
Financial Statements

Avalon Rare Metals Inc.
(formerly Avalon Ventures Ltd.)

For the Nine Months Ended May 31, 2009

Unaudited - See Notice to Reader

INDEX

Balance Sheets	1
Statements of Operations and Deficit	2
Statements of Comprehensive Income (Loss)	3
Cash Flow Statements	4
Notes to the Financial Statements	5 - 17

NOTICE TO READER

The accompanying unaudited interim financial statements have been prepared by the Company's management and the Company's independent auditors have not performed a review of these financial statements.

Avalon Rare Metals Inc.

(formerly Avalon Ventures Ltd.)

Balance Sheets

As at May 31, 2009 and August 31, 2008

Unaudited - See Notice to Reader

	May 31, 2009	August 31, 2008
Assets		
Current Assets		
Cash and cash equivalents	\$ 6,995,864	\$ 10,738,700
Receivables	205,259	152,165
Prepaid expenses	72,457	130,226
	<u>7,273,580</u>	<u>11,021,091</u>
Investments Available for Sale	3,943	3,943
Resource Properties (note 4)	17,936,999	13,188,626
Property, Plant and Equipment	<u>133,080</u>	<u>170,930</u>
	<u>\$ 25,347,602</u>	<u>\$ 24,384,590</u>
Liabilities		
Current Liabilities		
Accounts payable	<u>\$ 670,789</u>	<u>\$ 892,806</u>
Shareholders' Equity		
Share Capital (note 5)	44,684,682	43,273,243
Contributed Surplus (note 6)	1,231,589	54,175
Deficit	(21,231,258)	(19,827,434)
Accumulated Other Comprehensive Loss	<u>(8,200)</u>	<u>(8,200)</u>
	<u>24,676,813</u>	<u>23,491,784</u>
	<u>\$ 25,347,602</u>	<u>\$ 24,384,590</u>

Approved on behalf of the Board

_____, "Donald S. Bubar", Director

_____, "Brian MacEachen", Director

Avalon Rare Metals Inc.

(formerly Avalon Ventures Ltd.)

Statements of Operations and Deficit

For the Periods Ended May 31

Unaudited - See Notice to Reader

	Nine Months Ended		Three Months Ended	
	May 31, 2009	May 31, 2008	May 31, 2009	May 31, 2008
Revenue				
Interest income	\$ 132,212	\$ 257,536	\$ 35,265	\$ 93,778
Expenses				
Amortization	37,850	30,984	12,616	19,015
Consulting fees	42,388	32,985	7,575	13,212
Directors' fees	29,000	31,000	9,000	11,000
Insurance	43,855	35,045	17,173	14,481
Interest and financing costs	19,036	69,799	6,724	40,586
Office and general	22,265	27,911	6,317	10,671
Professional fees	146,403	138,181	36,094	51,480
Public and investor relations	399,524	414,266	162,931	177,233
Rent and utilities	83,578	81,131	30,549	27,867
Salaries and benefits	406,459	501,031	98,209	155,813
Shareholders' information	21,157	23,399	1,733	1,916
Stock based compensation	539,563	444,677	239,527	162,725
Transfer and filing fees	56,050	200,656	3,165	2,801
Travel	93,908	128,785	40,650	43,318
	<u>1,941,036</u>	<u>2,159,850</u>	<u>672,263</u>	<u>732,118</u>
Loss Before the Undernoted Items	(1,808,824)	(1,902,314)	(636,998)	(638,340)
Recoveries of Resource Properties	-	10,000	-	-
Loss before Income Taxes	(1,808,824)	(1,892,314)	(636,998)	(638,340)
Recovery of Future Income Taxes	405,000	1,373,500	-	-
Net Income (Loss) for the Period	(1,403,824)	(518,814)	(636,998)	(638,340)
Deficit - Beginning of Period	(19,827,434)	(18,435,853)	(20,594,260)	(18,316,327)
Deficit - End of Period	<u>\$ (21,231,258)</u>	<u>\$ (18,954,667)</u>	<u>\$ (21,231,258)</u>	<u>\$ (18,954,667)</u>
Loss per Share, basic and fully diluted	<u>\$ (0.02)</u>	<u>\$ (0.01)</u>	<u>\$ (0.01)</u>	<u>\$ (0.01)</u>
Weighted Average Number of Common Shares				
Outstanding, basic and fully diluted	<u>66,753,052</u>	<u>60,653,770</u>	<u>68,309,036</u>	<u>64,470,590</u>

Avalon Rare Metals Inc.

