

## **AVALON VENTURES LTD.**

### Management Discussion and Analysis of Financial Statements For the three months ended November 30, 2008

This Management Discussion and Analysis (“MDA”) of Avalon Ventures Ltd. (the "Company") provides analysis of the Company's financial results for the three months ended November 30, 2008. The following information should be read in conjunction with the accompanying unaudited financial statements and the related notes thereto.

This MDA includes certain statements that may be deemed "forward-looking statements". All statements in this discussion, other than statements of historical fact, that address future production, reserve potential, exploration drilling, exploitation activities and events or developments that the Company expects, are forward-looking statements. Although the Company believes the expectations expressed in such forward-looking statements are based on reasonable assumptions, such statements are not guarantees of future performance and actual results or developments may differ materially from those in the forward-looking statements.

Factors that could cause actual results to differ materially from those in forward-looking statements include market prices, exploitation and exploration successes, continued availability of capital and financing and general economic, market or business conditions. Investors are cautioned that any such statements are not guarantees of future performance and that the actual results or developments may differ materially from those projected in the forward-looking statements. This report is prepared as of *January 13, 2009*.

#### **Nature of Business and Overall Performance**

Avalon Ventures Ltd. is a Canadian junior mineral exploration and development company which is listed on the Toronto Stock Exchange. The Company seeks to build shareholder value by becoming a diversified producer of rare metals and minerals and expanding the markets for its mineral products.

Avalon operates exclusively in Canada with a primary focus on rare metals and minerals including calcium feldspar, lithium, tantalum, cesium, beryllium, indium, gallium, yttrium and the rare earth elements (“**REEs**”). By definition, REEs refers specifically to the lanthanide series of elements (atomic numbers 57 – 71), whereas the term “rare metals” is a more general “umbrella” term that includes the REEs as well as other rare metals including those named above.

The Company is in the process of exploring or developing five of its eight mineral resource properties. Four of the five active projects (Thor Lake, Separation Rapids, East Kemptville and Warren Township) are rare minerals or rare metals properties that are at an advanced stage with identified mineral resources that are potentially economic, provided that sales contracts with customers can be secured and project financing arranged. The other project (Red Hill) is a base metal property that is at an early stage where drilling is required to delineate resources.

A positive Preliminary Economic Assessment (“PEA”) on the REE development potential of Thor Lake project was completed in 2007 and this project has become the Company’s top priority due to the large size of the resource and its exceptional enrichment in the “heavy” rare earths, europium through lutetium (“**HREE**”). It is intended that this project will be advanced to the pre-feasibility level of analysis in 2009.

Avalon has adopted the Principles and Guidelines for Responsible Exploration being developed by the Prospectors and Developers Association of Canada (“PDAC”), as policy of the Company

and made Corporate Social Responsibility (“CSR”) a Company priority. It has applied these principles on the Thor Lake project particularly with respect to its environmental and community engagement practice.

The global financial crisis in 2008 has resulted in reduced demand and dramatically lower prices for most mineral commodities, but many of the rare metals are notable exceptions, with prices declining to a lesser degree than other mineral commodities. This is attributable to steady demand for these metals due to their importance in a growing number of applications in technology related to energy efficiency and a cleaner environment. Reduced carbon emissions and less reliance on fossil fuels remain a top policy priority for many governments around the world, which should continue to stimulate demand for rare metals, even in a recessionary environment.

The Company remains well-funded and does not expect that the recent volatility in the capital markets will have a significant impact on its operations.

### **Selected Annual Information**

Unless otherwise noted, all currency amounts are stated in Canadian dollars.

The following selected financial data for each of the three most recently completed fiscal years are derived from the audited annual financial statements of the Company, which were prepared in accordance with Canadian generally accepted accounting principles.

