it pledged a used drill rig which it owned against amounts due to a supplier for rebuilding the drill rig. The drill rig has a book value of \$3,420,000 and, as at 31 January 2011, the Company is paying the supplier \$1,115,000 over time for work on the drill.
- e) On 31 October 2008, the Company entered into agreements with Glencore wherein Glencore will provide marketing services covering concentrates, metal, or intermediate products at prevailing market terms for at least the first five years of production.
- f) On 31 January 2011, the Company had outstanding commitments related to equipment, rent, consultants and the environmental review process of approximately \$1,300,000 predominantly due over the next year. Subsequent to 31 January 2011, PolyMet entered into an agreement with the State of Minnesota's Department of Natural Resources committing it to an additional \$2,818,000 through 1 April 2012 with respect to the Supplemental Draft Environmental Impact Study.
- g) At 31 January 2011 the Company had non-binding commitments in 2011 and 2012 of \$1.106 million to pay options to maintain its right to acquire certain lands that it will need at permitting. These lands include land that the Company expects to exchange with the USFS for surface rights at the mine site and land for wetland credits.

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**15. Financial Instruments and Risk Management**

Categories of financial assets and liabilities

Under Canadian GAAP, financial instruments are classified into one of the following five categories: held-for-trading; held to maturity investment; loans and receivables; available-for-sale financial assets, and other financial liabilities. The carrying values of the Company's financial instruments are classified into the following categories:

	<b>31 January 2011</b>	31 January 2010
Held-for-trading (1)	\$ <b>10,361</b>	\$ 21,282
Available-for-sale	<b>66</b>	140
Loans and receivables	<b>318</b>	88
Other financial liabilities (2)	<b>38,602</b>	38,735

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(1) Includes cash and equivalents.

(2) Includes accounts payable and accrued liabilities, convertible debt and long-term debt.

The Company has determined the estimated fair values of its financial instruments based on appropriate valuation methodologies.

Risks arising from financial instruments and risk management

The Company's activities expose it to a variety of financial risks: market risk (including foreign exchange), credit risk, liquidity risk, interest rate risk and investment risk. Reflecting the current stage of development of the Company's NorthMet Project, PolyMet's overall risk management program focuses on facilitating the Company's ability to continue as a going concern and seeks to minimize potential adverse effects on PolyMet's ability to execute its business plan.

Risk management is the responsibility of executive management. Material risks are identified and monitored and are discussed with the audit committee and the board of directors.

Foreign exchange risk

The Company incurs expenditures in Canada and in the United States. The functional and reporting currency of the Company is the United States dollar. Foreign exchange risk arises because the amount of Canadian dollar cash and equivalents, receivables, investment or payables will vary in United States dollar terms due to changes in exchange rates.

As the majority of the Company's expenditures are in United States dollars, the Company has kept a significant portion of its cash and equivalents in United States dollars. The Company has not hedged its exposure to currency fluctuations.

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**15. Financial Instruments and Risk Management - continued**

As at 31 January 2011, the Company is exposed to currency risk through the following assets and liabilities denominated in Canadian dollars:

	<b>31 January 2011</b>	31 January 2010
Held-for-trading (1)	\$ 554	\$ 157
Available-for-sale	66	140
Loans and receivables	102	25
Other financial liabilities (2)	<u>(192)</u>	<u>(302)</u>
	<b>\$ 530</b>	<b>\$ 20</b>

(1) Includes cash and equivalents.

(2) Includes accounts payable and accrued liabilities.

Based on the above net exposures, as at 31 January 2011, a 10% change in the Canadian / United States exchange rate would impact the Company's loss by \$53,000.

Credit risk

Credit risk arises on cash and equivalents held with banks and financial institutions, as well as credit exposure on outstanding accounts receivable. The maximum exposure to credit risk is equal to the carrying value of the financial assets of \$10,679,000.

The Company's cash and equivalents are held through a large Canadian financial institution.

Liquidity risk

Liquidity risk arises through the excess of financial obligations over available financial assets due at any point in time. The Company's objective in managing liquidity risk is to maintain sufficient readily available reserves in order to meet its liquidity requirements at any point in time. The Company achieves this by maintaining sufficient cash and equivalents. Additional information relating to liquidity risk and going concern is disclosed in Note 1.

Interest rate risk

Interest rate risk arises on cash and equivalents and long-term debt and fluctuations in the related interest rates. The Company has not hedged any of its interest rate risk.

As at 31 January 2011, the Company is exposed to interest rate risk through the following assets and liabilities:

	<b>31 January 2011</b>	31 January 2010
Held-for-trading (1)	\$ 10,361	\$ 21,282
Other financial liabilities (2)	<b>36,158</b>	35,782

(1) Includes cash and equivalents.

(2) Represents long-term debt (Note 5) and convertible debt (Note 7).

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**15. Financial Instruments and Risk Management - continued**

Investment risk

The Company's investment in the common shares of a publicly traded Canadian mining company bears investment risk. The maximum exposure to investment risk is equal to the carrying value of the investment.

The Company's investment in the Project (Note 4) is also at risk since the Project is pledged in part as security to Cliffs and otherwise is pledged wholly as security to Glencore.

As at 31 January 2011, the Company is exposed to investment risk through the following assets:

	<b>31 January 2011</b>	31 January 2010
Available-for-sale (1)	\$ 66	\$ 140

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(1) Includes investment.

Fair Value Measurements

PolyMet's financial assets and liabilities are measured or disclosed at fair value on a recurring basis and classified in their entirety based on the lowest level of input that is significant to the fair value measurement. There are three levels of fair value hierarchy that prioritize the inputs to valuation techniques used to measure fair value, with level 1 inputs having the highest priority. The levels and the valuation techniques used to value the Company's financial assets and liabilities are described below:

Level 1 – Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

Investments in marketable securities are valued using quoted market prices in active markets, obtained from securities exchanges. Accordingly, these items are included in Level 1 of the fair value hierarchy.

Level 2 – Quoted prices in markets that are not active, quoted prices for similar assets or liabilities in active markets, or inputs that are observable, either directly or indirectly, for substantially the full term of the asset or liability.

Level 3 – Unobservable (supported by little or no market activity) prices.

Cash equivalents are recorded at face value. Accounts receivable and advances are short-term in nature and represent the initial price of the good or service. Long term and convertible debt have been fair valued using assumptions with respect to interest rates relevant to similar debt taking into account the collateral involved.

**PolyMet Mining Corp.**

(a development stage company)

## **Notes to Consolidated Financial Statements**

**For the years ended 31 January 2011, 2010 and 2009**

*Tabular amounts in Thousands of U.S. Dollars except for price per share, shares and options*

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### **15. Financial Instruments and Risk Management - Continued**

The fair values of the Company's financial assets, cash and equivalents, accounts receivables and advances, and investment approximate their carrying amounts, and are considered to be level 2 fair value hierarchy with observable inputs.

The fair values of the Company's accounts payable and accrued liabilities are below its carrying amount due to liquidity risk of the Company. Also, see Note 1. The fair value of the Company's long term debt and convertible debt approximate the carrying amounts.

#### Capital Management

Similar to other companies in the development stage, the Company is in discussions with certain parties to provide funding which will enable the Company to execute its business plan. With the completion of the DFS and taking into account the current permitting process the Company is in, PolyMet will require additional funds through Project construction. Funding for the Project could come from a number of sources and include internal cash flows (for the second stage of the construction), bank project financing and capital market financing. During the upcoming fiscal year, the Company's objective is to identify the source or sources from which it will obtain the capital required to complete the Project.

The Company has no externally imposed capital requirements. In the management of capital, the Company includes the components of shareholders' equity, convertible debt and long-term debt. The Company manages the capital structure and makes adjustments to it depending on economic conditions and the rate of anticipated expenditures. To maintain or adjust the capital structure, the Company may attempt to issue new shares, issue new debt, acquire or dispose of assets.

In order to assist in management of its capital requirements, the Company prepares expenditure budgets that are updated as necessary depending on various factors. The budgets are approved by the Company's Board of Directors.

Although the Company plans to have the resources to carry out its plans and operations through 31 January 2012 (Note 1), it does not currently have sufficient capital to meet its estimated project capital expenditure requirements and is currently in discussions to arrange sufficient capital to meet these requirements.

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**PolyMet Mining Corp.**

(a development stage company)

**Notes to Consolidated Financial Statements**

**For the years ended 31 January 2011, 2010 and 2009**

*Tabular amounts in Thousands of U.S. Dollars except for price per share, shares and options*

**16. Differences Between Canadian and United States Generally Accepted Accounting Principles**

These consolidated financial statements are prepared in accordance with Canadian generally accepted accounting principles (“GAAP”). The U.S. Securities and Exchange Commission requires that financial statements of foreign registrants contain a reconciliation presenting the statements on the basis of accounting principles generally accepted in the U.S. U.S. GAAP also requires additional disclosures which are set out in this financial statement note. Any differences in accounting principles as they pertain to the accompanying consolidated financial statements are not material except as follows:

- a) Under Canadian GAAP, all of the elements of the convertible debt transaction are fair valued and then allocated book value on a pro-rated basis. The conversion feature on the debt is treated as equity. Under US GAAP the conversion feature is treated as debt. This resulted in a \$250,000 difference between convertible debt and shareholders’ equity in the year ended 31 January 2011 (2010 - \$250,000).

The effects of the above difference in accounting principle on convertible debt and shareholders’ equity are as follows:

	<b>2011</b>	2010	2009
Convertible Debt – Canadian GAAP basis	<b>\$ 27,633</b>	\$ 25,253	\$ 13,943
Convertible Debt – US GAAP basis	<b>\$ 27,883</b>	\$ 25,503	\$ 14,193
Shareholders’ Equity – Canadian GAAP basis	<b>\$ 102,618</b>	\$ 97,567	\$ 70,335
Shareholders’ Equity – US GAAP basis	<b>\$ 102,368</b>	\$ 97,317	\$ 70,085

(b) Development Stage Company

The Company meets the definition of a development stage enterprise under United States Accounting Standard Codification (“ASC”) 915 (formerly Statement of Financial Accounting Standards (“SFAS”) No. 7), Accounting and Reporting by Development Stage Enterprises. The following additional disclosures are required under this standard. Management has determined, in accordance with ASC 915 that the Company was dormant for a period to 31 January 2002, as such the required disclosures have been included commencing from 1 February 2003.

**PolyMet Mining Corp.**

(a development stage company)

**Notes to Consolidated Financial Statements**

**For the years ended 31 January 2011, 2010 and 2009**

*Tabular amounts in Thousands of U.S. Dollars except for price per share, shares and options*

**16. Differences Between Canadian and United States Generally Accepted Accounting Principles -**  
*Continued*

**Consolidated Statements of Loss, Other Comprehensive Loss and Deficit**

**Cumulative from 1 February 2003 to 31 January 2011**

	Cumulative from 1 February 2003 to 31 January 2011 (unaudited)
<b>Pre-feasibility Costs</b>	<u>21,679</u>
<b>General and Administrative</b>	
Amortization	162
Asset retirement obligation accretion	1,948
Consulting fees	3,072
Exploration	193
Financing costs write-off	1,830
Investor relations and financing	1,380
Office and corporate wages	7,476
Professional fees	2,999
Shareholders' information	1,480
Stock-based compensation	11,212
Transfer agent and filing fees	829
Travel	2,631
Warrant amendment	5,464
	<u>40,676</u>
<b>Other Expenses (Income)</b>	
Interest income, net	(1,886)
Loss (gain) on foreign exchange	(207)
Gain on sale of resource properties	(220)
Loss on refinancing of convertible debt	3,647
Loss on sale of property, plant and equipment	9
Loss on asset held for sale	520
Investment loss	2,415
Rental income	(625)
	<u>3,653</u>
<b>Cumulative Loss for the Period before tax</b>	66,008
Tax recovery on warrant expiration	(1,390)
<b>Cumulative Loss for the Period</b>	64,618
<b>Other Comprehensive Income</b>	
Unrealized loss on investment	6
<b>Comprehensive Loss</b>	<u>64,624</u>
<b>Deficit Beginning of the Period</b>	<u>14,214</u>
<b>Deficit End of the Period</b>	<u>78,832</u>

**PolyMet Mining Corp.**

(a development stage company)

**Notes to Consolidated Financial Statements****For the years ended 31 January 2011, 2010 and 2009***Tabular amounts in Thousands of U.S. Dollars except for price per share, shares and options***16. Differences Between Canadian and United States Generally Accepted Accounting Principles - Continued****Consolidated Statements of Changes in Shareholder's Equity (unaudited)****Cumulative from 1 February 2003 to 31 January 2011**

	Issue Price Per Share	Shares	Amount	Contributed Surplus	Accumulated Other Comprehensive Income	Deficit	Total
Balance – 31 January 2003		32,657,526	14,183	-	-	(14,214)	(31)
Loss for the year		-	-	-	-	(147)	(147)
Shares issued for cash:							
Private placements, net of finders' fees and issuance costs	0.09	11,708,318	999	-	-	-	999
Share subscriptions received	-	-	763	-	-	-	763
Exercise of warrants	0.08	486,610	41	-	-	-	41
Exercise of options	0.06	89,600	5	-	-	-	5
Shares issued to settle debt	0.07	50,000	4	-	-	-	4
Stock-based compensation		-	-	55	-	-	55
Balance 31 January 2004		44,992,054	15,995	55	-	(14,361)	1,689
Loss for the year		-	-	-	-	(4,416)	(4,416)
Shares issued for cash:							
Private placements, net of finders' fees and issuance costs	0.58	2,955,626	1,715	-	-	-	1,715
Share subscriptions received	-	-	(763)	-	-	-	(763)
Exercise of warrants	0.16	5,277,573	829	-	-	-	829
Exercise of options	0.07	1,088,400	81	-	-	-	81
Shares issued for property	0.23	1,000,000	229	-	-	-	229
Stock-based compensation		-	-	993	-	-	993
Fair value of stock options exercised		-	42	(42)	-	-	-
Shares allotted for exercise of warrants	0.12	224,925	26	-	-	-	26
Shares allotted for bonus	0.55	1,590,000	873	-	-	-	873
Balance 31 January 2005		57,128,578	19,027	1,006	-	(18,777)	1,256

**PolyMet Mining Corp.**

(a development stage company)

**Notes to Consolidated Financial Statements**

For the years ended 31 January 2011, 2010 and 2009

Tabular amounts in Thousands of U.S. Dollars except for price per share, shares and options

**16. Differences Between Canadian and United States Generally Accepted Accounting Principles - Continued**

**Consolidated Statements of Changes in Shareholder's Equity (unaudited) (continued)**  
**Cumulative from 1 February 2003 to 31 January 2011**