(formerly Avalon Ventures Ltd.)

Statements of Comprehensive Income (Loss)

For the Periods Ended May 31

Unaudited - See Notice to Reader

	<u>Nine Months Ended</u>		<u>Three Months Ended</u>	
	<u>May 31,</u> <u>2009</u>	<u>May 31,</u> <u>2008</u>	<u>May 31,</u> <u>2009</u>	<u>May 31,</u> <u>2008</u>
Net Income (Loss) for the period	\$ (1,403,824)	\$ (518,814)	\$ (636,998)	\$ (638,340)
Other Comprehensive Income	-	-	-	-
Comprehensive Income (Loss) for the period	<u>\$ (1,403,824)</u>	<u>\$ (518,814)</u>	<u>\$ (636,998)</u>	<u>\$ (638,340)</u>

Avalon Rare Metals Inc.

(formerly Avalon Ventures Ltd.)

Cash Flow Statements

For the Periods Ended May 31

Unaudited - See Notice to Reader

	<u>Nine Months Ended</u>		<u>Three Months Ended</u>	
	<u>May 31,</u> <u>2009</u>	<u>May 31,</u> <u>2008</u>	<u>May 31,</u> <u>2009</u>	<u>May 31,</u> <u>2008</u>
Cash Flows from Operating Activities				
Cash paid to suppliers and employees	\$ (1,395,823)	\$ (1,585,854)	\$ (430,276)	\$ (642,072)
Interest received	132,212	257,536	35,265	93,778
Interest paid	(73,969)	(45,273)	-	-
	<u>(1,337,580)</u>	<u>(1,373,591)</u>	<u>(395,011)</u>	<u>(548,294)</u>
Cash Flows from Financing Activities				
Share capital - private placements	1,400,625	15,527,155	-	-
Share capital - exercise of warrants	903,040	1,317,769	903,040	-
Share capital - exercise of options	150,625	265,500	25,000	89,500
	<u>2,454,290</u>	<u>17,110,424</u>	<u>928,040</u>	<u>89,500</u>
Cash Flows from Investing Activities				
Resource property expenditures	(4,859,546)	(3,822,390)	(2,025,999)	(1,919,017)
Recoveries of resource properties	-	10,000	-	-
Purchase of property, plant, and equipment	-	(140,073)	-	(103,725)
	<u>(4,859,546)</u>	<u>(3,952,463)</u>	<u>(2,025,999)</u>	<u>(2,022,742)</u>
Change in cash and cash equivalents	<u>(3,742,836)</u>	<u>11,784,370</u>	<u>(1,492,970)</u>	<u>(2,481,536)</u>
Cash and cash equivalents				
- beginning of period	<u>10,738,700</u>	<u>1,562,102</u>	<u>8,488,834</u>	<u>15,828,008</u>
Cash and cash equivalents				
- end of period	<u>\$ 6,995,864</u>	<u>\$ 13,346,472</u>	<u>\$ 6,995,864</u>	<u>\$ 13,346,472</u>

Avalon Rare Metals Inc.

(formerly Avalon Ventures Ltd.)

Notes to the Financial Statements

For the Nine Months Ended May 31, 2009

Unaudited - See Notice to Reader

1. Accounting Policies

These interim financial statements have been prepared by the Company in accordance with Canadian generally accepted accounting principles. These financial statements are based on accounting principles and practices consistent with those used in the preparation of the Company's annual financial statements except for the changes made to adopt the new accounting standards as described in the following paragraph. Certain information and note disclosure normally included in annual financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. These interim financial statements should be read together with the audited financial statements and the accompanying notes of the Company for the year ended August 31, 2008.