<b>For the Years Ending August 31,</b>	<b>2008</b>	<b>2007</b>	<b>2006</b>
	\$	\$	\$
Net revenues	357,539	92,446	87,588
Loss before discontinued operations and extraordinary items	1,391,581	903,019	1,287,581
Loss before discontinued operations and extraordinary items, per share basic and fully diluted	0.02	0.02	0.03
Net loss	1,391,581	903,019	1,287,581
Net loss, per share basic and fully diluted	0.02	0.02	0.03
Total assets	24,384,590	9,130,719	6,930,933
Total long term liabilities	-	-	-
Cash dividends	-	-	-

The Company has recorded losses in each of its three most recently completed fiscal years and expects to continue to record losses until such time as an economic resource is identified, developed and brought into profitable commercial operation on one or more of the Company’s properties or otherwise disposed of at a profit. Since the Company has no revenue from operations, annual operating losses typically represent the sum of business expenses plus any write-offs of mineral properties abandoned during the period. The Company expects to increase its level of business activity in coming years and consequently investors should anticipate that the Company’s annual operating losses will also increase until a new operation begins to generate cash flow.

### **Results of Operations**

#### *Exploration and Development Activities*

Resource property expenditures for the three months ended November 30, 2008 totalled \$1,786,911, a 151% increase over the level of expenditures in the comparable period of the previous fiscal year (\$712,454). Most of these expenditures were incurred on the Thor Lake rare metals project (91%) with the balance being largely incurred on the Warren Township, East

Kemptville, and Separation Rapids projects. The expenditures on Thor Lake and East Kemptville were funded from the flow-through component of the proceeds of the private placement financing completed in November, 2007 while the expenditures on Warren Township and Separation Rapids were funded from working capital. No properties were abandoned during the quarter and no expenditures were written off.

### **Thor Lake**

On the Thor Lake rare metals project, expenditures during the three months ended November 30, 2008 totalled \$1,624,068. Most of these expenditures were incurred on the completion of the summer drilling program on the Lake Zone REE deposit, environmental baseline studies and site clean-up and continuing metallurgical studies.

The summer drilling program began on June 24, 2008 and was completed on September 20, 2008 with 5,405 metres in 27 holes being drilled. Drilling costs incurred during the quarter totalled \$704,096 and an additional \$89,980 was incurred for geological and geophysical consulting work done in support of this program. The cumulative total drilling on the Lake Zone since August, 2007 totals 16,640 metres in 85 holes. Drilling operations were carried out under the direct supervision of J.C. Pedersen, P.Geol., under the overall direction of the Company's Vice-President, Exploration, Dr. William Mercer, P.Geol.

All assay results from the summer program were disclosed in the Company's news release dated December 22, 2008 and, as reported, this program produced some of the best results to date from the Lake Zone deposit both in terms of grades and thicknesses of the REE mineralization. While limits to the economic grade REE mineralization were defined on the eastern margins of the deposit, the southern and western extensions, where some of the highest grades have been intersected, remain wide open.

As previously reported, the higher grade sub-zone of the Lake Zone, called the Basal Zone, forms a gently dipping tabular sheet situated near the base of the mineralized envelope that is notable for its relatively high proportion of the more valuable heavy rare earth elements europium through lutetium ("HREE"). The interim REE resource estimate for the Lake Zone deposit (and the Basal Zone in particular), which was to be based on all the drilling results received by July 31, 2008, and that the Company had anticipated disclosing earlier this fall, unfortunately could not be completed on schedule. This was due to slow assay turnaround, capacity issues with our technical consultants, and some initial technical challenges in modeling the Basal Zone resource as a distinct sub-zone of the deposit. Consequently, the plan to release an interim resource estimate has now been abandoned and with all the results from the summer drilling program now being available, work will continue toward preparing a comprehensive resource estimate incorporating all of the available data, as well as results from some of the historic holes. This work is targeted for completion in January, 2009.

