

# NEMI Northern Energy & Mining Inc.

## Management's Discussion and Analysis of Financial Position and Results of Operations

The following information, prepared as of February 8, 2010, should be read in conjunction with the unaudited consolidated financial statements of NEMI Northern Energy & Mining Inc. ("NEMI" or the "Company") for the three months ended December 31, 2009 as well as the audited consolidated financial statements and the related management's discussion and analysis (the "Annual MD&A") for the year ended September 30, 2009. All amounts are expressed in Canadian dollars unless otherwise indicated.

### Forward-Looking Statements

Forward-looking statements look into the future and provide an opinion as to the effect of certain events and trends on the business. Forward-looking statements may include words such as "plans", "intends", "anticipates", "should", "estimates", "expects", "believes", "indicates", "suggests" and similar expressions.

This MD&A, and in particular the "Outlook" and "Peace River Coal Limited Partnership" sections, contains forward-looking statements. These forward-looking statements are based on current expectations and various estimates, factors and assumptions and involve known and unknown risks, uncertainties and other factors.

It is important to note that:

- Unless otherwise indicated, forward-looking statements in this MD&A describe the Company's expectations as of February 8, 2010.
- Readers are cautioned not to place undue reliance on these statements as the Company's actual results, performance or achievements may differ materially from any future results, performance or achievements expressed or implied by such forward-looking statements if known or unknown risks, uncertainties or other factors affect the Company's business, or if the Company's estimates or assumptions prove inaccurate. Therefore, the Company cannot provide any assurance that forward-looking statements will materialize.
- The Company assumes no obligation to update or revise any forward-looking statement, whether as a result of new information, future events or any other reason.

The material assumptions that were applied in making the forward looking statements in this MD&A include the future business prospects of the Peace River Coal Limited Partnership.

For a description of material factors that could cause the Company's actual results to differ materially from the forward-looking statements in this MD&A, please see "Risks and Uncertainties".

### General

NEMI is a Canadian company incorporated under the Business Corporations Act of Alberta and extra-provincially registered under the Business Corporations Act of British Columbia.

The Company's principal asset is the interest it holds in the Peace River Coal Limited Partnership ("Peace River Coal LP" or "PRC"), which currently stands at 12.2%.

Prior to 2006, the NEMI was a mine development company focused on exploration, development and production of metallurgical coal assets in northeast British Columbia.

## **Peace River Coal LP**

The Peace River Coal LP was established in November 2006 as a joint venture between the Company, Hillsborough Resources Limited (“Hillsborough”) and Anglo Coal Canada Limited (“Anglo”), indirectly a wholly-owned subsidiary of Anglo American plc (“Anglo American”). Anglo is the general partner and operational manager of PRC. PRC's production is being marketed by Anglo Coal Marketing Limited.

PRC was formed pursuant to and is governed by a Limited Partnership Agreement made as of October 16, 2006, as amended November 24, 2006. Under the terms of the Limited Partnership Agreement, the partners are not obliged to fully participate in any of the partnership's programs and budgets, but they are subject to dilution provisions should they elect not to fully participate. Currently NEMI holds a 12.2% interest, Anglo a 74.8% interest and Hillsborough a 13.0% interest in PRC.

PRC operates the Trend Mine near Tumbler Ridge, British Columbia and holds substantial metallurgical coal assets under exploration and development in northeast British Columbia, including the Roman and Horizon properties, and a 50% interest in the Belcourt Saxon properties. The Trend Mine, with some 320 employees, is targeting annual sales volume of 1.5 million tonnes per year of hard coking coal at full capacity. PRC's metallurgical coal, which is exported to steel mills around the world, is currently railed to Prince Rupert, British Columbia where it is loaded into ocean going vessels at the Ridley Terminals Inc. port facility.

Commercial operations at the Trend Mine commenced in January 2008. PRC sold 0.7 million tonnes of metallurgical coal in calendar year 2009, up 14% on 2008. Further growth in production is envisioned in 2010 with various capital projects completed and others nearing completion.