New Accounting Policies

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.

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.

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.

Avalon Rare Metals Inc.

(formerly Avalon Ventures Ltd.)

Notes to the Financial Statements

For the Nine Months Ended May 31, 2009

Unaudited - See Notice to Reader

2. Capital Disclosures

The Company includes equity, comprised of share capital, contributed surplus and deficit in the definition of capital.

The Company's objectives when managing capital are as follows:

- (i) to safeguard the Company's ability to continue as a going concern;
- (ii) to raise sufficient capital to finance its exploration and development activities on its Thor Lake Project;
- (iii) to raise sufficient capital to meet its general and administrative expenditures, and to explore and develop its other resource properties;

The Company manages its capital structure and makes adjustments to it, based on the general economic conditions, the Company's short term working capital requirements, and its planned exploration and development program expenditure requirements. The Company does not have any externally imposed capital requirements.

3. Financial Instruments

The Company has classified its financial instruments as follows:

<u>Financial Instrument</u>	<u>Classification</u>	<u>Accounting Treatment</u>
Cash and cash equivalents	Held for trading	Fair market value
Receivables	Loans and receivables	Amortized cost
Investments available for sale	Available-for-sale	Fair market value
Accounts payable	Other liabilities	Amortized cost

Cash and cash equivalents include bank deposits and highly liquid short term money market investments such as bankers acceptance notes, treasury bills and guaranteed investment certificates.

Investments available for sale ("Investments") consist of shares received as consideration for resource property interest. All Investments are in publicly traded companies.

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

Credit risk

The Company is not exposed to any significant credit risk as at May 31, 2009. The Company's cash and cash equivalents are either on deposit with a highly rated banking group in Canada or invested in bankers acceptance notes or guaranteed investment certificates issued by two highly rated Canadian banking groups.

Avalon Rare Metals Inc.

(formerly Avalon Ventures Ltd.)

Notes to the Financial Statements

For the Nine Months Ended May 31, 2009

Unaudited - See Notice to Reader

3. Financial Instruments (continued)

Liquidity risk

The Company has sufficient funds to cover its short term working capital requirements.

Market risk

(i) Interest rate risk

The Company has significant cash and cash equivalents balances and it has no interest-bearing debt. The Company's current policy is to invest its excess cash in highly liquid money market investments such as bankers acceptance notes, treasury bills and guaranteed investment certificates. These short term money market investments are subject to interest rate fluctuations.

(ii) Foreign currency risk

The Company's functional currency is primarily the Canadian dollar. The majority of the Company's purchases are transacted in Canadian dollars. As at May 31, 2009, the Company had US\$34,214 in cash.

(iii) Price risk

The prices of metals fluctuate widely and are affected by many factors outside of the Company's control. The prices of metals and future expectation of such prices have a significant impact on the market sentiment for investment in mining and mineral exploration companies. This in turn may impact the Company's ability to raise equity financing for its long term working capital requirements.

In addition, the values of the Company's Investments are subject market price fluctuations.

Sensitivity analysis

Based on management's knowledge and experiences of the financial markets, the Company's management believes the following movements are "reasonably possible" over a three month period.

As at May 31, 2009, approximately 44% of the Company's cash and cash equivalents are at fixed interest rates within the next three months. Sensitivity to a plus or minus 25 basis points change in rates would increase or decrease the Company's net loss by approximately \$6,000 over a three month period.

The Company had US\$34,214 in cash as at May 31, 2009 and its quarterly average expenditures transacted in US dollars is approximately US\$10,000. If the Canadian Dollar weakens or strengthens 10% against the United States Dollar with other variables held constant, the Company's net loss would not change significantly over a three month period.

A plus or minus 10% change in the market price of the Company's Investments would not have any significant effect on the Company's net loss.

Avalon Rare Metals Inc.

(formerly Avalon Ventures Ltd.)