	Issue Price Per Share	Shares	Amount	Contributed Surplus	Accumulated Other Comprehensive Income	Deficit	Total
Balance 31 January 2005 (brought forward)		57,128,578	19,027	1,006	-	(18,777)	1,256
Loss for the year	-	-	-	-	-	(15,976)	(15,976)
Shares issued for cash:							
Private placements, net of finders' fees and issuance costs	0.66	29,347,568	15,827	3,653	-	-	19,480
Exercise of warrants	0.58	5,700,628	3,296	-	-	-	3,296
Exercise of options	0.11	1,795,852	197	-	-	-	197
Shares issued for property	1.22	6,200,547	7,564	-	-	-	7,564
Stock-based compensation	-	-	-	3,523	-	-	3,523
Fair value of stock options exercised	-	-	98	(98)	-	-	-
Balance 31 January 2006		100,173,173	46,009	8,084	-	(34,753)	19,340
Loss for the year	-	-	-	-	-	(18,126)	(18,126)
Issuance of shares for bonus	0.55	2,350,000	1,289	-	-	-	1,289
Shares issued for cash:							
Exercise of warrants	0.98	14,662,703	17,963	(3,653)	-	-	14,310
Exercise of options	0.35	2,193,000	765	-	-	-	765
Shares issued for property	3.08	2,000,000	6,160	-	-	-	6,160
Stock-based compensation	-	-	-	4,723	-	-	4,723
Warrants issued for deferred financing costs	-	-	-	1,197	-	-	1,197
Fair value of stock options exercised	-	-	737	(737)	-	-	-
Balance – 31 January 2007		121,378,876	72,923	9,614	-	(52,879)	29,658

**PolyMet Mining Corp.**

(a development stage company)

**Notes to Consolidated Financial Statements**

**For the years ended 31 January 2011, 2010 and 2009**

*Tabular amounts in Thousands of U.S. Dollars except for price per share, shares and options*

**16. Differences Between Canadian and United States Generally Accepted Accounting Principles - Continued**

**Consolidated Statements of Changes in Shareholder's Equity (unaudited) (continued)**

**Cumulative from 1 February 2003 to 31 January 2011**

	Issue Price Per Share	Shares	Amount	Contributed Surplus	Accumulated Other Comprehensive Income	Deficit	Total
Balance – 31 January 2007 (brought forward)		121,378,876	72,923	9,614	-	(52,879)	29,658
Loss for the year	-	-	-	-	-	(4,124)	(4,124)
Shares and warrants issued:							
Exercise of options	0.66	462,200	303	-	-	-	303
Fair value of stock options exercised	-	-	212	(212)	-	-	-
Private placement, net of finders' fees and issuance costs	2.61	15,149,999	31,177	8,346	-	-	39,523
Stock-based compensation	-	-	-	3,077	-	-	3,077
Balance – 31 January 2008		136,991,075	104,615	20,825	-	(57,003)	68,437
Loss for the year	-	-	-	-	-	(5,523)	(5,523)
Shares and warrants issued:							
Exercise of options	1.45	312,800	452	-	-	-	452
Fair value of stock options exercised	-	-	245	(245)	-	-	-
Convertible debt – conversion factor and warrants	-	-	-	441	-	-	441
Accrual of Milestones 2 and 4 Bonus Shares	-	-	-	3,912	-	-	3,912
Amendment to previously issued warrants	-	-	-	544	-	-	544
Stock-based compensation	-	-	-	1,822	-	-	1,822
Balance – 31 January 2009		137,303,875	105,312	27,299	-	(62,526)	70,085

**PolyMet Mining Corp.**

(a development stage company)

**Notes to Consolidated Financial Statements**

For the years ended 31 January 2011, 2010 and 2009

Tabular amounts in Thousands of U.S. Dollars except for price per share, shares and options

**16. Differences Between Canadian and United States Generally Accepted Accounting Principles - Continued**

**Consolidated Statements of Changes in Shareholder's Equity (unaudited) (continued)**  
**Cumulative from 1 February 2003 to 31 January 2011**

	Issue Price Per Share	Shares	Amount	Contributed Surplus	Accumulated Other Comprehensive Income	Deficit	Total
Balance – 31 January 2009 (brought forward)		137,303,875	105,312	27,299	-	(62,526)	70,085
Loss for the year	-	-	-	-	-	(9,023)	(9,023)
Other comprehensive income for the year	-	-	-	-	71	-	71
Shares and warrants issued:							
Equity offering and issuance costs	2.60	9,433,962	24,501	-	-	-	24,501
Exercise of options	0.62	775,000	477	-	-	-	477
Fair value of stock options exercised	-	-	307	(307)	-	-	-
Exercise of warrants	2.94	167,954	494	-	-	-	494
Fair value of warrants exercised	-	-	254	(254)	-	-	-
Convertible debt – conversion factor	-	-	-	352	-	-	352
Milestones 2 and 4 Bonus Shares cost amortization	-	-	-	4,200	-	-	4,200
Amendment to previously issued warrants	-	-	-	4,920	-	-	4,920
Issuance of Milestone 2 Bonus Shares	0.55	1,300,000	721	(721)	-	-	-
Stock-based compensation	-	-	-	1,240	-	-	1,240
Balance – 31 January 2010		148,980,791	132,066	36,729	71	(71,549)	97,317
Loss for the period	-	-	-	-	-	(7,283)	(7,283)
Other comprehensive income for the period	-	-	-	-	(77)	-	(77)
Shares and warrants issued:							
Equity offering and issuance costs	1.98	5,000,000	9,019	875	-	-	9,894
Exercise of options	0.96	845,000	808	-	-	-	808
Fair value of stock options exercised	-	-	480	(480)	-	-	-
Refinancing of convertible debt	-	-	-	3,125	-	-	3,125
Milestone 4 Bonus Shares cost amortization	-	-	-	(89)	-	-	(89)
Future income tax recovery	-	-	-	(1,390)	-	-	(1,390)
Stock-based compensation	-	-	-	63	-	-	63
Balance – 31 January 2011		154,825,791	142,373	38,833	(6)	(78,832)	102,368

**PolyMet Mining Corp.**

(a development stage company)

**Notes to Consolidated Financial Statements**

For the years ended 31 January 2011, 2010 and 2009

Tabular amounts in Thousands of U.S. Dollars except for price per share, shares and options

**16. Differences Between Canadian and United States Generally Accepted Accounting Principles -**

*Continued*

**Consolidated Statements of Cash Flows**

Cumulative from 1 February 2003 to 31 January 2011

	Cumulative from 1 February 2003 to 31 January 2011 (unaudited)
<b>Operating Activities</b>	
<b>Loss for the period</b>	\$ (60,971)
<b>Items not involving cash</b>	
Consulting fees and Office and Corporate wages	2,161
Amortization	162
Asset retirement obligation	1,948
Financing cost write-off	1,830
Future income tax recovery	(1,390)
Investment loss	2,415
Loss on asset held for sale	520
Stock-based compensation	11,212
Warrant amendment	5,464
Gain on sale of resource properties	(220)
Loss on sale of property, plant and equipment	9
<b>Changes in non-cash working capital items</b>	
Accounts receivable and advances	(312)
Prepaid expenses	(636)
Accounts payable and accrued liabilities	377
<b>Net cash used in operating activities</b>	<u>(37,431)</u>
<b>Financing Activities</b>	
Share capital - for cash	117,432
Long-term debt repayment	(7,900)
Convertible debt	24,277
Share subscriptions received	763
Deferred financing costs	(633)
<b>Net cash provided by financing activities</b>	<u>133,939</u>
<b>Investing Activities</b>	
Purchase of investment	(2,495)
Proceeds on disposal of equipment	33
Proceeds on sale of resource property	220
Purchase of mineral property, plant and equipment	(83,908)
<b>Net cash used in investing activities</b>	<u>(86,150)</u>
<b>Net Increase (Decrease) in Cash and Cash Equivalents Position</b>	10,358
<b>Cash and Cash Equivalents Position - Beginning of Period</b>	3
<b>Cash and Cash Equivalents Position - End of Period</b>	<u>\$ 10,361</u>

**PolyMet Mining Corp.**

(a development stage company)

**Notes to Consolidated Financial Statements**

**For the years ended 31 January 2011, 2010 and 2009**

*Tabular amounts in Thousands of U.S. Dollars except for price per share, shares and options*

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**16. Differences Between Canadian and United States Generally Accepted Accounting Principles -**  
*Continued*

**Consolidated Schedules of Pre-Feasibility Costs**

**Cumulative from 1 February 2003 to 31 January 2011**

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	Cumulative from 1 February 2003 to 31 January 2011 (unaudited)
<b>Direct</b>	
Camp and general	\$ 298
Consulting fees	1,846
Drilling	3,169
Engineering	1,441
Environmental	6,130
Geological and geophysical	303
Land lease, taxes and licenses	469
Metallurgical	2,275
Mine planning	3,597
Permitting	321
Plant maintenance and repair	725
Sampling	1,001
Scoping study	104
<b>Cumulative Total Costs for the Period</b>	<b><u>\$ 21,679</u></b>

**PolyMet Mining Corp.**

(a development stage company)

**Notes to Consolidated Financial Statements**

**For the years ended 31 January 2011, 2010 and 2009**

*Tabular amounts in Thousands of U.S. Dollars except for price per share, shares and options*

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**16. Differences Between Canadian and United States Generally Accepted Accounting Principles -**  
*Continued*

(c) Mineral Rights

The total amount paid for mineral rights to 31 January 2011 was \$1,925,000.

(d) Accounts Payable

The components of accounts payable and accrued liabilities as at 31 January are as follows:

	<u>2011</u>	<u>2010</u>
Operating payables	236	376
Project development payables	1,093	1,561
Equipment payables	1,115	1,016
	<hr/>	<hr/>
Total	\$2,444	\$2,953

(e) Stock-Based Compensation

As at 31 January 2010, there were 1,855,000 unvested stock options with an average grant date fair value of \$1.16 per option. As at 31 January 2011, there were 1,722,500 unvested stock options with an average grant date fair value of \$1.20 per option. During the year ended 31 January 2011, 122,500 additional stock options vested.

The intrinsic value of a stock option is the difference between the current market price for PolyMet's common shares and the exercise price of the option. At 31 January 2011, the aggregate intrinsic value of vested and unvested stock options, based on the 31 January 2011 closing price for PolyMet's common shares of \$2.05 was \$(104,000).

The weighted average remaining contractual term of all stock options outstanding as at 31 January 2011 is 2.88 years. The weighted average remaining contractual term of all stock options vested as at 31 January 2011 was 2.69 years.

The unrecognized compensation cost for non-vested stock options at 31 January 2011 was \$323,000. The weighted average period over which it is expected to be recognized is 2.28 years.

PolyMet records stock-based compensation expense as a separate line item in the Company's consolidated statements of loss, other comprehensive loss and deficit. If stock-based compensation had been recorded on the same line as cash compensation for the individuals who received the stock options, a recovery of \$119,000 for the year ended 31 January 2011, an expense of \$915,000 for the year ended 31 January 2010, and an expense of \$487,000 for the year ended 31 January 2009 would have been recorded under office and corporate wages expense.

The Company has estimated the expected life of incentive stock options to be 1.5 years based on historic option exercise patterns and the timeline for material developments in the past and anticipated in future.

**PolyMet Mining Corp.**

**(a development stage company)**

## **Notes to Consolidated Financial Statements**

**For the years ended 31 January 2011, 2010 and 2009**

*Tabular amounts in Thousands of U.S. Dollars except for price per share, shares and options*

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### **16. Differences Between Canadian and United States Generally Accepted Accounting Principles - Continued**

f) **Recent U.S. Accounting Pronouncements**

The Company transitioned to IFRS on 1 February 2011 and will no longer be required to prepare a reconciliation to US GAAP. Accordingly, PolyMet has not assessed the impact of adopting recent US accounting pronouncements with an application date of 1 February 2011 or beyond in the Company's financial statements and disclosures.

**POLYMET MINING CORP.**  
**MANAGEMENT DISCUSSION AND ANALYSIS**

FORM 51-102F1

For the year ended 31 January 2011

*US Funds*

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***General***

The following information, prepared as at 4 May 2011, should be read in conjunction with the audited consolidated financial statements of PolyMet Mining Corp. (the "Company" or "PolyMet") for the year ended 31 January 2011 and related notes attached thereto, which are prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). All amounts are expressed in United States dollars unless otherwise indicated.

The Audit Committee of the Board of Directors of the Company, consisting of four independent directors, has reviewed this document pursuant to its mandate and charter.

***Forward Looking Statements***

This Management Discussion and Analysis ("MD&A") contains certain forward-looking statements concerning anticipated developments in PolyMet's operations in the future. These forward-looking statements appear in a number of different places in this MD&A and can frequently, but not always, be identified by words such as "expects", "anticipates", "believes", "intends", "estimates", "potential", "possible", "projects", "plans" and similar expressions, or statements that events, conditions or results "will", "may", "could" or "should" occur or be achieved or their negatives or other comparable words. Such forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause PolyMet's actual results, performance or achievements to be materially different from any future results, performance or achievements that may be expressed or implied by such forward-looking statements. Forward-looking statements include statements regarding the outlook for the Company's future operations, plans and timing for PolyMet's exploration and development programs, statements about future market conditions, supply and demand conditions, forecasts of future costs and expenditures, the outcome of legal proceedings, and other expectations, intentions and plans that are not historical fact. The Company's actual results may differ materially from those in the forward-looking statements due to risks facing PolyMet or due to actual facts differing from the assumptions underlying the Company's predictions. Some of these risks and assumptions include: general economic and business conditions, including changes in interest rates; prices of natural resources, costs associated with mineral exploration and development, and other economic conditions; natural phenomena; actions by governments and authorities including changes in government regulation; uncertainties associated with legal proceedings; changes in the resource market; future decisions by management in response to changing conditions; future decisions by management in response to changing conditions; the Company's ability to execute prospective business plans, and misjudgments in the course of preparing forward-looking statements.

The Company advises you that these cautionary remarks expressly qualify in their entirety all forward-looking statements attributable to PolyMet or persons acting on its behalf. The Company expressly disclaims any obligation to update publicly, or otherwise, these statements, whether as a result of new information, future events or otherwise except to the extent required by law. Readers should carefully review the cautionary statements and risk factors contained in this and all other documents that the Company files from time to time with regulatory authorities.