- An 18 month, \$104 million capitalization program to acquire and operate a mining equipment fleet was completed in December 2009.
- A new haul road linking the coal preparation plant to the rail load-out facility has been completed, reducing haul distances and costs for clean coal.
- A second train set was leased to improve rolling stock availability.
- Construction on the raw coal rotary breaker and coal preparation plant feed system has been completed in December 2009, improving the plant's throughput rate.

In all, approximately \$150 million of capital expenditure has been invested into the business over the last two years as PRC has transitioned away from a contractor based mining operation. PRC now has an improved coal washing plant and road and rail logistics chain. A further \$25 million will be invested in the Wash Plant upgrade, where the first phase is already underway.

Major drilling programs were completed on PRC's properties over the last two years which have increased the coal reserves at the Trend Mine and extended the resources at Roman Mountain. Trend Mine comprised a total resource base of 51.6 million tonnes as at December 2009. Included in the resource base are Proved and Probable Reserves of 20.6 and 2.5 million tonnes respectively. The Roman resource base comprises a total of 34.1 million tonnes, of which 21.1 million tonnes is Measured Resources, 7.5 million tonnes is Indicated Resources and 5.5 million tonnes Inferred Resources. Further exploration to expand the resource base is currently being carried out. Total coal resources for the PRC properties, including Trend Mine, Roman Mountain and Horizon, all in which PRC holds a 100% interest, are currently estimated to be in excess of 300 million tonnes.

In addition to capital improvements and resource extensions at the Trend Mine, PRC is conducting development work on its other properties.

A pre-feasibility study is progressing on the Roman Mountain project, which is adjacent to the Trend Mine. Development of a mine at Roman Mountain is expected to increase overall production to approximately 4 million tonnes per year. PRC intends to submit the Roman Mountain project to the Environmental Assessment Office of British Columbia for an Environmental Assessment approval early in 2010.

With respect to the Horizon property, initial conceptual studies indicate that Horizon would be developed primarily as an underground mine with annual production of approximately 2 million tonnes.

With respect to the Belcourt Saxon Coal Limited Partnership, in which PRC holds a 50% interest, in 2008 a technical study was completed and a NI 43-101 Technical Report dated March 2009 was filed on SEDAR by NEMI and by Western Coal Corporation, which holds the other 50% interest. The report states coal reserves for the Belcourt North and Belcourt South properties comprising 85.7 million tonnes Proven Reserves and 0.7 million tonnes of Probable Reserves included in the Coal resource estimate of 167.7 million tonnes of Measured Resources, 4.2 million tonnes of Indicated Resources, and 0.2 million tonnes of Inferred Resources. The project has the potential to produce approximately 4 million tonnes per year of metallurgical coal product for 15 years. Further evaluation work is being conducted.

PRC's coking coal has been very well received by steel mills in Asia, Europe, and South America. Demand for its coal remains very strong supporting further production growth.

### **Results of Operations**

The Company recorded a loss of \$188,185 (\$0.00 per share) for the first quarter ended December 31, 2009 as compared to a loss of \$2,061,094 (\$0.04 per share) reported in the same quarter of 2008.

The 2008 loss included a \$1 million break fee and \$358,000 in professional fees relating to the transaction with Aviva Corporation that was cancelled.

The Company's interest in PRC is being accounted for using the equity method. As of February 1, 2010, PRC has not finalized its financial statements for the year ended December 31, 2009. Consequently, the results for the period ended December 31, 2009 include \$336,000 as NEMI's estimated share of the income of PRC based upon preliminary numbers of PRC available as of that date.

Expenses for the quarter decreased from \$620,331 to \$137,523 with the decrease due to the \$358,000 in professional fees associated with the Aviva transaction and current management's focus on a general reduction in expenditures since March 31, 2009.

Administrative expense was offset by \$15,406 (2008 - \$83,062) in interest income earned on the Company's surplus cash balance.

