

AVALON RARE METALS INC.
(formerly Avalon Ventures Ltd.)

Management Discussion and Analysis of Financial Statements
For the six months ended February 28, 2009

This Management Discussion and Analysis (“MDA”) of Avalon Rare Metals Inc. (the “Company”) provides analysis of the Company's financial results for the six months ended February 28, 2009. 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 *April 9, 2009*.

Nature of Business and Overall Performance

Avalon Rare Metals Inc. 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, 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”). A new NI 43-101 resource estimate for the lake Zone REE deposit was filed in March, 2009 and it is intended that this project will be advanced to the pre-feasibility level of analysis by the end of 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.

For the Years Ending August 31,	2008	2007	2006
	\$	\$	\$
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 February 28, 2009 totalled \$1,269,365, an 8% increase over the level of expenditures in the comparable period of the

previous fiscal year (\$1,180,780). Most of these expenditures were incurred on the Thor Lake rare metals project (93%) with the balance being largely incurred on the 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 December, 2008 while the expenditures on Separation Rapids and Warren Township 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 February 28, 2009 totalled \$1,186,204. Most of these expenditures were incurred on the preparation of the resource estimate for the Lake Zone REE deposit, initiation of the winter 2009 definition drilling program, a market study on the rare earth elements and continuing metallurgical studies.

The new NI-43-101 compliant resource estimate for the Lake Zone REE deposit was disclosed in a news release dated February 3, 2009 and the full technical report was filed by independent technical consultants, Wardrop Engineering Ltd. (“Wardrop”) of Toronto, ON, on SEDAR subsequent to the end of the quarter in late March. The new resource estimate provided the first separate estimate of resources in the “Basal Zone” portion of the deposit as detailed below, which due to its relative enrichment in the more scarce and valuable HREE, is considered the main target for initial development.

ZONE	Resource Class	Cut-off TREO (%)	Tonnes (x1000)	TREO (%)	HREO (%)	H/T (%)
Basal	IND	1.60	2,186	2.14	0.43	20.0%
Basal	IND	1.80	1,573	2.31	0.47	20.4%
Basal	IND	2.00	1,054	2.52	0.53	20.9%
Basal	IND	2.20	731	2.71	0.57	21.1%
Basal	IND	2.40	505	2.90	0.63	21.7%

ZONE	Resource Class	Cut-off TREO (%)	Tonnes (x1000)	TREO (%)	HREO (%)	H/T (%)
Basal	INF	1.60	28,447	1.99	0.44	22.1%
Basal	INF	1.80	18,181	2.16	0.49	22.4%
Basal	INF	2.00	11,795	2.31	0.52	22.4%
Basal	INF	2.20	6,594	2.48	0.57	22.9%
Basal	INF	2.40	3,460	2.64	0.64	24.1%

Notes:

1. HREO (Heavy Rare Earth Oxides) is the total concentration of: Y₂O₃, Eu₂O₃, Gd₂O₃, Tb₄O₇, Dy₂O₃, Ho₂O₃, Er₂O₃, Tm₂O₃, Yb₂O₃ and Lu₂O₃.
2. TREO (Total Rare Earth Oxides) is HREO plus: La₂O₃, Ce₂O₃, Pr₆O₁₁, Nd₂O₃ and Sm₂O₃.
3. Wardrop considers a 1.60% TREO cut-off grade to be a reasonable estimate of potentially economic resources, based on a preliminary estimate of operating costs of \$197.00/tonne.
4. To determine a recommended cut-off grade, Gross Metal Values (GMV) were calculated using 4 year average REE prices (where available) and assuming recoveries of: 74.6% for Y₂O₃ and 82.1% for all other rare earth elements. The metallurgical recoveries include both mineral processing (flotation) and hydrometallurgical recoveries. A 1.60 % TREO cut-off grade closely approximates a \$200/tonne GMV.
5. IND = Indicated, INF = Inferred, H/T = ratio of HREO to TREO expressed as percent.