Cautionary note to U.S. investors: the terms "measured and indicated mineral resource", "mineral resource", and "inferred mineral resource" used in this Management Discussion and Analysis are Canadian geological and mining terms as defined in accordance with National Instrument 43-101, Standards of Disclosure for Mineral Projects ("NI 43-101") under the guidelines set out in the Canadian Institute of Mining, Metallurgy and Petroleum (the "CIM") Standards on Mineral Resources and Mineral Reserves. U.S. investors are advised that while such terms are recognized and required under Canadian regulations, the SEC does not recognize these terms. Mineral Resources do not have demonstrated economic viability. It cannot be assumed that all or any part of a Mineral Resource will ever be upgraded to Mineral Reserves. Under Canadian rules, estimates of inferred mineral resources may not form the basis of or be included in feasibility or other studies. U.S. investors are cautioned not to assume that any part of an inferred mineral resource exists, or is economically or legally mineable.

Specific reference is made to PolyMet's most recent Form 20-F/Annual Information Form on file with the SEC and Canadian securities authorities for a discussion of some of the factors underlying forward-looking statements.

**POLYMET MINING CORP.**  
**MANAGEMENT DISCUSSION AND ANALYSIS**

FORM 51-102F1

For the year ended 31 January 2011

*US Funds*

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***Description of Business and Summary of Recent Events***

PolyMet is a Toronto Stock Exchange and NYSE Amex listed Issuer engaged in the exploration and development, when warranted, of natural resource properties. The Company's primary mineral property and principal focus is the commercial development of its NorthMet Project, a polymetallic project in northeastern Minnesota, USA which hosts copper, nickel, cobalt and platinum group metal mineralization.

Asset Acquisitions

On 15 November 2005 the Company, through its Minnesota subsidiary (Poly Met Mining, Inc.), completed the early exercise of PolyMet's option with Cliffs Natural Resources, Inc. (formerly Cleveland Cliffs, Inc.) (NYSE:CLF) ("Cliffs") to acquire the Erie Plant, which is located 10 kilometers (6 miles) west of PolyMet's NorthMet deposit. The plant was operated by Cliffs for many years and was acquired by Cliffs in early 2001 from LTV Steel Mining Company after that company's bankruptcy at which time the plant was placed on care-and-maintenance with a view to a potential restart. With minor modification, the crushing and milling circuits can be used for the NorthMet ore. The plant assets now owned by PolyMet include crushing and milling equipment, comprehensive spare parts, plant site buildings, real estate, tailings impoundments and mine workshops, as well as access to extensive mining infrastructure including roads, rail, water, and power. A new hydrometallurgical plant is planned to be installed adjacent to the existing mill on surplus land.

PolyMet plans to refurbish and reactivate the crushing, concentrating and tailings facilities at the Erie Plant to produce concentrates containing copper, nickel, cobalt and precious metals. The concentrates are planned to be sold prior to completion of construction and commissioning of the new hydrometallurgical metal recovery processing facilities. Once completed, the new hydrometallurgical plant will produce copper metal, nickel-cobalt hydroxide and a precious metals precipitate.

On 20 December 2006 the Company acquired from Cliffs, property and associated rights sufficient to provide it with a railroad connection linking the mine development site and the Erie Plant. This transaction also included 120 railcars, locomotive fueling and maintenance facilities, water rights and pipelines, large administrative offices on site and an additional 6,000 acres of land to the east and west of and contiguous to its existing tailing facilities.

PolyMet has indemnified Cliffs for ongoing reclamation and remediation associated with the property under both transactions.

Feasibility Study, Mineral Resources and Mineral Reserves

With publication of the Definitive Feasibility Study ("DFS") in September 2006, summarized in a Technical Report under National Instrument 43-101 ("NI 43-101"), PolyMet established SEC-standard mineral reserves. Proven and probable mineral reserves were estimated at 181.7 million short tons grading 0.31% copper, 0.09% nickel and 0.01 ounces per ton ("opt") of precious metals. In September 2007, PolyMet reported an expansion in these proven and probable mineral reserves to 274.7 million short tons grading 0.28% copper, 0.08% nickel and 0.01 opt of precious metals (palladium, platinum and gold).

These reserves are based on copper at \$1.25 per pound, nickel at \$5.60 per pound, and precious metal prices of \$210, \$800, and \$400 per ounce respectively for palladium, platinum and gold.

**POLYMET MINING CORP.**  
**MANAGEMENT DISCUSSION AND ANALYSIS**

FORM 51-102F1

For the year ended 31 January 2011

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The reserves lie within measured and indicated mineral resources that were expanded to 638.2 million tons grading 0.27% copper, 0.08% nickel and 0.01 opt of precious metals (palladium, platinum and gold). In addition, inferred mineral resources total 251.6 million tons grading 0.28% copper, 0.08% nickel and 0.01 opt of precious metals.

PolyMet has transitioned into detailed engineering in preparation for the start of construction. This includes detailed planning for the construction phase, commencement of detailed design work, and scheduling long lead-time equipment. As a result of continuing economic and financial market instability which started in mid 2008, and until there is greater certainty on the timeline to complete permitting, the Company has scaled back detailed engineering and design work that is not needed for permitting and has deferred placing orders for equipment.

*DFS Update*

On 20 May 2008 PolyMet reported revised plans and cost estimates for construction and operating costs. The revised plans include:

- the sale of concentrate during the construction and commissioning of new metallurgical facilities resulting in a shorter pre-production construction period (12-15 months) and reduced capital costs prior to first revenues (\$312 million versus \$380 million);
- the new metallurgical facilities to be constructed during initial production and sales of concentrate. PolyMet anticipates that much of the additional \$290 million of capital costs, including \$20 million of additional environmental measures, will be funded from cash flow from initial operations;
- mine plans (based on copper at \$1.25 per pound) reflect the increase in reserves and decrease in stripping ratio reported on 26 September 2007, the use of 240-ton trucks, and owner versus contract mine operations, and
- \$77 million of mining equipment, which was assumed to be provided by a mining contractor in the DFS has been incorporated as an operating lease in updated operating costs.

Environmental Review

In October 2005, the Minnesota Department of Natural Resources (MDNR) published its Environmental Assessment Worksheet Decision Document establishing the MDNR as the lead state agency and the US Army Corps of Engineers ("USACE) as the lead federal agency (together the "Lead Agencies") for preparation of an Environmental Impact Statement ("EIS") for the project. In 2006 these Lead Agencies selected an independent environmental contractor ("the EIS Contractor") to prepare the EIS. The EIS Contractor is Environmental Resources Management, a leading global provider of environmental, health and safety, risk, and social consulting services. The EIS Contractor team included members with expertise and experience in mining sulfidic ores. Several other government agencies (including the US Forest Service, the Bois Forte Band of Chippewa and the Fond Du Lac Band of Lake Superior Chippewa) joined the EIS preparation team as Cooperating Agencies which brought their special expertise to the process.

In January 2007, the Company submitted a Detailed Project Description ("DPD") to state and federal regulators. The DPD lays out the Company's development plans and proposed environmental safeguards including a mine plan, a wetland mitigation plan, air and water quality monitoring plans and a closure plan with closure estimate. Since then, the Company has submitted a supplemental DPD as well as more than 100 supporting research studies,

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including comprehensive mine waste characterization studies, water quality modeling and air quality modeling.

Under state and federal guidelines and regulations, a Draft EIS identifies the environmental impact of a proposed project as well as evaluating alternatives and ways to mitigate potential impacts. PolyMet was involved in the process of alternative/mitigation development and had input into the technical and economical feasibility of potential alternatives and mitigations. The EIS Contractor prepared a series of preliminary versions of the Draft EIS that were reviewed and commented on by the Lead Agencies, other governmental agencies, and PolyMet.

In October 2009, the Lead Agencies published the PolyMet Draft EIS with formal notification of publication in the Minnesota Environmental Quality Board ("EQB") Monitor and the Federal Register on 2 November and 6 November 2009, respectively. The formal notification of publication started a 90-day period for public review and comment, which ended on 3 February 2010. During this period, the lead Agencies held two public meetings – one in the town of Aurora, MN near the project location and one in Blaine, MN in the metropolitan Minneapolis-St. Paul area.

The Lead Agencies received more than 3,700 submissions containing approximately 22,000 separate comments, including an extensive comment letter from the US Environmental Protection Agency ("EPA") in its role as reviewer of projects that could impact the environment.

On 25 June 2010 the Lead Agencies announced that they intend to complete the EIS process by preparing a Supplemental Draft EIS that incorporates the proposed US Forest Service (USFS) land exchange and expands government agency cooperation. The USFS will join the US Army Corps of Engineers (USACE) as a federal co-lead agency through the completion of the EIS process. In addition, the U.S. Environmental Protection Agency (EPA) will join the effort as a cooperating agency. The MDNR remains the state co-lead agency.

On 13 October 2010 the USACE and the USFS published a Notice of Intent to complete the Supplemental Draft EIS, which will:

- Supplement and supersede the Draft EIS and respond to concerns identified by the US Environmental Protection Agency ("EPA") and other comments on the Draft EIS.
- Incorporate potential effects from the proposed land exchange between the USFS Superior National Forest and PolyMet.

Public review of the scope of the land exchange ended on 29 November 2010. The USACE and the USFS stated that they expect to complete the Supplemental Draft EIS in the summer of 2011, with the final EIS anticipated six to nine months later.

The Notice of Intent stated that the proposed land exchange would eliminate conflicts between the United States and private mineral ownership and consolidate land ownership to improve Superior National Forest management effectiveness and public access to federal lands. The proposed exchange is in accordance with Forest Service Strategic Plan Goals to provide and sustain long-term socioeconomic benefits to the American people, conserve open space, and sustain and enhance outdoor recreation activities.

The NorthMet mine site encompasses approximately 2,840 of the 6,650 acres of land proposed for exchange to private ownership; the remaining federal property would improve intermingled and inefficient ownership patterns and eliminate conflicts if minerals development were to expand in the future.

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The lands that would be received by the Superior National Forest consist of forest and wetland habitat as well as lake frontage. These lands would enhance public recreation opportunities and complement existing federal ownership by eliminating or reducing private holdings surrounded by Superior National Forest land.

Once the Supplemental Draft EIS is completed, it will be made available for public review prior to preparation of the final EIS. Completion of the final EIS and a subsequent Adequacy Decision by the DNR and Record of Decision by the federal agencies are necessary before the land exchange can occur and various permits required to construct and operate the project can be issued.

Prior to receipt of the permits, the Company intends to secure construction financing that would be available upon receipt of key permits, with construction slated to start upon availability of construction finance.

Construction of NorthMet is expected to be made up of four major components:

1. Implementation of environmental safeguards;
2. Construction of the mine and reactivation of some existing mine infrastructure;
3. Refurbishment of the existing Erie Plant facilities and construction of new flotation facilities, and
4. Construction of a new hydrometallurgical plant.

#### Key Developments

In April 2010, Cliffs entered into a consent decree with the Minnesota Pollution Control Agency ("MPCA") relating to alleged violations on the Cliffs Erie Property. This consent decree required submission of Field Study Plan Outlines, which have been approved by the MPCA, and Short Term Mitigation Plans, which have not yet been formally approved. As part of its prior transactions with Cliffs, PolyMet has agreed to indemnify Cliffs for certain on-going site environmental liabilities.

At the annual shareholders' meeting on 7 July 2010, Messrs. Corneliuson and Swearingen did not stand for re-election to the Company's Board of Directors owing to other personal commitments. The Board thanked them for their contributions to the Company during their tenure.

On 31 October 2010, 1,100,000 warrants to purchase shares of PolyMet common stock at \$4.00 per share that had been issued to BNP Paribas Loan Services ("BNPP") expired.

On 12 November 2010, PolyMet announced that Glencore AG ("Glencore") had agreed to purchase 15 million shares of PolyMet common stock at \$2.00 per share in three tranches over the next two years. In addition, Glencore has agreed to extend the maturity date of the \$25 million (initial principal) debentures issued to Glencore under the 2008 financing to 30 September 2012 and has cancelled the final \$25 million debenture financing commitment and the 6.25 million share purchase warrants issued as part of the 2008 financing. PolyMet has issued warrants to purchase 3 million shares at \$2 per share at any time until December 31, 2015 as compensation for the additional financing and other changes.

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On 17 January 2011 PolyMet closed the first tranche of this private placement, issuing 5 million common shares of the Company to Glencore at US\$2.00 per Share for gross proceeds of US\$10 million.

On 16 December 2010 the Board of the Iron Range Resources and Rehabilitation Board ("IRRRB") approved, on the commissioner's recommendation, a secured loan to Poly Met Mining, Inc. of up to \$4 million. A legal challenge as to whether the IRRRB was authorized to make such a loan was withdrawn following passage of state legislation that clarified that the IRRRB is an economic development agency with no regulatory oversight for mine permitting activities.

Proceeds from the loan will be used to purchase forest land, wetlands, and lakes with high natural resource and recreational value that would become available for public use and enjoyment. These properties, which we currently have under purchase option, would be purchased for future use as part of a proposed land exchange for surface rights at the proposed NorthMet mine site currently controlled by the USFS Superior National Forest.

With effect from 31 December 2010, William Murray stepped down as Executive Chairman and George Molyviatis resigned his board membership. Mr. Murray will continue to serve as a non-management director of the Company. Ian Forrest and Frank Sims, both independent directors, will serve as independent co-Chairmen. Mr. Forrest will continue as Chair of the Audit Committee and Mr. Sims will continue as Chair of the Corporate Governance Committee.

On 31 December 2010, warrants to purchase 3,842,046 shares of PolyMet common stock at \$3.00 per share, which had been issued in connection with the April 2007 financing, expired.

On 24 January 2011 Bradley H. (Brad) Moore was appointed Executive Vice-President, Environmental & Governmental Affairs. Mr. Moore has more than 25 years experience in environmental regulation and review and is assuming overall responsibility for the Company's effort to complete environmental review and obtain permits necessary for construction and operation of the NorthMet copper-nickel-precious metals project located in the established Mesabi mining district in northeastern Minnesota. Mr. Moore served as Commissioner of the Minnesota Pollution Control Agency ("MPCA") from 2006 to 2008, and as Assistant Commissioner for Operations of the Minnesota Department of Natural Resources (MDNR) from January 1999 to August 2006.