Notes to the Financial Statements

For the Nine Months Ended May 31, 2009

Unaudited - See Notice to Reader

4. Resource Properties

For the Nine Months ended May 31, 2009

	Separation Rapids Lithium- Tantalum Project	Warren Township Anorthosite Project	Thor Lake Rare Metals Project	Red Hill Copper- Zinc-Silver Project	East Kemptville Rare Metals Project	Total
Acquisition costs	\$ -	\$ -	\$ 590	\$ -	\$ -	\$ 590
Community consultation	-	2,775	151,904	-	-	154,679
Diamond drilling	-	-	2,226,427	-	-	2,226,427
Environmental studies/permitting	68,531	859	834,146	-	-	903,536
Feasibility/engineering studies	3,120	67	226,843	-	-	230,030
Geochemical	-	-	-	-	32,348	32,348
Geology	-	-	236,321	295	95,599	332,215
Geophysical	-	-	74,934	-	-	74,934
Metallurgical/market studies	54,642	4,125	705,831	-	1,856	766,454
Other	5,662	300	21,198	-	-	27,160
Current expenditures	131,955	8,126	4,478,194	295	129,803	4,748,373
Balance - August 31, 2008	3,713,949	1,185,805	7,281,767	598,264	408,841	13,188,626
Balance - May 31, 2009	\$ 3,845,904	\$ 1,193,931	\$ 11,759,961	\$ 598,559	\$ 538,644	\$ 17,936,999

Avalon Rare Metals Inc.

(formerly Avalon Ventures Ltd.)

Notes to the Financial Statements

For the Nine Months Ended May 31, 2009

Unaudited - See Notice to Reader

4. Resource Properties (continued)

For the Three Months ended May 31, 2009

	Separation Rapids Lithium- Tantalum Project	Warren Township Anorthosite Project	Thor Lake Rare Metals Project	Red Hill Copper- Zinc-Silver Project	East Kemptville Rare Metals Project	Total
Community consultation	\$ -	\$ 850	\$ 74,058	\$ -	\$ -	\$ 74,908
Diamond drilling	-	-	932,541	-	-	932,541
Environmental studies/permitting	5,972	-	175,732	-	-	181,704
Feasibility/engineering studies	1,463	-	99,427	-	-	100,890
Geology	-	-	91,166	-	2,068	93,234
Geophysical	-	-	68,311	-	-	68,311
Metallurgical/market studies	12,998	275	205,489	-	-	218,762
Other	549	-	21,198	-	-	21,747
Current expenditures	20,982	1,125	1,667,922	-	2,068	1,692,097
Balance - February 28, 2009	3,824,922	1,192,806	10,092,039	598,559	536,576	16,244,902
Balance - May 31, 2009	\$ 3,845,904	\$ 1,193,931	\$ 11,759,961	\$ 598,559	\$ 538,644	\$ 17,936,999

Avalon Rare Metals Inc.

(formerly Avalon Ventures Ltd.)

Notes to the Financial Statements

For the Nine Months Ended May 31, 2009

Unaudited - See Notice to Reader

5. Share Capital

a) Issued and Outstanding:

	<u>Number</u>	<u>Amount</u>
Common Shares		
Balance - August 31, 2008	64,649,748	\$ 40,032,502
Issued pursuant to: private placement	3,000,000	1,500,000
exercise of warrants	1,302,200	1,394,755
exercise of options	552,500	229,472
Finders' fees - cash paid	-	(99,375)
Finders' fees - compensation warrants issued	-	(36,192)
Tax effect on issuance of flow-through shares	-	(405,000)
	<u>69,504,448</u>	<u>\$ 42,616,162</u>
Warrants		
Balance - August 31, 2008	3,805,000	\$ 1,461,881
Issued for finders' fees	198,750	36,192
Exercised	(1,302,200)	(491,715)
Expired/Cancelled	<u>(2,545,300)</u>	<u>(977,905)</u>
Balance - May 31, 2009	<u>156,250</u>	<u>28,453</u>
Stock Options		
Balance - August 31, 2008	4,327,500	\$ 1,353,140
Granted	1,232,000	141,367
Exercised	(552,500)	(78,847)
Expired/Cancelled	(557,000)	(199,509)
Fair value of options recognized relating to previous option grants	<u>-</u>	<u>398,196</u>
Balance - May 31, 2009	<u>4,450,000</u>	<u>\$ 1,614,347</u>
Agents' Compensation Options		
Balance - August 31, 2008 and May 31, 2009	<u>725,000</u>	<u>\$ 425,720</u>
		<u>\$ 44,684,682</u>

Avalon Rare Metals Inc.