A \$1.5 million winter drilling program, financed with the proceeds of the flow-through private placement completed in December, 2008, is scheduled to commence in February, 2009. The main objectives of this program will be further exploration of the southern extensions of the deposit for additional high-grade mineralization and in-fill drilling to better define the deposit and increase the confidence level on the known resource in support of the pre-feasibility study to be completed in 2009. The drill contract is currently being tendered and, given the dramatic slowdown in activity in the industry, management is optimistic that a reduction in the average all-in drilling costs and faster assay turnaround will be achieved in 2009.

Expenditures of \$204,889 were incurred on the continuation of the metallurgical studies at SGS Lakefield Research ("SGS") to design a process flowsheet for beneficiating the REE bearing minerals and to design a hydrometallurgical process for recovering the rare earth oxides from the mineral concentrate. The Company has retained the services of Mr. J. R. Goode, P.Eng., a

consulting metallurgist with over 40 years of international experience, to provide oversight on this work. Very preliminary flotation study results reported by SGS are indicating recoveries to an initial bulk cleaner concentrate of about 85% of REE, about 70% of niobium and tantalum, and just over 80% of the zirconium with a fivefold concentration of these elements. Further trials are being undertaken to upgrade this concentrate.

Environmental expenditures of \$509,267 were incurred during the quarter, primarily on a program of environmental baseline studies on the property, which are being carried out by Jacques Whitford AXYS. This initial program, for which fieldwork is now complete, included studying both surface and ground waters, water chemistry in the lakes of the area, aquatic biology, terrane analysis and collecting meteorological data.

The Company has placed a high priority on its performance with respect to community, environment, health and safety at Thor Lake and, during the quarter, there were no lost time accidents. Site inspections by government land use and WCB inspectors have generally produced positive reports and any issues raised were addressed immediately. The sole material concern raised was with respect to excessive rutting which occurred locally while moving the drill and which resulted in the current practice not being in compliance with the requirements of the land-use permit. The Company is required to submit its plan to rectify the problem. Coincidentally, the recent environmental work revealed the presence of permafrost under parts of the Lake Zone area, which may be partially responsible for the excessive rutting, as it causes the ground to become very soft when it melts. Recognizing this as a probable cause will help in designing solutions.

During the quarter, a program of environmental site remediation work was carried out to clean up waste material and debris left behind by previous operators on the site. The cleanup work was carried out under a contract with the Deninu Kue First Nation of Fort Resolution, NWT, consistent with the Company's policy of maximizing employment opportunities for local communities. To this end, the Company has initiated the development of training programs for local native people in co-operation with the NWT Mine Training Society. These programs will focus on surface diamond drilling and first aid, being two areas where there are chronic labour shortages in the NWT.

Fourteen individuals from local native communities were employed on the project at different times during the 2007-2008 work program. The Company held three community consultation meetings during the quarter including formal presentations to the Chiefs and council of the Yellowknives Dene First Nation and the leadership of the North Slave Metis Alliance. Both groups have indicated their support for the project provided that the environment is respected and some economic benefits flow to the communities.

### **Warren Township**

Expenditures of \$2,817 were incurred on the Warren Township Anorthosite Project during the three months ended November 30, 2008. These were mainly related to the completion of the marketing studies under the supervision of Ian London, P.Eng.

The Company continues its work toward securing a production permit for the Warren Township project under the *Aggregate Resources Act* of Ontario. This work, being carried out under the direction of Fudge & Associates of North Bay, Ontario, has also included community consultation work in the Foleyet area and with First Nations in the Chapleau area. Agreement was reached on a Memorandum of Understanding with the Chapleau Cree First Nation during this quarter which is expected to be signed during the second quarter.

Some issues over the size of the permit area have yet to be resolved with the Ontario Ministry of Natural Resources. There are no specific timelines in place for initiation of any new work programs on the project.

### **Separation Rapids**

During the three months ended November 30, 2008, the Company incurred \$63,988 in expenditures on the Separation Rapids Lithium-Tantalum Project which is host to the Big Whopper Petalite Deposit. These costs were mainly related to metallurgical process research and market development work for the Company's lithium minerals product for which there is continuing encouragement of emerging demand from the glass and ceramics industry in the U.S.