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**SELECTED ANNUAL FINANCIAL INFORMATION**

	Year Ended 31 January		
	(thousands of U.S. dollars including notes)		
	2011	2010	2009
	\$	\$	\$
Revenue	-	-	-
Loss for the Year	7,283 <sup>(1)</sup>	9,023 <sup>(2)</sup>	5,523 <sup>(2)</sup>
Loss per Share	(0.05)	(0.06)	(0.04)
Total Assets	145,032 <sup>(4)</sup>	139,648 <sup>(5)</sup>	101,599
Long Term Debt <sup>(6)</sup>	29,408	33,782	24,006
US GAAP Long Term Debt <sup>(6)</sup>	29,658	34,032	24,256
Total Shareholders' Equity	102,618	97,567	70,335
U.S. GAAP Total Shareholders' Equity	102,368	97,317	70,085

- (1) Includes stock based compensation recovery of \$119, a write-off of financing costs of 1,830, warrant amendment expense of \$nil, a loss on asset held for sale of \$520, a non-cash loss on refinancing of convertible debt of \$3,647 and a future income tax recovery of 1,390.
- (2) Includes stock based compensation expense of \$915 and warrant amendment expense of \$4,920.
- (3) Includes stock based compensation of expense of \$487 and warrant amendment expense of \$544.
- (4) Increase compared to 31 January 2010 primarily due to cash proceeds from equity financing and increases in mineral property, plant and equipment as a result of amounts capitalized in the year.
- (5) Increase compared to 31 January 2009 primarily due to cash proceeds from convertible debt and equity financings and increases in mineral property, plant and equipment as a result of amounts capitalized in the year.
- (6) Debt represents the unpaid cash portion of the consideration for the Cliffs transactions and the fair value of the convertible debt obtained from Glencore AG, net of associated costs.

This financial information has been reported in accordance with Canadian GAAP and denominated in United States dollars, the Company's reporting currency. The only material differences between Canadian and United States GAAP for the Company relates to the fair value of the conversion feature on the convertible debt is recorded as shareholders' equity under the Canadian basis and as convertible debt under the U.S. basis.

**Results of Operations**

Comparison of the years ending 31 January 2011 and 31 January 2010

a) Loss for the Year:

During the year ended 31 January 2011, the Company incurred a loss of \$7.283 million (\$0.05 loss per share) compared to a loss of \$9.023 million (\$0.06 loss per share) in 2010. The decrease in the net loss for the period was primarily attributable to:

- A non-cash future income tax recovery related to expiration of stock purchase warrants previously issued of \$1,390,000 (31 January 2010 – \$nil);

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- A non-cash reversal of previously recorded stock-based compensation costs relating to board and other management changes resulting in a credit of \$119,000 in the current year (31 January 2010 – expense of \$915,000);
- A non-cash charge of \$4.920 million for the amendment of stock warrants in the prior year period (current year period - \$nil), and
- Investor relations and financing expenses of \$420,000 due to the filing of an F-3 registration statement during the prior year period (current year period - \$118,000).

These items were partially offset by a \$3.647 million non-cash loss on refinancing of convertible debt during the current year. During the current year the Company's decision to review alternatives for construction financing and not to renew its agreement with BNP Paribas Loan Services, to advise and assist PolyMet in all aspects of preparation for construction finance, which expired on 31 July 2010. As such, the \$1.830 million, \$1.197 million of which was non-cash related to the fair value of warrants issued, recorded as a deferred financing cost asset was written off to the consolidated statement of loss in the current year. In addition, the Company recorded a loss of \$520,000 in the current year period as a result of its decision to reclassify an asset as held for sale and write-down its carrying value to fair value less cost to sell.

b) Cash Flows:

Cash used in operating activities in the year ended 31 January 2011 was \$3.068 million compared to cash used in the prior year of \$2.429 million. The variance is primarily due to the cash based operating activity differences described above, \$193,000 of exploration expenses in the current year (prior year - \$nil) and changes in working capital balances.

Cash provided by financing activities for the year ended 31 January 2011 was \$8.666 million compared with \$34.111 million in the prior year. The activity in the current year was primarily due to net proceeds of \$9.894 million from a Glencore equity offering (prior year period \$24.501 million), the net funding from issuance of exchangeable secured debentures of \$nil (prior year period - \$9.994 million), the scheduled repayment of \$2,000 million of debt (prior year period - \$1.250 million). During the current year period, the Company received \$808,000 from the issuance of common shares on exercise of stock options (prior year period - \$477,000) and \$nil from the issuance of common shares on the exercise of share warrants (prior year period - \$494,000).

Cash used in investing activities for the year ended 31 January 2011 was \$16.519 million compared with \$17.754 million in the preceding year, with the decrease being primarily the result of lower engineering, project and environmental / permitting costs in the current year period as the Company continued to scale back detailed engineering and design work that is not needed for permitting.

Total cash for the year ended 31 January 2011 decreased by \$10.921 million for a balance of \$10.361 million compared to the year ended 31 January 2010 when cash increased by \$13.928 million to a balance of \$21.282 million.

c) Capital Expenditures:

During the year ended 31 January 2011 the Company capitalized \$14.399 million (2010 - \$23.922 million) of costs primarily directly related to site activity, definition drilling, the draft EIS and permitting as well as engineering and project planning costs.

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Comparison of the years ending 31 January 2010 and 31 January 2009

a) Loss for the Year:

During the year ended 31 January 2010, the Company incurred a loss of \$9.023 million (\$0.06 loss per share) compared to a loss of \$5.523 million (\$0.04 loss per share) in 2009. The increase in the net loss for the period was primarily attributable to:

- A non-cash charge of \$4.920 million for the amendment of stock warrants (prior year period - \$544,000);
- Stock-based compensation expense of \$915,000 (prior year period - \$487,000) with the increase being predominantly due to the granting of additional stock options in the first quarter and the extension of the term of all PolyMet stock options outstanding at 24 June 2009 by two years which was approved by the disinterested shareholders at the Company's Annual and Special of shareholders on 24 June 2009;
- Interest income of \$5,000 (prior year period - \$154,000) with the decrease being due to lower cash balances and interest rates;
- Investor relations and financing expenses of \$420,000 due to the filing of an F-3 registration statement during the 2010 third quarter and additional financing related activities, and
- A foreign exchange loss of \$156,000 in the prior year period due to the strengthening of the U.S. dollar versus the Canadian dollar, compared to a loss of \$24,000 in the current year period.

This was partially offset by an other than temporary impairment loss of \$1,365,000 in the prior year period (current year period - \$nil).

b) Cash Flows:

Cash used in operating activities in the year ended 31 January 2010 was \$2.429 million compared to cash used in the prior year of \$3.290 million. The variance is primarily due to the cash based operating activity differences described above and changes in working capital balances.

Cash provided by financing activities for the year ended 31 January 2010 was \$34.111 million compared with \$13.336 million in the prior year. The activity in the year ended 31 January 2010 was primarily due to net proceeds of \$24.501 million from two Glencore equity offerings in the fourth quarter, the net funding from issuance of exchangeable secured debentures of \$9.944 million (prior year period - \$14.333 million), the scheduled repayment of \$1.250 million of debt (prior year period - \$1.400 million) and deferred financing costs of \$55,000 (prior year period - \$49,000). During the year ended January 31, 2010, the Company received \$477,000 from the issuance of common shares on exercise of stock options (prior year period - \$452,000) and \$494,000 from the issuance of common shares on the exercise of share warrants (prior year period - \$nil).

Cash used in investing activities for the year ended 31 January 2010 was \$17.754 million compared with \$22.776 million in the preceding year, with the decrease being primarily the result of lower engineering, project and environmental / permitting costs in the current year period as the Company scaled back detailed engineering and design work that is not needed for permitting.

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Total cash for the year ended 31 January 2010 increased by \$13.928 million for a balance of \$21.282 million compared to the year ended 31 January 2009 when cash decreased by \$12.730 million to a balance of \$7.354 million.

c) Capital Expenditures:

During the year ended 31 January 2010 the Company capitalized \$23.922 million (2009 - \$27.605 million) of costs primarily directly related to site activity, bonus share accrual, the draft EIS and permitting as well as engineering and project planning costs.

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**Summary of Quarterly Results**

*(All figures in Thousands of U.S. dollars except Loss per share)*

Three Months Ended	Jan. 31 2011 \$	Oct. 31 2010 \$	July 31 2010 \$	Apr 30 2010 \$	Jan 31 2010 \$	Oct. 31 2009 \$	July 31 2009 \$	Apr. 30 2009 \$
<b>Total Revenues</b>	-	-	-	-	-	-	-	-
<b>General and Administrative</b>	(848)	(378)	(2,563)	(942)	(6,177)	(883)	(1,089)	(1,009)
<b>Other Income (Expenses)</b>	(2,872)	168	69	83	12	42	54	27
<b>Net Loss</b>	(3,720)	(210)	(2,494)	(859)	(6,165)	(841)	(1,035)	(982)
<b>Loss per share</b>	(0.02)	(0.00)	(0.02)	(0.01)	(0.03)	(0.01)	(0.01)	(0.01)

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

A non-cash loss of \$3.647 million on refinancing of convertible debt. There were no similar losses recorded in other quarters.

A recovery of previously expensed stock based compensation costs of \$212,000 due to the forfeiture of unvested stock options was recorded in the quarters ended 31 January 2011 and 31 October 2010, respectively. There were no similar stock based compensation recoveries recorded in the other quarters.

The Company recorded future income tax recoveries as the expiration of warrants triggered a capital gain for tax purposes which was offset by the application of tax losses carried forward resulting in a credit of \$1,219,000 and \$171,000 in the quarters ended 31 January 2011, and 31 October 2010, respectively. There were no similar tax recoveries recorded in the other quarters.

A financing cost write-off of \$1.830 million was recorded in the quarter ended 31 July 2010. There were no similar financing cost write-offs recorded in the other quarters.

A loss on asset held for sale was recorded in the quarter ended 31 January 2011.

Exploration expense of \$193,000 was recorded in the quarter ended 30 April 2010. There were no exploration expenses recorded in the other quarters.

Warrant amendment expenses of \$3.915 million and \$1.005 million were recorded in the quarters ended 31 January 2010 and 31 October 2009, respectively. There were no warrant amendment expenses recorded in the other quarters.

The net loss included stock based compensation expense (recovery) for the quarters ended:

1. 31 January 2011 - \$50,000
2. 31 October 2010 - \$(203,000)
3. 31 July 2010 - \$24,000
4. 30 April 2010 - \$10,000
5. 31 January 2010 - \$33,000
6. 31 October 2009 - \$97,000
7. 31 July 2009 - \$332,000
8. 30 April 2009 - \$453,000

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***Financing Activities***

On 17 January 2011, the Company closed an equity financing with Glencore for 5,000,000 common shares at \$2.00 per share for gross proceeds of \$10 million. Transaction costs for the financing were \$106,000.

On 24 November 2009, the Company closed an equity financing with Glencore for 3,773,585 common shares at \$2.65 per share for gross proceeds of \$10 million. On 26 January 2010, the Company closed the second tranche of the previously announced equity financing with Glencore of an additional 5,660,377 common shares at \$2.65 per common share for gross proceeds of \$15 million. Transaction costs for these two financings totaled \$499,000;

During the year ended 31 January 2011 the Company issued 845,000 shares (prior year period – 775,000) upon exercise of options for proceeds of \$808,000 (prior year period - \$477,000) and nil shares (prior year – 167,954) upon exercise of share warrants for proceeds of \$nil (prior year - \$494,000).

On 27 August 2009, the Company announced that it had filed a universal shelf registration on Form F-3 with the U.S. Securities and Exchange Commission (“SEC”). This universal shelf registration allows PolyMet to have the option to offer and sell, from time to time in one or more offerings, up to \$500 million of its debt securities, common shares, warrants and units.

On 18 June 2009 the Company received \$5 million under an existing exchangeable secured debenture agreement. On 31 August 2009 PolyMet received an additional \$5 million under the exchangeable secured debenture agreement (the “Debentures”). These two transactions were part of the financing agreement that the Company entered into on 31 October 2008 with Glencore for an aggregate of US\$50 million exchangeable secured debentures due on 30 September 2011 to be issued by PolyMet US and guaranteed by the Company. The Debentures bear interest at 12-month US dollar LIBOR plus 4% and interest is payable in cash or by increasing the principal amount of the Debentures, at PolyMet’s option, for payments on or before 30 September 2009, and at Glencore’s option thereafter. The Debentures are secured by the assets of PolyMet and PolyMet US, including PolyMet’s 100% shareholding in PolyMet US.

The Debentures are exchangeable into common shares of PolyMet at Glencore’s option at US\$4.00 per share. The Issuer can, at its option, prepay the Debentures if PolyMet’s shares trade at a 20-day volume weighted average price equal to or exceeding US\$6.00, at which time, and at Glencore’s option, Glencore could exchange the Debentures for common shares of PolyMet within 30 days in lieu of payment. Repayment between 1 October 2009 and 30 September 2010 would be at 105% of the then outstanding principal of the Debentures, repayment between 1 October 2010 and 30 September 2011 would be at 102.5% of the outstanding principal.

US\$7.5 million of the Debentures were issued on 31 October 2008, US\$7.5 million were issued on 22 December 2008, \$5.0 million on 18 June 2009 and \$5.0 million on 31 August 2009.

On 31 October 2008, PolyMet issued to Glencore warrants to purchase 6.25 million common shares of PolyMet at US\$5.00 if exercised before the NorthMet Project has produced a total of 20,000 metric tonnes of concentrate, or US\$6.00 thereafter. The warrants expire on 30 September, 2011. If the volume-weighted 20-day average price of PolyMet’s common shares

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trade at a 50% premium to the then applicable exercise price, Glencore must exercise the warrants within 30 days or the warrants will expire.

On 17 November 2009, the Company announced that it agreed to modify certain terms of the above transaction. Under the new terms the Glencore Warrants entitle Glencore to purchase 6.25 million common shares of PolyMet at US\$3.00 and expire on 30 September, 2011. If the 20-day volume weighted average price of PolyMet's shares is 150% of the exercise price or more (\$4.50), and the Final EIS has been published in the Minnesota Department of Natural Resources EQB Monitor, PolyMet can accelerate the expiration of the Glencore Warrants to not less than 21 business days after the notice of acceleration. The incremental \$158,000 increase in the fair value of the warrants due to the warrant exchange was debited to warrant amendment expense and credited to contributed surplus.

PolyMet can accelerate the expiration of the Glencore Warrants to not less than 21 business days after the notice of acceleration.

Separately in November 2009, PolyMet agreed to modify the terms of the final \$25 million Tranche E of the \$50 million Debenture with Glencore such that Tranche E, if drawn, can be exchanged at US\$2.65 per share. The first four tranches totaling US\$25 million (excluding capitalized interest) that have already been drawn will continue to be exchangeable at US\$4.00 per share.