(formerly Avalon Ventures Ltd.)

Notes to the Financial Statements

For the Nine Months Ended May 31, 2009

Unaudited - See Notice to Reader

5. Share Capital (continued)

During the nine months ended May 31, 2009, the Company:

- i) completed a private placement and issued 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 December 15, 2010.

The estimated fair value of the warrants totalled \$36,192. The fair value of the warrants was estimated at the issuance date based on the Black-Scholes pricing model, using the following assumptions:

Expected dividend yield	Nil
Risk-free interest rate	1.49%
Expected life	2.00 years
Expected volatility	96%

Warrant pricing models require the input of highly subjective assumptions including the expected 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 measure of the fair value of the Company's warrants.

- ii) issued 1,302,200 non-flow-through common shares pursuant to the exercise of an equivalent number of common share purchase warrants for cash proceeds of \$903,040. The estimated fair value at issuance of these options was \$491,715, and this amount has been added to the recorded value of the issued shares.
- ii) issued 552,500 non-flow-through common shares pursuant to the exercise of an equivalent number of stock options for cash proceeds of \$150,625. The estimated fair value at issuance of these options was \$78,847, and this amount has been added to the recorded value of the issued shares.

b) 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.

c) Warrants

During the quarter ended May 31, 2009, the Company amended the exercise price of 3,805,000 share purchase warrants that were expiring on May 22, 2009 from \$2.00 to \$0.70. 1,259,700 of these warrants were exercised and the balance of 2,545,300 expired unexercised.

Avalon Rare Metals Inc.

(formerly Avalon Ventures Ltd.)

Notes to the Financial Statements

For the Nine Months Ended May 31, 2009

Unaudited - See Notice to Reader

5. Share Capital (continued)

As at May 31, 2009, the Company had 156,250 non-flow-through warrants issued and outstanding. Each warrant entitles the holder to purchase one common share at \$0.50 per share, expiring December 15, 2010.

During the nine months ended May 31, 2009, share purchase warrants were issued, exercised or expired/cancelled as follows:

	Number of Warrants	Weighted Average Exercise Price
Balance - August 31, 2008	3,805,000	\$ 2.00
Issued	198,750	0.50
Exercised	(1,302,200)	0.69
Expired/Cancelled	(2,545,300)	0.70
Balance - May 31, 2009	<u>156,250</u>	<u>\$ 0.50</u>

d) Stock Option Plan

The shareholders have approved a Stock Option Plan (the "Plan") that provides for the issue of up to 10% of the number of issued and outstanding common shares of the Company to eligible employees, directors and service providers of the Company.

The Plan authorizes the granting of options to purchase shares of the Company's common stock at an option price equal to or greater than the closing price of the shares for either the trading day prior to the grant or the day of the grant. The options generally vest over a period of one to four years, and generally have a term of two to five years (but can have a maximum term of 10 years).

During the nine months ended May 31, 2009, stock options were granted, exercised and expired/cancelled as follows:

	Number of Options	Weighted Average Exercise Price
Balance - August 31, 2008	4,327,500	\$ 1.13
Granted	1,232,000	0.70
Exercised	(552,500)	0.27
Expired/Cancelled	(557,000)	1.50
Balance - May 31, 2009	<u>4,450,000</u>	<u>\$ 1.07</u>
Vested options included in outstanding options above - May 31, 2009	<u>2,106,250</u>	<u>\$ 1.07</u>

Avalon Rare Metals Inc.

(formerly Avalon Ventures Ltd.)