The metallurgical process research work was done to develop a modified petalite process flowsheet to remove potentially hazardous reagents, and was successfully completed at SGS Lakefield Research by Srdjan Bulatovic, P.Eng. who also developed the original flowsheet. Next steps will involve updating the 1999 pre-feasibility study to reflect the costs associated with the new process flowsheet and developments in the lithium minerals market.

The Company continues to implement a pro-active market development program with the glass and ceramics industry to demonstrate the energy-savings and environmental benefits associated with the use of lithium in its batch formulations. This has involved a number of presentations to glass industry participants and interest is growing along with public pressure for the industry to reduce its greenhouse gas emissions.

The Company is in the process of securing a Mining Lease for the Big Whopper Petalite Deposit and neighbouring lands that may be needed for development work.. This work primarily included a perimeter survey to precisely define the lease boundaries which is being supervised by Fudge & Associates of North Bay, ON. Both the market development work and the metallurgical research are being carried out under the direction of Ian London, P.Eng.

### **East Kemptville**

During the three months ended November 30, 2008, the Company incurred expenditures totalling \$95,743 on the East Kemptville Tin-Rare Metals Project in Yarmouth Co., Nova Scotia. These expenditures were mainly related to regional exploration work on the claims surrounding the Special Licence covering part of the past-producing East Kemptville mine property as well as assays related to re-sampling of historic drill core from the mine. This work is being conducted by Bruce Hudgins, P.Geo. of Dartmouth, N.S. ("Hudgetec"), under the supervision of the Company's Vice-President, Exploration, Dr. William Mercer, P.Geo.

The main objective of the current work is to complete a NI43-101 compliant resource estimate and Preliminary Economic Assessment ("PEA") on the historic tin resource. The PEA is to be done by Wardrop Engineering Ltd. ("Wardrop") of Toronto, ON, which completed a positive desktop study in 2008.

Some of the assays from re-sampling of historic drill cores for rare metals such as indium were received during the quarter but assays for most of these samples are still awaited. These will be incorporated into the new resource estimate, which is now expected during the first quarter of calendar 2009. Preparation of the PEA will commence following receipt of the resource estimate and \$250,000 is being budgeted to complete this study in 2009.

### **Red Hill**

Expenditures on the Red Hill project during the three months ended November 30, 2008 totalled just \$295.

A NI43-101 compliant technical report compiling all the results of the Company's 2005 and 2006 drilling programs is in preparation. Approximately \$570,000 in additional expenditures was required on the Red Hill property before December 31, 2008 in order for the Company to exercise its option to acquire a 100% interest in the property. The Company has received an extension of time from the property owner to complete this requirement and will re-commence efforts to secure a partner for this project in 2009.

#### *Administration*

Administrative expenses incurred during the three months ended November 30, 2008 totalled \$572,407 a 17% increase over the amount incurred during the comparable quarter in fiscal 2008. The main areas of increased administrative expenditures were public and investor relations and salaries and benefits reflecting an increased level of overall business activity.

Expenditures on public and investor relations ("IR") activities for the three months ended November 30, 2008 totalled \$117,612, a 37% increase over the comparable period in fiscal 2008 (\$85,521). The increase relates primarily to the Company's participation in two additional conferences; the German Private Equity Forum in Frankfurt and the San Francisco Hard Asset Investment Conference, which were not attended in 2007. During the quarter, the Company entered into a consulting agreement with Arrowhead BID of New York, NY, to introduce the Company to socially responsible investors in the U.S. An IR consulting agreement with O&M partners of New York, NY, that expired during the quarter, was not renewed.

Salaries and benefits increased to \$161,562 from \$108,600 in fiscal 2008, reflecting the addition of one additional staff member and a general increase in staff salaries. Transfer and filing fees also increased by \$16,099 due mainly to the higher fees related to the Company's graduation to the TSX in March, 2008.