The Basal Zone represents an undulating, gently dipping sheet, averaging approximately 20 metres in thickness and extending over a broad area at the base of the Lake Zone deposit at depths typically in the order of 200-250 metres. The current drilling program has two main objectives: 1) better define the southern part of the Basal Zone where some of the best grades and thicknesses were obtained in the 2008 drilling and 2) complete in-fill drilling to reduce average drill spacing and improve the confidence level on the resource to allow more of the Inferred resources to be classified as Indicated. As at the date of this report, 13 holes totalling 3676 metres had been completed with drilling expected to continue until late April when it is anticipated that spring conditions will necessitate suspension of the drilling until summer. Initial assay results from this program are expected to be available for disclosure in mid-April.

Drilling costs incurred during the quarter totalled \$589,790 which included pre-paid expenditures for fuel purchase and delivery and a deposit on the drill contract. An additional \$61,798 was incurred for geological consulting work done in support of this program. This program has a budget of \$1.5 million and is being financed with the proceeds of the flow-through private placement completed in December, 2008. As a consequence of more favourable drilling rates and on-site efficiencies, average contract drilling costs are running approximately \$50/m or 30% below 2008 program costs. Drilling operations were carried out under the direct supervision of J.C. Pedersen, P.Geo., under the overall direction of the Company's Vice-President, Exploration, Dr. William Mercer, P.Geo.

Expenditures of \$295,453 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. This work is being supervised by Mr. J. R. Goode, P.Eng., a consulting metallurgist with over 40 years of international experience. Flotation study results reported by SGS are indicating recoveries to a bulk cleaner concentrate of 75% to 85% of REE, about 70% to 77% of niobium and tantalum, and 85% of the zirconium with a fourfold concentration of these elements. Further trials are planned with the objective to upgrade this concentrate. Hydrometallurgical testing continues with results show up to 98% to 99% REE and zirconium recovery with NaOH caustic cracking at 600°C followed by HCl dissolution. Tests using H₂SO₄ in place of HCl are promising as a potentially lower cost processing route.

Environmental expenditures of \$149,147 were incurred during the quarter, for continuing costs related to a program of environmental baseline studies on the property, initiated in 2008 and carried out by Jacques Whitford AXYS Stantec. This program included studying both surface and ground waters, water chemistry in the lakes of the area, aquatic biology, terrane analysis and collecting meteorological data. During the current program, environmental work consisted of packer test holes to measure groundwater conditions and some aquatic studies under winter conditions. In addition, office work relating to previous fieldwork is ongoing.

Other expenditures included community consultation of \$52,792 and feasibility/engineering studies of \$37,224 which were related to evaluating proposals from engineering companies for the pre-feasibility study on the Lake Zone deposit. In addition, meetings were held with various groups that may assist with project advancement, including companies in the areas of power generation, barge transportation, air transportation and trucking, and possible industrial plant sites.

During and subsequent to the end of the quarter, the Company carried out a round of community consultations with community leadership in Lutselk'e, Fort Resolution, Hay River and Yellowknife. This was in connection with the Company's application for a two-year extension to its land use permit, scheduled to expire in July. No opposition to the proposed permit extension was received. In fact, the Company was praised by several community leaders and local government officials for its work in initiating the development of two training programs for local

native people in co-operation with the NWT Mine Training Society. The first was for First Aid responders required on all remote job sites, and the second program was for surface diamond drilling helpers. There were ten successful graduates from the driller training program and four of these are getting initial on-the-job training at Thor Lake with the Company's current drilling contractor, Foraco Inc. The Company also continues to employ local native people on the site as technicians in support of the drilling program.

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. One worker had a knee injury that resulted a short period of light duty, and he has since returned to work at site. Site inspections by government land use and WCB inspectors have generally produced positive reports and any issues raised were addressed immediately. The only issues that have been raised have been minor and easily addressed. All land use inspection reports have been filed on the Company's website in the Sustainability section.

Warren Township

Expenditures of \$4,184 were incurred on the Warren Township Anorthosite Project during the three months ended February 28, 2009. These were mainly related to the ongoing efforts to secure an operating permit under the *Aggregate Resources Act* of Ontario and for the finalization of a Memorandum of Understanding ("MOU") with the Chapleau Cree First Nation (CCFN). This work is being carried out under the supervision of Ian London, P.Eng.