On 12 November 2010, the Company announced that it had renegotiated its debenture financing from Glencore. The agreed amendments to the debenture financing are as follows:

- The maturity date and, therefore accounting for accretion, of the Tranche A-D Debentures has been extended from 30 September, 2011 to 30 September, 2012. The Issued Debentures were issued in four tranches between October 2008 and September 2009. The total initial principal of the Debentures is US\$25 million with US\$2.334 million of accrued interest as of 31 October, 2010. The Issued Debentures continue to be exchangeable into common shares of PolyMet at US\$4.00 per share, as agreed to in 2008.
- Cancellation of Glencore's commitment to purchase, and the Company's commitment to issue, US\$25 million of Tranche E Debentures which were to be issued upon publication of the Final Environmental Impact Statement, receipt of a term sheet for construction financing, and other customary conditions.
- Cancellation of warrants to purchase 6.25 million common shares of PolyMet at US\$3.00 at any time until 30 September, 2011 issued to Glencore in connection with Debentures.
- Issuance of warrants to purchase 3 million common shares of PolyMet at US\$2.00 at any time until 31 December, 2015, issued to Glencore in consideration of the amendments listed above.

Separately, on 12 November 2010, the Company announced that it had entered into a definitive agreement with Glencore to sell in a private placement 15 million common shares at US\$2.00 per share for gross proceeds of US\$30 million, before deducting estimated offering expenses. Completion of the sale of these shares and funding are expected to occur in the following three tranches subject, in each case, to certain closing conditions:

- Tranche 1 of US\$10 million (closed on 17 January, 2011);
- Tranche 2 of US\$10 million will close on the earlier of (i) the date of the Company's funding requirement as set forth in the Company's three year operating budget to be approved by Glencore (the "Budget"), and (ii) 17 October, 2011, and

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- Tranche 3 of US\$10 million is expected to close on the earlier of a) within ten business days following receipt by PolyMet of key permits, in a form reasonably acceptable to Glencore, that will enable the start of construction of the Project, and b) 15 October, 2012.

On 12 November 2010, the Company announced that it had entered into a definitive agreement with Glencore to sell in a private placement 15 million common shares at US\$2.00 per share for gross proceeds of US\$30 million, before deducting estimated offering expenses. Completion of the sale of these shares and funding are expected to occur in the following three tranches subject, in each case, to certain closing conditions:

- Tranche 1 of US\$10 million closed on 17 January 2011;
- Tranche 2 of US\$10 million will close on the earlier of (i) the date of the Company's funding requirement as set forth in the Company's three year operating budget to be approved by Glencore (the "Budget"), and (ii) 17 October 2011, and
- Tranche 3 of US\$10 million will close on the earlier of (i) the date of the Company's funding requirement as set forth in the Company's three year operating budget to be approved by Glencore (the "Budget"), ii) within ten business days following receipt by PolyMet of key permits, in a form reasonably acceptable to Glencore, that will enable the start of construction of the Project, and iii) 15 October 2012.

Glencore has a right of first refusal to provide all material financings, subject to regulatory approval, if it owns 10% or more of the issued and outstanding shares of PolyMet and, if it owns more than 5% of the issued and outstanding shares of PolyMet, Glencore has the right to participate in any equity-related financing to maintain its partially diluted ownership interest (19.6% as of 31 January 2011).

In accordance with both Canadian GAAP and US GAAP, the 12 November 2010 transactions, whereby PolyMet's existing convertible debt at that date with a book value of \$26.730 million was deemed to have been extinguished and reissued, all of the costs associated with the transaction have been recorded as a non-cash expense of \$3,647,000, comprising:

- The change in fair value of the conversion feature resulting from its term being extended from 30 September 2011 to 30 September 2012 of \$2.533 million;
- The difference in fair value between the warrants to purchase 6.25 million common shares at \$3 per share exercisable until 30 September 2011 and the warrants to purchase 3 million common shares at \$2 per share exercisable until 31 December 2015 of \$3.217 million;
- The amounts of discount and deferred costs remaining to accreted and amortized over the life of the debt of \$522,000, less
- The premium of \$2.625 million resulting from the price of the common shares to be sold to Glencore compared with the market price at the time of the arrangement.

During the year ended 31 January 2009 the Company issued 312,800 shares upon exercise of options for proceeds of \$452,000.

During the year ended 31 January 2008 the Company issued 15 million units at US\$2.75 per unit, with each unit comprising one common share and one-half of one warrant (for accounting purposes, the value of the units was bifurcated between the common shares and the warrants). Each whole warrant was exercisable into a common share at a price of US\$4.00 at any time until 13 October 2008 (see amendment below), subject to an early trigger if the 20-day volume weighted average price of the common shares is US\$6.00 or more. In connection with the private placement, the Company paid finders' fees totaling US\$1.43 million in cash,

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150,000 shares and 520,000 broker warrants having the same terms as the warrants described above. During the period the Company also issued 462,200 shares upon exercise of options for proceeds of \$303,000.

On 10 October 2008, the Company announced that it had received the consent from the holders of more than two-thirds of the 8,020,000 warrants issued as part of the April 2007 private placement to exchange those warrants into:

- 4,010,000 warrants, each warrant entitling the holder to purchase one share of PolyMet common stock at US\$3.00 per share at any time until the sooner of 30 calendar days after publication of the draft Environmental Impact Statement by the State of Minnesota in the state's Environmental Quality Board Monitor and 13 October, 2009, and
- 4,010,000 warrants, each warrant entitling the holder to purchase one share of PolyMet common stock at US\$5.00 if exercised before the NorthMet Project has produced a cumulative total of 20,000 metric tonnes of concentrate, or US\$6.00 thereafter and prior to 31 August, 2011. PolyMet can accelerate the expiration of the warrants if PolyMet's volume-weighted 20-day average stock price trades at a 50% premium to the exercise price applicable at any time.

The incremental \$544,000 increase in the fair value of the warrants due to the warrant exchange was debited to warrant amendment expense and credited to contributed surplus in the year ended 31 January 2009.

In October 2009, the Company received the consent from holders of more than two-thirds of the above warrants to exchange those the 4,010,000 warrants due to expire on 13 October 2009 for 4,010,000 warrants, each warrant entitling the holder to purchase one share of PolyMet common stock at US\$3.00 per share at any time until the sooner of 30 calendar days after publication of the draft Environmental Impact Statement by the State of Minnesota in the state's Environmental Quality Board Monitor and 31 December, 2009. The incremental \$1,005,000 increase in the fair value of the warrants due to the warrant exchange was debited to warrant amendment expense and credited to contributed surplus.

In November 2009, the Company received the consent from holders of more than two-thirds of the above warrants to exchange the 4,010,000 warrants due to expire the earlier of 30 calendar days after publication of the draft Environmental Impact Statement by the State of Minnesota in the state's Environmental Quality Board Monitor and 31 December, 2009 for 4,010,000 warrants, each warrant entitling the holder to purchase one share of PolyMet common stock at US\$3.00 per share at any time until the sooner of 21 business days after publication of the final Environmental Impact Statement by the State of Minnesota in the state's Environmental Quality Board Monitor and 31 December 2010. The incremental \$3,757,000 increase in the fair value of the warrants due to the warrant exchange was debited to warrant amendment expense and credited to contributed surplus.

Warrants to purchase 167,954 shares of PolyMet common stock had been exercised prior to 31 January 2010 and, on 31 December 2010 warrants to purchase 3,842,046 shares of PolyMet common stock at \$3.00 per share expired. The Company recorded a future income tax recovery as the expiration of the warrants triggered a capital gain for tax purposes which was offset by the application of tax losses carried forward resulting in a credit of \$1,219,000.

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***Liquidity and Capital Resources***

As at 31 January 2011 the Company had working capital of \$779,000 compared with working capital of \$16.313 million at 31 January 2010 consisting primarily of cash of \$10.361 million (31 January 2010 - \$21.282 million), prepaid expenses of \$636,000 (31 January 2010 - \$512,000), accounts payable and accrued liabilities of \$2.444 million (31 January 2010 - \$2.953 million), the current portion of the notes to Cliffs of \$6.750 million (31 January 2010 - \$2.000 million) and the current portion of asset retirement obligations of \$1.408 million (31 January 2010 - \$756,000). The Company expects to pay the remaining balance of \$1.775 million (31 January 2010 - \$8.529 million) long term notes to Cliffs and the convertible debt principal balance of \$25 million plus capitalized interest from working capital, additional financing and funds from operations once commercial production has commenced. The Company's cash is primarily held in deposits and bearer deposits of a major Canadian bank and does not include any exposure to asset-backed commercial paper.

The following table lists as of 31 January 2011 information with respect to the Company's known contractual obligations:

<i>Contractual Obligations</i>	<i>Payments due by period</i>				
	<i>Total</i>	<i>Less than 1 year</i>	<i>1 – 3 years</i>	<i>3 – 5 years</i>	<i>More than 5 years</i>
Accounts payable and accrued liabilities	\$2,444,000	\$2,444,000	\$-	\$-	\$-
Long-term debt obligations	38,720,000	8,340,000	30,380,000	-	-
Asset retirement obligation	26,495,000	1,469,000	615,000	537,000	23,874,000
<b>Total</b>	<b>\$67,659,000</b>	<b>\$12,253,000</b>	<b>\$30,995,000</b>	<b>\$537,000</b>	<b>\$23,874,000</b>

Long-term debt obligations (including the current portion) are comprised of long-term and convertible debt balances, are set out in this table on an undiscounted basis and include anticipated interest. Asset retirement obligation represents the undiscounted obligation at 31 January 2011.

At 31 January 2011 the Company had non-binding commitments in 2011 and 2012 of \$1.106 million to pay options to maintain its right to acquire certain lands that it will need at permitting. These lands include land that the Company expects to exchange with the USFS for surface rights at the mine site and land for wetland credits.

As at 31 January 2011 the Company, in addition to its obligation to Cliffs and Glencore as described herein, has obligations to issue shares under the Company's Bonus Share Plan. The Company has received shareholder approval for the Bonus Shares of Milestones 1 – 4 and regulatory approval for Milestones 1, 2 and 3. Milestone 4 is subject to regulatory approval. To 31 January 2011, 5,240,000 shares have been issued for the achievement of Milestones 1, 2 and 3. The bonus shares allocated for Milestones 1 through 3 are valued using the Company's closing trading price on 28 May 2004 of CDN\$0.75 per share, the date of the approval of the bonus plan by the disinterested shareholders. The bonus shares allocated for Milestone 4 are valued using the Company's closing trading price on 17 June 2008 of US\$3.80 per share, the date of the approval of the bonus plan by the disinterested shareholders. As at 4 May 2011, the Company has outstanding firm commitments of approximately \$3.500 million, the majority of which relates to the Supplemental Draft Environmental Impact Study process.

In May 2009, the Company determined that Milestone 2 of its Bonus Share Plan, the negotiation and completion of an off-take agreement with a senior metals producer for the purchase of nickel-hydroxide produced from the NorthMet Project, and / or an equity

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investment in the Company by such a producer or producers, had been achieved. As a result, the Company issued the related 1,300,000 common shares to certain directors and insiders.

While these consolidated financial statements have been prepared on the basis that the Company will continue as a going concern, which assumes that the Company will be able to meet its commitments, continue operations, realize its assets and discharge its liabilities in the normal course of business for the foreseeable future, there are conditions that cast significant doubt on the validity of that assumption. The Company has incurred losses since inception and has an accumulated deficit of \$78.832 million at 31 January 2011.

The Company will need to raise sufficient funds to meet its current obligations as well as fund ongoing development, capital expenditures and administration expenses, in accordance with the Company's spending plans.

On 12 November 2010, the Company announced that it had entered into a definitive agreement with Glencore AG ("Glencore") to sell in a private placement 15 million common shares at US\$2.00 per share for gross proceeds of US\$30 million, before deducting estimated offering expenses. Completion of the sale of these shares and funding are expected to occur in the following three tranches subject, in each case, to certain closing conditions:

- Tranche 1 of US\$10 million closed on 17 January, 2011 (received by the Company);
- Tranche 2 of US\$10 million will close on the earlier of (i) the date of the Company's funding requirement as set forth in the Company's three year operating budget approved by Glencore (the "Budget"), and (ii) 17 October, 2011; and
- Tranche 3 of US\$10 million will close on the earlier of (i) the date of the Company's funding requirement as set forth in the Budget, (ii) the tenth Business Day following receipt by the Company of key permits, in forms reasonably acceptable to Glencore, that enable the Company to begin construction of the Project, and (iii) 15 October, 2012.

In order to meet all of its obligations for the period to 31 January 2012, including paying off the current portion of its long-term debt, PolyMet Mining Corp. will have to receive all of the remaining equity tranches, or obtain alternative financing. Management is in the latter stage of discussions with Glencore with respect to the budget and believes that agreement will be reached by 30 June 2011, which will enable the Company to access to the second and third \$10 million tranches of the equity funding in a timely manner that will enable it to meet its obligations. However, this cannot be assured.

Management believes that based upon the underlying value of the NorthMet Project, that it will be able to obtain the necessary financing from Glencore or other sources to meet PolyMet Mining Corp.'s requirements on an ongoing basis; however, there can be no assurance that the necessary financing will be obtained. Factors that could affect the availability of financing include the state of international debt and equity markets, investor perceptions and expectations and the global metals markets.

PolyMet's financial statements do not reflect any adjustments to the carrying values of assets and liabilities, reported expenses, and balance sheet classifications that would be necessary should the Company be unable to continue as a going concern, and these adjustments could be material.

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***Shareholder Rights Plan***

Effective 25 May 2007, the Company adopted an updated Shareholder Rights Plan ("Rights Plan"), which was approved by the Company's shareholders on 27 June 2007 and modified by the Company's shareholders on 17 June 2008. Under the Rights Plan, the Company has issued one right for no consideration in respect of each outstanding common share of the Company to all holders of record of common shares on 4 December 2003. All common shares subsequently issued by the Company during the term of the Rights Plan will have one right represented for each common share held by the shareholder of the Company. The term of the Rights Plan is 10 years, unless the rights are earlier redeemed or exchanged. The Rights issued under the Rights Plan become exercisable only if a party acquires 20% or more of the Company's common shares without complying with the Rights Plan or without the approval of the Board of Directors of the Company.

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

***Off Balance-Sheet Arrangements***

The Company does not utilize off-balance sheet arrangements.

***Related Party Transactions***

The Company has conducted transactions with officers, directors and persons or companies related to directors and paid or accrued amounts as follows:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Consulting fees paid to David Dreisinger, a Director of the Company	\$ 59	\$ 59	\$ 56
	<u>\$ 59</u>	<u>\$ 59</u>	<u>\$ 56</u>

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

During the year ended 31 January 2011, the Company paid \$59,000 (2010 - \$59,000 and 2009 - \$56,000) to Dr. Dreisinger for consulting fees primarily in connection with activities related to the processing / technical side of the NorthMet Project and related expenses (the latter were supported by invoices and receipts). The consulting fees were based on a monthly fee of Canadian \$5,500 plus general sales tax. Throughout the term of his engagement, Dr. Dreisinger has conducted in-person and telephonic meetings with Mr. William Murray, formerly the Company's Executive Chairman and before that its President and Chief Executive Officer, and other members of management at which he provided both verbal and written updates on the status of test work and made recommendations for future activities. These meetings occurred approximately every two to three weeks for the past six years.