Despite a decrease in interest rates, increased cash and cash equivalents in the treasury, due to the November, 2007 private placement, resulted in increased interest income of \$44,246 for the three month period compared with \$22,399 for the comparable period in fiscal 2008.

#### **Summary of Quarterly Results**

The following selected financial data is derived from the unaudited interim financial statements of the Company, which were prepared in accordance with Canadian generally accepted accounting principles.

<b>Fiscal Year</b>	<b>2009</b>	<b>2008</b>				<b>2007</b>		
<b>For the Quarters Ended</b>	<b>Nov. 30</b>	<b>Aug. 31</b>	<b>May 31</b>	<b>Feb. 28</b>	<b>Nov. 30</b>	<b>Aug. 31</b>	<b>May 31</b>	<b>Feb. 28</b>
	\$	\$	\$	\$	\$	\$	\$	\$
Net revenues	44,246	100,003	93,778	141,359	22,399	21,066	28,502	24,147
Income (loss) before discontinued operations and extraordinary items	(528,161)	(872,767)	(638,340)	(787,411)	906,937	(445,335)	184,396	(251,702)
Income (loss) before discontinued operations and extraordinary items, per share, basic and fully diluted	(0.01)	(0.01)	(0.01)	(0.01)	0.02	(0.01)	-	-
Net income (loss)	(528,161)	(872,767)	(638,340)	(787,411)	906,937	(445,335)	184,396	(251,702)
Net income (loss), per share, basic and fully diluted	(0.01)	(0.01)	(0.01)	(0.01)	0.02	(0.01)	-	-

The fluctuation on quarterly net loss is primarily due to stock-based compensation expenses recognized on stock options granted to directors, officers, employees and consultants of the Company, the write-downs of resource properties and recovery of future income taxes. The costs of resource properties are written down at the time the properties are abandoned or considered to be impaired in value. The write-downs are usually much more significant in terms of dollar amounts in comparison to the Company's expenses for its ordinary activities.

### **Liquidity and Capital Resources**

In management's view, given the nature of the Company's operations, which consist of the exploration and evaluation of mining properties, the most relevant financial information relates primarily to current liquidity, solvency, and planned property expenditures. The Company's financial success will be dependent on the economic viability of its resource properties and the extent to which it can discover new mineral deposits. Such development may take several years to complete and the amount of resulting income, if any, is difficult to determine. The sales value of any mineralization discovered by the Company is largely dependent on factors beyond the Company's control, including the market value of the metals and minerals to be produced. The Company does not expect to receive significant revenue from any of its properties until 2011 at the earliest.

As at November 30, 2008, the Company had working capital of \$7,964,822 (including investments of \$3,943) and cash and cash equivalents on hand of \$8,309,199.

On December 15, 2008, subsequent to the end of the quarter, the Company completed a non-brokered private placement, resulting in gross proceeds of \$1,500,000, as more fully described under "Subsequent Events".

The Company's current operating expenditures, excluding expenditures on resource property work programs, are approximately \$180,000 per month but management is making efforts to reduce its overhead expenditures in 2009. As at the date of this report, the Company's current anticipated expenditures on its fiscal 2009 work programs are estimated at approximately \$3,000,000, with most of these expenditures being allocated to the Thor Lake REE project for the pre-feasibility study and further definition drilling. This budget could be adjusted depending on the availability of new financing in 2009.

The Company's present cash resources are sufficient to meet all of its current contractual obligations for the foreseeable future. The Thor Lake, Warren Township, Separation Rapids and Lilypad Lakes properties are all 100% owned by the Company with minimal holding costs, the most significant being annual lease rental fees on Thor Lake of \$15,422.

Under the terms of the East Kemptville special licence, the Company has optional expenditure obligations totalling \$2.5 million over three years and it is currently in good standing. Approximately \$750,000 in additional expenditures is required before August 1, 2009. It is presently estimated that the Preliminary Economic Assessment planned for 2009, will cost no more than \$250,000 to complete. Accordingly, the Company plans to request an extension of time to incur the balance of the expenditures required before August 1, 2009.