### **Capital Expenditures and Investments**

Investing activity during the three months ended December 31, 2009 was comprised of \$6,794,480 (2008-\$5,306,834) in funds contributed to PRC and \$3,613,601(2008-\$18,862,003) in distributions received from PRC..

## Summary of NEMI's Quarterly Results (unaudited)

Three months ended	Dec. 31, 2009	Sept 30, 2009	June 30, 2009	Mar. 31, 2009	Dec. 31, 2008	Sept 30, 2008	June 30, 2008	Mar. 31, 2008
Total revenues	\$nil	\$nil	\$nil	\$nil	\$nil	\$nil	\$nil	\$nil
Net earnings (loss)	\$(188,185)	\$(1,320,647)	\$(753,830)	\$(65,320)	\$(2,061,094)	\$(167,597)	\$193,617	\$(1,675,050)
Income (loss) per share (Basic and diluted)	(\$0.01)	(\$0.02)	(\$0.01)	(\$0.00)	(\$0.03)	\$0.00	\$0.00	(\$0.03)
Deferred expenditures	\$nil	\$nil	\$nil	\$nil	\$nil	\$nil	\$nil	\$nil
Total assets	\$64,893,475	\$65,964,728	\$66,694,022	\$67,991,714	\$67,369,056	\$69,624,440	\$69,450,187	\$66,747,535

The loss for the quarter ended December 31, 2008 included a \$1 million break fee payment and \$358,000 in transaction costs associated with the cancelled Aviva transaction. The loss for the quarter ended March 31, 2008 was primarily due to the Company's share of the loss of PRC of \$1.38 million. The net earnings for the quarter ended December 31, 2007 includes a \$5,000,000 gain on the Company receiving free cash carry in funding its portion of the PRC 2007 Supplemental Program and Budget of \$25 million. This gain was partially offset by an equity loss of \$167,000 in relation to the Company's interest in PRC.

### Financing Activities

There were no financing activities during the three months ended December 31, 2009 or 2008.

The Company issued \$12.7 million in unsecured convertible debentures on March 12 and April 1, 2008 for net proceeds of \$11.8 million. The Debentures are unsecured and bear interest at a rate of 8% per annum, payable semi-annually in arrears, on June 30th and December 31st each year commencing June 30th, 2008. The Debentures mature on March 12, 2013 and are convertible into common shares of the Company at any time up until maturity at a conversion price of \$0.90 per share. After March 12, 2010, the Company has the right, under certain circumstances, to redeem the debentures in whole or in part. In addition, the Company has the right to repay the principal amount of the Debentures in common shares at a price equal to 95% of the weighted average trading price of the Company's shares on the Toronto Stock Exchange for the 20 trading day period ending 5 trading days prior to the date fixed for redemption or at maturity.

### Normal Course Issuer Bid

On April 7, 2009, the Company announced its intention to make a Normal Course Issuer Bid ("NCIB") to buy back its common shares through the facilities of the TSX. The maximum number of common shares that may be purchased for cancellation pursuant to the NCIB is that number of common shares that represents 5% of the issued and outstanding common shares on the date that the Exchange approves the NCIB. Based on the 57,869,745 common shares outstanding as at April 1, 2009, the maximum number of shares available for purchase and cancellation was 2,893,487.

Purchases under the NCIB were permitted to commence on April 13, 2009 and during the year ended September 30, 2009, the Company used \$378,328 to acquire 987,390 securities with an average price of \$0.38 per share. During the quarter ended December 31, 2009, the Company completed its NCIB, purchasing a further 1,906,097 shares for \$770,347 for an average price of \$0.40 per share.

All purchases made pursuant to the NCIB were made in accordance with the rules of the TSX and at the market price of the common shares at the time of the acquisition. NEMI made no purchases of common shares other than open market purchases.

## Purchase of Hillsborough shares

During the year ended September 30, 2009 the Company acquired 1,360,500 common shares of Hillsborough for a purchase price of \$392,842 representing an average price of \$0.29 per share. The shares were purchased for investment purposes.