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The agreement with Dr. Dreisinger was entered into at a time when the Company's current business plans were being formulated and were month to month and oral in nature. The agreement was approved by Mr. William Murray. It was discussed with the Company's board of directors who did not consider that a formal approval and written contract was necessary at that time. The Company believes that the contract was at terms at least as good as could be obtained from third parties.

***Proposed Transactions***

There are no proposed transactions that will materially affect the performance of the Company.

***Subsequent Events***

On 2 February 2011 the Company announced that it had simplified the proposed metallurgical process and now plans to build the project in two phases:

- Phase I: produce and market concentrates containing copper, nickel, cobalt and precious metals, and
- Phase II: process the nickel concentrate through a single autoclave, resulting in production and sale of high grade copper concentrate, value added nickel-cobalt hydroxide, and precious metals precipitate products.

Previous plans included a second autoclave and a copper solvent extraction/electro-winning ("SX-EW") circuit to produce copper metal along with value added nickel-cobalt hydroxide and precious metals precipitate products. The changes reflect continued metallurgical process and other project improvements as well as improved environmental controls that are being incorporated into the Supplemental Draft EIS. The advantages, compared with the earlier plan, include a better return on capital investment, reduced financial risk, lower energy consumption, and reduced waste disposal and emissions at site. Approximately \$127 million of the total \$602 million capital costs estimated in the May 2008 DFS Update will not be incurred in this revised plan.

On 10 March 2011 PolyMet appointed Alan R. (Al) Hodnik and Michael M. (Mike) Sill to its Board of Directors. Mr. Hodnik was named President of ALLETE, Inc. in May 2009 and CEO of that company in May 2010. Since joining ALLETE in 1982, Mr. Hodnik has served as Vice President-Generation Operations, Senior Vice President of Minnesota Power Operations, and Chief Operating Officer. As Chief Operating Officer, he led transmission, distribution, generation, and engineering for all aspects of the Company. Mr. Hodnik was the elected mayor of the City of Aurora, MN from 1988 to 1998. He is a member of the board of Essential Health - East Region and of the Area Partnership for Economic Expansion (APEX).

Mr. Sill has served as President and CEO of Road Machinery & Supplies Co. since 1994, having joined the company in 1988. Road Machinery is a distributor of construction, mining and forestry equipment. Educated at Dartmouth College and J.L. Kellogg Graduate School of Management, Mr. Sill started his career as a financial analyst and commercial lending officer with The Northern Trust Company. He has served on the boards of the Equipment Distributors Association of MN, Associated General Contractors of MN, and the Twin Cities Regional Board of US Bank.

On 10 March 2011, the Company granted 750,000 options to certain independent directors with an average exercise price of USD\$2.04 per option. The Board of Directors also approved bonuses comprising 327,500 restricted stock for US employees and consultants and restricted

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stock units for Canadian employees and consultants. 50% of each award to be issued upon receipt of permits and the balance to be issued upon the start of production.

In March 2011, PolyMet entered into an agreement with the State of Minnesota's Department of Natural Resources committing it to an additional \$2,818,000 through 1 April 2012 for continued work on the SDEIS.

On 15 April 2011 PolyMet reported that the Company and the Lead Agencies expect to finalize detailed work plans for the Supplemental Draft EIS by early May. The detailed project, which includes the simplified metallurgical process and reduction in capital costs that the Company announced on 2 February, 2011, will then be modeled to predict environmental impacts of the project. The third party contractor hired by the lead agencies will then prepare a preliminary supplemental draft Environmental Impact Statement, which will be reviewed by the lead agencies, cooperating agencies (including the US Environmental Protection Agency and tribal governments) and PolyMet. Once that review process has been completed, the supplemental draft EIS will be finalized for publication and public comment. The lead agencies anticipate that the public comment period will commence during the fall of 2011.

On 15 April 2011 the Board of the IRRRB reapproved a secured loan to Poly Met Mining, Inc. of up to \$4 million, which is expected to close on or before 30 June 2011. The loan will be secured by the land to be acquired from proceeds of the loan, carry a fixed interest rate of 5% per annum, and will be repayable on 30 June 2016. Subject to regulatory approval, PolyMet also agreed to issue warrants giving the IRRRB the right to purchase up to 400,000 shares of its common stock at US\$2.50 per share at any time until the earlier of 30 June 2016 and one year after permits are received.

***International Financial Reporting Standards ("IFRS") and update on plan to transition to IFRS***

The Company is required to present full comparative financial information under IFRS for the year ended 31 January 2012. The transition date to IFRS is 1 February, 2010. The transition requires the restatement of the opening balance sheet at the transition date, as well as the results reported under Canadian GAAP for the year ended 31 January 2011, on a quarterly basis.

Management is in the process of assessing the implications of IFRS transitions. Management has completed a detailed diagnostic review, identifying significant GAAP differences that will impact the Company's financial statements.

Management has added to its IFRS resources in order to position it to carry out the IFRS transition.

Management has performed detailed component evaluations for the balances and totals that existed at 31 January 2010. On a preliminary basis, management has identified the following potential areas of major differences between the Company's current accounting policies and those that the Company expects to apply in preparing IFRS financial statements:

- Impairment of Assets – Under IFRS the Company is to consider impairment indicators and compare the carrying value of assets to the present value of projected cash flows in order to determine whether any impairments are required. Impairments may be reversed in subsequent periods.

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- Convertible Debt – Under IFRS, the Company would use the residual method to allocate proceeds to the various elements of its convertible debt transactions and expense the portion relating to warrants.
- Asset Retirement Obligations – IFRS requires estimates of provisions to be revisited at every reporting date. This includes re-assessing the appropriateness of assumptions used in estimating the carrying value of the provisions. The Company expects that the estimate of asset retirement obligations will have to be updated at every reporting date, including updates to the discount rate used in determining the present value of the obligations reflecting a risk-free as opposed to credit-risk adjusted rate.

Management has completed the detailed component evaluations. This process has allowed the Company to determine the major differences between IFRS and the Company's current accounting policies and quantify those differences.

IFRS 1 contains various elective exemptions, which are intended to provide relief from fully retrospective application of specific IFRS standards. Not all of the available exemptions currently apply to the Company, however, management has evaluated the following elections with regards to the applicable exemptions:

Business Combinations – an entity may elect to take an exemption from IFRS 3R and IAS 21 for historic business combinations which, in the case of PolyMet, may have occurred prior to February 2003.

Share based payments – a first-time adopter is not required to apply IFRS 2 to equity instruments that were granted after 7 November 2002 and vested before the date of transition to IFRS.

Fair valuation of property plant and equipment at deemed cost – an entity may elect to measure an item of property, plant and equipment at the date of transition to IFRS at its fair value and use that fair value as its deemed cost at that date. The Company does not expect to make use of this exemption.

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**Other MD&A Requirements**

**Outstanding Share Data**

Authorized Capital: Unlimited common shares without par value.

Issued and outstanding: As at 4 May 2011, 154,995,791 common shares were issued and outstanding.

Outstanding options, warrants and convertible securities as at 4 May 2011:

Type of Security	Number	Exercise Price (US\$)	Expiry Date
Common share warrants	4,010,000	(Note 1)	August 31, 2011
Stock options	725,000	0.69	05 July 2011
Stock options	50,000	0.83	18 October 2011
Stock options	75,000	0.68	30 March 2012
Stock options	350,000	0.89	1 May 2012
Stock options	40,000	0.99	15 June 2012
Stock options	1,240,000	1.43	19 September 2012
Stock options	200,000	1.26	24 October 2012
Stock options	200,000	1.21	5 December 2012
Stock options	2,400,000	2.90	20 March 2013
Stock options	325,000	3.12	19 June 2013
Stock options	300,000	4.01	1 September 2013
Stock options	75,000	3.68	22 September 2013
Stock options	525,000	3.46	5 January 2014
Stock options	1,250,000	2.99	13 February 2014
Stock options	250,000	2.92	12 March 2014
Stock options	50,000	2.89	23 March 2014
Stock options	360,000	3.00	4 September 2014
Stock options	205,000	3.05	12 December 2014
Stock options	70,000	3.03	11 January 2015
Stock options	100,000	2.87	31 January 2015
Stock options	500,000	2.72	15 February 2015
Stock options	100,000	3.92	2 June 2015
Stock options	175,000	3.22	30 July 2015
Common share warrants	3,000,000	(Note 2) 2.00	31 December 2015
Stock options	585,000	0.82	30 January 2016
Stock options	910,000	0.82	17 February 2016
Stock options	115,000	2.67	15 October 2016
Stock options	60,000	3.54	8 January 2017
Stock options	300,000	2.17	25 January 2018
Stock options	750,000	2.04	10 March 2018

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Note 1: Each warrant entitles the holder to purchase one share of PolyMet common stock at US\$5.00 if exercised before the NorthMet Project has produced a cumulative total of 20,000 metric tonnes of concentrate, or US\$6.00 thereafter and prior to 31 August, 2011. PolyMet can accelerate the expiration of the warrants if PolyMet's volume-weighted 20-day average stock price trades at a 50% premium to the exercise price applicable at any time.

Note 2: Each warrant entitles the holder to purchase one common share of PolyMet at US\$2.00 and expire on 31 December 2015.

At the Annual and Special Meeting of the shareholders of PolyMet on 24 June 2009, the disinterested shareholders of the Company approved an extension of the expiry date by two years of all stock options outstanding as at 24 June 2009.

Effective 25 May 2007, the Company adopted a new Omnibus Share Compensation Plan ("Stock Option Plan"), which was approved by the Company's shareholders' on 27 June 2007. The Stock Option Plan covers the Company's employees, directors, officers and consultants. The options are granted for varying terms ranging from two to five years. The maximum number of common shares under the stock option plan shall not exceed (i) 10% of the outstanding common shares of the Company at the time of granting of the options and (ii) 18,592,888 common shares of the Company, of which 3,640,000 common shares are reserved for issuance as awards other than options.

***Risks and Uncertainties***

An investment in the Company's common shares is highly speculative and subject to a number of risks and uncertainties. Only those persons who can bear the risk of the entire loss of their investment should participate. An investor should carefully consider the risks described below and other information filed with the Canadian and United States securities regulators before investing in the Company's common shares. The risks described below are not the only ones faced. Additional risks that the Company currently believes are immaterial may become important factors that affect the Company's business. If any of the following risks occur, the Company's business, operating results and financial condition could be seriously harmed and investors could lose all of their investment.

Risks Relating to PolyMet's Business

*The Company's metals exploration and development efforts are highly speculative in nature and may be unsuccessful.*

As a development stage company, PolyMet's work is speculative and involves unique and greater risks than are generally associated with other businesses.

The development of mineral deposits involves uncertainties, which careful evaluation, experience, and knowledge cannot eliminate. Although the discovery of an ore body may result in substantial rewards, few properties explored are ultimately developed into producing mines. It is impossible to ensure that the current development program the Company has planned will result in a profitable commercial mining operation. Significant capital investment is required to achieve commercial production from successful exploration efforts.

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PolyMet is subject to all of the risks inherent in the mining industry, including, without limitation, the following:

- Success in discovering and developing commercially viable quantities of minerals is the result of a number of factors, including the quality of management, the interpretation of geological data, the level of geological and technical expertise and the quality of land available for exploration;
- Exploration for minerals is highly speculative and involves substantial risks, even when conducted on properties known to contain significant quantities of mineralization, and most exploration projects do not result in the discovery of commercially mineable deposits of ore;
- Operations are subject to a variety of existing laws and regulations relating to exploration and development, permitting procedures, safety precautions, property reclamation, employee health and safety, air and water quality standards, pollution and other environmental protection controls, all of which are subject to change and are becoming more stringent and costly to comply with;
- A large number of factors beyond the Company's control, including fluctuations in metal prices and production costs, inflation, the proximity and liquidity of precious metals and energy fuels markets and processing equipment, government regulations, including regulations relating to prices, taxes, royalties, land tenure, land use, importing and exporting of minerals and environmental protection, and other economic conditions, will affect the economic feasibility of mining;
- Substantial expenditures are required to construct mining and processing facilities;
- Title to mining properties may be subject to other claims, and
- In the development stage of a mining operation, PolyMet's mining activities could be subject to substantial operating risks and hazards, including metal bullion losses, environmental hazards, industrial accidents, labor disputes, encountering unusual or unexpected geologic formations or other geological or grade problems, encountering unanticipated ground or water conditions, cave-ins, pit-wall failures, flooding, rock falls, periodic interruptions due to inclement weather conditions or other unfavorable operating conditions and other acts of God. Some of these risks and hazards are not insurable or may be subject to exclusion or limitation in any coverage which the Company obtains or may not be insured due to economic considerations.

*PolyMet has no production history and the Company does not know if it will generate revenues in the future.*

While PolyMet was incorporated in 1981, it has no history of producing minerals. The Company has not developed or operated any mines, and has no operating history upon which an evaluation of its future success or failure can be made. PolyMet currently has no mining operations of any kind. The Company's ability to achieve and maintain profitable mining operations is dependent upon a number of factors, including its ability to either attract a partner to operate, or to successfully build and operate mines, processing plants and related infrastructure itself.

The Company is subject to all the risks associated with establishing new mining. It may not successfully establish mining operations or profitably produce metals at any of PolyMet's properties. As such, PolyMet does not know if it will ever generate revenues.

*PolyMet has a history of losses which it expects to continue into the future.*

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As a development stage company with no holdings in any producing mines, PolyMet continues to incur losses and expects to incur losses in the future. As of 31 January 2011, the Company had an accumulated deficit of \$78,832,000. The Company may not be able to achieve or sustain profitability in the future. If it does not begin to generate revenues or find alternate sources of capital, the Company may either have to suspend or cease operations.

*PolyMet may not be able to raise the funds necessary to develop its mineral properties.*

The Company will need to seek additional financing to complete its development and construction of the NorthMet Project. Sources of such external financing include future equity offerings, advance payments by potential customers to secure long-term supply concentrate or metal supply contracts, grants and low-cost debt from certain state financial institutions, and commercial debt secured by the NorthMet Project. The failure to obtain such additional financing could have a material adverse effect on the Company's results of operations and financial condition. It may not be able to secure the financing necessary to sustain exploration and development activities in the future. If the Company cannot raise the money necessary to continue to explore and develop its property, it will have to suspend or cease operations.