The Red Hill property is held under option from Teck Cominco Limited ("TCL"). Following receipt of an extension from TCL, expenditures of approximately \$570,000 on this project are required by December 31, 2009 to exercise the option to acquire a 100% interest in this property..

A joint venture with an industry partner or end-user may represent an attractive alternative for financing the more advanced stages in the development of any of the Company's four advanced

rare metals projects at Separation Rapids, Thor Lake, East Kemptville, or Warren Township projects, when capital requirements become relatively large.

The Company has an operating lease for its office premises. As at January 12, 2009, the minimum lease commitments under this lease are as follows:

2009	\$51,833
2010	\$88,858
2011	\$88,858
2012	\$29,619

### **Off Balance Sheet Arrangements**

As at November 30, 2008, the Company had no material off balance sheet arrangements such as guaranteed contracts, contingent interests in assets transferred to an entity, derivative instrument obligations or any instruments that could trigger financing, market or credit risk to the Company.

### **Transactions with Related Parties**

All transactions with related parties are in the normal course of business and are measured at the exchange amount. During the three months ended November 30, 2008, the Company:

- a) incurred accounting fees of \$18,000 with an accounting firm in which an officer is the principal. As at November 30, 2008, accounts payable included \$11,000 accrued to this accounting firm; and
- b) incurred consulting fees of \$38,500 with a company owned by an officer of the Company, which were deferred as resource property costs. As at November 30, 2008, accounts payable included \$11,393 payable to this company.

### **Subsequent Events**

Subsequent to the three months ended November 30, 2008, the Company:

- a) completed a private placement for 3,000,000 flow-through common shares at a price of \$0.50 per share for gross proceeds of \$1,500,000.

In connection with this private placement, the Company paid finders' fees of \$99,375 and granted 198,750 non-transferable finders' warrants to the finders. Each warrant entitles the holder to purchase one non-flow-through common share at a price of \$0.50 per share, exercisable until November 15, 2010; and

- b) granted 200,000 stock options to a consultant. Each option entitles the holder to purchase one common share of the Company at a price of \$0.50 per share until December 31, 2010. These options vest at the rate of 25% every three months following December 31, 2008.

### **Proposed Transactions**

With four active projects, the Company is not aggressively searching for new mineral property acquisition opportunities at the present time and there are no proposals for new projects under active consideration. However, management is always interested in evaluating potential transactions or business combinations that are of possible long term strategic value. The Company does not plan any equity offerings in the foreseeable future.

## **Corporate Social Responsibility (“CSR”)**

In 2008, the Company adopted the Principles and Guidelines for Responsible Exploration being developed by the Prospectors and Developers Association of Canada (PDAC) as policy of the Company. In addition, the Company follows the Guidelines established by PDAC for environmental best practice under its E3 program (“Environmental Excellence in Exploration”). Specifically, the Company has committed to the following as core principles of its exploration and development programs:

- Open, honest and regular dialogue with local communities
- Minimizing impacts on the land
- Sustainability...beginning at the earliest stages of exploration and extending through mine closure
- The environment and workplace health and safety
- Hiring local people and promoting training programs
- Partnerships to provide lasting benefits

The Company will report on its performance against these principles as part of its continuous disclosure practice as it has in the section above on the Thor Lake project.

The Company’s CSR Advisory Committee did not meet during the quarter, but a meeting is planned for the second quarter.

## **Critical Accounting Estimates**

Critical accounting estimates used in the preparation of the financial statements include the value of stock-based compensation and the Company’s estimate of recoverable value of its resource properties. These estimates involve considerable judgment and are, or could be, affected by significant factors that are out of the Company’s control.