During the quarter ended December 31, 2009, Hillsborough completed a statutory arrangement (the "Arrangement") whereby Vitol Anker International B.V. ("Vitol") acquired all the shares of Hillsborough not owned by Vitol at a price of \$0.50 per share. As permitted by the terms of the Arrangement, NEMI has filed a notice of dissent and is currently evaluating Vitol's offer to pay in accordance with the dissent process. The price NEMI eventually receives may be more or less than \$0.50, based on the outcome of the dissent process.

## Liquidity and Capital Resources

The closing of the convertible debenture issue in 2008 has left NEMI in a strong financial position with \$14.5 million in cash and working capital of \$14.8 million at December 31, 2009 with the debentures not due until March 2013. The Company's aggregate operating, investing and financing activities during the quarter resulted in a net cash outflow in the amount of \$3.5 million.

## Contractual Obligations

As at December 31, 2009, the Company's contractual obligations included:

(thousands of dollars)	Payments Due by Period				
	Total	Less than 1 year	1 – 3 years	3 - 5 years	After 5 years
Lease agreement for office premises	\$211	\$42	\$169	\$nil	\$nil
Lease agreement for office <sup>(1)</sup>	\$306	183	\$123	\$nil	\$nil
Total Contractual Obligations	\$517	\$225	\$292	\$0	\$0

(1) NEMI has sublet this office space at cost to PRC.

## Transactions with Related Parties

During the three months ended December 31, 2009, consulting fees of \$19,500 (2008 - \$19,500) were charged in respect of services rendered by a company with a common officer.

The Trend Property was acquired in an agreement with and carries a 1% royalty interest (the "Trend Royalty") payable to a former officer of the Company. During the year ended September 30, 2006, the former President and CEO of the Company acquired approximately half of this royalty interest in a private transaction from the former officer of the Company for consideration of \$nil. The Trend property was transferred to and the Trend Royalty was assumed by PRC on November 29, 2006. There were no royalties paid or payable to the former President and CEO of the Company by NEMI during the three months ended December 31, 2008 and 2009, however, PRC paid royalties of US\$993,000 and US\$1,143,000 during the years ended September 30, 2008 and 2009, respectively on account of the trend Royalty.

## Critical Accounting Estimates

The Company's consolidated financial statements are impacted by the significant accounting policies used, and the estimates and assumptions made, by management during their preparation. The Company's accounting policies are described in Note 2 to the consolidated financial statements. The accounting estimates considered to be significant to the Company include the review of the carrying value of the Company's investment in PRC and the computation of stock-based compensation expense. Management will review the carrying value attributed to its investment in PRC on at least an annual basis. No write-down was taken during the year. There is a risk however that this investment could be written down in a future period.

The Company uses the fair-value method of accounting for stock-based compensation related to incentive stock options granted, modified or settled. Under this method, compensation cost attributable to all incentive stock options granted is measured at fair value at the grant date and expensed over the vesting period with a corresponding increase to contributed surplus. In determining the fair value, the Company makes estimates of the expected volatility of the stock as well as an estimated discount rate. Changes to these estimates could result in the fair value of the stock-based compensation being less than or greater than the amount recorded.

### **Adoption of new accounting standards**

#### **EIC-174 Mining Exploration Costs**

On March 27, 2009, the EIC issued EIC 174. In this EIC, the Committee reached a consensus that an enterprise that has initially capitalized exploration costs has an obligation in the current and subsequent accounting periods to test such costs for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable. The EIC is effective for periods ending after the issuance date and the Company has adopted the EIC -174.

### **Off-Balance Sheet Arrangements**

The Company has not entered into any material off-balance sheet arrangements such as guarantee contracts, contingent interests in assets transferred to unconsolidated entities, derivative financial obligations, or with respect to any obligations under a variable interest equity arrangement.

### **Financial Instruments**

The Company's financial instruments consist of cash and cash equivalents, marketable securities, accounts receivable and accounts payable. It is management's opinion that the Company is not exposed to significant interest, currency or credit risks arising from these financial instruments. The fair values of the financial instruments approximate their amortized cost value due to their short-term nature.