Notes to the Financial Statements

For the Nine Months Ended May 31, 2009

Unaudited - See Notice to Reader

5. Share Capital (continued)

During the nine months ended May 31, 2009, the Company granted:

- i) 32,000 stock options to a consultant of the Company. Each option entitles the holder to purchase one common share of the Company at a price of \$1.86 per share until September 1, 2010. These options vest at the rate of 25% every three months following September 1, 2008. These options were cancelled during the period, including 16,000 of these options that had been earned prior to their cancellation, with an estimated fair value of \$2,063 which has been recorded as stock-based compensation expense.
- ii) 200,000 stock options to a consultant of the Company. 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. As at May 31, 2009, 83,333 options had been earned. The estimated fair value of these options totalled \$51,026 and this amount had been recorded as stock-based compensation expense.
- iii) an aggregate of 200,000 stock options to three consultants of the Company. Each option entitles the holder to purchase one common share of the Company at a price of \$0.70 per share until January 13, 2011. These options vest at the rate of 25% every three months following January 13, 2009. As at May 31, 2009, 75,000 options had been earned. The estimated fair value of these options totalled \$38,612 and this amount had been recorded as stock-based compensation expense.
- iv) 50,000 stock options to a consultant of the Company. Each option entitles the holder to purchase one common share of the Company at a price of \$0.63 per share until January 27, 2011. These options vest at the rate of 25% every three months following January 27, 2009. As at May 31, 2009, 16,660 options had been earned. The estimated fair value of these options totalled \$9,696 and this amount had been recorded as stock-based compensation expense.
- v) 100,000 stock options to a new officer of the Company. Each option entitles the holder to purchase one common share of the Company at a price of \$0.63 per share until January 27, 2014. These options vest at the rate of 25% every twelve months following January 27, 2009. The estimated fair value of these options totalled \$53,850 and this amount is being amortized and expensed as stock-based compensation over the vesting terms. As May 31, 2009, \$4,488 had been recognized and recorded as stock-based compensation expense.
- vi) an aggregate of 400,000 stock options to the Company's directors and officers. Each option entitles the holder to purchase one common share of the Company at a price of \$0.75 per share until February 13, 2014. These options vest at the rate of 25% every twelve months following February 13, 2009. The estimated fair value of these options totalled \$222,120 and this amount is being amortized and expensed as stock-based compensation over the vesting terms. As May 31, \$16,196 had been recognized and recorded as stock-based compensation expense.

Avalon Rare Metals Inc.

(formerly Avalon Ventures Ltd.)

Notes to the Financial Statements

For the Nine Months Ended May 31, 2009

Unaudited - See Notice to Reader

5. Share Capital (continued)

- vii) an aggregate of 150,000 stock options to three consultants of the Company. Each option entitles the holder to purchase one common share of the Company at a price of \$0.75 per share until February 13, 2011. These options vest at the rate of 25% every three months following February 13, 2009. As at May 31, 43,740 options had been earned. The estimated fair value of these options totalled \$18,448, and this amount had been recorded as stock-based compensation expense.
- viii) 100,000 stock options to an employee of the Company. Each option entitles the holder to purchase one common share of the Company at a price of \$0.55 per share until April 7, 2014. These options vest at the rate of 25% every twelve months following April 7, 2009. The estimated fair value of these options totalled \$40,210 and this amount is being amortized and expensed as stock-based compensation over the vesting terms. As May 31, 2009, \$838 had been recognized and recorded as stock-based compensation expense.

During the nine months ended May 31, 2009, the Company also recorded stock-based compensation expense of \$398,196 related to stock options with graded vesting schedules which were earned during the nine months ended May 31, 2009.

The fair value of stock options to employees and directors was estimated at the grant date and the options to service providers were estimated at the service completion date based on the Black-Scholes pricing model, using the following weighted average assumptions:

Expected dividend yield	Nil
Risk-free interest rate	1.74%
Expected life	3.70 years
Expected volatility	102%

Option pricing models require the input of highly subjective assumptions including the expected 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 measure of the fair value of the Company's stock options.

Avalon Rare Metals Inc.

(formerly Avalon Ventures Ltd.)