*PolyMet's actual mineral reserves and mineral resources may not conform to its established estimates.*

The figures for mineral reserves and mineral resources stated in this MD&A are estimates and no assurances can be given that the anticipated tonnages and grades will be achieved or that the indicated level of recovery will be realized. Market fluctuations and the prices of metals may render reserves and mineral resources uneconomic. Moreover, short-term operating factors relating to the mineral deposits, such as the need for the orderly development of the deposits or the processing of new or different grades of ore, may cause a mining operation to be unprofitable in any particular accounting period.

*There is no assurance that any of PolyMet's mineral resources, not currently classified as mineral reserves, will ever be classified as mineral reserves under the disclosure standards of the SEC.*

This MD&A discusses PolyMet's mineral resources in accordance with Canadian National Instrument 43-101. Resources are classified as "measured resources", "indicated resources" and "inferred resources" under NI 43-101. However, U.S. investors are cautioned that the SEC does not recognize these resource classifications. There is no assurance that any of PolyMet's mineral resources, not currently classified as mineral reserves, will be converted into mineral reserves under the disclosure standards of the United States Securities and Exchange Commission.

*PolyMet's future activities could be subject to environmental laws and regulations which may have a materially adverse effect on its future operations.*

PolyMet, like other development stage companies doing business in the United States and Canada, is subject to a variety of federal, provincial, state and local statutes, rules and regulations designed to, among other things:

- protect the environment, including the quality of the air and water in the vicinity of exploration, development, and mining operations;

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- remediate the environmental impacts of those exploration, development, and mining operations;
- protect and preserve wetlands and endangered species, and
- mitigate negative impacts on certain archeological and cultural sites.

The Company is required to obtain various governmental permits to conduct exploration, development, construction and mining activities at its properties. Obtaining the necessary governmental permits is often a complex and time-consuming process involving numerous U.S. or Canadian federal, provincial, state, and local agencies. The duration and success of each permitting effort is contingent upon many variables not within the Company's control. In the context of obtaining permits or approvals, PolyMet must comply with known standards, existing laws, and regulations that may entail greater or lesser costs and delays depending on the nature of the activity to be permitted and the interpretation of the laws and regulations implemented by the permitting authority. The failure to obtain certain permits or the adoption of more stringent permitting requirements could have a material adverse effect on the Company's business, operations, and properties and it may be unable to proceed with its exploration and development programs.

Federal legislation and implementing regulations adopted and administered by the U.S. Environmental Protection Agency, Forest Service, Bureau of Land Management, Fish and Wildlife Service, Mine Safety and Health Administration, and other federal agencies, and legislation such as the Federal Clean Water Act, Clean Air Act, National Environmental Policy Act, Endangered Species Act, and Comprehensive Environmental Response, Compensation, and Liability Act, have a direct bearing on U.S. exploration, development and mining operations. Due to the uncertainties inherent in the permitting process, the Company cannot be certain that it will be able to obtain required approvals for proposed activities at any of its properties in a timely manner, or that its proposed activities will be allowed at all.

The process of obtaining federal and local regulatory approvals is increasingly cumbersome, time-consuming, and expensive, and the cost and uncertainty associated with the permitting process could have a material adverse effect on exploring, developing or mining PolyMet's properties. Moreover, compliance with statutory environmental quality requirements described above may require significant capital outlays, significantly affect the Company's earning power, or cause material changes in its intended activities. Environmental standards imposed by federal, state, or local governments may be changed or become more stringent in the future, which could materially and adversely affect the Company's proposed activities.

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*Because the price of metals fluctuate, if the prices of metals in PolyMet's ore body decrease below a specified level, it may no longer be profitable to develop the NorthMet Project.*

Prices of metals are determined by some of the following factors:

- expectations for inflation;
- the strength of the United States dollar;
- global and regional supply and demand, and
- political and economic conditions and production costs in major metals producing regions of the world.

The aggregate effect of these factors on metals prices is impossible for the Company to predict. In addition, the prices of metals are sometimes subject to rapid short-term and/or prolonged changes because of speculative activities. The current demand for and supply of various metals affect the prices of copper, nickel, cobalt, platinum, palladium and gold, but not necessarily in the same manner as current supply and demand affect the prices of other commodities. The supply of these metals primarily consists of new production from mining. If the prices of copper, nickel, cobalt, platinum, palladium and gold are, for a substantial period, below PolyMet's foreseeable costs of production, the Company could cease operations.

*PolyMet may not have adequate, if any, insurance coverage for some business risks that could lead to economically harmful consequences to the Company.*

The Company's businesses are generally subject to a number of risks and hazards, including:

- industrial accidents;
- railroad accidents;
- labor disputes;
- environmental hazards;
- electricity stoppages;
- equipment failure, and
- severe weather and other natural phenomena.

These occurrences could result in damage to, or destruction of, mineral properties, production facilities, transportation facilities, or equipment. They could also result in personal injury or death, environmental damage, waste of resources or intermediate products, delays or interruption in mining, production or transportation activities, monetary losses and possible legal liability. The insurance the Company maintains against risks that are typical in its business may not provide adequate coverage. Insurance against some risks (including liabilities for environmental pollution or certain hazards or interruption of certain business activities) may not be available at a reasonable cost or at all. As a result, accidents or other negative developments involving the Company's mining, production or transportation facilities could have a material adverse effect on its operations.

*The mining industry is an intensely competitive industry.*

PolyMet faces intense competition from other mining and producing companies. In recent years, the mining industry has experienced significant consolidation among some of the Company's competitors, as a result these companies may be more diversified than PolyMet.

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The Company cannot assure you that the result of current or further consolidation in the industry will not adversely affect it.

In addition, because mines have limited lives the Company must periodically seek to replace and expand its reserves by acquiring new properties. Significant competition exists to acquire properties producing or capable of producing copper, nickel and other metals.

*PolyMet is dependent on its key personnel.*

The Company's success depends on key members of management. The loss of the services of one or more of such key management personnel could have a material adverse effect on the Company. PolyMet's ability to manage its exploration and development activities, and hence its success, will depend in large part on the efforts of these individuals. The Company faces intense competition for qualified personnel, and it cannot be certain that it will be able to attract and retain such personnel.

*PolyMet may experience delays, higher than expected costs, difficulties in obtaining environmental permits and other obstacles when implementing its capital expenditure projects.*

The Company is investing heavily in various facets of its NorthMet Project. The project is subject to a number of risks that may make it less successful than anticipated, including:

- it may encounter delays or higher than expected costs completing the environmental review process necessary before construction and operating permits can be issued and the process for issuance of the permits may take longer than the Company anticipates;
- it may encounter delays or higher than expected costs in obtaining the necessary equipment or services to build and operate the project, and
- adverse mining conditions may delay and hamper its ability to produce the expected quantities of minerals.

If the Company is unable to successfully manage these risks, its growth prospects and profitability may suffer.

*PolyMet may be subject to risks relating to the global economy.*

Market events and conditions, including disruptions in the international credit markets and other financial systems and the deterioration of global economic conditions could impede our access to capital or increase the cost of capital. In 2007 and into 2008, the U.S. credit markets began to experience serious disruption due to, among other things, deterioration in residential property values, defaults and delinquencies in the residential mortgage market and a decline in the credit quality of mortgage backed securities. These problems led to a slow-down in residential housing market transactions, declining housing prices, delinquencies in non-mortgage consumer credit and a general decline in consumer confidence. These conditions worsened in 2008 and continued in 2009, causing a loss of confidence in the broader U.S. and global credit and financial markets and resulting in the collapse of, and government intervention in, major banks, financial institutions and insurers and creating a climate of greater volatility, less liquidity, widening of credit spreads, a lack of price transparency, increased credit losses and tighter credit conditions. Notwithstanding various actions by the U.S. and foreign governments, concerns about the general condition of the capital markets, financial instruments, banks, investment banks, insurers and other financial institutions caused

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the broader credit markets to further deteriorate and stock markets to decline substantially. In addition, general economic indicators have deteriorated, including declining consumer sentiment, increased unemployment and declining economic growth and uncertainty about corporate earnings.

These unprecedented disruptions in the current credit and financial markets have had a significant material adverse impact on a number of financial institutions and have limited access to capital and credit for many companies. These disruptions could, among other things, make it more difficult for the Company to obtain, or increase its cost of obtaining capital and financing for its operations. PolyMet's access to additional capital may not be available on terms acceptable to it or at all.

The Company is also exposed to liquidity risks in meeting its operating and capital expenditure requirements in instances where cash positions are unable to be maintained or appropriate financing is unavailable. These factors may impact PolyMet's ability to obtain loans and other credit facilities in the future and, if obtained, on terms favourable to the Company. If these increased levels of volatility and market turmoil continue, PolyMet's operations could be adversely affected and the trading price of its shares could be adversely affected. As a result of current global financial conditions, numerous financial institutions have gone into bankruptcy or have been rescued by government authorities. As such, PolyMet is subject to the risk of loss of its deposits with financial institutions that hold its cash.

Risks Related to the Ownership of PolyMet's Stock

*PolyMet may experience volatility in its stock price.*

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

*A large number of shares will be eligible for future sale and may depress PolyMet's stock price.*

The Company's shares that are eligible for future sale may have an adverse effect on the price of its stock. As of 31 January 2011 there were 154,825,791 of PolyMet's common shares outstanding. The average trading volume for the three months prior to 31 January 2011 was approximately 113,000 shares per day on the Toronto Stock Exchange and 519,000 shares per day on the NYSE Amex. Sales of substantial amounts of the Company's common shares, or a perception that such sales could occur, and the existence of options or warrants to purchase common shares at prices that may be below the then current market price of PolyMet's common shares, could adversely affect the market price of PolyMet's common shares and could impair the Company's ability to raise capital through the sale of its equity securities.

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*Your ownership interest, voting power and the market price of PolyMet's common stock may decrease because the Company has issued, and may continue to issue, a substantial number of securities convertible or exercisable into its common stock.*

The Company has issued common shares and options, and warrants to purchase its common shares to satisfy its obligations and fund its operations. In the future, because it currently does not have a source of revenue, the Company will likely issue additional common shares, options, warrants, preferred stock or other securities exercisable for or convertible into PolyMet's common shares to raise money for its continued operations or as non-cash incentives to its own and its subsidiaries' directors, officers, insiders, and key employees. If additional sales of equity occur, your ownership interest and voting power in PolyMet will be diluted and the market price of the Company's common shares may decrease.

Under PolyMet's 2007 Omnibus Share Compensation Plan (the "Plan") which was adopted on 25 May 2007, approved by the Company's shareholders on 27 June 2007, options may be granted equal in number the greater of (i) 10% of the Company's issued and outstanding common shares and (ii) 18,592,888 common shares, representing 13.62% of the Company's outstanding common shares at the time of the approval of the Plan, of which 4,640,000 common shares are reserved for issuance as awards other than options. As of 31 January 2011 options were issued or could be issued to purchase up to 11,630,000 shares. Under the PolyMet's bonus share incentive plan (the "Bonus Plan") for its directors and key employees approved by the disinterested shareholders at the Company's shareholders' meeting held on 28 May 2004 PolyMet may issue an additional 3,640,000 shares upon achieving certain milestones.

Upon any issuances or exercise of options issued, the ownership interests and voting power of existing shareholders may be further diluted.

*PolyMet has a Shareholders Rights Plan Agreement and certain employment and management contracts that contain provisions designed to discourage a change of control.*

Effective 25 May 2007, the Company adopted an updated Shareholder Rights Plan ("Rights Plan"), which was approved by the Company's shareholders' on 27 June 2007 and modified by the Company's shareholders on 17 June 2008. The Rights Plan and certain employment and management agreements contain provisions that could discourage an acquisition or change of control without PolyMet's board of directors' approval. Under the Shareholders Rights Plan, if a shareholder individually or in concert with other shareholders acquires 20% or more of the Company's common shares outstanding without complying with the Shareholder Rights Plan or without the approval of its Board of Directors, all holders of record will have a right to one common share for each share owned. Each right entitles the holder to a certain number of shares, as calculated under the Rights Plan. PolyMet has also entered into agreements with certain key employees and officers that contain severance provisions in the event of a take-over bid. The Rights Plan and the preceding agreements may make it more difficult for a third party to acquire control of the Company, even if such a change of control is more beneficial to shareholders.

*Because PolyMet believes that it will be classified as a passive foreign investment company (a PFIC), U.S. holders of the Company's common stock may be subject to United States federal income tax consequences that are worse than those that would apply if it was not a PFIC.*

Because PolyMet believes that it will be classified as a passive foreign investment company (a PFIC), U.S. holders of the Company's common stock may be subject to United States federal

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income tax consequences that are worse than those that would apply if it was not a PFIC, such as ordinary income treatment plus a charge in lieu of interest upon a sale or disposition of shares of the Company's common stock even if the shares were held as a capital asset. See "Certain United States Federal Income Tax Consequences" in PolyMet's Form 20-F / Annual Information Form on file with the SEC and Canadian securities authorities.

*Conflicts of Interest*

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

*Absence of Dividends*

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

*Increased Costs and Compliance Risks as a Result of Being a Public Company*

Legal, accounting and other expenses associated with public company reporting requirements have increased significantly in the past few years. The Company anticipates that general and administrative costs associated with regulatory compliance will continue to increase with recently adopted governance requirements, including requirements under the Sarbanes-Oxley Act of 2002, as well as new rules implemented by the United States Securities and Exchange Commission, Canadian Securities Administrators, the New York Stock Exchange Amex and the TSX. The Company expects these rules and regulations to significantly increase its legal and financial compliance costs and to make some activities more time consuming and costly. There can be no assurance that the Company will continue to effectively meet all of the requirements of these new regulations, including Sarbanes-Oxley Section 404 and Canadian National Instrument 52-109. Any failure to effectively implement new or improved internal controls, or to resolve difficulties encountered in their implementation, could harm the Company's operating results, cause the Company to fail to meet reporting obligations or result in management being required to give a qualified assessment of the Company's internal controls over financial reporting or the Company's independent auditors providing an adverse opinion regarding management's assessment. Any such result could cause investors to lose confidence in the Company's reported financial information, which could have a material adverse effect on the Company's stock price. The Company also expects these new rules and regulations may make it more difficult and more expensive for it to obtain director and officer liability insurance, and it may be required to accept reduced policy limits and coverage or incur substantially higher costs to obtain the same or similar coverage. As a result, it may be more difficult for the Company to attract and retain qualified individuals to serve on its board of directors or as executive officers. If the Company fails to maintain the adequacy of its internal controls, the Company's ability to provide accurate financial statements and comply

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with the requirements of the Sarbanes-Oxley Act of 2002 and/or Multilateral Instrument 52-109 could be impaired, which could cause the Company's stock price to decrease.