The substance of the MOU was disclosed in a news release dated February 26, 2009 and a formal signing ceremony was conducted during the PDAC convention on March 3, 2009, The MOU outlines the principles under which the project would be developed in co-operation with CCFN and other impacted First Nations in the area. The MOU contemplates that a Resource Benefits Agreement ("RBA") will be negotiated and agreed to between the Company and CCFN before the commencement of any mine development work. The RBA will provide an arrangement for sharing of economic benefits from the operation through some combination of equity participation, resource revenue sharing, service contracts and community program sponsorship, at a level that does not unreasonably encumber its future economic viability.

Some issues over the size of the permit area have yet to be resolved with the Ontario Ministry of Natural Resources. This work is being carried out under the direction of Fudge & Associates ("Fudge") of North Bay, Ontario. There are no specific timelines in place for initiation of any new work programs on the project.

Separation Rapids

During the three months ended February 28, 2009, the Company incurred \$46,985 in expenditures on the Separation Rapids lithium-tantalum project. These costs were mainly related to market development work and surveying work related to the Company's application for a Mining Lease.

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 also 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 involved a now-complete perimeter survey to precisely define the lease boundaries. This work is being

supervised by Fudge and it is expected that the lease application will be completed and submitted during the fourth calendar quarter. The market development work is being carried out under the direction of Ian London, P.Eng. with the assistance of technical consultants Amalgamet Canada and Hains Technology Associates.

East Kemptville

During the three months ended February 28, 2009, the Company incurred expenditures totalling \$31,992 on the East Kemptville Tin-Rare Metals Project in Yarmouth Co., Nova Scotia. The work is being conducted by Bruce Hudgins, P.Ge. of Dartmouth, N.S. (“Hudgetec”), under the supervision of the Company’s Vice-President, Exploration, Dr. William Mercer, P.Ge.

Most of the expenditures incurred during the period were relating to the filing of a detailed update report with the Nova Scotia government as required under the terms of the Special Licence. This was completed earlier in 2008 but revisions were required during the last quarter. The balance of the costs was mainly incurred for geochemical analysis of historic drill core relating to planned metallurgical testing of the tin-indium mineralization.

The main objective of the current work is to complete a NI43-101 compliant resource estimate and PEA on the historic tin resource at East Kemptville. The PEA is to be done by Wardrop, and is targeted for completion by August 1, 2009.

Red Hill

No expenditure was incurred on the Red Hill project during the three months ended February 28, 2009 and none are planned for 2009.

Administration

Administrative expenses incurred during the three months ended February 28, 2009 totalled \$696,366, a 26% decrease over the amount incurred during the comparable quarter in fiscal 2008. The main areas of decreased administrative expenditures were transfer and filing fees, salaries and benefits and public and investor relations reflecting the Company’s efforts to reduce its administrative overhead expenditures in 2009. For the six month period, administrative expenses totalled \$1,268,773 compared with \$1,427,732 during the comparable period in 2008. The main areas of decrease administrative expenditures for the six month period were transfer and filing fees, salaries and benefits and travel expenses. The decreases in these areas were partly offset by the increase in professional fees.

Expenditures on public and investor relations (“IR”) activities for the three months ended February 28, 2009 totalled \$118,981, a 21% decrease over the comparable period in fiscal 2008 (\$151,512). The decrease relates to reduced participation in investment conferences, reduced advertising expenditures and the termination of several IR consulting contracts. During the quarter the Company participated in the Vancouver Resource investment conference and the Triple Gold investment conference in New York, and, subsequent to the end of the quarter, in the Investor Exchange of the PDAC annual convention and the Calgary Resource and Clean Energy Investment conference. The Company’s rare metals story attracted considerable new investor interest at all four events.

The Company is presently incurring extraordinary costs related to the change of name to Avalon Rare Metals Inc. for design work, promotional materials, and consulting expenses related to development and implementation of an overall corporate re-branding strategy. One new initiative was the creation of an internet “blog” in co-operation with Pro-edge Consultants, to provide a general source of information on new developments in the world of rare metals. During the third quarter the Company will also complete a re-design of the corporate website.

Salaries and benefits decreased to \$146,688 from \$236,618 in fiscal 2008. The primary reason for the decrease was that a bonus awarded to the Company's President and CEO in 2008, did not recur in 2009. Transfer and filing fees decreased by \$161,069 compared to the same quarter in 2008. The decrease in transfer and filing fees compared to the comparable period in 2008 was due to the listing fee paid on Company's graduation to the TSX in February, 2008.