Notes to the Financial Statements

For the Nine Months Ended May 31, 2009

Unaudited - See Notice to Reader

5. Share Capital (continued)

As at May 31, 2009, the following options were vested and outstanding:

Option Price	Number of Options		Weighted Average Remaining Contractual Life
	Unvested	Vested	
\$ 1.82	168,750	56,250	3.5 years
\$ 1.80	50,000	50,000	2.2 years
\$ 1.61	375,000	375,000	2.0 years
\$ 1.20	500,000	450,000	2.9 years
\$ 1.08	-	150,000	2.1 years
\$ 0.98	200,000	200,000	2.6 years
\$ 0.80	-	300,000	2.4 years
\$ 0.75	512,500	37,500	3.9 years
\$ 0.70	150,000	50,000	1.6 years
\$ 0.69	-	200,000	1.8 years
\$ 0.63	137,500	12,500	3.7 years
\$ 0.55	100,000	-	4.8 years
\$ 0.50	150,000	-	1.6 years
\$ 0.48	-	225,000	1.5 years
	<u>2,543,750</u>	<u>2,106,250</u>	

e) Agents' Compensation Options

As at May 31, 2009, the Company had 725,000 Agents' Compensation Options issued and outstanding. Each Agent's Compensation Option entitles the agent holder to purchase one common share at a price of \$1.55 per share, exercisable until November 22, 2009.

6. Contributed Surplus

Contributed surplus consists of expired warrants and options. The changes in contributed surplus during the nine months ended May 31, 2009 are summarized as follows:

Balance - August 31, 2008	\$ 54,175
Warrants expired/cancelled	977,905
Options expired/cancelled	<u>199,509</u>
Balance - May 31, 2009	<u>\$ 1,231,589</u>

Avalon Rare Metals Inc.

(formerly Avalon Ventures Ltd.)

Notes to the Financial Statements

For the Nine Months Ended May 31, 2009

Unaudited - See Notice to Reader

7. Future Income Tax Recoveries

During the nine months ended May 31, 2009, the Company issued 3,000,000 flow-through common shares for gross proceeds of \$1,500,000. Pursuant to the share subscription agreements, the Company is required to incur Canadian exploration expenses ("CEE") equal to the gross proceeds amount (of which \$724,348 has been incurred as at February 28, 2009) and the Company had renounced the CEE amount of \$1,500,000 to the investors with the effective date of December 31, 2008. The renunciation reduced the Company's future income tax assets by \$405,000. The Company accordingly reduced the share capital by the tax effect of \$405,000 at issuance. However, as the Company has not recognized its future income tax assets, the \$405,000 is recorded as a future income tax recovery on the statement of operations.

8. Related Party Transactions

During the nine months ended May 31, 2009, the Company incurred:

- a) accounting fees of \$38,000 with an accounting firm in which an officer is the principal. As at May 31, 2009, accounts payable included \$13,000 accrued to this accounting firm;
- b) consulting fees of \$112,525 with a company owned by an officer of the Company, which were deferred as resource property costs. As at May 31, 2009, accounts payable included \$12,206 payable to this company; and
- c) consulting fees of \$48,400 with an officer of the Company, of which \$32,313 were deferred as resource property costs. As at May 31, 2009, accounts payable included \$7,508 payable to this officer.

9. Recent Accounting Pronouncements

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, 2011. 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.

10. Subsequent Events

Subsequent to the nine months ended May 31, 2009, the Company:

- a) issued 475,000 non-flow-through common shares pursuant to the exercise of an equivalent number of stock options for cash proceeds of \$271,000;

Avalon Rare Metals Inc.

(formerly Avalon Ventures Ltd.)

Notes to the Financial Statements

For the Nine Months Ended May 31, 2009

Unaudited - See Notice to Reader

10. Subsequent Events (continued)

- b) granted an aggregate of 200,000 stock options to two of the Company's officers. Each option entitles the holder to purchase one common share of the Company at a price of \$1.41 per share until June 2, 2014. These options vest at the rate of 25% every twelve months following June 2, 2009; and
- c) cancelled 250,000 stock options with an exercise price of \$1.61 per share which expired unexercised.