Cash and cash equivalents include cash and highly liquid investments held in the form of bankers' acceptances. These investments are stated at cost plus accrued value, which approximates market value. Investments of cash are of sufficient quality and diversity to ensure a high probability of liquidity at the accrued value, at such times as needed to meet financial obligations. Furthermore, the investment terms are less than three months at the time of acquisition.

### **Outstanding Share Data**

#### **Authorized Capital:**

- Unlimited number of Class A no par value voting common shares
- Unlimited number of Class B no par value non-voting common shares
- Unlimited number of Class C no par value non-voting common shares
- Unlimited number of Class D no par value non-voting, non-cumulative redeemable and retractable preferred shares

#### **Issued and outstanding:**

54,976,258 common shares as at February 8, 2010

#### **Fully diluted:**

68,698,480 common shares as at February 8, 2010

#### **Outstanding options, warrants, and convertible securities as at February 8, 2010:**

Type of Security	Number	Exercise Price	Expiry date
Stock options	150,000	\$0.90	April 1, 2013
	250,000	\$0.41	May 27, 2014
Warrants	100,000	\$0.90	March 12, 2010
Convertible debentures	13,222,222	\$0.90	March 12, 2013
Total dilution	<u>13,722,222</u>		

## **Risks and Uncertainties**

The Company is involved in coal mining operations to the extent of its 12.2% partnership interest in Peace River Coal LP. The exploration for and development of coal deposits are highly speculative activities and are subject to significant risks. The Company's ability to realize its investments in exploration projects is dependent upon a number of factors, including its ability to continue to raise the financing necessary to complete the exploration and development of those projects and the existence of economically recoverable reserves within its projects. The Company's operations are subject to a number of risk factors as detailed in the Annual MD&A.

### ***Internal Control over Financial Reporting***

As at the date of this report, management is not aware of any change in the Company's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

## **Outlook**

NEMI owns a 12.2% partnership interest in PRC, which owns the Trend mine as well as a number of other coal properties in northeast British Columbia. PRC is managed and operated by Anglo American. With the global recovery gathering pace, the metallurgical coal market is looking increasingly positive in 2010, and PRC will benefit from expected higher coal prices going forward. There are reports that recent spot coking coal prices have exceeded \$200 per tonne as compared with the 2009 benchmark contract price of \$129 per tonne.

Management of NEMI is investigating and evaluating business opportunities related to its partnership interest in PRC with the aim of maximizing value for NEMI's shareholders.

In the past nine months, to the extent allowed under its NCIB, the Company repurchased its own shares, increasing the effective PRC ownership per NEMI share at favourable prices. The Company intends to renew its NCIB in April 2010 and resume repurchasing shares if NEMI's share price remains significantly undervalued.

The Company made its investment in Hillsborough with the same intention of increasing the effective PRC ownership per NEMI share at favourable prices. Hillsborough's recently completed plan of arrangement (the "Arrangement"), which resulted in Vitol Anker International B.V. acquiring Hillsborough, pre-empted further acquisition of Hillsborough shares and in the opinion of management, resulted in an unsatisfactory price paid to Hillsborough shareholders. The Company is pursuing a resolution under the dissent process.

In addition, management has been advised by legal counsel that the Arrangement resulted in an "indirect transfer" of Hillsborough's PRC interest, triggering a right of first refusal for Anglo American and or NEMI to purchase Hillsborough's PRC interest.

In October 2009, Anglo American announced that it was restructuring its global portfolio of assets, including the divestiture of its interest in PRC. Anglo American has indicated that this will be undertaken in a manner and on a timetable that will maximize value for Anglo American while protecting the PRC business and the interests of the other partners of PRC. Under the terms of the PRC limited partnership agreement, NEMI has a right of first refusal with respect to any direct or indirect disposition of Anglo American's PRC interest. Management believes that the value of this right of first refusal may be significant.

## **Other Information**

Additional information related to the Company, including its Annual Information Form, is available for viewing on SEDAR at [www.sedar.com](http://www.sedar.com).