***Critical Accounting Policies***

The consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in Canada that require management to make assumptions and estimates that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities as at the date of the financial statements. Significant estimates used in the preparation of these consolidated financial statements include, amongst other things, expected economic lives of plant and equipment, anticipated costs of asset retirement obligations including the reclamation of mine site, valuation of options and share purchase warrants, and the assessment of impairment in value of long lived assets.

Mineral Property, Plant and Equipment

Mineral property costs, aside from mineral property acquisition costs, incurred prior to determination of the DFS are expensed as incurred and expenditures incurred subsequent to the DFS and mineral property acquisition costs are deferred or capitalized until the property is placed into production, sold, allowed to lapse or abandoned. Acquisition costs include cash and fair market value of common shares.

As a result of the DFS on the NorthMet Project, the Project entered the development stage effective 1 October 2006. The Company has deferred mineral property development expenditures related to the NorthMet Project from that date.

Plant and equipment are recorded at cost and depreciated over the estimated life of the related assets calculated on a unit of production or straight-line basis, as appropriate. Mineral property, plant and equipment related to the NorthMet Project will begin to be amortized at the time the project commences operations.

The Company performs impairment tests on its mineral property, plant and equipment when events or changes in circumstances indicated that the carrying values of assets may not be recoverable. These tests require the comparison of the undiscounted future cash flows to be derived from these assets with the carrying value of the assets. If a shortfall exists, the assets are written down to fair value, determined primarily using discounted cash flow models.

Stock-Based Compensation and Share Purchase Warrants

All stock-based awards made to directors, employees and non-employees are measured and recognized using a fair value based method. For directors and employees, the fair value of the options is measured at the date of the grant. For non-employees, the fair value of the options is measured on the earlier of the date at which the counterparty performance is complete or the date the performance commitment is reached or the date at which the equity instruments are granted if they are fully vested and non-forfeitable. For directors, employees and non-employees, the fair value of the options is accrued and charged either to operations or mineral property plant and equipment, with the offsetting credit to contributed surplus, on a graded method over the vesting period. If and when the stock options are ultimately exercised, the applicable amounts of contributed surplus are transferred to share capital.

The Company issues share purchase warrants in connection with certain equity transactions. The fair value of the warrants, as determined using the Black-Scholes option pricing model, is

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credited to contributed surplus. The recorded value of share purchase warrants is transferred to share capital upon exercise.

When the Company amends the terms of either stock options or share purchase warrants, the incremental change in the fair value of the options or warrants due to the amendment is booked to warrant amendment expense and contributed surplus.

Asset Retirement Obligations

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

The operations of the Company may in the future be affected from time to time in varying degrees by changes in environmental regulations, including those for future removal and site restoration costs. Both the likelihood of new regulations and their overall effect upon the Company may vary greatly and are not predictable.

Financial Instruments

Section 3855 of the CICA Handbook requires that all financial assets, except those classified as held to maturity, and derivative financial instruments, must be measured at fair value. All financial liabilities must be measured at fair value when they are classified as held for trading, otherwise, they are measured at cost. Investments classified as available for sale are reported at fair market value based on quoted market prices with unrealized gains or losses excluded from earnings and reported as other comprehensive income or loss. All financial assets and liabilities have been classified as either held-to-maturity, available-for-sale, held for trading or loans and receivables effective 1 February 2007. Investments subject to significant influence are reported at cost and not adjusted to fair market value.

**Disclosure Controls and Procedures**

Management of the Company conducted an evaluation of the disclosure controls and procedures as required by Multilateral Instrument 52-109 issued by the Canadian Securities Administrators. They concluded that at 31 January 2011 the Company's disclosure controls and procedures were effective in providing reasonable assurance that material information regarding this annual report and other disclosures was made known to them on a timely basis. In reaching this conclusion, the Company recognizes two factors that must be and are present:

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- a) the Company is dependent upon its advisors and consultants (primarily legal counsel) to assist in recognizing, interpreting and understanding and complying with the various securities regulations disclosure requirements, and
- b) an active Board of Directors and Management with open lines of communication.

It should be noted that while the Company's Management believe that the Company's disclosure controls and procedures provide a reasonable level of assurance that they are effective, they do not expect that the disclosure controls and procedures will prevent all errors and fraud. A control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objects of the control system are met.

**Internal Controls over Financial Reporting**

Management of the Company is responsible for designing internal controls over financial reporting or causing them to be designed under their supervision in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP.

Management has assessed the effectiveness of the Company's internal control over financial reporting as at 31 January 2011. In making its assessment, management has used the criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") to evaluate the Company's internal control over financial reporting.

During the quarter ended 31 October 2010, the Company experienced difficulties moving to a new accounting and financial reporting system. These difficulties were primarily in the input and review of transactions and in particular concerned the accurate recording of foreign exchange and intercompany transactions. Termination of an outsource accounting service provider and use of non-accounting personnel to undertake accounting duties exacerbated the problems.

Management undertook a rigorous process to ensure that all transactions were recorded completely and accurately in the accounting records. As a result of these difficulties and this review process, the Company was unable to meet its filing deadline to provide consolidated financial statements, management's discussion and analysis and CEO and CFO certifications for its quarter ended 31 October 2010.

Management recognized the need to implement changes to the Company's internal control over financial reporting relating to the input and review of all transactions, including foreign exchange and intercompany transactions. Since filing the third quarter interim financials, Management has been implementing changes to the Company's internal control over financial reporting including strengthening the segregation of duties, reallocating responsibilities, and strengthening the financial reporting team. The Company is in the process of engaging independent advise in connection with complex accounting issues and tax,

Management has made significant progress, but implementation of the changes was not sufficiently complete during preparation of year-end financial statements and, as a consequence, the Company was unable to meet its filing deadline to provide consolidated financial statements, management's discussion and analysis and CEO and CFO certifications for its year ended 31 January 2011.

Management recognizes the lack of timely preparation of financial information and key schedules to be a Material Weakness in its internal control over financial reporting.

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Management believes that the changes described, once more fully implemented, will ensure the timely provision of financial information to the Company's shareholders in future, in accordance with the filing deadlines established by regulators.

There have been no other changes in the Company's internal control over financial reporting during the year ended 31 January 2011 that have materially affected, or are reasonably likely to material affect, its internal control over financial reporting.

***Management's Responsibility for Financial Statements***

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

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

***Management's Annual Report on Internal Control over Financial Reporting***

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of the Consolidated Financial Statements for external reporting purposes in accordance with GAAP.

Internal control over financial reporting, no matter how well designed, has inherent limitations. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management has assessed the effectiveness of the Company's internal control over financial reporting as at 31 January 2011. In making its assessment, management has used the criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") to evaluate the Company's internal control over financial reporting.

Management identified a material weakness in its internal control over financial reporting relating to timely preparation of financial statements and key schedules for internal review. The underlying cause of the material weakness was the implementation of a new accounting and financial reporting system during the third fiscal quarter. Termination of an outsource accounting service provider and use of non-accounting personnel to undertake accounting duties exacerbated the problems of timeliness. Prior to filing its financial statements for the year ended 31 January 2011, management had taken steps to address this weakness and plans further changes to its internal controls in the light of continued problems in the year-end reporting. Based on this assessment, management has concluded that the Company did not maintain, in all material respects, effective internal control over financial reporting as at January 31, 2011.

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***Additional Information***

*Additional information related to the Company is available for view on SEDAR and EDGAR, respectively, at [www.sedar.com](http://www.sedar.com) and at [www.sec.gov](http://www.sec.gov), and at the Company's website [www.polymetmining.com](http://www.polymetmining.com).*

**FORM 52 – 109F1**  
**CERTIFICATION OF ANNUAL FILINGS**

I, Douglas Newby, Chief Financial Officer of PolyMet Mining Corp., certify that:

1. **Review:** I have reviewed the AIF annual financial statements and annual MD & A, including for greater certainty, all documents and information that are incorporated by reference in the AIF (together, the “annual filings”) of PolyMet Mining Corp. (the issuer) for the financial year ended January 31, 2011.
2. **No Misrepresentations:** Based on my knowledge, having exercised all reasonable diligence, the annual filings do not contain any untrue statement of a material fact or omit to state a material fact required to be stated or that is necessary to make a statement not misleading in light of the circumstances under which it was made, for the period covered by the annual filings.
3. **Fair presentation:** Based on my knowledge, having exercised all reasonable diligence, the annual financial statements together with the other financial information included in the annual filings fairly present in all material respects the financial condition, results of operations and cash flows of the issuer, as of the date of and for the periods presented in the annual filings.
4. **Responsibility:** The issuer’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (DC&P) and internal controls over financial reporting (ICFR), as those terms are defined in National Instrument 52-109 *Certification of Disclosure in Issuers’ Annual and Interim Filings*, for the issuer.
5. **Design:** Subject to the limitations, if any, described in paragraphs 5.2 and 5.3, the issuer’s other certifying officer and I have, as at the financial year end:
  - (a) designed DC&P, or caused it to be designed under our supervision, to provide reasonable assurance that:
    - (i) material information relating to the issuer, is made known to us by others, particularly during the period in which the annual filings are being prepared, and
    - (ii) information required to be disclosed by the issuer in its annual filings, interim filings or other reports filed or submitted by it under securities legislation is recorded, processed, summarized and reported within the time periods specified in securities legislation; and
  - (b) designed ICFR, or caused it to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with the issuer’s GAAP.
- 5.1 **Control Framework:** The control framework of the issuer’s other certifying officer and I used to design the issuer’s ICFR is Committee of Sponsoring Organizations of the Treadway Commission (“COSO”) framework.

5.2 N/A

5.3 N/A

6. **Evaluation:** The issuer's other certifying officer and I have:

- (a) evaluated, or caused to be evaluated under our supervision, the effectiveness of the issuer's DC&P at the financial year end and the issuer has disclosed in its annual MD&A our conclusions about effectiveness of DC&P at the financial year end based on that evaluation;
  - (b) evaluated, or caused to be evaluated under supervision, the effectiveness of the issuer's ICFR at the financial year end and the issuer has disclosed in its annual MD&A:
    - (i) our conclusions about the effectiveness of ICFR at the financial year end based on that evaluation, and
    - (ii) for each material weakness relating to operation existing at the financial year end:
      - A. a description of the material weakness;
      - B. the impact of the material weakness on the issuer's financial reporting and its ICFR, and
      - C. the issuer's current plans, if any, or any actions already undertaken, for remediating the material weakness.
8. **Reporting changes in ICFR:** The issuer has disclosed in its MD&A any change in the issuer's ICFR that occurred during the period beginning on February 1, 2010 and ended on January 31, 2011 that materially affected, or is reasonably likely to materially affect, the issuer's ICFR.
9. **Reporting to the issuer's auditors and board of directors or audit committee:** The issuer's other certifying officer and I have disclosed, based on our most recent evaluation of ICFR, to the issuer's auditors, and the board of directors or the audit committee of the board of directors any fraud that involves management or other employees who have a significant role in the issuer's ICFR.

Dated: May 6, 2011

"Douglas Newby" (signed)  
Douglas Newby  
Chief Financial Officer

**FORM 52 – 109F1**  
**CERTIFICATION OF ANNUAL FILINGS**

I, Joseph Scipioni, President and Chief Executive Officer of PolyMet Mining Corp., certify that:

1. **Review:** I have reviewed the AIF, , annual financial statements and annual MD & A, including for greater certainty, all documents and information that are incorporated by reference in the AIF (together, the “annual filings”) of PolyMet Mining Corp. (the issuer) for the financial year ended January 31, 2011.
2. **No Misrepresentations:** Based on my knowledge, having exercised all reasonable diligence, the annual filings do not contain any untrue statement of a material fact or omit to state a material fact required to be stated or that is necessary to make a statement not misleading in light of the circumstances under which it was made, for the period covered by the annual filings.
3. **Fair presentation:** Based on my knowledge, having exercised all reasonable diligence, the annual financial statements together with the other financial information included in the annual filings fairly present in all material respects the financial condition, results of operations and cash flows of the issuer, as of the date of and for the periods presented in the annual filings.
4. **Responsibility:** The issuer’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (DC&P) and internal controls over financial reporting (ICFR), as those terms are defined in National Instrument 52-109 *Certification of Disclosure in Issuers’ Annual and Interim Filings*, for the issuer.
5. **Design:** Subject to the limitations, if any, described in paragraphs 5.2 and 5.3, the issuer’s other certifying officer and I have, as at the financial year end:
  - (a) designed DC&P, or caused it to be designed under our supervision, to provide reasonable assurance that:
    - (i) material information relating to the issuer, is made known to us by others, particularly during the period in which the annual filings are being prepared, and
    - (ii) information required to be disclosed by the issuer in its annual filings, interim filings or other reports filed or submitted by it under securities legislation is recorded, processed, summarized and reported within the time periods specified in securities legislation; and
  - (b) designed ICFR, or caused it to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with the issuer’s GAAP.
- 5.1 **Control Framework:** The control framework of the issuer’s other certifying officer and I used to design the issuer’s ICFR is Committee of Sponsoring Organizations of the Treadway Commission (“COSO”) framework.

5.2 N/A

5.3 N/A

6. **Evaluation:** The issuer's other certifying officer and I have:

- (a) evaluated, or caused to be evaluated under our supervision, the effectiveness of the issuer's DC&P at the financial year end and the issuer has disclosed in its annual MD&A our conclusions about effectiveness of DC&P at the financial year end based on that evaluation;
  - (b) evaluated, or caused to be evaluated under supervision, the effectiveness of the issuer's ICFR at the financial year end and the issuer has disclosed in its annual MD&A:
    - (i) our conclusions about the effectiveness of ICFR at the financial year end based on that evaluation, and
    - (ii) for each material weakness relating to operation existing at the financial year end:
      - A. a description of the material weakness;
      - B. the impact of the material weakness on the issuer's financial reporting and its ICFR, and
      - C. the issuer's current plans, if any, or any actions already undertaken, for remediating the material weakness.
8. **Reporting changes in ICFR:** The issuer has disclosed in its MD&A any change in the issuer's ICFR that occurred during the period beginning on February 1, 2010 and ended on January 31, 2011 that materially affected, or is reasonably likely to materially affect, the issuer's ICFR.
9. **Reporting to the issuer's auditors and board of directors or audit committee:** The issuer's other certifying officer and I have disclosed, based on our most recent evaluation of ICFR, to the issuer's auditors, and the board of directors or the audit committee of the board of directors any fraud that involves management or other employees who have a significant role in the issuer's ICFR.

Dated: May 6, 2011

"Joseph Scipioni" (signed)  
Joseph Scipioni  
President & Chief Executive Officer