The factors affecting stock-based compensation include estimates of when stock options might be exercised and the stock price volatility. The timing for exercise of options is out of the Company’s control and will depend upon a variety of factors, including the market value of the Company’s shares and the financial objectives of the stock-based instrument holders.

The Company’s recoverability of the recorded value of its resource properties is based on market conditions for minerals, underlying mineral resources associated with the properties and future costs that may be required for ultimate realization through mining operations or by sale. The Company is in an industry that is dependent on a number of factors, including environmental, and legal risks, the existence of economically recoverable reserves, and the ability of the Company to obtain necessary financing to complete the development and future profitable production of its properties or to secure any proceeds from their disposition.

## **Changes in Accounting Policies Including Initial Adoption**

On September 1, 2008, the Company adopted three new accounting standards issued by the CICA: Handbook Section 1535, “Capital Disclosures”, Handbook Section 3862, “Financial Instruments – Disclosures”, and Handbook Section 3863, “Financial Instruments – Presentation”. The Company has applied these new standards on a prospective basis.

### Capital Disclosures

Handbook Section 1535 requires disclosure of an entity’s objectives, policies and process for managing capital, quantitative data about what the entity regards as capital and whether the

entity has complied with any capital requirements and, if it has not complied, the consequences of such non-compliance. The Company has included disclosures recommended by this new Handbook section in note 2 of the financial statements.

#### Financial Instruments – Disclosures

Handbook Section 3862 requires an entity to provide disclosures to enable users to evaluate the significance of financial instruments for an entity's financial position and performance, including disclosures about fair value. In addition, disclosure is required of qualitative and quantitative information about the nature and extent of risks arising from financial instruments, including specified minimum disclosures about liquidity risk and market risk. The quantitative disclosures must also include a sensitivity analysis for each type of market risk to which an entity is exposed, showing how net income and other comprehensive income would have been affected by reasonably possible changes in the relevant risk variable. The Company has included disclosures recommended by this new Handbook section in note 3 of the financial statements.

#### Financial Instruments – Presentation

Handbook Section 3863 replaces the existing requirements on presentation of financial instruments which have been carried forward unchanged to this new section. The adoption of this standard did not have any impact on the presentation of the Company's financial statements.

Recent accounting pronouncements issued and not yet effective:

#### International Financial Reporting Standards (“IFRS”)

The CICA plans to incorporate IFRS into the CICA Handbook as a replacement for current Canadian Generally Accepted Accounting Principles for most publicly accountable enterprises effectively for fiscal years beginning on or after January 1, 2011. The transition date of September 1, 2011 for the Company will require restatement for comparative purposes of amounts reported by the Company for the year ended August 31, 2010. While the Company has begun assessing the adoption of IFRS for 2011, the financial reporting impact of the transition to IFRS has not been determined at this time.

#### **Financial Instruments and Other Risk Factors**

The Company's financial instruments consist of cash and cash equivalents, receivables, investments available for sale, and accounts payable.

Management does not believe these financial instruments expose the Company to any significant interest, currency or credit risks arising from these financial instruments. The fair market values of cash and cash equivalents, receivables and accounts payable approximate their carrying values. Investments available for sale are carried at fair market value.

In conducting its business, the principal risks and uncertainties faced by the Company relate to exploration and development success as well as metal prices and market sentiment to a lesser extent.

Exploration for minerals and development of mining operations involve significant risks, many of which are outside the Company's control. In addition to the normal and usual risks of exploration and mining, the Company often works in remote locations that lack the benefit of infrastructure and easy access.

The prices of metals fluctuate widely and are affected by many factors outside of the Company's control. The relative prices of metals and future expectations for such prices have a significant impact on the market sentiment for investment in mining and mineral exploration companies. The Company relies on equity financing for its long term working capital requirements and to fund its exploration programs. The Company does not anticipate using existing funds to put any of its resources interests into production from its own financial resources. There is no assurance that other forms of financing will be available to the Company, or that it will be available on acceptable terms.