Interest income totalled \$52,701 for the three months ended February 28, 2009 compared to \$141,359 for the same three month period in fiscal 2008, reflecting the decreased level of cash and cash equivalents in the treasury as well as the decrease in interest rates.

During the quarter, Ms. Mary Quinn resigned as Corporate Secretary of the Company and was replaced by Ms. Alana Kelcey effective February 2, 2009.

During the three months ended February 28, 2009, the Company renounced Canadian exploration expenditures of \$1,500,000 to the investors in the flow-through private placement completed in December, 2008. This renunciation resulted in a reduction of the Company's future income tax assets of \$405,000 and a corresponding reduction in share capital. However, as the Company has not recognized its future income tax assets, this amount is recorded as a future income tax recovery on the statement of operations.

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.

Fiscal Year For the Quarters Ended	2009		2008				2007	
	Feb.28	Nov. 30	Aug. 31	May 31	Feb. 29	Nov. 30	Aug. 31	May 31
	\$	\$	\$	\$	\$	\$	\$	\$
Net revenues	52,701	44,246	100,003	93,778	141,359	22,399	21,066	28,502
Income (loss) before discontinued operations and extraordinary items	(238,665)	(528,161)	(872,767)	(638,340)	(787,411)	906,937	(445,335)	184,396
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)	(238,665)	(528,161)	(872,767)	(638,340)	(787,411)	906,937	(445,335)	184,396
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 February 28, 2009, the Company had working capital of \$7,755,646 (including investments of \$3,943) and cash and cash equivalents on hand of \$8,488,834.

The Company's current overhead expenditures, excluding expenditures on resource property work programs, were approximately \$170,000 per month for the three months ended February 28, 2009, but management is making efforts to further reduce its overhead expenditures in subsequent quarters 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 has requested an extension of time to incur the balance of the expenditures required before August 1, 2009 and extend the deadline to meet the full \$1.25 million expenditure requirement to August 1, 2011.

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 April 9, 2009, the minimum lease commitments under this lease are as follows:

2009	\$34,555
2010	\$88,858
2011	\$88,858
2012	\$29,619

Off Balance Sheet Arrangements

As at February 28, 2009, 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 six months ended February 28, 2009, the Company incurred:

- a) accounting fees of \$29,000 with an accounting firm in which an officer is the principal. As at February 28, 2009, accounts payable included \$10,000 accrued to this accounting firm;
- b) consulting fees of \$75,400 with a company owned by an officer of the Company, which were deferred as resource property costs. As at February 28, 2009, accounts payable included \$16,144 payable to this company; and
- c) consulting fees of \$20,350 with an officer of the Company, of which \$11,413 were deferred as resource property costs. As at February 28, 2009, accounts payable included \$10,054 payable to this officer.

Subsequent Events

There were no material transactions or events that occurred subsequent to the six months ended February 28, 2009, up to the date of this report.

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 met during the quarter to provide input into the scope of work for the proposed environmental baselines studies at Thor Lake and to consider how best to approach certain community consultation objectives there, notably meetings with locally-based environmental NGO's in the NWT.

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 the date of this report, the Company had 68,152,248 common shares issued and outstanding.

b) Warrants

As at the date of this report, the Company had 4,003,750 warrants issued and outstanding with a weighted average exercise price of \$1.93.

c) Stock Options

As at the date of this report, the Company had an aggregate of 4,632,000 incentive stock options outstanding with a weighted average exercise price of \$1.09.

d) Agents' Compensation Options

As 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 to permit timely decisions regarding public disclosure.

The Chief Executive Officer and Chief Financial Officer have designed or caused to be designed under their supervision, disclosure controls and procedures 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 and to provide reasonable assurance 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.

Design of Internal Controls

The Chief Executive Officer and Chief Financial Officer have also designed or caused to be designed under their supervision, internal controls over financial reporting to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes.

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 February 28, 2009 that have materially affected, or is reasonably likely to materially affect, the Company's internal controls over financial reporting.

Other Information

Additional information on the Company, including the Company's AIF, is available on SEDAR at www.sedar.com and on the Company's website at www.avalonraremetals.com.