An additional risk factor that has developed over the past two years is access to adequate human resources to carry out work programs, particularly skilled professionals for which there is currently an industry-wide shortage, which can cause delays completing work programs on schedule and in meeting program budgets.

### **Outstanding Share Data**

#### *a) Common and Preferred Shares*

The Company is presently authorized to issue an unlimited number of common shares without par value. The Company is also authorized to issue up to 25,000,000 preferred shares without par value, of which none have been issued.

As at November 30, 2008 the Company had 64,649,748 common shares issued and outstanding.

Subsequent to three months ended November 30, 2008, the Company completed a private placement for 3,000,000 flow-through common shares at a price of \$0.50 per share for gross proceeds of \$1,500,000.

Accordingly as at the date of this report 67,649,748 common shares were issued and outstanding.

#### *b) Warrants*

As at November 30, 2008, the Company had an aggregate of 3,805,000 warrants outstanding with a weighted average exercise price of \$2.00.

Subsequent to three months ended November 30, 2008, the Company issued 198,750 non-transferable finders warrants to the finders of its above-mentioned private placement. Each warrant entitles the holder to acquire one non-flow-through common share at a price of \$0.50 per share, exercisable until November 15, 2010.

Accordingly as at the date of this report 4,003,750 warrants were outstanding with a weighted average exercise price of \$1.93.

#### *c) Stock Options*

As at November 30, 2008 the Company had an aggregate of 4,359,500 incentive stock options outstanding with a weighted average exercise price of \$1.13.

Subsequent to three months ended November 30, 2008, the Company granted 200,000 stock options to a consultant. Each option entitles the holder to purchase one common share of the Company at a price of \$0.50 per share until December 31, 2010. These options vest at the

rate of 25% every three months following December 31, 2008.

Accordingly as at the date of this report 4,559,500 options were outstanding with a weighted average exercise price of \$1.11.

*d) Agents' Compensation Options*

As at November 30, 2008 and the date of this report, the Company had 725,000 Agents' Compensation Options issued and outstanding. Each Agent's Compensation Option entitles the agent holder to purchase one Unit at a price of \$1.55 per Unit, exercisable until November 22, 2009. Each Unit will consist of one common share and one-half of one common share purchase warrant. Each whole warrant entitles the holder to purchase one common share at an exercise price of \$2.00 per share until May 22, 2009. No warrants will be issued upon any exercise of the Agents' Compensation Options after May 22, 2009.

**Disclosure Controls and Procedures**

Disclosure controls and procedures are designed to provide reasonable assurance that material information is gathered and reported to senior management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to permit timely decisions regarding public disclosure.

Management, including the Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures as of November 30, 2008. Based on this evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures, as defined in Multilateral Instrument 52-109 – Certification of Disclosure in Issuer's Annual and Interim Filings, are designed effectively to ensure that the information required to be disclosed in reports that are filed or submitted under Canadian securities legislation are recorded, processed, summarized and reported within the time period specified in those rules.

During the process of review and evaluation, it was determined that the Company's disclosure controls and procedures are operating effectively as at November 30, 2008.

**Design of Internal Controls**

The Company evaluated the design of its internal controls and procedures over financial reporting, as defined under Multilateral Instrument 52-109, for the three months ended November 30, 2008. This evaluation was performed by the Chief Executive Officer and the Chief Financial Officer, with the assistance of other corporate personnel to the extent necessary or appropriate. Based on this evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the design of these internal controls and procedures over financial reporting was effective.

The Company has very limited administrative staffing and in many instances, the implementation of internal controls relying on segregation of duties is not possible. The Company relies on senior management review and approval to ensure that the controls are as effective as possible.

There has been no change in the Company's internal control over financial reporting during the quarter ended November 30, 2008.

**Other Information**

Additional information on the Company, including the Company's AIF, is available on SEDAR at [www.sedar.com](http://www.sedar.com) and on the Company's website at [www.avalonventures.com](http://www.avalonventures.com).